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Uruguay: Fifth and Sixth Reviews Under the Stand-By Arrangement, Requests for Waiver of Nonobservance of Performance Criteria, and Financing Assurances Review—Staff Report; Staff Supplement; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Uruguay

In the context of the fifth and sixth reviews under the Stand-By Arrangement, requests for a waiver of nonobservance of performance criteria, and financing assurances review, the following documents have been released and are included in this package:

- the staff report for the Fifth and Sixth Reviews Under the Stand-By Arrangement and Request for Waiver of Performance Criteria, and Financing Assurances Review, prepared by a staff team of the IMF, following discussions that ended on November 15, 2006, with the officials of Uruguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 7, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff statement of December 22, 2006 updating information on recent developments;

- a Press Release summarizing the views of the Executive Board as expressed during its December 22, 2006 discussion of the staff report that completed the review; and

- a statement by the Executive Director for Uruguay.

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

Letter of Intent sent to the IMF by the authorities of Uruguay*
*Also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

URUGUAY

Fifth and Sixth Reviews Under the Stand-By Arrangement, Requests for Waiver of Nonobservance of Performance Criteria, and Financing Assurances Review

Prepared by the Western Hemisphere Department
(In collaboration with other departments)

Approved by Ranjit Teja and Adrienne Cheasty

December 7, 2006

Exit from Fund arrangement. On November 8, 2006 the authorities announced that they would shortly repay all outstanding obligations to the Fund and cancel the current stand-by arrangement. Full repayment of SDR 727 million (US$1.1 billion) was made on November 30, 2006. In the attached Letter of Intent, the authorities indicate that they will cancel the stand-by arrangement shortly after the completion of the fifth and sixth reviews, and that they will not make any associated purchases. The authorities' motivation for requesting the completion of the pending reviews is closure—a final review to confirm policy performance and signal commitment to macroeconomic stability and structural reform beyond the timelines and deadlines of Fund conditionality.

Economic outcomes. Economic growth has been faster than expected, and is projected to reach 6½ percent in 2006, 2 points higher than envisaged in the program. Inflation, which had been pushed up by higher oil prices and drought, has eased to 6 percent, and remains within the programmed target range. Capital inflows and renewed market access have permitted a substantial increase in net international reserves, which currently exceed the level programmed for the end of the arrangement in 2008.

Policy implementation. Monetary and fiscal policies have been implemented as envisaged in the program. All quantitative performance criteria were met through end-September, except for the ceiling on public debt (while gross debt was higher than programmed, reflecting faster than expected access to market borrowing, net debt was not). In structural area, there was progress in financial sector reforms and, most importantly, the long-awaited tax reform is expected to be passed by Congress by the time of Board consideration of the reviews. However, the effort to secure tax reform delayed legislative initiatives in other areas. As a result, several waivers are needed to complete the pending reviews.

Mission. Discussions were held during August 3–18 (for the fifth review) and November 6–15 (for the sixth review) in Montevideo. The mission comprised, at various points, M. Piñón (Head), S. Eble, A. López-Mejía (all WHD), H. Finger and G. Adler (PDR), A. Hajdenberg (FAD), S. Seelig (MCM), and G. Gelos (Resident Representative). D. Vogel (OED) participated in the policy discussions.

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I. An Overview of Progress under the Stand-by Arrangements

A positive external environment and sound policies have yielded strong macroeconomic results, paving the way for an early exit from Fund financial support. Despite significant progress, challenges remain, particularly in the structural area.

1. ***Macroeconomic outcomes***. Uruguay's recovery from the crisis of 2002 has exceeded all expectations (Figure 1).

- ***Output and inflation***. Following a drop of 11 percent in 2002, sustained growth has brought GDP in 2006 to 15 percent above the pre-crisis level, and the unemployment rate near a historical low. Inflation has declined from 26 percent in 2002 to about 6 percent in 2006. Still, while poverty has fallen, it remains above pre-crisis levels.

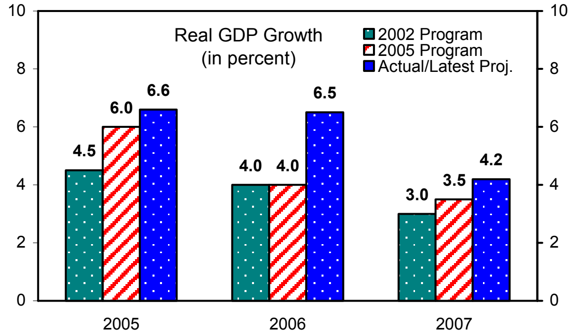
Uruguay: Economic Recovery

	2001	2002/03	2006		
	Before crisis	Through crisis	Projected at 2002 program	Projected at 2005 program	Latest proj.
Output and prices					
GDP growth	-3.4	-11.0	4.0	4.0	6.5
GDP per capita (in current US dollars)	5,625	3,397	5,303	5,458	5,791
Inflation (end of period)	3.6	25.9	4.9	5.5	6.0
REER (2001=100)	100	65	68	79	81
Unemployment	15.3	19.8	...	...	10.5
Public finances					
Primary fiscal balance (in percent of GDP)	-1.2	0.0	4.3	3.7	3.7
Overall fiscal balance (in percent of GDP)	-2.7	-4.3	-2.4	-1.3	-0.5
Public debt (in percent of GDP)	46	104	76	70	65
Sovereign risk spread (avg., basis point)	295	1,982	700	450	250
External position					
External current account (excl. pulp mill projects)	-2.9	3.2	-0.1	-2.1	-1.1
Gross reserves (US$ mil., after Fund repayment)	3,099	469	1,376	2,866	2,777
Reserves to ST debt and FX deposits (eop)	18	7	...	26	28
NIR (US$ mil., current prog. definition)	232	-2,274	-574	-1,692	661
Financial system					
Nonperforming loans to total loans (excl. housing bank, BHU)	12	37	...	...	2
Banking system reserve coverage of ST debt and FX deposits	47	38	...	...	78

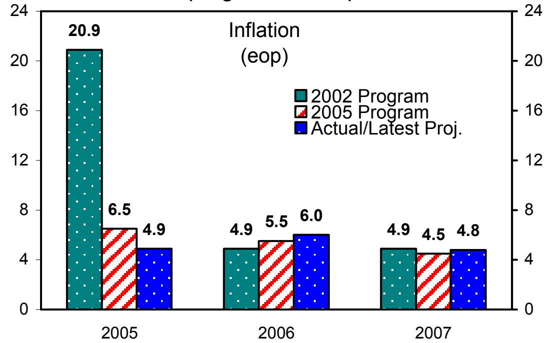
Figure 1. Program Achievements

Macroeconomic performance has exceeded expectations at the time of the approval of the arrangements.

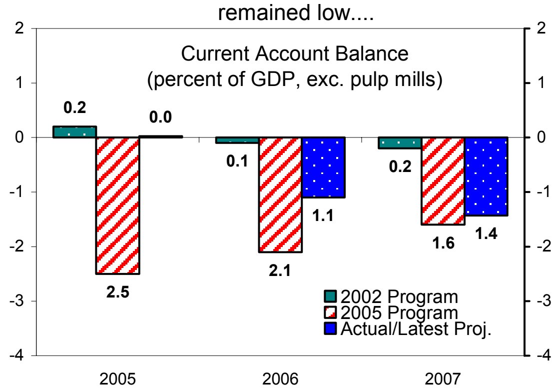
Growth has exceeded program expectations, driven by strong exports and domestic demand...



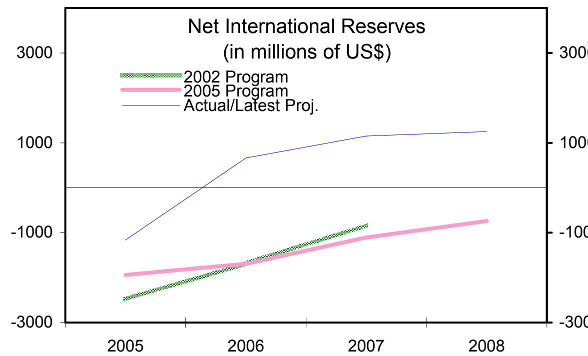
...and inflation has remained broadly in line with program assumptions.



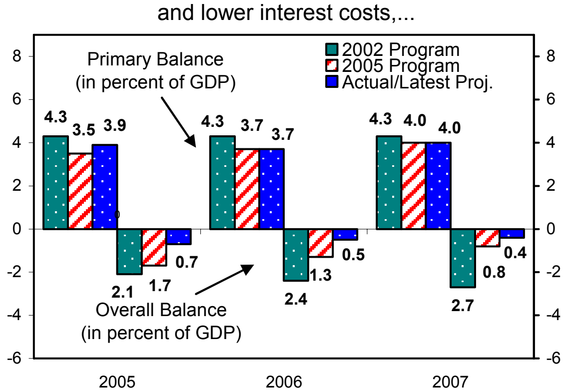
The underlying current account deficit has remained low....



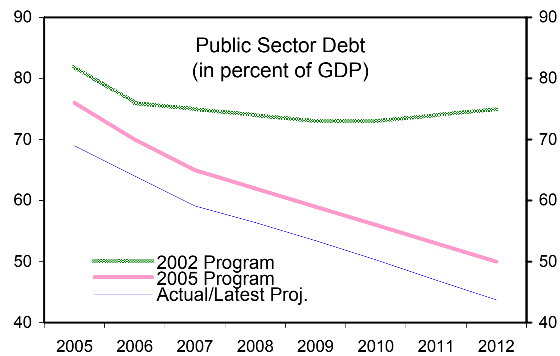
...and strong capital inflows have led to a significant overperfomance in NIR accumulation.



The fiscal balance is stronger, with solid revenues and lower interest costs,...



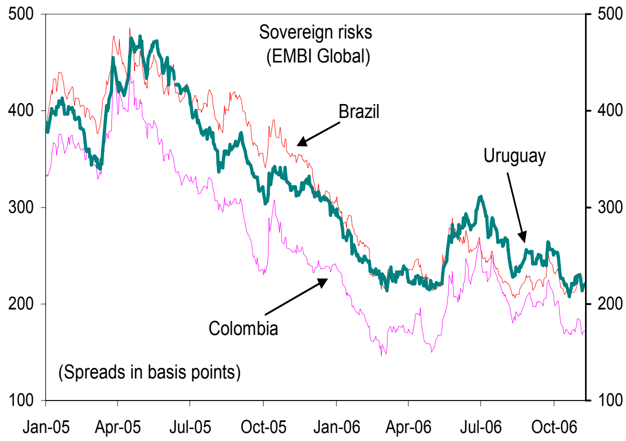
...and the debt outlook has improved markedly.



Sources: Central Bank of Uruguay, Ministry of Finance; and Fund staff estimates and projections.

- ***External position***. Despite a sizable recovery in imports, including FDI-related imports, vigorous export growth has contained the current account deficit. With strong access to capital markets, net international reserves are now about US$1 billion above the level envisaged for 2008 (i.e. at the *end* of the program). Even after having repaid all Fund obligations, reserve coverage of short-term debt and dollar-denominated deposits is higher than programmed under both arrangements. Sovereign spreads have declined to a historical low. For the second time since 2002, Standard and Poor's has upgraded Uruguay's long-term foreign and local currency sovereign credit ratings (to B+).

Despite global market volatility in mid-2006, Uruguay's sovereign spreads remain low by historical standards.



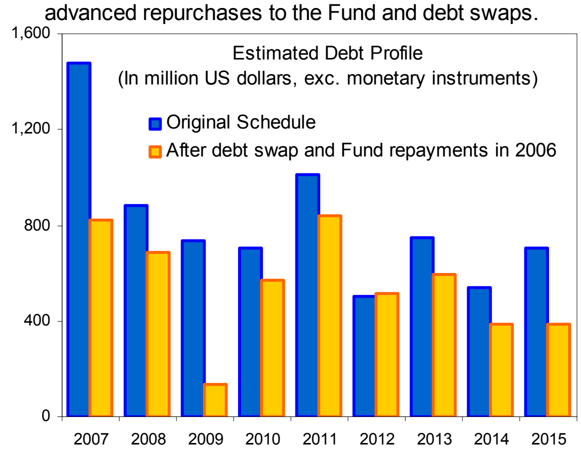
2. ***Macroeconomic policies***. These positive outcomes have been supported by a strong macroeconomic policy stance:

- ***Monetary policy***. Monetary restraint has been instrumental in consolidating inflation and inflation expectations at mid-single digits. A flexible exchange rate regime adopted in mid-2002 has helped the economy adjust to shocks. Faced with large private capital inflows in late 2005 and early 2006, the central bank intervened in the foreign exchange market to build up reserves and slow down peso appreciation, while supporting the remonetization of the economy.

- ***Fiscal policy***. The primary surplus has progressively been raised towards its medium-term target of 4 percent of GDP, and the overall deficit is well below projections. This achievement was made possible by the economic rebound, stronger tax administration, prudent expenditure policies, and lower interest costs. At the same time, to address the social dislocation from the 2002 crisis, the budget made space for a two-year Social Emergency Program.

- ***Debt management***. The net present value of public debt declined and its structure improved after the 2003 debt exchange. Further fundamental improvements have taken place since then. Vigorous growth, the strengthened fiscal position, and

The amortization profile has significantly improved with advanced repurchases to the Fund and debt swaps.



currency appreciation have lowered the debt-to-GDP ratio from above 100 to 65 percent. Recently, taking advantage of strong market access and sharply lower spreads, the authorities have improved the debt profile by using long-term bond issues to repay short-term, floating rate or more expensive debts. This includes the full repayment of all remaining Fund obligations (SDR 726 million) in November. Also, the government increased issuance of inflation-indexed bonds and swapped US$1.1 billion in amortization payments due mostly in 2011 and 2015 into longer maturity bonds. As a result, the average maturity of public debt has risen from about 7 years at end-2004 to 11½ years in November 2006.

- ***Financial system***. Financial soundness indicators are substantially above 2002 levels. Non-resident deposits, which proved volatile in the face of external developments, have dropped to 20 percent of total deposits and nonperforming loans have fallen to 2 percent of total loans (excluding the housing bank). Vulnerabilities have also been reduced by banks' high liquidity, which, together with central bank reserves, cover almost 80 percent of short-term debt and foreign currency deposits. Resident deposits have recovered to about 85 percent of pre-crisis level.

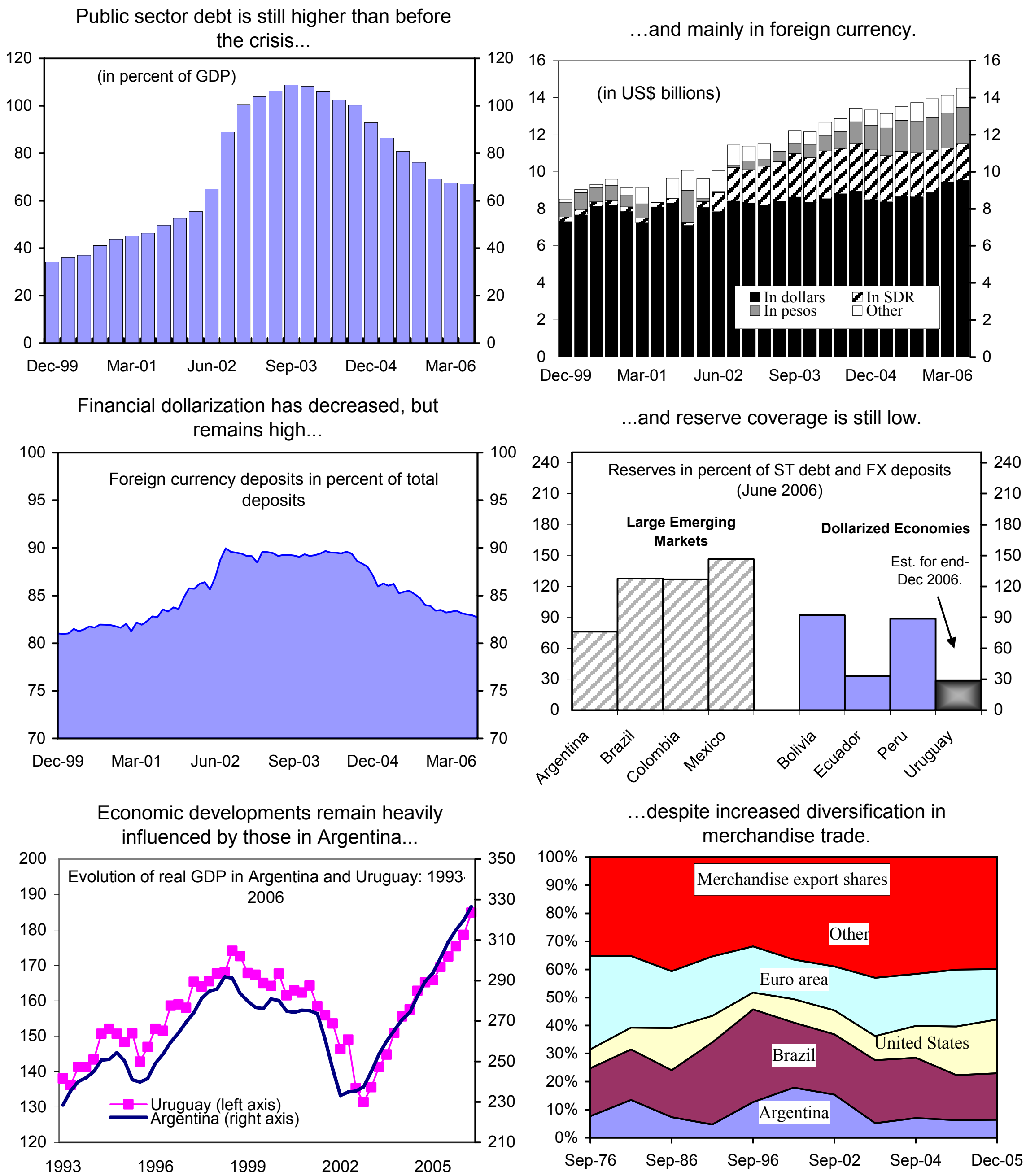
3. ***Structural reforms***. Important progress has been achieved in several areas, often with Fund technical cooperation. A new public debt management office has led the strategy for regaining market access, permitting early repayment of all Fund financing. On the fiscal side, Congress approved in late 2005 a *five-year budget* with a medium-term primary surplus target of 4 percent of GDP and, is expected shortly to pass a comprehensive tax reform, which introduces a personal income tax, and streamlines and eliminates minor taxes; tax administration has also been significantly strengthened. In the financial sector, prudential norms were tightened to internalize risks from high dollarization and exposure to regional contagion, the supervisory framework was strengthened, and a deposit insurance scheme was introduced. *Nuevo Banco Comercial*, the bank formed with performing assets of three failed banks, was privatized this year. A bankruptcy framework is being discussed in Congress.

4. ***Delays***. All this is not to suggest that adherence to the program's timetable for structural reforms has been flawless. Indeed, in many areas, there were delays, reflecting the fact that the reform agenda was ambitious and front-loaded, and required more time to gather the necessary political consensus. Thus, for example, congressional approval of the tax reform has taken longer than envisaged. The effort to secure passage of the tax reform, in turn, led to delays and changes in the sequencing of other reforms, including the submission/approval of specialized pension funds reforms, and the financial sector law aimed at enhancing central bank independence. Also, reflecting difficult negotiations with unions, the restructuring of the housing bank (BHU) has moved slower than envisaged.

5. ***Vulnerabilities***. While significantly reduced, vulnerabilities remain (Figure 2). The public debt ratio is still high and projected to decline below 50 percent only in 2011, and the debt is denominated in U.S. dollars. The financial system too is highly dollarized (85 percent

Figure 2. Vulnerability Indicators

While significantly declining, vulnerabilities remain important.



Sources: Central Bank of Uruguay; Ministry of Economy and Finance; and Fund staff estimates.

of deposits), with a large share in sight deposits, and currency mismatches in the corporate sector expose banks to exchange rate risk. While bank liquidity is an important buffer, international reserves are not as high as in other dollarized economies.

II. Recent Developments

Macroeconomic outcomes and policies continue to be very strong and, despite delays, progress also has been made in key structural reforms.

6. ***Macroeconomic developments***. Economic performance remains positive:

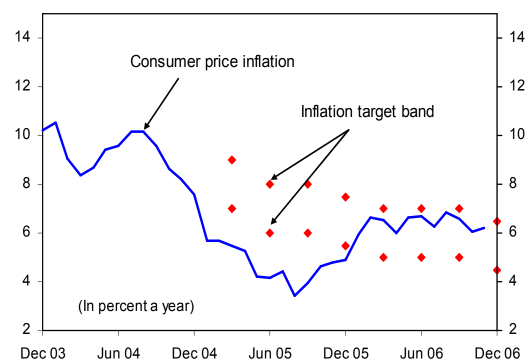
- ***Growth***. GDP growth of 8½ percent during the first semester (year-on-year) exceeded expectations, and led to a sharp drop in unemployment (Figure 3). Domestic demand has taken over as the main driver of growth. In recent months, however, growth in industrial production and capital good imports have decelerated.

- ***Inflation***. Annual inflation was 6.2 percent in November, within the central bank's target range of 4½–6½ percent. Inflation expectations for end-2007 are at 6 percent.

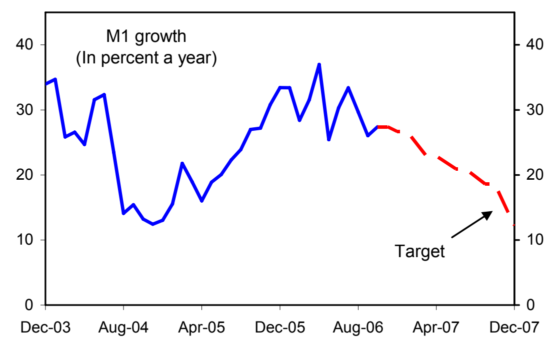
7. ***Macroeconomic management***. The policy framework has evolved as anticipated under the program.

- ***Monetary and exchange rate policy***. Despite evidence of rapid monetization, inflation pressures early in the year prompted the authorities to slow down the growth of monetary aggregates. The annual growth of base money declined from 31 percent in April to 22 percent in November. In October, the central bank confirmed the reduction of the one-year-ahead M1 growth rate target to 18 percent, down from 22 percent for end-2006, and extended the inflation target range

Inflation is stabilizing at the upper half of the band.



The M1 growth target is projected to decline,...



...and the central bank has limited intervention in the foreign exchange market.

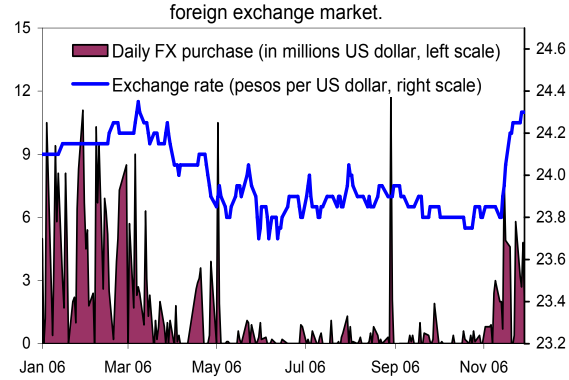
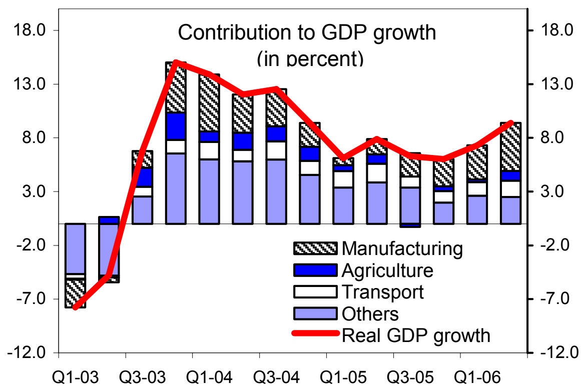


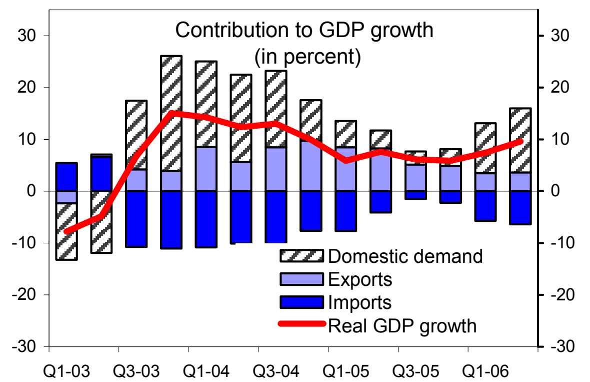
Figure 3. The Economic Recovery

Growth in 2006 has been strong, led by manufacturing and domestic demand.

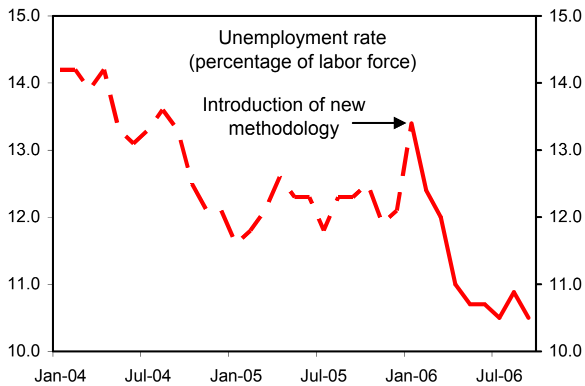
The strong growth in 2006 is mostly explained by manufacturing...



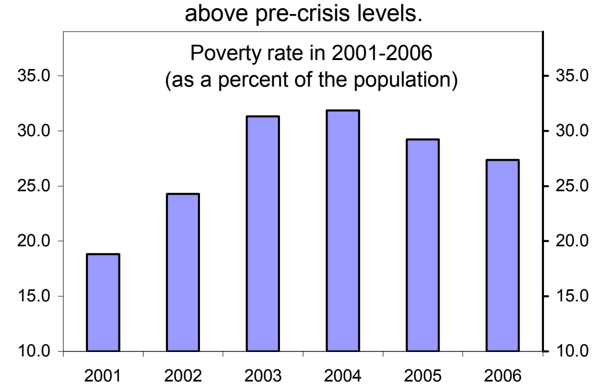
...and largely led by domestic demand.



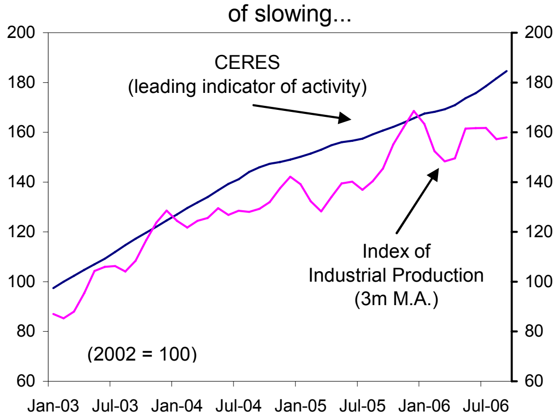
Unemployment has declined...



...and poverty has also started to decline but remains above pre-crisis levels.



With monthly indicators showing few signs of slowing...



...market participants have revised upward their growth expectations for 2006 and 2007.

Source: Central Bank of Uruguay; Instituto Nacional de Estadisticas (INE) and Fund staff estimates.

of 4½–6½ percent through March 2008. The central bank has limited intervention in the foreign exchange market as private capital inflows have moderated—thus reducing sterilization costs and pressures on monetary aggregates. However, purchases by the government to cover its foreign exchange needs continue to influence the exchange rate. Net international reserves have increased significantly, reflecting government access to global capital markets.

- ***Fiscal performance***. The primary surplus reached 3.4 percent of GDP (annualized) in the first three quarters of 2006, exceeding the program target by about 0.3 percent of GDP. Weak financial performance of public enterprises—caused largely by the costs of a drought—was more than offset by stronger revenue collection and lower spending.

Fiscal performance in the first three quarters has been strong, despite weaker public enterprise outturns.

2006 Fiscal Performance
(as percent of GDP)

	Q1-Q3		Proj.
	Prog.	Est.	2006
Revenue	32.1	31.3	31.7
Of which: Current surplus of public enterprises	2.6	1.2	1.5
Noninterest expenditure	29.1	27.9	28.0
Current	25.7	24.9	25.7
Capital (Government and enterprises)	3.3	3.0	2.3
Primary balance	3.1	3.4	3.7
Interest	4.9	4.4	4.3
Overall balance	-1.8	-1.1	-0.5

8. ***Structural reforms***. Important progress has been achieved in several areas since the last review. In addition to the expected approval of the all important tax reform before Congress breaks for recess in mid-December, the authorities completed and began implementing reform plans of the budget process, customs, and the social security bank.

While there have been delays, structural reforms have been progressing.

2006 Structural Reform Agenda

	Date	Status
Fifth Review		
Performance criteria		
Transfer of NPLs of BHU to trusts and recapitalization	end-August	Corrective action taken.
Approval of tax reform	September 15	Prior action.
Benchmarks		
Privatization of NBC	end-June	Done.
Plan to strengthen the social security bank BPS	end-June	Done with small delay.
Submission of bankruptcy law	end-June	Done with small delay.
Plan to reform budget process	end-August	Done with small delay.
Plan to reform the customs agency	end-August	Mostly done.
Establish private sector relations office	end-August	Done.
Sixth Review		
Performance criteria		
Approval of police pension reform	end-October	Draft law in congress.
Submission of military and banking employee pension reforms to congress	end-November	Drafts being prepared.
Approval of financial sector law	end-November	Draft law in congress.
Transformation of BHU into a viable institution	end-November	Progress made.
Benchmarks		
Plan to capitalize the central bank	end-November	Delayed with the financial sector law.

Moreover, a budget office is already operating in the ministry of finance. The government established a private sector relations office and submitted to Congress a bankruptcy law. Also, despite delays, progress is being made toward completing the restructuring of the housing bank (BHU). The government has started negotiations on a Trade and Investment Framework Agreement with the United States.

III. Policy Framework for 2007

Given the planned cancellation of the stand-by arrangement, discussions focused on plans for entrenching macroeconomic stability and advancing the structural agenda.

9. ***Outlook***. The authorities stressed that they will continue to pursue the objectives of their economic program, including sound macroeconomic policies and structural reform, so as to further reduce vulnerabilities and improve social conditions. Growth is expected to slow down to 4.2 percent in 2007, broadly in line with the consensus forecast and significantly above the historical rate of around 2 percent. The risks of overheating are limited (Figure 4). Core inflation is easing, strong investment is lifting potential output, lending remains near the post crisis' low, and a widening of the trade deficit reflects increased FDI-related imports and a deterioration in the terms of trade. Moreover, the real effective exchange rate appears to be near its long-run equilibrium (Country Report No. 06/425). Medium-term prospects remain positive and broadly in line with the previous review. The announcement of new investment, including of a third pulp mill, suggests upside potential for growth, but continued opposition in Argentina to the construction of the two other major pulp mills poses downside risks.

The medium-term macroeconomic outlook remains broadly in line with earlier projections.

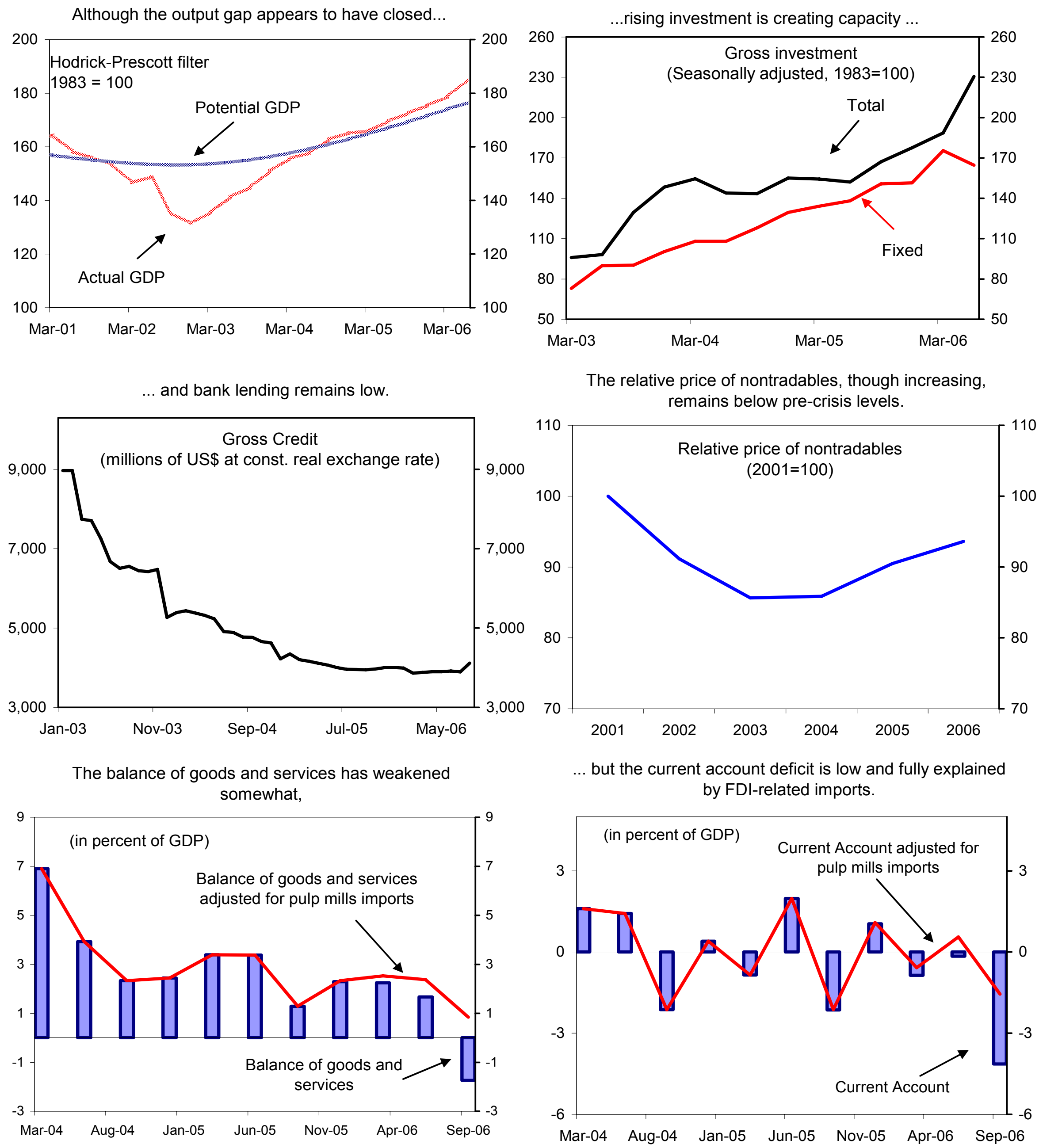
Uruguay: Medium-term Macroeconomic Framework
(Percent of GDP, unless otherwise indicated)

				2006		Projections	
	2003	2004	2005	EBS/06/79	Proj.	2007	2008
Real GDP (percentage change)	2.2	11.8	6.6	4.6	6.5	4.2	3.0
CPI (eop, percentage change)	10.2	7.6	4.9	5.5	6.0	4.8	4.0
Primary balance	2.7	3.8	3.9	3.7	3.7	4.0	4.0
Overall fiscal balance	-3.2	-2.2	-0.7	-0.9	-0.5	-0.4	-0.3
Public sector debt	104	92	69	67	64	59	56
External current account balance	-0.5	0.3	0.0	-4.3	-2.6	-3.6	-2.6
excluding: pulp mill projects	-0.5	0.3	0.0	-1.2	-1.1	-1.4	-1.6
Official reserves (millions of U.S. dollars)	2,087	2,512	3,438	3,963	2,777	3,266	3,377
As a % of ST debt + FX deposits	20.0	27.7	32.9	35.2	28.4	32.3	32.8

Sources: Uruguayan authorities; and Fund staff estimates.

Figure 4. Overheating - Are there any signs?

Despite a closing output gap, a growing importance of domestic absorption, and a weakening of the trade balance, the signs of overheating appear limited.

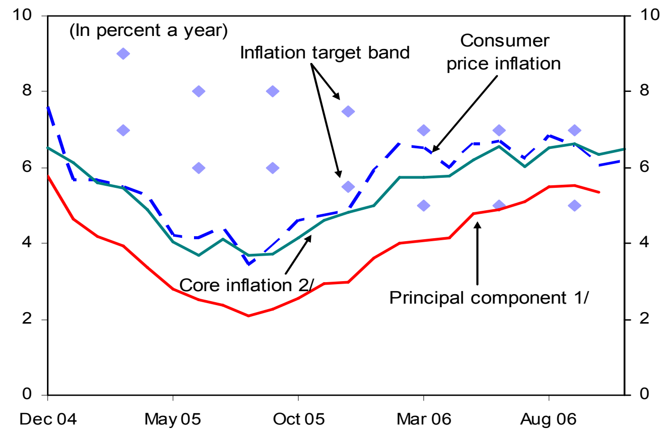


Source: Central Bank of Uruguay; and Fund staff estimates.

A. Monetary and Exchange Rate Policies

10. ***Inflation***. Following the pick up in inflation in early 2006 (reflecting demand growth, higher oil prices, and drought), price pressures have abated. With annual inflation running at 6.2 percent, inflation has begun to move closer to the center of the target range. Underlying inflation as measured by principal components and core inflation (i.e. excluding food and regulated prices) is within the target range and has started to decline.

Underlying inflation is well within the band.



1/ with a higher weight to the more persistent components in the CPI.
2/ excluding all regulated prices (including oil), fruits and vegetables.

11. ***Monetary tightening***. With underlying inflation rising earlier in the year, and given the relatively high inflation inertia, the tightening of monetary policy is appropriate. Balancing the need to contain potential inflation pressures, while continuing to support remonetization, the annual M1 growth target for September 2007 was lowered to 18 percent, and a further decline to 12 percent is expected by end-2007. The staff noted that an earlier reduction in money growth would facilitate meeting the end-2007 target. The authorities reiterated their readiness to tighten monetary conditions should inflation pressures reemerge.

12. ***Reserves***. With strong capital market access, Uruguay has exceeded the net international reserves targets by wide margins. Even so, given the still relatively low reserve coverage of short-term debt and foreign exchange deposits compared to other dollarized economies, the authorities concurred that much of the overperformance to date should be locked in or used to further reduce debt vulnerabilities. They aim to accumulate additional reserves in 2007, mainly through long-term international capital market borrowing, while continuing to purchase foreign exchange opportunistically, consistent with the inflation objective and maintaining exchange rate flexibility.

B. Fiscal Policies and Reforms

13. ***2007 budget***. The revised 2007 budget reaffirms the government's commitment to the program's medium-term primary surplus target of 4 percent of GDP. This balances the objectives of addressing spending needs and reducing the still high public debt, and is also consistent with a broadly neutral fiscal stance (near zero fiscal impulse). As envisaged, this

target will be monitored on a modified cash basis (i.e. adjusted for planned cuts in arrears and floating debt). The headline outcome also could be lower to the extent that infrastructure investments financed by privatization proceeds move forward (about 0.2 percent of GDP). Also, transferring the housing policy from BHU to the government (about 0.2 percent of GDP) would lower the headline figure, but not imply additional spending for the public sector as a whole. If all of these adjustments materialize, the primary balance would remain broadly unchanged in 2007 relative to 2006.

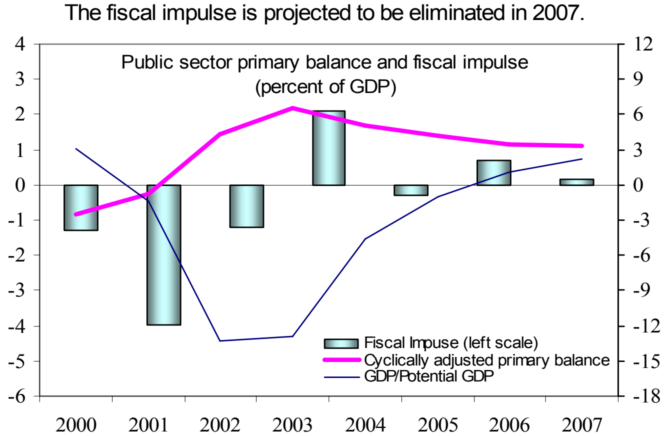
The revised 2007 budget remains consistent with a primary surplus of 4 percent of GDP, and assumes a sharp recovery in public enterprise performance with respect to 2006.

2007 Revised Budget
(as a percent of GDP)

		Proj.
	2006	2007
Revenue	**31.7**	**33.1**
Current surplus of public enterprises	1.5	2.6
Noninterest expenditure	**28.0**	**29.1**
Current	25.7	26.1
Wages	6.2	6.6
Social security benefits	12.7	13.0
Other current spending	6.8	6.5
Capital (Government and enterprises)	2.3	3.0
Primary balance 1/	**3.7**	**4.0**
Interest	4.3	4.4
Overall balance	**-0.5**	**-0.4**
Memorandum item:		
GDP (billion of pesos)	465	506

1/ 2006 on a cash basis; 2007 on a modified cash basis.

The fiscal impulse is projected to be eliminated in 2007.



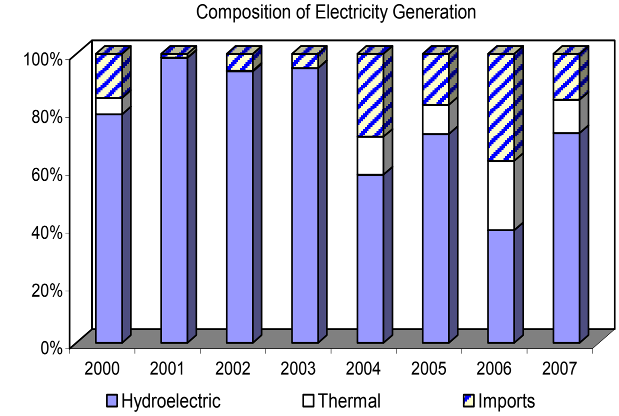
Even with adjustments, the primary balance remains broadly unchanged in 2007.

	Proj.	
	2006	2007
Primary balance (modified cash basis)	**4.0**	**4.0**
Minus:		
Reduction of arrears	0.3	0.3
Investment financed by privatization proceeds	0.0	0.2
Housing policy	0.2	0.2
Adjusted primary balance (cash)	**3.5**	**3.3**

14. ***Fiscal projections***. Discussions focused on the feasibility of achieving the primary balance objective, in light of the ambitious increase in revenues. The authorities considered that with progress in tax administration, their revenue projections were well within reach. They stressed that the improvement in public enterprise performance reflected a recovery from an unusually severe drought in 2005–06, and planned adjustments in electricity tariffs in January to reflect higher costs. Should

The drought in 2006 led to an increase in the use of expensive electricity sources.

Composition of Electricity Generation



revenues fall short, the authorities reaffirmed their readiness to use contingency measures, including administrative caps on non-essential spending, consistent with the budget law, after reconsidering spending priorities.

15. ***Tax reform***. The law preserves the equity and efficiency objectives of the reform, including by introducing a personal income tax, broadening the VAT base, reducing VAT and corporate tax rates, and eliminating minor taxes. Given that it would be approved only in mid-December, its implementation has been shifted to July 1 to give time for necessary regulations and tax administration reforms to be put in place. As the reform is broadly revenue neutral, the delay should not affect the 2007 fiscal program.

16. ***Other fiscal reforms***. Once the tax reform is approved, the government intends to work closely with Congress to ensure the passage of the police pension fund reform law in 2007. Bills for the reform of the banking employee and the military pension funds, needed to reduce contingent liabilities, are being prepared for submission to Congress in early 2007. Also, remaining domestic arrears (about ½ percent of GDP) are expected to be phased out in 2007–08. On public enterprises, measures to ensure more efficient operations over the medium term are being considered, including stronger links of wages to productivity gains, and establishing public-private partnerships. Over the medium term significant fiscal rigidities, posed by high social security transfers and wage outlays, remain a challenge. The ongoing reforms to specialized pension funds and the envisaged civil service reform are therefore important steps in the right direction.

C. Financial Sector Reforms

17. ***Financial sector law***. The draft law in Congress would address key vulnerabilities identified in the FSAP, including by increasing central bank independence and strengthening the supervisory, deposit insurance and bank resolution frameworks. Although the law was submitted to Congress a year ago, discussions to reach consensus will only start in 2007 due to the crowded legislation agenda. While opposition to some aspects of the reform could arise in the Congressional debate, the authorities reaffirmed their commitment to the reform package and expressed confidence that it will be approved next year. Capitalization of the central bank will follow approval of the financial sector law, which the authorities expect in 2007. There are also plans to improve financial sector supervision further to ensure that the new regulatory framework can be effectively implemented and enforced.

18. ***Housing bank***. Despite difficult and protracted negotiations with the unions, BHU's restructuring has moved forward and its completion is now expected in early to mid-2007 (Box 1). All nonperforming loans have been transferred or prepared for transfer to fiduciary trusts. A law has been submitted to Congress that will create a housing finance agency to administer the trusts and limit BHU's activities to granting mortgage loans on commercial terms. Still, the submission and approval of the business plan by the superintendency is pending, as the external consultants developing the plan have been making slow progress.

Box 1. BHU Restructuring

Key features. The plan was adopted in February 2006 to transform the state housing bank into a viable institution. It includes recapitalizing the bank, reducing operating costs, and limiting its mandate to residential mortgage lending on commercial terms, while transferring housing policy to the government.

- ***Fiduciary trusts***. Trusts are being established with the ministry of finance and BHU as the beneficiaries. Following the resolution of labor disputes in July, the conversion of the loan portfolio of BHU to a new system began with a delay and all nonperforming loans have been transferred or have been prepared for transfer to trusts.
- ***Recapitalization***. With the transfer of all nonperforming assets the government will assume a similar amount of liabilities and further recapitalize BHU (some US$170 million were approved in the context of the revised 2007 budget).
- ***New agency***. Legislation has been sent to Congress to create an agency within the nonfinancial public sector. It will manage the nonperforming assets held by trusts, and conduct the housing policy for the government.
- ***Reducing operating costs***. Agreement has been reached with the union to reduce total labor costs by about two-thirds, partly by transferring housing policy to the government.
- ***Business plan***. The authorities expected to finalize a business plan satisfactory to the Superintendent of Banks, and modify laws and regulations to harmonize BHU's new mission with the plan in early 2007.

IV. Program Monitoring

Waivers for the nonobservance of mainly structural performance criteria are requested based on strong macroeconomic outcomes, delayed implementation, remedial actions, and commitment to implement measures between now and end-2007.

19. ***Quantitative performance criteria***. All quantitative criteria for end-June 2006 were observed. Preliminary data for end-September indicate that all quantitative performance criteria as well as all continuous criteria were met, except for one: the performance criterion on *gross* public debt was missed due to higher-than-expected bond placements. However, this was compensated by higher international reserves and government deposits in the central bank, implying no increase in net debt. Final data will be reported prior to the Board meeting.

20. ***Structural conditionality***. Waivers are being requested for the non-observance of the following structural performance criteria, based on the strong macroeconomic outcomes, and

remedial actions in place, or reforms expected to be implemented in December 2006 and in 2007 (Letter of Intent, Table 1):

- ***Begin to implement a comprehensive tax reform*** (September 15). A waiver is requested as the tax reform is expected to be adopted with a delay by the time of the Board meeting (prior action).

- ***BHU restructuring*** (end-August and end-November). Remedial actions have been taken: all nonperforming loans have been transferred to a trust or prepared for such transfer. With progress in other key areas, including submission of legislation to restrict BHU's activities, restructuring is moving forward. The waivers are requested based on progress consistent with completion of the reform in early to mid-2007.

- ***Begin to implement financial sector reform*** (end-November). Given the crowded legislative agenda and the time needed to garner political consensus, the authorities are working with Congress to ensure implementation of the law in 2007.

- ***Specialized pension fund reforms*** (end-October and end-November). The authorities intend to submit to Congress the reform of the banking employee fund and the military pension fund reform in early 2007. With Congress in recess from mid-December to March, the delay should have only a minor impact on the timing of Congressional passage. On the police pension reform, the authorities are also committed to work with Congress to ensure that it is passed in 2007; its delayed implementation will only have a minor impact on the public finances.

21. ***Financing assurances***. The authorities are making good faith efforts to honor in 2007–08 obligations that are due, including overdue obligations that are small and do not pose risks to the program's financing.

V. Staff Appraisal

Early exit from Fund financial support signals impressive progress since the crisis, but it will be important to continue to entrench macroeconomic stability and deepen structural reforms.

22. ***Achievements***. Sound macroeconomic policies and favorable external conditions, have contributed to the sharp recovery since the 2002 crisis. Several years of large primary fiscal surpluses, sound debt management, and financial sector restructuring have led to a significant fall in debt ratios and a reduction of rollover risk, and a strengthened liquidity position of the financial system. Prudent monetary policy, within a framework of exchange rate flexibility, has been instrumental in reducing inflation and inflation expectations to

single digits. This has been accompanied by key fiscal and financial reforms, improving Uruguay's growth potential and enhancing access to international markets.

23. ***Exit from the Fund arrangement***. The authorities' decision to end the arrangement reflects the growing strength of the external position, and the improvement in the debt profile. It also reflects a sense that the task of implementing various structural reforms requires a more flexible timetable than associated with formal conditionality, and that the country has earned a measure of market confidence in its ability to deliver results.

24. ***Remaining vulnerabilities and challenges***. Even as the economy has been made more resilient to shocks, public debt remains high and exchange rate risk significant, which emphasizes the importance of further reducing the debt ratio and tilting its composition toward local currency instruments. International reserves, though much higher than envisaged, are still low compared to other dollarized economies. And much remains to be done to complete the structural reform agenda, including enhancing central bank independence, reducing financial system vulnerabilities, and addressing long-standing weaknesses of specialized pension schemes.

25. ***Monetary policy***. The central bank has appropriately lowered monetary targets and tightened monetary conditions, signaling the authorities' commitment to low inflation. The central bank should remain ready to tighten monetary policy further should inflation pressures reemerge; an earlier reduction in money growth will facilitate meeting the end-2007 objectives. Within the overall framework of exchange rate flexibility and policies to deliver low inflation, it is key to continue purchasing foreign exchange opportunistically.

26. ***Fiscal policy and reform***. To ensure achievement of the fiscal targets, spending plans should be executed as projected revenues are secured. In the event of slower than projected improvements in public enterprises or tax revenue shortfalls, it will be key to adopt compensatory measures, without compromising the quality of public spending. The impending approval of the tax reform would be a major accomplishment, and should yield important improvements in the efficiency and fairness of the tax system. It is now essential to press ahead with preparing the collection agencies for the administration of the new personal income tax and implementing regulations. It is also key to resist demands for additional spending and to continue adjusting public tariffs in line with underlying cost developments. The reform plans for the budget process, the customs agency, and the auditing and enforced collection functions of the social security bank are important steps, and their implementation over the next year should further bolster public finances. It will also be important to address expenditure rigidities, including through civil service reform and moving ahead with specialized pension reform.

27. ***Financial sector reforms***. The progress in tightening prudential regulations to internalize risks from high financial dollarization and strengthening the supervisory framework is commendable. While delays in restructuring the housing bank are regrettable,

remedial actions have been taken. Swift adoption of a business plan will enable the bank to function as a viable institution in the near term. Approval of the financial sector law, aimed at increasing central bank independence and strengthening the supervisory, deposit insurance and bank resolution frameworks, as well as capitalization of the central bank, are key next steps in the authorities' reform agenda.

28. ***Other growth-enhancing reforms***. The recent establishment of a private sector relations office at the ministry of finance to facilitate private investment and to help sustain growth is a welcome development. Approval of the bankruptcy bill currently in Congress will also represent an important milestone to improve the business environment.

29. ***Completion of the reviews***. Staff recommends completion of the fifth and sixth reviews and the financing assurances review. Although there have been some delays in implementing the ambitious structural agenda, approval of the all important tax reform is a prior action for Board consideration, the track record of macroeconomic management is strong, and the authorities intend to persevere with remaining reforms. As such, the staff supports the authorities' requests for waivers for the nonobservance of the quantitative performance criterion on public debt and the structural performance criteria citied in Table 1 of the Letter of Intent.

Table 1. Uruguay: Selected Economic and Social Indicators

Population (estimate)	3.2	Physicians per 1,000	3.7
		Hospital beds per 1,000	4.4
Life expectancy at birth (years)	74.6		
Crude birth rate (per thousand)	9.7	Access to safe water	
Infant mortality rate (per thousand live births)	14.0	(percent of population)	98.0
Income share held by highest 10 percent of households	33.5	Adult literacy rate	97.7
Income share held by lowest 20 percent of households	4.8	Gross enrollment rate	
Gini coefficient	44.6	Primary education	108.3
Unemployment rate	10.9	Secondary education	101.5
Poverty rate	27.8	Tertiary education	37.7
GDP per capita in 2005 (in US$)	5,208		
Human Development Index Rank	46		

				2006		Proj.		
	2003	2004	2005	Report 06/425	Proj.	2007	2008	2009
				(Percent change)				
				I. Output, prices, and employment				
Real GDP	2.2	11.8	6.6	4.6	6.5	4.2	3.0	3.1
Real consumption	1.1	10.5	2.5	2.7	5.5	3.7	2.8	2.4
Real investment	18.0	22.0	10.1	55.0	41.0	17.3	-4.6	5.5
Contributions to real growth (percent) 1/								
Consumption	1.0	9.6	2.2	3.4	4.8	3.1	2.4	2.0
Investment	1.9	2.7	1.4	6.0	5.6	3.2	-0.9	1.0
Net exports	-0.7	-0.4	3.0	-4.7	-3.9	-2.1	1.6	0.0
GDP (Ur$ billions)	316	379	411	452	465	506	541	580
GDP (US$ billions)	11.2	13.3	16.9	18.6	19.4	20.9	22.0	23.3
Investment	32.1	24.9	9.0	52.7	37.7	16.7	1.3	10.5
Consumption	20.1	18.3	8.5	8.3	12.2	8.6	6.8	6.5
GDP deflator	18.4	7.5	1.7	5.1	6.2	4.4	3.9	4.0
CPI inflation (average)	19.4	9.2	4.7	6.1	6.3	4.8	4.0	4.0
CPI inflation (eop)	10.2	7.6	4.9	5.5	6.0	4.8	4.0	4.0
Exchange rate change (Ur$/US$)(average)	30.4	1.5	-15.0	...	...	...	...	...
Exchange rate change (Ur$/US$) (eop)	7.3	-9.9	-10.1	...	...	...	...	...
Average public sector wage (end-of-period)	7.9	9.7	10.2	10.5	9.8	11.4	9.3	6.8
Unemployment (in percent)	16.9	13.1	12.1	...	...	...	...	...
				II. Monetary indicators				
Base Money (average)	19.3	7.7	28.5	27.7	21.5	9.8	6.9	7.1
Base Money (eop)	24.9	11.1	34.1	22.7	16.8	9.8	6.9	7.1
Currency issued	22.4	15.7	22.0	21.8	14.5	9.8	6.9	7.1
M-1	34.6	13.4	29.4	28.0	21.0	12.2	6.9	7.1
M-2	17.4	12.8	22.3	23.0	17.1	12.2	6.9	7.1
M-3	21.7	-2.0	0.1	7.7	11.2	9.1	6.9	7.1
Credit to the private sector (constant exch. rate)	-23.9	-11.2	2.7	9.9	5.0	9.6	6.9	7.1
				(Percent of GDP, unless otherwise indicated)				
				III. Public sector operations				
Revenue	32.0	30.9	31.8	32.7	31.7	33.1	33.2	33.5
Non-interest expenditure (incl. discrepancy)	29.3	27.2	27.9	29.0	28.0	29.1	29.2	29.5
Primary balance	2.7	3.8	3.9	3.7	3.7	4.0	4.0	4.0
Interest	6.0	6.0	4.6	4.6	4.3	4.4	4.3	4.2
Overall balance	-3.2	-2.2	-0.7	-0.9	-0.5	-0.4	-0.3	-0.2
Public sector debt 3/	104	92	69	67	64	59	56	53
Public debt service (as a percent of GDP)	14.1	18.8	15.5	17.2	26.6	8.6	7.9	6.9

Table 1. Uruguay: Selected Economic and Social Indicators (concluded)

				2006			Proj.	
	2003	2004	2005	Report 06/425	Proj.	2007	2008	2009
IV. Savings and investment								
Gross domestic investment	12.6	13.1	13.2	18.3	16.0	17.2	16.3	16.8
Gross national savings	12.1	13.4	13.2	14.0	13.4	13.6	13.6	14.2
Foreign savings	0.5	-0.3	0.0	4.3	2.6	3.6	2.6	2.6
V. External indicators								
Merchandise exports, fob (US$ millions)	2,281	3,145	3,758	4,140	4,433	4,865	5,277	5,593
Merchandise imports, fob (US$ millions)	2,098	2,992	3,730	4,936	4,894	5,552	5,732	6,084
Merchandise terms of trade (percentage change)	2.9	-3.1	-9.7	-4.6	-2.7	-0.9	-1.4	-1.1
Current account balance	-0.5	0.3	0.0	-4.3	-2.6	-3.6	-2.6	-2.6
Of which: excluding pulp mills projects	-0.5	0.3	0.0	-1.2	-1.1	-1.4	-1.6	-1.5
Foreign direct investment	3.6	2.4	4.2	6.9	6.0	4.4	3.3	2.8
Overall balance of payments (US$ millions)	1,380	454	951	525	-689	489	111	107
External debt 4/	98.2	87.4	67.5	61.9	53.7	52.2	49.8	47.2
Of which: external public debt	85.3	76.9	60.2	55.2	47.3	46.3	44.2	41.9
External debt service (percent of exports of goods and services)	52.3	44.8	53.1	54.8	89.7	26.8	26.5	23.7
Gross official reserves (US$ millions) 5/	2,087	2,512	3,438	3,963	2,777	3,266	3,377	3,484
In months of imports of goods and services	6.6	6.5	7.1	8.0	5.1	5.7	5.6	5.6
In percent of short-term debt	131.3	112.4	153.8	139.7	221.3	248.6	284.5	238.7
In percent of short-term debt plus bank non-resident deposits	51.2	55.4	75.8	75.7	75.5	85.2	88.7	83.4
In percent of short-term debt plus FX deposits	20.0	27.7	32.9	35.2	28.4	32.3	32.8	32.1
REER (percentage depreciation -, e.o.p.)	-13.2	9.3	11.9	...	...	...	...	...

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

1/ 2006-08 numbers are large driven by the large scale FDI project in pulp mills.
2/ Program definition (end of period data).
3/ Covers debt of the NFPS and the central bank (excluding monetary policy instruments and free reserves).
4/ Excludes nonresident deposits.
5/ Includes reserve buildup through reserve requirements of resident financial institutions.

Table 2. Uruguay: Performance under the 2006 Economic Program 1/

Area	Structural Conditionality	Date	Status
A. Performance criteria			
Fiscal	Have in place a five-year spending plan, complemented with revenue projections and deficit targets consistent with the program's fiscal targets.	February 28, 2006	Observed.
Tax reform	Submit to congress a comprehensive tax reform as described in paragraph 7 of the MEFP.	February 28, 2006	Done with small delay. Not observed. Waiver was granted at the time of the third review.
Tax reform	Begin to implement the comprehensive tax reform.	September 15, 2006	Not observed. Expected by the time of the Board consideration of the reviews (prior action).
Central Bank	Begin to implement financial sector reform laws that: (i) give appropriate autonomy to the central bank (as described in paragraph 12 of the MEFP); (ii) strengthen the regulation of the financial system (as described in paragraph 13 of the MEFP); and (iii) provide a suitable bank resolution framework (as described in paragraph 14 of the MEFP).	November 30, 2006	Not observed. To be implemented in 2007.
BROU & BHU	Government to ensure timely service of BHU note and BROU fiduciary notes to BROU in accordance with the current payment schedules.	Continuous	Observed.
BHU	Move nonperforming loans into a fideicomiso and adequately capitalize BHU as specified in paragraph 11 of the TMU.	August 31, 2006	Not observed. Remedial actions were taken.
BHU	Transform BHU into an institution with a viable business plan and a strong regulatory framework as specified in paragraph 12 of the TMU.	November 30, 2006	Not observed. To be implemented in 2007.
Pensions	Begin to implement reform of the pension fund for the police.	October 31, 2006	Not observed. To be implemented in 2007.
Pensions	Submit to Congress reform of the pension fund for the military and bank employees as described in paragraph 12 of the SMEFP.	November 30, 2006	Not observed. To be implemented in 2007.
B. Benchmarks			
Tax administration	Formulate a plan to strengthen the auditing and enforced collection functions of the BPS.	June 30, 2006	Done with small delay. Not observed.
Tax administration	Finalize the design of a comprehensive reform plan for the customs agency (including establishing collection targets consistent with the program).	August 31, 2006	Largely done. 2/ Not observed.
Budget	Prepare recommendations, with a timetable, to improve legislation, coverage, classification, formulation, controls, and transparency of the budget process.	August 31, 2006	Done with small delay. Not observed.
Financial sector	Adopt a detailed schedule for the implementation of the BHU action plan.	February 28, 2006	Observed.
Financial sector	Sell shares of NBC in amounts that yield managerial control to the private sector.	June 30, 2006	Observed.
Central Bank	Adopt plan to strengthen the central bank finances (outright capitalization or interest payment on government paper).	November 30, 2006	Not observed. To be implemented in 2007.
Growth	Publish agenda of growth-enhancing reforms (including timetable for implementation) prepared by the business environment commission.	March 31, 2006	Done with small delay. Not observed.
Growth	Submit to Congress bankruptcy law (to include Chapter-11 type corporate restructuring).	June 30, 2006	Done with small delay. Not observed.
Growth	Establish a private sector relations office at the MEF.	August 31, 2006	Observed.

Table 2: Performance Under the 2006 Economic Program (concluded) 1/

	2005 Stock	2006 Targets												
		Mar. 31				Jun. 30				Sept. 30				
	Sept. 30	Target	Target (adj.)	Actual	**Margin (+)**	Target	Target (adj.)	Actual	**Margin (+)**	Target	Target (adj.)	Prel.	**Margin (+)**	
A. Quantitative performance criteria														
				(In millions of Uruguayan pesos)										
1. Combined public sector primary balance (floor) 3/	n.a.	2,651	2,651	5,134	**2,483**	5,196	5,196	7,844	**2,648**	10,434	10,270	11,868	**1,598**	
2. General government noninterest expenditure (ceiling) 3/	n.a.	13,409	13,409	12,144	**1,265**	27,050	27,050	25,270	**1,780**	39,870	39,881	37,735	**2,146**	
3. Net domestic assets of the BCU (ceiling) 4/	51,525	-3,136	-6,088	-14,797	**8,708**	-6,029	-9,732	-18,637	**8,905**	-12,278	-34,263	-46,423	**12,160**	
				(In millions of U.S. dollars)										
4. Net international reserves of the BCU (floor) 4/	-1,546	250	374	779	**406**	469	624	1,001	**377**	732	1,652	2,087	**435**	
5. Nonfinancial public sector gross debt (ceiling) 5/	12,309	12,882	13,087	12,324	**763**	13,074	12,670	12,565	**105**	13,082	12,254	12,594	**-340**	6/
6. Accumulation of external payment arrears of the public sector (on a continuous basis) 2/	0	0	0	0	**0**	0	0	0	**0**	0	0	0	**0**	
B. Indicative targets														
				(In millions of Uruguayan pesos)										
7. Combined public sector overall balance (floor) 3/	n.a.	-3,076	-3,076	23	**3,099**	-5,394	-5,394	-2,267	**3,127**	-5,935	-6,099	-3,729	**2,370**	
8. Combined public sector primary balance (extended) (floor) 3/	n.a.	2,651	2,651	5,541	**2,890**	5,196	5,196	8,581	**3,385**	10,434	10,270	12,994	**2,724**	
9. Monetary base (ceiling) 4/	16,146	3,140	3,140	4,558	**-1,418**	5,118	5,118	4,799	**319**	6,075	6,075	3,910	**2,165**	

PC= Performance Criterion; IT=Indicative Target.

Sources: Ministry of Economy and Finance; and Central Bank of Uruguay.

1/ As defined in the Technical Memorandum of Understanding.

2/ Customs reform plan did not include collection targets, as it was considered to be premature at this stage.

3/ Cumulative changes from the previous calendar year.

4/ 2006 targets are cumulative from end-September 2005.

5/ All maturities.

6/ Waiver requested based on that the higher-than-expected bond placementes were fully reflected in higher government deposits with the central bank and official international reserves.

Table 3. Uruguay: Summary Accounts of the Banking System
(In millions of U.S. dollars)

	2003	2004	2005	2006 Report 06/425	2006 Proj.	Proj. 2007
1. Banco Central del Uruguay						
Net foreign assets	-52	-51	1,307	1,942	2,995	3,507
Net international reserves 1/	-321	-164	1,135	1,728	2,777	3,266
Gross international reserves	2,087	2,512	3,438	3,963	2,777	3,266
Reserve liabilities 1/	-2,407	-2,675	-2,304	-2,235	0	0
Other net foreign assets	269	113	172	214	218	241
Net domestic assets	532	652	-287	-867	-1,917	-2,325
Net credit to the public sector	2,464	2,626	1,969	1,741	716	266
Net credit to the financial system	-2,112	-1,905	-1,975	-1,981	-2,044	-2,040
Credit to the private sector	71	62	65	65	65	68
Securities issued by the BCU	-243	-563	-904	-1,361	-1,273	-1,301
Other	352	431	558	669	619	682
Peso monetary liabilities	480	600	1,020	1,075	1,078	1,182
Memorandum items: 2/						
Monetary base (average) 3/	...	594	763	1,074	1,022	1,120
Monetary base (end of period) 3/		584	857	1,061	1,009	1,106
NIR program definition	...	-2,218	-1,166	-257	661	1,150
NDA program definition	...	2,811	1,950	1,317	348	-43
2. Public and Private Banks 4/						
Net foreign assets	1,213	1,887	2,030	2,128	2,428	2,649
Net domestic assets	5,331	5,090	5,397	5,712	5,735	6,265
Net credit to the public sector	219	437	0	-124	-22	-22
Net credit to the financial system	2,612	2,256	2,602	2,925	2,847	3,109
Credit to the private sector	4,726	4,307	4,533	4,699	4,699	5,131
Other	-2,226	-1,909	-1,738	-1,788	-1,788	-1,953
Liabilities to the private sector (residents)	6,544	6,977	7,426	7,840	8,163	8,915
Public banks	3,409	3,670	3,842	4,058	4,217	4,605
Local currency	394	520	682	807	766	837
Foreign currency	3,016	3,149	3,160	3,251	3,451	3,768
Private banks	3,135	3,307	3,584	3,782	3,947	4,310
Local currency	349	405	574	680	645	705
Foreign currency	2,785	2,902	3,010	3,101	3,301	3,605
3. Banking System						
Net foreign assets	1,161	1,835	3,337	4,070	5,523	6,156
Net domestic assets	5,788	5,738	4,952	4,875	3,713	3,929
Credit to the public sector	2,684	3,063	1,968	1,617	592	244
Credit to the rest of financial system	-173	-165	470	975	800	1,057
Credit to the private sector	4,797	4,369	4,598	4,764	4,763	5,199
Other	-1,519	-1,529	-2,084	-2,481	-2,442	-2,572
Broad money (M3)	6,949	7,573	8,288	8,945	9,236	10,086
Memorandum items:			(Percentage change)			
Base money (average)	19.3	7.7	28.5	27.7	21.5	9.6
Base money (end-of-period)	24.9	11.1	34.1	22.7	16.8	9.6
M-1	34.6	13.4	29.4	27.7	26.7	12.2
M-1 (authorities' definition) 5/	34.0	13.0	33.0	28.0	20.0	12.2
M-2	17.4	12.8	22.3	23.0	17.1	12.2
M-3	21.7	-2.0	0.1	7.7	11.2	9.2

Sources: Central Bank of Uruguay; and Fund staff estimates and projections.
1/ Includes all outstanding liabilities to the IMF, but excludes liabilities to resident financial institutions.
2/ Program figures for 2005 are estimated at December 2004 exchange rates, while those for 2006 are estimated at September 2005 exchange rates.
3/ Monetary base excludes from peso monetary liabilities the net government and BPS deposits with BROU, which are subject to 100 percent requirements.
4/ The Banco de la Republica Oriental de Uruguay (BROU), Banco Hipotecario de Uruguay (BHU; mortgage institution), private banks, and cooperatives.
5/ Includes government and nonbank financial institution deposits at the central bank.

Table 4. Uruguay: Public Sector Operations
(In millions of pesos)

				2006						
				Q1-Q3 4/				Proj.		
	2003	2004	2005	Prog. 5/	Est.	Report 06/425	Proj.	2007	2008	2009
Revenue	**101,081**	**117,367**	**130,818**	**108,886**	**109,125**	**147,808**	**147,383**	**167,413**	**179,726**	**194,435**
Taxes	70,096	83,002	92,280	75,027	79,484	103,586	106,431	115,872	123,497	132,984
VAT and excise taxes	37,667	47,200	53,124	44,166	44,547	60,794	60,715	67,018	69,850	75,186
On income and profits	15,621	17,683	20,148	16,030	17,757	22,600	23,137	27,837	31,868	34,468
On foreign trade	3,780	4,958	5,195	3,723	4,177	5,490	5,748	5,076	4,175	4,496
On property and other	13,028	13,161	13,813	11,107	13,004	14,702	16,832	15,940	17,604	18,833
Social security contributions	14,696	16,657	21,526	17,759	18,951	24,072	25,314	28,527	31,070	33,314
Nontax revenue	6,200	7,831	8,399	7,311	6,418	9,698	8,615	9,729	10,225	10,963
Current surplus of public enterprises	10,090	9,876	8,614	8,789	4,272	10,452	7,023	13,285	14,934	17,174
Noninterest expenditure	**92,431**	**103,082**	**114,858**	**98,452**	**97,356**	**130,906**	**130,114**	**147,174**	**158,066**	**171,211**
Current 3/	84,623	93,780	105,276	87,229	86,796	117,789	119,261	131,870	142,231	153,070
Wages	19,701	23,409	25,499	21,004	20,959	28,641	28,722	33,172	36,583	39,806
Goods and services	15,031	17,015	19,386	17,170	16,506	22,620	22,871	24,349	24,975	27,359
Of Which: SEP	0	0	780	2,040	1,814	2,553	2,554	1,800	0	0
Social security benefits	44,218	47,702	53,057	42,909	43,406	58,226	59,000	65,526	70,665	76,350
Other	5,673	5,654	7,333	6,145	5,925	8,303	8,668	8,824	10,008	9,555
Capital (Government and enterprises) 4/	7,808	9,303	9,582	11,223	10,560	13,117	10,853	15,303	15,836	18,141
Primary balance 1/	**8,651**	**14,284**	**15,960**	**10,434**	**11,770**	**16,902**	**17,268**	**20,239**	**21,659**	**23,224**
Interest	18,881	22,666	18,753	16,689	15,499	20,984	19,817	22,486	23,308	24,318
Overall balance 1/	**-10,231**	**-8,382**	**-2,793**	**-6,255**	**-3,729**	**-4,082**	**-2,548**	**-2,246**	**-1,649**	**-1,094**

Table 4. Uruguay: Public Sector Operations (continued)
(In percent of GDP)

				2006				Proj.		
				Q1-Q3 4/						
	2003	2004	2005	Prog. 5/	Est.	Report 06/425	Proj.	2007	2008	2009
Revenue	**32.0**	**30.9**	**31.8**	**32.6**	**31.3**	**32.7**	**31.7**	**33.1**	**33.2**	**33.5**
Taxes	22.2	21.9	22.5	22.5	22.8	22.9	22.9	22.9	22.8	22.9
VAT and excise taxes	11.9	12.4	12.9	13.2	12.8	13.5	13.1	13.2	12.9	13.0
On income and profits	5.0	4.7	4.9	4.8	5.1	5.0	5.0	5.5	5.9	5.9
On foreign trade	1.2	1.3	1.3	1.1	1.2	1.2	1.2	1.0	0.8	0.8
On property and other	4.1	3.5	3.4	3.3	3.7	3.3	3.6	3.2	3.3	3.2
Social security contributions	4.7	4.4	5.2	5.3	5.4	5.3	5.4	5.6	5.7	5.7
Nontax revenue	2.0	2.1	2.0	2.2	1.8	2.1	1.9	1.9	1.9	1.9
Current surplus of public enterprises	3.2	2.6	2.1	2.6	1.2	2.3	1.5	2.6	2.8	3.0
Noninterest expenditure	**29.3**	**27.2**	**27.9**	**29.5**	**27.9**	**29.0**	**28.0**	**29.1**	**29.2**	**29.5**
Current	26.8	24.7	25.6	26.1	24.9	26.1	25.7	26.1	26.3	26.4
Wages	6.2	6.2	6.2	6.3	6.0	6.3	6.2	6.6	6.8	6.9
Goods and services	4.8	4.5	4.7	5.1	4.7	5.0	4.9	4.8	4.6	4.7
Of Which: SEP	0.0	0.0	0.2	0.6	0.5	0.6	0.5	0.4	0.0	0.0
Social security benefits	14.0	12.6	12.9	12.8	12.4	12.9	12.7	13.0	13.1	13.2
Other	1.8	1.5	1.8	1.8	1.7	1.8	1.9	1.7	1.8	1.6
Capital (Government and enterprises)	2.5	2.5	2.3	3.4	3.0	2.9	2.3	3.0	2.9	3.1
Primary balance 1/	**2.7**	**3.8**	**3.9**	**3.1**	**3.4**	**3.7**	**3.7**	**4.0**	**4.0**	**4.0**
Interest	6.0	6.0	4.6	5.0	4.4	4.6	4.3	4.4	4.3	4.2
Overall balance 1/	**-3.2**	**-2.2**	**-0.7**	**-1.9**	**-1.1**	**-0.9**	**-0.5**	**-0.4**	**-0.3**	**-0.2**
Memorandum items:										
(in percent of GDP unless otherwise noted)										
Primary balance (cash basis) ...	...	...	...	...	...	...	3.7	3.7	3.8	4.0
Stock of floating debt and arrears (percent of GDP) 2/	1.2	1.2	1.0	...	0.9	...	0.6	0.3	0.1	0.1
Augmented overall balance 3/	-3.2	-0.3	-0.7	-2.2	-1.2	-3.2	-2.8	-0.4	-0.3	-0.2
GDP (billions of pesos)	**315**	**379**	**411**	**...**	**...**	**452**	**465**	**506**	**541**	**580**

Sources: Ministry of Finance; and Fund staff estimates.

1/ Up to 2006 on a cash basis. Starting in 2007, on a modified cash basis, which includes variations of the stock of arrears and floating debt.

The 2007 fiscal balance may be adjusted downward by up to 0.2 percent of GDP for capital spending in identified projects financed with proceeds of the sale of NBC.

2/ Starting in 2004 the definition includes an expanded government concept, forestry subsidies, and membership fees of international organizations.

3/ Asset recoveries related to bank restructuring costs incurred in 2002 are credited in 2004. In 2006 includes US$20 million for financing of the deposit insurance scheme and US$407 million for the net value of the recapitalization of the BHU

4/ For Q1-Q3 figures, amounts as percentage of 3/4 of annual GDP.

5/Country Report No. 05/109.

Table 5. Uruguay: Public Sector Financing Outlook, 2006-2007 1/
(In millions of U.S. dollars)

	Actual			Projections		
	2006					2007
	Q1	Q2	Q3	Q4	Year	Year
Public sector gross borrowing requirements	**1,259**	**407**	**1,088**	**492**	**3,246**	**1,363**
Of which : IMF repurchases	679	0	904	1,079	2,663	0
Of which : World Bank/IDB 2/	555	72	66	63	756	220
Of which : Bond amortizations	227	45	47	418	738	438
Sources of financing	**1,259**	**407**	**1,088**	**492**	**3,246**	**1,363**
Of which : IMF disbursements	169	123	0	0	292	0
Of which : World Bank/IDB 3/	24	35	65	22	145	216
Of which : Bond placements	1,126	125	1,014	503	2,767	1,167
10 year maturity international issuances	1,011	0	911	503	2,425	849
UI bonds	59	102	102	0	263	318
Letras	56	23	0	0	79	0
Of which : Short-term debt	0	0	0	0	0	0
Banking system credit	-88	16	79	-114	-107	112
Bilaterals and others	28	108	-70	81	148	-133
Memorandum items:						
Fund credit outstanding	1,816	1,983	1,074	0	0	0
(as a share of quota)	411	439	237	0	0	0
Net World Bank/IDB 3/	-532	-37	-1	-42	-611	-4
Net bond placements	899	79	966	84	2029	729

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Excludes the assumption of net liabilities (noncash) from BHU in the fourth quarter of 2006 of US$407 million.
2/ Includes official debt.

Table 6. Uruguay: Balance of Payments

(In millions of US$, unless otherwise stated)

	2003	2004	2005	2006 Report 06/425	2006 Proj.	Projections 2007	Projections 2008	Projections 2009
				1. Balance of Payments				
Current account	**-56**	**43**	**2**	**-798**	**-503**	**-751**	**-578**	**-601**
Trade balance	183	153	28	-796	-461	-687	-455	-491
Exports, f.o.b.	2,281	3,145	3,758	4,140	4,433	4,865	5,277	5,593
Imports, f.o.b.	2,098	2,992	3,730	4,936	4,894	5,552	5,732	6,084
Services	167	365	409	474	457	470	461	517
Exports, f.o.b.	803	1,151	1,335	1,450	1,355	1,464	1,568	1,703
Imports, f.o.b.	636	786	926	976	898	995	1,107	1,185
Income (net)	-489	-588	-585	-602	-614	-655	-704	-753
Transfers (net)	83	113	149	126	115	121	120	126
Financial and capital account	**1,039**	**67**	**1,016**	**1,323**	**-303**	**1,240**	**689**	**708**
Foreign direct investment	401	315	715	1,276	1,164	917	728	650
Portfolio investment	-541	-422	766	603	1,773	355	-69	80
Government securities	-5	240	566	701	1,801	539	99	50
Issues	613	504	1,094	1,118	2,256	662	167	11
Amortization 1/	618	263	528	417	455	123	68	-40
Banks	-537	-663	200	-99	-28	-184	-168	30
Other capital flows (net)	1,179	174	-466	-555	-3,240	-32	30	-22
Loans	375	-133	-198	-713	-2,983	-4	-41	-4
Of which: WB, IDB, commercial (net)	237	-37	80	-502	-424	-4	-41	-4
Disbursements	472	479	689	240	380	328	407	426
Amortization	235	517	609	743	804	332	447	430
Of which: IMF (net)	422	152	-176	-135	-2,373	0	0	0
Disbursements	502	552	304	538	294	0	0	0
Amortization 2/	80	400	480	673	2667	0	0	0
Deposits, net	267	180	-428	0	-99	0	0	0
Other flows, net	537	128	161	157	-158	-28	71	-18
Errors and omissions	397	345	-66	0	116	0	0	0
Overall balance	1,380	454	951	525	-689	489	111	107
Reserve assets (- increase)	**-1,380**	**-454**	**-951**	**-525**	**689**	**-489**	**-111**	**-107**
				2. Reserve Adequacy and External Indicators				
Gross official reserves (stock)	**2,087**	**2,512**	**3,438**	**3,963**	**2,777**	**3,266**	**3,377**	**3,484**
In months of next year's imports of goods and services	6.6	6.5	7.1	8.0	5.1	5.7	5.6	5.6
In percent of short-term debt excl. nonres. deposits	131.3	112.4	153.8	139.7	221.3	248.6	284.5	238.7
In percent of short-term debt incl. nonres. deposits	51.2	55.4	75.8	75.7	75.5	85.2	88.7	83.4
Net international reserves (stock) 3/	**-763**	**-2,218**	**-1,166**	**-257**	**661**	**1,150**	**1,250**	**1350**
				(As percent of GDP)				
Exports	20.3	23.7	22.2	22.3	22.9	23.3	23.9	24.0
Imports	18.7	22.6	22.1	26.6	25.3	26.5	26.0	26.1
Current account	-0.5	0.3	0.0	-4.3	-2.6	-3.6	-2.6	-2.6
Underlying current account 4/	-0.5	0.3	0.0	-1.2	-1.1	-1.4	-1.6	-1.5
Financial and capital account	9.3	0.5	6.0	7.1	-1.6	5.9	3.1	3.0
Of which: foreign direct investment (net)	3.6	2.4	4.2	6.9	6.0	4.4	3.3	2.8
Of which: government securities (net)	0.0	1.8	3.3	3.8	9.3	2.6	0.4	0.2
Of which: IMF (net)	6.0	0.8	-1.0	-0.7	-12.3	0.0	0.0	0.0
Overall balance	12.3	3.4	5.6	2.8	-3.6	2.3	0.5	0.5
Changes in GIR	-12.3	-3.4	-5.6	-2.8	3.6	-2.3	-0.5	-0.5
External debt	98.2	87.4	67.5	61.9	53.7	52.2	49.8	47.2
Short-term debt (residual maturity)	21.4	12.0	13.2	15.3	6.4	6.2	5.3	6.2
External public debt	85.3	76.9	60.2	55.2	47.3	46.3	44.2	41.9
External debt + NR deposits	118.1	106.1	81.1	74.8	66.1	64.2	61.6	58.8
				(As percent of annual exports of goods and services)				
Total external debt	357.1	269.9	224.2	205.8	179.5	172.6	160.4	151.2
Total external debt (including nonresidential deposits)	429.3	327.8	269.3	248.7	220.9	212.0	198.4	188.1
Debt service	52.3	44.8	53.1	54.8	89.7	26.8	26.5	23.7
Of which: interest payments	19.2	16.7	16.6	18.5	18.0	16.4	16.1	15.6
				(Annual percent changes)				
Exports	18.7	37.9	19.5	10.2	18.0	9.8	8.5	6.0
Imports	12.0	42.6	24.7	29.0	31.2	13.5	3.2	6.1
Export prices in US$ (year-on-year percent change) 4/	7.4	6.4	5.1	2.6	5.8	0.7	-0.5	-0.8
Import prices in US$ (year-on-year percent change) 4/	5.1	9.1	12.2	5.7	8.1	0.9	0.2	-0.4
Terms of trade 4/	2.2	-2.4	-6.3	-2.9	-2.2	-0.1	-0.7	-0.4
Export volume 4/	9.4	28.7	16.2	8.6	11.4	8.7	7.7	7.0
Import volume 4/	6.2	29.1	9.4	9.8	13.3	10.2	8.3	7.0

Sources: Central Bank of Uruguay; and Fund staff estimates and projections.

1/ Includes secondary market transactions between residents and non-residents.

2/ Projected amortization payments on obligation schedule.

3/ Follows respective TMU definitions.

4/ Excluding imports related to the construction of pulp mill projects (Botnia and ENCE).

Table 7. Uruguay: Vulnerability Indicators

	2003	2004	2005	Proj. 2006
(Percent change, unless otherwise indicated)				
Financial sector indicators				
Broad money	21.7	-2.0	0.1	11.2
Credit to the private sector (const. exch. rate)	-23.9	-11.2	2.7	5.0
Share of nonperforming loans in total loans (in percent) 1/	9.4	3.8	2.7	2.1
Provisions to nonperforming loans (in percent) 1/	91.4	106.8	118.8	130.2
Capital to asset ratio (in percent) 1/	7.2	8.3	8.6	10.1
Return on assets (in percent) 1/	-1.1	-0.1	0.7	1.7
Interbank interest rates (percent, end-of-period) 1/	2.5	1.3	1.0	3.0
FX deposits held by residents (in percent of total deposits)	88.8	87.6	83.7	82.0
FX loans to residents (in percent of total loans)	77.6	73.3	70.0	70.0
Public debt indicators				
Public sector gross debt (PSGD, in percent of GDP)	104.5	92.5	69.3	63.6
Of which: Exposed to rollover risk (in percent of total PSGD)	12.1	13.5	16.0	...
Exposed to exchange rate risk (in percent of total PSGD)	94.3	90.2	87.0	...
Exposed to interest rate risk (in percent of total PSGD)	45.5	44.6	40.0	...
External indicators				
Merchandise exports	18.7	37.9	19.5	18.0
Merchandise imports	12.0	42.6	24.7	31.2
Merchandise terms of trade	2.9	-3.1	-9.7	-2.7
REER appreciation (+)	-13.2	9.3	11.9	...
(Percent of GDP, unless otherwise indicated)				
Current account balance	-0.5	0.3	0.0	-2.6
Capital and financial account balance	9.3	0.5	6.0	-1.6
Of which: Net foreign direct investment	3.6	2.4	4.2	6.0
Government securities	0.0	1.8	3.3	9.3
Other net inflows	5.7	-3.7	-1.6	-16.9
Total gross external debt (ED) in percent of GDP	98.2	87.4	67.5	53.7
Of which: Short-term ED (original maturity, in percent of total ED)	6.7	7.6	6.4	8.5
ED to foreign official sector (in percent of total ED)	51.1	50.7	48.4	24.5
External interest payments (in percent of exports of GNFS)	19.2	16.7	16.6	18.0
External amortization payments (in percent of exports of GNFS)	33.1	28.2	36.4	71.7
(U.S. million, unless otherwise indicated)				
Central Bank reserve liabilities 2/	2,407	2,675	2,304	0
Short-term foreign assets of the banking system	4,989	5,637	6,880	7,499
Short-term foreign liabilities of the banking system 3/	4,597	4,389	4,504	2,376
Gross official reserves	2,087	2,512	3,438	2,777
In months of imports GNFS	6.6	6.5	7.1	5.1
In percent of short-term external debt excl. nonres FX deposits	131.3	112.4	153.8	221.3
In percent of short-term external debt plus bank NR deposits	51.2	55.4	75.8	75.5
In percent of short-term debt plus FX deposits	20.0	27.7	32.9	28.4
In percent of broad money	28.7	34.3	37.9	38.0
In percent of base money	427.3	418.1	386.3	372.9
Banking system foreign assets as percent of short-term external debt plus all FX deposits 3/ 4/	56.9	68.1	74.5	71.5
Financial market indicators				
Foreign currency debt rating (Moody's) 5/	B3	B3	B3	B3
Foreign currency debt rating (S&P) 5/	B-	B	B	B+
EMBI secondary market spread (bps, end of period) 5/	624	388	298	223
Exchange rate (per U.S. dollar, period average)	28.2	28.6	24.4	…
Exchange rate (per U.S. dollar, end-of-period)	29.3	26.4	24.1	…

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Excludes BHU. End-September 2006 figures.
2/ Includes all use of Fund credit.
3/ By remaining maturity.
4/ Excludes nonreserve assets from the BCU.
5/ As of November 27, 2006.

Table 8. Uruguay: Schedule of Purchases Under the Stand-By Arrangement, 2005–08

Availability Date	Amount of Purchase		Conditions
	SDR	Percent Quota	
June 8, 2005	30.65	10.0	Program approval
September 28, 2005	30.65	10.0	Completion of first review and observance of structural PCs and end-June quantitative PCs
January 18, 2006	30.65	10.0	Completion of second review and observance of structural PCs and end-December quantitative PCs
March 27, 2006	85.82	28.0	Completion of third review and observance of structural PCs and end-December quantitative PCs
June 28, 2006	85.82	28.0	Completion of fourth review and observance of structural PCs and end-March quantitative PCs
December 22, 2006	85.82	28.0	Completion of fifth review and observance of structural PCs and end-September quantitative PCs
December 22, 2006	85.82	28.0	Completion of sixth review and observance of structural PCs and end-September quantitative PCs
February 28, 2007	67.43	22.0	Completion of seventh review and observance of structural PCs and end-December quantitative PCs
May 31, 2007	67.43	22.0	Completion of eighth review and observance of structural PCs and end-March quantitative PCs
August 31, 2007	67.43	22.0	Completion of ninth review and observance of structural PCs and end-June quantitative PCs
November 30, 2007	67.43	22.0	Completion of tenth review and observance of structural PCs and end-September quantitative PCs
February 28, 2008	30.65	10.0	Completion of eleventh review and observance of structural PCs and end-December quantitative PCs
May 31, 2008	30.65	10.0	Completion of twelfth review and observance of structural PCs and end-March quantitative PCs
Total access	**766.25**		
Percent of quota	**250.0**		

Source: Fund staff estimates.

Table 9. Uruguay: Projected Payments to the Fund and Capacity to Repay

	2003	2004	2005	2006	2007	2008	2009	2010	2011
				(In SDR million)					
Fund disbursements (existing and prospective)									
Principal disbursements	364.2	372.8	201.1	202.3	0.0	0.0	0.0	0.0	0.0
Existing	364.2	372.8	201.1	202.3	0.0	0.0	0.0	0.0	0.0
Prospective	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund repurchases and charges (existing and prospective)									
Principal (repurchases) 1/	57.1	270.3	317.3	1,814.4	0.0	0.0	0.0	0.0	0.0
On existing purchases	57.1	270.3	317.3	1,814.4	0.0	0.0	0.0	0.0	0.0
On prospective purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Charges and interest	49.0	64.0	77.9	71.9	0.0	0.0	0.0	0.0	0.0
On existing purchases	49.0	64.0	77.9	71.9	0.0	0.0	0.0	0.0	0.0
On prospective purchases	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total payments to Fund 1/	106.1	334.4	395.2	1,886.4	0.0	0.0	0.0	0.0	0.0
In millions of U.S. dollars	148.6	495.2	584.0	2,769.7	0.0	0.0	0.0	0.0	0.0
In percent of exports of goods and NFS	4.8	11.5	11.5	47.9	0.0	0.0	0.0	0.0	0.0
In percent of GDP	1.3	3.7	3.5	14.3	0.0	0.0	0.0	0.0	0.0
In percent of quota	34.6	109.1	128.9	615.5	0.0	0.0	0.0	0.0	0.0
In percent of overall external debt service	9.2	25.7	21.6	53.3	0.0	0.0	0.0	0.0	0.0
In percent of gross reserves	7.1	19.7	17.0	99.7	0.0	0.0	0.0	0.0	0.0
				(End-of-period)					
Fund credit outstanding									
In millions of SDRs	1,625.9	1,728.4	1,612.2	0.0	0.0	0.0	0.0	0.0	0.0
In millions of U.S. dollars	2,385.9	2,662.3	2,307.3	0.0	0.0	0.0	0.0	0.0	0.0
In percent of exports of goods and NFS	77.4	62.0	45.3	0.0	0.0	0.0	0.0	0.0	0.0
In percent of GDP	21.3	20.1	13.6	0.0	0.0	0.0	0.0	0.0	0.0
In percent of quota	530.5	563.9	526.0	0.0	0.0	0.0	0.0	0.0	0.0
In percent of public sector external debt	25.0	26.1	22.7	0.0	0.0	0.0	0.0	0.0	0.0
In percent of overall external debt	21.7	23.0	20.2	0.0	0.0	0.0	0.0	0.0	0.0
In percent of gross reserves	114.3	106.0	67.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:			(In millions of U.S. dollars unless otherwise noted)						
Exports of goods and NFS	3,084	4,296	5,093	5,788	6,330	6,845	7,295	7,794	8,280
Quota (millions of SDRs)	306.5	306.5	306.5	306.5	306.5	306.5	306.5	306.5	306.5
GDP	11,211	13,268	16,904	19,353	20,921	22,050	23,352	24,773	26,379
U.S. dollar per SDR, e.o.p.	1.5	1.5	1.4	1.5	1.5	1.5	1.5	1.5	1.5
U.S. dollar per SDR, average	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Public sector debt	11,705	12,272	11,720	12,300	12,360	12,411	12,434	12,423	12,364
Public sector external debt 2/	9,557	10,206	10,176	9,147	9,683	9,741	9,787	9,791	9,770
Overall external debt service	1,614	1,926	2,703	5,192	1,695	1,817	1,726	2,015	2,118
Overall external debt	11,012	11,594	11,417	10,388	10,924	10,982	11,028	11,032	11,011
Gross foreign reserves	2,087	2,512	3,438	2,777	3,266	3,377	3,484	3,700	3,806

Sources: Finance Department; and Fund staff estimates and projections.

1/ Projections on obligations basis.
2/ Excluding public commercial banks.

Appendix I. Table 1. Uruguay: Public Sector Debt Sustainability 1/

						Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
						A. Assumptions						
Real GDP growth (percent)	-3.4	-11.0	2.2	11.8	6.6	6.5	4.2	3.0	3.1	3.0	3.0	3.0
Interest rate spread (bps)	284	1400	900	600	387	247	300	300	300	300	300	300
Real U.S. dollar exchange rate (avg.) (change in percent)	-13.7	-11.0	-22.1	-0.2	10.4	5.9	1.2	0.5	0.5	0.8	1.0	0.9
Primary balance: Consolidated public sector	**-1.2**	**0.0**	**2.7**	**3.8**	**3.9**	**3.7**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**	**4.0**
Non-financial public sector	-1.0	0.2	2.9	4.0	4.1	3.9	4.2	4.2	4.2	4.2	4.2	4.2
BCU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Overall Balance: Consolidated public sector	**-4.1**	**-4.6**	**-3.2**	**-2.2**	**-0.7**	**-0.5**	**-0.4**	**-0.3**	**-0.2**	**-0.1**	**0.1**	**0.3**
Non-financial public sector	-3.8	-4.3	-2.9	-1.2	-0.6	-0.3	-0.1	0.0	0.1	0.2	0.3	0.6
BCU 2/	-0.3	-0.3	-0.4	-1.0	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
						B. Debt Dynamics (in percent of GDP)						
Gross non-financial public sector debt	**46**	**96**	**104**	**92**	**69**	**64**	**59**	**56**	**53**	**50**	**47**	**44**
Of which:												
Contribution from REER (cum since 2004)	...	...	...	...	0	4	4	4	4	5	5	5
Contribution from Growth (cum since 2004)	...	...	...	...	0	5	10	13	16	19	22	24
						C. Cash Flow (in millions of U.S. dollars)						
Gross borrowing needs 3/	**1,210**	**3,209**	**1,251**	**2,504**	**2,588**	**3,653**	**1,363**	**896**	**725**	**1,096**	**1,176**	**747**
Augmented public sector deficit	707	2,524	324	161	95	490	25	19	-3	-34	-81	-150
Public sector deficit	707	526	324	161	95	53	15	10	-13	-42	-88	-156
Bank assistance 3/	0	1,998	0	0	0	437	10	10	10	8	7	6
Buildup in free reserves at the central bank	-7	-364	6	631	633	-1109	450	100	100	100	100	100
Amortization	510	1,049	921	1,711	1,859	4,271	888	777	628	1,030	1,157	798
Long-term bonds and inflation-indexed bonds	403	349	221	29	289	628	130	157	169	539	711	350
Letras (2 years)	...	...	...	...	422	110	308	148	0	0	0	0
Peso bonds (short-term)	0	209	209	637	127	45	0	0	0	0	0	0
Commercial bank loans	0	214	217	307	89	69	112	163	139	162	104	110
Supplier credits	0	0	0	0	42	0	117	25	29	36	32	28
IDB/WB and other official debt	97	205	234	339	411	756	220	285	291	293	310	310
IMF	10	72	40	400	480	2663	0	0	0	0	0	0
Gross Financing 3/	**1,209**	**3,209**	**1,251**	**2,504**	**2588**	**3,653**	**1,363**	**896**	**725**	**1,096**	**1,176**	**747**
Long-term bonds (external)	1,292	143	405	371	1,091	2,425	849	214	19	382	465	47
Inflation-indexed instruments	...	...	...	...	318	263	318	250	250	250	250	250
Letras (2 years)	...	...	...	...	310	79	0	0	0	0	0	0
Peso bonds (short-term)	-15	677	637	544	92	0	0	0	0	0	0	0
Commercial bank	33	-16	-475	365	19	-107	112	163	139	162	104	110
Use of deposits	26	-21	-543	200	-103	176	0	0	0	0	0	0
Loans	7	5	68	165	122	69	112	163	139	162	104	110
IDB/WB and other official debt	198	789	461	366	370	145	216	244	287	266	326	313
IMF	0	1,603	484	552	297	292	0	0	0	0	0	0
Central bank credit (net) (net of IMF disbursments)	0	0	0	0	0	0	0	0	0	0	0	0
Other inflows (net) 4/	-299	13	-261	307	91	555	-133	25	29	36	32	28
Residual financing needs	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
					D. Other Indicators							
Total debt service (in percent of GDP)	5.6	13.1	14.0	18.1	15.6	26.3	8.6	7.9	6.9	8.2	8.3	6.5
Average interest rate (in percent)	12.6	5.5	5.7	6.6	6.6	6.9	7.4	7.7	7.9	8.2	8.4	8.4
Memorandum items:												
GDP (millions of dollars)	18,561	12,089	11,211	13,268	16,904	19,353	20,921	22,050	23,352	24,773	26,379	28,050
Nominal debt (millions of dollars)	8,538	11,551	11,705	12,272	11,720	12,300	12,360	12,411	12,434	12,423	12,364	12,237
Commerical bond placements (net) (millions of dollars)	889	-207	184	342	1,008	2,029	729	160	101	93	4	-53
World Bank/IDB (net)	...	...	...	...	49	-580	215	-28	6	-18	25	11
Rollover of Fund obligations (in percent)	...	...	...	...	62	0	0	0	0	0	0	0
Fund credit outstanding (millions of dollars)	145	1,754	2,386	2,662	2,307	0	0	0	0	0	0	0
Fund credit outstanding (in percent of GDP)	0.8	14.5	21.3	20.1	13.6	0	0	0	0	0	0	0
Fund credit outstanding (as a share of quota)	0	555	530	564	526	0	0	0	0	0	0	0

Sources: Ministry of Finance, Banco Central del Uruguay, and Fund staff estimates.

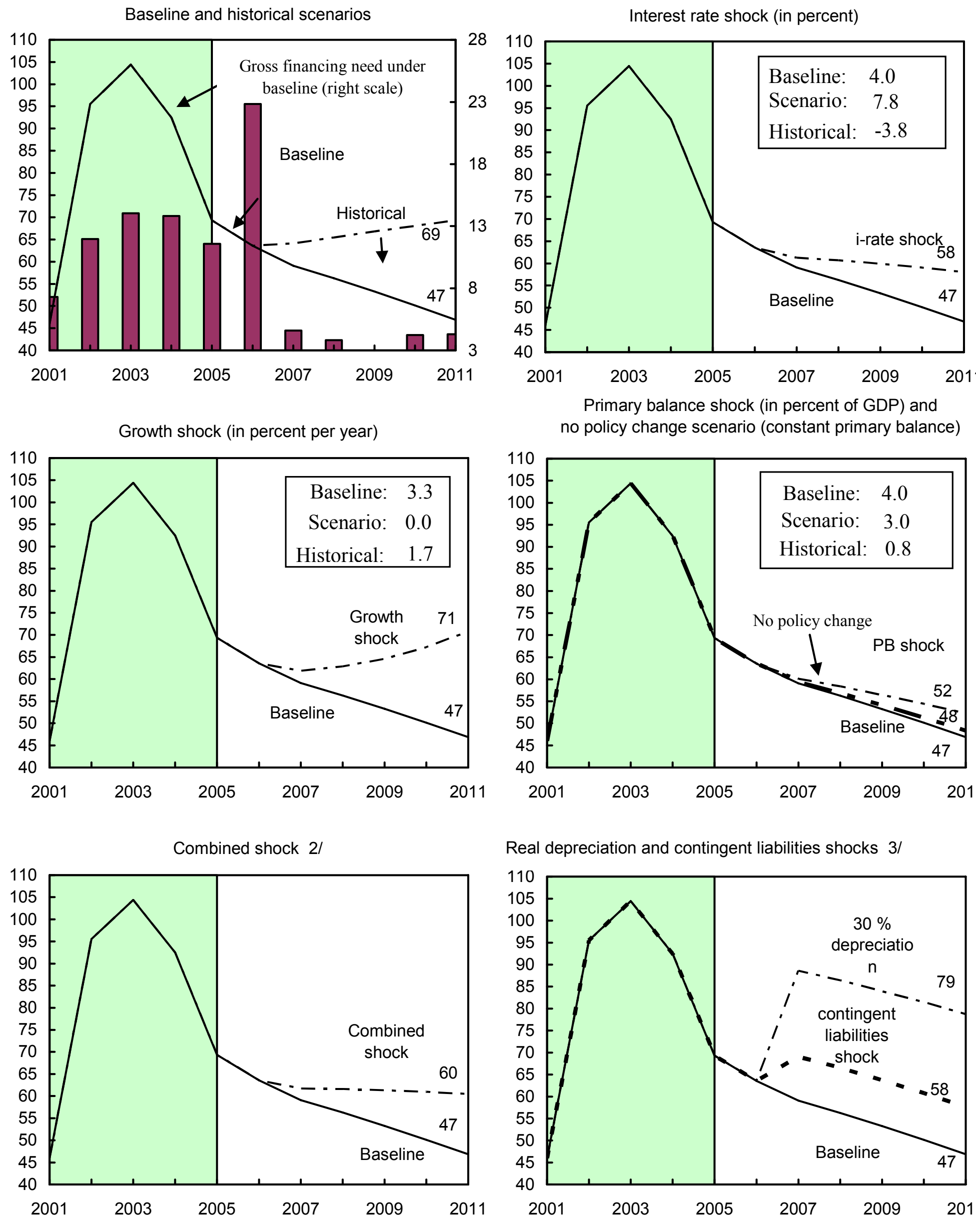
1/ Net of free reserves and monetary policy instruments.
2/ This does not reflect the planned strengthening of the BCU finances yet.
The overall fiscal position will not be affected as interest costs of the central bank would be shifted to the government.
3/ Includes in 2006 the funding of the deposit insurance scheme of US$20 million and assumption of the BHU liabilities of US$407 million (net),
of which US$895 million are in form of non-cash liabilities and US$488 in form of financial assets (assumed recovery rate of 60 percent).
4/ In 2006: assumption of BHU financial obligations and cancellation of BHU deposits.

Appendix I. Table 2. Uruguay: Public Sector Debt Sustainability Framework, 2001-2011
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Debt-stabilizing primary balance 1/
Baseline: Public sector debt 2/	46.0	95.5	104.4	92.5	69.3	**63.6**	**59.1**	**56.3**	**53.2**	**50.1**	**46.9**	**0.8**
Of which : foreign-currency denominated	43.2	76.6	94.7	83.4	62.5	57.3	53.3	50.8	48.0	45.2	42.3	
Change in public sector debt	7.5	49.5	8.9	-11.9	-23.2	-5.8	-4.5	-2.8	-3.0	-3.1	-3.3	
Identified debt-creating flows (4+7+12)	10.3	57.5	-8.3	-14.0	-18.6	-7.5	-4.8	-3.6	-3.6	-3.3	-3.3	
Primary deficit	1.2	-0.1	-2.7	-3.8	-3.9	-3.7	-4.0	-4.0	-4.0	-4.0	-4.0	
Revenue and grants	33.2	31.1	31.1	30.1	30.6	29.3	29.3	29.1	29.1	29.1	29.1	
Primary (noninterest) expenditure	34.4	31.1	28.4	26.3	26.7	25.6	25.3	25.1	25.1	25.1	25.1	
Automatic debt dynamics 3/	9.2	40.7	-5.6	-10.3	-14.7	-3.8	-0.8	0.5	0.4	0.7	0.7	
Contribution from interest rate/growth differential 4/	2.3	2.2	-10.7	-11.6	-2.5	-3.8	-0.8	0.5	0.4	0.7	0.7	
Of which contribution from real interest rate	1.0	-2.6	-8.9	-1.3	3.1	0.2	1.7	2.1	2.1	2.2	2.2	
Of which contribution from real GDP growth	1.3	4.8	-1.7	-10.3	-5.6	-4.0	-2.5	-1.7	-1.6	-1.5	-1.4	
Contribution from exchange rate depreciation 5/	6.9	38.5	5.1	1.3	-12.2	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	16.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	16.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 6/	-2.8	-8.0	17.1	2.1	-4.6	1.7	0.3	0.8	0.5	0.2	0.0	
Public sector debt-to-revenue ratio 2/	138.5	306.9	336.2	307.6	226.5	216.7	201.6	193.4	182.9	172.3	161.1	
Gross financing need 7/	7.3	12.0	14.0	13.8	11.6	22.8	4.6	3.8	2.9	4.2	4.3	
in billions of U.S. dollars	1.4	1.4	1.6	1.8	2.0	4.4	1.0	0.8	0.7	1.1	1.1	
Debt service	...	...	...	17.6	15.5	26.6	8.6	7.9	6.9	8.2	8.3	
Scenario with key variables at their historical averages 8/						**63.6**	**64.2**	**65.4**	**66.8**	**68.1**	**69.3**	**2.2**
Scenario with no policy change (constant primary balance) in 2005-2010						**63.6**	**59.4**	**56.9**	**54.1**	**51.3**	**48.3**	**0.8**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	-3.4	-11.0	2.2	11.8	6.6	6.5	4.2	3.0	3.1	3.0	3.0	
Average nominal interest rate on public debt (in percent) 9/	7.8	10.7	7.5	6.8	5.4	6.9	7.5	7.8	8.0	8.2	8.4	
Average real interest rate (nominal rate minus change in GDP deflator, in pe	2.5	-8.0	-10.9	-0.6	3.8	0.7	3.1	3.9	4.0	4.5	4.7	
Nominal appreciation (increase in US dollar value of local currency, in percer	-15.3	-45.7	-6.8	-1.5	17.6	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.3	18.7	18.4	7.5	1.7	6.2	4.4	3.9	4.0	3.8	3.7	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.4	-19.6	-6.6	3.5	8.2	2.1	3.0	2.2	3.1	3.0	3.0	
Primary deficit	1.2	-0.1	-2.7	-3.8	-3.9	-3.7	-4.0	-4.0	-4.0	-4.0	-4.0	

1/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.
2/ Framework covers the public sector (net of free reserves and monetary policy instruments).
3/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
4/ The real interest rate contribution is derived from the denominator in footnote 3/ as r - p (1+g) and the real growth contribution as -g.
5/ The exchange rate contribution is derived from the numerator in footnote 3/ as ae(1+r).
6/ For projections, this line includes exchange rate changes.
7/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
8/ The key variables include real GDP growth and primary balance in percent of GDP.
9/ Derived as nominal interest expenditure divided by previous period debt stock.

Appendix I. Figure 1. Uruguay: Public Debt Sustainability: Bound Tests 1/
(Public debt in percent of GDP)



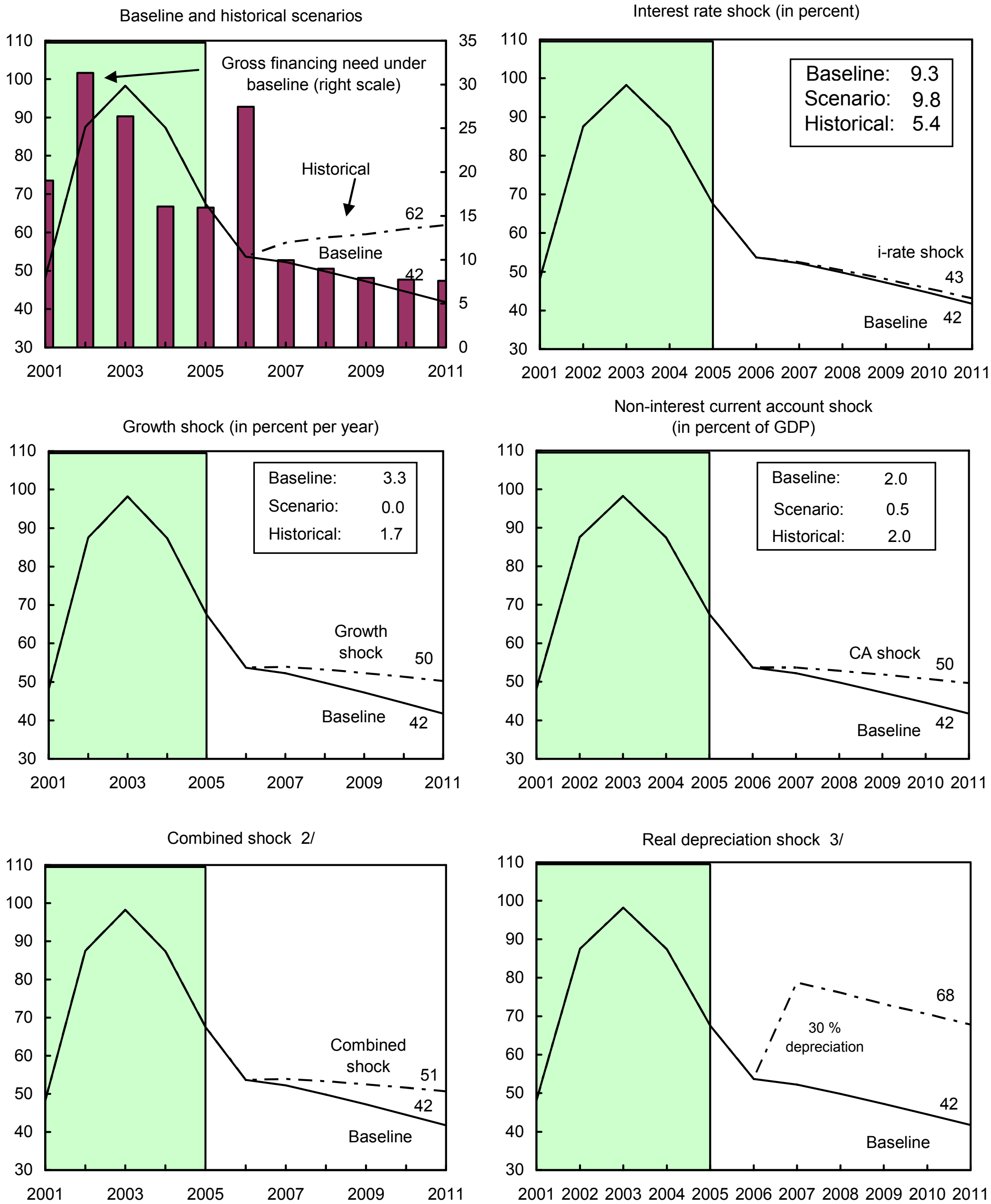
Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data.Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2006, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Appendix I. Table 3. Uruguay: External Debt Sustainability Framework, 2001-2011
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	48.1	87.5	98.2	87.4	67.5	**53.7**	**52.2**	**49.8**	**47.2**	**44.5**	**41.7**	**-0.5**
2 Change in external debt	3.9	39.4	10.7	-10.8	-19.8	-13.9	-1.5	-2.4	-2.6	-2.7	-2.8	
3 Identified external debt-creating flows (4+8+9)	10.7	21.1	3.8	-17.9	-23.0	-7.3	-2.9	-2.2	-1.7	-2.0	-1.7	
4 Current account deficit, excluding interest payments	0.2	-7.8	-2.6	-5.4	-4.6	-2.3	-0.9	-1.9	-1.8	-2.8	-2.8	
5 Deficit in balance of goods and services	2.4	-1.7	-3.1	-3.9	-2.6	0.0	1.0	0.0	-0.1	-1.3	-1.4	
6 Exports	17.6	22.3	27.5	32.4	30.1	29.9	30.3	31.0	31.2	31.5	31.4	
7 Imports	20.1	20.6	24.4	28.5	27.5	29.9	31.3	31.0	31.1	30.2	30.0	
8 Net non-debt creating capital inflows (negative)	-1.7	-1.5	-3.6	-2.4	-4.2	-6.0	-4.4	-3.3	-2.8	-2.1	-1.7	
9 A1. Key variables are at their historical averages in 2007-11 3/	12.2	30.4	9.9	-10.1	-14.2	1.0	2.4	3.0	2.9	2.9	2.8	
10 Contribution from nominal interest rate	3.0	4.6	3.1	5.1	4.6	4.9	4.5	4.5	4.4	4.2	4.0	
11 Contribution from real GDP growth	1.8	8.2	-2.1	-9.8	-4.5	-3.8	-2.1	-1.5	-1.5	-1.3	-1.3	
12 Contribution from price and exchange rate changes 2/	7.4	17.6	8.9	-5.4	-14.3	...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-6.8	18.2	6.9	7.1	3.2	-6.6	1.4	-0.2	-0.9	-0.7	-1.1	
External debt-to-exports ratio (in percent)	272.8	392.8	357.1	269.9	224.2	179.5	172.6	160.4	151.2	141.5	133.0	
Gross external financing need (in billions of US dollars) 4/	3.5	3.8	3.0	2.1	2.7	5.3	2.1	2.0	1.9	1.9	2.0	
B5. One time 30 percent nominal depreciation in 2007	19.0	31.3	26.4	16.1	16.0	27.5	10.0	9.0	8.0	7.7	7.6	
Scenario with key variables at their historical averages 5/						**53.7**	**57.3**	**58.7**	**59.6**	**60.9**	**61.9**	**2.6**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	-3.4	-11.0	2.2	11.8	6.6	6.5	4.2	3.0	3.1	3.0	3.0	
GDP deflator in US dollars (change in percent)	-14.3	-26.8	-9.2	5.8	19.6	7.5	3.7	2.3	2.7	3.0	3.4	
Nominal external interest rate (in percent)	5.6	6.2	3.2	6.1	6.7	8.2	9.0	9.1	9.3	9.4	9.6	
Growth of exports (US dollar terms, in percent)	-10.5	-17.8	14.5	39.3	18.6	13.6	9.4	8.1	6.6	6.8	6.2	
Growth of imports (US dollar terms, in percent)	-11.2	-33.1	9.7	38.2	23.2	24.4	13.0	4.5	6.3	2.8	5.9	
Current account balance, excluding interest payments	-0.2	7.8	2.6	5.4	4.6	2.3	0.9	1.9	1.8	2.8	2.8	
Net non-debt creating capital inflows	1.7	1.5	3.6	2.4	4.2	6.0	4.4	3.3	2.8	2.1	1.7	

1/ 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
e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.
2/ 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 (b
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Appendix I. Figure 2. Uruguay: External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2007.

Appendix I. Table 4. Uruguay: Public Sector Debt Sustainability Framework—Gross Public Sector Financing Need, 2001–2011
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
I. Baseline Projections											
Gross financing need 1/	7.3	12.0	14.0	13.8	11.6	22.8	4.6	3.8	2.9	4.2	4.3
in billions of U.S. dollars	1.4	1.4	1.6	1.8	2.0	4.4	1.0	0.8	0.7	1.1	1.1
II. Stress Tests											
Gross financing need 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2006-10 3/						22.8	8.6	8.0	7.7	10.1	11.2
A2. No policy change (constant primary balance) in 2006-10						22.8	4.9	4.2	3.3	4.7	4.8
B. Bound Tests											
B1. Real interest rate is at baseline plus one-half standard deviations						22.8	7.0	6.4	5.7	7.6	8.1
B2. Real GDP growth is at baseline minus one-half standard deviations						22.8	5.8	6.3	6.6	10.1	12.4
B3. Primary balance is at baseline minus one-half standard deviations						22.8	5.7	5.1	4.3	5.9	6.2
B4. Combination of B1-B3 using 1/4 standard deviation shocks						22.8	6.5	6.1	5.4	7.5	8.1
B5. One time 30 percent real depreciation in 2006 4/						22.8	6.7	7.9	6.7	9.2	9.7
B6. 10 percent of GDP increase in other debt-creating flows in 2006						22.8	5.3	5.2	4.2	5.9	6.2
Gross financing need in billions of U.S. dollars 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2006-10 3/						4.4	1.8	1.7	1.7	2.3	2.7
A2. No policy change (constant primary balance) in 2006-10						4.4	1.0	0.9	0.8	1.2	1.3
B. Bound Tests											
B1. Real interest rate is at baseline plus one-half standard deviations						4.4	1.5	1.4	1.3	1.9	2.1
B2. Real GDP growth is at baseline minus one-half standard deviations						4.4	1.2	1.3	1.4	2.2	2.8
B3. Primary balance is at baseline minus one-half standard deviations						4.4	1.2	1.1	1.0	1.5	1.6
B4. Combination of B1-B3 using 1/4 standard deviation shocks						4.4	1.3	1.3	1.2	1.7	2.0
B5. One time 30 percent real depreciation in 2006 4/						4.4	0.9	1.1	1.0	1.5	1.7
B6. 10 percent of GDP increase in other debt-creating flows in 2006						4.4	1.1	1.1	1.0	1.5	1.6

1/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period. Excludes assumption of liabilities for 2006.
2/ Gross financing under the stress test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average ma on medium- and long-term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenar
3/ The key variables include real GDP growth and primary balance in percent of GDP.
4/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Appendix I. Table 5. Uruguay: External Sustainability Framework--Gross External Financing Need, 2001-2011

	Actual				Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
					I. Baseline Projections						
Gross external financing need in billions of U.S. dollars 1/	3.5	3.8	3.0	2.1	2.7	5.3	2.1	2.0	1.9	1.9	2.0
in percent of GDP	19.0	31.3	26.4	16.1	16.0	27.5	10.0	9.0	8.0	7.7	7.6
					II. Stress Tests						
Gross external financing need in billions of U.S. dollars 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2007-11 3/						5.3	1.5	1.6	1.5	1.8	1.9
B. Bound Tests											
B1. Nominal interest rate is at baseline plus one-half standard deviations						5.3	2.1	2.1	1.9	2.0	2.1
B2. Real GDP growth is at baseline minus one-half standard deviations						5.3	2.1	2.0	1.9	2.0	2.2
B3. Non-interest current account is at baseline minus one-half standard deviations						5.3	2.4	2.4	2.4	2.6	2.8
B4. Combination of B1-B3 using 1/4 standard deviation shocks						5.3	2.3	2.2	2.2	2.3	2.5
B5. One time 30 percent nominal depreciation in 2007						5.3	2.1	2.1	2.0	2.2	2.4
Gross external financing need in percent of GDP 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2007-11 3/						27.5	8.0	8.7	8.0	10.0	10.8
B. Bound Tests											
B1. Nominal interest rate is at baseline plus one-half standard deviations						27.5	10.3	9.4	8.3	8.2	8.1
B2. Real GDP growth is at baseline minus one-half standard deviations						27.5	10.3	9.7	9.0	9.3	9.6
B3. Non-interest current account is at baseline minus one-half standard deviations						27.5	11.5	10.9	10.1	10.4	10.7
B4. Combination of B1-B4 using 1/4 standard deviation shocks						27.5	11.1	10.5	9.7	10.1	10.4
B5. One time 30 percent nominal depreciation in 2007						27.5	15.5	14.6	13.1	13.6	13.7

1/ Defined as non-interest current account deficit, plus interest and amortization on medium- and long-term debt, plus short-term debt at end of previous period.
2/ Gross external financing under the stress-test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.
3/ 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.

APPENDIX II: SUMMARY OF ANNEXES

The full annexes to this report can be viewed in CyberDocs on the Fund's intranet and on the secure extranet for Executive Directors and member officials.

Fund relations

On June 8, 2005, a three-year SBA was approved under the exceptional access procedures (SDR 766.3 million, 250 percent of quota). SDR 503 million remains to be disbursed. Following advance repurchases of SDR 619.88 million on August 7, Uruguay repurchased the remaining Fund obligations of SDR 726.7 (237 percent of quota) on November 30, 2006. A safeguards assessment was completed in September 2005. In April, 2006, Uruguay's *de facto* exchange rate regime was reclassified from an independent float to a managed float with no predetermined path for the exchange rate. The 2006 Article IV consultation was concluded by the Executive Board on June 28, 2006 (Country Report No. 06/425).

Relations with the World Bank Group[1]

The current investment portfolio comprises six projects in the Education, Transport, Agriculture, and Public Services areas, totaling US$193.5 million in commitments, with an undisbursed amount of US$120.6 million as of November 28, 2006. The Bank's exposure to Uruguay stood at US$653.8 million as of October 31, 2006. The last Country Assistance Strategy (CAS) Report was discussed at the Board on June 9, 2005, which envisages new lending of up to US$800 million over the period FY2005-10, anchored around programmatic development loans, expected to support the Government in key policy areas including public sector management, financial sector reform, and reform of social programs.

Relations with the Inter-American Development Bank[2]

As of September 30, 2006 the IDB exposure to Uruguay stood at US$1.8 billion. The Bank's current portfolio includes financing of 17 investment projects and three policy based operations for the strengthening of the banking and social sectors and for the improvement in tax administration and efficiency in public expenditures. The lending portfolio amounts to US$1.2 billion of which US$0.5 billion are pending disbursements. Weak portfolio performance was mainly related to fiscal constraints. The IDB's 2005–09 Country Strategy entails a lending scenario of US$1.2 billion, which includes policy-based loans as well as investment projects in the areas of competitiveness, the social sector, and public sector management. This, together with the loan portfolio, should ensure that net lending flows remain relatively neutral.

[1] Adopted from text prepared by World Bank staff on November 28, 2006.

[2] Adopted from text prepared by IDB staff on November 27, 2006.

Attachment I. Supplementary Letter of Intent

December 7, 2006

Dear Mr. de Rato:

1. ***Achievements***. After several years of vigorous growth and low inflation, and with a much improved external position, the country is now prepared to exit from Fund support. Official reserves are already above the level envisaged for end-2008 and the primary fiscal balance is approaching our medium-term target. Public debt as a percent of GDP has declined sharply, and the debt maturity profile has improved markedly.

2. ***Last program reviews***. Against this background, we have paid off all outstanding obligations to the Fund. We do not intend to make any further drawings under the current arrangement. The pending reviews will be the last ones under the arrangement, which we intend to cancel by the end of this month.

3. ***Program implementation***. All performance criteria on macroeconomic variables have been observed, except the one on public debt, reflecting faster than anticipated reaccess to capital markets, and for which a waiver is requested. At the same time, we have advanced our reform agenda, with the passage of the tax reform, a key milestone, expected to be secured in mid-December, prior to consideration of the program reviews. Important progress has also been made in strengthening the financial sector, public finances, and the investment climate. We request waivers for the nonobservance of the structural performance criteria listed in Table 1. In some cases, the measures are expected to be implemented with only a brief delay (tax reform) or remedial actions were taken (all nonperforming loans in BHU have been either transferred to trusts or prepared for transfer); in other cases, delays reflect the crowded legislative and reform agenda, and will be implemented in 2007.

4. ***Policy framework***. We remain committed to the broad macroeconomic and reform agenda set out in previous Letters of Intent. In particular, we would emphasize:

- *Fiscal objective.* A key objective remains to lower the debt-to-GDP ratio, anchored by the medium-term fiscal balance set out in our program and in the 2005-9 budget framework. Effective implementation of the tax reform will be an early priority, as will be strengthening tax administration.
- *Monetary policy.* The central bank will continue to support low inflation, while maintaining exchange rate flexibility and building reserves.
- *Structural reforms*. The broad objectives for reform in the financial sector, debt management, and pensions will continue to be advanced.

5. ***Exit from Fund support***. As we make this last request for completion of the reviews, we thank the Fund for its crucial support over the past years. While our strengthened position allows us to exit Fund financial support, we hope to remain in close touch with the Fund on the technical aspects of our reform effort.

Sincerely yours,

/s/	/s/
Walter Cancela President of the Central Bank	Danilo Astori Minister of Economy and Finance

Table 1. Uruguay: Structural Performance Criteria requiring Waivers

Area	Measure	Date	Status
Tax reform	Begin to implement the comprehensive tax reform.	September 15, 2006	To be approved before congress enters in recess in mid-December.
Central Bank	Begin to implement the laws that: (i) give appropriate autonomy to the central bank; (ii) strengthen the regulation of the financial system; and (iii) provide a suitable bank resolution	November 30, 2006	To be implemented in 2007.
BHU	Move nonperforming loans into a fideicomiso and adequately capitalize BHU.	August 31, 2006	Remedial actions taken in mid-November.
BHU	Move all nonperforming assets into a fideicomiso and transform BHU into an institution with a viable business plan and a strong regulatory framework.	November 30, 2006	To be implemented in 2007.
Pensions	Begin to implement reform of the pension fund for the police.	October 31, 2006	To be implemented in 2007.
Pensions	Submit to Congress reform of the pension fund for the military and bank employees.	November 30, 2006	To be implemented in 2007.

Sources: Ministry of Economy and Finance; and Central Bank of Uruguay.

URUGUAY—APPENDICES TO THE FIFTH AND SIXTH REVIEW

Contents Page

Fund Relations

(As of October 31, 2006)

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

I. Financial Relations

II. **General Resources Account**:

	In millions of SDRs	In percent of Quota
Quota	306.50	100.0
Fund holdings of currency	1,033.21	337.10
Reserve position	0.0	0.0

III. **SDR Department**:

	In millions of SDRs	Percent of Allocation
Net cumulative allocation	49.98	100.0
Holdings	11.56	23.12

IV. **Outstanding Purchases and Loans**:

	In millions of SDRs	In percent of quota
Stand-By Arrangements	726.70	237.10

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	Amount Approved (SDR Millions)	Amount Drawn (SDR Millions)
Stand-By	6/08/05	6/07/08	766.25	263.59
Stand-By	4/01/02	3/31/05	1,988.50	1,988.50
Of which: SRF	6/25/02	8/08/02	128.70	128.70
Stand-By	5/31/00	3/31/02	150.00	150.00

VI. **Projected Payments to Fund (Obligation basis):**[1] (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	0.00	113.61	139.64	299.66	137.78
Charges/interest	11.12	41.86	34.71	22.63	8.80
Total	11.12	155.51	174.35	322.29	146.57

VII. **Projected Payments to Fund (Expectation basis):** (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	0.00	253.26	299.66	137.78	36.01
Charges/interest	11.12	41.13	22.94	8.79	2.65
Total	11.12	294.38	322.60	146.56	38.67

II. Nonfinancial Relations

VII. **Safeguards Assessment:** The authorities are in the process of addressing all safeguards concerns raised in the safeguards assessment completed in September 2005, and have already implemented many of the recommendations proposed by staff. In particular, (i) Uruguay's total obligations to the Fund are now included in the BCU's financial statements; (ii) data submitted to the Fund is periodically reviewed for consistency with the Technical Memorandum of Understanding; and (iii) the criteria for the selection and appointment of the BCU's external audit firm have been amended in line with the safeguards recommendation

[1] This schedule is not the currently applicable schedule of payments to the IMF. Rather, the schedule presents all payments to the IMF under the illustrative assumption that repayment expectations would be extended to their respective obligation dates by the IMF Executive Board upon request of the debtor country.

VIII. **Exchange Rate Arrangement**: The currency is the Uruguayan peso (Ur$). Uruguay has followed an independently floating exchange rate regime since July 29, 2002. In April 2006, Uruguay's *de facto* exchange rate regime was reclassified from an independent float to a managed float with no predetermined path for the exchange rate. On November 27, 2006, buying and selling interbank rates for the U.S. dollar, the intervention currency, were Ur$24.27 and Ur$24.32, respectively. Uruguay's exchange system is free of restrictions on payments and transfers for current international transactions. The exchange restriction associated with the reprogramming of time deposits at BROU and BHU during the 2002 crisis was removed ahead of schedule in April 2005.

IX. **Article IV Consultation:** The 2006 Article IV consultation was concluded by the Executive Board on June 28 (Country Report No. 06/79). Uruguay is on the standard consultation cycle governed by the provisions approved by the Executive Board on July 15, 2002.

X. **Ex Post Assessment:** The Ex Post Assessment of Longer-Term Program Engagement was considered by the Executive Board on March 18, 2005 (Country Report No. 05/202).

XI. **FSAP participation and ROSCs**: The Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). The ROSC-module on fiscal transparency was published on March 5, 2001. A ROSC-module on data dissemination practices was published on October 18, 2001.

XII. **Technical Assistance**: Technical assistance on tax, customs, and social security administration was provided by FAD in March 2006, June 2005, and July 2003, on tax policy in October 2005 and May 2003, and on public financial management in March 2005 and July 2006. In April 2003, STA provided technical assistance on adequate recording of loans funded by the FSBS. MFD has been providing substantial and continuous technical assistance since 2002 in the resolution of intervened banks, the restructuring of the public bank BROU, and recently on BHU, and in July 2005 jointly with ICM on debt management. Further, MFD has been recently providing technical assistance to strengthen the formulation and conduct of monetary and exchange rate policies.

XIII. **Resident Representative**: Mr. Gaston Gelos.

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of November 27, 2006)

The Inter-American Development Board of Executive Directors approved a new Country Strategy for Uruguay on March 15, 2006. The Bank's Country Strategy supports the Government's policy, which seeks to consolidate growth and improve the population's social welfare. In support of this longer-term goal, the Strategy focuses on the following priority areas: (i) improving public sector management, to increase its efficiency and efficacy, while supporting fiscal and debt sustainability; (ii) enhancing regional and international competitiveness of domestic output and encouraging private investment in order to promote sustainable growth; and (iii) reducing poverty and increasing social inclusion.

The implementation of the Bank's strategy proposes a likely lending scenario of about US$1.2 million for the five-year period 2005–09, which together with a normal execution of the loan portfolio, mainly investment projects, will allow for the net lending flows to remain relatively neutral. This program includes lending to support the Government in the key policy areas of competitiveness, the social sectors, and public sector management. To this end, during 2005 a loan for a program to support the productivity and development of new livestock products, for US$15.8 million, was approved in July; a social sector loan, for US$250 million, was approved in August, to support the development and implementation of Government's social policy aimed at reducing poverty, improving the human resource base among the poor, and strengthening the sector's institutional framework; and a loan to support the public debt management unit for US$2.45 million was approved in November. During 2006 an investment project to improve cluster competitiveness for US$9 million was approved in July; and a two-year programmatic loan to improve competitiveness for a total of US$150 million –for US$75 million each– is under preparation, with the expected approval of the first and second loans in early 2007 and 2008 respectively. Within the public sector management area, a three-year programmatic loan to support improvements in tax administration and public sector management is being prepared. The first loan for US$50 million was approved in October while the amount for the next two years is to be determined. The lending program also includes investment projects with new operations planned in the area of microfinance, to support transport infrastructure, sanitation in Montevideo and social programs such as a neighborhood improvement programs.

As of May 22, 2006 the Bank's current portfolio in Uruguay includes loans for the financing of 17 investment projects; and three policy based operations, for strengthening the banking sector and for the social sectors and for improvements in tax administration and efficiency in public expenditures. The lending portfolio, which is largely aligned to the administration's priorities and consistent with the Bank's Country Strategy, amounts to US$1,220.2 million, of which US$546.5 million are pending disbursement. Portfolio performance in the recent past was affected by the Government's fiscal constraint, which entailed cuts in budgetary allocations to levels below the required amounts in order to maintain a normal pace of project implementation. An important challenge ahead in terms of portfolio management, for both the Bank and the authorities, will be to ensure that the projects increase the pace of project execution while setting the stage for a normal implementation of the new projects within the context of the budgetary allocations approved in the five-year Budget Law and in the recent Budget Review Law. As part of their debt management strategy, the authorities paid in February, US$100 million due and in March, and pre paid the remaining US$300 million due in August 2006 and 2007, corresponding to the Social Protection and Sustainability Program, that was approved in August 2002.

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(In millions of U.S. dollars)

Total outstanding loans: US$1,792.8[1]

Loan transactions:

	2000	2001	2002	2003	2004	2005	2006[2]
Disbursements	162.9	214.2	558.6	367.2	53.1	242.3	118.1
Amortization	59.4	60.7	73.1	103.7	113.3	220.0	520.2
Net Loan Flows	**103.5**	**153.5**	**485.5**	**263.6**	**-60.2**	**22.3**	**-402.1**

Source: Inter-American Development Bank.

[1] As of September 30, 2006
[2] IDB staff projection

Relations with the World Bank Group
(As of November 28, 2006)

The World Bank Board of Executive Directors approved a new Country Assistance Strategy (CAS) on June 9, 2005. The CAS envisages a base case scenario of up to US$800 million in new lending over the period FY05–10. The lending program will be modulated on the strength of the Government's program and its ability to implement it, as well as the evolution in the country's creditworthiness.

The Bank's strategy in the new CAS is anchored around a series of programmatic development loans that are expected to be multi-sectoral in focus and support the Government in key policy areas including public sector management, financial sector reform, and reform of social programs. The CAS also proposes to rebuild the investment portfolio with new operations planned to support priority investments in infrastructure, social programs and innovation. Two investment operations for Integrated Natural Resources and Transport Infrastructure and Rural Access, in the amount of US$30 million and US$70 million respectively were approved by the Board on June 9, 2005 together with the CAS.

The previous Country CAS was approved on May 5, 2000 and a CAS Progress Report on July 25, 2002. Following the 2002 crisis, the Bank increased its financial support, shifting to a high case lending scenario of US$550 million for fiscal years 2002–04, concentrated in adjustment lending. A Structural Adjustment Loan (SAL I) and a Special Structural Adjustment Loan (SSAL I) were approved with the CAS Progress Report, totaling US$303 million, to assist Uruguay in addressing structural weaknesses and in managing the economic crisis. On April 8, 2003, another structural adjustment package (SAL II and SSAL II) was approved totaling US$252.5 million, focusing on improving public services and human development policies. Progress in implementation of SAL I and SSAL I has been satisfactory, and the last tranches in an aggregate amount of US$100 million (US$50 million of SAL I and US$50 million of SSAL I) were released in October 2004.

In the context of the new CAS, the Government has reaffirmed its commitment to the objectives of SAL II taking into account the results of the 2003 referenda on petroleum products and water. A proposal to proceed with the release of the second tranche in an amount of US$40 million and cancellation of the third tranche of the loan is being presented to the Board of Executive Directors, at the request of the Government, in December 2006. With regard to SSAL II, the objectives of the program have been achieved and, with the immediate crisis over and the beginning of a new CAS period, the outstanding second and third tranches of this operation have been cancelled at the Government's request. The social reform agenda continues to be supported by a new development policy loan (DPL1), approved by the Board of Executive Directors together with the CAS on June 9, 2005. The DPL1 in an amount of US$75 million supports reform progress in social policies over the last two years, as well as early but important measures that the new Government has taken with respect to health, education and social protection. The DPL1 has been fully disbursed.

The current investment portfolio comprises six projects totaling US$193.5 million in commitments, with an undisbursed amount of US$120.6 million as of November 28, 2006. The performance of the investment portfolio improved significantly in CY04 and CY05, with disbursements for investment operations aggregating to US$43.8 million and US$ 58.6 million respectively. This was a reflection of the substantially improved economic situation, as well closer portfolio monitoring, with portfolio performance reviews being conducted every six months. Projected disbursements from the investment portfolio in CY06 are in the order of US$40 million, with a decrease with respect to previous years as a consequence of the renewal of the portfolio and slow start-up of new operations.

On November 21, 2006, the Board of Executive Directors of the WB Group approved a loan of US$170 million by the IFC, and a guarantee of US$350 million by MIGA, to the Finnish company Botnia for the construction of a wood pulp plant in Fray Bentos.

FINANCIAL RELATIONS WITH THE WORLD BANK GROUP
(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disbursed	Undisbursed
I. IBRD Operations (as of November 28, 2006)			
Agriculture	48.5	18.5	30.0
Central Government and Administration	151.5	51.5	100.0
Telecommunication	6.0	1.7	4.3
Education	42.0	19.8	22.2
Transportation	70.0	8.2	61.8
Water Supply	27.0	24.7	2.3
Total	**345.0**	**124.4**	**220.6**

II. IFC Operations (as of October 31, 2006)

	Loans	**Equity**	**Quasi**	**Participation**
Committed	16.38	0.21	9.17	0.0
Outstanding	16.38	0.19	9.17	0.0

III. IBRD Loan Transactions (calendar year)

	1996	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Disbursements	38.7	50.4	143.9	66.3	134.2	64.7	233.5	97.4	143.8	134.0
Repayments	69.9	67.9	64.1	63.2	57.9	72.5	75.3	78.2	80.2	103.6
Net Lending	**-31.2**	**-17.5**	**79.8**	**3.1**	**76.3**	**-7.8**	**158.2**	**19.2**	**63.6**	**30.4**

Statement by the IMF Staff Representative
December 22, 2006

Since the issuance of the staff report, the following information has become available. It does not alter the thrust of the staff appraisal.

1. ***Prior action***. The tax reform bill was passed by Congress on December 19, 2006, and is in line with the draft bill discussed in the staff report.

2. ***Performance criteria***. Final data confirm that all end-September 2006 quantitative performance criteria have been observed, except for the ceiling on the nonfinancial public sector gross debt, which was missed by a margin of US$418 million, slightly more than the margin of US$340 million mentioned in the staff report (Table 1). The higher debt is fully reflected in net international reserves and government deposits in the central bank, implying no increase in net debt relative to program targets

.

Table 1: Performance Under the 2006 Economic Program 1/

	2005 Stock	2006 Targets													
		Mar. 31				Jun. 30				Sept. 30				
	Sept. 30	Target	Target (adj.)	Actual	**Margin (+)**	Target	Target (adj.)	Actual	**Margin (+)**	Target	Target (adj.)	Actual	**Margin (+)**	
A. Quantitative performance criteria														
				(In millions of Uruguayan pesos)										
1. Combined public sector primary balance (floor) 2/	n.a.	2,651	2,651	5,134	**2,483**	5,196	5,196	7,844	**2,648**	10,434	10,270	11,868	**1,598**	
2. General government noninterest expenditure (ceiling) 3/	n.a.	13,409	13,409	12,144	**1,265**	27,050	27,050	25,270	**1,780**	39,870	39,881	37,735	**2,146**	
3. Net domestic assets of the BCU (ceiling) 3/	51,525	-3,136	-7,382	-14,797	**7,415**	-6,029	-11,092	-18,637	**7,545**	-12,278	-36,112	-46,423	**10,311**	
				(In millions of U.S. dollars)										
4. Net international reserves of the BCU (floor) 3/	-1,546	250	428	779	**352**	469	681	1,001	**320**	732	1,730	2,087	**357**	
5. Nonfinancial public sector gross debt (ceiling) 4/	12,309	12,882	13,087	12,324	**763**	13,074	12,670	12,565	**105**	13,082	12,196	12,613	**-418**	5/
6. Accumulation of external payment arrears of the public sector (on a continuous basis) 2/	0	0	0	0	**0**	0	0	0	**0**	0	0	0	**0**	
B. Indicative targets														
				(In millions of Uruguayan pesos)										
7. Combined public sector overall balance (floor) 2/	n.a.	-3,076	-3,076	23	**3,099**	-5,394	-5,394	-2,267	**3,127**	-5,935	-6,099	-3,729	**2,370**	
8. Combined public sector primary balance (extended) (floor) 2/	n.a.	2,651	2,651	5,541	**2,890**	5,196	5,196	8,581	**3,385**	10,434	10,270	12,994	**2,724**	
9. Monetary base (ceiling) 3/	16,146	3,140	3,140	4,558	**-1,418**	5,118	5,118	4,799	**319**	6,075	6,075	3,910	**2,165**	

Sources: Ministry of Economy and Finance; and Central Bank of Uruguay.

1/ As defined in the Technical Memorandum of Understanding.

2/ Cumulative changes from the previous calendar year.

3/ 2006 targets are cumulative from end-September 2005.

4/ All maturities.

5/ Waiver requested based on the fact that the higher-than-expected bond placements were fully reflected in higher government deposits with the central bank and official international reserves.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Final Reviews Under Uruguay's Stand-By Arrangement

The Executive Board of the International Monetary Fund (IMF) completed today the fifth and sixth reviews under the three-year, SDR 766.25 million (about US$1.15 billion) Stand-By Arrangement for Uruguay (see Press Release No. 05/136). As part of the reviews, the Board also granted waivers for nonobservance of performance criteria, and completed a financing assurances review..

On November 8, 2006, the Uruguayan authorities announced that they would shortly repay all outstanding obligations to the Fund and cancel the current Stand-By Arrangement. Full repayment of the equivalent of SDR 727 million (about US$1.1 billion) was made on November 30, 2006 and the authorities indicated that they wanted the arrangement to be cancelled shortly after the completion of the fifth and sixth reviews. Therefore, they do not intend to make any disbursement associated with the reviews.

In commenting on the Board meeting, Mr. Murilo Portugal, Deputy Managing Director and Acting Chair, said:

"The recovery of the Uruguayan economy from the crisis of 2002 has exceeded all expectations, paving the way for an early exit from Fund financial support. Sound policies and a supportive external environment have delivered a sharp economic recovery and low inflation, a declining debt ratio and rollover risk, and a vastly improved external position. The banking system, once at the center of the crisis, is now substantially stronger—better capitalized and with tighter prudential regulations to internalize risks from high financial dollarization.

"Continued policy efforts are needed to entrench macroeconomic stability, deepen structural reforms, and further reduce vulnerabilities. In the fiscal policy area, the intention to pursue policies in 2007 consistent with the medium-term primary surplus target of 4 percent of GDP, while maintaining appropriate levels of investment and social spending, is welcomed, as high primary surpluses should remain at the core of the strategy to reduce the debt burden and anchor policy credibility.

"With the recent passage of the tax reform, a major milestone in the reform agenda, preparations for its implementation in July 2007 need to proceed vigorously. It will also be important to move ahead with reform plans for the budget, customs, the social security bank, and the specialized pension schemes.

"While inflation is relatively low, the authorities should stand ready to adjust policies should inflation pressures emerge. Continued central bank buildup of foreign exchange reserves, consistent with exchange rate flexibility and the inflation objectives, would help increase reserve coverage, which is not as high as in other dollarized economies.

"In the financial sector, vulnerabilities need to be reduced further. Passage and implementation of the financial sector law in 2007 will be key to enhance central bank independence and strengthen the supervisory and bank resolution frameworks. Completing the restructuring of the housing bank (BHU) into a viable institution in the near term will also be important," Mr. Portugal said.

Statement by Hector Torres, Alternate Executive Director for Uruguay and David Vogel, Advisor to Executive Director December 22, 2006

A Natural Skepticism

1. By the time the current Uruguayan government was elected, there was skepticism amongst some IMF staff and Executive Directors on the risks and benefits of a new Arrangement with Uruguay. Admittedly this skepticism seemed to be reasonable considering the prevailing figures. At the end of 2004, the public debt-to-GDP ratio was 92 percent, and despite the fact that the debt outlook had improved after the 2003 debt exchange operation (the average maturity of public debt was about 7 years), there were large amortization payments due over the next few years. Furthermore, many analysts had serious doubts on how the authorities could reach unprecedented fiscal primary surpluses consistent with debt sustainability, while meeting social and investment needs stemming from the 2002 crisis.

2. Meanwhile, Uruguay's outstanding debt to the Fund was SDR 1,635 million, ranking fifth in terms of total Fund exposures, although it was the second largest in terms of a country's quota (533.64 percent) and, by far the largest debt to the Fund relative to a country's GDP (18 percent). The above-referred skepticism was clearly summed up in the staff report on "Assessment of the Risks and the Fund's Liquidity Position" prepared by the Finance and Policy Development and Review Departments in June 2005. In this document, it was noted that "Uruguay represents a significant risk for the Fund", concluding that "its financial impact would still be sizable, and it could also have broader ramifications, including reputational and credibility risks for the Fund". Wondering whether it would be possible to achieve a significant reduction in exposure over a prospective program period, many Directors soundly recommended the country not to become a chronic Fund-dependent.

Dissipating Doubts

3. There were some important milestones that help explain how a cooperative environment between Uruguay and the Fund was built, which was key to promoting productive negotiations, and later on reaching a successful arrangement. First of all, even before this administration took office, the elected authorities underscored the critical role the Fund played to help Uruguay overcome the country's worst financial and economic crisis in its history. They stressed that without the Fund's timely and exceptional assistance, the Uruguayan people would have suffered substantially more severe and detrimental consequences. Likewise, the government clearly stated its strong commitment to fully honor Uruguay's obligations and, more generally, to fully respect the rule of law, as has been Uruguay's tradition.

4. Just before the new administration took office in January 2005, the Director of the Western Hemisphere Department and his staff working on Uruguay visited the country to participate in a workshop. The meeting took place with the participation of the whole incoming economic team and also several future Ministers. During the seminar the new authorities were impressed with the open-mindedness of the IMF staff and their gentle approach and realized that many of the views expressed by the staff were not as different to theirs as they might have previously thought. On the other hand, the staff noted that the incoming government was coming into office with a very well-qualified team with a strong ownership of the program. An absolute respect for the counterpart's view prevailed in the meetings, and, any preconceptions tended to vanish.

5. An equally important step in building the cooperative environment to which we referred above was the Executive Board meeting on Ex-Post Assessment on Uruguay's Longer-Term Program Engagement in March 2005, which further elaborated on the country's future arrangement. The document representing the authorities' position underscored some of Uruguay's program targets, based on the critical need of substantially reducing financial, external, and social vulnerabilities. Among other aspects noted were the objectives of ensuring debt sustainability for which GDP growth would have the utmost importance together with a consistent primary surplus; further strengthening bank regulation and supervision; reforming the revenue administration and the tax system; increasing Central Bank reserves; continuing to diversify the country's external markets; attracting private investment as the necessary condition to enhance the level and quality of employment; implementing a temporary program aimed at mitigating poverty conditions; and boosting social equity.

6. In March 2005, the situation of Cofac, a small but relevant cooperative bank, worsened. The authorities had to suspend the bank's operations and used this moment as a window of opportunity to introduce a deposit insurance scheme, while demonstrating that the government was serious in no longer making guarantees or public funds available to bail out private creditors.

"This is the Economic Program of Uruguay"

7. In June 2005, the Executive Board approved an IMF supported program, which had one main characteristic: this was the authorities' wholehearted ownership of the program. Immediately after the Board approved the Stand-By Arrangement, Uruguay's Minister of Finance publicly stated that "this is the economic program of Uruguay and not of the Fund", underscoring the authorities' firm decision to fulfill the program's targets and that this was just the beginning of Uruguay's reform agenda. With the benefit of hindsight it is clear now that this statement was not just rhetoric but reflected a strong commitment and political leadership.

8. The authorities' policies and their good results further enhanced confidence, which, meanwhile, allowed to streamline the program without putting any of its objectives at risk but rather reinforcing them. In this regard, it is worth recalling the episode related to the use of the proceeds resulting from the sale of Nuevo Banco Comercial. Underlining the indissoluble link between investment and growth, and the critical need to revamp Uruguay's infrastructure so as to support private investment, the authorities considered it necessary to use part of those revenues to finance a few high-quality investment projects. Thus, in agreement with the Fund, an adjustor to the fiscal targets was introduced into the program as a way of accommodating higher investment coming from Public-Private Partnerships (PPP). Once again, the openness and flexibility of the staff, Management and Directors was important to reinforce and encourage ownership.

Walking Without the Fund's Support

9. Since the beginning of this successful program the authorities have stressed their intention to establish a well-articulated exit strategy from the Fund's financial support. This naturally depended on regaining access to external financial markets. Having established a strong IMF-supported program and fulfilled envisaged targets, Uruguay successfully attained access to external markets, in which the efficient and professional work undertaken by the Debt Management Unit –created last year as another of the government's own conditionalities supported by the Fund– played a key role.

10. In addition to the bond issuance of US$ 400 million (in Indexed Units) in September 2006, Uruguay placed bonds for the equivalent of US$ 800 million (of which US$ 300 million was in Indexed Units) in October. Once this last issuance was concluded, the government offered to swap bonds –most of which were due between 2011 and 2015– giving the option to exchange them for bonds with a longer maturity and liquidity, or cash (for which the above-referred proceeds would be used). As another sign of confidence in Uruguay, the market exhibited an overwhelming preference for the new bonds instead of cash.

11. The latter, as part of a virtuous circle, allowed Uruguay to proceed with the early repayment of its outstanding debt to the Fund. This decision was fully consistent with the authorities' strategy aimed at reducing debt costs and lengthening debt maturities. The choice of this early repayment decision was made without placing Uruguay's macroeconomic stability and growth prospects at risk, and, it is worth emphasizing that the decision did not include any ideological aspects.

12. Although much remains to be done, substantial improvements have taken place since the beginning of the program, an accomplishment that the authorities and the Fund can be proud of. Among others, GDP is growing at a robust rate (about 7 percent in 2006); driven by skillful monetary policies, inflation (somewhat below 6 percent) is subdued and within the target-range established by the Central Bank (despite a full pass-through of hikes in oil prices

and a severe drought); the primary fiscal surplus is fully in line with the program's targets; capital inflows (a vast part of which is FDI) and exports (highly and increasingly diversified as result of Uruguay's efforts to further strengthen its participation into the global economy, a process that will be deepened) have significantly risen; unemployment (although still high, is currently at 10.5 percent) and poverty rates (falling about 5 percentage points) have been reduced substantially; net international reserves exceed previous envisaged targets by wide margins; public debt-to-GDP ratio has drastically fallen (to about 65 percent) and the average maturity of public debt has increased to about 13 years. Moreover, the staff report underlines a number of structural reforms that have been achieved, while delays reflect an ambitious and front-loaded reform agenda that required building up political consensus. The government will pursue all pending reforms as well as others not contemplated in the arrangement with the Fund (we underscore the critical reform that will aim to comprehensively reform Uruguay's public sector).

13. The new situation and the favorable outlook point eloquently to a promising future. The country is now moving on to a new stage, walking on its own, that is, without the Fund's financial assistance. The authorities consider that the exit of the "Fund's supported stage" must be orderly, diligent and responsible, consistent with Uruguay's behavior and with its sentiment of gratitude for the IMF. Furthermore, the new period does not imply any decrease at all in the excellent level of relations with the Fund as the authorities are eager to continue receiving its technical assistance, and to hold periodical meetings with the staff in order to exchange opinions on the program's issues.

Looking Forward

14. Beyond the macroeconomic indicators to which we referred, there are others, perhaps less noticeable but certainly not less relevant, that underpin our positive outlook. It is worth noting that the Economist Intelligence Unit placed Uruguay in a rather small group of countries that could be deemed to enjoy a full democracy, whereas the last report of Transparency International shows that the country is making ongoing improvements both in absolute and relative terms. Those countries that experienced a deep crisis will surely appreciate how difficult it is to preserve democratic checks and balances while dealing with social unrest and economic turmoil. Moreover, Uruguay has a competent workforce and the government continues to encourage developments in science and technology.[1] Finally, in cases as this, where the government has demonstrated a strong ownership of the program, the graduation from the Fund's financial assistance means that a country is fully prepared to keep prudent macroeconomic policies and continue progressing with the structural reforms in order to continue paving the way for a higher and sustainable economic, human, and social development.

[1] Among the recent developments, it is worth noting that a few days ago, a regional center of the Institut Pasteur of France was inaugurated in Montevideo, which is expected to be one of the most relevant scientific laboratories in Latin America.