INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/81

URUGUAY

March 2015

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—STAFF REPORT; AND PRESS RELEASE

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV Consultation with Uruguay, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on a lapse of time basis, following discussions that ended on December 12, 2014, with the officials of Uruguay on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 30, 2015.
- An **Informational Annex** prepared by the IMF.
- A **Press Release**

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

Selected Issues Paper

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

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International Monetary Fund
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INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

January 30, 2015

Elections: The candidate of the ruling coalition Frente Amplio, former president Tabaré Vazquez, won the presidency and will take office in March 2015. With Frente Amplio retaining majority in both houses of Parliament, broad continuity in macroeconomic policy making is expected.

Focus: Amid moderating but still solid growth, the 2014 consultation focused on four broad themes: confronting inflation, reinforcing fiscal sustainability, safeguarding financial stability, and bolstering strong and inclusive growth for the medium run.

Main Policy Advice:

- A comprehensive disinflation strategy is needed to bring inflation to the mid-point of the target range. This would include maintaining a tight monetary policy stance, moving towards tighter fiscal policy, reducing the extent of backward-looking indexation of wages, well-crafted central bank communication on the direction of monetary policy, and enhanced central bank autonomy. The present conjuncture provides an unusually good opportunity to achieve a paradigm shift in expectations.

- Fiscal sustainability would be reinforced by raising the primary balance by 2 percent of GDP over the medium term to ensure a downward trend in net public debt.

- Banks' exposures to exchange rate depreciation risks bear continued close monitoring. It would be useful to strengthen risk weights for foreign currency loans to unhedged borrowers and incorporate greater exchange rate stress into the supervisory stress tests.

- Uruguay's medium-term growth would benefit additionally from heightened efforts to boost infrastructure, strengthen education outcomes, and foster an innovation-friendly business environment.

Past advice: In recent Article IV consultations, there has been broad agreement between the authorities and Fund staff on the macroeconomic policy objectives. Views have differed on the appropriate stance of fiscal policy, with staff favoring a tighter stance. The tightening in the monetary policy stance since mid-2013 has been in line with staff advice. The authorities have taken several steps to reduce the fiscal risks stemming from the impact of recurrent droughts on the balances of the state-owned electricity company, including by boosting investment in wind power, creating an energy stabilization fund, and purchasing weather related insurance. The authorities continue to make steady progress in implementing the 2012 FSAP recommendations to further strengthen financial regulation and supervision, and improve access to finance.

Approved By
Charles Enoch and Masato Miyazaki

Discussions took place in Montevideo during December 1–12, 2014. The staff team comprised Oya Celasun (Head), Diva Singh, Elif Türe, Yulia Ustyugova (all WHD) and Hideyuki Tanimoto (MCM). Charles Enoch (WHD) and Rafael Portillo (RES) joined the mission in the second week. The team was assisted by Stella Addo, John McCoy, and Joanna Meza-Cuadra (all WHD) in headquarters, and Natalia Melgar and Sandra Shaw (Montevideo Office) in the field. Staff met with Vice President Astori, Minister Bergara (Economy and Finance), Central Bank President Graña, Undersecretary Loustaunau (Labor), other senior government officials, members of the incoming administration, as well as representatives of the private sector and civil society.

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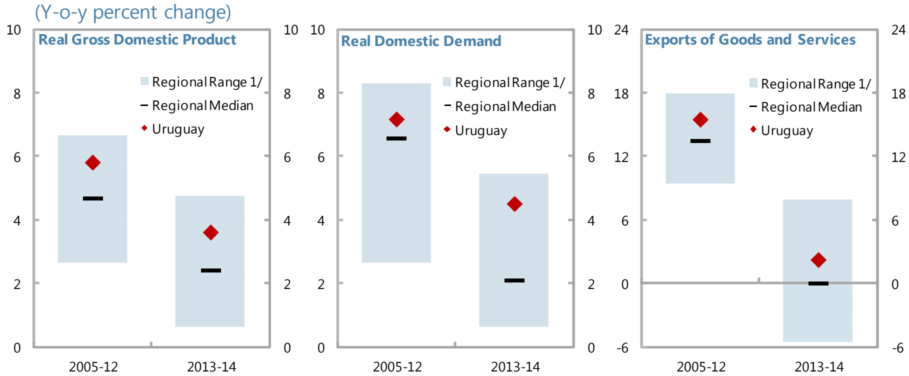
CONTEXT

1. **Uruguay's economy performed strongly over the last decade and has so far weathered the regional slowdown quite well**. Buoyant FDI inflows since 2005 have contributed to strong growth in productivity and real incomes. Per capita income has risen by 75 percent following the 2002 crisis, while poverty and inequality have declined to historic lows (Box 1). The public sector balance sheet has been fortified substantially, with net public debt at less than half its post-crisis peak and the average maturity of central government debt among the longest in the world. Investments in renewable energy have started reducing the country's dependence on oil imports and the volatility of the public sector balance. Uruguay's economy is now cooling off in the context of a regional slowdown, but has achieved a robust pace of growth through 2014.

Uruguay vs. the Region: Growth of GDP, Domestic Demand, and Exports

(Y-o-y percent change)



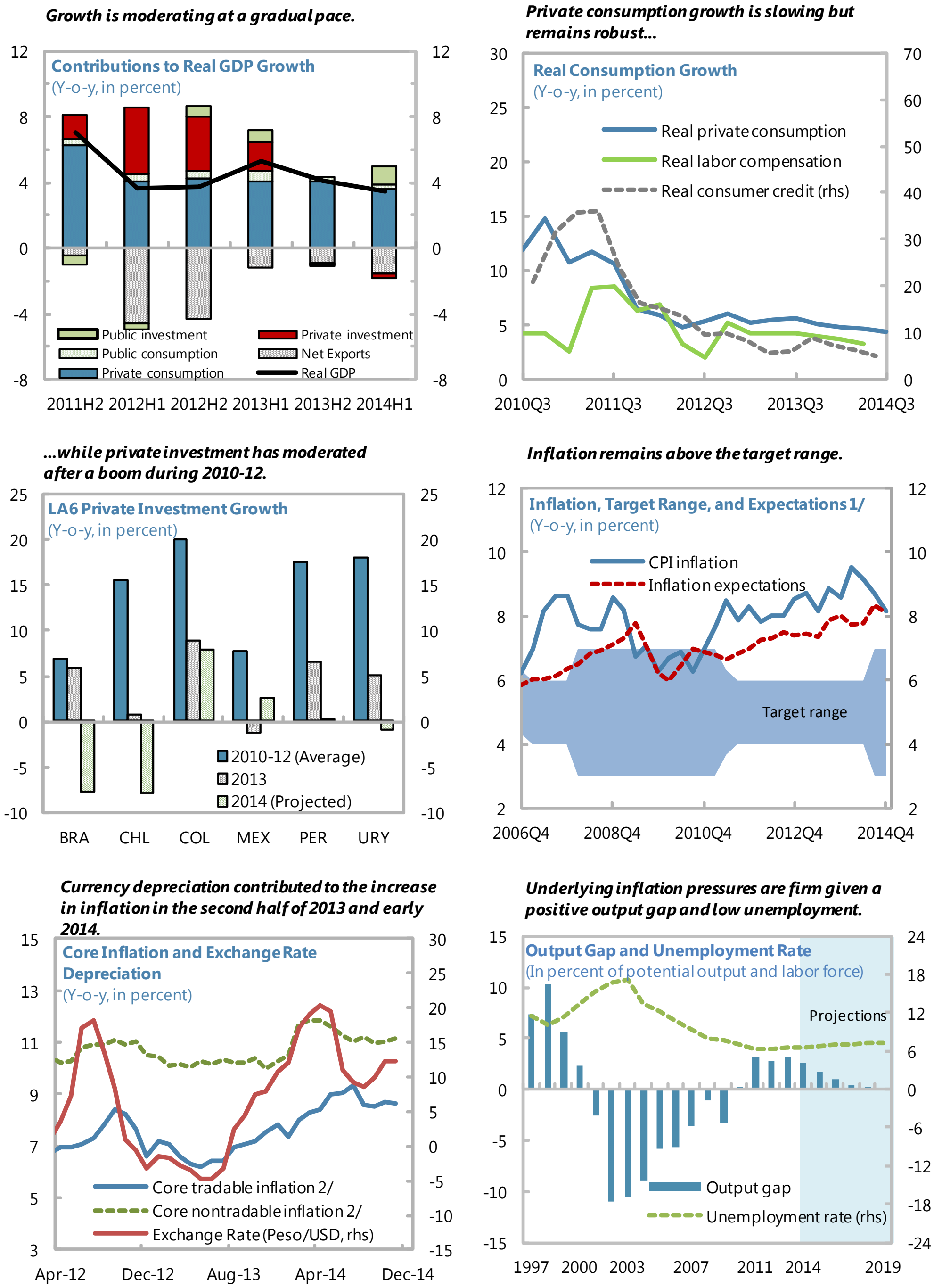
Sources: World Economic Outlook and Fund staff calculations. Real GDP and domestic demand are expressed in constant price local currency units. Export of goods and services are expressed in current U.S. dollars.
1/ Includes Argentina, Brazil, Chile, Colombia, Mexico, and Peru.

2. **Entrenching strong growth in the medium term will require taking policy actions to reinforce macroeconomic stability as well as accelerating supply-enhancing reforms**. Robust growth in recent years has been accompanied by above target inflation and a marked decline in the primary fiscal balance. Although near term risks seem manageable given Uruguay's strong liquidity cushions, the uncertain external environment calls for continued prudence in macroeconomic management. The aftermath of the elections is an auspicious time to take forward a policy agenda to consolidate macroeconomic stability, strengthen institutions, and accelerate supply-side reforms.

RECENT DEVELOPMENTS

3. **The economy is decelerating gradually** (Figure 1). Real GDP growth is estimated to have declined to around 3¼ percent in 2014 from 4½ percent in 2013. Private consumption growth has geared down from its torrid pace in 2010–11 but has remained robust. Private investment is moderating from record high levels. Although commodity exports were solid in 2014, the growth of overall export receipts has slowed down markedly from a few years ago. Weak economic conditions in Argentina, in particular, have continued to weigh on Uruguay's external services balance and current account (Figure 2).

Figure 1. Uruguay: Real Activity and Inflation



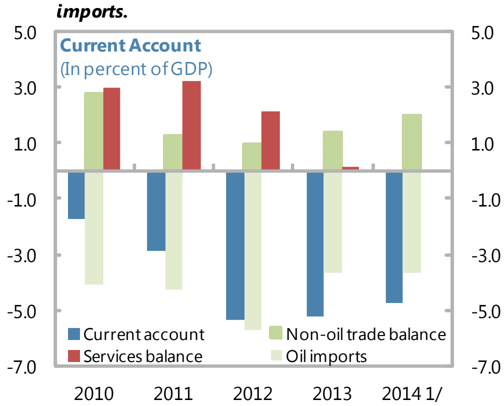
Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, and Fund staff estimates and calculations.

1/ BCU survey, median of expected inflation for the 12 months ahead.

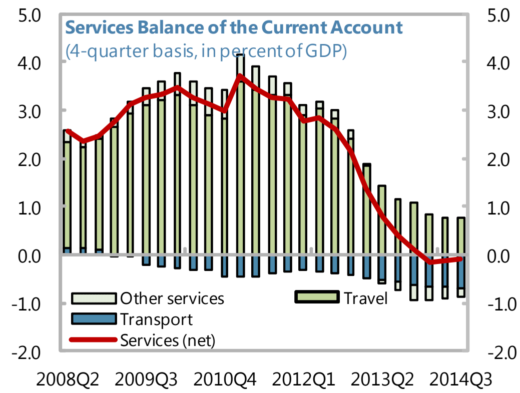
2/ Core tradable CPI is calculated by excluding fruit, vegetables, and fuel prices from the tradable component of the CPI. Core nontradable CPI excludes non-fuel administered prices (including electricity tariffs) from the nontradable CPI.

Figure 2. Uruguay: External Accounts

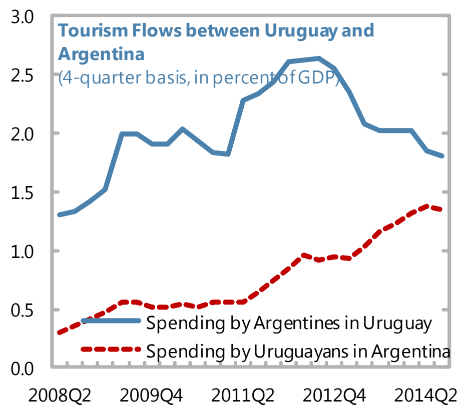
The movements in the current account largely reflected those of the services balance and oil imports.



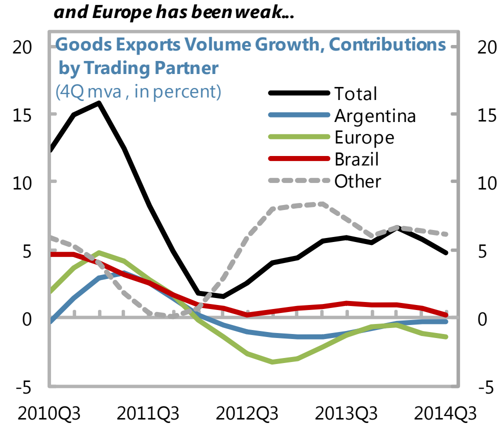
The weakening in the net services balance since 2011...



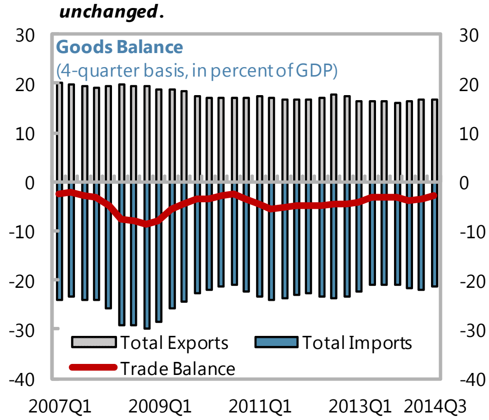
...was mostly due to a lower bilateral tourism balance vis a vis Argentina.



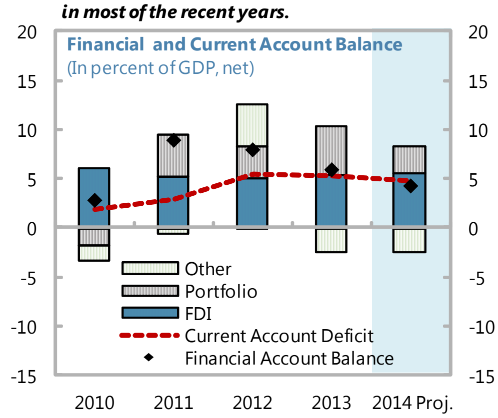
Goods export growth to the immediate region and Europe has been weak...



...but the trade balance remains broadly unchanged.

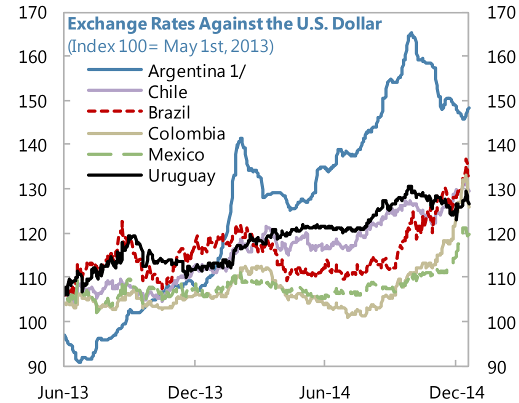


FDI has exceeded the current account deficit in most of the recent years.



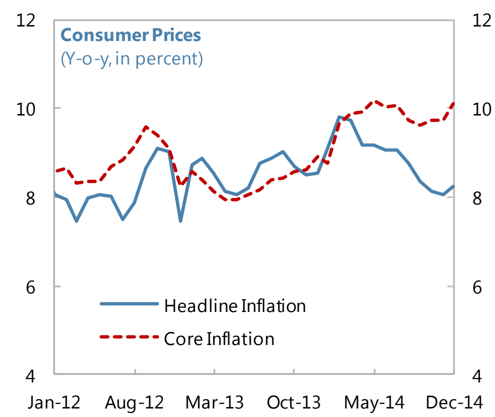
Sources: Banco Central de Uruguay (BCU), World Economic Outlook, Haver Analytics, and Fund staff calculations.
1/ The last observation covers the 4 quarters through 2014Q3.

4. The surge in nonresident purchases of local securities has abated and the Uruguayan peso has depreciated towards levels consistent with fundamentals. The peso has weakened by about 30 percent against the U.S. dollar and 7 percent in real effective terms since the Fed's May 2013 tapering announcement, broadly in line with the trends in the region. Noting the reversal of appreciation pressures, the authorities eased the reserve requirements on nonresident purchases of public debt securities in September 2014. They also intervened in the foreign exchange market, selling about US$500 million in forward contracts in the second half of 2014. International reserves remain comfortably above norms and the exchange rate slightly on the strong side of fundamentals (0–5 percent, Annex I).



Source: Bloomberg L.P.
1/ Simple weekly average of official and informal market rates.

5. Inflation remains above the central bank's 3–7 percent target range (Figure 1). After being pushed to near 10 percent in early 2014 by food price shocks and the pass-through of peso depreciation, consumer price (CPI) inflation eased to 8¼ percent at the end of the year. The easing in inflation was due to one-off measures and subdued increases in administered prices enabled in part by lower electricity generation costs.[1] Core CPI inflation, which excludes fruit, vegetable, and administered price inflation, remains around 10 percent. Above target inflation reflects a shrinking but still positive output gap, upward shocks to food and fuel prices in 2010–13, and pervasive backward-looking wage indexation that embedded these shocks. Against a backdrop of upward pressures on inflation, and a period of accommodative monetary policy during the 2011–13 capital inflow surge, inflation expectations have not been anchored within the target range.



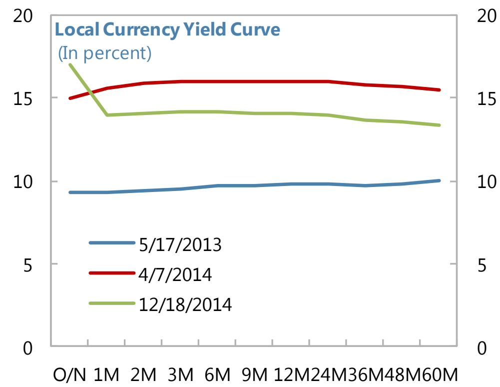
Sources: Haver Analytics and Fund staff calculations.

[1] The one-off measures in force since March 2014, estimated to subtract about ½ percentage point from the CPI for a temporary period, include reduced VAT on fruits, vegetables, and energy and telephone tariffs, a subsidy on health care contributions, and lower lottery prices. Core CPI excludes these effects.

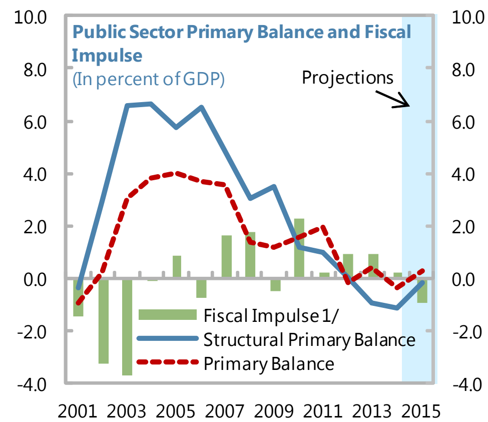
6. Monetary policy has been tight while fiscal policy has been slightly expansionary in 2014 (Figure 3).

- Since the introduction of money growth targets in July 2013, the growth rate of M1 plus savings deposits (M1+) has declined from around 14 percent in the previous year to about 7 percent in 2014Q3 and the peso yield curve has hovered 400–500 basis points above its level prior to July 2013. Reflecting the monetary policy tightening as well as cooling demand, a slowdown now appears to be taking hold for both peso and FX loans.

- Current fiscal spending has continued to grow faster than real GDP in 2014, implying an expansionary fiscal policy stance. The budget approved for 2015 will keep central government discretionary spending constant in nominal terms—in line with a convention for post-election years. This, together with a moderation of investment by public enterprises and a strengthening of their operating balances, will improve the public sector primary balance by ¾ percentage point of GDP.

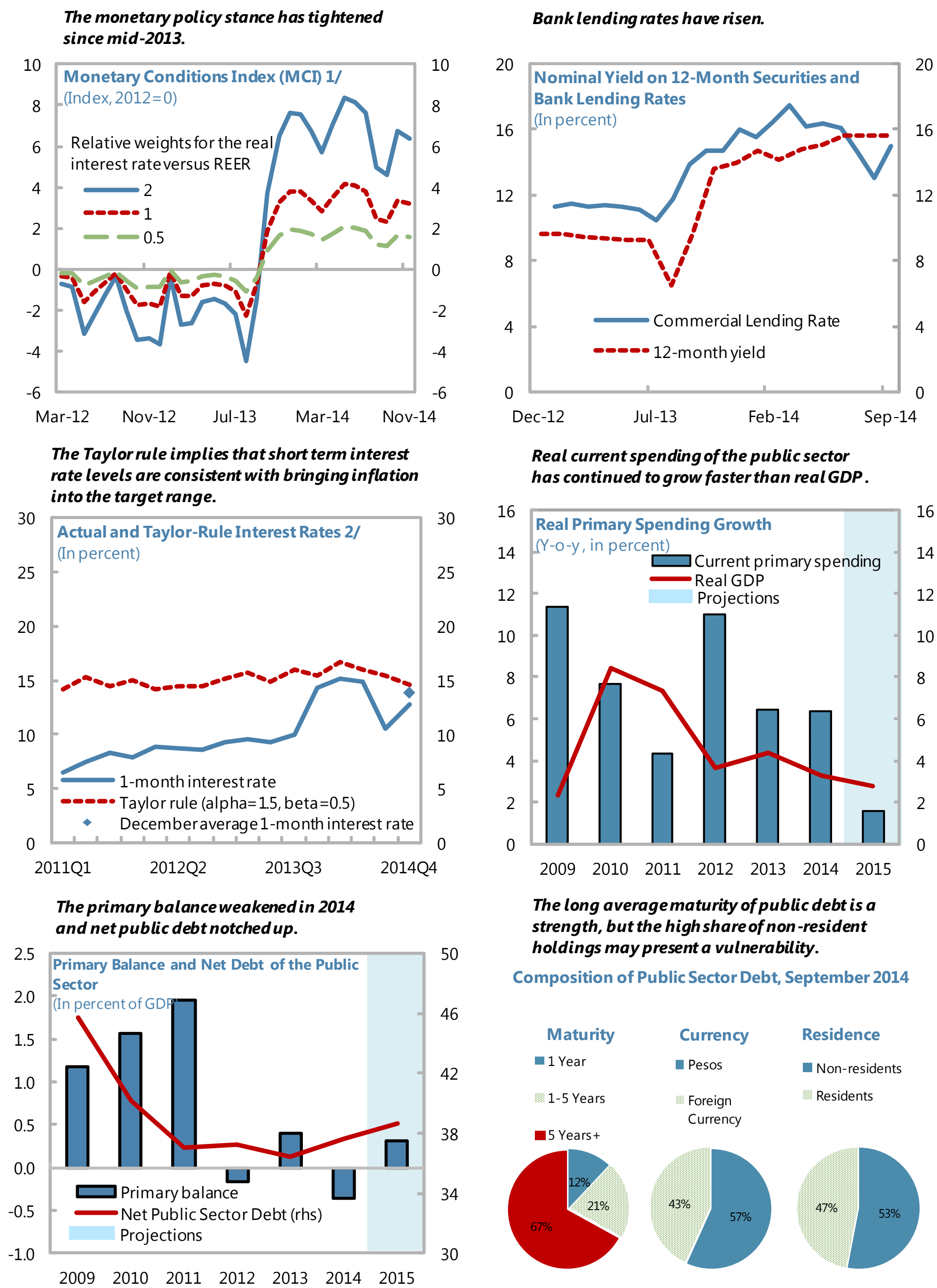


Sources: Bolsa Electrónica de Valores del Uruguay S.A.



Sources: Ministerio de Economia y Finanzas and Fund staff calculations.
1/ Change in the structural primary deficit.

Figure 3. Uruguay: Macroeconomic Policy Mix



Sources: World Economic Outlook, Banco Central del Uruguay, Haver Analytics, and Fund staff calculations.
1/ The MCI is a weighted average of the changes in the real interest rate of 12-month Central Bank securities and the real effective exchange rate (REER) relative to their values in a base period, January 2012.
2/ A standard Taylor Rule was calibrated $i_t = c + \alpha(\pi_t - \pi^*) + \beta(y_t - y_t^*)$, where c is the nominal neutral rate calculated as the sum of the mid-point of the official inflation target range and the estimated real neutral rate (3.5 percent); π^* is the mid-point of the official inflation target range; $(y-y^*)$ is the estimated output gap.

7. Banks continue to account for the bulk of financial intermediation, and report adequate capital levels and ample liquidity (Table 1).[2] Bank resilience indicators are generally strong, with non-performing loans (NPLs) at less than 2 percent of total loans, total loan-loss provisions on average three times larger than NPLs, and net foreign exchange positions below 1 percent of capital. Nonetheless, a few indicators of soundness are less strong than they were a few years ago (Figure 4). In particular, foreign currency credit to borrowers in the nontradables sector has increased as a share of total credit, banks' capital buffers have declined somewhat, and the share of NPLs has inched up in 2014. Bank profitability remains subdued given high deposit dollarization and high U.S. dollar liquidity, low interest rates on U.S. dollar assets, and high operating costs.[3]

Table 1. Uruguay: Selected Financial Soundness Indicators

	2010	2011	2012	2013	2014 1/	LA5 2/
Regulatory capital in percent of risk-weighted assets	16.1	13.7	12.8	11.7	12.8	15.6
Non-performing loans in percent of total loans	1.0	1.3	1.5	1.3	1.6	2.9
Non-performing loans in percent of total household loans	3.5	3.1	3.5	3.7	3.6	...
Specific loan-loss provisions in percent of non-performing loans	73.1	71.1	69.0	56.2	61.6	...
Operating costs in percent of gross income	91.3	83.4	81.0	83.1	86.4	...
Return on assets 3/	0.8	0.8	1.0	1.6	0.9	2.0
Return on equity 4/	8.1	7.9	12.6	19.7	12.0	19.3
Liquidity ratio 5/	47.4	47.8	52.6	52.6	56.8	30.6
Dollar loans in percent of total loans	59.4	58.5	57.9	59.6	60.9	22.1
Dollar deposits in percent of total deposits	74.1	71.9	71.9	73.5	77.6	21.7
Non-resident deposits in percent of total deposits	16.4	14.6	15.2	15.0	14.7	...
Private sector credit in percent of GDP 6/	19.7	20.1	22.1	23.3	24.6	36.3
Household consumer credit in percent of GDP 6/	8.4	8.3	8.7	9.0	9.5	...
Implicit exchange rate risk 6/ 7/	26.0	29.0	28.0	29.7	31.0	...
Memorandum items:						
Loan dollarization (constant exchange rate, January 2013)	50.8	52.9	52.3	51.4	50.2	...
Deposit dollarization (constant exchange rate, January 2013)	68.6	67.2	67.4	67.2	70.0	...

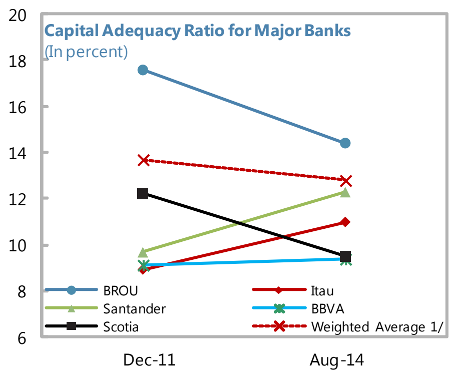
Sources: Banco Central del Uruguay, IMF Global Financial Stability Report, and Fund staff calculations.
1/ Latest available data (August 2014).
2/ Median of Brazil, Chile, Colombia, Mexico, and Peru for 2013. Definitions of soundness indicators vary by country.
3/ Annualized net income before extraordinary items and taxes, from the beginning of the year until the reporting month, in percent of the average value of total assets over the same period.
4/ Same as footnote 3 but in percent of average value of capital over the same period.
5/ Liquid assets with maturity up to 30 days in percent of total liabilities expiring within the same period.
6/ For 2014, latest available data (2014Q2).
7/ Foreign currency bank credit to borrowers without natural hedges as a share of total bank loans to the private sector.

[2] In December 2012, capital requirements were modified to cover operational risks and capital surcharges were established for systemically important banks (0.5-2.0 percentage points).

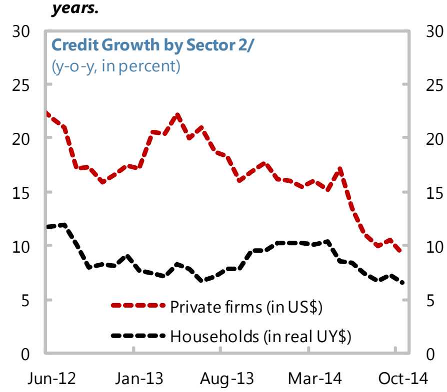
[3] The profitability indicators (ROA and ROE) for 2014 are held down by an inflation adjustment to fixed assets as accumulated inflation exceeded the threshold of 25 percent in the previous 3 years. Excluding this adjustment, profitability indicators are largely unchanged from end-2013. Banks' net worth is not affected by this adjustment.

Figure 4. Uruguay: Credit and Banking

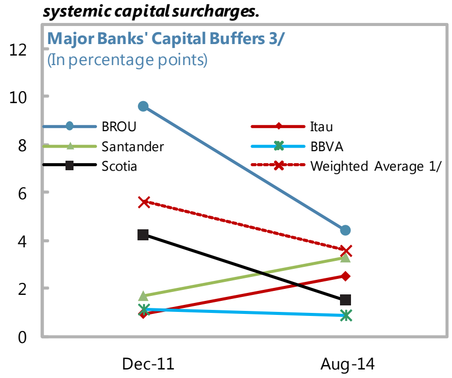
Average capital adequacy has declined since 2011…



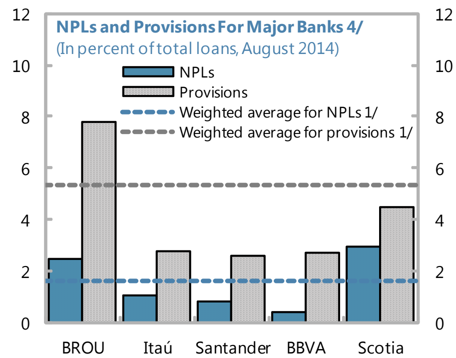
…with buoyant credit growth in the past few years.



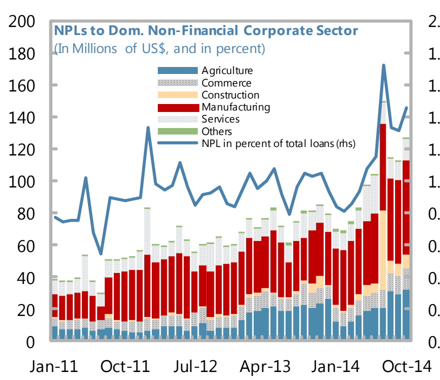
The erosion in capital buffers was partly due to the incorporation of operational risk weights and systemic capital surcharges.



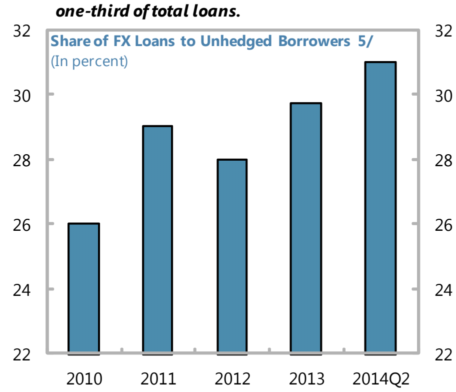
The level of provisions are high…



…though NPLs have notched up from low levels.



FX lending to unhedged borrowers stands around one-third of total loans.



Sources: World Economic Outlook, Banco Central del Uruguay (BCU), and Fund staff estimates and calculations.
1/ Weighted average of all private banks and Banco de la República Oriental del Uruguay (BROU).
2/ BCU reports credit numbers in US$. Household credit is converted to pesos using the end of period nominal exchange rate and deflated using CPI, since the majority of household credit is denominated in local currency.
3/ Capital buffers are given by the actual minus the required capital ratio.
4/ Provisions include specific, general, and dynamic provisions.
5/ Foreign currency bank credit to borrowers without natural hedges as a share of total bank credit to the private sector.

OUTLOOK AND RISKS

8. **The sharp decline in oil prices will start having a significant effect on Uruguay's economy in 2015**. The drop in global crude oil prices is expected to lower Uruguay's oil import bill by almost 1½ percentage points of GDP in 2015, and to reduce the current account deficit despite the projected slowdown in export earnings. However, the pass through of lower crude oil prices to end-user prices is expected to be gradual, as part of the windfall will initially be absorbed by the state-owned petroleum company to shore up its operating balance.

9. **The deceleration in activity is expected to continue in the near term**. GDP growth is projected to soften to around 2¾ percent in 2015. The programmed slowdown in fiscal spending and continued weak external conditions—including lower export prices for soy and grains—are projected to outweigh the positive impact of lower gasoline prices on private consumption and the ramping up of exports by the recently completed Montes del Plata pulp mill.[4]

10. **In the medium term, growth is projected to return to the potential rate of 3–3½ percent as external demand growth recovers and private investment growth picks up**. The downward revision to medium-term growth—from the 4 percent projected one year ago—reflects significant downward revisions to growth prospects in key trading partners. CPI inflation is projected to decline gradually to within the target range as monetary policy remains tight, the output gap closes, and lower oil prices are gradually passed through to retail prices. Net public debt is projected to crawl up to 43 percent of GDP by 2019 from 36½ percent in 2013 with the primary balance remaining below the debt-stabilizing level.

11. **There are risks stemming from external and domestic factors** (detailed in the RAM).

- **The immediate region**. Uruguay's economic linkages with the immediate region have lessened in some respects but remain relevant (Annex II). Subpar performance in Argentina and Brazil has already lowered Uruguay's growth, and poses further near- and medium-term risks.[5]

- **The global economy**. Being a small and open economy that mostly exports agricultural commodities, imports all its oil, and has nonresidents holding a high share of its public debt, Uruguay would not be immune to further changes in global commodity prices or global financial conditions.[6]

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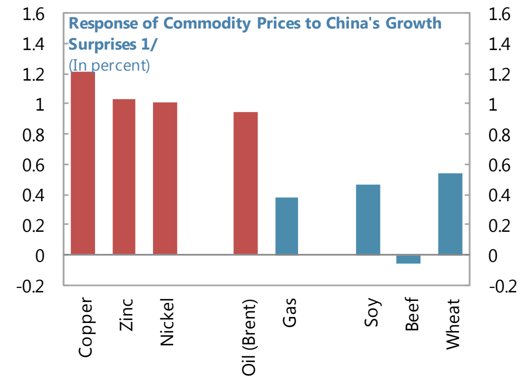
[4] The Montes del Plata pulp mill started production in June 2014. Its exports are estimated at US$300 million in 2014 and are expected to increase to US$700 million in 2015 (close to 1½ percent of GDP).

[5] A one percentage point drop in Argentina's GDP growth is estimated to reduce Uruguay's GDP growth by slightly more than ½ percentage point; the impact could be lower now given diminished economic linkages. Growth shocks in Brazil have typically had a muted effect on Uruguay. See Annex I in the 2013 Article IV Staff Report, "Is the Uruguayan Economy Decoupling from its Neighbors? An Analysis of Inwards Spillovers to Uruguay".

[6] See Selected Issues Paper "How is the Normalization of U.S. Monetary Policy Likely to Affect Uruguay?" by Diva Singh and Yulia Ustyugova.

- **Domestic fiscal outlook**. A delay in tightening fiscal policy beyond 2015 would leave net debt on an upward trend and raise the possibility of a more austere procyclical adjustment later.

12. The authorities broadly agreed with staff's outlook but saw more limited downside risks. They felt that the decoupling of Uruguay's economic performance from economic developments in Argentina and Brazil has been self evident in recent years, and that the reduced trade and tourism linkages especially with Argentina would imply lower negative spillovers than in the past. They stressed that a slowdown in China would hurt Uruguay less than other regional commodity exporters as agricultural commodity prices would be unlikely to fall as much as those for oil or metals. Finally, they emphasized that the public sector's strong liquidity buffers and the flexible exchange rate would help buffer Uruguay's economy against adverse shocks.



Sources: Bloomberg; and Fund staff calculations.
1/ The response denotes the coefficient from individual regressions in which the dependent variable is the percent change of each commodity price (spot or future) over the three days following each data release. The only explanatory variable is a surprise in China's industrial value added growth (the difference between the actual year-on-year change and Bloomberg's median forecast at the time of the data release), scaled by the standard deviation of historical surprises. Red bars denote that the coefficient is significant at the 95 percent confidence level. The data span from March 2005 to December 2014.

Uruguay: Risk Assessment Matrix (RAM)

Sources of Risk	Relative Likelihood	Impact if Realized
External		
An abrupt surge in global financial market volatility, tighter global financial conditions, and persistent U.S. dollar strength.	**High/Medium**	**Medium/Low (↓)** • Bond yields would increase and there could be a slowdown or reversal of capital flows into Uruguay. • The peso depreciation would put upward pressure on inflation. It could also raise the default rate on FX loans to unhedged borrowers. • Near-term public sector financing risks would be limited given comfortable levels of liquid dollar assets and high average debt maturity. • External financing risks would be contained by the high level of reserves and the high share of FDI-financing of the current account deficit.
Protracted period of slower growth in advanced and emerging economies / China.	**High/Medium**	**Medium (↓)** • A slowdown in global demand could trigger a further decline in Uruguay's export prices, as two-thirds of Uruguay's exports are linked to agricultural commodities. However, the decline in oil prices that would likely accompany such a scenario would buffer the adverse impact by reducing Uruguay's import bill.
Sharply lower growth in the region.	**Medium**	**Medium (↓)** • A sharp slowdown in Argentina and Brazil could adversely impact Uruguay through trade, tourism and FDI channels.
Significant disruptions in global commodity, financial, and goods markets due to increased geopolitical tensions.	**Medium**	**Low (↓)** • The recent investment boom in renewable energy and the current low level of oil prices would temper the adverse effects of potential oil market disruptions.
A slowdown in FDI inflows due to a darker external outlook, lower commodity prices, or tighter global financial conditions.	**Low**	**High (↓)** • Averaging 5¼ percent of GDP from 2003–12, FDI over-financed Uruguay's current account deficits for over a decade and fostered strong productivity gains. A sharp slowdown in FDI to Uruguay would hurt medium term growth prospects. At the same time, a softening in FDI flows would come hand in hand with a decline in capital goods imports, lowering the current account deficits and external financing needs.

Domestic		
Delay in tightening the fiscal stance.	**Medium**	**Medium (↓)** • The fiscal withdrawal projected for 2015 would not be sufficient to stabilize the net debt to GDP ratio under staff's baseline macroeconomic projections. A delay in tightening fiscal policy beyond 2015 would raise the possibility of a more austere procyclical adjustment later, especially if external shocks were to raise the debt burden.
Increased mining revenues in the medium term.	**Medium**	**Medium (↑)** • The start of large-scale iron mining would boost investment, and eventually export and fiscal revenues in the medium term. The current account could potentially widen in the initial phase of the project due to FDI-financed capital goods imports.

POLICY ISSUES

A. Confronting Inflation

13. Confronting inflation remains a priority. Inflation taxes low income households and presents an obstacle for financial de-dollarization. Inflation persisting above the target range also creates the risk of unhinging inflation expectations and prevents the use of monetary policy as a countercyclical tool.

14. Bringing CPI inflation to the mid-point of the target range requires a comprehensive disinflation effort. The recent decline in oil prices will create an excellent window of opportunity to bring inflation closer to the target range. A strategy to reduce inflation further to 5 percent, the mid-point of the target range, should include maintaining tight macroeconomic policies, a strategy for reducing the backward-looking indexation of wages, steps towards strengthening the central bank's influence on inflation expectations through forward-looking communication, and enhanced autonomy for the Banco Central del Uruguay (BCU). If implemented together, the measures would be mutually reinforcing and hence bring down the cost of the disinflation. A comprehensive disinflation strategy along these lines would also eliminate the need to resort to ad hoc measures—such as fiscally costly VAT cuts—to hold inflation down in the case of further commodity price shocks.

- **Policy stance**. The slowdown in M1+ growth and the substantial increase in real interest rates since mid-2013 represent a welcome tightening in financial conditions. The current monetary policy stance—with short term interest rates about 600 basis points above inflation—is consistent with the goal of lowering inflation. In order to durably reduce inflation to the middle of the target range, monetary policy needs to stay tight for some time, with appropriate recalibration if economic circumstances change. Tighter fiscal policy would also help lower inflation by tempering the growth of domestic demand.

- **Reducing inflation persistence**. Reducing the indexation of wages to past inflation is critical for lessening inflation persistence and lowering the cost of disinflation. The government's wage-setting guidelines for the bargaining rounds of 2015 and 2016 should solely recommend nominal contracts. To ensure the success of the effort, it will be critical to lower inflation further and get a tighter grip on inflation expectations through well-crafted central bank communication on the direction of monetary policy.

- **Improving the policy framework**. A major currency depreciation spurred in part by the Fed's tapering announcement in mid-2013 fueled inflationary pressures and created serious challenges for the disinflationary effort within the monetary framework introduced in mid-2013. Therefore, it seems too early to assess the efficacy of this framework in anchoring expectations. However, given the challenges involved in predicting money demand, it is important that the authorities monitor the performance of the new framework closely and remain open to considering other frameworks as needed over time. To enhance the framework, there would be merit in allowing more variable M1+ growth targets to ensure that the monetary policy stance is appropriately responsive to shocks and to avoid carrying over past errors in predicting money demand (Box 2).

- **Further enhancing central bank communication and autonomy**.

  - **Communication**. There is scope to strengthen the expectations channel of monetary policy through well-crafted communication efforts. Providing a more detailed assessment of the impact of money growth on inflation, publishing inflation forecasts, and explaining how monetary policy would respond to shocks could strengthen the BCU's influence on inflation expectations.

  - **Autonomy**. Though no institutional framework guarantees success, there is evidence that central banks that pursue their established objectives independent of political considerations are more effective in reaching their goals. In this regard, there is scope to increase the BCU's autonomy through legislation that delinks the terms for the President and Board members from the electoral cycle, as was envisaged in the draft central bank law submitted to Uruguay's Parliament in December 2005.

15. Authorities' views on inflation dynamics. The authorities indicated that they expected inflation to trend down in the near term given the tight monetary policy stance and the eventual pass-through of the drop in global crude oil prices to retail prices. They noted that some of the recent decline in administrative prices reflected structural changes, for instance cheaper electricity production given the coming-on-stream of wind power. The authorities considered the current policy mix to be consistent with lowering inflation and did not consider fiscal policy to have a significant effect on inflation at this time. They felt that inflationary risks from exchange rate depreciation had lessened with the real exchange rate being near equilibrium.

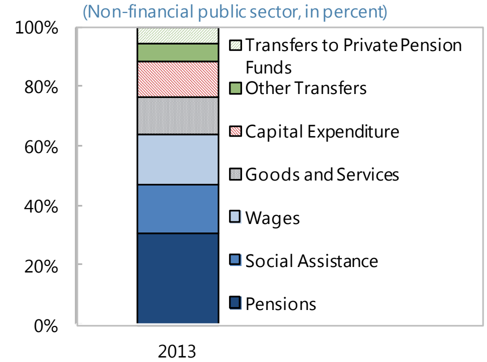
16. Authorities' views on the monetary policy framework and central bank autonomy. The authorities took note of the staff's view that allowing for more variable monetary growth targets may be necessary to enhance the responsiveness of the monetary policy stance to shocks and to avoid carrying over past errors in predicting money demand. Nevertheless, they felt that communicating more variable targets might be a challenge. The authorities considered that the BCU has an appropriate level of autonomy, giving it significant flexibility in choosing the monetary policy settings.

B. Reinforcing Fiscal Sustainability

17. The upcoming budget is an opportunity to restore a downward trend in the public debt-to-GDP ratio. Under unchanged fiscal policies beyond 2015 and staff's macroeconomic projections, the net debt ratio would creep upwards over the medium term, approaching less comfortable levels. Moreover, adverse shocks to growth, interest rates, and the exchange rate could worsen the debt dynamics (Annex III). Staff welcomed the planned fiscal withdrawal for 2015, and recommended increasing the structural fiscal balance by an additional 2 percentage points of GDP in the following four years, which would help keep net public debt close to current levels in 2019 and on a firm downward trend in the medium run.

18. The improvement in the primary fiscal balance could come from a mix of expenditure and revenue measures. The relatively high share of rigid spending (pensions, social assistance and wages) poses a challenge to improving the primary balance through expenditure restraint alone. Therefore, revenue-enhancing measures would also be needed. While sustained expenditure restraint could gradually deliver part of the targeted improvement in the primary balance, revenue measures could be adopted upfront, in 2016, to reduce the eventual adjustment need and achieve a visible change in the direction of debt right away. Table 2 presents an adjustment path along these lines.

Composition of Primary Fiscal Expenditure
(Non-financial public sector, in percent)



Sources: Ministerio de Economia y Finanzas and Fund staff calculations.

- **On the expenditure side**, real spending growth could be kept below real GDP growth. For instance, capping the growth of real primary expenditures at 2 percent from 2016 onwards would contribute two-thirds of the recommended adjustment over four years. To help ensure compliance with expenditure targets, there would be merit in incorporating a numerical expenditure rule in the next five-year budget. The real expenditure growth targets could be converted into a nominal expenditure ceiling for each individual year of the five-year budget period and be reduced over time if disinflation proceeds faster than expected. Also, targeting higher spending efficiency would help accommodate any new spending priorities without stretching the expenditure envelope.

- **On the revenue side**, a mix of measures could be considered. In particular, lowering the minimum income threshold for the PIT (currently, only about 35 percent of employees are estimated to contribute to the PIT), limiting VAT exemptions (estimated at 3 percent of GDP), and reviewing the business tax exemptions (about 2 percent of GDP) and eliminating those that are not clearly conducive to long-term growth could deliver the remaining adjustment.

Table 2. Uruguay: Baseline and Fiscal Adjustment Scenarios 1/

(In percent of GDP, unless indicated otherwise)

	2013	2014	2015	2016	2017	2018	2019
				Baseline Scenario			
Real GDP growth (percent)	4.4	3.3	2.8	2.9	3.0	3.3	3.3
CPI inflation (percent, eop)	8.5	8.3	7.4	7.3	7.0	6.7	6.4
Overall balance of the public sector	-2.4	-3.3	-2.8	-2.8	-2.9	-2.9	-2.8
Primary balance of the Central government, BPS and NFPEs	0.4	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Primary revenues	30.4	30.3	30.2	30.1	29.9	29.7	29.7
Primary expenditure	30.1	30.7	29.9	30.0	30.0	30.0	30.0
Real growth of primary expenditure (percent)	*8.6*	*5.3*	*0.0*	*3.2*	*3.0*	*3.2*	*3.1*
Real growth of primary non-pension expenditure (percent)	*10.5*	*5.5*	*-1.7*	*3.3*	*2.8*	*3.2*	*3.1*
Structural primary balance of the public sector	-0.9	-1.1	-0.2	-0.2	-0.3	-0.3	-0.3
Gross public sector debt	62.1	63.6	64.3	65.1	65.5	66.2	66.9
Net public sector debt (Gross debt minus liquid financial assets)	36.5	37.6	38.7	39.8	40.9	42.0	43.0
				Fiscal Adjustment Scenario 2/, 3/			
Real GDP growth (percent)	4.4	3.3	2.8	2.7	2.9	3.2	3.3
CPI inflation (percent, eop)	8.5	8.3	7.4	7.1	6.9	6.6	6.3
Overall balance of the public sector	-2.4	-3.3	-2.8	-1.9	-1.5	-0.9	-0.4
Primary balance of the Central government, BPS and NFPEs	0.4	-0.4	0.3	1.1	1.1	1.4	1.8
Primary revenues	30.4	30.3	30.2	30.7	30.5	30.4	30.4
Primary expenditure	30.1	30.7	29.9	29.6	29.3	29.0	28.6
Real growth of primary expenditure (percent)	*8.6*	*5.3*	*0.0*	*2.0*	*2.0*	*2.0*	*2.0*
Real growth of primary non-pension expenditure (percent)	*10.5*	*5.5*	*-1.7*	*1.2*	*1.2*	*1.4*	*1.2*
Structural primary balance of the public sector	-0.9	-1.1	-0.2	0.8	1.0	1.4	1.8
Gross public sector debt	62.1	63.6	64.3	64.3	63.4	62.5	61.1
Net public sector debt (Gross debt minus liquid financial assets)	36.5	37.6	38.7	38.9	38.8	38.1	37.1

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

1/ Both the baseline and the fiscal adjustment scenarios assume that the ratio of primary expenditures to GDP declines by 0.8 percentage points in 2015, as the discretionary expenditures of the central government are kept constant in nominal terms and spending by nonfinancial public enterprises (NFPE) slows down.

2/ The fiscal consolidation scenario assumes a 2.0 percent cap on the growth rate of real primary expenditures and a persistent increase in revenues of about ½ percentage point of GDP from 2016 onwards.

3/ The assumed GDP multipliers are 0.3 for expenditures and 0.2 for revenues, consistent with empirical research for emerging markets. See, for example, N. Batini, L. Eyraud, and A. Weber, 2014, "A Simple Method to Compute Fiscal Multipliers," IMF Working Paper 14/93 (Washington: International Monetary Fund); and E. Ilzetzki, 2011, "Fiscal Policy and Debt Dynamics in Developing Countries," Policy Research Working Paper 5666 (Washington: The World Bank), which show that in emerging markets spending multipliers generally range from 0.1 to 0.3, while revenue multipliers lie between 0.2 and 0.4.

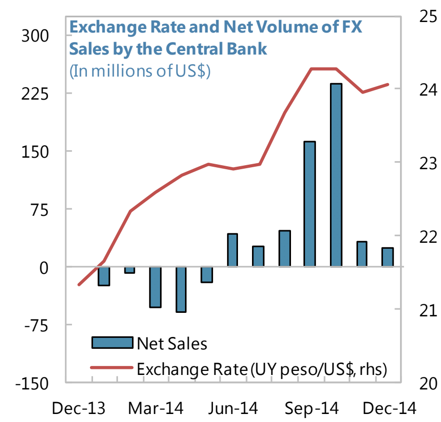
19. Authorities' views on fiscal policy:

- **Objectives and composition**. The authorities agreed that keeping the net debt to GDP ratio stable over the next five-year budget period would be desirable. They noted that a precise policy strategy would be outlined in the next five-year budget to be submitted to Parliament by June 2015. They stressed that a number of investment projects implemented by the state-owned enterprises would be completed in the near term, improving the public sector balance. The authorities saw limited scope for reducing tax exemptions, which they consider to be well targeted. They underscored the success of investment incentives in attracting FDI and noted that revising the business tax exemptions would create uncertainty and potentially undermine investment prospects.

- **Framework**. The authorities stressed that their fiscal policy framework already incorporates a net debt rule imposing a limit on the annual increase in the net liabilities of the consolidated public sector.[7] They took note of staff's argument that an expenditure rule would entail less procyclicality than a net debt rule.

C. Responding to Inward Spillovers

20. The floating exchange rate should remain the main absorber of external shocks. Exchange rate intervention should not substitute for strong macroeconomic policies. There is scope, however, to respond to external shocks by reducing reserves towards prudential norms if macroeconomic policy settings are at appropriate levels and the exchange rate is not deemed stronger than warranted by fundamentals. Staff considers the FX intervention in September–October 2014 to have been justified by exchange rate depreciation pressures emanating from the volatile external environment (particularly in the immediate region) in the context of a disinflationary monetary policy stance, an effective real exchange rate very close to equilibrium, and international reserves well-above prudential norms.



Sources: Banco Central del Uruguay and Fund staff calculations.

21. There is limited scope to respond to adverse spillovers with countercyclical macroeconomic policies. With inflation above the target range and a structural primary fiscal balance that is lower than the level that would stabilize the public debt-to-GDP ratio, there is limited room for active monetary or fiscal policy easing to combat adverse spillovers. Automatic fiscal stabilizers built into Uruguay's solid social safety net and tax system would help shelter the economy from adverse developments.

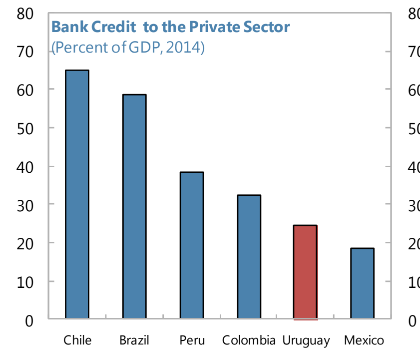
22. Nevertheless, the strong liquidity buffers of the public sector and the banking system would enable an orderly adjustment to shocks.

- Public sector financing risks are limited in the near term as the central government has access to 3½ percent of GDP in contingent credit lines and has a stock of liquid financial assets sufficient to cover public debt service through end-2015 (4½ percent of GDP). Central bank reserves

[7] Since 2010 the limit is fixed in inflation-indexed units. In 2013, it corresponded to about 1¼ percentage points of GDP.

stood around 32 percent of GDP in October 2014, whereas 'liquid' reserves (excluding required reserves against FX deposits) amounted to 18½ percent of GDP, comfortably exceeding prudential benchmarks (Annex I). The high share of private nonresident holdings of Uruguay's public debt, however, could make domestic financial conditions susceptible to changes in global financial sentiment.

- The modestly sized and highly liquid banking system is unlikely to act as a major amplifier of shocks. Nevertheless, there is a need to continue monitoring closely the resilience of banks and their customers. FX-denominated bank credit to borrowers in the nontradables sector, around one third of total loans to the private sector or 7 percent of GDP, could be a point of vulnerability (Table 1, paragraph 24–27).



Sources: World Economic Outlook and Fund staff calculations.

- Macroprudential policy settings could be eased in case of liquidity strains. The reserve requirement on nonresident holdings of central bank paper could be unwound if there were disruptive portfolio outflows, and in case of liquidity stress in the local banking system, reserve requirements on bank deposits could be lowered.

23. Authorities' views. The authorities argued that with international reserves significantly above traditional prudential benchmarks and money growth in line with the BCU's reference range, occasional FX intervention is appropriate for smoothing potential excessive volatility in the exchange rate. They also argued that foreign currency sales entailed lower fiscal costs than issuing central bank securities to withdraw peso liquidity.

D. Safeguarding Financial Stability

24. Heightened external risks call for continued vigilant regulation and supervision of the highly dollarized banking system. A comprehensive set of regulations for mitigating FX-related credit, market, and liquidity risks is in place (Table 3). The authorities' plan to impose the Basel III Liquidity Coverage Ratio requirements by currency is welcome; staff recommended that the new requirements also take into account the higher potential run-off rates of nonresident deposits. Staff also encouraged continued proactive efforts to monitor the risks associated with FX-denominated lending, and recommended applying higher capital risk-weights to FX loans to unhedged borrowers.

25. Authorities' views on FX exposures. The authorities did not see a need to further tighten regulations related to FX lending to unhedged borrowers, noting that verifying the currency of borrowers' earnings would present a challenge for applying different risk weights to FX loans to unhedged versus hedged borrowers. They argued that the provisioning rules, with banks periodically assessing the payment ability of borrowers under real currency depreciations of 20 and 35 percent, ensured that banks hold greater cushions against FX loans to unhedged borrowers.

26. Staff recommended making the supervisory stress tests more stringent and requiring banks to incorporate the test results into their capital planning. Staff welcomed the authorities' plan to differentiate the impact of shocks across corporate versus household borrowers, and by the currency denomination of the loans, starting with the 2015 stress tests. Staff pointed out that the real depreciations assumed in the "adverse" scenario of the latest supervisory stress tests (carried out in 2014Q2) were less than five percent, calling to make them more stringent.[8] Staff also urged to make the stress test results more binding, by requiring any banks that faced capital shortfalls in the tests to submit capital plans for the authorities' approval, describing how they would deal with contingencies.

27. Authorities' views on the stress tests. With banks adequately meeting the current regulatory and supervisory requirements, the authorities saw no significant risks to financial stability. In responding to staff's query on the stringency of supervisory stress tests, they discussed the results of internal stress tests (prepared for the Financial Stability Committee) which featured deeper exchange rate stress. The authorities argued that any capital deficiencies resulting from the considered shocks could be resolved through recapitalization without creating systemic risks. They explained that with the planned introduction in 2015 of banks' self-assessment of capital adequacy, they would start a dialogue with banks on the implications of the stress test results.

28. Progress continues towards implementing the recommendations of the 2012 FSAP. The authorities explained that an organizational change of the Superintendency of Financial Services (SSF) to enhance the supervisory capacity will be incorporated in the 2015 budget. Staff welcomed the efforts to strengthen the safety net and crisis management through an information exchange agreement between the SSF and COPAB—the deposit insurance fund. Moreover, the authorities are considering amendments to the bank resolution legal framework, consistent with the 2012 FSAP and recent Fund technical assistance. The authorities also mentioned that they are planning to implement a simulation exercise for bank resolution to enhance coordination among involved agencies.

[8] The authorities' May 2014 stress test entails shocks of -3.2 percent for real GDP, 11.3 percent for the exchange rate, 9.1 percent for inflation, and increments of 335 and 70 basis points in country risk and international interest rates, respectively.

Table 3. Uruguay: Key Prudential Regulations for FX-Related Risks

<table>
<tr>
<td>Capital requirements</td>
<td>Higher risk weights are applied to FX loans compared to peso loans to the nonfinancial sector.
<table>
<tr><td>FX loans:
✓ 125 percent</td><td>Peso loans (except housing):
✓ 100 percent</td><td>Peso housing loans:
✓ 75 percent</td></tr>
</table>
Capital requirements for market risk are applied to open FX positions by currency (8 percent for currencies with an associated sovereign rating of AA or above and 10 percent for other currencies).</td>
</tr>
<tr>
<td>Provisioning for loan losses</td>
<td>Specific and differentiated provisioning rules are applied for anticipated (not realized) losses on FX loans.
<table>
<tr><td>FX commercial loans:
✓ Banks assess borrowers' payment ability under real peso depreciations of 20 or 35 percent.
→ Higher provisions required if a problem is anticipated in payment ability.</td><td>FX consumer loans:
✓ Monthly payments do not exceed 15 percent of income (as opposed to 30 percent for peso loans).
→ Considered normal.
✓ Monthly payments exceed 15 percent of income.
→ Higher provisions required.</td></tr>
</table></td>
</tr>
<tr>
<td>Liquidity requirements</td>
<td>Differentiated liquidity requirements are applied to FX-denominated or nonresident liabilities.
<table>
<tr><td>FX liabilities to residents:
Up to 180 days: 25 percent
Over 180 days: 19 percent</td><td>FX liabilities to nonresidents:
30 percent</td><td>Peso liabilities:
Up to 29 days: 17 percent
30 to 90 days: 9 percent
91 to 180 days: 6 percent
181 to 366 days: 4 percent</td></tr>
</table>
Liquidity requirements must be met with liquid assets (for example, cash, demand deposits at BCU or foreign banks, or government bonds) in FX and local currency, respectively.</td>
</tr>
<tr>
<td>Limits on open FX positions</td>
<td>The net asset or liability position, defined as the difference between assets (excluding operating fixed assets) and liabilities, cannot exceed 150 percent of net worth.</td>
</tr>
<tr>
<td>Reserve requirements</td>
<td>Differentiated minimum reserve requirements are applied to FX liabilities.
<table>
<tr><td>FX liabilities to residents:
Up to 180 days: 18 percent
Over 180 days: 14 percent</td><td>FX liabilities to nonresidents:
18 percent</td><td>Peso liabilities:
Up to 29 days: 15 percent
30 to 90 days: 9 percent
91 to 180 days: 6 percent
181 to 366 days: 4 percent</td></tr>
</table>
Effective August 1, 2013, marginal reserve requirements are applied, consisting of 45 percent on FX deposits and 25 percent of peso deposits on the daily average balance minus the corresponding April 2011 balance. FX and peso reserve requirements must be met with cash and deposits at the BCU. Both the minimum and marginal reserves at BCU are remunerated.</td>
</tr>
</table>

E. Bolstering Inclusive Growth in the Medium Term

29. Supply-enhancing reforms are needed to secure the strong economic growth that Uruguay needs in order to continue deepening its social gains. Given limited scope for higher contribution from the growth of the labor force going forward, strong medium-run growth will require continued high investment rates and TFP growth (Figure 5).

30. The structural reform agenda of the incoming administration is well targeted to the identified potential impediments to future growth.

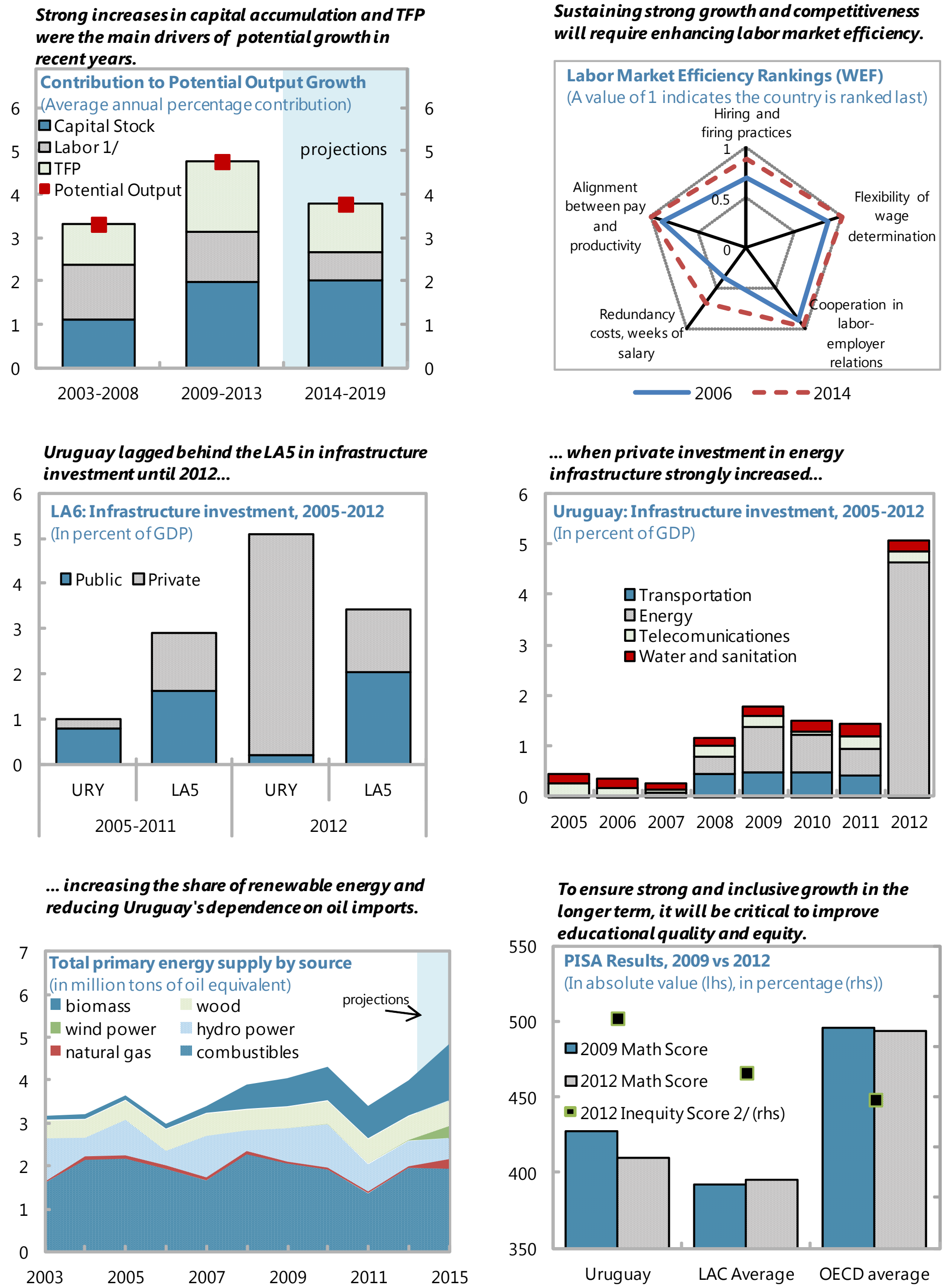
- **Infrastructure**. Unlike investments in energy and telecommunication infrastructure, investment in transport infrastructure has fallen below the needs of Uruguay's growing economy, which could hinder FDI prospects in the medium run. The authorities indicated that the modernization and maintenance of highways and railroads are a priority in their reform agenda, with several rehabilitation projects to be launched as Private Public Partnerships (PPP) in the near term. The authorities argued that the PPP investments should pick up as the private sector becomes more familiar with the framework, while acknowledging that there is room to improve the project design and approval procedures. Staff welcomes the authorities' intention to review the overall PPP process and introduce changes as needed.

- **Education**. There is broad consensus that reversing the quality decline in secondary education will be essential to sustain strong and inclusive growth in the long run (Box 1). The incoming administration is committed to undertake reforms to boost student enrollment and completion rates, and learning outcomes in secondary education. The reform will establish a set of analytical skills in order to help students better succeed in college and the labor market, create a common core curriculum to support the acquisition of those skills, and implement a national system of standardized evaluation. The authorities expect education spending to increase by 1 percent of GDP over the next five to ten years.

- **Labor skills**. The labor market has been tight in recent years, with anecdotal evidence of skill shortages in some sectors. There is a need to review the government funded training programs and ensure that their design is well aligned with the demands of Uruguay's current production structure. The authorities stressed the need to improve job training opportunities especially for the youth, and address the skill gaps in fast-growing sectors such as services and IT.

31. Fostering an enabling business environment will also be important in maintaining high productivity and investment rates in the years ahead. With business surveys ranking labor market efficiency as the most difficult aspect of doing business in Uruguay, it would be useful to evaluate the labor market regulations introduced in recent years and ensure that they strike a good balance between efficiency and appropriate protection for workers. The authorities emphasized their plans to launch a national system of competitiveness, an umbrella reform agenda that aims to facilitate an innovation-friendly business environment; not only by improving infrastructure and human capital, but also by promoting research, development and entrepreneurial capacities.

Figure 5. Uruguay: Medium-Term Growth



Sources: Banco Central del Uruguay, National Statistics Institute, World Economic Forum (WEF), Economic Comission for Latin America and the Caribbean (CEPAL), Ministry of Industry, Energy and Mining, OECD and Fund staff estimates.
1/ Adjusted for quality using data on average years of schooling based on Barro and Lee (2010), "A New Data Set of Educational Attainment in the World, 1950-2010".
2/ Percentage of variation in student performance explained by the students' socio-economic background.

32. A far-reaching financial inclusion law adopted in April 2014 will broaden households'access to financial services and promote their use of electronic payments. The law requires all salaries and pension benefits to be paid into bank accounts or debit cards by May 2017, mandates that workers be able to access affordable credit that is serviced directly from these accounts, and incentivizes electronic transactions through temporary VAT cuts on purchases with credit and debit cards. The authorities indicated that the number of debit card transactions tripled from less than 1 percent to around 3 percent of total transactions in the two months following the introduction of VAT cuts in August 2014, and noted that they expect cash transactions to halve by August 2015.

33. The authorities have also taken steps to facilitate household access to a greater range of saving instruments. Shares in money market funds backed by central bank securities can now be purchased at payment service providers. Once take up increases, the availability of alternative saving instruments should enhance competition for peso-denominated bank deposits and strengthen the impact of monetary policy on household saving decisions.

STAFF APPRAISAL

34. The Uruguayan economy is decelerating gradually after a decade of strong and inclusive growth. Export receipts are growing at a markedly lower clip than a few years ago and domestic demand growth is slowing towards a more sustainable pace. At the same time, inflation remains above the target range and the primary fiscal balance has weakened further in 2014.

35. The external environment presents risks as well as opportunities. As a small open economy that exports mostly agricultural products and has nonresidents holding a relatively high share of its public debt, Uruguay is exposed to the risk of lower global growth and tighter global financial conditions. At the same time, the recent drop in global crude oil prices will provide a welcome opportunity to improve the overall fiscal and balance of payments positions and reduce inflation.

36. Uruguay's strong liquidity buffers would allow an orderly adjustment in the event of adverse external shocks. Public debt maturity is high, reserves comfortably exceed prudential benchmarks, and banks and the public sector have ample U.S. dollar liquidity. However, above-target inflation would leave little room for a countercyclical monetary policy response, and a primary balance that is insufficient to stabilize net public debt would limit the policy space to deploy discretionary stimulus.

37. A multi-dimensional disinflation strategy is needed to bring inflation to the mid-point of the target range. Such a strategy would involve maintaining a monetary policy stance tight enough to keep inflation on a downward trend, moving towards tighter fiscal policy, a reduction in the backward-looking component of wage setting to temper inflation persistence, and bolstering the central bank's influence on inflation expectations through well-crafted communication efforts. Enhanced central bank autonomy would also be beneficial.

38. The upcoming five-year budget is an opportunity to reinforce fiscal sustainability. Improving the primary fiscal balance by about 2 percent of GDP over the medium term would help ensure that net public debt is put on a firmly declining path. The improvement in the fiscal balance could be achieved by keeping spending growth moderately below potential GDP growth over the next five years and modestly increasing revenues.

39. Financial regulation and supervision are solid, but could benefit from fine-tuning in some areas. The exposures to exchange rate depreciation risks bear continued close monitoring. There is scope to strengthen risk weights for foreign currency loans to unhedged borrowers, incorporate greater exchange rate stress into the supervisory stress tests, and require banks facing capital shortfalls in the stress tests to submit contingent capital plans for the SSF's approval. In addition, measures to assist financial deepening could enhance growth and social inclusion.

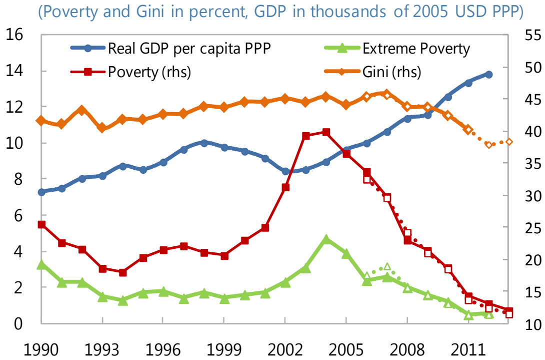
40. A key challenge is to bolster strong growth in the medium run in order to continue deepening Uruguay's social gains. The commitment of the incoming government to boost infrastructure investments, revamp secondary education and skill formation for the youth, and foster an innovation-friendly business environment is welcome.

41. Staff proposes that Uruguay remains on the 12-month Article IV consultation cycle.

Box 1. Uruguay's Experience with Inclusive Growth 1/

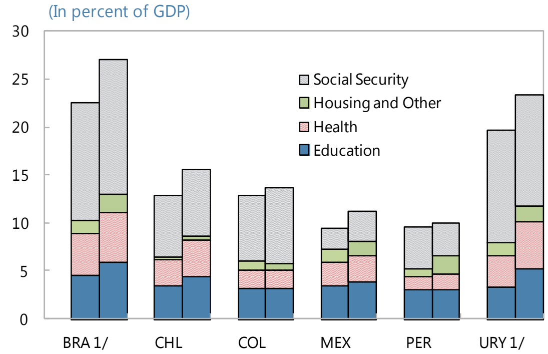
Uruguay has a long history of high living standards comparable to many developed countries and has made further progress in improving social conditions in the last decade. The recession leading to the 2002 crisis took a severe toll on social indicators. However, rising employment and labor incomes, as well as the introduction of targeted public transfers, kept poverty on a declining trend after 2005 and reduced it to multi-decade lows. Income inequality has also declined after 2007.

Uruguay: Poverty, Inequality, and Growth /1
(Poverty and Gini in percent, GDP in thousands of 2005 USD PPP)



Source: National Statistics Institute (INE), and World Bank (WDI).
1/ Solid series represent data for urban areas (with more than 5000 inhabitants). Dotted series, which begin in 2006, cover urban as well as rural areas.

LA6: Social Public Expenditure, 2005 and 2010
(In percent of GDP)

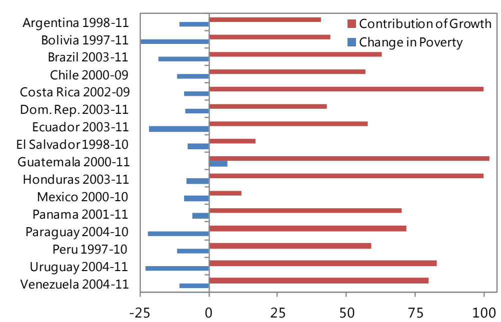


Source: Economic Commission for Latin America and the Caribbean.
1/ For Brazil and Uruguay, the latest social expenditure data are for 2009.

Public social spending increased from 20 percent of GDP in 2005 to 25 percent in 2012, reflecting a deliberate social policy effort. The government implemented a temporary social emergency plan (PANES) between 2005 and 2007, aimed at reducing extreme poverty through targeted cash transfers. The more comprehensive and permanent Equity Plan launched in 2007 included an expansion in the coverage and amount of social assistance transfers, as well as far-reaching tax and health care reforms. The tax reform introduced personal income taxes and improved the progressivity of the tax system, while the health care reform doubled by 2010 the health insurance coverage under public plans. In 2010, further steps were taken to expand the coverage of health care, unemployment insurance, and non-contributory pension benefits.

Preserving strong and stable growth, and ensuring the fiscal sustainability of social policies, will be essential to cementing and deepening these social gains going forward. The reduction in poverty following the 2002 crisis in large part owes to strong economic growth, which raised employment and incomes while also enabling higher spending on social policies.

LA: Contribution of Growth in Poverty Reduction /1
(Poverty reduction in percentage points, contribution in percent)

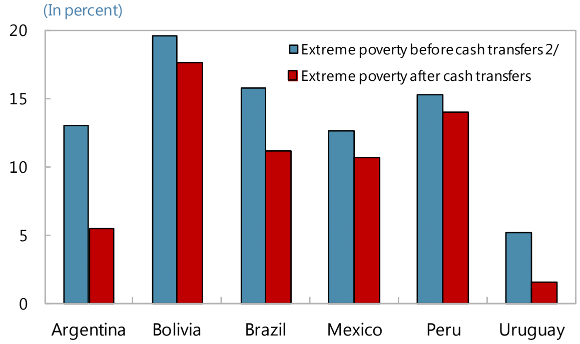


Source: Lustig, Lopez-Calva and Ortiz-Juarez (2013), "Deconstructing the decline in inequality in Latin America", World Bank Policy Research Working Paper No. 6552.
1/ Datt-Ravallion methodology using US$ 4 PPP poverty line, decomposing the poverty reduction into mean household income growth and inequality components. The growth component reflects a shift in the income distribution maintaining its shape, while the inequality component reflects a change in the shape of the income distribution maintaining its mean.

Box 1. Uruguay's Experience with Inclusive Growth (concluded)

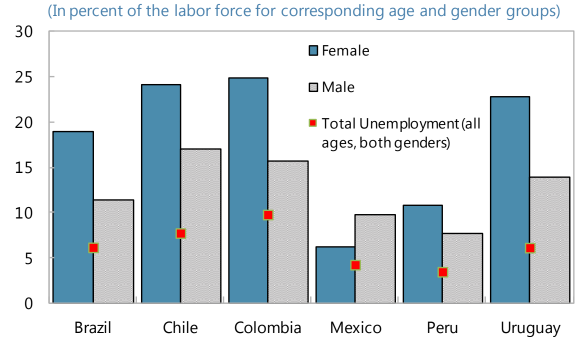
Strong skill formation, especially for women and youth, would help ensure that the reduction in poverty is durable. Although Uruguay's cash transfer policies were successful in reducing the poverty rate over the last decade, a sizable share of the population remains at risk of falling back into poverty. Strengthening job training opportunities and job search assistance, especially for women and youth, would help insert the poor and vulnerable population into the labor market, thereby providing a durable strategy for eliminating poverty and vulnerability.

Extreme Poverty before and after Cash Transfers, 2009 /1
(In percent)



Source: Lustig, Pessino and Scott (2014), "The impact of taxes and social spending on inequality and poverty in Argentina, Bolivia, Brazil, Peru, Uruguay: An overview", Commitment to Equity Working Paper No. 13.
1/ 2010 for Mexico.
2/ Extreme poverty measured at the US$ 2.5 PPP a day poverty line.

Youth Unemployment for Ages 15-24, 2012 /1
(In percent of the labor force for corresponding age and gender groups)



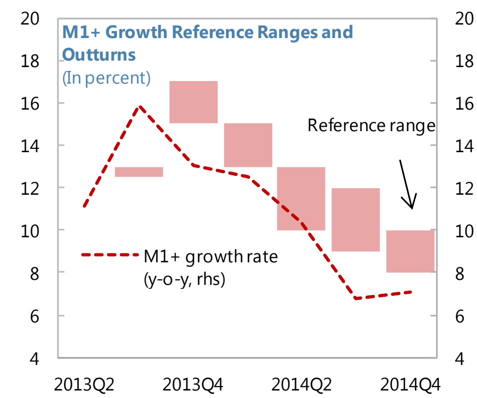
Source: Socio-Economic Database for Latin America and the Caribbean.
1/ 2011 for Chile.

Enhancing the quality of education is crucial for improving equity and raising growth potential in the longer-term. Declining PISA scores and the high dependence of student performance on socioeconomic conditions are a concern (Figure 5). Uruguay currently spends about 4. 6 percent of GDP on education, below the 5.4 percent average among OECD countries. While additional resources could be allocated to improve the quality of education, there is room to improve the efficiency of education spending as well.

1/ This box summarizes the analysis presented in the Selected Issues Paper "Inclusive Growth: The Tale of Uruguay", by Elif Türe.

Box 2. Uruguay's Money-Targeting Framework: Takeaways From the First Six Quarters of Implementation 1/

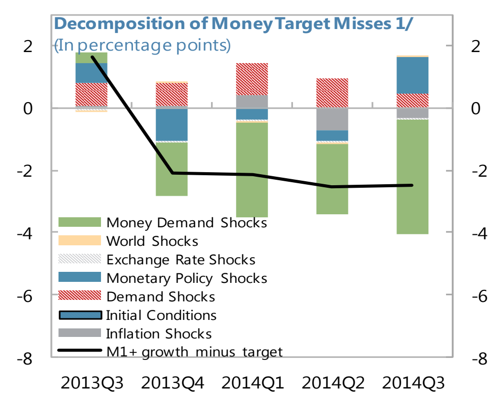
In July 2013, the BCU switched from using the overnight interest rate as the intermediate target to announcing reference ranges for the growth of M1+ within its inflation targeting framework. At the inception of the framework, the BCU announced its intention to reduce M1+ growth from an average of about 14 percent in the previous year to 8 percent by mid-2015, and started setting M1+ growth targets for the quarter ahead. In the event, M1+ growth declined to under 8 percent by 2014Q3.



Sources: Banco Central del Uruguay and Fund staff calculations.

The new framework has delivered a significant tightening in the monetary policy stance, but its first six quarters of implementation highlighted some operational challenges.

- **Money demand has proven difficult to predict**. The M1+growth rate has undershot the reference range in four out of the six quarters of implementation. Analysis based on a calibrated macroeconomic model suggests that the observed deviations from the reference range mostly reflected money demand shocks—i.e. unexpected decreases in money demand. The undershooting of targets was appropriate in view of the disinflation objective, as keeping M1+ growth in the originally-announced reference range would have implied a looser monetary stance. In the converse case of higher-than-expected monetary demand, however, it would be preferable to avoid an overshooting of targets and hold on to the gains in lowering inflation.



Sources: Fund staff calculations.
1/ M1+ growth minus mid-point of target range.

- **There is a need to analyze the deviations of M1+ growth from the reference range and ensure that errors in predicting money demand do not get carried over**. The BCU has been working with the year-on-year growth rate of M1+, which allows abstracting from seasonality. However, setting a smooth path for year-on-year growth could lead to a carry-over of past errors in predicting money demand, as the growth rate is applied to the M1+ level one year ago. Accepting some variability in money targets is essential to calibrate the policy stance appropriately—both to react to new shocks and to correct for past errors in predicting money demand.

1/ This box is based on "A Calibrated Macroeconomic Model of Uruguay for Monetary Policy Analysis," by Rafael Portillo and Yulia Ustyugova, forthcoming IMF working paper.

Table 4. Uruguay: Selected Economic Indicators

					Projection					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Output, prices, and employment										
Real GDP (percent change)	8.4	7.3	3.7	4.4	3.3	2.8	2.7	2.9	3.2	3.3
GDP (US$ billions)	38.9	47.2	50.0	55.7	55.1	57.3	59.9	63.1	66.6	70.2
Unemployment (in percent, eop)	7.0	6.3	6.3	6.5	6.5	6.8	7.0	7.0	7.2	7.2
CPI inflation (in percent, average)	6.7	8.1	8.1	8.6	8.9	7.9	7.5	7.1	6.7	6.5
Exchange rate (UY$/US$, average)	20.1	19.3	20.3	20.5	23.2	…	…	…	…	…
Real effective exchange rate (percent change, eop)	3.5	6.8	10.1	-1.6	-4.4	…	…	…	…	…
	(Percent change, unless otherwise specified)									
Monetary and banking indicators 1/										
Base money	16.2	17.3	26.7	12.9	2.7	…	…	…	…	…
Broader M1 (M1 plus savings deposits)	30.0	20.8	11.2	15.0	7.2	…	…	…	…	…
M2	30.3	22.0	12.3	11.6	5.4	…	…	…	…	…
Growth of credit to households (in real UY$)	15.8	2.1	7.3	9.9	6.4	…	…	…	…	…
Growth of credit to firms (in US$)	18.8	26.5	17.5	16.2	8.4	…	…	…	…	…
Bank assets (in percent of GDP)	58.2	60.2	58.5	62.8	66.6	…	…	…	…	…
Private credit (in percent of GDP) 2/	23.1	23.4	24.0	26.9	26.8	…	…	…	…	…
Foreign bank market share (in percent of total loans)	54.1	56.0	56.6	59.3	62.3	…	…	…	…	…
	(Percent of GDP, unless otherwise specified)									
Public sector indicators										
Revenue 3/	29.8	28.5	28.4	30.4	30.3	30.2	30.1	29.9	29.8	29.8
Non-interest expenditure 3/	28.5	26.8	28.7	30.1	30.7	29.9	30.0	30.1	30.1	30.1
Wage bill	5.0	4.9	5.1	5.1	5.2	5.0	5.1	5.2	5.2	5.2
Primary balance 4/	1.6	2.0	-0.2	0.4	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Interest 4/	3.1	2.9	2.6	2.8	2.9	3.1	2.9	2.7	2.6	2.6
Overall balance 4/	-1.5	-0.9	-2.8	-2.4	-3.3	-2.8	-2.8	-2.9	-2.9	-2.9
Gross public sector debt	61.6	59.0	59.5	62.1	63.6	64.3	65.1	65.5	66.2	66.9
Public sector debt net of liquid financial assets 5/	40.2	37.0	37.2	36.5	37.6	38.7	39.8	40.9	42.0	43.0
External indicators										
Merchandise exports, fob (US$ millions)	8,031	9,274	9,916	10,291	10,934	10,985	11,393	11,990	12,656	13,377
Merchandise imports, fob (US$ millions)	8,558	10,704	12,277	11,593	11,743	11,245	11,926	12,611	13,390	14,223
Terms of trade (percent change)	-3.4	-0.2	6.6	0.0	2.6	4.2	-2.3	-0.4	-0.1	0.3
Current account balance	-1.9	-2.9	-5.4	-5.2	-4.8	-3.7	-3.9	-3.8	-3.6	-3.5
Foreign direct investment	5.9	5.3	5.1	5.4	5.5	5.0	4.7	4.5	4.1	3.8
Overall balance of payments (US$ millions)	-361	2,564	3,287	2,945	1,667	666	446	679	972	961
Total external debt + non-resident deposits	47.5	40.0	40.3	42.9	44.5	44.4	44.2	44.5	44.4	43.8
Of which: External public debt	34.0	31.5	31.8	33.9	35.5	35.4	35.1	35.5	35.3	34.8
External debt service (in percent of exports of g&s)	29.9	21.6	15.8	22.0	22.1	23.8	24.0	24.4	24.3	24.2
Gross official reserves (US$ millions)	7,655	10,302	13,604	16,279	17,946	18,612	19,058	19,736	20,708	21,669
In months of imports of goods and services	9.1	9.7	11.1	13.2	14.3	15.4	15.0	14.7	14.6	14.4
In percent of:										
Short-term external (STE) debt	139.0	212.6	214.9	264.1	263.3	315.6	305.2	262.8	270.0	277.9
STE debt plus banks' non-resident deposits	80.9	126.2	140.0	153.9	160.6	178.5	173.4	157.7	159.9	162.1

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

1/ Percent change of end-of-year data on one year ago. For 2014, latest available data.

2/ Includes bank and non-bank credit.

3/ Non-financial public sector excluding local governments.

4/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado.

5/ Gross debt of the public sector minus liquid financial assets of the public sector. Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits and the domestic currency claims of the non-financial public sector on resident financial institutions.

Table 5. Uruguay: Main Fiscal Aggregates

	2010	2011	2012	2013	Projection 2014	2015	2016	2017	2018	2019
	(In billions of pesos, unless otherwise indicated)									
I. Primary balance of the non-financial public sector (A+B+C)	12.9	18.6	-1.2	5.4	-3.6	5.5	2.9	-1.6	-3.6	-3.8
A. Primary balance of central government, BPS and NFPE 1/ 2/	10.2	16.1	-2.4	4.4	-4.7	4.3	1.6	-3.0	-5.2	-5.5
Revenues	232.5	260.2	288.6	347.4	388.7	428.8	472.3	516.4	567.1	623.0
Taxes	152.2	175.0	191.3	222.5	248.6	270.3	298.7	328.2	360.5	396.2
Non tax	12.4	15.5	16.2	20.9	20.6	22.7	24.9	27.4	30.1	32.9
Social security	49.7	59.9	72.6	86.0	101.0	111.9	123.7	136.3	149.9	164.8
NFPE operating balance 2/	18.1	9.8	8.5	18.0	18.6	23.9	25.1	24.5	26.6	29.1
Primary expenditures	222.3	244.1	291.0	343.1	393.4	424.5	470.8	519.4	572.2	628.5
Current	193.7	219.5	261.9	302.6	348.6	380.5	422.9	467.3	515.0	565.7
Capital	28.6	24.6	29.1	40.4	44.9	44.0	47.9	52.1	57.2	62.9
B. Primary balance of local governments	-0.2	0.9	-0.8	-0.8	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3
C. Primary balance of BSE 3/	2.8	1.6	2.0	1.8	1.3	1.4	1.6	1.7	1.9	2.1
II. Primary balance of the BCU 4/	-0.7	-0.8	-0.4	-0.8	-0.9	-1.0	-1.1	-1.3	-1.4	-1.5
III. Primary balance of the public sector (I+II)	12.2	17.8	-1.7	4.6	-4.6	4.5	1.8	-2.8	-4.9	-5.3
IV. Interest	23.8	26.2	26.4	31.9	37.3	44.7	46.0	47.4	49.7	54.3
of which: BCU 4/	4.5	4.2	3.0	4.4	7.2	10.2	9.3	8.2	7.3	7.2
V. Overall balance of the public sector (III-IV)	-11.6	-8.4	-28.0	-27.4	-41.9	-40.2	-44.2	-50.3	-54.6	-59.6
	(In percent of GDP, unless otherwise indicated)									
I. Primary balance of the non-financial public sector (A+B+C)	1.7	2.0	-0.1	0.5	-0.3	0.4	0.2	-0.1	-0.2	-0.2
A. Primary balance of central government, BPS and NFPE 1/ 2/	1.3	1.8	-0.2	0.4	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Revenues	29.8	28.5	28.4	30.4	30.3	30.2	30.1	29.9	29.7	29.7
Taxes	19.5	19.2	18.8	19.5	19.4	19.0	19.0	19.0	18.9	18.9
Non tax	1.6	1.7	1.6	1.8	1.6	1.6	1.6	1.6	1.6	1.6
Social security	6.4	6.6	7.1	7.5	7.9	7.9	7.9	7.9	7.9	7.9
NFPE operating balance 2/	2.3	1.1	0.8	1.6	1.4	1.7	1.6	1.4	1.4	1.4
Primary expenditures	28.5	26.8	28.7	30.1	30.7	29.9	30.0	30.0	30.0	30.0
Current	24.8	24.1	25.8	26.5	27.2	26.8	27.0	27.0	27.0	27.0
Capital	3.7	2.7	2.9	3.5	3.5	3.1	3.1	3.0	3.0	3.0
B. Primary balance of local governments	0.0	0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
C. Primary balance of BSE 3/	0.4	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
II. Primary balance of BCU 4/	-0.1	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
III. Primary balance of the public sector (I+II)	1.6	2.0	-0.2	0.4	-0.4	0.3	0.1	-0.2	-0.3	-0.3
IV. Interest	3.1	2.9	2.6	2.8	2.9	3.1	2.9	2.7	2.6	2.6
Of which: BCU 4/	0.6	0.5	0.3	0.4	0.6	0.7	0.6	0.5	0.4	0.3
V. Overall balance of the public sector (III-IV)	-1.5	-0.9	-2.8	-2.4	-3.3	-2.8	-2.8	-2.9	-2.9	-2.8
Memorandum Items:										
GDP (in billions of pesos)	780	912	1,016	1,141	1,282	1,420	1,569	1,730	1,906	2,095

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

1/ Banco de Prevision Social (BPS).

2/ Non-financial public enterprises (NFPE).

3/ Banco de Seguros del Estado (BSE).

4/ Banco Central del Uruguay (BCU).

Table 6. Uruguay: Public Sector Debt and Assets 1/

					Projection					
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
	(In billions of U.S. dollars, unless otherwise indicated)									
Public Sector Debt										
Gross debt of the public sector	23.9	27.0	31.1	33.1	33.5	35.1	37.3	39.6	42.2	44.9
of which:										
Non-financial public sector debt	17.8	20.8	23.5	23.9	24.2	25.4	26.8	28.6	30.5	32.5
Central bank debt	6.1	6.2	7.7	9.2	9.2	9.7	10.5	11.0	11.7	12.5
External debt of the public sector	13.2	14.4	16.7	18.0	18.6	19.3	20.1	21.4	22.5	23.4
Domestic debt of the public sector	10.7	12.6	14.5	15.1	14.8	15.8	17.2	18.1	19.7	21.6
Public Sector Assets										
Gross assets of the public sector	11.6	13.9	17.5	20.1	21.4	22.2	22.7	23.5	24.6	25.7
of which:										
Financial assets of the non-financial public sector	2.9	2.7	3.1	2.9	2.6	2.7	2.8	2.9	3.0	3.2
Reserve assets of the central bank	8.7	11.2	14.4	17.1	18.8	19.5	19.9	20.6	21.6	22.5
Liquid reserve assets of the central bank	5.4	7.4	8.5	10.7	11.0	11.3	11.7	12.0	12.5	12.9
Liquid assets of the public sector 2/	8.3	10.1	11.7	13.7	13.7	14.0	14.5	14.8	15.5	16.1
Net Public Sector Debt										
Gross debt minus liquid financial assets 2/	15.6	17.0	19.5	19.4	19.8	21.1	22.8	24.7	26.7	28.9
Authorities' definition 3/	12.3	13.2	13.6	13.0	12.0	12.9	14.6	16.1	17.6	19.3
	(In percent of GDP, unless otherwise indicated) 1/									
Public Sector Debt										
Gross debt of the public sector	61.6	59.0	59.5	62.1	63.6	64.3	65.1	65.5	66.2	66.9
of which:										
Non-financial public sector debt	45.9	45.4	44.8	44.8	46.1	46.5	46.8	47.3	47.8	48.3
Central bank debt	15.6	13.6	14.7	17.4	17.6	17.8	18.3	18.2	18.4	18.5
External debt of the public sector	34.0	31.5	31.8	33.9	35.5	35.4	35.1	35.5	35.3	34.8
Domestic debt of the public sector	27.6	27.5	27.7	28.3	28.1	28.9	29.9	30.1	30.9	32.1
Public Sector Assets										
Gross financial assets of the public sector	29.9	30.3	33.5	37.7	40.8	40.6	39.6	38.9	38.6	38.2
of which:										
Financial assets of the non-financial public sector	7.5	5.9	6.0	5.5	5.0	5.0	4.9	4.8	4.7	4.7
Liquid assets of the public sector 2/	21.4	22.0	22.3	25.7	26.0	25.6	25.3	24.6	24.3	23.9
Net Public Sector Debt										
Gross debt minus liquid financial assets 2/	40.2	37.0	37.2	36.5	37.6	38.7	39.8	40.9	42.0	43.0
Authorities' definition 3/	31.7	28.7	26.0	24.5	22.8	23.7	25.5	26.6	27.7	28.7

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

1/ Stocks are converted into pesos using the end of period exchange rate and divided by GDP.

2/ Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits and the domestic currency claims of the non-financial public sector on resident financial institutions.

3/ Gross debt minus total financial assets of the public sector.

Table 7. Uruguay: Statement of Operations of the Central Government 1/

	2008	2009	2010	2011	2012	2013
	(In percent of GDP, based on the 2001 GFS Manual)					
Revenue	26.5	30.4	31.0	30.5	30.7	32.1
Taxes	18.2	19.5	19.6	19.4	19.3	19.7
Social contributions	5.8	9.0	9.2	9.3	9.9	10.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	2.4	1.9	2.2	1.8	1.5	2.1
Expense	25.6	30.3	30.5	29.6	31.3	32.2
Compensation of employees	6.1	7.5	7.0	7.0	7.3	7.4
Use of goods and services	3.8	3.8	3.8	3.5	3.6	3.8
Consumption of fixed capital 2/	….	….	….	….	….	0
Interest	2.9	2.8	2.5	2.5	2.4	2.5
Subsidies	2.6	0.4	0.2	0.2	0.3	0.3
Grants	0.0	0.7	0.0	0.0	0.0	0.0
Social benefits	10.3	13.2	13.9	13.6	14.6	15.0
Other expenses	0.0	2.0	3.0	2.8	3.2	3.3
Net acquisition of nonfinancial assets	1.8	1.6	1.4	1.5	1.5	1.5
Gross operating balance	0.9	0.1	0.5	0.9	-0.6	-0.1
Net operating balance 2/	….	….	….	….	….	-0.1
Net lending (+) borrowing (-)	-0.9	-1.5	-0.9	-0.6	-2.1	-1.6
Net acquisition of financial assets	-0.9	4.7	-2.4	3.5	0.7	-0.3
By instrument						
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	-1.2	1.9	-2.2	3.3	0.2	-1.0
Debt securities	0.0	2.0	0.1	0.4	0.0	-0.1
Loans	0.3	0.1	-0.4	-0.1	0.4	0.8
Equity and shares	0.0	0.7	0.0	0.0	0.0	0.0
By residency						
Domestic	-0.9	4.7	-2.4	3.3	0.3	-0.3
External	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	0.2	6.4	-1.2	4.1	2.7	1.4
By instrument						
SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	-0.9	1.5	-0.1	4.7	2.2	2.2
Loans	1.1	4.9	-1.2	-0.6	0.5	-0.8
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	1.5	3.9	-0.8	4.3	0.6	-1.4
External	-1.3	2.5	-0.4	-0.2	2.1	2.8
Memorandum items:						
Public sector net lending (+) borrowing (-)	-1.6	-1.7	-1.5	-0.9	-2.8	-2.4
Public sector primary balance	1.4	1.2	1.6	2.0	-0.2	0.4

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

1/ Central government and Social Security Bank. Collection of above the line data for municipalities is not feasible at this moment. 2013 below the line data is not consolidated.

2/ Not compiled by the authorities until 2013.

Table 8. Uruguay: Central Government Stock Positions 1/

	2008	2009	2010	2011	2012	2013
	(In percent of GDP, based on the 2001 GFS Manual)					
Net financial worth	-47.9	-39.8	-36.9	-35.5	-34.4	-34.9
Financial assets	9.3	11.4	9.0	10.5	10.1	9.2
By instrument						
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	6.8	7.2	4.5	6.9	6.7	4.8
Debt securities	0.0	1.6	2.1	2.5	2.5	2.3
Loans	2.5	1.9	1.7	0.6	0.5	1.8
Equity and shares	0.0	0.7	0.6	0.5	0.4	0.3
By residency						
Domestic	9.3	11.4	8.9	10.5	10.1	9.2
External	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	57.3	51.2	45.8	46.0	44.5	44.1
By instrument						
SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	42.8	36.7	33.7	35.2	35.2	36.3
Loans	14.4	14.6	12.1	10.9	9.3	7.9
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	20.7	20.8	18.5	21.4	19.9	17.4
External	36.5	30.4	27.3	24.7	24.6	26.7

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

1/ Central government and Social Security Bank. 2013 data is not consolidated.

Table 9. Uruguay: Balance of Payments and External Sector Indicators

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Projection					
	(In millions of U.S. dollars, unless otherwise indicated)									
Balance of Payments										
Current account	-733	-1,374	-2,691	-2,920	-2,625	-2,131	-2,337	-2,381	-2,437	-2,481
Trade balance	-527	-1,431	-2,361	-1,302	-809	-260	-533	-621	-735	-847
Exports, f.o.b.	8,031	9,274	9,916	10,291	10,934	10,985	11,393	11,990	12,656	13,377
Imports, f.o.b.	8,558	10,704	12,277	11,593	11,743	11,245	11,926	12,611	13,390	14,223
Of which*:* Fuel products	1,593	2,011	2,851	2,055	1,945	1,226	1,409	1,528	1,628	1,691
Of which*:* Non-fuel products	6,965	8,694	9,426	9,538	9,798	10,019	10,517	11,083	11,762	12,532
Services balance	1,157	1,519	1,074	78	-23	-6	158	303	493	692
Exports, f.o.b.	2,688	3,594	3,482	3,273	3,248	3,269	3,515	3,814	4,144	4,496
Imports, f.o.b.	1,531	2,075	2,408	3,195	3,271	3,275	3,357	3,511	3,651	3,805
Income balance (net)	-1,503	-1,618	-1,519	-1,825	-1,924	-1,997	-2,094	-2,195	-2,328	-2,459
Transfers (net)	140	156	115	129	131	132	132	132	132	133
Financial and capital account	1,057	4,190	6,286	4,605	4,291	2,797	2,783	3,060	3,409	3,443
Foreign direct investment	2,289	2,504	2,536	3,030	3,054	2,891	2,812	2,819	2,766	2,711
Portfolio investment	-683	1,976	1,643	2,771	1,556	1,395	1,305	1,357	1,392	1,503
Other capital flows (net)	-609	-297	2,064	-1,393	-1,313	-1,483	-1,329	-1,110	-743	-765
Reserve assets (- increase)	361	-2,564	-3,287	-2,945	-1,667	-666	-446	-679	-972	-961
Reserve Adequacy and External Indicators										
Gross official reserves (stock)	7,655	10,302	13,604	16,279	17,946	18,612	19,058	19,736	20,708	21,669
In months of imports of goods and services	9.1	9.7	11.1	13.2	14.3	15.4	15.0	14.7	14.6	14.4
In percent of short-term debt	139.0	212.6	214.9	264.1	263.3	315.6	305.2	262.8	270.0	277.9
	(As percent of GDP)									
Balance of Payments										
Current account	-1.9	-2.9	-5.4	-5.2	-4.8	-3.7	-3.9	-3.8	-3.6	-3.5
Trade balance	-1.4	-3.0	-4.7	-2.3	-1.5	-0.5	-0.9	-1.0	-1.1	-1.2
Exports of goods	20.7	19.6	19.8	18.5	19.8	19.2	19.0	18.9	18.9	19.0
Imports of goods	22.0	22.7	24.6	20.8	21.3	19.6	19.9	20.0	20.1	20.3
Of which*:* Fuel products	4.1	4.3	5.7	3.7	3.5	2.1	2.4	2.4	2.4	2.4
Of which*:* Non-fuel products	17.9	18.4	18.9	17.1	17.8	17.5	17.5	17.6	17.7	17.8
Services balance	3.0	3.2	2.1	0.1	0.0	0.0	0.3	0.5	0.7	1.0
Exports	6.9	7.6	7.0	5.9	5.9	5.7	5.9	6.0	6.2	6.4
Imports	3.9	4.4	4.8	5.7	5.9	5.7	5.6	5.6	5.5	5.4
Financial and capital account	2.7	8.9	12.6	8.3	7.8	4.9	4.6	4.8	5.1	4.9
Foreign direct investment	5.9	5.3	5.1	5.4	5.5	5.0	4.7	4.5	4.1	3.8
Other capital flows (net)	-1.6	-0.6	4.1	-2.5	-2.4	-2.6	-2.2	-1.8	-1.1	-1.1
Reserve assets (- increase)	0.9	-5.4	-6.6	-5.3	-3.0	-1.2	-0.7	-1.1	-1.5	-1.4
Total external debt + non-resident deposits	47.5	40.0	40.3	42.9	44.5	44.4	44.2	44.5	44.4	43.8
Of which: Short-term debt (residual maturity)	14.2	10.3	12.7	11.1	12.4	10.3	10.4	11.9	11.5	11.1
Of which: External public debt	34.0	31.5	31.8	33.9	35.5	35.4	35.1	35.5	35.3	34.8
	(As percent of annual exports of goods and services)									
External Debt										
Total external debt (including non-resident deposits)	171.9	142.6	157.6	168.5	165.1	170.3	169.8	170.1	168.4	164.8
Debt service	29.9	21.6	15.8	22.0	22.1	23.8	24.0	24.4	24.3	24.2
Of which: Interest payments	7.8	6.7	5.4	6.0	5.3	5.7	2.7	1.0	3.7	3.3
	(Annual percent changes)									
External Trade										
Exports of goods in US$	25.6	15.5	6.9	3.8	6.3	0.5	3.7	5.2	5.6	5.7
Imports of goods in US$	24.1	25.1	14.7	-5.6	1.3	-4.2	6.0	5.8	6.2	6.2
Export prices in US$	7.4	12.5	5.0	-1.1	0.6	-4.3	-0.8	0.5	0.6	0.6
Import prices in US$	11.6	12.7	-1.5	-1.1	-1.9	-8.2	1.5	0.9	0.7	0.3
Terms of trade for goods	-3.4	-0.2	6.6	0.0	2.6	4.2	-2.3	-0.4	-0.1	0.3
Export volume (goods and non-factor services)	14.2	6.7	-0.9	-0.1	2.0	2.2	3.5	3.9	4.1	4.3
Import volume (goods and non-factor services)	11.0	13.1	15.9	1.4	2.7	3.1	3.6	4.2	4.6	5.0
Export volume (goods)	16.5	2.7	1.8	5.0	5.6	5.0	4.5	4.7	4.9	5.1
Import volume (goods)	11.2	11.0	16.4	-4.5	3.3	4.3	4.4	4.8	5.4	5.9
Of which*:* Non-fuel products	15.0	20.0	9.7	9.8	5.2	3.9	4.8	5.3	5.9	6.4
Of which*:* Fuel products	-8.1	-4.1	40.4	-27.3	2.3	7.0	2.0	2.0	2.1	2.2

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

Table 10. Uruguay: Monetary Survey

	2010	2011	2012	2013	2014 1/
	(End of period, in billions of pesos)				
Banco Central del Uruguay (BCU)					
Net foreign assets	153.9	205.4	254.4	330.6	409.7
Net international reserves 2/	153.8	205.0	263.9	348.2	430.4
Other net foreign assets	0.1	0.4	-9.5	-17.6	-20.6
Net domestic assets	-86.5	-123.7	-155.0	-211.7	-288.6
Net credit to the public sector	51.0	22.2	43.0	75.6	63.8
Net credit to the financial system	-35.7	-51.8	-82.5	-128.9	-169.1
Credit to the private sector	0.3	0.3	0.3	0.3	0.5
Securities issued by the BCU	-123.3	-120.5	-155.2	-202.4	-220.7
Other	18.3	27.5	36.8	28.2	6.4
Peso monetary liabilities 3/	67.4	81.7	99.4	118.9	121.2
Public and Private Banks 4/					
Net foreign assets	98.6	94.8	70.9	64.7	90.6
Net domestic assets	224.3	287.3	346.2	438.3	497.7
Net credit to the public sector	11.1	25.8	25.1	19.9	20.9
Net credit to the financial system	94.0	110.8	148.6	190.2	231.9
Credit to the private sector	179.8	213.4	243.9	305.9	333.7
Other	-60.6	-62.7	-71.4	-77.7	-88.8
Liabilities to the private sector (residents)	322.8	382.1	417.1	503.0	588.3
Public banks	2.8	3.5	4.2	4.4	4.6
Local currency	56.3	70.5	82.0	94.0	97.1
Foreign currency	104.5	121.1	131.6	163.2	197.5
Private banks	2.3	2.9	3.0	3.1	3.2
Local currency	46.9	57.2	59.1	66.5	66.2
Foreign currency	115.1	133.3	144.4	179.2	227.1
Banking System (Central, Private, and Public Banks)					
Net foreign assets	252.5	300.2	325.3	395.3	500.3
Net domestic assets	88.5	102.1	117.1	132.0	106.1
Credit to the public sector	62.1	48.0	68.1	95.5	84.7
Credit to the rest of financial system	11.9	-3.9	-5.5	-17.8	-9.6
Credit to the private sector	180.1	213.7	244.2	306.2	334.2
Other	-165.6	-155.6	-189.8	-251.9	-303.2
Broad money (M-3)	341.0	402.4	442.4	527.3	606.4
	(In percent of total private credit) 5/ 6/				
Composition of Credit					
Credit to firms	54.2	55.1	56.8	57.4	59.7
Credit to households	45.8	44.9	43.2	42.6	40.3
Consumption	52.5	62.1	63.7	63.1	61.2
Car loans	0.6	0.6	0.7	1.0	1.3
Mortgages	47.0	37.3	35.6	35.9	37.5
	(Percentage change) 7/				
Memorandum Items:					
Base money	16.2	17.3	26.7	12.9	2.7
M-1	28.9	18.8	9.1	12.2	5.7
Broader M-1 (M1 plus savings deposits)	30.0	20.8	11.2	15.0	7.2
M-2	30.3	22.0	12.3	11.6	5.4
M-3	22.1	18.0	10.0	19.2	13.4
Credit to firms (in US$)	18.8	26.5	17.5	16.2	8.4
Credit to households (in real UY$) 6/	15.8	2.1	7.3	9.9	6.4

Source: Banco Central del Uruguay.

1/ For 2014, latest available data (August 2014).

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

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

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

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

6/ For 2014, latest available data (September 2014).

7/ Percent change of end-of-year data on one year ago. For 2014, latest available data. In pesos, unless indicated otherwise.

Table 11. Uruguay: Medium-Term Macroeconomic Framework

	2010	2011	2012	2013	Projections 2014	2015	2016	2017	2018	2019
					(Annual percent change, unless otherwise indicated)					
National Accounts										
Real GDP	8.4	7.3	3.7	4.4	3.3	2.8	2.7	2.9	3.2	3.3
Total domestic demand	10.9	9.7	7.7	5.0	3.4	3.0	2.8	3.1	3.5	3.7
Final consumption expenditure	11.5	9.0	5.4	5.2	4.1	3.8	3.0	3.2	3.3	3.4
Private final consumption expenditure	12.8	9.8	5.5	5.3	4.1	4.1	3.1	3.2	3.4	3.5
Public final consumption expenditure	3.1	3.8	4.6	4.2	3.9	1.2	1.9	2.5	2.8	3.2
Gross capital formation	8.7	12.5	16.6	4.2	0.9	0.3	2.1	2.9	4.2	4.6
Gross fixed capital formation	13.6	6.4	19.2	6.2	0.2	0.2	2.1	3.0	4.2	4.6
Private fixed capital formation	20.4	11.0	22.2	5.0	-1.0	1.0	1.5	2.5	4.0	4.5
Public fixed capital formation	-6.0	-10.7	5.3	12.4	6.2	-3.3	4.9	5.0	5.1	5.1
Change in inventories (contribution to growth)	-0.9	1.2	-0.3	-0.4	0.2	0.0	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-2.7	-2.7	-4.4	-1.1	-0.5	-0.6	-0.4	-0.6	-0.7	-0.8
Consumer Prices										
CPI inflation (average)	6.7	8.1	8.1	8.6	8.9	7.9	7.5	7.1	6.7	6.5
CPI inflation (end of period)	6.9	8.6	7.5	8.5	8.3	7.4	7.3	7.0	6.7	6.4
Core CPI inflation (average)	8.4	8.9	8.8	8.3	9.8	...	...	...	...	...
Balance of Payments										
Current account balance (percent of GDP)	-1.9	-2.9	-5.4	-5.2	-4.8	-3.7	-3.9	-3.8	-3.6	-3.5
Exports of goods and services (volume)	7.0	6.0	2.1	0.1	2.0	2.2	3.5	3.9	4.1	4.3
Export of goods (volume)	16.5	2.7	1.8	5.0	5.6	5.0	4.5	4.7	4.9	5.1
Imports of goods and services (volume)	14.9	13.2	14.0	2.8	2.7	3.1	3.6	4.2	4.6	5.0
Imports of goods (volume)	11.2	11.0	16.4	-4.5	3.3	4.3	4.4	4.8	5.4	5.9
Terms of trade (goods)	93.9	93.8	100.0	100.0	102.6	106.9	104.5	104.1	104.0	104.3
					(In percent of GDP, unless otherwise indicated)					
Public Sector Finance										
Primary balance 1/	1.6	2.0	-0.2	0.4	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Revenue 2/	29.8	28.5	28.4	30.4	30.3	30.2	30.1	29.9	29.8	29.8
Primary expenditure 2/	28.5	26.8	28.7	30.1	30.7	29.9	30.0	30.1	30.1	30.1
Structural primary balance	1.2	1.0	0.0	-0.9	-1.1	-0.2	-0.2	-0.3	-0.3	-0.3
Overall balance	-1.5	-0.9	-2.8	-2.4	-3.3	-2.8	-2.8	-2.9	-2.9	-2.9
Public sector gross debt	61.6	59.0	59.5	62.1	63.6	64.3	65.1	65.5	66.2	66.9
Gross Debt (NFPS)	45.9	45.4	44.8	44.8	46.1	46.5	46.8	47.3	47.8	48.3
Assets of the public sector	29.8	29.4	35.1	36.0	38.9	38.7	37.9	37.2	36.9	36.6
Liquid assets of the public sector 3/	21.4	22.0	22.3	25.7	26.0	25.6	25.4	24.6	24.4	24.0
Net public sector debt (gross debt minus liquid assets)	40.2	37.0	37.2	36.5	37.6	38.7	39.8	40.9	42.0	43.0
External Debt										
Gross external debt	47.5	40.0	40.3	42.9	44.5	44.4	44.2	44.5	44.4	43.8
Public sector gross external debt	34.0	31.5	31.8	33.9	35.5	35.4	35.1	35.5	35.3	34.8
Gross international reserves (US$ billions)	7.7	10.3	13.6	16.3	17.9	18.6	19.1	19.7	20.7	21.7
Saving and Investment										
Gross domestic investment	18.9	21.1	23.6	23.6	22.3	21.1	20.5	20.1	19.9	19.8
Public sector gross investment	4.7	3.7	4.2	4.6	4.5	4.0	4.0	3.9	3.9	3.9
Private sector gross investment	14.2	17.4	19.4	19.0	17.7	17.1	16.5	16.2	16.0	15.9
Gross national saving	17.0	18.2	18.2	18.1	17.5	17.4	16.6	16.3	16.2	16.3
Public sector gross saving	2.2	1.8	0.1	1.1	0.2	0.3	0.2	0.1	0.1	0.2
Private sector gross saving	14.8	16.4	18.1	17.0	17.3	17.1	16.4	16.2	16.1	16.1
Unemployment and Output Gap										
Unemployment rate (percent)	7.0	6.3	6.3	6.5	6.5	6.8	7.0	7.0	7.2	7.2
Output gap (percent of potential output)	0.2	3.1	2.7	3.2	2.6	1.7	0.9	0.3	0.1	0.0

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

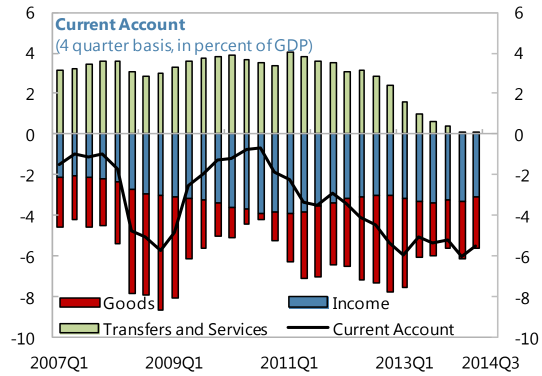
1/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado.

2/ Non-financial public sector excluding local governments.

3/ Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits and the domestic currency claims of the non-financial public sector on resident financial institutions.

Annex I. Uruguay: External Stability Assessment

1. Uruguay's non-oil current account (CA) deficit widened in 2013 as weak external conditions, particularly in Argentina, hit the external services balance. After averaging -1.2 percent of GDP from 2002–11, Uruguay's CAD widened significantly in 2012 due to a drought that necessitated higher oil imports for electricity generation. In 2013, oil imports declined, but the deficit widened significantly relative to 2011 as the economic deterioration and tight FX controls in Argentina triggered a decline in Uruguay's tourism receipts as well as higher spending by Uruguayans in Argentina (given the sharp depreciation of the Argentine peso in the informal market). From averaging 3 percent of GDP in surpluses from 2009–12, Uruguay's services balance declined to almost zero in 2013—and is projected to turn slightly negative in 2014. The goods balance has served to partly offset the decline on the services side, with the trade deficit improving in 2013 relative to 2012 due to lower oil imports, and shrinking further in 2014 due to strong commodity exports and a lower oil import bill. The current account deficit, estimated at 4¾ percent of GDP in 2014, is projected to decrease to 3¾ percent of GDP in 2015, thanks to a lower oil import bill that is projected to more than offset the impact of lower prices for many of Uruguay's agricultural commodity exports. Over the medium term, the CAD is projected to return to about 3½ percent of GDP as goods and services exports recover gradually in line with stronger performance in trading partners.



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

Uruguay: Merchandise Trade Balance

	2010	2011	2012	2013	2014 1/
	(In percent of GDP)				
Trade balance	-1.4	-3.0	-4.7	-2.3	-1.8
Exports	20.7	19.6	19.8	18.5	19.1
Imports	22.0	22.7	24.5	20.8	20.9
Fuel	4.1	4.3	5.7	3.7	3.2
Non-fuel	18.0	18.3	17.2	17.2	17.9
Capital	3.7	3.4	3.1	3.5	4.0
Consumption	5.2	5.3	5.3	5.1	5.3
Intermediary	9.1	9.6	8.8	8.7	8.6

Sources: Banco Central del Uruguay and Fund staff calculations.
1/ Four quarters through 2014Q3

2. FDI has continued to exceed the current account deficit. Averaging 5¼ percent of GDP, FDI more than financed Uruguay's CAD most years between 2003 and 2013, and is estimated to have done so in 2014 as well. Net portfolio investment inflows to Uruguay averaged a strong 4 percent of GDP in 2011–13 as the country regained its investment-grade sovereign rating, but have slowed down since end-2013 (to 2 percent of GDP in the 4 quarters through 2014Q3). Other investment flows have proved volatile and have not shown a clear trend.

3. Staff estimates the Uruguayan peso to be slightly on the strong side of fundamentals.

- The EBA current account model, based on data available as of October 2014, suggests a cyclically-adjusted current account "norm" of -3.2 percent of GDP for Uruguay. The actual cyclically adjusted CA balance in 2014 is projected to be -3.3 percent of GDP, in line with the norm.

- Calculations based on the EBA external stability approach indicate that a current account of -1.3 percent of GDP would be required to stabilize Uruguay's net foreign assets to GDP ratio in the medium-term.
- Based on staff estimates of the relationship between the current account and the REER for Uruguay, the EBA current account and external stability results suggest Uruguay's REER is between 0 and 5 percent above its norm.
- Finally, an estimate using an EBA-like equilibrium real exchange rate regression suggests that Uruguay's REER is 3 percent above its equilibrium value. Uruguay is not included in the official EBA REER regression due to data gaps; therefore, an auxiliary regression was estimated based on a cross-country sample, using an imputed series for Uruguay's financial home bias.

Uruguay: Exchange Rate Assessment

Deviation from equilibrium (in percent) 1/

I. EBA - Current Account Model 2/ 4/	0.2
II. External Sustainability (ES) approach 3/ 4/	5.2
III. Equilibrium Real Exchange Rate (ERER) approach 5/	3.2

Source: Fund staff calculations

1/ Positive values indicate overvaluation.

2/ Based on the October 2014 EBA CA norm.

3/ Desk calculations based on the EBA ES approach.

4/ The CA elasticity used to translate CA gap to REER gap is 0.415 (average of desk calculation given current export and import ratios, and the small economy elasticity for Uruguay estimated in Tokarick (2010), IMF WP 10/180).

5/ Uruguay is not included in the official EBA REER sample. The results presented are based on an auxiliary EBA regression based on a cross-country sample including Uruguay. An imputed series is used for Uruguay's financial home bias due to data gaps prior to 2008.

4. **Despite the relatively high CA deficit, external stability risks for Uruguay remain contained.** Uruguay's international reserves remain comfortably above the upper bound of the IMF reserve adequacy metric range and other prudential benchmarks. The sum of the foreign assets of the central bank and commercial banks exceeds the sum of foreign currency denominated bank deposits (resident and nonresident) and short-term external debt. Given the strong level of reserves, and the high contribution of relatively stable FDI inflows in financing the CAD, external stability risks remain contained.

Uruguay: Gross International Reserves

In billions of U.S. dollars (latest)	17.9
In months of imports (2013)	14.6
In percent of:	
GDP (2013)	32.2
Short-term external (STE) debt (2013 Q4)	291.1
STE debt and foreign currency deposits (2013 Q4)	67.1
STE debt and nonresident deposits (2013 Q4)	174.7
M2 (latest)	197.7
M3 (latest)	72.8
Memo items:	
IMF's new reserve adequacy metric range in US$, billions (2013 Q4) 1/	5.8 to 8.7
Banks' gross foreign assets (US$, billions)	8.3
Ratio of gross reserves plus banks' foreign assets to STE debt and foreign currency deposits (percent)	98.0

Sources: Banco Central del Uruguay and Fund staff calculations.

1/ Reserve adequacy metric range is the minimum reserve adequacy to 1.5 times the minimum.

Annex II. Uruguay's Economic Ties with Argentina and Brazil

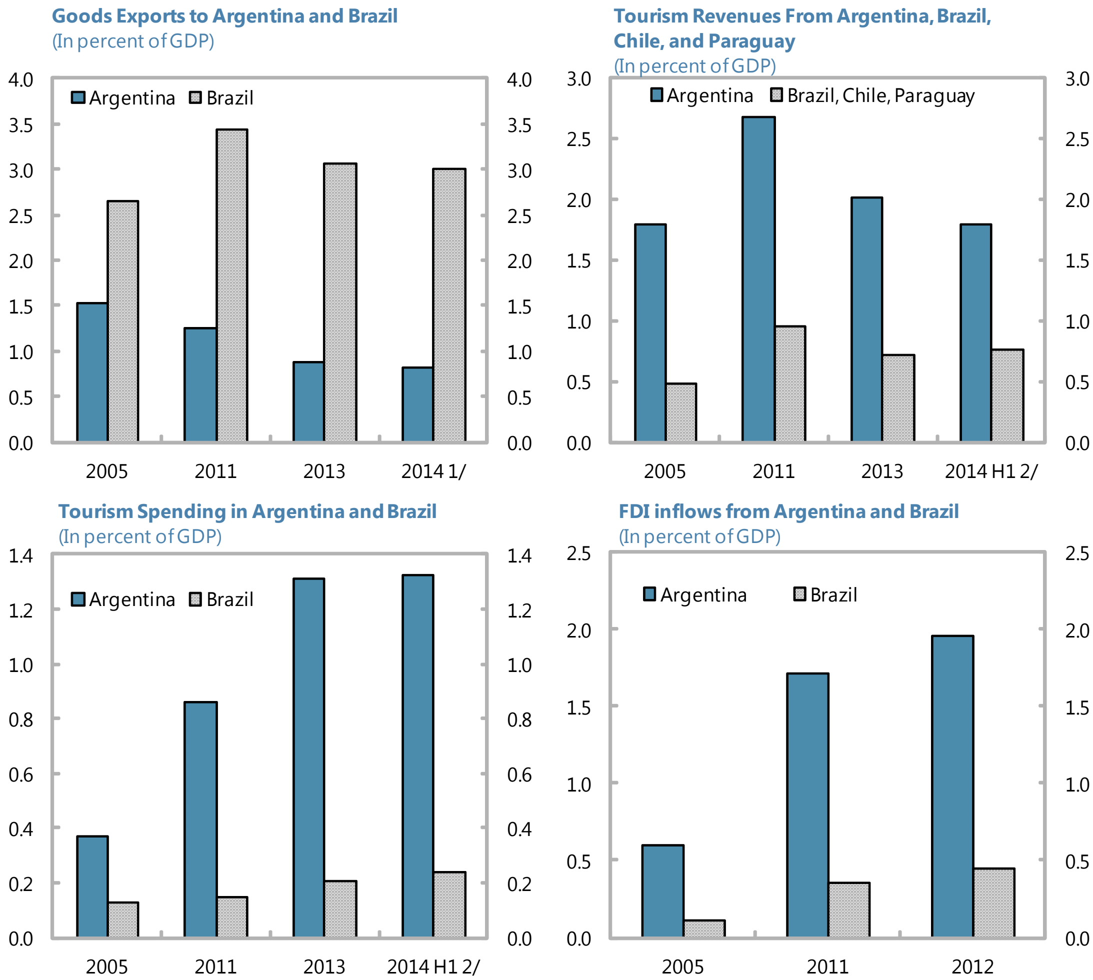
Argentina. The shares of Uruguay's merchandise and service exports to Argentina have diminished in recent years, but remain relevant. There has been a sharp drop in banking linkages between the two countries since the early 2000s.

- The share of nonresident deposits (traditionally dominated by Argentine holders) in Uruguay's bank deposits has fallen from a peak of 40 percent in 2001 to about 15 percent in 2014.
- Argentina accounts for 60 percent of tourism spending in Uruguay. Even so, spending by Argentine tourists in Uruguay has dropped from 2.7 percent of GDP in 2011 to 2 percent in 2013 following the introduction of foreign exchange controls in Argentina. Conversely, spending by Uruguayans in Argentina increased from 0.8 percent of GDP to 1.3 percent of GDP against the backdrop of a sharp depreciation of the Argentine peso.
- In 2013, Argentina accounted for only 5 percent of Uruguay's goods exports (1 percent of GDP), a historical low compared to an average of 10 percent of exports during the last two decades.
- In 2009–12, FDI from Argentina accounted for about one-third of total FDI inflows into Uruguay (mainly into agriculture and real estate). Through data for 2013 is not yet available, anecdotal evidence suggests that there was a decline in real estate purchases by Argentines in 2013, following a bilateral tax information exchange treaty signed by the two countries.

Brazil. Brazil remains an important trade destination for Uruguay, and its share in tourism and FDI inflows has increased over the past decade.

- Brazil's share in Uruguay's goods exports has increased from 13 percent in 2005 to 19 percent in 2013. In contrast to Uruguay's exports to Argentina, more than two-thirds of which are specialized manufactured products without an alternative market, the majority of Uruguay's exports to Brazil are commodity-based, and thus easier to export to alternative markets when growth slows in Brazil. On the services side, Brazil, combined with Chile and Paraguay, has accounted for around one-fifth of tourism receipts (0.8 percent of GDP) in recent years.
- FDI inflows from Brazil to Uruguay are also significant. Their share in total FDI has increased from less than 1 percent in 2001 to almost 9 percent in 2012.

Figure A2.1. Uruguay: Economic Ties with Argentina and Brazil, 2005-14



Sources: Banco Central de Uruguay and Fund staff calculations.
1/ The last observation covers four quarters through 2014Q3.
2/ The last observation covers four quarters through 2014Q2.

Annex III. Uruguay: Public Sector Debt Sustainability Analysis (DSA)

Under current policies and macroeconomic projections, the gross debt of Uruguay's public sector is projected to increase to 67 percent of GDP in 2019 from 62 percent of GDP in 2013. However, the high level of liquid financial assets of the public sector—26 percent of GDP at end-2013—as well as the high average maturity of the public debt, mitigate near-term financing risks. Uruguay's gross financing needs exceed the DSA benchmarks because short-term central bank securities are included in the total public sector debt stock. The central bank's debt is more than covered by its "free" reserve assets.

Composition of the Public Sector Financial Balance Sheet

The gross debt of the public sector has a broad institutional coverage. It includes:

- *Central government debt*, which stood at 40 percent of GDP at end-2013. Currently the average maturity of central government debt is close to 15 years and about half of the debt is in local-currency.
- *Central bank debt*, which stood at 17 percent of GDP at end-2013. The debt of the central bank mostly consists of shorter-term securities (with maturity below 2 years) issued to sterilize the liquidity created by reserve accumulation. About 85 percent of the central bank debt is in local currency.
- *Public enterprises' debt*, which stood at 4 percent of GDP at end-2013.

In total, at end-2013 about 40 percent of Uruguay's public sector gross debt was in foreign currency. About 70 percent of the local-currency debt of the public sector was in CPI-indexed units.

The public sector has access to contingent credit lines of 3½ percent of GDP and at end-2013 had total gross financial assets of 38 percent of GDP. Net public debt—gross debt minus liquid assets—stood at 36½ percent of GDP at the end of 2013.

- *The gross foreign reserve assets of the central bank* reached about 29 percent of GDP at end-2013.
- *The financial assets of the non-financial public sector* amounted to 5½ percent of GDP at end-2013, in line with the authorities' prefunding policy aimed at holding enough liquid assets to cover at least 12 months of total interest and amortization payments.
- *The stock of liquid foreign assets of the public sector* stood at 26 percent of GDP, given by total gross public sector assets minus (i) the required reserves held at by BCU against foreign currency

deposits and (ii) the domestic currency claims of the nonfinancial public sector on resident banks.[1]

Baseline and Alternative Scenarios

Under the DSA baseline scenario, the gross and net public debt ratios would creep upwards over the projection horizon. In particular, net public debt would increase from 36½ percent of GDP in 2013 to 43 percent of GDP in 2019. The increase in gross public debt would be slightly less, from 62 percent of GDP in 2013 to about 67 percent of GDP in 2019, assuming that the pace of asset accumulation moderates over the next few years with an attendant slowdown in the issuance of central bank securities. The gross financing need would rise over the medium term, consistent with higher global interest rates and a rising debt stock. The baseline scenario assumes the maturity profile of the public debt stock to remain tilted to the medium and long term, and the share of local currency debt to remain slightly above 50 percent of the total.

Assuming that the real GDP growth rate, real interest rates, the rate of exchange rate depreciation, and the pace of asset purchases remain at their levels projected for 2019, the medium term debt-stabilizing primary balance is estimated at about 1¼ percent of GDP, about 1½ percentage points of GDP above the projected medium term level of the primary balance.[2]

The analysis of past forecast errors for key macroeconomic variables suggests that the baseline assumptions are generally realistic. The level of the projected primary balance for Uruguay is comparable to those seen in the past.

A "historical" scenario (that assumes that the key macroeconomic variables behave as in the last decade) yields a downward-sloping debt path, since Uruguay experienced high growth rates and exchange rate appreciation in the last decade as it recovered from its 2002 financial crisis.

Vulnerability of the Financing Profile

Uruguay's gross public and external financing needs do not imply near-term vulnerabilities, although they are slightly above the benchmark levels of 15 percent of GDP. The elevated gross public financing needs reflect primarily the short-term maturity of the central bank securities. Refinancing risks for these securities are contained since their amount is smaller than the central bank's liquid foreign reserves. External financing risks are also mitigated by the high liquidity buffers—including the liquid financial assets of the public sector and its contingent credit lines. Uruguay's current account deficits in the last several years have been more than or mostly covered

[1] The latter adjustment removes the domestic currency assets from total assets and thus implies that all the liquid assets are in foreign currency.

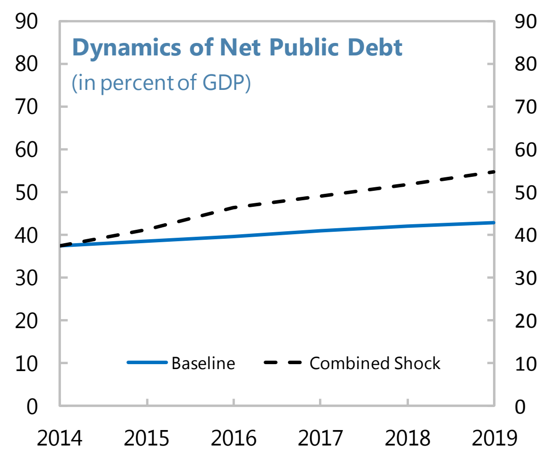
[2] The expected rate of domestic currency depreciation against the U.S. dollar is given by the inflation differential between Uruguay and the United States, on the basis of assuming a constant real exchange rate between the domestic currency and the U.S. dollar.

by FDI inflows. A softening in FDI flows, should it occur, would come hand in hand with a decline in capital goods imports, which would contribute to lower current account deficits and external financing needs.

At 53 percent of total public sector debt, the share of public sector debt held by nonresidents is found to be slightly above the benchmark. This exposure could make domestic financial conditions susceptible to potential external shocks and needs to be monitored.

Stress Tests

Debt dynamics in Uruguay remain sensitive to shocks. In a stylized downside scenario that combines a permanent exchange rate depreciation (relative to the baseline) of about 18 percent with a temporary drop in growth and primary balances and a permanent increase in real interest rates, the gross debt ratio rises by about 16 percentage points over the five-year forecast horizon. The net debt ratio rises by 12 percentage points in the same scenario. The sensitivity of net debt to exchange rate shocks is lower than that of gross debt, as the presence of similar amounts of foreign currency assets and debt imply offsetting valuation effects in response to exchange rate changes. Fan charts of the projected gross debt distribution confirm that the debt dynamics under statistical distributions of combined shocks are generally manageable—gross public debt would remain below 80 percent of GDP in the vast majority of scenarios, while net public debt would remain below 55 percent of GDP under the combined shock scenario as shown in the text chart.



Source: Fund staff calculations.
Note: Combined shock as described in Figure A3.5.

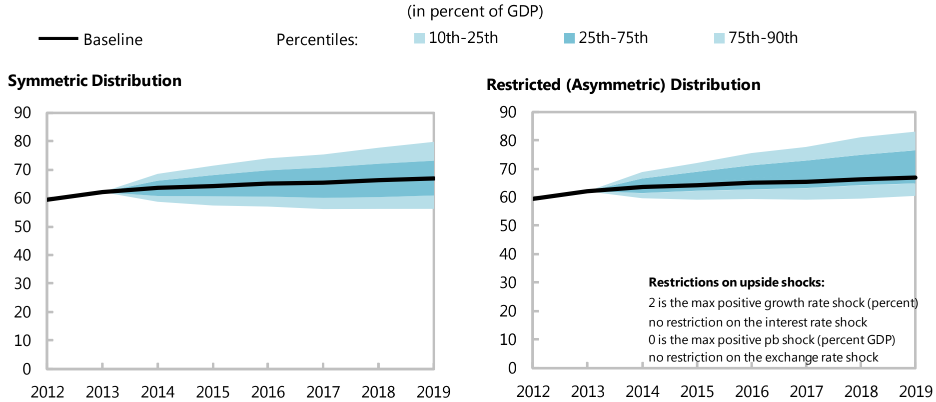
Figure A3.1. Uruguay Public DSA Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

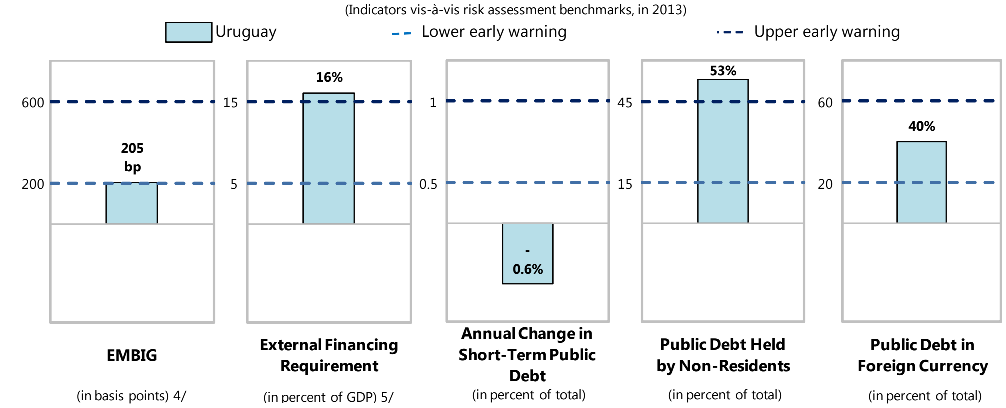
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2013)



Source: Fund staff estimates and calculations.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

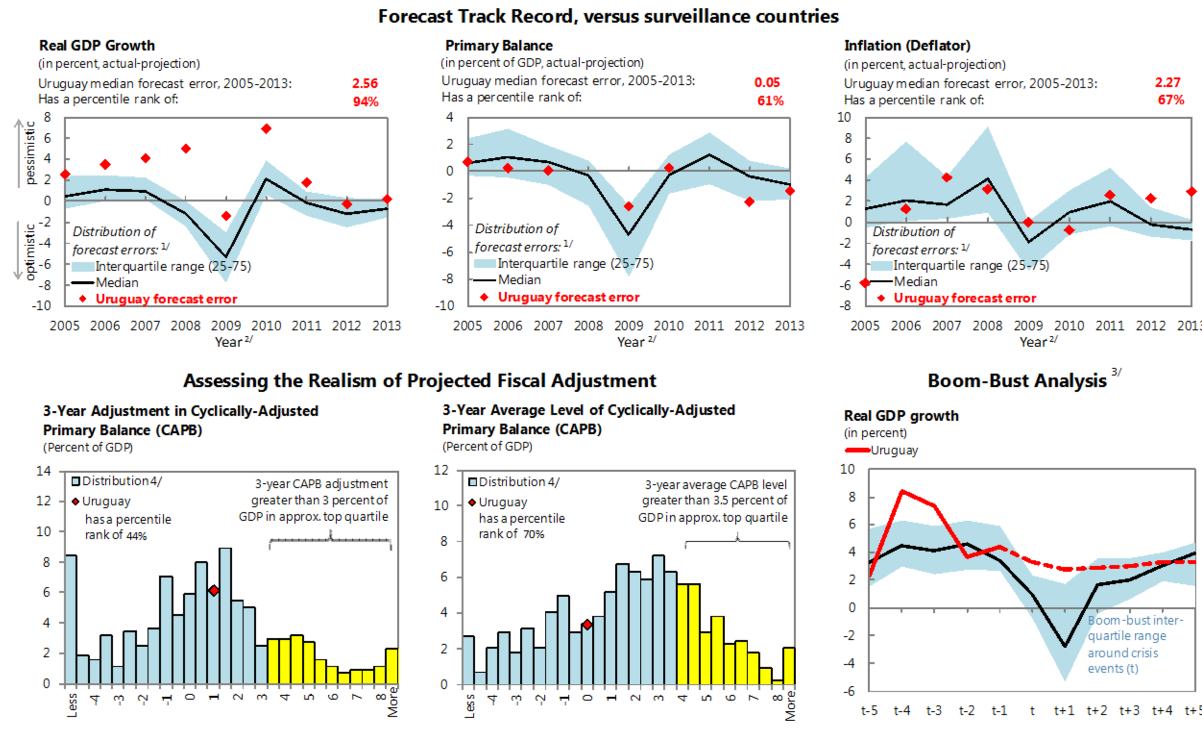
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant,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

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 11-Oct-14 through 09-Jan-15.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure A3.2. Uruguay Public DSA—Realism of Baseline Assumptions



Source: Fund staff estimates and calculations.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Uruguay has had a positive output gap for 3 consecutive years, 2011-2013. For Uruguay, t corresponds to 2014; for the distribution, t corresponds to the first year of the crisis.

4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure A3.3. Uruguay Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(in percent of GDP unless otherwise indicated)

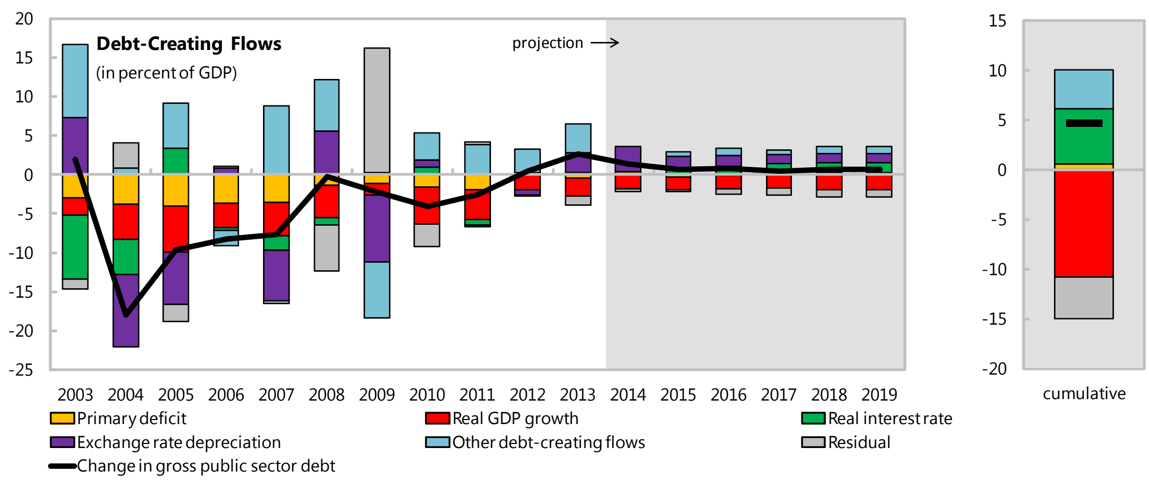
Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2003-2011 [2]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	76.3	59.5	62.1	63.6	64.3	65.1	65.5	66.2	66.9
Public gross financing needs	12.9	12.0	13.4	15.3	17.1	16.8	18.8	18.1	20.9
Net public debt	47.0	37.2	36.5	37.6	38.6	39.7	40.9	41.9	43.0
Real GDP growth (in percent)	5.5	3.7	4.4	3.3	2.8	2.9	3.0	3.3	3.3
Inflation (GDP deflator, in percent)	7.8	7.4	7.6	8.7	7.8	7.4	7.0	6.7	6.4
Nominal GDP growth (in percent)	13.7	11.3	12.3	12.3	10.8	10.5	10.2	10.2	9.9
Effective interest rate (in percent) [4]	5.4	4.9	5.3	5.5	5.9	6.3	6.2	6.0	5.9

As of January 09, 2015		
Sovereign Spreads		
EMBIG (bp) 3/		232
5Y CDS (bp)		192
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB-	BBB-
Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [8]
Change in gross public sector debt	-5.6	0.5	2.7	1.4	0.7	0.8	0.4	0.7	0.6	4.7	
Identified debt-creating flows	-6.4	0.6	3.8	1.7	1.0	1.6	1.3	1.7	1.6	8.9	
Primary deficit	-2.7	0.2	-0.4	0.4	-0.3	-0.1	0.2	0.3	0.3	0.6	1.3
Primary (noninterest) revenue and grants	28.3	28.4	30.4	30.3	30.2	30.1	29.9	29.7	29.7	180.0	
Primary (noninterest) expenditure	25.6	28.6	30.0	30.7	29.9	30.0	30.0	30.0	30.0	180.6	
Automatic debt dynamics [5]	-7.0	-2.6	0.5	1.4	0.7	0.8	0.6	0.4	0.5	4.4	
Interest rate/growth differential [6]	-5.2	-1.9	-2.0	-1.8	-0.9	-0.6	-0.6	-0.7	-0.7	-5.4	
Of which: real interest rate	-1.3	0.0	0.3	0.0	0.7	1.1	1.2	1.2	1.3	5.5	
Of which: real GDP growth	-3.8	-1.9	-2.3	-1.8	-1.6	-1.7	-1.8	-2.0	-2.0	-10.8	
Exchange rate depreciation [7]	-1.9	-0.7	2.5	3.2	1.7	1.4	1.2	1.2	1.1	9.7	
Other identified debt-creating flows	3.3	3.1	3.8	0.0	0.6	0.9	0.5	1.0	0.9	3.9	
Privatization Receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows (asset purchases)	3.3	3.1	3.8	0.0	0.6	0.9	0.5	1.0	0.9	3.9	
Residual	0.8	-0.2	-1.2	-0.3	-0.3	-0.7	-0.9	-1.0	-1.0	-4.2	



Source: Fund staff estimates and calculations.

1/ Public sector is defined as consolidated public sector.

2/ Based on available data.

3/ EMBIG.

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

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

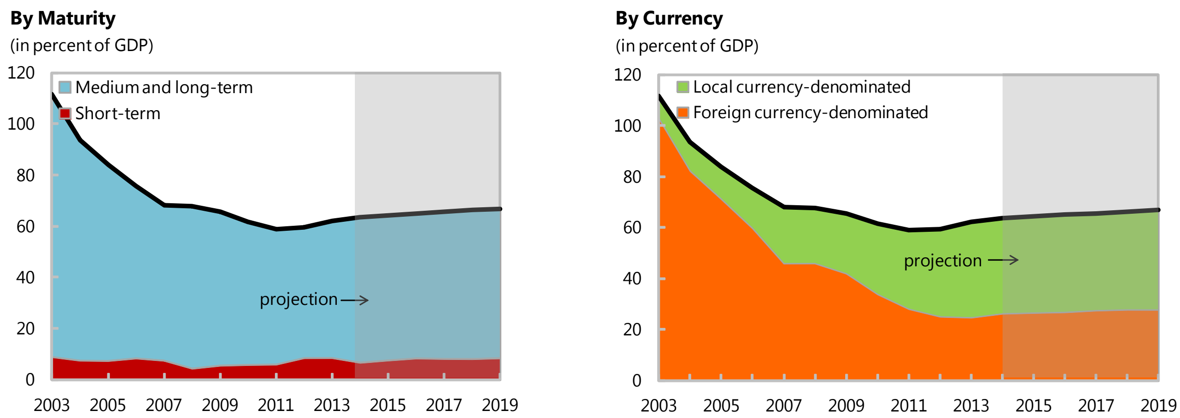
6/ The real interest rate contribution is derived as r - π (1+g)+π[Debt in indexed units] to take into account a high share of debt indexed to inflation in total debt. The real growth contribution is derived as -g.

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

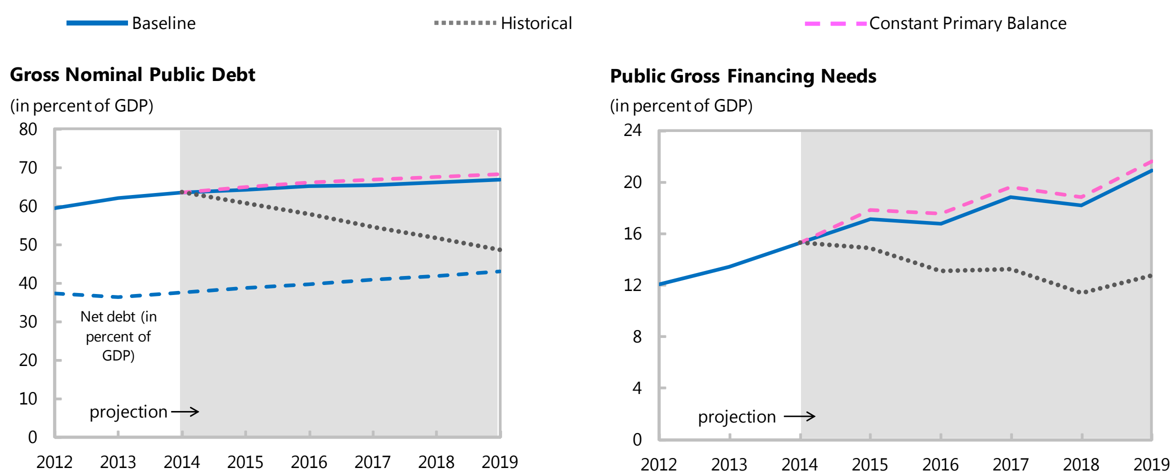
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure A3.4. Uruguay Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions

(in percent)

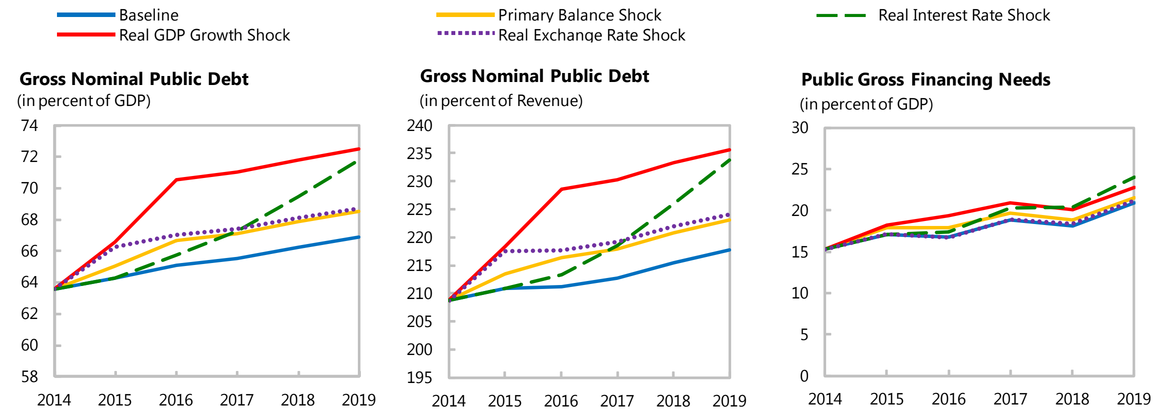
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	2.8	2.9	3.0	3.3	3.3
Inflation	8.7	7.8	7.4	7.0	6.7	6.4
Primary Balance	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Effective interest rate	5.5	5.9	6.3	6.2	6.0	5.9
Constant Primary Balance Scenario						
Real GDP growth	3.3	2.8	2.9	3.0	3.3	3.3
Inflation	8.7	7.8	7.4	7.0	6.7	6.4
Primary Balance	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Effective interest rate	5.5	5.9	6.2	6.2	6.0	5.9

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	5.5	5.5	5.5	5.5	5.5
Inflation	8.7	7.8	7.4	7.0	6.7	6.4
Primary Balance	-0.4	2.1	2.1	2.1	2.1	2.1
Effective interest rate	5.5	5.9	6.2	6.2	6.0	5.9

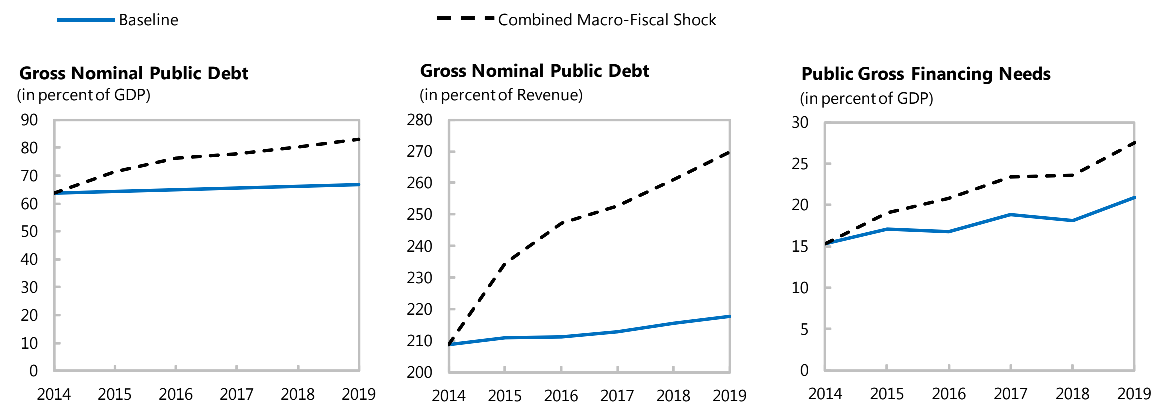
Source: Fund staff estimates and calculations.

Figure A3.5. Uruguay Public Gross DSA—Stress Tests 1/

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	2.8	2.9	3.0	3.3	3.3
Inflation	8.7	7.8	7.4	7.0	6.7	6.4
Primary balance	-0.4	-0.5	-0.7	-0.2	-0.3	-0.3
Effective interest rate	5.5	5.9	6.3	6.3	6.0	5.9
Real Interest Rate Shock						
Real GDP growth	3.3	2.8	2.9	3.0	3.3	3.3
Inflation	8.7	7.8	7.4	7.0	6.7	6.4
Primary balance	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Effective interest rate	5.5	5.9	7.4	8.1	8.3	8.6
Combined Shock						
Real GDP growth	3.3	0.8	0.9	3.0	3.3	3.3
Inflation	8.7	7.3	6.9	7.0	6.7	6.4
Primary balance	-0.4	-0.5	-1.4	-0.2	-0.3	-0.3
Effective interest rate	5.5	6.3	7.3	8.0	8.3	8.5
Nominal exchange rate deviation from baseline	0.0	17.7	17.7	17.7	17.7	17.7

Real GDP Growth Shock	2014	2015	2016	2017	2018	2019
Real GDP growth	3.3	0.8	0.9	3.0	3.3	3.3
Inflation	8.7	7.3	6.9	7.0	6.7	6.4
Primary balance	-0.4	-0.4	-1.4	-0.2	-0.3	-0.3
Effective interest rate	5.5	5.9	6.3	6.3	6.1	5.9
Real Exchange Rate Shock						
Real GDP growth	3.3	2.8	2.9	3.0	3.3	3.3
Inflation	8.7	12.2	7.4	7.0	6.7	6.4
Primary balance	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Effective interest rate	5.5	6.3	6.2	6.2	6.0	5.9
Nominal exchange rate deviation from baseline	0.0	17.7	17.7	17.7	17.7	17.7

Source: Fund staff estimates and calculations.
1/ For a description of scenarios see http://www.imf.org/external/pubs/ft/dsa/mac.htm.

Annex IV. Uruguay: External Debt Sustainability Analysis (DSA)

Table A4.1. Uruguay: External Debt Sustainability Framework, 2009-2019
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	**Debt-stabilizing non-interest current account 7/**
1 **Baseline: External debt 1/**	51.3	47.5	40.0	40.3	42.9			**44.5**	**44.4**	**44.2**	**44.5**	**44.4**	**43.8**	**-5.5**
2 Change in external debt	-7.7	-3.8	-7.5	0.3	2.6			1.6	-0.1	-0.2	0.4	-0.1	-0.7	
3 Identified external debt-creating flows (4+8+9)	-3.2	-15.1	-10.9	-1.9	-4.4			-2.3	-2.6	-2.0	-1.9	-1.9	-1.7	
4 Current account deficit, excluding interest payments	0.6	1.9	3.0	5.1	5.0			3.6	2.4	3.4	3.7	2.9	2.8	
5 Deficit in balance of goods and services	-1.5	-1.6	-0.2	2.5	2.3			1.6	0.5	0.7	0.5	0.4	0.2	
6 Exports	24.9	27.6	28.1	25.6	25.5			27.0	26.1	26.1	26.2	26.5	26.7	
7 Imports	23.4	26.0	27.9	28.1	27.8			28.5	26.6	26.7	26.8	26.8	26.9	
8 Net non-debt creating capital inflows (negative)	-4.3	-5.9	-5.5	-4.8	-5.7			-5.8	-5.3	-4.9	-4.7	-4.4	-4.0	
9 Automatic debt dynamics 2/	0.5	-11.1	-8.4	-2.2	-3.7			0.0	0.3	-0.4	-1.0	-0.4	-0.5	
10 Contribution from nominal interest rate	0.7	0.0	0.0	0.0	0.4			1.4	1.5	0.7	0.3	1.0	0.9	
11 Contribution from real GDP growth	-1.4	-3.4	-2.9	-1.4	-1.6			-1.4	-1.2	-1.1	-1.2	-1.4	-1.4	
12 Contribution from price and exchange rate changes 3/	1.2	-7.7	-5.5	-0.8	-2.5			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 4/	-4.5	11.3	3.4	2.2	7.0			3.8	2.5	1.7	2.3	1.8	1.1	
External debt-to-exports ratio (in percent)	206.3	171.9	142.6	157.6	168.5			165.1	170.3	169.5	169.7	168.0	164.0	
Gross external financing need (in billions of US dollars) 5/	4.7	6.1	7.5	8.1	8.9			9.2	9.0	8.5	9.7	9.8	10.1	
in percent of GDP	13.3	15.6	16.4	15.4	16.7			17.4	16.5	14.9	16.1	15.5	15.0	
Scenario with key variables at their historical averages 6/						10-Year Historical Average	10-Year Standard Deviation	**44.5**	**37.7**	**31.2**	**26.0**	**20.8**	**15.7**	**-7.6**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	2.4	8.4	7.3	3.7	4.4	5.5	2.0	3.3	2.8	2.7	2.9	3.2	3.3	
GDP deflator in US dollars (change in percent)	-2.0	17.7	13.2	2.1	6.7	10.6	7.4	-4.2	1.1	1.9	2.4	2.2	2.1	
Nominal external interest rate (in percent)	1.2	0.0	0.0	0.0	1.2	0.9	0.7	3.3	3.5	1.6	0.6	2.3	2.1	
Growth of exports (US dollar terms, in percent)	-7.0	23.0	20.0	4.1	1.2	16.9	14.5	4.6	0.5	4.6	6.0	6.3	6.4	
Growth of imports (US dollar terms, in percent)	-20.7	23.2	26.7	14.9	0.7	20.0	19.9	1.5	-3.3	5.3	5.5	5.7	5.8	
Current account balance, excluding interest payments	-0.6	-1.9	-3.0	-5.1	-5.0	-2.0	2.6	-3.6	-2.4	-3.4	-3.7	-2.9	-2.8	
Net non-debt creating capital inflows	4.3	5.9	5.5	4.8	5.7	5.4	1.6	5.8	5.3	4.9	4.7	4.4	4.0	

1/ External debt includes non-resident deposits.

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

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

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

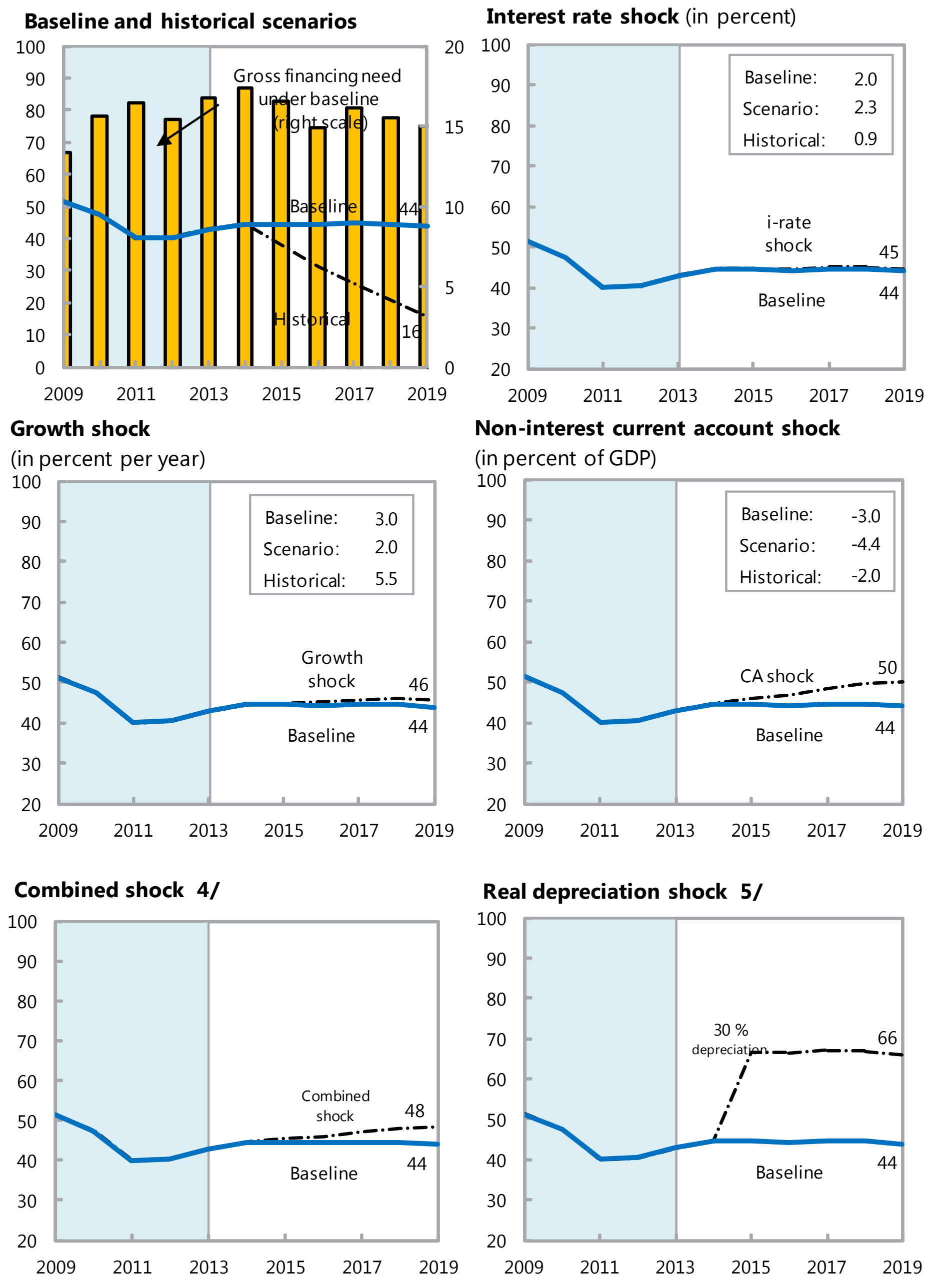
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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

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

Figure A4.1. Uruguay: External Debt Sustainability: Bound Tests 1/ 2/ 3/

(External debt in percent of GDP)



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

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

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

3/ External debt includes non-resident deposits.

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

5/ One-time real depreciation of 30 percent occurs in 2010.

INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 30, 2015

Prepared By

The Western Hemisphere Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2014)

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

II. General Resources Account:	SDR Million	% Quota
Quota	306.50	100.00
Fund holdings of currency	192.19	62.70
Reserve Tranche Position	114.32	37.30

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	293.26	100.00
Holdings	245.73	83.79

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

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

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

	Forthcoming				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.03	0.03	0.03	0.03	0.03
Total	0.03	0.03	0.03	0.03	0.03

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

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

Exchange Rate Arrangement. The currency is the Uruguayan peso (UY$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. Since June 2013, monetary policy targets the growth rate of M1 plus saving deposits as the intermediate instrument. On December 30, 2014, the exchange rate in the official market was UY$ 24.333 per U.S. dollar. Uruguay has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions on payments and transfers for current international transactions.

FSAP participation and ROSCs. A Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). An FSAP Update was conducted in 2012 and the FSSA was published on May 31, 2013 (Country Report No. 13/152). A ROSC module on fiscal transparency was published on March 5, 2001. A ROSC module on data dissemination practices was published on October 18, 2001. A ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 12, 2006 (Country Report No. 06/435). A data module ROSC was published on February 11, 2014 (Country Report No. 14/42).

Technical Assistance 2008–14.

Department	**Purpose**	**Date of Delivery**
FAD	Treasury Management	August 2014
	Tax, Customs, and Social Security Administration	August 2014, March 2014, November 2012, November 2011, and September 2010
	Performance Informed Budgeting	March 2011
	Private Public Partnership	May 2010
LEG	Assist the authorities on strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2014
	Follow up of the implementation of the AML/CFT National Strategy	October 2013
	Assist the authorities on the launch of the recently designed AML/CFT National Strategy	June 2012
	Assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	Conduct a money laundering/terrorist financing country risk assessment consistent with the objectives of the AML/CFT National Strategy	January, April, and July 2009
MCM	Bank Resolution	June 2014
	FSAP Update	September 2012
STA	Data ROSC reassessment	August 2012
	Government Finance Statistics, to assist in improving the quality of public debt data	February 2008

RELATIONS WITH THE WORLD BANK UNDER JMAP

(As of October 13, 2014)

Title	Products	Provisional timing of missions	Expected delivery date*
World Bank Work Program	**A. Lending** 1. Uruguay Climate Events' Impact Mitigating Investment Project Financing	October 2014	December 2014
	B. ESW 1. Uruguay Low Carbon Study		November 2014
	2. Water for Uruguay		April 2015
	3. Poverty and Gender Analysis		April 2015
	4. Climate-smart Agriculture and Integrated Water Resources Management and Development Includes (4 pillars TA)		April 2015
	5. Systematic Country Diagnostic		April/May 2015
	6. Demographic Change and Social Policies in Uruguay		May 2015
	7. Uruguay Policy Notes		June 2015
	8. Pro-growth public policies, competitiveness and business investment climate		June 2015
	9. Country Partnership Framework		July/August 2015

Title	Products	Provisional timing of missions	Expected delivery date*
	C. Technical Assistance 1. Program market regulation		March 2015
	2. Competition regulatory framework		March 2015
	3. Uruguay Improvement of Pollution Control		April 2015
	4. Dam Safety regulatory framework development		April 2015
	5. Climate Smart Water Agriculture Management		April 2015
	6. Capacity Building for Uruguay's Oil and Gas Sectors		June 2015
	7. Uruguay Integrated Urban Water Management in Uruguayan Cities		December 2015

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of September 30, 2014)

The Inter-American Development Bank's (IDB) Board of Executive Directors approved in August 2011 a Country Strategy with Uruguay (2010–15). Sovereign-guaranteed lending under the program is expected to reach approximately US$1.8 billion. The program includes additional non reimbursable financing for technical assistance and analytical work.

Under the Strategy, the national authorities and the IDB identified the following priority sectors in which the IDB Group would focus both its financial and nonfinancial products and services: (i) transport; (ii) energy; (iii) water, sanitation, and solid waste; (iv) science and technology; (v) social protection; (vi) education and job training; (vii) agribusiness; (viii) services exports; (ix) public management and finances; and (x) urban development and citizen security. It is also expected that all four of the Bank's private sector windows will approve loans and technical assistance in the energy, transport, agribusiness and global services sectors. The strategic areas were selected taking into account: (i) a context of strong economic growth, which imposes heavy investment requirements on a number of sectors; (ii) business opportunities, which in turn contribute to the Bank's institutional goals within the framework of the 9th General Capital Increase; (iii) greater complementarity between the multilateral financial institutions working in Uruguay; (iv) the Bank's accumulated operational experience and technical knowledge from having worked for several decades in the country; and (v) the government's interest for continued IDB engagement.

As of September 30th 2014, the IDB's portfolio in Uruguay includes loans for the financing of 45 projects; five of which are without sovereign guarantee. The 5 loans earmarked towards the private sector account for US$494 million (22 percent of the approved amounts). The lending portfolio amounts to US$2,249 million, of which US$1,379.8 million are pending disbursement. One operation amounting to US$550 million is a contingent line of credit that would only be disbursed in case the government needs it. Disbursements in 2014 for sovereign loans are expected to total US$176 million. US$58.8 million has already been disbursed this year for private loans. The current portfolio includes lending to support the Government in the following sectors: promotion of exports and investments (32.5 percent of the approved amounts); water and sanitation (19.2 percent of the approved amounts); urban development and citizenship security (12.2 percent of the approved amounts); energy (11.4 percent of the approved amounts); institutional capacity and finance (8.3 percent of the approved amounts); transport (5.7 percent of the approved amounts); and other sectors such as labor training, science and technology, agro-industry and social protection (10.7 percent of the approved amounts).

In 2014, the Bank approved loans to the public sector for approximately US$392.5 million in the areas of integration, financial and budget public management, education, water and sanitation, productive infrastructure (mainly in the renewable energy sector), and innovation and productive development.

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

(In millions of U.S. dollars)

Total outstanding loans: US$1,755.2 (As of September 30, 2014)

	Loan transactions									
	2005	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014[2]**
Disbursement	242.3	114.8	112.9	337.2	477.3	54.3	138.2	121.6	195.9	174.9
Amortization	222.3	520.8	142.1	138.7	162.0	465.1	115.4	120.7	591.7	97.8
Net Loan Flows	20.0	-406.0	-29.2	198.5	315.3	-410.8	22.8	0.9	-395.8	77.1

Source: Inter-American Development Bank.

[1] Only loans with sovereign guarantee are considered.

[2] Preliminary.

STATISTICAL ISSUES

(As of January 27, 2014)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but broadly adequate for surveillance. Most affected area is national accounts.
National Accounts: In 2009, the Uruguayan authorities completed a revision of national accounts statistics, in which they updated the benchmark year (from 1983 to 1997 and 2005) and adopted the *System of National Accounts (SNA) 1993*. However, national accounts statistics still have some shortcomings: limited coverage of the enterprise survey, partial update of business register, poor quality source data for some components of GDP, inadequate information on the informal economy, and incomplete quarterly accounts. About 60 percent of the GDP calculation is based on fixed input-output ratios from 1997. Household consumption is not independently derived and changes in inventories are obtained as residuals. Household income and expenditure survey are conducted every ten years. The central bank (BCU) compiles and disseminates annual but not quarterly GDP by the expenditure approach at current prices, and does not compile annual integrated economic accounts by institutional sector, in particular, the income account. Gross national income, gross disposable income and gross savings are also available annually. Detailed national accounts data are only available up to 2008. Long-time series are not available on the BCU website. There is no regular schedule for updating the base year of the national accounts. The causes of the current revisions to the quarterly national accounts are not explained to users. A monthly index of economic activity is not disseminated. For the national accounts there is a need to plan for the adoption of the 2008 SNA and updating of the base year.
Prices: Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *IFS*. The new base period for the consumer price index is December 2010 = 100. The CPI has national coverage and includes more than forty thousand price quotations. It does not cover either the implicit rent or the net acquisitions of owner-occupied dwellings. For the CPI, reselection of the sample of detailed products has not been done for an extended period. The base of the wholesale price index has been updated to 2001. Producer price indices (March 2010 = 100) for national products have been recently disseminated. The PPI does not cover utilities, construction, business and other services and exported output. The authorities do not provide trade price and volume indices for publication in the *International Financial Statistics (IFS)*. For both the CPI and PPI, statistical outputs/intermediate results are not validated with available information from alternative sources. The CPI and PPI would benefit from a more regular and frequent schedule of weight updates.
Government Finance Statistics: Official data on the central administration, the state enterprises and the social security system are complete and current, but there are problems with the timeliness of the data on local governments. There are also problems with the timeliness of financing and debt data reported for inclusion in the Fund's statistical publications. Information on a monthly and quarterly basis for financing and debt data respectively, are disseminated on

the BCU website from 1999 onwards for the central government and total public sector, but no information is reported for publication in the *International Financial Statistics*. The information reported for publication in the *Government Finance Statistics Yearbook* covers transactions on revenue and expense for the consolidated central government (data on revenue and expense for local governments have not been reported since 1994), and the general government's operations on financial assets and liabilities, both in terms of flows (financing) and stocks (debt).

Monetary and Financial Statistics: Monetary and financial statistics are prepared in accordance with the IMF's *Monetary and Financial Statistics Manual (2000).* Authorities report monetary data for the central bank, other depository corporations, and other financial corporation's (OFCs) using the standardized reporting forms (SRFs). However, data for the OFCs are limited to off-shore financial institutions. A mission could be fielded to expand the institutional coverage of the OFCs and compile the SRF for OFCs with full institutional coverage.

Financial Sector Surveillance: Authorities participate in the IMF's Coordinated Direct Investment Survey (CDIS), Coordinated Portfolio Investment Survey (CPIS) and financial soundness indicators (FSIs) databases. FSIs on non-financial corporations, households, market liquidity and real estate markets are not available. BCU disseminates FSIs for individual banks on a monthly basis and staff estimates FSIs for the banking system by weighting individual bank FSIs by their asset share.

External Sector Statistics: Balance of payments statements are compiled and published on a quarterly basis. Data are compiled following the recommendations of the fifth edition of the *Balance of Payments Manual*. Uruguay compiles and reports to STA quarterly data on balance of payments and annual data on the international investment position (IIP) for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*. New surveys are allowing for improved coverage of the private sector in the IIP.

Uruguay started disseminating the international reserves and foreign currency liquidity data template on the Fund's external website in 2005. The BCU also disseminates quarterly external debt statistics in the format prescribed by the SDDS on the National Summary Data Page (NSDP).

II. Data Standards and Quality

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

III. Reporting to STA

Annual GFS are regularly reported to STA for publication in the *Government Finance Statistics Yearbook.* No high frequency GFS are reported for publication in the *International Financial Statistics*.

URUGUAY: COMMON INDICATORS REQUIRED FOR SURVEILLANCE
(As of November 25, 2014)

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/	Memo items:	
						Data Quality – Methodological Soundness 8/	Data Quality – Accuracy and Reliability 9/
Exchange Rates	11/24/14	11/24/14	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	11/20/14	11/20/14	M	M	M		
Reserve/Base Money	10/14	11/1/14	M	M	M		
Broad Money	10/14	11/1/14	M	M	M		
Central Bank Balance Sheet	9/14	10/1/14	M	M	M		
Consolidated Balance Sheet of the Banking System	9/14	10/1/14	M	M	M		
Interest Rates 2/	11/24/14	11/24/14	D	D	D		
Consumer Price Index	10/14	11/1/14	M	M	M	O, LO, O, O	LO, O, O, LNO, NO
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government 4/	9/14	10/1/14	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 4/ 5/	Q2/14	10/1/14	Q	Q	Q		
External Current Account Balance	Q2/14	10/1/14	Q	Q	Q		

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/	Memo items:	
						Data Quality – Methodological Soundness 8/	Data Quality – Accuracy and Reliability 9/
Exports and Imports of Goods and Services	Q2/14	10/1/14	Q	Q	Q		
GDP/GNP	Q2/14	10/1/14	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LO, O, LO
Gross External Debt	Q2/14	10/1/14	Q	Q	Q		
International Investment Position 6/	2012A1	2014Q1	A	A	A		

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

INTERNATIONAL MONETARY FUND
COMMUNICATIONS DEPARTMENT

Press Release No. 15/77
FOR IMMEDIATE RELEASE
February 26, 2015

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

IMF Executive Board Concludes 2014 Article IV Consultation with Uruguay

On February 20, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Uruguay, and considered and endorsed the staff appraisal without a meeting.[2]

Recent Developments and Outlook

The Uruguayan economy continues to decelerate gradually. Real GDP growth is estimated to have softened to a still robust 3¼ percent in 2014 from 4½ percent in 2013, mostly reflecting the moderation in domestic demand growth amid a less favorable external environment. Weak economic conditions abroad have continued to weigh on Uruguay's current account, particularly on the services side. At the same time, the surge in inflows to the local securities market abated and the Uruguayan peso has depreciated towards levels broadly consistent with fundamentals.

Inflation remains above the central bank's 3–7 percent target range. After being pushed to near 10 percent in early 2014 by food price shocks and the pass-through of peso depreciation, consumer price inflation receded to 8¼ percent at the end of the year, in part due to subdued increases in administrative prices and one-off measures to ease inflation. Above target inflation reflects a shrinking but still positive output gap, upward shocks to food and fuel prices in 2010–13, and pervasive backward-looking wage indexation that embedded these shocks.

Monetary policy has been tight while fiscal policy has been slightly expansionary in 2014. The peso yield curve remained 400–600 basis points above inflation and credit growth has slowed markedly. Public sector spending continued to grow faster than real GDP in 2014, but the budget approved for 2015 will generate a fiscal withdrawal of about ¾ percentage point of GDP, mostly by slowing spending.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

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

Bank resilience indicators are generally strong, but less so than a few years ago. In particular, foreign currency credit to borrowers in the nontradables sector has increased as a share of total credit, banks' capital buffers have declined somewhat, and the share of nonperforming loans has inched up in 2014, albeit from a low level. Deposit dollarization remains elevated.

Economic activity is projected to decelerate further but remain solid. The pass-through of lower global oil prices to end-user prices will be gradual, as part of the windfall from lower oil prices will initially be used to shore up the operating balance of the state-owned petroleum enterprise. The programmed fiscal tightening and continued weak external conditions will outweigh the positive impact of reduced gasoline prices on domestic demand, with growth shifting down to about 2¾ percent in 2015. Inflation is projected to decline gradually to within the target range over the medium term as monetary policy remains tight, the output gap closes, and retail prices for gasoline decline. Net public debt is projected to crawl up to 43 percent of GDP in 2019 from 36½ percent in 2013, with the primary balance remaining below the level required to keep debt constant.

Key risks to the outlook relate to uncertainties regarding global and regional economic growth and U.S. monetary policy normalization. The strong liquidity buffers of the private and public sectors would facilitate an orderly adjustment to external shocks. Nevertheless, the high shares of nonresident-holdings of public debt and foreign currency denominated bank credit to borrowers in the nontradables sector could present vulnerabilities.

Executive Board Assessment

The Uruguayan economy is decelerating gradually after a decade of strong and inclusive growth. Export receipts are growing at a markedly lower clip than a few years ago and domestic demand growth is slowing towards a more sustainable pace. At the same time, inflation remains above the target range and the primary fiscal balance has weakened further in 2014.

The external environment presents risks as well as opportunities. As a small open economy that exports mostly agricultural products and has nonresidents holding a relatively high share of its public debt, Uruguay is exposed to the risk of lower global growth and tighter global financial conditions. At the same time, the recent drop in global crude oil prices will provide a welcome opportunity to improve the overall fiscal and balance of payments positions and reduce inflation.

Uruguay's strong liquidity buffers would allow an orderly adjustment in the event of adverse external shocks. Public debt maturity is high, reserves comfortably exceed prudential benchmarks, and banks and the public sector have ample U.S. dollar liquidity. However, above-target inflation would leave little room for a countercyclical monetary policy response, and a primary balance that is insufficient to keep net public debt around its current level would limit the policy space to deploy discretionary stimulus.

A multi-dimensional disinflation strategy is needed to bring inflation to the mid-point of the target range. Such a strategy would involve maintaining a monetary policy stance tight enough to keep inflation on a downward trend, moving towards tighter fiscal policy, a reduction in the backward-looking component of wage setting to temper inflation persistence, and bolstering the central bank's influence on inflation expectations through well-crafted communication efforts. Enhanced central bank autonomy would also be beneficial.

The upcoming five-year budget is an opportunity to reinforce fiscal sustainability. Improving the primary fiscal balance by about 2 percent of GDP over the medium term would help ensure that net public debt is put on a firmly declining path. The improvement in the fiscal balance could be achieved by keeping spending growth moderately below potential GDP growth over the next five years and modestly increasing revenues.

Financial regulation and supervision are solid, but could benefit from fine-tuning in some areas. The exposures to exchange rate depreciation risks bear continued close monitoring. There is scope to strengthen risk weights for foreign currency loans to unhedged borrowers, incorporate greater exchange rate stress into the supervisory stress tests, and require banks facing capital shortfalls in the stress tests to submit contingent capital plans for the approval of the Superintendency of Financial Services. In addition, measures to assist financial deepening could enhance growth and social inclusion.

A key challenge is to bolster strong growth in the medium run in order to continue deepening Uruguay's social gains. The commitment of the incoming government to boost infrastructure investments, revamp secondary education and skill formation for the youth, and foster an innovation-friendly business environment is welcome.

Table 4. Uruguay: Selected Economic Indicators

	2010	2011	2012	2013	Projection 2014	2015	2016	2017	2018	2019
Output, prices, and employment										
Real GDP (percent change)	8.4	7.3	3.7	4.4	3.3	2.8	2.7	2.9	3.2	3.3
GDP (US$ billions)	38.9	47.2	50.0	55.7	55.1	57.3	59.9	63.1	66.6	70.2
Unemployment (in percent, eop)	7.0	6.3	6.3	6.5	6.5	6.8	7.0	7.0	7.2	7.2
CPI inflation (in percent, average)	6.7	8.1	8.1	8.6	8.9	7.9	7.5	7.1	6.7	6.5
Exchange rate (UY$/US$, average)	20.1	19.3	20.3	20.5	23.2	...	...	...	...	...
Real effective exchange rate (percent change, eop)	3.5	6.8	10.1	-1.6	-4.4	...	...	...	...	...
					(Percent change, unless otherwise specified)					
Monetary and banking indicators 1/										
Base money	16.2	17.3	26.7	12.9	2.7	...	...	...	...	...
Broader M1 (M1 plus savings deposits)	30.0	20.8	11.2	15.0	7.2	...	...	...	...	...
M2	30.3	22.0	12.3	11.6	5.4	...	...	...	...	...
Growth of credit to households (in real UY$)	15.8	2.1	7.3	9.9	6.4	...	...	...	...	...
Growth of credit to firms (in US$)	18.8	26.5	17.5	16.2	8.4	...	...	...	...	...
Bank assets (in percent of GDP)	58.2	60.2	58.5	62.8	66.6	...	...	...	...	...
Private credit (in percent of GDP) 2/	23.1	23.4	24.0	26.9	26.8	...	...	...	...	...
Foreign bank market share (in percent of total loans)	54.1	56.0	56.6	59.3	62.3	...	...	...	...	...
					(Percent of GDP, unless otherwise specified)					
Public sector indicators										
Revenue 3/	29.8	28.5	28.4	30.4	30.3	30.2	30.1	29.9	29.8	29.8
Non-interest expenditure 3/	28.5	26.8	28.7	30.1	30.7	29.9	30.0	30.1	30.1	30.1
Wage bill	5.0	4.9	5.1	5.1	5.2	5.0	5.1	5.2	5.2	5.2
Primary balance 4/	1.6	2.0	-0.2	0.4	-0.4	0.3	0.1	-0.2	-0.3	-0.3
Interest 4/	3.1	2.9	2.6	2.8	2.9	3.1	2.9	2.7	2.6	2.6
Overall balance 4/	-1.5	-0.9	-2.8	-2.4	-3.3	-2.8	-2.8	-2.9	-2.9	-2.9
Gross public sector debt	61.6	59.0	59.5	62.1	63.6	64.3	65.1	65.5	66.2	66.9
Public sector debt net of liquid financial assets 5/	40.2	37.0	37.2	36.5	37.6	38.7	39.8	40.9	42.0	43.0
External indicators										
Merchandise exports, fob (US$ millions)	8,031	9,274	9,916	10,291	10,934	10,985	11,393	11,990	12,656	13,377
Merchandise imports, fob (US$ millions)	8,558	10,704	12,277	11,593	11,743	11,245	11,926	12,611	13,390	14,223
Terms of trade (percent change)	-3.4	-0.2	6.6	0.0	2.6	4.2	-2.3	-0.4	-0.1	0.3
Current account balance	-1.9	-2.9	-5.4	-5.2	-4.8	-3.7	-3.9	-3.8	-3.6	-3.5
Foreign direct investment	5.9	5.3	5.1	5.4	5.5	5.0	4.7	4.5	4.1	3.8
Overall balance of payments (US$ millions)	-361	2,564	3,287	2,945	1,667	666	446	679	972	961
Total external debt + non-resident deposits	47.5	40.0	40.3	42.9	44.5	44.4	44.2	44.5	44.4	43.8
Of which: External public debt	34.0	31.5	31.8	33.9	35.5	35.4	35.1	35.5	35.3	34.8
External debt service (in percent of exports of g&s)	29.9	21.6	15.8	22.0	22.1	23.8	24.0	24.4	24.3	24.2
Gross official reserves (US$ millions)	7,655	10,302	13,604	16,279	17,946	18,612	19,058	19,736	20,708	21,669
In months of imports of goods and services	9.1	9.7	11.1	13.2	14.3	15.4	15.0	14.7	14.6	14.4
In percent of:										
Short-term external (STE) debt	139.0	212.6	214.9	264.1	263.3	315.6	305.2	262.8	270.0	277.9
STE debt plus banks' non-resident deposits	80.9	126.2	140.0	153.9	160.6	178.5	173.4	157.7	159.9	162.1

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

1/ Percent change of end-of-year data on one year ago. For 2014, latest available data.
2/ Includes bank and non-bank credit.
3/ Non-financial public sector excluding local governments.
4/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del Estado.
5/ Gross debt of the public sector minus liquid financial assets of the public sector. Liquid financial assets are given by deducting from total public sector assets the part of central bank reserves held as a counterpart to required reserves on foreign currency deposits and the domestic currency claims of the non-financial public sector on resident financial institutions.