INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/62

URUGUAY

February 2016

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR URUGUAY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2015 Article IV consultation with Uruguay, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 8, 2016 consideration of the staff report that concluded the Article IV consultation with Uruguay.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 8, 2016, following discussions that ended on December 11, 2015 , 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 19, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Uruguay.

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

Selected Issues

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February 16, 2016

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IMF Executive Board Concludes 2015 Article IV Consultation with Uruguay

On February 8, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Uruguay.

Recent Developments and Outlook

Uruguay has achieved more than a decade of high and inclusive economic growth, supported by social stability and reduced regional linkages. International financial markets have recognized Uruguay's stability and strong financial buffers. Yet, economic activity in Uruguay markedly slowed in 2015, triggered by a regional downturn and weakening prices of its export commodities. Real GDP growth is estimated to have fallen to 1.5 percent in 2015, as investment and consumption growth have declined from recent highs. Meanwhile, inflation remains entrenched above the central bank's 3–7 percent target range. Defying the closing output gap, a relatively tight monetary stance over the past two years, and low international food and energy prices, headline inflation has edged up to more than 9 percent since July.

Depreciation pressures intensified during 2015, broadly in line with the regional and global trend among emerging markets. Domestic deposit dollarization picked up, although more than half of the increase was driven by valuation effects rather than a portfolio shift. Gross international reserves have dropped by US$2.6 billion since June, as the central bank has extensively intervened in the foreign exchange market to contain the depreciation of the peso.

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

The medium-term budget for the new government's 5-year term foresees an improvement of the primary fiscal balance by 1.5 percent of GDP over 2015–2019. The 2015 primary balance is estimated at close to zero, in line with the budget, as lower tax revenues were offset by a sharper reduction in public investment. The overall fiscal deficit in 2015 is estimated at 3.6 percent of GDP, 0.3 higher than in the budget, because of higher interest payments.

GDP growth is projected to remain tepid in 2016 as external conditions remain weak and consumer confidence has dropped. The further slowdown in fiscal spending and consumption is likely to temper domestic demand. In the medium term, growth is expected to rise back to a potential rate of 3.1 percent.

Risks to the outlook are mostly external. Although Uruguay's regional economic linkages have lessened, a worse-than-expected slowdown in Argentina and Brazil could significantly weigh on Uruguay's economy. A global slowdown would affect Uruguay's commodity exports, and increased volatility in oil prices would impact on import costs. A tightening in global financial conditions could raise financing costs.

Near-term financial risks seem limited. There is no evidence of a credit bubble or excessive private sector leverage. The 2015 uptick in non-performing loans, from low levels, does not, at this stage, seem a cause for significant concern. Uruguay's strong liquidity buffers should facilitate an orderly adjustment to shocks.

Executive Board Assessment[2]

Executive Directors commended the Uruguayan authorities for their sound macroeconomic policies, institutions, and reforms, which have supported strong and inclusive growth over the last decade and have helped achieve one of the lowest poverty and income inequality rates in Latin America. While the economy's strong fundamentals position the country well to weather

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

the recent slowdown, Directors encouraged the authorities to continue implementing prudent macroeconomic policies and structural reforms to further strengthen the economy's resilience, lower persistently high inflation, and boost potential growth.

Directors emphasized that continued exchange rate flexibility is essential to absorb external shocks. They welcomed the authorities' intention to limit foreign exchange interventions to smooth excessive volatility, which should also help avoid premature erosion of the country's reserve buffers.

Directors stressed the importance of continued efforts to put inflation on a downward path. They supported the authorities' tight monetary policy, and noted that a prudent fiscal stance should help the monetary policy effort. They welcomed the new wage setting guidelines aimed at curbing inflation inertia, but encouraged further steps to fully remove backward indexation. Directors also called on the authorities to closely monitor the performance of the new monetary policy framework.

Directors welcomed the government's five year budget, which appropriately combines budgetary consolidation with efforts to support infrastructure development and key social objectives. The authorities' commitment to fiscal consolidation and continued improvements in the public sector's primary balance will be essential to stabilize net debt over the medium term. Directors also stressed the importance of restoring the financial soundness of the public oil distribution company expeditiously and of improving the financial performance of state owned enterprises more generally. They agreed that well designed private public partnerships, with strong control of liabilities, could help finance needed infrastructure investment and improve project management.

Directors welcomed the recent initiatives to promote financial inclusion and deepening, such as the financial inclusion law. They noted that these initiatives may require upgrades to the country's solid regulatory framework, including the full implementation of the Basel III standards. Directors observed that foreign currency credit to unhedged borrowers in the non tradable sector has moderated from its 2013 high, but underscored that close monitoring of this ratio remains warranted, particularly given the recent peso depreciation.

Directors agreed that further diversification of export markets and expansion of higher value added commodity production could help reduce the country's exposure to adverse external shocks. They welcomed the authorities' efforts to upgrade transport and logistics infrastructure, and encouraged initiatives to reform secondary education in order to boost growth potential.

Uruguay: Selected Economic Indicators

	2013	2014	2015 est.	Projections 2016	2017
Output					
Real GDP growth (%)	5.1	3.5	1.5	1.4	2.6
Employment					
Unemployment (%)	6.0	6.5	7.9	7.6	7.5
Prices					
CPI inflation (%, average)	8.6	8.9	8.7	8.2	7.7
General government finances					
Revenue 1/ (% GDP)	29.5	29.0	28.9	28.9	29.0
Non-interest expenditure 1/ (% GDP)	29.1	29.3	28.7	29.0	28.8
Primary balance 2/ (% GDP)	0.4	-0.6	0.0	-0.4	-0.1
Overall balance 2/ (% GDP)	-2.3	-3.5	-3.6	-3.4	-3.0
Gross public sector debt 3/ (% GDP)	60.2	61.3	61.9	63.1	64.0
Net public sector debt 3/, 4/ (% GDP)	35.9	34.9	36.6	38.6	39.9
Monetary and banking indicators					
Base money (% change, eop)	12.9	1.4	...	...	...
Credit to firms (in US$, % change)	16.2	6.8	...	...	...
Credit to households (in real UY$, % change)	9.9	4.7	...	...	...
Balance of payments					
Current account (% GDP)	-4.9	-4.3	-3.8	-4.0	-3.8
Exports of goods (% GDP)	17.8	18.0	17.7	17.6	17.9
Imports of goods (% GDP)	20.2	19.6	18.6	18.4	18.9
Services balance (% GDP)	0.4	0.2	0.5	0.5	1.0
Financial and capital account (% GDP)	8.2	8.6	-1.5	4.0	4.3
FDI (% GDP)	5.3	4.8	4.5	4.4	4.4
Reserves (months of imports)	13.2	14.6	14.6	15.2	14.7
External debt 5/	41.6	43.4	50.2	50.6	51.2
Exchange rate					
REER (% change)	6.7	-1.7	4.2	...	...

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

1/ Non-financial public sector excluding local governments.

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

3/ Overall public sector.

4/ Gross debt minus liquid financial assets.

5/ External debt plus non-resident deposits.

INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

January 19, 2016

KEY ISSUES

Context. Uruguay has achieved more than a decade of high and inclusive economic growth, supported by social stability and reduced regional linkages. The country has weathered the recent global and regional headwinds relatively well so far. Yet the economy is slowing down, while inflation remains above target, and deposit dollarization has risen. While the baseline projection foresees a temporary and moderate slowdown, the country is exposed to further shocks, especially from the immediate region.

Main Policy Advice

- The fiscal agenda launched by the new government in 2015 envisages a welcome combination of budgetary consolidation and emphasis on supporting infrastructure development and key social objectives. Its implementation should focus on stabilizing public debt in the medium term and ensuring sustainable growth.
- More generally, and especially at this time of heightened regional uncertainty, enhancing the credibility of the anchors for fiscal and monetary policy would complement Uruguay's policy buffers for weathering economic and financial shocks.
- In this context, bringing inflation into its target range remains a key policy priority.
- Exchange-rate flexibility should be the central tool for absorbing external shocks.
- Financial deepening can also help better insulate the economy against external shocks, support growth, and strengthen the credit channel of monetary policy.
- The public petroleum distribution company's financial soundness should be restored.

Past advice. There has been broad agreement between the authorities and Fund staff on the priorities for macroeconomic policy. Broadly in line with staff recommendations on the importance of exchange rate flexibility, the authorities have allowed the exchange rate to adjust in response to market pressures, albeit with recent interventions to smooth the adjustment. In light of the above-target inflation, monetary policy has been tightened since mid-2013 in line with staff advice. The 2014 Article IV staff report recommended a gradual increase in the primary fiscal balance by 2 percent of GDP; the recent 5-year budget incorporates a somewhat smaller adjustment.

Approved By
Charles Enoch and Vikram Haksar

Discussions took place in Montevideo during November 30–December 11, 2015. The staff team comprised Jan Kees Martijn (Head), Dyna Heng, Frederic Lambert, and Diva Singh (all WHD). The team was assisted by John McCoy. Staff met with Minister Astori, Minister Murro, Director of OBP Garcia, Central Bank President Bergara, Under Secretary Ferreri, other senior government officials, as well as representatives of public enterprises, the private sector, unions, and civil society.

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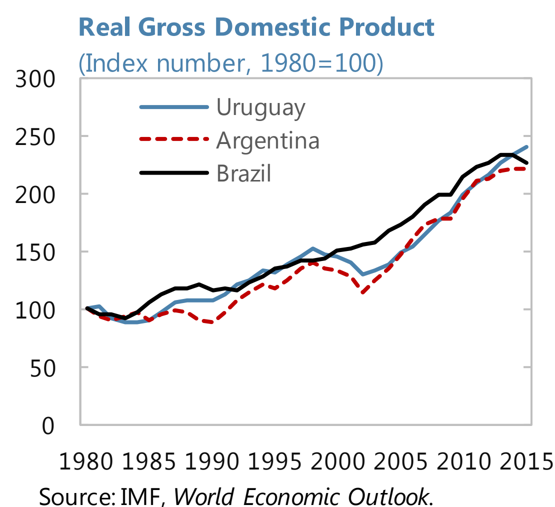
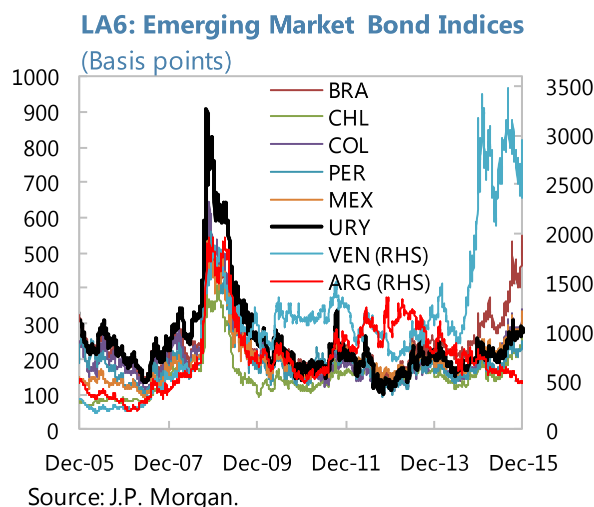
CONTEXT

1. Uruguay has experienced more than a decade of high economic growth, and has become a bastion of stability in a volatile region. Since the financial crisis of 2002, living standards have greatly improved, with a per capita GDP that is among the highest in Latin America, while inequality and poverty are among the lowest. This success owes much to broadly shared societal support for social stability and inclusion, combined with a growth model that emphasized diversification into new markets and new products, thereby reducing regional linkages, while embracing the opportunities in agriculture, forestry, and tourism offered by the country's natural resources.

2. Over the last five years, growth has been higher than in neighboring countries and international financial markets have recognized Uruguay's stability and strong financial buffers. Against a historically high correlation with growth in Argentina and Brazil, growth in Uruguay has remained relatively resilient since 2010. Uruguay has also distinguished itself through prudent debt management. Its relatively steady sovereign spreads are indicative of the ongoing differentiation by international investors between Uruguay and other countries in the region, in a context of increased volatility.



Source: IMF, *World Economic Outlook*.



Source: J.P. Morgan.

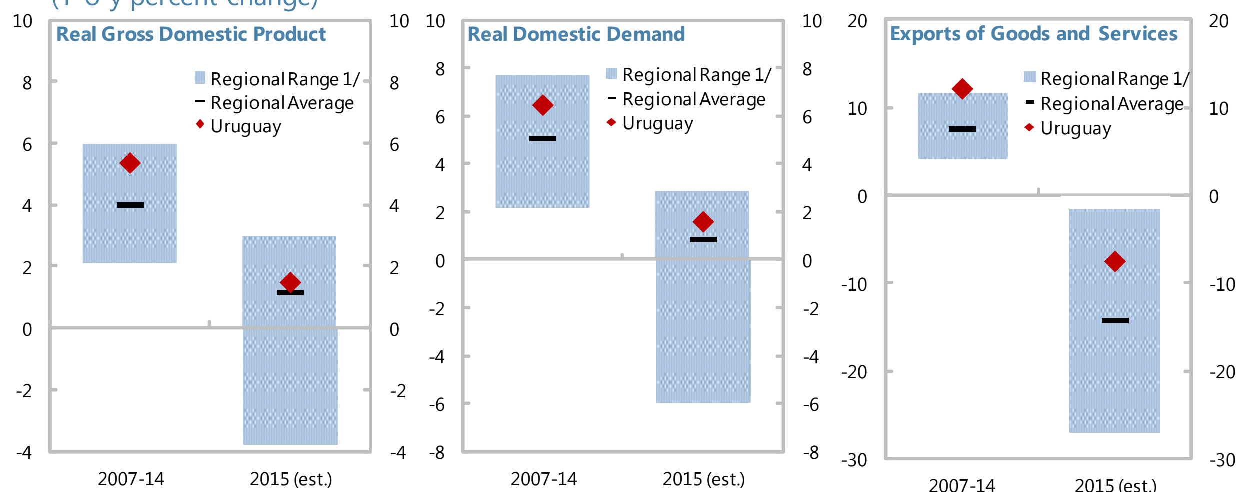
RECENT DEVELOPMENTS

3. During 2015, economic activity in Uruguay markedly slowed, triggered by a regional downturn and weakening prices of its export commodities. Growth is estimated to have decelerated to 1.5 percent in 2015, the lowest level since the 2002 crisis, due to a cooling off in investment (including the completion of a large pulp mill) and private consumption from recent highs. The second quarter saw a small contraction in real activity (on a y/y basis) for the first time since 2003, followed by a moderate rebound in the third quarter. Although the second-quarter

decline was driven mostly by a large, albeit transient, drop in electricity production due to drought, there is also evidence of a more persistent slowdown, with a decline in consumer and business confidence, and weaker credit growth for both firms and households. The latter seems to be due to lower demand for credit rather than to supply constraints. Unemployment rose during 2015, to 7.9 percent in November. The current account deficit is estimated to have fallen to 3¾ percent of GDP in 2015 as the lower oil import bill and higher pulp exports from the new pulp mill offset the effects of lower agricultural export prices and weak demand from key trading partners Argentina and Brazil.

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

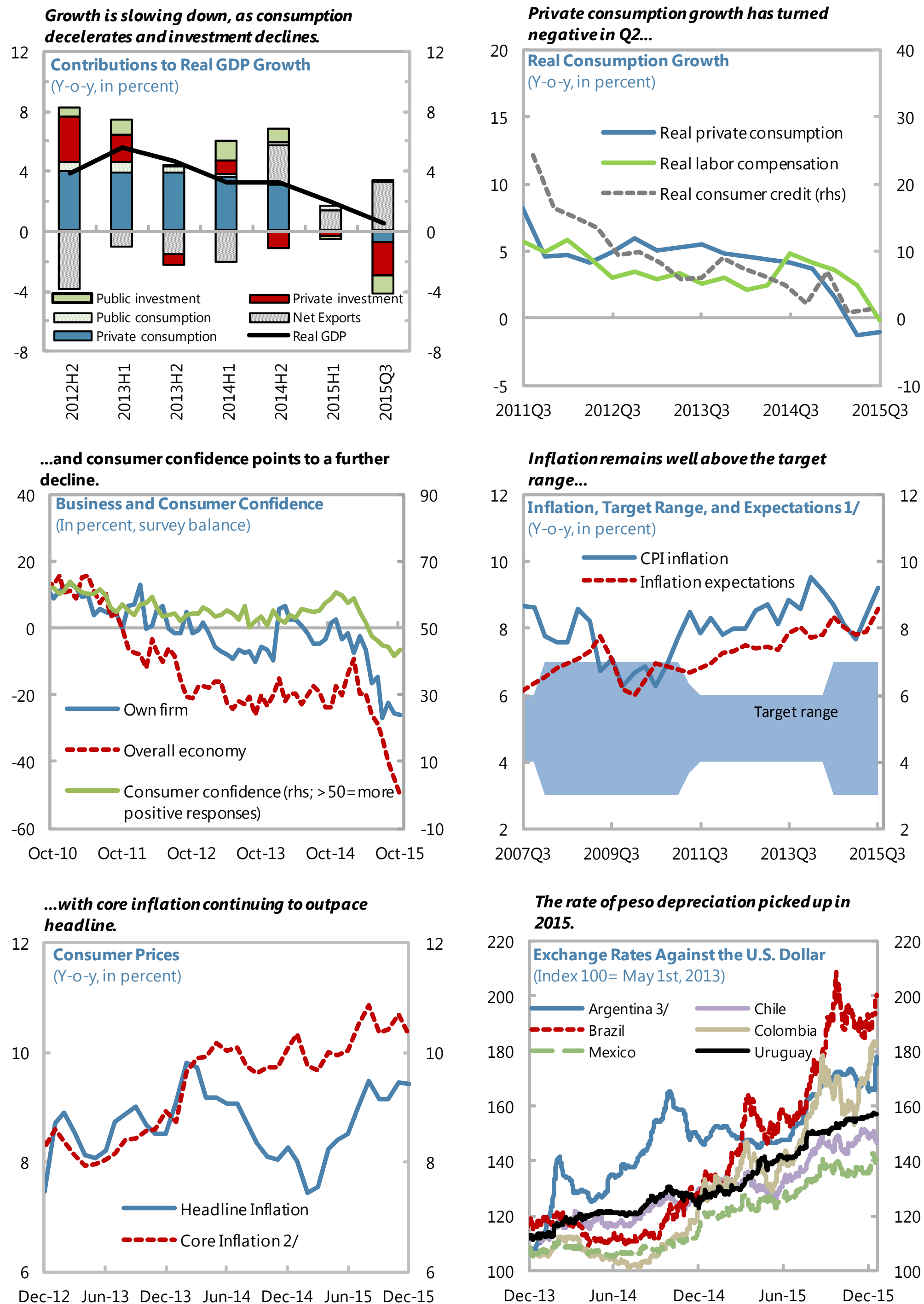
(Y-o-y percent change)



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.

4. **Despite the cooling economy, inflation remains entrenched above the central bank's 3–7 percent target range**. Defying the closing output gap, a relatively tight monetary stance over the past two years, and low international food and energy prices, headline inflation has edged up to more than 9 percent (y/y) since July, while core inflation (excluding food and administered prices) has exceeded 10 percent (y/y) since June. Significant depreciation of the peso against the U.S. dollar has contributed to inflationary pressures. The pass-through of low international fuel prices has been limited, in an effort to improve the financial health of the state-owned oil distribution company, ANCAP.

Figure 1. Uruguay: Real Activity and Inflation



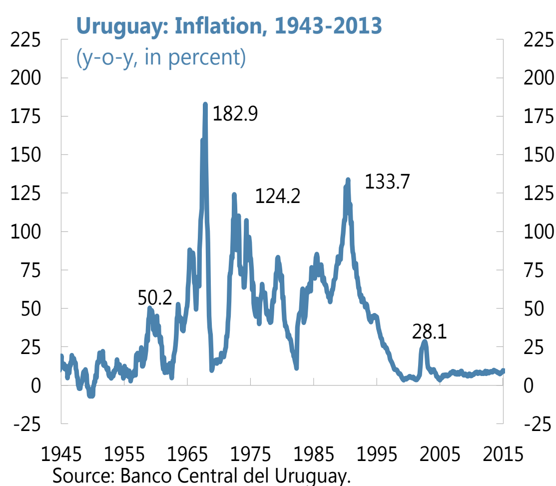
Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadistica, Bloomberg L.P., and Fund staff estimates and calculations.
1/ BCU survey, median of expected inflation for the 12 months ahead.
2/ The one-off measures in force since March 2014, estimated to subtract about 1/2 percentage points from the CPI for a temporary period, include reduced VAT on fruits, vergetables, and energy and telephone tariffs, a subsidy on health care contributions and lower lottery prices. Core CPI excludes these effects.
3/ Simple weekly average of official and informal market rates.

Box 1. The Drivers of Inflation in Uruguay

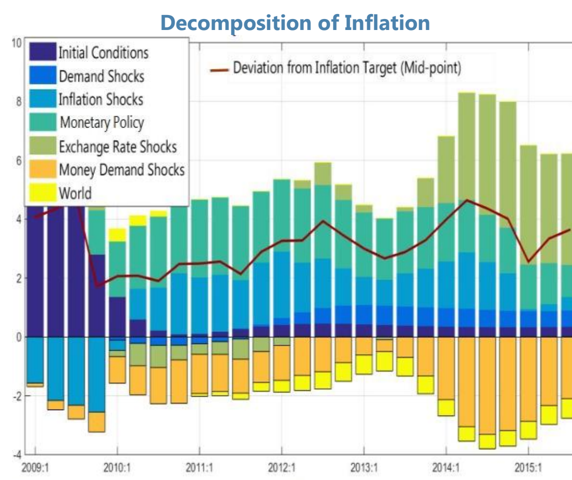
Against a history of chronic high inflation from the 1960s to the early 1990s, inflation has been reduced to single-digit levels since 2004. However, inflation has remained stubbornly above the official inflation target range.

Earlier (2013) staff estimates of the Phillips curve showed that the inflation process in Uruguay was driven by both past and expected inflation.[1] The findings also indicated that inflation expectations (which in recent months have drifted up to 9.35 percent at a one-year horizon) are influenced by actual inflation. The output gap and labor costs were also found to influence inflation. Most collective wage agreements include clauses stipulating ex-post corrections for the deviation of actual from expected inflation. Such wage indexation can help explain why lagged inflation remains a particularly important driver of inflation.

A decomposition of inflation dynamics (measured as deviations from the mid-point of the inflation target range) also points to the role of the recent depreciation and the delayed impact of monetary tightening.[2] The decomposition in terms of structural shocks that drive inflation, shows that exchange rate depreciation has contributed to excess inflation since early 2014. It also highlights that—although monetary policy has become tighter following the adoption of money targeting in July 2013—the earlier more relaxed monetary stance still contributes to excess inflation, as a result of the strong inflation inertia.



Source: Banco Central del Uruguay.



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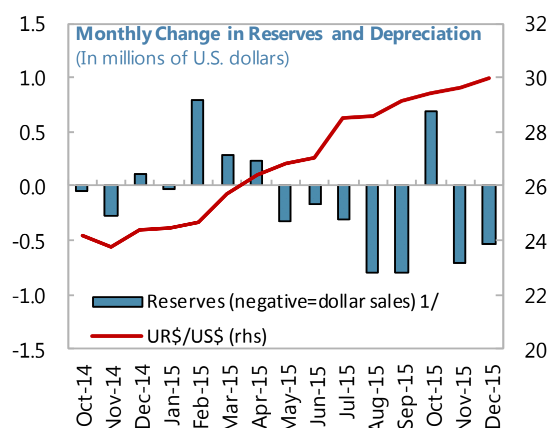
[1] Camilo Tovar (2013), "Why are Inflation and Inflation Expectations above Target in Uruguay?" Selected Issues Paper, IMF Country Report 14/7, pp. 3–12.

[2] The decomposition uses the Kalman smoother in a macroeconomic model calibrated to the Uruguayan economy, based on "A Model for Monetary Policy Analysis in Uruguay" by Rafael Portillo and Yulia Ustyugova, IMF Working Paper 15/170 (2015).

5. Depreciation pressures intensified during 2015. After depreciating through 2014, the peso has weakened further against the U.S. dollar in 2015 (22 percent since the start of the year), broadly in line with the regional and global trend among emerging markets. As the surge in nonresident purchases of local government securities had abated, in April 2015 the authorities eliminated the only remaining capital flow management measure—the 30 percent reserve requirement on nonresident purchases of central bank securities. Pressures on the peso intensified during July through October, with portfolio outflows on both the asset and the liability side, as domestic pension funds purchased Uruguayan securities from non-residents and increased their foreign-currency assets (closing in on their regulatory exposure limit). In particular, domestic investors (including pension funds) purchased around 20 percent of the successful issuance of a US$1.7 billion external government bond in October. In addition, domestic deposit dollarization picked up during 2015, rising from 77 percent to more than 81 percent of total deposits, although more than half of the increase was driven by valuation effects rather than a portfolio shift.[1] Preliminary indications are that these pressures abated in November. FDI inflows have slowed down a notch in recent quarters but continued to fully finance the current account deficit.



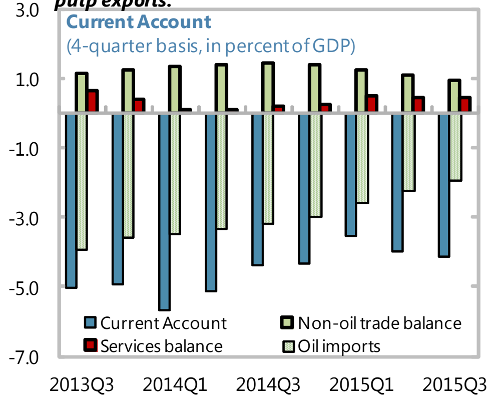
Sources: Banco Central del Uruguay and Fund staff calculations.
1/ In February and October, 2015, there were government bond issuances of US$ 1.2 bn and US$ 1.7 bn, respectively.

6. Extensive central bank intervention in the foreign exchange market since July has contained the pace of depreciation of the peso, lowering reserves. Gross international reserves have dropped by US$ 2.6 billion since June, despite the issuance of the aforementioned external government bond. The central bank (BCU) has sold U.S. dollars in the spot and forward markets to support the peso and, in October, bought back peso securities amounting to US$650 million, mostly from domestic pension funds, in exchange for foreign currency (accommodating these funds' transactions mentioned above). The interventions to support the peso declined sharply in November. At 29 percent of GDP (14½ months of imports), end-2015 reserves remained comfortably above the upper bound of the IMF reserve adequacy metric, and various other prudential benchmarks. Furthermore, the BCU and commercial banks' foreign assets taken together are sufficient to cover total foreign currency denominated bank deposits. The real effective exchange rate (REER) is estimated to remain in line with fundamentals: analysis based on the EBA current account model suggests a 1 percent undervaluation of the REER, while staff estimates using the external stability approach point to a 5 percent overvaluation. (Annex I).

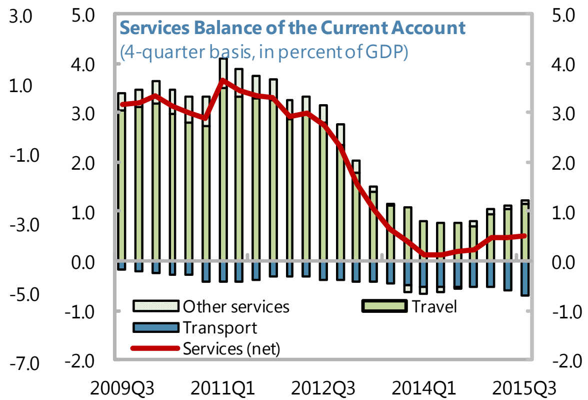
[1] The associated increase in banks' deposits abroad, as they offset the increase in their U.S. dollar liabilities, is recorded in the balance of payments under 'other capital flows'.

Figure 2. Uruguay: External Accounts

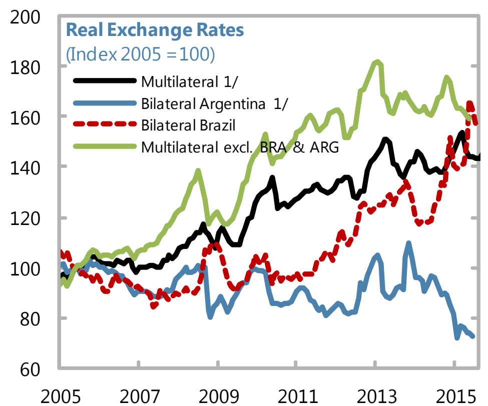
The current account is estimated to have improved in 2015 due to a lower oil import bill and strong pulp exports.



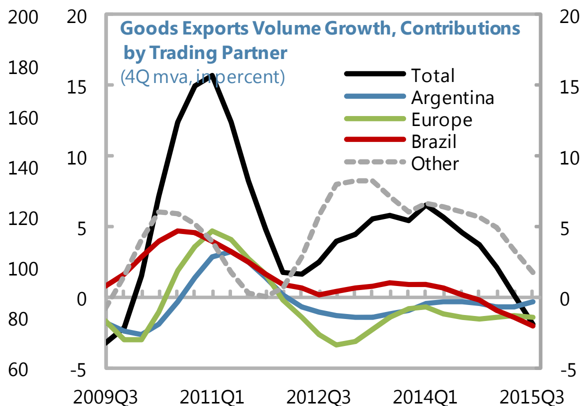
The net services balance has picked up slightly...



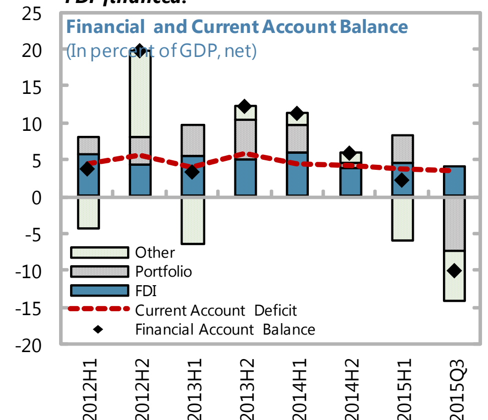
...aided by a large depreciation against Argentina, though the REER appreciated against Brazil.



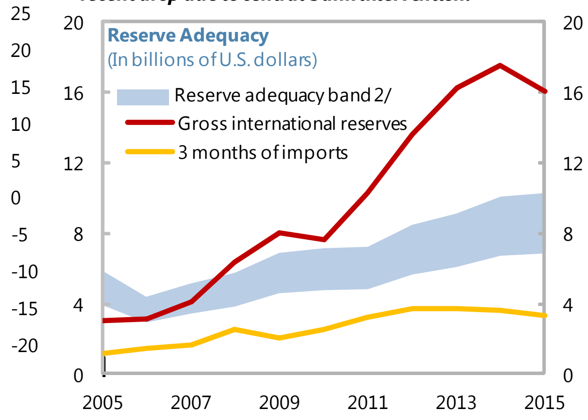
Goods export growth to the immediate region and Europe continues to be depressed.



The current account deficit remains mostly FDI-financed.

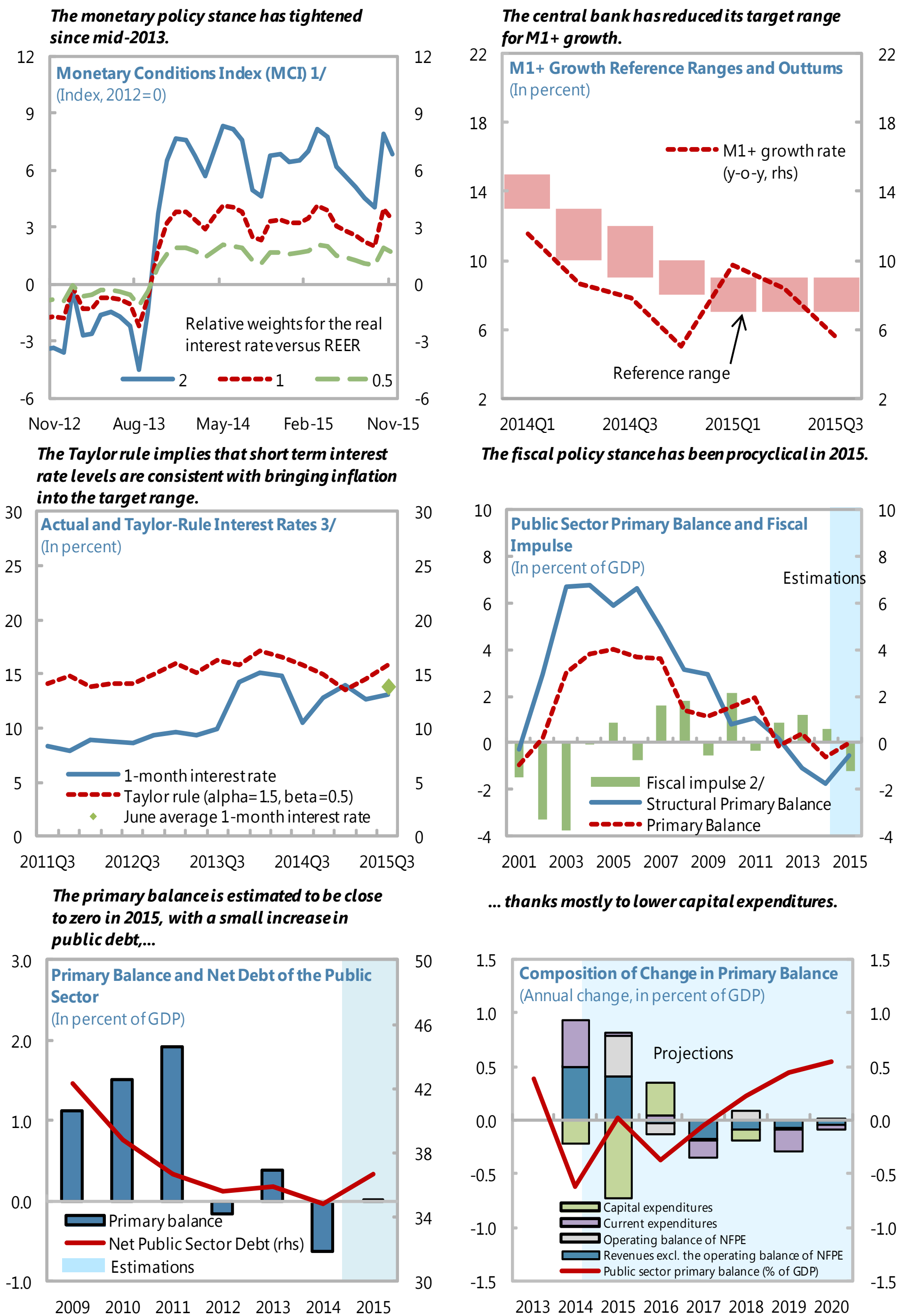


Reserves are well above prudential norms despite a recent drop due to central bank intervention.



Sources: Banco Central de Uruguay (BCU), World Economic Outlook, Instituto Nacional de Estadistica data, Haver Analytics, and Fund staff calculations.
1/ The real exchange rate against Argentina is calculated using the unofficial CPI for Argentina and the average of the unofficial and official exchange rates for the Argentine peso. Latest available data (November 2015).
2/ Band spans 100 to 150 percent of the Fund's reserve adequacy metric.

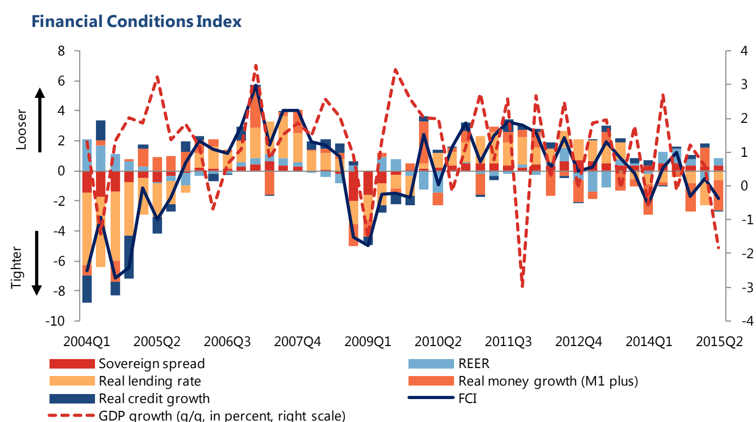
Figure 3. Uruguay: Macroeconomic Policy Mix



Sources: World Economic Outlook, Banco Central del Uruguay, Ministerio de Economia y Finanzas, 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/ Change in the structural primary balance.
3/ 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. The monetary policy stance has tightened over the last two years. The introduction of operational targets for base-money growth, in mid-2013, coincided with an overall tightening of financial conditions, with real money growth slowing and real interest rates picking up. After several quarters during which base money growth undershot its target range, the central bank lowered the range from 8–10 to 7–9 percent on December 30, 2014. M1+ growth has slowed further since then (even though the recent foreign exchange interventions have been mostly sterilized), with a coinciding decline in the demand for base money as a result of the economic slowdown and the pickup in deposit dollarization. With one-month interest rates at about 15 percent, the monetary policy stance is in line with what a Taylor rule would suggest (Figure 3).

Financial Conditions Index

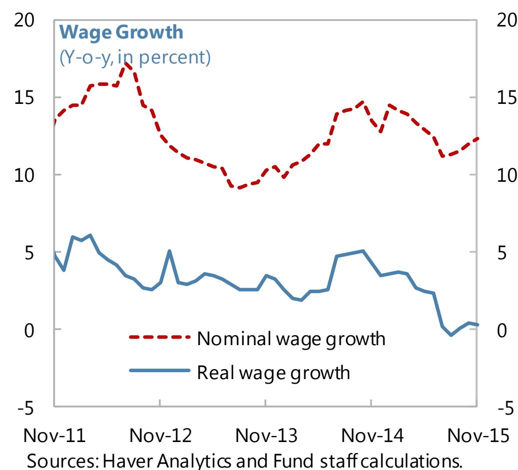


Source: IMF staff estimates.
Note: The financial condition index provides a summary measure of the effect of financial variables on economic activity. The computation follows IMF Country Report 13/220.

8. The medium-term budget for the new government's 5-year term projects a tightening of the primary fiscal deficit by 1½ percent of GDP over 5 years (Box 2). For 2015, the primary balance is estimated at close to zero, aligned with the budget, as lower tax revenues were offset by a sharper reduction in public investment. The overall fiscal deficit in 2015 is estimated at 3.6 percent of GDP, 0.3 higher than in the budget, because of higher interest payments. Staff forecasts a reduction in the overall deficit from 3.5 percent of GDP in 2014 to 2.5 percent by 2019, which is in line with the budget, albeit with lower interest costs than in the budget (owing to the recent reduction in costly central bank debt) and a correspondingly smaller improvement in the primary balance, by 1 percent of GDP by 2019. Based on these assumptions, the impact of the fiscal consolidation on the path of net public sector debt would be less than foreseen in the budget, and would not fully stabilize the debt-to-GDP ratio.[2] An important deviation from earlier practices is that the nominal spending levels in the budget have been stipulated for only the next two years. In 2017, the government will assess appropriate spending levels for the period 2018–19, based on the evolution of external and domestic economic developments, and allowing for adjustments as needed to meet the 5-year targets.

[2] The simultaneous reduction in both the BCU's assets and debt (along with some other liability management operations) promises a reduction in net public sector interest payments of around 0.5 percent of GDP per year. However by selling reserves, the BCU also foregoes the expected valuation gains on these reserves that would result from the depreciation of the peso. Indeed, the expected depreciation (driven by the persistent inflation differential) is a major determinant of the high carry cost of reserves. Staff estimates that the forgone valuation gains would offset about 40 percent of the improvement in net debt dynamics that results from the reduction in net interest payments.

9. The government has proposed new wage-setting guidelines that could moderate wage growth and alleviate the indexation of wages to past inflation (Box 3). Employers and unions are currently negotiating new multi-year wage agreements. The guidelines for the negotiations—the bulk of which is expected to be concluded by end-2016—envisage an increase in nominal wages between 6–10 percent per year, based on sectoral performance. The few sectoral agreements already signed did not fully incorporate the features of the guidelines that could moderate inflation inertia.



Sources: Haver Analytics and Fund staff calculations.

10. Since the new government took office in March 2015, it has initiated important reforms. Key initiatives would aim to improve education, boost infrastructure investment with private funding, and enhance the monitoring of public enterprises. The successful and timely implementation of these and other reforms could be challenging.

Box 2. The Government's Budget Plans for 2015–19

The five-year budget plan presented by the government in August 2015 was approved by Parliament in December. The budget envisages a reduction in the overall fiscal deficit by 1 percent of GDP over 5 years and an improvement in the primary balance of 1.6 percent of GDP. Half of this improvement would come from a reduction in current and capital expenditures. On the revenue side, higher revenues from public enterprises would contribute to a fourth of the overall improvement.

Current expenditures of the non-financial public sector are expected to remain stable as a percentage of GDP, excluding the 2014 payment to the Energy Stabilization Fund of 0.3 percent of GDP. Public wage expenditures should remain at 5 percent of GDP, which includes keeping real wages constant as well as additional spending in the areas of education, public health, and security.

The budget also includes a broader initiative to boost public investment, a third of which would be financed by private funds, including through public-private partnerships (PPPs). Public sector capital expenditures as a percentage of GDP would be around 2.7 percent over the period, which corresponds to their 2011 level.

Five-year infrastructure investment budget

Sector	Total amount (in millions of dollars)	Of which: PPPs	Of which: Other private funds
Energy	4,230	465	2,133
Roads	2,360	740	30
Social infrastructures	1,870	652	n.a.
Housing	1,320	n.a.	n.a.
Telecommunications	750	n.a.	n.a.
Water and sanitation	550	n.a.	n.a.
Ports	550	n.a.	200
Railways	360	90	n.a.
Other	380	n.a.	n.a.
Total	**12,370**	**1,947**	**2,363**

On the revenue side, the budget foresees an increase in revenues by 0.6 percent of GDP between 2014 and 2019. In particular, the cumulative operating profits of public enterprises are projected to increase by $440 million over five years. Tax revenues would increase by 0.3 percent of GDP between 2014 and 2019 as a result of higher tax revenues from public enterprises, improvement in collection and payroll increases.
The budget documents foresee that the above measures would raise the gross and net public debt by about 4 percentage points of GDP through 2018 before stabilizing by 2019.

Budget for the consolidated public sector (in percent of GDP)

	2014	2015	2016	2017	2018	2019	Change between 2014 and 2019
Revenues of the non-financial public sector	**29.0**	**29.1**	**29.2**	**29.3**	**29.5**	**29.6**	**0.6**
Revenues of the central government	19.9	19.9	20.0	20.0	20.1	20.2	0.3
Social security	7.6	7.4	7.4	7.5	7.5	7.5	-0.1
Profit from public enterprises	1.5	1.8	1.8	1.8	1.9	1.9	0.4
Expenditures of the non-financial public sector	**29.3**	**28.8**	**28.9**	**28.8**	**28.7**	**28.5**	**-0.8**
Wages	5.0	5.0	5.0	5.0	5.0	5.0	0.0
Other current expenditures	21.1	21.0	21.1	21.0	21.0	20.8	-0.3
Capital expenditures	3.2	2.8	2.8	2.8	2.7	2.7	-0.5
Primary balance of local governments, BSE, and BCU	**-0.3**	**-0.3**	**-0.2**	**-0.2**	**-0.2**	**-0.2**	**0.1**
Primary balance of the consolidated public sector	**-0.6**	**0.0**	**0.1**	**0.3**	**0.6**	**1.0**	**1.6**
Interest	2.8	3.2	3.3	3.3	3.3	3.4	0.6
Overall balance	**-3.5**	**-3.3**	**-3.1**	**-2.9**	**-2.7**	**-2.5**	**1.0**

Box 3. The New Wage-Setting Guidelines

The government's guidelines for the ongoing sixth round of wage council negotiations propose wage increases set in nominal terms that vary by sector depending on growth performance. The proposal includes a backward-correction mechanism that would be activated if accumulated inflation after the first two years of the wage agreements exceeds the proposed nominal increases, to ensure that employees bear no real wage loss.[1] In addition, a safeguard clause allows for an immediate adjustment of nominal wages if accumulated inflation over a 12-month period exceeds 12 percent.

The new guidelines would alter the wage setting practices relative to previous rounds, which focused on wage increases set in real terms, with actual wages being adjusted for past and expected inflation. While the government's guidelines for the previous round of negotiations offered the option of setting wage increases in nominal terms (to reduce the impact of automatic indexation of wages on inflation), only 5 out of 183 agreements used that option. Furthermore, the new proposed nominal wage increases are lower than those agreed in the previous round of negotiations (for the 5 sectors which opted for such nominal adjustments) and are differentiated by sector. In fact, the highest suggested nominal wage increase over the next three years remains below projected nominal GDP growth. In addition, the sectoral differentiation of wage increases provides a first attempt to address the heterogeneity across sectors in terms of productivity growth, and to limit competitiveness losses in exporting sectors. The guidelines recommend higher increases for the lowest wages to contain wage inequalities within each sector.

Proposed nominal wage increases

	Sectors in difficulty	Intermediate sectors	Dynamic sectors
Fisrt year	8.0%	8.5%	10.0%
Second year	6.5%	7.5%	9.0%
Third year	6.0%	7.0%	8.0%

Note: Dynamic sectors are defined as sectors growing faster than 4 percent per year.

The proposed guidelines would help reduce the wage inertia that has contributed to inflation persistence. Adjustments based on past inflation would be made only after two years and only to avoid real wage declines, and the trigger for the safeguard clause that could lead to adjustments within the first two years is set well above the 3–7 percent inflation target range and inflation expectations. This contrasts with the semiannual and annual adjustments for inflation included in the agreements following the previous negotiation round.

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[1] Wage agreements are typically negotiated for two or—more commonly—three years.

OUTLOOK AND RISKS

11. GDP growth is expected to remain tepid at 1.4 percent in 2016 as external conditions remain weak and consumer confidence has dropped. Adding to weak external demand, the further slowdown in fiscal spending and consumption is likely to temper domestic demand. Despite a projected moderate deterioration in the terms of trade relative to 2015, the current account deficit is projected to hold steady at 4 percent of GDP as lower demand for imports broadly offsets weaker foreign demand for exports. In the medium-term, growth is expected to rise back to a potential rate of 3.1 percent as external demand and investment recover. The current account deficit is projected to narrow to 3½ percent of GDP in the medium-term, as external demand recovers.

12. Risks to the outlook are mostly external:

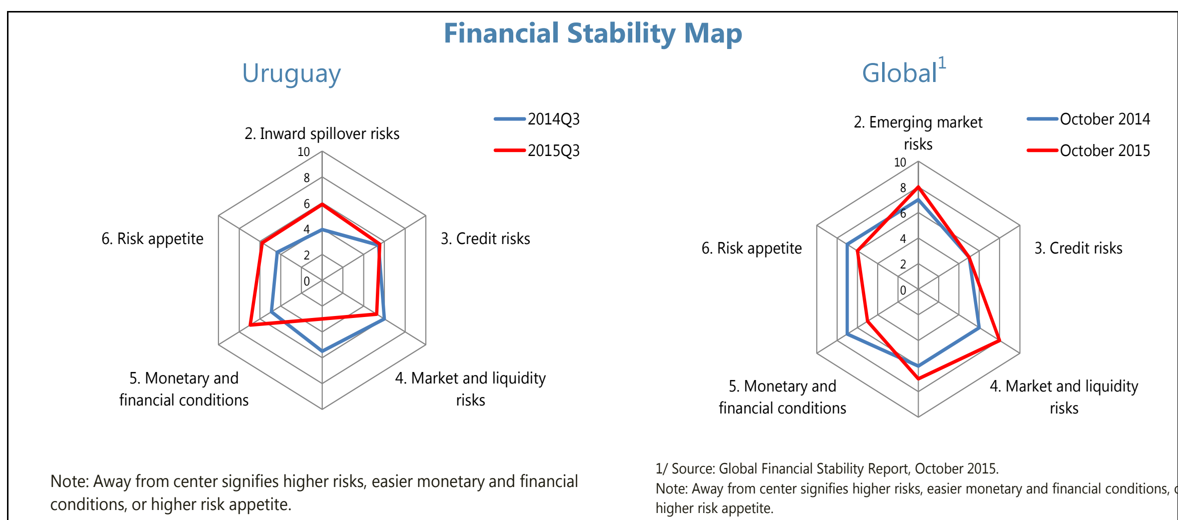
- **The immediate region**. Although Uruguay's regional economic ties have lessened, a worse-than-expected slowdown in Argentina and Brazil could significantly weigh on Uruguay's economy. Historically, spillovers from Argentina have had the largest impact, with the country accounting for more than half of Uruguay's sizeable tourism receipts, and importing mostly specialized manufactured products without obvious alternative markets. Although Brazil imports one-fifth of Uruguay's merchandise exports (four times more than Argentina), these are predominantly commodities, for which thus far alternative markets could be more readily found. The role of financial linkages as a transmission channel for regional shocks has decreased significantly in the past decade. Also, there has been no evidence of contagion in the sovereign bond market resulting from recent events in Brazil. Non-resident deposits (mostly from Argentina) have declined to 16 percent of total deposits, making a potential rapid withdrawal manageable in light of banks' plentiful foreign currency liquidity. Nevertheless, Argentina and Brazil still accounted for about a third of FDI inflows into Uruguay in 2013.

- **The global economy**. A global slowdown would affect Uruguay's commodity exports, and increased volatility in oil prices would affect import costs. However, the agricultural content of Uruguay's commodity exports (two-thirds of the total) makes the country less vulnerable than other commodity exporters to a slowdown or further rebalancing in China from investment to consumption. While increased volatility in oil prices would affect Uruguay, which imports all of its oil, the positive correlation between agricultural commodity prices and oil prices has so far provided a natural hedge. A tightening in global financial conditions could raise the cost of financing: empirical analysis indicates that the impact of the Fed's tapering announcement in May 2013 on local and foreign currency bond yields in Uruguay was moderate and broadly in line with the region. The high share of nonresident holdings of Uruguay's public debt may pose an external risk.

Table 1. Uruguay: Selected Financial Soundness Indicators

	2011	2012	2013	2014	2015 1/	LA5 2/
Regulatory capital in percent of risk-weighted assets	13.7	12.8	11.7	11.8	10.8	15.3
Non-performing loans in percent of total loans	1.3	1.5	1.3	1.5	2.3	3.1
Non-performing loans in percent of total household loans	3.1	3.5	3.7	3.6	3.5	...
Specific loan-loss provisions in percent of non-performing loans	71.1	69.0	56.2	65.2	61.4	...
Operating costs in percent of gross income	83.4	81.0	83.1	86.0	86.7	...
Return on assets 3/	0.8	1.0	1.6	0.9	1.1	1.7
Return on equity 4/	7.9	12.6	19.7	11.4	14.1	19.0
Liquidity ratio 5/	47.8	52.6	52.6	54.8	60.2	30.6
Dollar loans in percent of total loans	58.5	57.9	59.6	59.0	61.3	22.4
Dollar deposits in percent of total deposits	71.9	71.9	73.5	76.8	81.2	17.6
Non-resident deposits in percent of total deposits	14.6	15.2	15.0	14.7	16.4	...
Private sector credit in percent of GDP	19.8	21.5	22.6	24.6	21.0	39.7
Household consumer credit in percent of GDP 6/	8.2	8.5	8.7	9.1	7.6	...
Implicit exchange rate risk 6/ 7/	29.0	33.0	33.1	31.7	31.0	...
Memorandum items:						
Loan dollarization (constant exchange rate, January 2013)	52.9	52.3	51.4	49.6	46.3	...
Deposit dollarization (constant exchange rate, January 2013)	67.2	67.4	67.2	68.4	70.4	...

Sources: Banco Central del Uruguay, IMF Global Financial Stability Report, and Fund staff calculations.
1/ Latest available data (November 2015).
2/ Median of Brazil, Chile, Colombia, Mexico, and Peru for 2014. 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 2015, latest available data (2015Q3).
7/ Foreign currency bank credit to borrowers without natural hedges as a share of total bank loans to the private sector.



13. While domestic confidence indicators point to weaker demand, near-term financial risks seem limited. The reliability of the confidence indicators in foretelling domestic consumption and investment is hard to gauge, as is the potential impact of further regional turmoil on domestic confidence. In addition, a possible further rise in deposit dollarization could contribute to pressure on the exchange rate. However, there is no evidence of a credit bubble or excessive private sector leverage. Banks' regulatory capital ratio has declined over the last few years, in an effort to reduce the costs of excess capital. The banking system remains adequately capitalized and an uptick in non-performing loans in 2015 does not, at this stage, seem a cause for significant concern, as provisions for loan losses remain high. Foreign currency credit to unhedged borrowers in the non-tradable sector has also moderated from its 2013 high, although close monitoring of this ratio remains warranted, particularly given the recent peso depreciation.

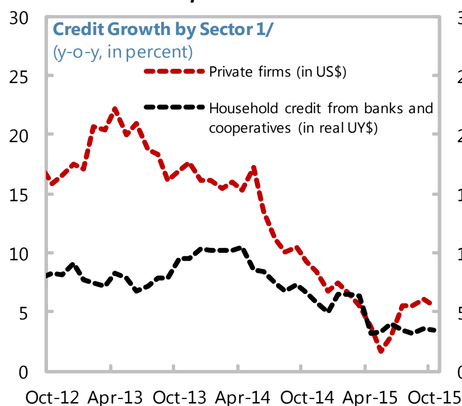
14. Uruguay's strong liquidity buffers should facilitate an orderly adjustment to shocks.

- Government financing risks are limited given access to contingent credit lines (including from the World Bank and IaDB) amounting to 4 percent of GDP and liquid financial assets (6 percent of GDP) sufficient to cover debt service through the end of 2016. Furthermore, the average maturity of public debt is high, at 15.5 years, reducing short-term risks.

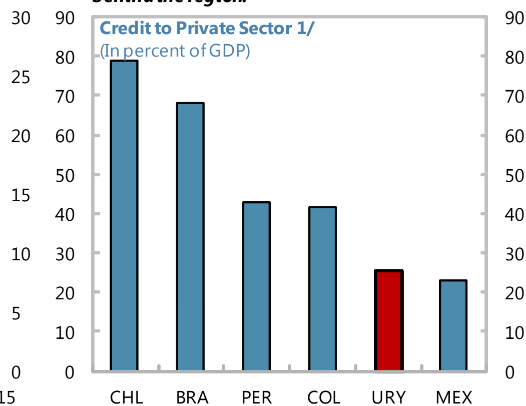
- The BCU's ample gross reserves could help cushion severe external shocks. Taking into account Uruguay's high level of financial sector dollarization (80 percent of deposits and 60 percent of banking system loans are in U.S. dollars), reserves still cover 96 percent of end-2014 foreign currency deposits, and almost four times the amount of end-2014 non-resident deposits (Annex I).

Figure 4. Uruguay: Credit and Banking

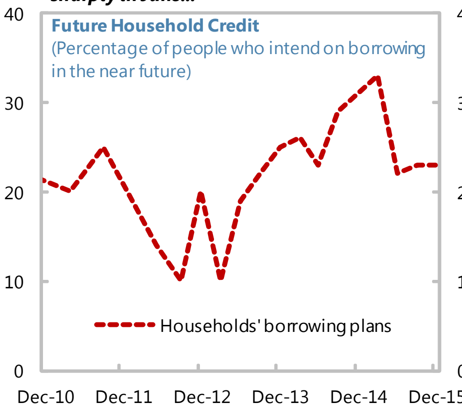
Credit growth has recently slowed for both households and firms...



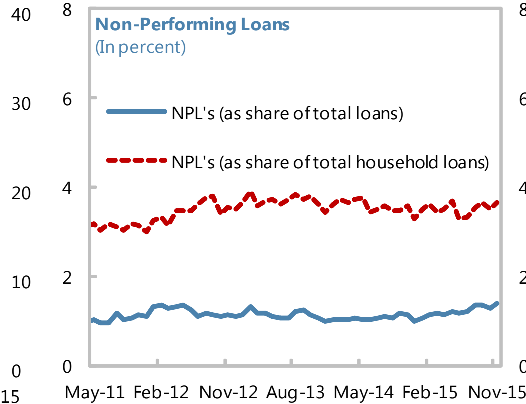
...while credit to the private sector still lags behind the region.



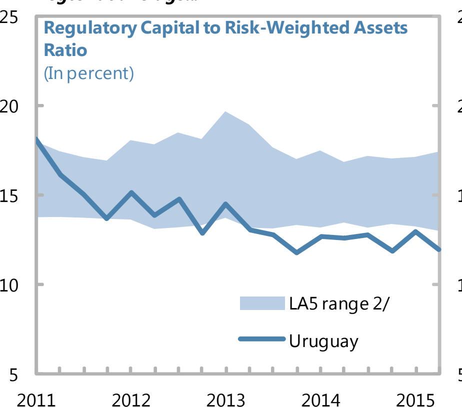
Households' borrowing plans contracted sharply in June...



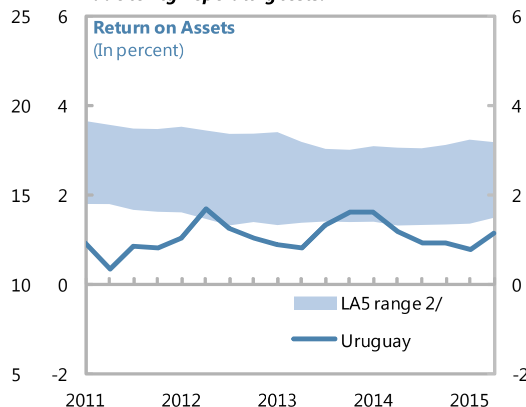
... while non-performing loans have slightly increased.



Banks' capital adequacy ratio is below the regional average...



...as banks' profitability has been subdued due to high operating costs.



Sources: IMF, *World Economic Outlook*; Banco Central del Uruguay (BCU); Pronto!, *Monitor del mercado de Crédito al Consumo;* and Fund staff estimates and calculations.
1/ Latest available data for Colombia is end of 2014 and 2015Q3 for all other countries.
2/ LA5 includes Brazil, Chile, Colombia, Mexico, and Peru; data is through 2015Q2.

Uruguay: Risk Assessment Matrix

Sources of Risk	Relative Likelihood	Impact if Realized
Sharp asset price decline and decompression of credit spreads, and surge in the U.S. dollar.	**High**	**Medium/Low (↓)** • Further peso depreciation could continue to 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.
Sharper-than-expected growth slowdown in emerging economies/China, and structurally weak growth in key advanced and emerging economies.	**High/Medium**	**Low/medium (↓)** • A sharp slowdown in global demand could trigger a further decline in Uruguay's export prices. However, the likely decline in oil prices would buffer the adverse impact.
Sharply lower growth in the region.	**High**	**Medium/High (↓)** • A sharp slowdown in Argentina and Brazil could adversely impact Uruguay through trade, tourism and FDI channels.
Persistently low oil prices.	**High**	**Medium (↑)** • Uruguay imports all its oil (fuel products accounted for 20 percent of imports from 2010–14), so a persistent drop in oil prices would lower the import bill and have a positive macroeconomic impact.
Implementing the planned reforms to bolster macroeconomic stability could be challenging.	**Medium**	**Medium (↓)** • Smaller-than-planned fiscal consolidation and continued backward-indexation of wages could push inflation above the psychological threshold of 10 percent, and feed into dollarization.

15. The authorities broadly concurred with staff's outlook but saw smaller regional spillover risks. They foresaw somewhat higher growth in 2015 and 2016 than in the staff's baseline projection. They nuanced the risks stemming from possible deeper Brazilian and Argentinean recessions, noting that Uruguay had already successfully absorbed significant shocks from the region. They also emphasized the decline in the estimated correlation between growth in Argentina and Uruguay and offered that Uruguay could benefit from the dismantling of existing Argentinean trade restrictions. They considered that domestic reform implementation risk was low, pointing to the recent approval of the five-year budget by Parliament without any additional expenditure increase, and progress in the wage negotiations in accordance with the government's guidelines.

POLICY DISCUSSIONS

Enhancing the Resilience to Macroeconomic Shocks

16. Uruguay's flexible exchange rate offers an important instrument for responding to inward spillovers.

- The flexible exchange rate should remain the key stabilizer that absorbs external shocks. The recent depreciation of the peso reflects a reassessment by financial markets of the region's comparative external outlook. Maintaining competitiveness, in particular vis-à-vis regional markets and competitors, will be vital for supporting growth.

- The BCU's ample gross reserves can help cushion severe external shocks. That said, interventions in the exchange market should be used to counter disorderly market conditions, and not to counter trends driven by fundamentals. In this regard, staff welcomes the sharp decline of central bank foreign exchange sales in November. Continued interventions would not be warranted if external depreciation pressures continued. Prolonged interventions could erode the country's buffers prematurely, with substantial financial risks still ahead. Moreover, resisting market expectations of a further depreciation through interventions that delay the adjustment could feed into asset dollarization pressures.

17. Strengthening the credibility of the targets for monetary and medium-term fiscal policy could more firmly anchor expectations and confidence, both domestically and in international financial markets. Increased global risk aversion, Fed lift-off, and regional shocks could test the positive assessment of Uruguay's financial position. In this context, reinforcing budgetary and monetary frameworks could promote more favorable international borrowing terms and reduce economic volatility.

18. In the near term—until fiscal consolidation has been fully entrenched, and inflation is comfortably within its target range—there is only limited room for countercyclical policies to counter adverse external shocks to growth.

19. Authorities views on external resilience. The authorities confirmed the importance of exchange rate flexibility as a shock absorber. They clarified that the goal of the central bank's interventions had been to smooth exchange rate volatility, including from large transactions that could disrupt the relatively small foreign exchange market, and to prevent overshooting driven by political noise from neighboring countries—and not to prevent a depreciation of the currency driven by fundamentals. Their estimation confirmed that the exchange rate was in line with its fundamentals. The authorities indicated that the sale of part of the BCU's excess reserves allowed for a welcome reduction in the BCU's costly short-term domestic-currency debt, which would contribute to the improvement in the overall fiscal balance for the consolidated public sector. They expected that interventions would continue to decrease in the next months.

Reducing Inflation

20. Reducing inflation remains a key policy priority. Lowering inflation would promote de-dollarization and create scope to use monetary policy as a countercyclical tool. It would also reduce the inflation tax on low-income households, with no bank account, or only a checking account paying little if any interest. Furthermore, given the current level of inflation, a relatively small price or exchange rate shock could trigger a rise to double-digit inflation that, in turn, could feed into inflation expectations.

21. A more effective and comprehensive disinflation strategy is needed to put inflation on a downward path. Tight monetary policy has helped contain inflationary pressures in recent years. The fiscal tightening that commenced in 2015 will complement this effort. As the output gap is expected to close, inflationary pressures are projected to show a gradual decline, with inflation remaining above target through 2018 due to inflation inertia—which staff expects to moderate gradually, with the new wage agreements.

- **Keeping a tight policy stance**. The slowdown in M1+ growth and the substantial increase in real interest rates since mid-2013 has led to a tightening in financial conditions. Nevertheless, inflation has remained high owing, in particular, to the weakness of the credit channel and the muted effect of interest rates on domestic demand. Given the imperative of reducing inflation and a still positive output gap, the tight monetary policy stance should be maintained, even in case of moderate further downward shocks to growth.

- **Reducing inflation persistence**. The new wage-setting guidelines set by the government include a helpful focus on wage increases in nominal terms, but still include indexation provisions. It would be advisable to move toward the full elimination of backward indexation as expeditiously as possible to reduce inflation persistence.

- **Strengthening the monetary policy framework**. It is still too early to convincingly assess the efficacy of the new monetary framework in controlling monetary conditions and anchoring expectations. It will be important to closely monitor the performance of the framework and remain open to adjustments as needed. In particular, the M1+ growth target should be attuned to changes in money demand. In the near term, the impact of rising dollarization and lower economic growth

could imply a need for reducing the target for M1+ growth to avoid an undue relaxation of the monetary stance. Furthermore, a comprehensive strategy should not need price agreements with domestic suppliers of consumer goods to reduce inflation pressures temporarily.

22. Authorities views on inflation and monetary policy. In explaining the persistence of inflation, the authorities pointed to the still strong domestic demand as well as to the inertia of nontradables prices, stemming in part from wage indexation. They emphasized that consistent policies were in place, with a contractionary monetary policy, a cautious fiscal stance, and wage guidelines that would dampen the impact of indexation. They pointed out that the new monetary framework had allowed for the tightening of monetary policy since mid-2013 while avoiding excessive volatility of the medium and longer term interest rates. They considered that price agreements played a useful supplementary role, by helping to anchor expectations. They felt that recent the pickup in deposit dollarization did not pose significant risks and pointed to the de-dollarization process of public debt and of retail bank lending.

Implementing Structural Fiscal Consolidation

23. The government's commitment to fiscal consolidation over the 5-year government term will be critical for stabilizing public sector debt over the medium term. The adoption of the 5-year budget is an important step in this direction. Assuming that the revenue underperformance of 2015 persists through the budget period, staff baseline projections foresee a smaller primary surplus than the budget and an ensuing gradual rise in both gross and net debt as a share of GDP through 2020. The staff therefore advised that the authorities should achieve the full budgeted improvement in the primary balance to a surplus of 1 percent of GDP by 2019, so as to ensure that net debt is put on a stable path by the end of the budget period. The projected decline in the BCU's net interest costs would complement the strengthening of the primary balance in achieving this goal but would not on its own be sufficient to stabilize net debt given valuation effects.

24. Alongside a gradual further reduction of the cyclically-adjusted primary balance, there is scope for automatic stabilizers to operate in case risks to growth were to materialize. Staff advised that a strong commitment to the structural adjustment path for the primary balance that is embedded in the budget would provide adequate room for automatic fiscal stabilizers—stemming from the social safety net as well the progressive tax system—to operate to cushion cyclical shocks.

25. The authorities may wish to consider options for fortifying the fiscal anchor over the longer run. The fiscal expansion since 2009 was accommodated within the existing rule that limits the increase in net debt, and debt levels are projected to edge up further over the next few years. Against this backdrop, a cap to indebtedness could be made part of the rule, to prevent debt from reaching uncomfortable levels. More generally, a periodic recalibration of the fiscal path will be important for ensuring that debt targets are met given the sensitivity of the debt outlook to shocks, especially to growth or interest rates.

26. Furthermore, active liability management remains an important tool for reducing debt vulnerabilities. Over the last decade, the debt management strategy has limited refinancing risk by increasing the maturity of the debt and smoothing the redemption profile, and reduced both the share of debt denominated in foreign currency and the share of debt at floating rate. This strategy should be continued, while taking into account developments in international and domestic financial markets. Furthermore, there could be opportunities for diversifying the debt portfolio across currencies and for deepening the local bond market.

27. The consolidation effort is focused on enhancing the efficiency of public enterprises and increasing reliance on the private sector for infrastructure investments. Investment plans of the—autonomous—public enterprises have been constrained and placed under government scrutiny. Effective execution of plans for strengthening the monitoring and corporate governance of public enterprises will be important to support the targeted improvement in their financial performance. The authorities' plans also foresee that private funding—in particular through PPPs—will support one-third of the agenda for expanding investments in energy, transportation, and other infrastructure. PPPs are expected to finance 30 percent of the investments in road infrastructure, one-fourth of the investment in railways and more than 10 percent of the projected investment in the energy sector. The use of PPPs can help to improve project management and risk-sharing with private entities. However, proper contract design, effective monitoring and oversight, and strong controls of explicit and contingent liabilities will be essential.

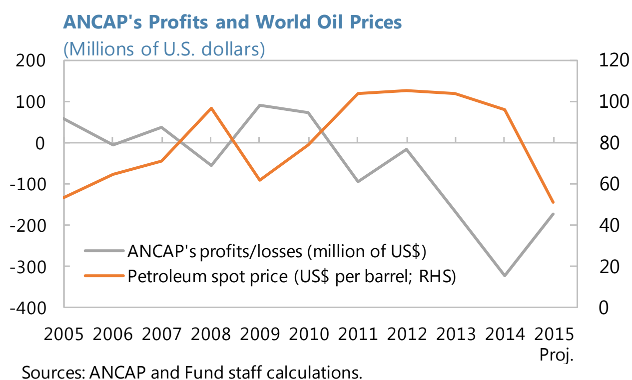
28. A state intervention in ANCAP combined with low oil prices should provide an opportunity to improve the financial position of the company, before moving towards a more transparent system of passing through oil price changes. Restoring ANCAP's financial soundness is a policy priority, and in December 2015, the government announced a recapitalization of the company, combined with strict new oversight (Box 4). ANCAP is currently benefiting from lower global oil prices that, given the limited pass through allowed to domestic prices, should help the company restore its financial position. Looking ahead, further efficiency gains will be critical, and should create room to allow prices to adjust in line with the world market, based on a transparent formula (and maintaining an appropriate tax that covers the environmental cost of fuel). This would restore financial discipline and remove the risks to the budget inherent in the stabilization of domestic fuel prices.

29. Authorities view on fiscal policy. The authorities reaffirmed their commitment to a reduction in the overall fiscal balance to 2.5 percent of GDP by 2019 and emphasized the possibility of revising the budget in 2017 to meet this objective. They mentioned the expected reduction in net interest payments by the BCU, as well as the targeted improved performance of state-owned enterprises, as major factors contributing to a lower deficit. They expressed skepticism about possible amendments to the current debt rule, which in their view is predictable without unduly constraining the ability of future governments to set policies. They saw the restoration of ANCAP's financial soundness as a prerequisite for a decrease in domestic fuel prices.

Box 4. Resolving ANCAP's Financial Situation

On December 23, 2015, the government announced a rescue package for the public oil distribution company, ANCAP. Administración National de Combustibles, Alcohol y Portland (ANCAP) is Uruguay's state-owned oil distribution company. The company has a monopoly in refining activities. ANCAP is the largest Uruguayan corporation, with total assets of US$2.3 bn in 2014.

ANCAP has been running losses for the past five years, despite the drop in international oil prices. In 2014, ANCAP's losses reached US$323 million, bringing net worth down to $424 million at the end of the year. The apparent negative correlation between ANCAP's profits and oil prices was broken in 2012. The losses may be explained by high distribution costs and high capital spending levels between 2009 and 2014, which have increased ANCAP's indebtedness and debt service costs.



ANCAP's debt at end-October 2015 is estimated at US$1.4 bn, half of which is owed to banks. More than half of the debt is denominated in U.S. dollars. The foreign exchange risk is compounded by the fact that all ANCAP's oil imports are also dollar denominated. Much of the debt is short term, which creates a rollover risk and, with 40 percent at variable rates, also implies a serious interest rate risk in the context of tightening global financial conditions.

The government announced a plan to improve ANCAP's financial position and increase efficiency. ANCAP will be recapitalized and put under direct ministerial oversight. Debt owed to the central government will be forgiven (a large share of this debt stems from a recent loan to ANCAP to allow the early repayment of the debt to the Venezuelan oil-company PDVSA) and bank debt will be re-profiled by reducing the dollar denominated part and extending debt maturities. The implementation of the plan is to be supported by a loan from the Development Bank of Latin America (CAF).

ANCAP's debt at end-October 2015 (in percent of total debt unless otherwise noted)

Total debt (in US$ million)	**1,424**
Debt in US$	56
Debt in indexed units	44
Debt maturing in 2015	25
Debt at variable rate	41
Bank debt	50
Debt to MEF	44

Source: Ministerio de Economia y Finanzas.

Aiming for Higher and Sustainable Growth

30. While Uruguay has achieved relatively high living standards, supported by strong social policies, recent developments have prompted a reassessment of Uruguay's medium-term growth outlook. In particular, staff's projection of potential growth has been revised down from 3.3 percent to 3.1 percent, reflecting lower domestic investment growth. This adjustment puts a premium on the identification of policy options for boosting growth.

31. Further diversification of export markets and quality upgrades to existing products and services can boost Uruguay's growth potential. Greater diversification of markets would also

help reduce exposure to adverse external shocks. An upgrade of Uruguay's transport and logistics infrastructure, improvements in the quality and enrollment of secondary education, expansion of vocational training programs, and increase in labor market efficiency to better tie wages to productivity are key requirements for raising Uruguay's medium- and long-term growth potential. In this context, staff welcomed the broad consensus on the need to upgrade transport infrastructure to meet the needs of Uruguay's growing economy, which could also enhance FDI.

32. Important progress has been made in moving towards energy self-sufficiency based on renewable sources. On average, more than half of Uruguay's power stems from hydropower (although with large weather-related fluctuations), and for the remainder the country is progressively switching to other renewable sources, in particular wind-energy. The power company is also investing in a larger connection with the Brazilian grid, to accommodate exports of the expected excess power supply.

33. The authorities emphasized their efforts to boost infrastructure and strengthen education outcomes. The authorities have started rolling out a series of infrastructure investment plans though PPPs, in particular for highways and railroad projects. The authorities indicated that improving the quality of secondary education and upgrading labor skills would be essential to sustain strong and inclusive growth in the long run. They also noted the increase in public spending on vocational training as well as a series of initiatives to support youth employment, small and medium-sized enterprises, and high quality jobs through FDI.

Investing in Financial Deepening and Stability

34. The steadfast implementation of the far-reaching financial inclusion law has the potential to enhance resilience to shocks, policy transmission, and growth. The low level of bank credit to GDP in Uruguay suggests there is scope for strengthening the credit channel. The segmented and concentrated structure of the banking market also limits bank lending in pesos rather than in U.S. dollars. The implementation of the 2014 financial inclusion law—which increases households' access to financial services—is already creating competition among banks for salary accounts, which should facilitate access to credit and foster more competition in the peso market, leading to efficiency gains.

35. Government projects for infrastructure investment can be designed to foster the development of new capital markets instruments. New instruments can, in particular, offer more opportunities for retail investors in the peso market. The public power company has lead the way, with a tranche of a 2015 windfarm project reserved for retail investors, and several new such initiatives are under preparation.

36. These financial innovations require related upgrades in the prudential framework. The supervisor's increased attention to monitoring nontraditional entrants into the financial system and correspondent relationships of traditional banks is essential. The ongoing implementation of the Basel III standards, including the liquidity coverage requirements, and the move to International

Financial Reporting Standards (IFRS) accounting norms should also help to maintain and further strengthen Uruguay's robust prudential framework.

37. Authorities views on financial deepening and reforms. The authorities noted the initial positive effects of the 2014 financial inclusion law, in particular the five-time increase in the volume of transactions paid with debit cards, a significant reduction in the cost of interbank transfers, and progress in the interoperability of point-of-sale terminal networks. Regarding regulatory reforms, the authorities assessed the effect of the introduction of the new Basel III requirements on banks at each step of the implementation process. They mentioned that five out of twelve banks had been classified as systemically important and would face a capital surcharge, scheduled for 2017.

STAFF APPRAISAL

38. Following a decade of high and inclusive growth, economic activity in Uruguay has slowed. Notwithstanding the progress made in economic diversification and in decoupling from neighboring countries, the economy is affected by slowing activity across Latin America, and anemic growth in other markets, and declining commodity prices. The currency has depreciated broadly in line with other countries in the region, and remains broadly aligned with fundamentals. At the same time, inflation continues to exceed the central bank's target range.

39. As a small open economy exporting mostly agricultural products, importing all its oil, and dependent on international financial markets, Uruguay remains exposed to possible further shocks. While the baseline projection foresees a temporary and mild slowdown, the near-term economic future of Argentina and Brazil presents important sources of uncertainty. In addition, the decline in domestic credit and in consumer and producer confidence weighs on the outlook for domestic spending.

40. With proper economic management, Uruguay should be well-positioned to weather the recent slowdown. Uruguay's flexible exchange rate offers a key tool for absorbing external shocks. In addition, ample gross reserves and the government's sizable liquidity buffers can help cushion severe external shocks. Nevertheless such buffers could be prematurely eroded by prolonged foreign exchange interventions if these continued after disorderly market conditions have subsided.

41. A strong public sector balance sheet is essential for underpinning confidence in Uruguay's economy. In this context, the government's 5-year budget appropriately combines emphasis on budgetary consolidation with efforts to support infrastructure development and key social objectives. A firm commitment is needed to continued improvements in the structural primary balance that will stabilize net debt over the medium term. Such commitment would offer scope for automatic stabilizers to operate along the structural consolidation path. Restoring the financial soundness of the oil-distribution company ANCAP is crucial for the fiscal outlook. Well-designed public-private partnerships can support project management and relieve immediate financing constraints.

42. A threefold strategy is needed to bring inflation back within the target range. Such a strategy involves keeping a tight monetary policy stance, supported by a prudent fiscal stance, eliminating wages' backward indexation to reduce inflation persistence, and ongoing strengthening of the monetary policy framework. Price stability would be an important element of a strategy to gradually reduce the high level of dollarization, which limits the effectiveness of monetary policy.

43. Greater economic diversification, infrastructure upgrades, and secondary education reform would contribute to boosting Uruguay's growth potential. Expanding higher value-added commodity production and processing, and increasing the diversification of markets would reduce exposure to adverse external shocks. Improvements in transport and logistics infrastructure will be important for keeping up with the demands of a growing and increasingly diversified economy.

44. The authorities' initiatives to promote financial deepening are promising. The 2014 financial inclusion law is expected to foster more competition in the retail banking market and improve intermediation efficiency. Ongoing upgrades in Uruguay's solid regulatory framework, including the judicious implementation of the Basel III requirements, should accompany the financial sector innovations

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

Table 2. Uruguay: Selected Economic Indicators

	2011	2012	2013	2014	2015 (est.)	2016	2017	2018	2019	2020
						Projections				
Output, prices, and employment										
Real GDP (percent change)	5.2	3.3	5.1	3.5	1.5	1.4	2.6	3.0	3.1	3.1
GDP (US$ billions)	48.0	51.4	57.5	57.5	54.0	52.9	54.7	57.2	59.9	63.2
Unemployment (in percent, eop)	5.6	5.6	6.0	6.5	7.9	7.6	7.5	7.2	7.2	7.2
CPI inflation (in percent, average)	8.1	8.1	8.6	8.9	8.7	8.2	7.7	7.2	6.5	6.4
Exchange rate (UY$/US$, average)	19.3	20.3	20.5	23.2	27.5	...	...	...	...	...
Real effective exchange rate (percent change, eop)	2.0	3.1	6.6	-1.7	4.2	...	...	...	...	...
	(Percent change, unless otherwise specified)									
Monetary and banking indicators 1/										
Base money	17.3	26.7	12.9	1.4	...	...	...	...	...	...
Broader M1 (M1 plus savings deposits)	20.8	11.2	15.0	3.7	...	...	...	...	...	...
M2	22.0	12.3	11.6	7.1	...	...	...	...	...	...
Growth of credit to households (in real UY$)	2.1	7.3	9.9	4.7	...	...	...	...	...	...
Growth of credit to firms (in US$)	26.5	17.5	16.2	6.8	...	...	...	...	...	...
Bank assets (in percent of GDP)	59.3	56.9	60.8	63.4	...	...	...	...	...	...
Private credit (in percent of GDP) 2/	23.1	23.4	26.0	27.0	...	...	...	...	...	...
Foreign bank market share (in percent of total loans)	56.0	56.6	59.3	60.4	...	...	...	...	...	...
	(Percent of GDP, unless otherwise specified)									
Public sector indicators										
Revenue 3/	28.1	27.7	29.5	29.0	28.9	28.9	29.0	29.2	29.2	29.3
Non-interest expenditure 3/	26.4	27.9	29.1	29.3	28.7	29.0	28.8	28.7	28.5	28.5
Wage bill	4.9	5.0	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Primary balance 4/	1.9	-0.2	0.4	-0.6	0.0	-0.4	-0.1	0.2	0.4	0.5
Interest 4/	2.8	2.5	2.7	2.8	3.6	3.1	3.0	2.7	2.9	3.0
Overall balance 4/	-0.9	-2.7	-2.3	-3.5	-3.6	-3.4	-3.0	-2.5	-2.5	-2.5
Gross public sector debt	58.1	57.9	60.2	61.3	61.9	63.1	64.0	64.2	64.3	64.7
Public sector debt net of liquid financial assets 5/	36.7	35.7	35.9	34.9	36.6	38.6	39.9	40.4	40.8	41.3
External indicators										
Merchandise exports, fob (US$ millions)	9,274	9,916	10,257	10,351	9,581	9,334	9,781	10,370	11,048	11,779
Merchandise imports, fob (US$ millions)	10,704	12,277	11,608	11,271	10,068	9,760	10,356	11,081	11,826	12,653
Terms of trade (percent change)	-0.2	6.7	-0.3	2.7	3.1	-0.9	-1.7	-0.5	-0.3	-0.1
Current account balance	-2.7	-5.0	-4.9	-4.3	-3.8	-4.0	-3.8	-3.7	-3.6	-3.5
Foreign direct investment	5.2	4.9	5.3	4.8	4.5	4.4	4.4	4.3	4.1	4.1
Overall balance of payments (US$ millions)	2,564	3,287	2,923	1,360	-1,924	-7	252	515	469	739
Total external debt + non-resident deposits	39.4	39.3	41.6	43.4	50.2	50.6	51.2	51.4	51.4	51.2
Of which: External public debt	31.0	31.0	32.8	34.7	41.5	41.8	42.4	42.7	42.7	42.5
External debt service (in percent of exports of g&s)	21.6	15.7	21.7	22.9	26.4	27.2	27.1	26.8	26.6	26.2
Gross official reserves (US$ millions)	10,302	13,604	16,279	17,574	15,650	15,643	15,895	16,410	16,879	17,618
In months of imports of goods and services	9.7	11.1	13.2	14.6	14.6	15.2	14.7	14.3	13.8	13.4
In percent of:										
Short-term external (STE) debt	212.6	214.9	264.0	241.1	209.0	211.6	220.4	216.7	212.6	211.7
STE debt plus banks' non-resident deposits	126.2	140.0	153.9	150.3	136.4	136.0	138.5	136.1	133.4	132.5

Sources: Banco Central del Uruguay, Ministerio de Economia y Finanzas, Instituto Nacional de Estadistica, and Fund staff calculations.
1/ Percent change of end-of-year data on one year ago.
2/ Includes bank and non-bank credit.
3/ Non-financial public sector excluding local governments.
4/ Total public sector. Includes the non-financial public sector, local governments, Banco Central del Uruguay, and Banco de Seguros del
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.

Table 3. Uruguay: Balance of Payments and External Sector Indicators

	2011	2012	2013	2014	2015 (est.)	2016	2017	2018	2019	2020
						Projections				
	(In millions of U.S. dollars, unless otherwise indicated)									
Balance of Payments										
Current account	-1,315	-2,593	-2,825	-2,494	-2,069	-2,129	-2,092	-2,128	-2,142	-2,221
Trade balance	-1,431	-2,361	-1,351	-920	-487	-426	-575	-711	-778	-874
Exports, f.o.b.	9,274	9,916	10,257	10,351	9,581	9,334	9,781	10,370	11,048	11,779
Imports, f.o.b.	10,704	12,277	11,608	11,271	10,068	9,760	10,356	11,081	11,826	12,653
Of which: Fuel products	2,011	2,851	2,055	1,722	948	803	971	1,137	1,279	1,408
Of which: Non-fuel products	8,694	9,426	9,553	9,549	9,120	8,957	9,385	9,944	10,547	11,245
Services balance	1,592	1,189	241	139	277	266	548	763	950	1,102
Exports, f.o.b.	3,642	3,601	3,482	3,337	3,084	2,837	3,167	3,438	3,804	4,206
Imports, f.o.b.	2,050	2,411	3,241	3,198	2,807	2,571	2,619	2,676	2,854	3,104
Income balance (net)	-1,631	-1,536	-1,843	-1,843	-1,990	-2,102	-2,199	-2,315	-2,450	-2,587
Transfers (net)	156	115	129	131	132	133	134	135	137	138
Financial and capital account	4,190	6,286	4,689	4,920	-817	2,122	2,344	2,643	2,611	2,961
Foreign direct investment	2,504	2,536	3,032	2,781	2,410	2,337	2,387	2,436	2,485	2,581
Portfolio investment	1,976	1,643	2,769	1,258	-110	662	695	694	803	826
Other capital flows (net)	-297	2,064	-1,308	882	-3,263	-863	-723	-473	-662	-431
Errors and omissions	-311	-406	1,059	-1,066	962	0	0	0	0	0
Overall balance	2,564	3,287	2,923	1,360	-1,924	-7	252	515	469	739
Reserve assets (- increase)	-2,564	-3,287	-2,923	-1,360	1,924	7	-252	-515	-469	-739
Reserve Adequacy and External Indicators										
Gross official reserves (stock)	10,302	13,604	16,279	17,574	15,650	15,643	15,895	16,410	16,879	17,618
In months of imports of goods and services	9.7	11.1	13.2	14.6	14.6	15.2	14.7	14.3	13.8	13.4
In percent of short-term debt	212.6	214.9	264.0	241.1	209.0	211.6	220.4	216.7	212.6	211.7
	(As percent of GDP)									
Balance of Payments										
Current account	-2.7	-5.0	-4.9	-4.3	-3.8	-4.0	-3.8	-3.7	-3.6	-3.5
Trade balance	-3.0	-4.6	-2.3	-1.6	-0.9	-0.8	-1.1	-1.2	-1.3	-1.4
Exports of goods	19.3	19.3	17.8	18.0	17.7	17.6	17.9	18.1	18.4	18.7
Imports of goods	22.3	23.9	20.2	19.6	18.6	18.4	18.9	19.4	19.7	20.0
Of which: Fuel products	4.2	5.5	3.6	3.0	1.8	1.5	1.8	2.0	2.1	2.2
Of which: Non-fuel products	18.1	18.3	16.6	16.6	16.9	16.9	17.2	17.4	17.6	17.8
Services balance	3.3	2.3	0.4	0.2	0.5	0.5	1.0	1.3	1.6	1.7
Exports	7.6	7.0	6.1	5.8	5.7	5.4	5.8	6.0	6.3	6.7
Imports	4.3	4.7	5.6	5.6	5.2	4.9	4.8	4.7	4.8	4.9
Financial and capital account	8.7	12.2	8.2	8.6	-1.5	4.0	4.3	4.6	4.4	4.7
Foreign direct investment	5.2	4.9	5.3	4.8	4.5	4.4	4.4	4.3	4.1	4.1
Portfolio investment (net)	4.1	3.2	4.8	2.2	-0.2	1.3	1.3	1.2	1.3	1.3
Other capital flows (net)	-0.6	4.0	-2.3	1.5	-6.0	-1.6	-1.3	-0.8	-1.1	-0.7
Reserve assets (- increase)	-5.3	-6.4	-5.1	-2.4	3.6	0.0	-0.5	-0.9	-0.8	-1.2
Total external debt + non-resident deposits	39.4	39.3	41.6	43.4	50.2	50.6	51.2	51.4	51.4	51.2
Of which: Short-term debt (residual maturity)	10.1	12.3	10.7	12.7	13.9	14.0	13.2	13.2	13.2	13.2
Of which: External public debt	31.0	31.0	32.8	34.7	41.5	41.8	42.4	42.7	42.7	42.5
	(As percent of annual exports of goods and services)									
External Debt										
Total external debt (including non-resident deposits)	142.0	156.3	166.4	173.9	197.0	213.0	210.1	207.8	203.5	198.4
Debt service	21.6	15.7	21.7	22.9	26.4	27.2	27.1	26.8	26.6	26.2
Of which: Interest payments	6.7	5.4	5.9	5.5	6.4	6.9	3.5	4.9	4.3	3.9
	(Annual percent changes)									
External Trade										
Exports of goods in US$	15.5	6.9	3.4	0.9	-7.4	-2.6	4.8	6.0	6.5	6.6
Imports of goods in US$	25.1	14.7	-5.4	-2.9	-10.7	-3.1	6.1	7.0	6.7	7.0
Export prices in US$	12.7	5.0	-1.2	0.5	-10.0	-4.6	0.6	0.8	0.9	0.7
Import prices in US$	12.9	-1.5	-0.9	-2.1	-12.7	-3.8	2.3	1.3	1.2	0.7
Terms of trade for goods	-0.2	6.7	-0.3	2.7	3.1	-0.9	-1.7	-0.5	-0.3	-0.1
Export volume (goods and non-factor services)	6.9	-0.4	0.2	-2.8	-2.4	-2.4	4.2	4.3	5.2	5.4
Import volume (goods and non-factor services)	12.6	16.2	1.7	-1.3	-1.3	-1.5	3.0	4.5	5.2	6.2
Export volume (goods)	2.4	1.8	4.7	0.4	2.8	2.1	4.2	5.2	5.6	5.9
Import volume (goods)	10.8	16.4	-4.5	-0.8	2.3	0.8	3.7	5.6	5.5	6.2
Of which: Non-fuel products	14.8	9.1	10.7	5.6	2.1	0.6	3.6	5.5	5.5	6.2
Of which: Fuel products	-4.1	40.4	-27.3	-9.4	-5.7	-20.0	13.7	11.1	9.7	9.1

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

Table 4. Uruguay: Main Fiscal Aggregates

						Projections				
	2011	2012	2013	2014	2015 (est.)	2016	2017	2018	2019	2020
	(In billions of pesos, unless otherwise indicated)									
I. Primary balance of the non-financial public sector (A+B+C)	18.6	-1.2	5.4	-7.3	1.3	-4.5	0.3	6.0	10.9	14.3
A. Primary balance of central government, BPS and NFPE 1/ 2/	16.1	-2.4	4.4	-4.6	4.2	-2.1	3.0	9.0	14.2	17.9
Revenues	260.2	288.6	347.4	387.2	429.8	472.9	522.6	580.3	635.9	698.1
Taxes	175.0	191.3	222.5	244.2	268.6	298.1	327.8	363.1	399.7	438.9
Non tax	15.5	16.2	20.9	21.6	22.5	24.1	26.7	29.7	32.4	35.4
Social security	59.9	72.6	86.0	101.0	110.5	121.3	135.9	150.1	163.4	179.0
NFPE operating balance 2/	9.8	8.5	18.0	20.4	28.2	29.4	32.2	37.4	40.5	44.7
Primary expenditures	244.1	291.0	343.1	391.9	425.6	475.0	519.6	571.3	621.7	680.2
Current	219.5	261.9	302.6	348.9	388.4	429.1	469.1	517.6	562.9	615.8
Capital	24.6	29.1	40.4	43.0	37.1	45.9	50.4	53.7	58.8	64.4
B. Primary balance of local governments	0.9	-0.8	-0.8	-2.0	-2.2	-2.5	-2.7	-3.0	-3.3	-3.6
C. Primary balance of BSE 3/	1.6	2.0	1.8	-0.6	-0.7	0.0	0.0	0.0	0.0	0.0
II. Primary balance of the BCU 4/	-0.8	-0.4	-0.8	-1.0	-1.2	-1.3	-1.4	-1.6	-2.1	-2.3
III. Primary balance of the public sector (I+II)	17.8	-1.7	4.6	-8.2	0.1	-5.8	-1.1	4.4	8.8	12.0
IV. Interest	26.2	26.4	31.9	37.9	53.7	50.6	53.4	54.6	62.2	71.9
of which: BCU 4/	4.2	3.0	4.4	7.4	16.3	5.7	3.3	-1.1	-1.7	-2.0
V. Overall balance of the public sector (III-IV)	-8.4	-28.0	-27.4	-46.1	-53.6	-56.4	-54.5	-50.1	-53.4	-60.0
	(In percent of GDP, unless otherwise indicated)									
I. Primary balance of the non-financial public sector (A+B+C)	2.0	-0.1	0.5	-0.5	0.1	-0.3	0.0	0.3	0.5	0.6
A. Primary balance of central government, BPS and NFPE 1/ 2/	1.7	-0.2	0.4	-0.3	0.3	-0.1	0.2	0.5	0.7	0.8
Revenues	28.1	27.7	29.5	29.0	28.9	28.9	29.0	29.2	29.2	29.3
Taxes	18.9	18.3	18.9	18.3	18.1	18.2	18.2	18.3	18.4	18.4
Non tax	1.7	1.6	1.8	1.6	1.5	1.5	1.5	1.5	1.5	1.5
Social security	6.5	7.0	7.3	7.6	7.4	7.4	7.5	7.5	7.5	7.5
NFPE operating balance 2/	1.1	0.8	1.5	1.5	1.9	1.8	1.8	1.9	1.9	1.9
Primary expenditures	26.4	27.9	29.1	29.3	28.7	29.0	28.8	28.7	28.5	28.5
Current	23.7	25.1	25.7	26.1	26.2	26.2	26.0	26.0	25.8	25.8
Capital	2.7	2.8	3.4	3.2	2.5	2.8	2.8	2.7	2.7	2.7
B. Primary balance of local governments	0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
C. Primary balance of BSE 3/	0.2	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
II. Primary balance of BCU 4/	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
III. Primary balance of the public sector (I+II)	1.9	-0.2	0.4	-0.6	0.0	-0.4	-0.1	0.2	0.4	0.5
IV. Interest	2.8	2.5	2.7	2.8	3.6	3.1	3.0	2.7	2.9	3.0
Of which: BCU 4/	0.5	0.3	0.4	0.6	1.1	0.3	0.2	-0.1	-0.1	-0.1
V. Overall balance of the public sector (III-IV)	-0.9	-2.7	-2.3	-3.5	-3.6	-3.4	-3.0	-2.5	-2.5	-2.5
Memorandum Items:										
GDP (in billions of pesos)	926	1,044	1,178	1,336	1,485	1,638	1,802	1,988	2,178	2,387

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 5. Uruguay: Public Sector Debt and Assets 1/

	2011	2012	2013	2014	2015 (est.)	Projections 2016	2017	2018	2019	2020
	(In billions of U.S. dollars, unless otherwise indicated)									
Public Sector Debt										
Gross debt of the public sector	27.0	31.1	33.1	33.6	30.7	32.3	34.0	35.9	37.8	40.1
of which:										
Non-financial public sector debt	20.8	23.5	23.8	24.5	25.9	27.5	29.1	30.7	32.5	34.4
Central bank debt	6.2	7.7	9.3	9.1	4.8	4.8	4.9	5.1	5.3	5.7
External debt of the public sector	14.4	16.7	18.0	19.0	20.6	21.4	22.5	23.8	25.1	26.3
Domestic debt of the public sector	12.6	14.5	15.1	14.6	10.1	10.9	11.5	12.0	12.7	13.8
Public Sector Assets										
Gross assets of the public sector	13.9	17.5	19.8	21.5	19.6	19.6	19.9	20.4	20.8	21.6
of which:										
Financial assets of the non-financial public sector	2.7	3.1	2.7	2.8	2.9	3.0	3.1	3.3	3.5	3.7
Reserve assets of the central bank	11.2	14.4	17.1	18.7	16.7	16.6	16.7	17.1	17.4	17.9
Liquid reserve assets of the central bank	7.3	8.8	10.7	11.7	9.6	9.5	9.7	10.0	10.3	10.9
Liquid assets of the public sector 2/	10.0	12.0	13.4	14.5	12.6	12.6	12.8	13.3	13.8	14.5
Net Public Sector Debt										
Gross debt minus liquid financial assets 2/	17.1	19.2	19.7	19.1	18.2	19.8	21.2	22.5	24.0	25.6
Authorities' definition 3/	13.2	13.6	13.3	12.1	11.1	12.7	14.1	15.5	16.9	18.5
	(In percent of GDP, unless otherwise indicated) 1/									
Public Sector Debt										
Gross debt of the public sector	58.1	57.9	60.2	61.3	61.9	63.1	64.0	64.2	64.3	64.7
of which:										
Non-financial public sector debt	44.7	43.6	43.3	44.7	52.2	53.8	54.8	55.1	55.3	55.5
Central bank debt	13.4	14.3	16.9	16.6	9.7	9.4	9.2	9.1	9.0	9.2
External debt of the public sector	31.0	31.0	32.8	34.7	41.5	41.8	42.4	42.7	42.7	42.5
Domestic debt of the public sector	27.1	26.9	27.4	26.6	20.4	21.3	21.6	21.5	21.6	22.3
Public Sector Assets										
Gross financial assets of the public sector	29.8	32.6	36.0	39.3	39.5	38.3	37.4	36.5	35.5	34.8
of which:										
Financial assets of the non-financial public sector	5.8	5.8	4.8	5.2	5.9	5.9	5.9	5.9	5.9	5.9
Liquid assets of the public sector 2/	21.4	22.2	24.3	26.4	25.3	24.5	24.1	23.9	23.5	23.4
Net Public Sector Debt										
Gross debt minus liquid financial assets 2/	36.7	35.7	35.9	34.9	36.6	38.6	39.9	40.4	40.8	41.3
Authorities' definition 3/	28.3	25.3	24.2	22.0	22.4	24.9	26.6	27.7	28.8	29.9

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

Table 6. Uruguay: Statement of Operations of the Central Government 1/

	2009	2010	2011	2012	2013	2014
	(In percent of GDP, based on the 2001 GFS Manual)					
Revenue	29.2	29.9	30.0	29.9	31.1	28.8
Taxes	18.7	18.9	19.1	18.8	19.0	18.5
Social contributions	8.7	8.9	9.1	9.7	10.1	8.5
Grants	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	1.8	2.1	1.8	1.5	2.0	1.8
Expense	29.1	29.4	29.1	30.5	31.2	29.7
Compensation of employees	7.2	6.8	6.9	7.1	7.2	7.4
Use of goods and services	3.6	3.7	3.4	3.5	3.7	3.7
Consumption of fixed capital 2/	….	….	….	….	0	0
Interest	2.7	2.4	2.4	2.3	2.4	2.3
Subsidies	0.3	0.2	0.2	0.3	0.2	0.2
Grants	0.6	0.0	0.0	0.0	0.0	0.0
Social benefits	12.7	13.4	13.4	14.2	14.5	13.2
Other expenses	1.9	2.9	2.7	3.1	3.2	2.9
Net acquisition of nonfinancial assets	1.6	1.4	1.5	1.4	1.4	1.4
Gross operating balance	0.1	0.5	0.9	-0.6	-0.1	-0.9
Net operating balance 2/	….	….	….	….	-0.1	-0.9
Net lending (+) borrowing (-)	-1.5	-0.9	-0.6	-2.0	-1.5	-2.2
Net acquisition of financial assets	4.5	-2.3	3.5	0.7	-0.3	0.2
By instrument						
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	1.9	-2.1	3.2	0.2	-0.9	0.7
Debt securities	1.9	0.1	0.3	0.0	-0.1	0.0
Loans	0.1	-0.3	-0.1	0.4	0.8	-0.4
Equity and shares	0.7	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	4.5	-2.3	3.2	0.2	-0.3	0.2
External	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	6.1	-1.2	4.1	2.7	1.3	2.5
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	1.4	0.0	4.6	2.2	2.1	2.3
Loans	4.7	-1.1	-0.5	0.5	-0.8	0.2
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	3.7	-0.8	4.3	0.6	-1.4	0.1
External	2.4	-0.4	-0.2	2.1	2.7	2.4
Memorandum items:						
Public sector net lending (+) borrowing (-)	-1.6	-1.4	-0.9	-2.7	-2.3	-3.5
Public sector primary balance	1.1	1.5	1.9	-0.2	0.4	-0.6

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 and 2014 below the line data is not consolidated.

2/ Not compiled by the authorities until 2013.

Table 7. Uruguay: Central Government Stock Positions 1/

	2009	2010	2011	2012	2013	2014
	(In percent of GDP, based on the 2001 GFS Manual)					
Net financial worth	-38.3	-35.6	-35.0	-33.5	-33.8	-35.1
Financial assets	11.0	8.6	10.4	9.9	8.9	9.0
By instrument						
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	6.9	4.4	6.8	6.5	4.7	5.3
Debt securities	1.5	2.0	2.5	2.5	2.2	2.2
Loans	1.8	1.6	0.6	0.5	1.7	1.2
Equity and shares	0.7	0.6	0.5	0.4	0.3	0.3
By residency						
Domestic	10.9	8.6	10.3	9.8	8.9	9.0
External	0.0	0.0	0.0	0.0	0.0	0.0
Liabilities	49.3	44.2	45.4	43.3	42.7	44.2
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	35.3	32.5	34.6	34.3	35.1	36.8
Loans	14.0	11.7	10.7	9.0	7.6	7.4
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0
By residency						
Domestic	20.0	17.9	21.0	19.3	16.9	16.8
External	29.2	26.3	24.3	24.0	25.9	27.4

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

1/ Central government and Social Security Bank. 2013 and 2014 data is not consolidated.

Table 8. Uruguay: Monetary Survey

	2011	2012	2013	2014	2015 1/
	(End of period, in billions of pesos)				
Banco Central del Uruguay (BCU)					
Net foreign assets	205.4	254.4	330.6	407.8	449.0
Net international reserves 2/	205.0	263.9	348.2	427.2	485.3
Other net foreign assets	0.4	-9.5	-17.6	-19.4	-36.3
Net domestic assets	-123.7	-155.0	-211.7	-288.7	-378.9
Net credit to the public sector	22.2	43.0	75.6	70.8	20.7
Net credit to the financial system	-51.8	-82.5	-128.9	-192.2	-259.1
Credit to the private sector	0.3	0.3	0.3	0.5	0.6
Securities issued by the BCU	-120.5	-155.2	-202.4	-202.0	-131.8
Other	27.5	36.8	28.2	8.5	-50.7
Peso monetary liabilities 3/	81.7	99.4	118.9	119.1	70.2
Public and Private Banks 4/					
Net foreign assets	94.8	70.9	64.7	74.2	148.5
Net domestic assets	287.3	346.2	438.3	530.6	616.0
Net credit to the public sector	25.8	25.1	19.9	33.3	39.2
Net credit to the financial system	110.8	148.6	190.2	231.7	258.7
Credit to the private sector	213.4	243.9	305.9	359.3	425.0
Other	-62.7	-71.4	-77.7	-93.6	-106.8
Liabilities to the private sector (residents)	382.1	417.1	503.0	604.8	764.5
Public banks	191.6	213.6	257.2	311.4	374.5
Local currency	70.5	82.0	94.0	101.3	108.5
Foreign currency	121.1	131.6	163.2	210.1	266.0
Private banks	190.5	203.5	245.7	293.4	390.0
Local currency	57.2	59.1	66.5	72.4	83.3
Foreign currency	133.3	144.4	179.2	221.0	306.7
Banking System (Central, Private, and Public Banks)					
Net foreign assets	300.2	325.3	395.3	482.0	597.5
Net domestic assets	102.1	117.1	132.0	147.3	176.7
Credit to the public sector	48.0	68.1	95.5	104.1	59.9
Credit to the rest of financial system	-3.9	-5.5	-17.8	-29.5	-19.3
Credit to the private sector	213.7	244.2	306.7	360.3	425.6
Other	-155.6	-189.8	-251.9	-287.1	-289.4
Broad money (M-3)	402.4	442.4	527.3	629.3	774.3
	(In percent of total private credit) 5/				
Composition of Credit					
Credit to firms	55.1	56.8	57.4	59.3	62.0
Credit to households	44.9	43.2	42.6	40.7	38.0
Consumption	62.1	63.7	63.1	61.8	60.5
Car loans	0.6	0.7	1.0	1.3	1.6
Mortgages	37.3	35.6	35.9	36.9	38.0
	(Percentage change) 6/				
Memorandum Items:					
Base money	17.3	26.7	12.9	1.4	14.2
M-1	18.8	9.1	12.2	1.9	10.3
Broader M-1 (M1 plus savings deposits)	20.8	11.2	15.0	3.7	9.4
M-2	22.0	12.3	11.6	7.1	13.1
M-3	18.0	10.0	19.2	19.3	26.9
Credit to firms (in US$)	26.5	17.5	16.2	6.8	4.2
Credit to households (in real UY$)	2.1	7.3	9.9	4.7	4.3

Source: Banco Central del Uruguay.

1/ Latest available data (November 2015).

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/ Percent change since one year ago. In pesos, unless indicated otherwise.

Table 9. Uruguay: Medium-Term Macroeconomic Framework

	2011	2012	2013	2014	2015 (est.)	Projections 2016	2017	2018	2019	2020
					(Annual percent change, unless otherwise indicated)					
National Accounts										
Real GDP	5.2	3.3	5.1	3.5	1.5	1.4	2.6	3.0	3.1	3.1
Total domestic demand	7.4	6.9	5.9	2.9	1.6	1.4	2.3	3.2	3.3	3.5
Final consumption expenditure	6.7	5.1	5.2	4.0	3.6	0.9	1.8	3.1	3.1	3.2
Private final consumption expenditure	7.2	5.0	5.2	4.2	3.8	0.8	1.7	3.1	3.1	3.2
Public final consumption expenditure	3.7	5.9	5.0	2.5	1.7	1.5	2.7	3.1	3.1	3.2
Gross capital formation	9.9	13.9	8.6	-1.2	-5.9	3.4	4.4	3.6	4.3	4.5
Gross fixed capital formation	7.0	18.5	4.3	2.6	-5.9	3.8	4.4	3.6	4.3	4.5
Private fixed capital formation	11.5	22.2	2.7	-0.8	-3.7	0.5	4.0	4.2	4.2	4.5
Public fixed capital formation	-9.9	1.5	13.3	19.9	-15.1	19.2	5.9	1.5	4.8	4.3
Change in inventories (contribution to growth)	0.6	-0.8	1.0	-0.9	0.0	-0.1	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	-2.4	-3.9	-1.3	0.4	-0.2	-0.1	0.1	-0.4	-0.5	-0.7
Consumer Prices										
CPI inflation (average)	8.1	8.1	8.6	8.9	8.7	8.2	7.7	7.2	6.5	6.4
CPI inflation (end of period)	8.6	7.5	8.5	8.3	9.4	8.1	7.0	6.7	6.4	6.3
Core CPI inflation (average)	8.9	8.8	8.3	9.8	10.2	…	…	…	…	…
Balance of Payments										
Current account balance (percent of GDP)	-2.7	-5.0	-4.9	-4.3	-3.8	-4.0	-3.8	-3.7	-3.6	-3.5
Exports of goods and services (volume)	5.8	3.1	0.2	1.9	-2.4	-2.4	4.2	4.3	5.2	5.4
Export of goods (volume)	2.4	1.8	4.7	0.4	2.8	2.1	4.2	5.2	5.6	5.9
Imports of goods and services (volume)	12.6	16.2	1.7	-1.3	-1.3	-1.5	3.0	4.5	5.2	6.2
Imports of goods (volume)	10.8	16.4	-4.5	-0.8	2.3	0.8	3.7	5.6	5.5	6.2
Terms of trade (goods)	94.0	100.3	100.0	102.7	105.9	105.0	103.2	102.7	102.4	102.3
					(In percent of GDP, unless otherwise indicated)					
Public Sector Finance										
Primary balance 1/	1.9	-0.2	0.4	-0.6	0.0	-0.4	-0.1	0.2	0.4	0.5
Revenue 2/	28.1	27.7	29.5	29.0	28.9	28.9	29.0	29.2	29.2	29.3
Primary expenditure 2/	26.4	27.9	29.1	29.3	28.7	29.0	28.8	28.7	28.5	28.5
Structural primary balance	1.1	0.2	-1.1	-1.7	-0.6	-0.6	-0.2	0.2	0.4	0.5
Overall balance	-0.9	-2.7	-2.3	-3.5	-3.6	-3.4	-3.0	-2.5	-2.5	-2.5
Public sector gross debt	58.1	57.9	60.2	61.3	61.9	63.1	64.0	64.2	64.3	64.7
Gross Debt (NFPS)	44.7	43.6	43.3	44.7	52.2	53.8	54.8	55.1	55.3	55.5
Assets of the public sector	28.9	34.1	34.4	37.5	36.3	37.0	36.3	35.6	34.8	34.2
Liquid assets of the public sector 3/	21.4	22.2	24.3	26.4	25.3	24.5	24.1	23.9	23.5	23.4
Net public sector debt (gross debt minus liquid assets)	36.7	35.7	35.9	34.9	36.6	38.6	39.9	40.4	40.8	41.3
External Debt										
Gross external debt	39.4	39.3	41.6	43.4	50.2	50.6	51.2	51.4	51.4	51.2
Public sector gross external debt	31.0	31.0	32.8	34.7	41.5	41.8	42.4	42.6	42.7	42.4
Gross international reserves (US$ billions)	10.3	13.6	16.3	17.6	15.7	15.6	15.9	16.4	16.9	17.6
Saving and Investment										
Gross domestic investment	20.9	22.8	22.7	21.4	19.0	18.8	18.8	18.5	18.4	18.4
Public sector gross investment	3.6	3.9	4.2	4.6	3.6	4.0	4.0	3.9	3.9	3.9
Private sector gross investment	17.3	18.9	18.5	16.8	15.5	14.8	14.8	14.7	14.6	14.5
Gross national saving	18.1	17.8	17.8	17.1	15.2	14.8	14.9	14.7	14.8	14.8
Public sector gross saving	1.8	0.1	1.1	-0.2	-1.1	-0.6	-0.2	0.2	0.3	0.2
Private sector gross saving	16.4	17.7	16.7	17.3	16.3	15.4	15.1	14.6	14.5	14.6
Unemployment and Output Gap										
Unemployment rate (percent)	6.3	6.3	6.5	6.6	7.6	7.8	7.6	7.3	7.2	7.2
Output gap (percent of potential output)	2.7	2.2	3.8	3.6	2.0	0.9	0.5	0.1	0.0	0.0

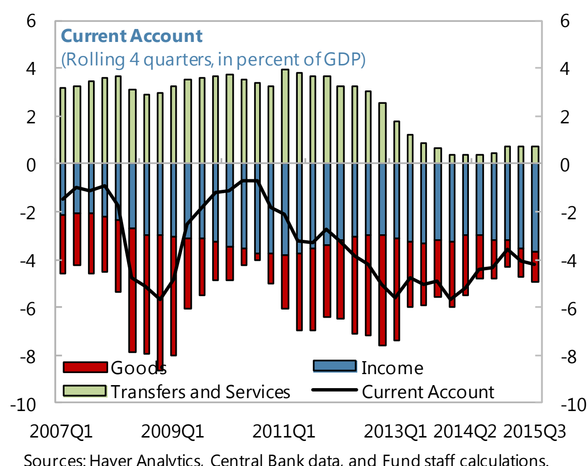
Sources: Banco Central del Uruguay, Haver Analytics and Fund staff calculations.

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.

Annex I. Uruguay—External Stability Assessment



Sources: Haver Analytics, Central Bank data, and Fund staff calculations.

Uruguay: Merchandise Trade Balance

	2010	2011	2012	2013	2014	2015 1/
	(in percent of GDP)					
Trade balance	-1.3	-3.0	-4.6	-2.3	-1.6	-0.4
Exports	19.9	19.3	19.3	17.8	18.0	16.9
Imports	21.2	22.3	23.9	20.2	19.6	18.0
Fuel	4.0	4.2	5.5	3.6	3.0	2.1
Non-fuel	17.4	18.0	16.7	16.7	17.0	16.2
Capital	3.6	3.3	3.0	3.4	3.7	3.5
Consumption	5.0	5.2	5.2	4.9	5.1	5.0
Intermediary	8.7	9.4	8.5	8.4	8.2	7.7

Sources: Banco Central del Uruguay and Fund staff calculations.
1/ 4 quarters through 2015Q3

Uruguay's current account deficit (CAD) narrowed in 2014–15 on the back of a lower oil import bill and strong commodity exports, in spite of continued weakness in the services account. The CAD narrowed to just under 4½ percent of GDP in 2014, from 5 percent of GDP in 2013, as the trade deficit improved owing to lower prices for oil imports and strong commodity exports. Weakness in the external services balance (from a surplus of 3 percent of GDP on average in 2009–12 to near balance in 2013) continued in 2014, due to a surge in Uruguayan tourism to Argentina (given the sharp depreciation of the parallel exchange rate in the latter) and lower tourism receipts from Argentina as the country continued to impose tight current and capital account controls and face deteriorating economic conditions. In 2015, the CAD is estimated to have shrunk further to 3¾ percent of GDP, as the persistence of lower international oil prices and first full year of production of the Montes del Plata pulp mill are expected to have counteracted the fall in price of key Uruguayan commodity exports as well as the economic slowdown in principal trading partners. Staff projects a CAD of around 4 percent of GDP in 2016, as the outlook for Uruguay's commodity export prices remains negative (albeit less so than in 2015), and given the economic difficulties facing Brazil and Argentina, even as import demand in Uruguay slows together with domestic activity.

FDI continues to fully finance Uruguay's current account deficit but other financial and portfolio flows have receded in 2015. Continuing the trend of the past decade, FDI inflows of 4¾ percent of GDP in 2014 comfortably financed the CAD. In the first half of 2015, despite slowing slightly relative to the same period in 2014, FDI inflows of US$1.4 billion were still more than sufficient to cover the CAD of US$1.1 billion, and are estimated to have done so for the year at large. On the other hand, net portfolio investment inflows to Uruguay have abated recently, slowing to 2½ percent of GDP in 2014 after averaging 4 percent of GDP from 2011–13. In 2015, portfolio flows in the first half were supported by the issuance of a U.S. dollar denominated global bond by the government; however, the second half of the year saw net portfolio outflows with a switch in portfolios by Uruguayan pension funds towards U.S. dollar denominated assets, as well as some nonresident selling of short-term local currency public securities. Furthermore, an increase in domestic deposit dollarization in 2015 has contributed to an increase in net other investment

outflows, as banks have sought to offset their rising domestic U.S. dollar liabilities with increased U.S. dollar assets abroad.

The peso has seen a marked depreciation against the U.S. dollar, broadly in line with the trend among emerging markets (EMs). After depreciating by 14 percent against the U.S. dollar in 2014, the peso has depreciated further, by 22 percent, in 2015. Pressures on the peso, largely in line with the strengthening of the U.S. dollar across all EMs, intensified in the second half of 2015, with the portfolio and other investment outflows mentioned above. The central bank of Uruguay accommodated these financial outflows in the second half through interventions in the foreign exchange market, slowing the pace of depreciation, with the aim of curbing excessive volatility and disorderly market conditions in the relatively small domestic foreign exchange market.

Staff estimates that the real effective exchange rate remains in line with fundamentals. The REER depreciated by 1.2 percent from January–November, 2015 (masking a real appreciation of 17 percent against Brazil). The exchange rate is close to its estimated norm. The EBA current account model (based on results from September 2015) indicated a cyclically-adjusted current account norm of -2.8 percent of GDP, somewhat larger than the -2.4 percent of GDP cyclically-adjusted current account deficit (CAD) estimated for 2015, suggesting a 1 percent undervaluation. The contribution of policy variables to the small gap between the projected cyclically adjusted CAD and the norm was minimal.[3] Calculations based on the EBA external stability approach, on the other hand, suggest a 5½ percent overvaluation, as a CAD of -1.2 percent of GDP would be required to stabilize Uruguay's net foreign assets to GDP ratio in the medium-term, while staff's medium-term CAD projection currently stands at -3½ percent of GDP.

Uruguay: Exchange Rate Assessment

	Deviation from equilibrium (in percent) 1/	CA norm	CA projection	Difference
I. EBA - Current Account Model 2/ 4/	-1.0	-2.8 5/	-2.4 5/	0.4
II. External Sustainability (ES) approach 3/ 4/	5.4	-1.2 6/	-3.5 7/	-2.3

Source: Fund staff calculations
1/ Positive values indicate overvaluation.
2/ Based on the September 2015 EBA results and data through December.
3/ Desk calculations based on the EBA ES approach.
4/ Using a CA elasticity of 0.415 (see IMF Country Report No. 15/81).
5/ Cyclically-adjusted.
6/ CAD required to stabilize NFA in the medium-term.
7/ 2020 CAD projection.

External stability risks for Uruguay remain contained. The flip side of the central bank's extensive intervention in the foreign exchange market in 2015 has been a decline in gross reserves of US$2.6 billion since June. Despite this, reserves remain well above the upper bound of the IMF reserve adequacy metric range, and various other prudential benchmarks. An illustrative exercise, simulating a 2002-type situation indicates that a similar run on foreign-currency denominated deposits and repayment of short-term external debt in Uruguay would currently cost about US$9 billion, corresponding

Uruguay: Gross International Reserves

In billions of U.S. dollars (December 2015)	15.7
In months of imports (2015)	14.6
In percent of:	
GDP (2015) 1/	29.1
Short-term external (STE) debt (2015)	209.7
STE debt and foreign currency deposits (2015)	59.3
STE debt and nonresident deposits (2015)	136.9
M2 (latest)	183.7
M3 (latest)	60.7
Memo items:	
IMF's new reserve adequacy metric range in US$, billions (2015 Q3) 2/	6.8 to 10.2
Banks' gross foreign assets (US$, billions, 2015)	11.0
Ratio of gross reserves plus banks' foreign assets to STE debt and foreign currency deposits (percent)	100.8

Sources: Banco Central del Uruguay and Fund staff calculations.
1/ Reserves-to-GDP ratio calculated after converting GDP to U.S. dollars.
2/ Reserve adequacy metric range is the minimum reserve adequacy to 1.5 times the minimum.

[3] The total contribution of identified policy gaps was -0.25, while the gap between the projected CA and norm was 0.4, yielding an unexplained residual of 0.65.

to 56 percent of the latest reserves numbers. Furthermore, the sum of the foreign assets of the central bank and commercial banks exceeds the sum of foreign currency denominated bank deposits (resident and non-resident) and short-term external debt. Given this strong level of reserves, and the financing of the CAD through relatively stable FDI inflows, external stability risks remain contained. Finally, although the net international investment position has worsened since 2007–11, this has primarily been due to an increase in FDI liabilities.

Annex II. Uruguay—Public Sector Debt Sustainability Analysis (DSA)

Uruguay is a particular case among emerging market economies as it is one of very few countries to report debt figures on a consolidated basis for the whole public sector, excluding public commercial banks but including the central bank. This broad institutional coverage yields public gross financing needs and debt ratios that are higher than the DSA benchmarks for higher scrutiny countries.[4] *Under the baseline scenario, gross debt of Uruguay's public sector is projected to increase from 61.3 percent of GDP in 2014 to 64.7 percent in 2020. However the long average maturity and favorable currency composition of the debt, as well as the high level of liquid financial assets of the public sector—26.4 percent of GDP at end-2014—mitigate short-term financing risks.*

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

- *Central government debt*, which stood at 39 percent of GDP at end-2014. The average maturity of central government debt exceeds 14 years and about 52 percent is local-currency denominated.
- *Central bank debt*, at 17 percent of GDP at end-2014. The debt of the central bank mostly consists of short-term securities issued to manage liquidity. About 83 percent of central bank debt is denominated in local currency.
- *Public enterprises' debt*, which stood at 5 percent of GDP at end-2014.
- *And the debt of local governments and other public sector entities (such as Banco de Seguros del Estado)*, which represented less than one percent of GDP at end-2014.

Overall, more than 56 percent of the debt of the public sector at end-2014 was in local currency, 64 percent of which was in CPI-indexed units.

The public sector holds sizable gross financial assets (including international reserves), amounting to 39.3 percent of GDP at end-2014. In addition, the government has access to contingent credit lines from multilateral institutions which represented 3.5 percent of GDP in 2014.

- *The total financial assets of the central bank (including foreign reserve assets, at 32.5 percent of GDP)* reached 34 percent of GDP at end-2014. About 13 percentage points of GDP in reserves were the counterpart to reserve requirements on foreign currency bank deposits.
- *The financial assets of the non-financial public sector* amounted to 5.2 percent of GDP at end-2014, most of which held in liquid instruments (e.g., securities and deposits), in line with the government's prefunding policy of holding enough liquid assets to cover at least 12 months of debt service.

[4] See IMF, *Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries*, May, 9 2013.

The net debt of the public sector, defined as gross debt minus liquid assets, stood at 34.9 percent of GDP at the end of 2014.

- *The stock of liquid assets of the public sector* is computed as total gross public sector assets minus the required reserves held by banks at the BCU against foreign currency deposits. This stock stood at 26.4 percent of GDP at end-2014.

Baseline scenario

The simultaneous reduction in both the central bank's assets and debt in 2015 has a significant effect on the path for both gross and net debt of the public sector. Sales of foreign reserves and other debt management operations by the government and the central bank are estimated to reduce gross debt by about 4.3 percent of GDP between 2014 and 2015, limiting the overall increase in gross debt to 0.6 percent of GDP in that year, despite the adverse valuation effect of the depreciation. The gross and net public debt ratios then slowly increase over the projection horizon. Gross public debt grows from 63.1 percent to 64.7 percent of GDP between 2016 and 2020. Net debt increases faster, from 38.6 percent to 41.3 percent of GDP, as the 2015 sales of reserves reduce the initial stock of liquid assets and, hence, subsequent valuation gains stemming from the continuous appreciation of the U.S. dollar vis-à-vis the peso. Public gross financing needs decrease in 2016 before rising again over the medium term, as global interest rates increase and gross debt rises.

Assuming that real GDP growth, real interest rates, and other identified debt-creating flows remain at the level projected for 2020, the debt-stabilizing primary balance is estimated at about 1 percent of GDP, about ½ percentage point of GDP above the projected medium term level of the primary balance.

The baseline assumptions are broadly plausible. Staff forecast track record is not systematically biased, as reflected in projection errors generally not being consistently on one side. The median forecast errors for inflation and primary balance over the period 2006–14 are broadly in line with those observed in other countries. Uruguay's growth forecast errors are often higher than the inter-quartile range of the distribution of past forecast errors for other countries, implying that growth in Uruguay has tended to surprise on the upside in the past. The projected fiscal adjustment is consistent with experiences across surveillance countries.

The fan charts show limited uncertainty around the baseline. The width of the symmetric fan chart, estimated at around 15 percent of GDP, illustrates a certain degree of confidence for equal-probability upside and downside shocks.

Alternative scenario

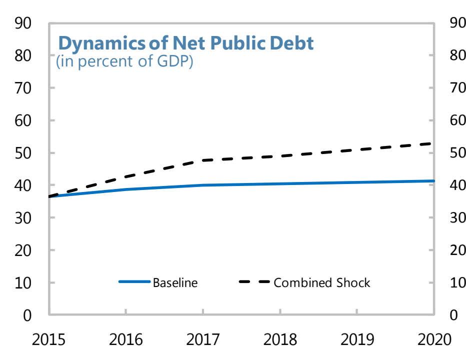
A "historical" scenario, assuming that the key macroeconomic variables behave as in the last decade, yields a downward-sloping debt path, since Uruguay experienced high growth rates and exchange rate appreciation as it recovered from the 2002 financial crisis.

Vulnerability of the financing profile

Public sector's financing needs do not imply near-term vulnerabilities. The share of public sector debt held by non-residents and total external financing needs are slightly above their respective benchmarks, but refinancing risks are limited by the presence of high liquidity buffers, including the sizable liquid financial assets of the public sector and the access to contingent credit lines. These considerations also apply to the assessment of external debt sustainability (Annex III).

Stress tests

Debt dynamics are moderately sensitive to shocks. In a stylized downside scenario that combines a permanent 20 percent exchange rate depreciation (relative to the baseline) with a temporary drop in growth and primary balances, and a permanent increase in real interest rates, the gross debt ratio rises by about 19 percentage points over the five-year forecast horizon. Net debt rises by almost 16 percentage points in the same scenario. The sensitivity of net debt to exchange rate shocks is lower than that of gross debt, as the valuation effects on assets from exchange rate changes partially offset the valuation effects on foreign-currency denominated debt. Fan charts of the projected debt distribution confirm that debt dynamics are generally manageable under statistical distributions of combined shocks.



Source: Fund staff calculations.
Note: Combined shock as described in the text.

Gross public debt would remain below 70 percent of GDP in 75 percent of the cases, while net public debt would remain below 53 percent of GDP under the combined shock scenario previously described.

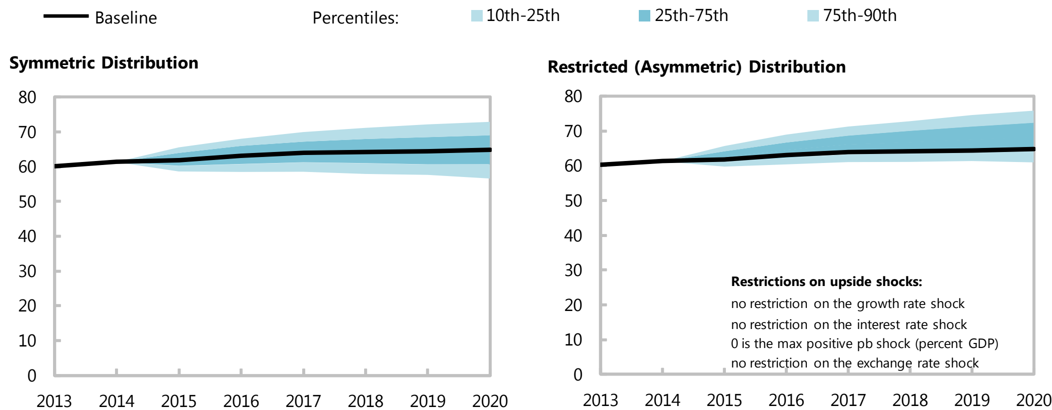
Uruguay Public DSA Risk Assessment

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

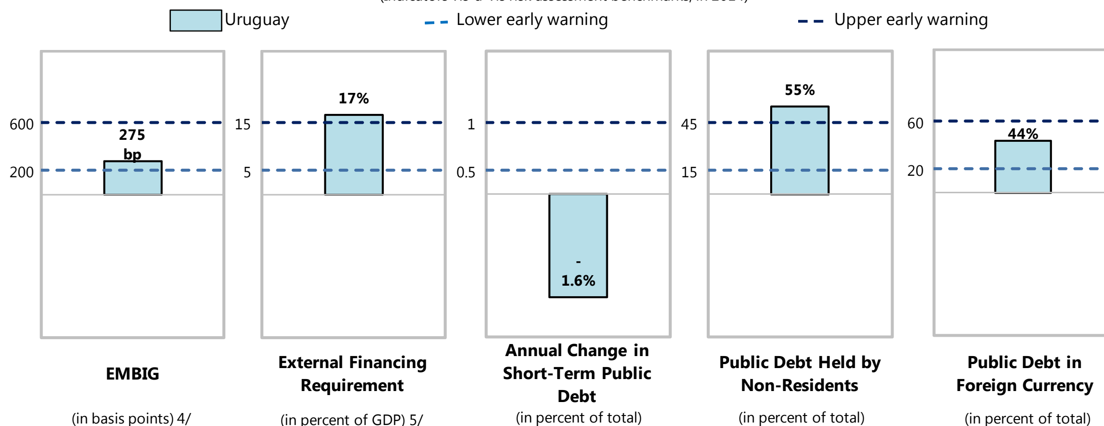
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2014)



Source: IMF staff.

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.

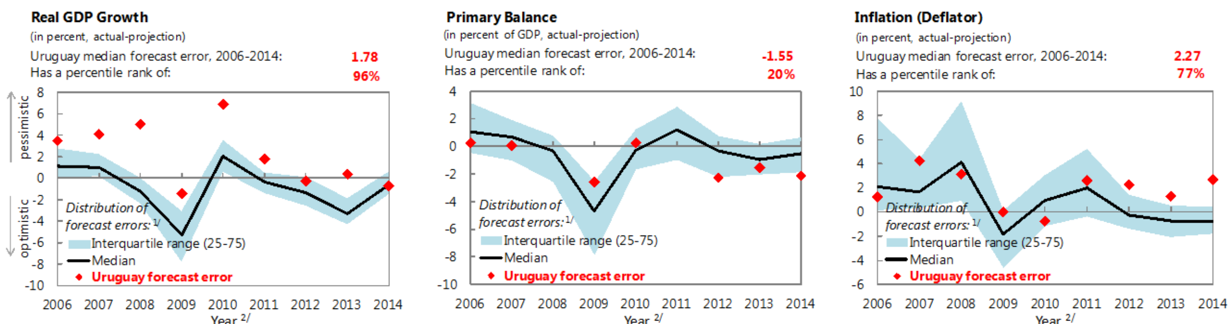
Lower and upper risk-assessment benchmarks are:
200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the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

4/ EMBIG, an average over the last 3 months, 25-Sep-15 through 24-Dec-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.

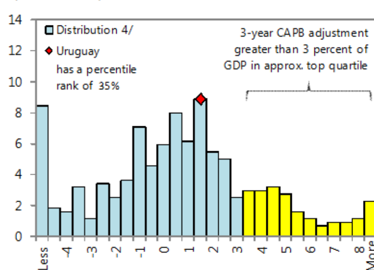
Uruguay Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries

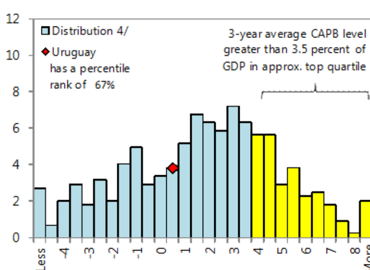


Assessing the Realism of Projected Fiscal Adjustment

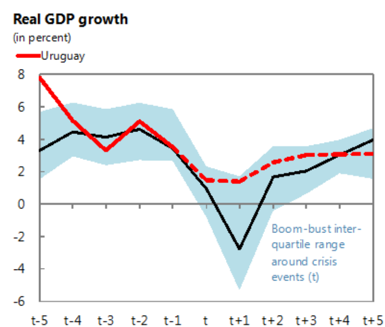
3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)



Boom-Bust Analysis 3/



Source: IMF Staff.

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, 2012-2014. For Uruguay, t corresponds to 2015; 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.

Uruguay Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

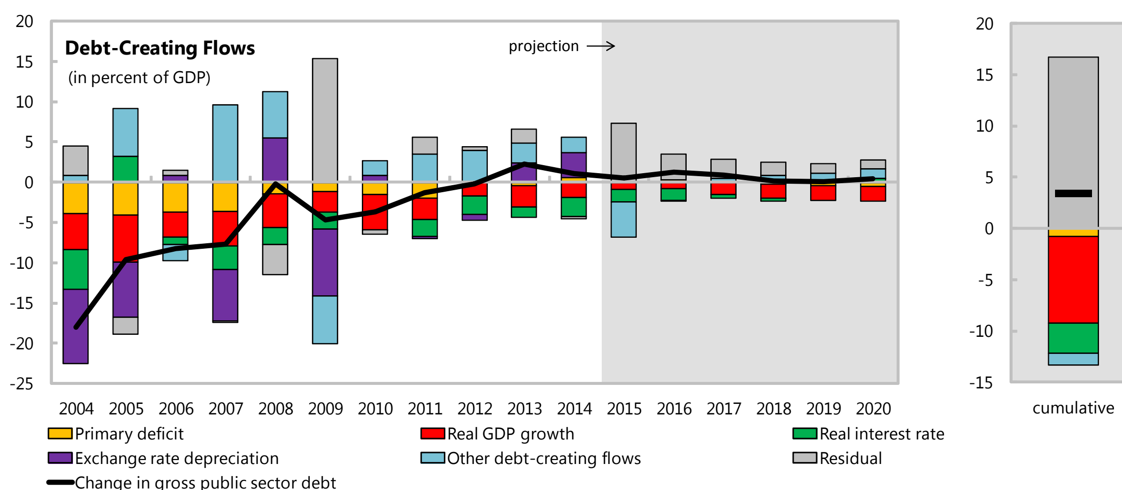
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of December 24, 2015		
	2004-2012 [2]	2013	2014	2015	2016	2017	2018	2019	2020	Sovereign Spreads		
Nominal gross public debt	69.7	60.2	61.3	61.9	63.1	64.0	64.2	64.3	64.7	EMBIG (bp) 3/		284
Public gross financing needs	11.8	12.9	14.6	17.4	11.9	12.5	12.5	13.8	16.3	5Y CDS (bp)		171
Net public debt	42.5	35.9	34.9	36.6	38.6	39.9	40.4	40.8	41.3			
Real GDP growth (in percent)	5.5	5.1	3.5	1.5	1.4	2.6	3.0	3.1	3.1	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	7.4	7.4	9.6	9.6	8.8	7.2	7.1	6.3	6.3	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	13.3	12.9	13.4	11.2	10.3	10.0	10.3	9.6	9.6	S&Ps	BBB	BBB
Effective interest rate (in percent) [4]	5.3	5.3	5.3	6.9	6.3	6.6	6.7	7.1	7.4	Fitch	BBB-	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing
Change in gross public sector debt	-6.0	2.3	1.1	0.6	1.3	0.9	0.2	0.1	0.4	3.4	primary
Identified debt-creating flows	-7.7	0.6	1.4	-6.8	-1.9	-1.4	-1.4	-1.1	-0.6	-13.3	balance [9]
Primary deficit	-2.3	-0.4	0.6	0.0	0.4	0.1	-0.2	-0.4	-0.5	-0.7	1.0
Primary (noninterest) revenue and grant	28.0	29.5	29.0	28.9	28.9	29.0	29.2	29.2	29.3	174.5	
Primary (noninterest) expenditure	25.7	29.1	29.6	28.9	29.2	29.1	29.0	28.8	28.7	173.7	
Automatic debt dynamics [5]	-8.0	-1.5	-1.2	-2.4	-2.2	-2.0	-2.1	-1.4	-1.3	-11.4	
Interest rate/growth differential [6]	-5.3	-3.9	-4.3	-2.4	-2.2	-2.0	-2.1	-1.4	-1.3	-11.4	
Of which: real interest rate	-1.6	-1.3	-2.4	-1.6	-1.5	-0.5	-0.4	0.4	0.5	-3.0	
Of which: real GDP growth	-3.7	-2.6	-1.9	-0.8	-0.8	-1.5	-1.8	-1.8	-1.8	-8.5	
Exchange rate depreciation [7]	-2.7	2.4	3.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	2.6	2.5	1.9	-4.4	0.0	0.5	0.9	0.8	1.2	-1.1	
Net 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 (incl. asset purchases	2.6	2.5	1.9	-4.4	0.0	0.5	0.9	0.8	1.2	-1.1	
Residual [8]	1.8	1.7	-0.3	7.4	3.2	2.3	1.6	1.2	1.1	16.7	



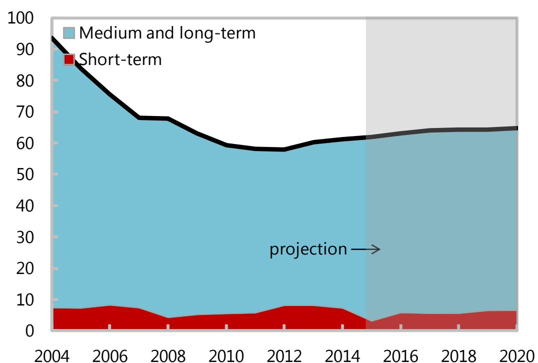
Source: IMF staff.
1/ Public sector is defined as consolidated public sector.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; 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 from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.
8/ Includes valuation changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Uruguay Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

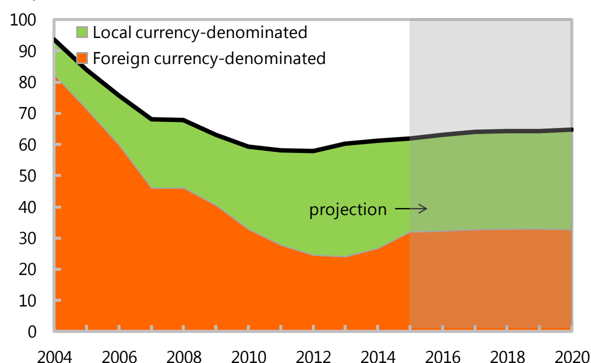
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

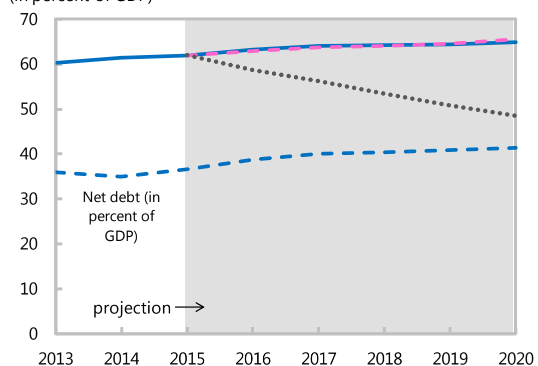


Alternative Scenarios

Baseline | Historical | Constant Primary Balance

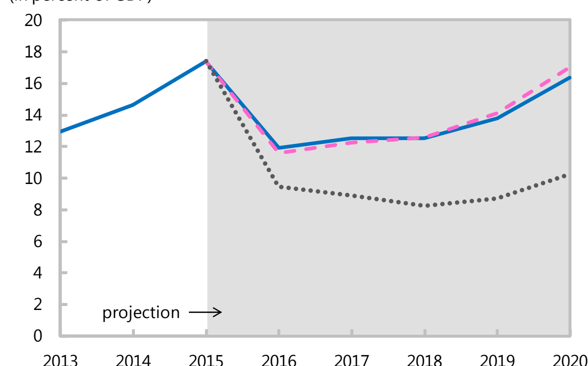
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

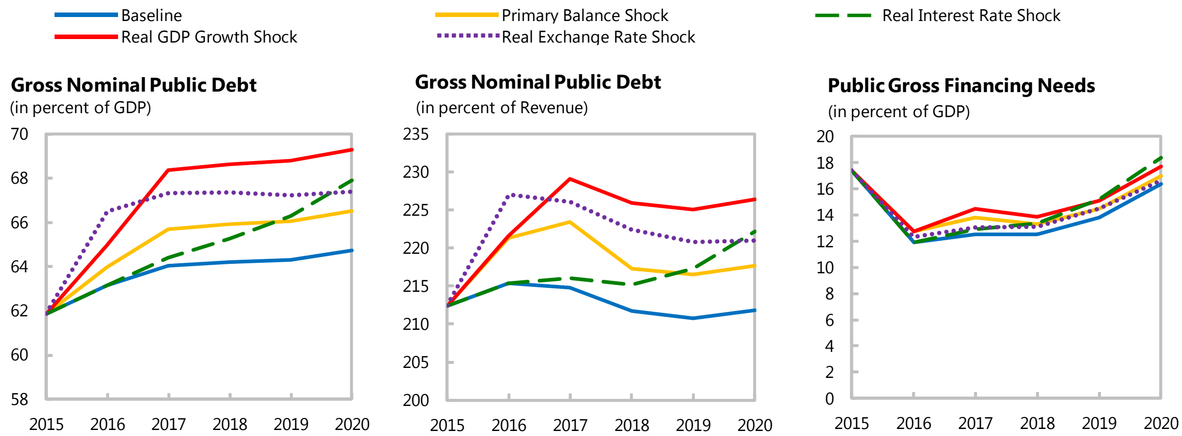
Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.5	1.4	2.6	3.0	3.1	3.1
Inflation	9.6	8.8	7.2	7.1	6.3	6.3
Primary Balance	0.0	-0.4	-0.1	0.2	0.4	0.5
Effective interest rate	6.9	6.3	6.6	6.7	7.1	7.4
Constant Primary Balance Scenario						
Real GDP growth	1.5	1.4	2.6	3.0	3.1	3.1
Inflation	9.6	8.8	7.2	7.1	6.3	6.3
Primary Balance	0.0	0.0	0.0	0.0	0.0	0.0
Effective interest rate	6.9	6.3	6.6	6.7	7.1	7.4

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	1.5	5.4	5.4	5.4	5.4	5.4
Inflation	9.6	8.8	7.2	7.1	6.3	6.3
Primary Balance	0.0	1.7	1.7	1.7	1.7	1.7
Effective interest rate	6.9	6.3	6.4	6.4	6.7	6.8

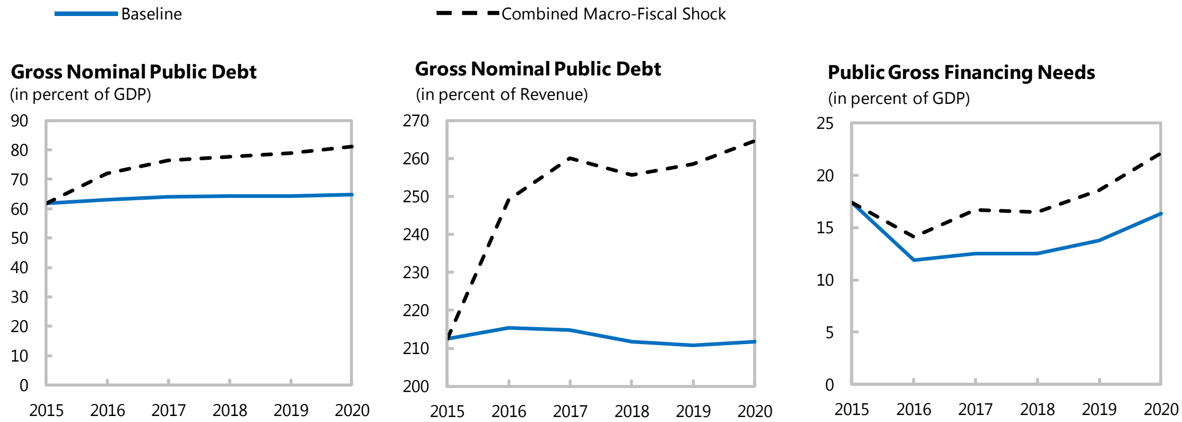
Source: IMF staff.

Uruguay Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.5	1.4	2.6	3.0	3.1	3.1
Inflation	9.6	8.8	7.2	7.1	6.3	6.3
Primary balance	0.0	-1.2	-0.9	0.2	0.4	0.5
Effective interest rate	6.9	6.3	6.6	6.8	7.2	7.4
Real Interest Rate Shock						
Real GDP growth	1.5	1.4	2.6	3.0	3.1	3.1
Inflation	9.6	8.8	7.2	7.1	6.3	6.3
Primary balance	0.0	-0.4	-0.1	0.2	0.4	0.5
Effective interest rate	6.9	6.3	7.2	7.8	8.7	9.3
Combined Shock						
Real GDP growth	1.5	-0.2	1.0	3.0	3.1	3.1
Inflation	9.6	8.4	6.8	7.1	6.3	6.3
Primary balance	0.0	-1.3	-1.6	0.2	0.4	0.5
Effective interest rate	6.9	6.9	7.2	7.9	8.7	9.3

Real GDP Growth Shock	2015	2016	2017	2018	2019	2020
Real GDP growth	1.5	-0.2	1.0	3.0	3.1	3.1
Inflation	9.6	8.4	6.8	7.1	6.3	6.3
Primary balance	0.0	-0.9	-1.2	0.2	0.4	0.5
Effective interest rate	6.9	6.3	6.6	6.8	7.2	7.4
Real Exchange Rate Shock						
Real GDP growth	1.5	1.4	2.6	3.0	3.1	3.1
Inflation	9.6	13.8	7.2	7.1	6.3	6.3
Primary balance	0.0	-0.4	-0.1	0.2	0.4	0.5
Effective interest rate	6.9	6.9	6.5	6.7	7.1	7.3

Source: IMF staff.

Annex III. Uruguay—External Debt Sustainability Analysis

After holding steady during 2010–14 (at an average of 42 percent of GDP), Uruguay's gross external debt is projected to have risen to 50 percent of GDP in 2015, mostly due to the significant depreciation of the nominal exchange rate against the U.S. dollar. Under staff's baseline scenario, gross external debt is projected to rise slightly further over the medium term, to 51 percent of GDP in 2020, largely driven by price and exchange rate dynamics. Gross external financing needs (which averaged 16 percent of GDP from 2010–14) are also projected to have seen a notable uptick to 20 percent of GDP in 2015, but are expected to moderate towards the historical average in the medium term.

Stress tests indicate that the standard growth and interest rate shocks would have a minimal impact on external debt. Shocks to the non-interest current account and a combined shock (to the real interest rate, growth and the current account) would weigh more on external debt, albeit still moderately. Exchange rate shocks would pose the biggest risk to Uruguay's external debt sustainability, as shown in the charts. Nonetheless, given Uruguay's sizeable gross international reserves and liquidity buffers, risks to external debt sustainability remain limited.

Table A3.1. Uruguay: External Debt Sustainability Framework, 2010-2020

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	**Debt-stabilizing non-interest current account 7/**
1 **Baseline: External debt 1/**	45.8	39.4	39.3	41.6	43.4			**50.2**	**50.6**	**51.2**	**51.4**	**51.4**	**51.2**	**-5.8**
2 Change in external debt	-3.5	-6.4	-0.1	2.3	1.9			6.8	0.4	0.6	0.2	0.0	-0.3	
3 Identified external debt-creating flows (4+8+9)	-17.5	-5.3	-4.6	-5.5	-1.3			-1.4	-1.1	-1.8	-2.0	-2.1	-2.1	
4 Current account deficit, excluding interest payments	-0.2	1.0	3.5	3.7	3.2			2.5	2.5	3.1	2.6	2.6	2.6	
5 Deficit in balance of goods and services	-1.6	-0.3	2.2	2.0	1.4			0.4	0.3	0.1	-0.1	-0.3	-0.4	
6 Exports	26.7	27.7	25.1	25.0	25.0			25.5	23.8	24.4	24.7	25.3	25.8	
7 Imports	25.1	27.4	27.3	27.0	26.4			25.9	24.1	24.4	24.6	25.0	25.4	
8 Net non-debt creating capital inflows (negative)	-3.8	-4.9	-4.7	-4.6	-5.5			-4.9	-4.6	-4.5	-4.4	-4.2	-4.2	
9 Automatic debt dynamics 2/	-13.5	-1.3	-3.4	-4.6	1.1			1.0	1.0	-0.4	-0.3	-0.4	-0.5	
10 Contribution from nominal interest rate	1.6	2.0	1.4	1.3	1.4			1.7	1.6	0.8	1.2	1.1	1.0	
11 Contribution from real GDP growth	-2.7	-2.2	-1.2	-1.7	-1.4			-0.7	-0.7	-1.3	-1.5	-1.5	-1.5	
12 Contribution from price and exchange rate changes 3/	-12.4	-1.1	-3.6	-4.2	1.1			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 4/	14.0	-1.2	4.4	7.8	3.1			8.2	1.5	2.4	2.2	2.1	1.8	
External debt-to-exports ratio (in percent)	171.9	142.0	156.3	166.4	173.9			197.0	213.0	210.1	207.8	203.5	198.4	
Gross external financing need (in billions of US dollars) 5/	6.1	7.5	8.0	8.8	9.5			10.0	9.5	9.1	9.5	9.9	10.3	
in percent of GDP	15.1	16.0	14.8	16.0	17.3			20.2	18.6	17.1	17.0	16.8	16.6	
Scenario with key variables at their historical averages 6/								**48.3**	**41.6**	**36.0**	**31.0**	**26.2**	**21.6**	**-7.8**
Key Macroeconomic Assumptions Underlying Baseline						10-Year Historical Average	10-Year Standard Deviation							
Real GDP growth (in percent)	7.8	5.2	3.3	5.1	3.5	5.4	1.6	1.5	1.4	2.6	3.0	3.1	3.1	
GDP deflator in US dollars (change in percent)	33.7	2.5	10.1	11.9	-2.7	8.7	12.5	-22.1	1.7	1.1	2.0	2.1	2.3	
Nominal external interest rate (in percent)	4.6	4.7	3.9	3.9	3.3	2.7	1.5	3.4	3.4	1.7	2.5	2.2	2.0	
Growth of exports (US dollar terms, in percent)	23.0	20.5	4.7	1.6	-0.4	13.1	13.0	-7.5	-3.9	6.4	6.6	7.6	7.6	
Growth of imports (US dollar terms, in percent)	23.2	26.4	15.2	1.1	-2.6	16.0	19.9	-11.0	-4.2	5.2	6.0	6.7	7.3	
Current account balance, excluding interest payments	0.2	-1.0	-3.5	-3.7	-3.2	-1.7	2.2	-2.5	-2.5	-3.1	-2.6	-2.6	-2.6	
Net non-debt creating capital inflows	3.8	4.9	4.7	4.6	5.5	5.5	1.3	4.9	4.6	4.5	4.4	4.2	4.2	

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).

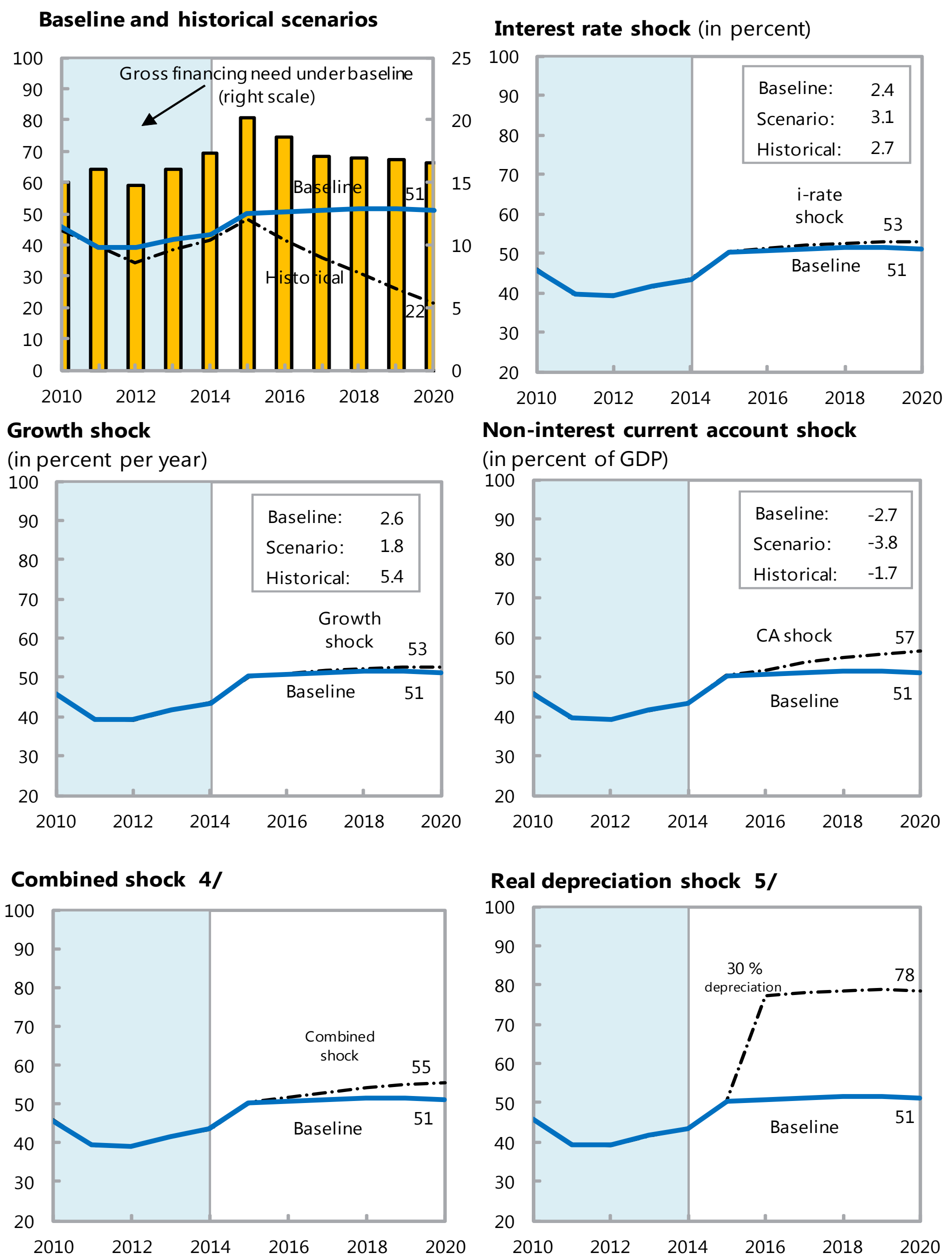
4/ For projection, line includes the impact of price and exchange rate changes.

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 A3.1. 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 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

January 19, 2016

Prepared By

The Western Hemisphere Department
(in consultation with other departments)

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FUND RELATIONS

(As of November 30, 2015)

Membership Status: Joined: March 11, 1946 Article VIII

General Resources Account:	**SDR Million**	**% Quota**
Quota	306.50	100.00
Fund holdings of currency	210.18	68.57
Reserve Tranche Position	96.32	31.43

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

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

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

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

	2016	2017	2018	2019	2020
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$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. Since June 2013, monetary policy targets the growth rate of M1 plus saving deposits as the intermediate instrument. On January 4 2016, the exchange rate in the official market was UY$ 29.873 per US 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 2008–15.

DPT	Purpose	Date of Delivery
FAD	Assist with strengthening customs' reform strategy and implementation of the governance framework	November 2015
	Tax Administration, PFM (Follow-up)	October 2015
	Treasury Management	August 2014
	Tax, customs, and social security administration	August 2014, March 2014, November 2012, November 2011, September 2010
	Performance Informed Budgeting	March 2011
	Private public partnership	May 2010
LEG	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2015
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2015
	Assist the authorities on strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2014
	Follow up of the implementation of the AML/CFT National Strategy	October 2013
	Assist the authorities on the launch of the recently designed AML/CFT national strategy	June 2012
	Assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	Conduct a money laundering/terrorist financing country risk assessment consistent with the objectives of the national AML/CFT strategy	January, April, and July 2009
MCM	Bank resolution	June 2014

	FSAP update	September 2012
STA	International Investment Position Statistics. BOP and external debts stats.	October 2015
	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 August 4, 2015)

Title	Products	Provisional timing of Missions	Expected delivery date*
World Bank work program	**A. Lending**		
	1. UY Non Communicable Diseases Prevention Project		December 31st 2015
	2. UY Institutions Building TAL		December 31st 2016
	3. UY OSE Sustainable and Efficient		February 28th 2018
	4. Sustainable Management of Natural Resources and Climate Change		March 1st 2017
	5. Road Rehabilitation and Maintenance Program		June 30th 2016
	6. Support to Uruguayan Public Schools Project		May 31st 2017
	7. Public Sector Management and Social Inclusion Development Policy Loan		June 30th 2016
	8. 2nd. Programmatic Public Sector, Competitiveness and Social Inclusion Development Policy Loan with Drawdown Option		June 25th 2018
	9. Drought Events impact Mitigating Investment Project Financing		December 31st 2017
	B. ESW		
	1. Uruguay Demographic Change and Social Policies in Uruguay (PA)		June 15th 2016
	i. Demographic Change and Social Policies		May 31st 2016

Title	Products	Provisional timing of Missions	Expected delivery date*
	2. Uruguay Pro-growth Public Policies and Competitiveness (PA) i. Trade competitiveness diagnostic ii. Integration into Global Value Chains		May 31st 2016 December 15th 2015 May 31st 2016
	C. Technical Assistance 1. Uruguay Pro-growth Public Policies and Competitiveness (PA) i. Competition regulatory framework ii. Report on Product Market Regulation 2. Water for Uruguay (PA) i. Dam safety regulatory framework development ii. UY TF Applying Integrated Urban Water Management in Uruguay iii. Strengthening Uruguay Hydromet Services iv. UY Climate-smart agricultural water management 3. Uruguay Demographic Change and Social Policies in Uruguay (PA) i. School to work transition 4. UY Strengthen Procurement Country System 5. UY-Support to the PPP program 6. Hydrocarbon Sector Capacity Building		May 31st 2016 October 19th 2015 December 4th 2015 April 22nd 2016 December 31st 2015 June 27th 2016 June 29th 2016 April 22nd 2016 June 15th 2016 June 3rd 2016 July 31st 2015 June 15th 2016 June 22nd 2016

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of December 31, 2015)

The Inter-American Development Bank's Board of Executive Directors approved in December 2015 a new Country Strategy with Uruguay (2016–2020). Sovereign-guaranteed lending under the new program is expected to reach approximately US$1.8 billion, which is considered to be consistent with Uruguay's five year budget. The program includes additional non reimbursable financing for technical assistance and analytical work. Approved lending under the previous Country Strategy (2010-2015) reached approximately US$1.9 billion in sovereign guaranteed loans[1] and US$1 billion in non-sovereign guaranteed loans.

The objectives of the Country Strategy for 2016–2020 are to: (i) boost productivity and competitiveness by promoting innovation, improving productive infrastructure, and supporting an integrated and coordinated policy for international positioning; (ii) promote equity and social inclusion by strengthening the human capital and employability of the population, supporting health care reform, improving habitat, and supporting the early childhood and youth segments of the most vulnerable population groups; and (iii) strengthen public sector management by supporting greater efficiency in public institutions and strengthening urban and departmental management.

As of October 31st 2015, the Bank's portfolio in execution in Uruguay includes 37 sovereign guaranteed loans for US$1.8 billion. Of this total, 34 are investment loan operations totaling US$1.3 billion, and 3 are policy-based loans for US$550.8 million with a deferred drawdown option. The main sectors comprising the active public sector portfolio are: export and investment promotion (31%); water, sanitation, and solid waste (18%); energy (16%); urban development and security (13%); science and technology (5%); agribusiness (4%); transportation (4%); public management and finance (4%); education and job training (3%); and social protection (2%). The active private sector portfolio is composed of 27 loans totaling US$842 million, primarily concentrated in the energy (64%) and agribusiness (32%) sectors.

[1] This includes US$366 million approved under the Reallocation Program and US$50 million from the China Co-financing Fund.

Financial Relations With the Inter-American Development Bank[1]

(In millions of U.S. dollars)

Total outstanding loans: US$1,627 (As of October 31, 2015)

Loan Transactions

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015[2]
Disbursement	114.8	112.9	337.2	477.3	54.3	138.2	121.6	195.9	166.3	167
Amortization	520.8	142.1	138.7	162.0	465.1	115.4	120.7	591.7	110.4	111
Net Loan Flows	-406.0	-29.2	198.5	315.3	-410.8	22.8	0.9	-395.8	55.9	56

Source: Inter-American Development Bank.

1/ Only loans with sovereign guarantee are considered.

2/ Preliminary.

STATISTICAL ISSUES

(As of December 29, 2015)

I. Assessment of Data Adequacy for Surveillance

General: Data provision has some shortcomings, but is broadly adequate for surveillance. Most affected area is national accounts.

National Accounts: In 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. 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. For the national accounts there is a need to plan adoption of the 2008 SNA and updating of the base year.

Prices: 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. 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 for 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).* The authorities report monetary data for the central bank, other depository corporations, and other financial corporations (OFCs) using the standardized reporting forms (SRFs). However, data for the OFCs are limited to off-shore financial institutions. A mission could be fielded to expand the institutional coverage of OFCs and compile the SRF for OFCs with full institutional coverage.

Financial sector surveillance: The authorities participate in the IMF's Coordinated Direct Investment Survey (CDIS), Coordinated Portfolio Investment Survey (CPIS), and Financial Soundness Indicators (FSIs) databases. However, only annual FSIs data from 2009 through 2013 have been reported, and the authorities have not responded to requests for more current data. FSIs on nonfinancial corporations, households, market liquidity, and real estate markets are not available. The BCU disseminates FSIs for individual banks on a monthly basis and generates FSIs for the banking system weighting individual bank FSIs by their asset share.

External sector statistics: Balance of payments and international investment position (IIP) statistics 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 disseminates the international reserves and foreign currency liquidity data template, submits quarterly external debt statistics to the Quarterly External Debt Statistics (QEDS) database, and participates in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS). There is room to improve the timeliness of CDIS data submission. The Central Bank of Uruguay is currently working on improving the quality and coverage of its services and direct investment related statistics.

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

Uruguay: Common Indicators Required For Surveillance
(As of December 29, 2015)

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/	Memo items:	
						Data Quality – Methological Soundness 8/	Data Quality – Accuracy and Reliability 9/
Exchange Rates	12/29/15	12/29/15	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	10/15	12/8/15	M	M	M		
Reserve/Base Money	11/15	12/15/15	M	M	M		
Broad Money	10/15	12/15/15	M	M	M		
Central Bank Balance Sheet	11/15	12/15/15	M	M	M		
Consolidated Balance Sheet of the Banking System	10/15	12/15/15	M	M	M		
Interest Rates 2/	11/24/14	11/24/14	D	D	D		
Consumer Price Index	11/15	12/14/15	M	M	M	O, LO, O, O	LO, O, O, LNO, NO
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government 4/	8/15	11/30/15	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 4/ 5/	Q2/15	9/30/15	Q	Q	Q		
External Current Account Balance	Q2/15	10/9/15	Q	Q	Q		
Exports and Imports of Goods and Services	Q2/15	10/9/15	Q	Q	Q		
GDP/GNP	Q3/15	12/15/15	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LO, O, LO
Gross External Debt	Q2/15	10/1/15	Q	Q	Q		
International Investment Position 6/	Q2/15	09/30/15	Q	Q	Q		

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

**Statement by Mr. Chodos, Executive Director on Uruguay,
and Mr. Vogel, Advisor to Executive Director
Board Meeting
February 8, 2016**

In 2015 Uruguay completed its thirteen consecutive year of positive growth, despite heightened global uncertainty and a marked regional slowdown. The staff report notes that "[the country] has become a bastion of stability in a volatile region". Not long ago, recessions experienced in Uruguay's biggest neighbors systematically spilled-over to the country—more often than not with amplified effects. Yet over the last few years Uruguay has been able to differentiate itself. Of course, there are substantial challenges and risks lying ahead in the short and medium term; nonetheless, it is clear that Uruguay is facing them from a position of strength. *What are the factors that may explain the country's resilience? What are the significant challenges looking forward?* This Buff statement will try to elaborate on some of them.

Economic and Social Achievements Go Hand in Hand

Uruguay exhibits the lowest poverty rates and inequality indicators in Latin America. According to the latest figures, in 2014 extreme poverty was 0.2 percent (1.4 percent in 2006) and poverty continued to fall to reach 6.4 percent (24.2 percent in 2006). Meanwhile, the Gini coefficient declined to 0.38 (0.46, eight years earlier). The Uruguayan authorities have repeatedly underlined a concept of global stability, which comprised economic, social and political stability. Growth can and should be accompanied by better conditions for society as a whole, and these social achievements have in turn provided the societal consensus to undertake a critical path of sound policies and deep structural reforms. On this issue, the Uruguayan authorities would like to congratulate the Fund for its increasing attention to social issues, particularly inequality and its effects on growth.

Mercosur and Beyond

Not long ago, exports to Mercosur countries represented roughly half of Uruguay's external sales. This has substantially changed over the last decade, as the economy opened up and diversified itself into new markets and products. As a result, Uruguay today sells goods to about 150 countries, and sales to Mercosur are less than a quarter of the total exports of

goods. The authorities have repeatedly stressed that Mercosur should not be an objective by itself; instead, this regional trade block should serve as a platform for further integration with other regions and the world in general.

The Selected Issues' chapter on "Boosting growth through diversification" provides a helpful perspective of the country's developments and challenges, although it also has some caveats, for instance, when including an analysis on Uruguay's linkages with Argentina based on data for the period 1980-2014; facts and links substantially changed over that long period, and thus an updated analysis that takes into account the structural changes that occurred during this time could be warranted.

From the Achilles Heel to an Essential Factor

Investment used to be one of the weakest sides of Uruguay's economy and a drag for growth. Nevertheless, policies, reforms and the country's investment law have allowed a reversal of the situation; investment is currently at about 24 percent of GDP and its allocation spreads across a number of sectors (involving goods and services) of the Uruguayan economy, constituting a key driver for diversification and growth. As a special case, it is worth noting that foreign direct investment (in terms of GDP) is—along with Chile—among the highest in the region, and continues to fully finance the current account deficit.

Mitigating Risks

Based on Uruguay's traditional pillar of fulfilling commitments and honoring debts, the country's policies over the past decade have driven the country to substantially reduce its debt-to-GDP ratio; as noted in the staff report, the country's net public debt-to-GDP exhibits a considerable decline when comparing current levels with the average in the period 2004-12.

Meanwhile, the work of the Debt Management Unit, created a decade ago, drastically reduced financial risks in Uruguay's debt portfolio, increasing the percentage of the Central Government debt denominated in local currency to 45 percent (vs. 11 percent ten years ago); the average time to maturity is one of the highest in the world (15.3 years, from 7.9 percent in 2005); and the composition of fixed-rate debt is 94 percent (vs. 78 percent).

Liquidity Buffers

The staff report refers to "Uruguay's strong liquidity buffers" and to "the BCU's ample gross reserves" that "could help cushion severe external shocks". Indicators related to gross international reserves, published in Annex 1 of the staff report, lead to the same conclusion. Until 2014, amidst strong appreciation pressures of the domestic currency vis-à-vis the U.S. dollar, the BCU's interventions aimed to moderate excessive volatility, which resulted in a considerable increase of international reserves and also, as a counterpart, in an increase of

fiscal deficits and gross public debt (it is worth highlighting the first paragraph of Annex II of the staff report which states that "Uruguay is a particular case among emerging market economies as it is one of very few countries to report debt figures on a consolidated basis for the whole public sector, excluding public commercial banks but including the central bank").

Thereafter, global circumstances changed and emerging-market currencies came to be under depreciating pressures. Thus, once again, Uruguay's central bank has intervened in order to smooth excessive exchange rate volatility and reduce the likelihood of an eventual overshooting. In any case, exchange rate flexibility is seen by the authorities as essential and there has not been any policy or movement that goes against fundamentals (indeed, Annex I on External Stability Assessment concluded that "the real effective exchange rate remains in line with fundamentals"). It is important to mention that the BCU recently used reserves to reduce its costly short-term debt, which is leading to a strengthening of Uruguay's balance sheet (thus, figure 2 of the staff report would benefit from a more nuanced analysis regarding the factors that explain the recent drop, when simply saying that "reserves are well above prudential norms despite a recent drop due to central bank intervention").

Low or Prudent?

Over the past decade, Uruguay has made critical reforms to its financial system; among which, it is worth highlighting the substantial transformation of the Banco de la República Oriental del Uruguay (BROU) as well as critical changes to the regulatory and supervisory frameworks. The Selected Issues' chapter on "Bank lending and completion in the banking sector" points out that "at just 25 percent of GDP in 2014, Uruguay's private credit intermediation is among the lowest in the Latin American region". At the same time, we can state that this relatively low credit indicator is to a good extent the consequence of Uruguay's prudent approach (from lenders, borrowers and the Superintendency of Financial Services) which allows the country to exhibit a sound financial system with, for instance, the lowest non-performing loans (in percent of total loans) among the region (at 2.3 percent).

In any case, the Uruguayan authorities share the assessment that there is a significant scope for financial deepening and, in fact, they have been establishing additional reforms, such as the financial inclusion law, which constitutes a major structural transformation established in 2015, and will entail relevant effects on credit, growth, and social inclusiveness. The authorities fully agree with the staff's comments that the expected changes will require "ongoing upgrades in Uruguay's solid regulatory framework".

There has been some increase in domestic deposit dollarization, but as noted in the staff report, a relevant part of the explanation is related to valuation effects. With regard to credit dollarization, paragraph 4 of the chapter on bank lending provides a clear picture of the situation: of the credit extended to households, only 4 percent was U.S. dollar denominated, while regulations significantly prevent currency mismatches among firms.

Consistent Objectives and Policies

The current slowdown presents a number of macroeconomic challenges; the reduction of inflation (under control but, admittedly, at higher rates than envisaged), the preservation of competitiveness, maintaining a sustainable path of fiscal accounts, and the continuation of the soundness of financial stability constitute high priorities for the Uruguayan government. In order to attain them, the Central Bank has kept a firm contractionary monetary policy stance (as said, in the context of a flexible exchange rate system); the five-year budget envisages a reduction in the fiscal deficit and a sound trajectory of the public debt; the authorities are fully committed to improving the efficiency of public enterprises and, particularly, restoring the financial position of the public oil distribution company. Furthermore, the government's guidelines for the new round of wage council negotiations are fully in line with the above-referred objectives.

Institutional Quality

Uruguay's solid institutions constitute a key factor when explaining the confidence that Uruguay enjoys from the investment community. In this regard, we could cite a few recent indicators that may mirror the country's institutional quality.

According to the 2015 report of Corruption Perception Index published by Transparency International, Uruguay ranks as the 21st country with the lowest level of corruption among 168 countries, and with the lowest corruption levels across all emerging markets (and many advanced economies).

In addition, the Democracy Index (The Economist Intelligence Unit) categorizes Uruguay as a full democracy (which implies an absolute respect for civil liberties and representative governance). Furthermore, the latest Latinobarometro's annual report enquired about the functioning of democracy; 70 percent of Uruguayans responded that they are satisfied or very satisfied (compared with an average of 37 percent in Latin America).

Looking Forward

Global, regional and domestic circumstances pose critical challenges and risks and, of course, the authorities will face them through their usual perspective: consistency among objectives and policies; substantial efforts to attain higher equality of opportunities, better income distribution and poverty reduction; and more structural changes. As also noted, Uruguay is facing this new situation from a solid position; amidst a very complicated regional situation, the country has been able to exhibit an expansion of its economy, have further upgrades in its sovereign debt ratings, and show steady sovereign spreads; the staff

report speaks about "the ongoing differentiation by international investors between Uruguay and other countries in the region".

However, the authorities are keen to emphasize that there is no room for complacency at all. Good results are just positive stimulus to face the future. The macroeconomic challenges of the new circumstances are substantial; and significantly more efforts are needed on many sides: a further integration with the world and other regions is critical; a deep change in the education system is vital; infrastructure must accompany the country's developments; the investment climate should continue improving in order to keep attracting productive investment; and public enterprises must be consistent with the efforts made by the public sector as a whole. The Uruguayan authorities will continue working on all of these issues and would like to thank the Fund for the positive and constructive tone of the staff report and its relevant comments and suggestions.