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Uruguay: 2001 Article IV Consultation and First Review under the Stand-By Arrangement—Staff Report; Public Information Notice and News Brief on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2001 Article IV consultation with Uruguay and firm review under the Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2001 Article IV consultation and first review under the Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 10, 2000,** 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 February 14, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) and a News Brief, summarizing the **views of the Executive Board as expressed during its February 26, 2001, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

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

Letter of Intent by the authorities of the member country*
Memorandum of Economic and Financial Policies by the authorities of the member country*
Recent Economic Developments paper
Technical Memorandum of Understanding*

*May also be included in Staff Report.

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URUGUAY

Staff Report for the 2001 Article IV Consultation, First Review under the Stand-By Arrangement, and Request for Waiver of Performance Criteria

Prepared by Western Hemisphere Department

Approved by Claudio M. Loser and Liam Ebrill

February 14, 2001

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I. Introduction

1. A mission[1] visited Montevideo during October 23—November 10, 2000 to conduct the 2001 Article IV consultation discussions and initiate the first review of the program supported by the 21-month stand-by arrangement that was approved on May 30, 2000. Discussions for the review were concluded in January 2001. The arrangement is in an amount of SDR150 million (27 percent of quota on an annual basis); the authorities are treating it as precautionary. Uruguay's outstanding Fund credit is SDR 114 million (37 percent of quota).

2. The 1999 Article IV Consultation was concluded on July 28, 1999. On that occasion, Directors welcomed Uruguay's quick policy response to the depreciation of the Brazilian *real* in January 1999, and recommended a partial relaxation of the public sector deficit objective of the program to reflect the effects of automatic stabilizers. During the discussion for approval of the current stand-by arrangement, Directors emphasized the need to accelerate structural reforms to adapt the economy to the more difficult cyclical circumstances, complete the lowering of inflation to industrial country levels, and increase economic efficiency.

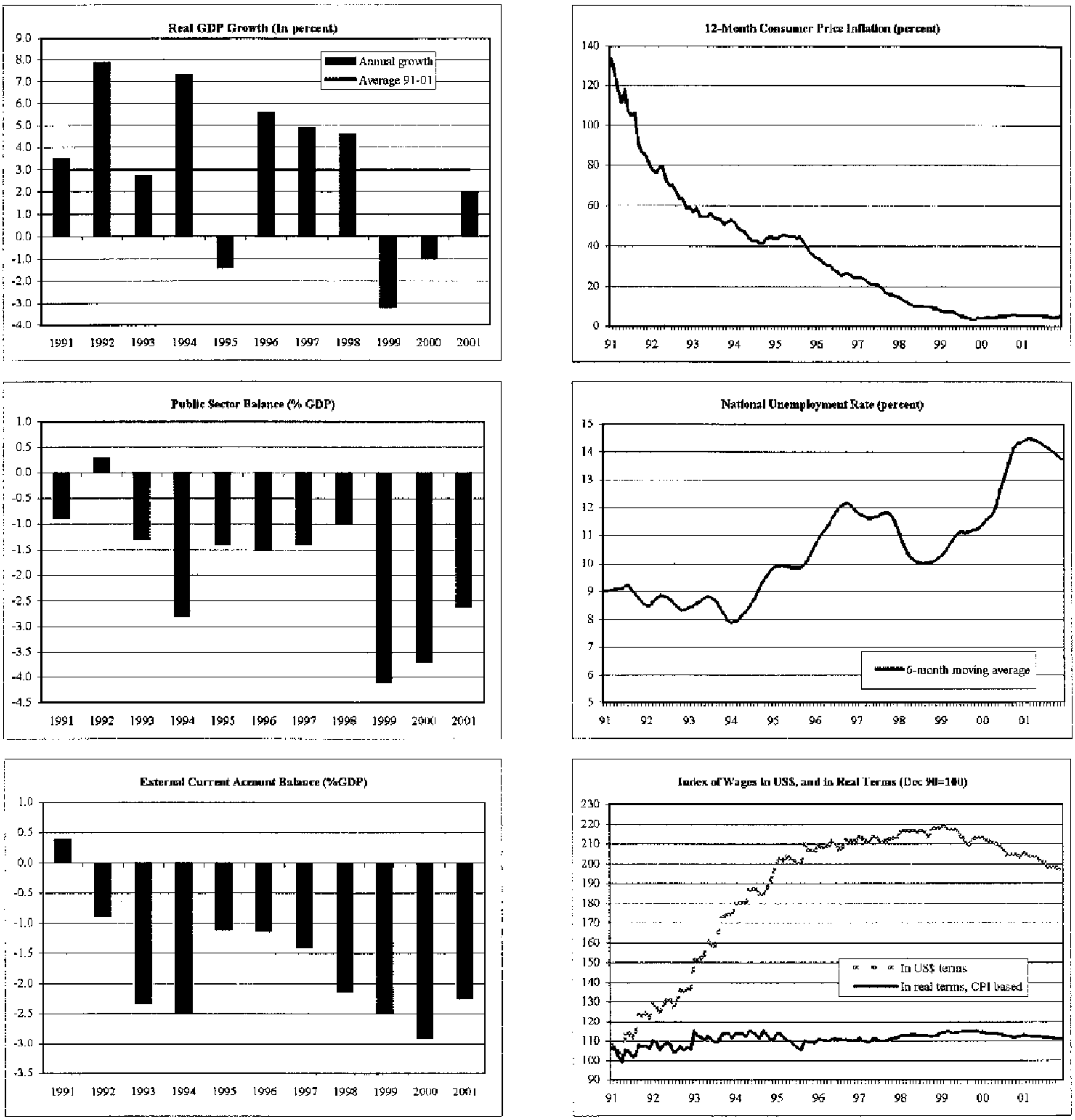
3. President Batlle of the Colorado party, heading a Colorado/Blanco government, took office on March 1, 2000. The government holds a small majority in Congress. The authorities are aiming for a significant strengthening of competitiveness in the economy through medium-term fiscal consolidation, and market-oriented structural reforms. In Uruguay's consensus based political culture, these plans will require broad support in Congress.

II. Background

The economy performed well during the 1990s. Real GDP growth averaged 3 ¼ percent a year, compared with population growth of ½ percent; inflation declined from nearly 140 percent in 1990 to 4 percent at end–1999; and the external current account deficit remained manageable. However, private investment was low, and the unemployment rate high at about 10 percent a year on average (Figure 1 and Table 1). For much of the 1990s, the external economic environment was benign—or the shocks, as in 1995, proved temporary—and Uruguay benefited from strong output growth in Brazil and Argentina. More recently, in 1999-2000, the regional economic situation turned adverse, with longer-lasting disturbances, whose impact on the Uruguayan economy has been felt largely on volumes (lower GDP, higher unemployment), in part because costs and structural factors have been slow to adjust in the context of Uruguay's gradualist and consensus policies.

[1] Comprising Messrs. Traa (head), Jaramillo, Braumann, and Ms. Honjo (all WHD). Messrs. Loser and Goldsbrough also participated in the mission during its last few days.

Figure 1. Uruguay: Selected Economic Indicators 1/



Source: Ministry of Economy; Central Bank of Uruguay; and staff estimates.

1/ Data for 2001 are program objectives and staff projections.

4. **After a recession in 1999, Uruguay continued to face difficult economic conditions in 2000.** A number of **adverse external shocks** plagued the economy, which the authorities quantified as having caused a loss of national income equivalent to US$800 million, or 4 percent of GDP. The problems in Argentina negatively influenced expectations, contributing to a sharp drop in domestic demand; the devaluation of the Brazilian *real* and of the euro depressed export earnings from these markets, while weak agricultural commodity export prices and the sharp jump in oil import prices implied a terms of trade drop of 7.5 percent (after dropping by 2.2 percent in 1999); international interest rates rose; and there were disruptions to Uruguay's exports as a result of actions in Brazil and Argentina.[2] Also, toward the end of the year, meat exports were halted following a local outbreak of foot-and-mouth disease. With these adverse developments, the expansion in output in the first quarter of 2000 was not sustained, and **real GDP** is estimated to have **declined by at least 1 percent** for the year. Together with the contraction in output in 1999 of 3¼ percent, this caused the output gap to turn negative at 3 percent of GDP by end–2000, according to staff estimates. The 12–month rate of **consumer price inflation** ended the year at 5.1 percent (4.2 percent in 1999), and the **unemployment rate** increased to 14.2 percent (11 percent at end–1999).

Box 1 Uruguay: A Comparison of Shocks

Uruguay has faced substantial adverse economic shocks in 1982 (external debt/domestic banking crisis), in 1995 (Mexico crisis), and now in 1999-2000. Output declined in each episode, but the recessions were different in duration. The 1982 shock had repercussions throughout the 1980s, in the form of high inflation, and lingering debt problems. The 1995 shock was sharp but short, essentially overcome by the second half of that year. The recession of 1999-2000 has already depressed output for two years, and activity remains weak.

	1982	1995	1999/2000
Real GDP (% change)	-9.7	-1.4	-4.3
Real consumption spending (% change)	-6.9	-2.9	-3.4
Terms of trade effect (%-points of GDP)	-0.9	0.2	-1.9
National income in US$ (% change)	...	10.9	-10.8
Unemployment rate (percent)	11.7	10.2	14.2
Inflation rate (percent, p.a.)	20.5	35.4	5.1

The recession in 1982 was deep, with inflation and unemployment doubling in the year. The deficit increased further in 1983 at a time that foreign financing dried up and inflation was set on its way to sustained high levels. The recession of 1995 was alleviated somewhat by a positive terms of trade effect and national income continued to increase. The 1999/2000 recession is also severe, driven in part by the large terms of trade loss following the devaluation in Brazil and the sharp jump in oil prices. In just two years, national income has been cut by 11percent in U.S. dollar terms.

[2] Trade disruptions, such as not permitting trucks to cross the border, ostensibly to prevent dumping or for sanitary reasons, included those on exports of dairy products, rice, bicycles, and wine.

5. **However, the economy is showing clear signs of adjustment.** Competitiveness is being addressed, labor costs are declining both in peso and U.S. dollar terms, and by end–2000 about half of the appreciation in the real effective exchange rate of early 1999 had been reversed. Moreover, to reduce their dependence on the Mercosur, exporters made progress in diversifying their markets, especially to the NAFTA countries and to Asia, while maintaining adequate volume growth in the traditional markets (albeit at lower prices). Also, the structure of aggregate demand is changing, resulting in a contribution to growth from the foreign balance of over 3 percentage points of GDP, offering prospects for sustainable output growth.

Uruguay: Aggregate Demand
(Annual percentage changes)

	1998	1999	2000 (Prel.)
Real GDP	4.6	-3.2	-1.0
Domestic demand 1/	8.1	-2.2	-4.3
Foreign balance 1/	-3.5	-1.0	3.3

1/ Contribution to growth.

6. **With national income, and hence revenue, much weaker than expected, the authorities did not meet their fiscal objectives under the program.** The consolidated public sector deficit was reduced to 3.7 percent of GDP (US$760 million), after 4.1 percent in 1999, but significantly exceeded the program target of 1.8 percent (Tables 2 and 3). However, the primary, or noninterest, deficit, was cut significantly, by 0.9 percentage points of GDP from 1999, underscoring the authorities' adjustment effort under trying circumstances. The larger-than-programmed deficit corresponded mainly to a drop in revenue for the central and local governments; the overall government expenditure target under the program was observed.[3] To finance the deficit, the government placed US$575 million in three foreign bond issues with an average spread of 290 basis points over comparable U.S. Treasury bonds,[4] and met the remaining financing need with domestic funds. Virtually all structural reform benchmarks under the program were observed (with some delay on the one on public bank's reporting to the BCU), but the publication of the state enterprises' quarterly annotated financial reports was not observed and is now scheduled for end-March 2001.

7. **Private sector banks saw some erosion in their soundness indicators; those for the public banks deteriorated faster** (Table 5). The profitability of private banks, which account for 60 percent of deposits and credit in the system, dropped by half, to around 6 percent on equity, and the share of loans with credit quality problems doubled to 8 percent

[3] The operating result of the state enterprises was weaker than expected, in part as the Telephone Company (ANTEL) had a disappointing year with an overrun in expenditure.

[4] In mid-2000, the rating agencies confirmed Uruguay's investment grade credit rating.

of total loans.[5] The public banks—the Bank of the Republic (BROU), and the National Mortgage Bank (BHU)—incurred a combined loss of over US$200 million (1 percent of GDP) during January-September 2000, and their problem loans increased to over 31 percent of total loans. Part of this increase is the result of a reclassification and downgrading of loans under the external independent audits that are underway for both banks. These numbers suggest a weaker position than was thought earlier, notwithstanding the large capital registered on the books of both banks (capital adequacy ratios are 20 percent for the BROU and 40 percent for the BHU). The liquidity position of both banks is adequate, and the public has confidence in them, as witnessed by the banks' ability to capture deposits at competitive interest rates, and because the government is seen as their guarantor. Regarding the two intervened banks, several potential buyers have expressed an interest in *La Caja Obrera*, but the *Banco de Crédito* incurs losses, and needs to be restructured to secure viability.[6]

8. **Exchange rate and interest rate policies have held steady in 2000.** Against the background of a highly dollarized economy, the adjustable band exchange rate regime worked well. The band is 3 percent wide and is depreciating at 7½ percent a year. On average, the peso remained in the most appreciated half of the band. The band is narrow, but the regime has not been subject to major pressures, partly because Uruguay tends to receive deposits from neighboring countries during times of regional economic uncertainty. The Central Bank lowered its call interest rate from 12 to 9½ percent in July 1999, in view of the slowing economic activity, and has maintained passive interest rate policies since then. The *interbank* call rate has been more volatile, because of occasional liquidity needs in a thin market, which can magnify short-term effects such as when wages are paid at the end of the month, or reflecting uncertainties, as during the election campaign at end–1999, or some contagion from the high interest rates in Argentina in late 2000 (Figure 2).

9. **The external current account deficit widened to 2.9 percent of GDP in 2000 (US$580 million)**. Merchandise exports and imports increased by around 3 percent in U.S. dollar terms (8 percent in volume for exports, unchanged for imports). Imports of oil were more than US$130 million (0.7 percent of GDP) higher than a year earlier; those of capital goods were down by US$70 million. Services have held up well, with more visitors from Argentina and Brazil contributing to a surplus in the nonfactor services balance of over US$500 million. The **financial account, and net international reserves,** turned out stronger than expected as Uruguay received nearly US$300 million in *net* inflows of nonresident deposits, and as the government placed debt abroad to help cover the wider fiscal deficit. Foreign direct investment, at US$180 million, was below 1 percent of GDP (Table 6).

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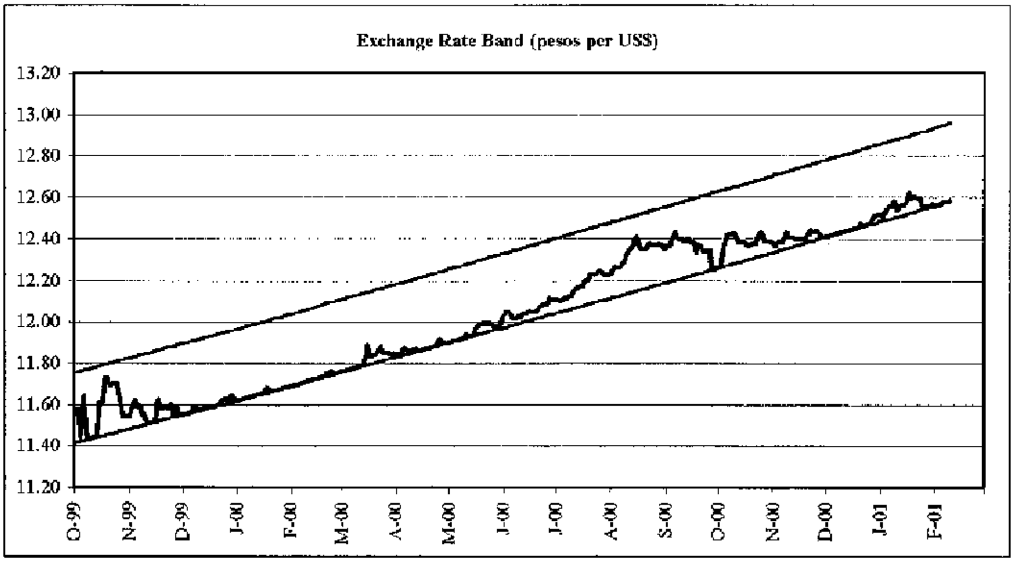
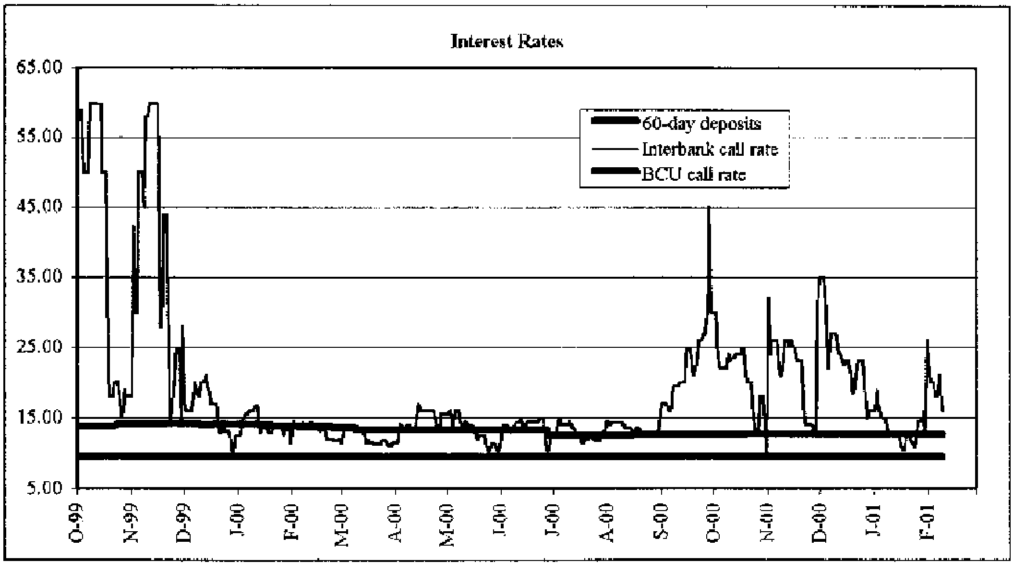
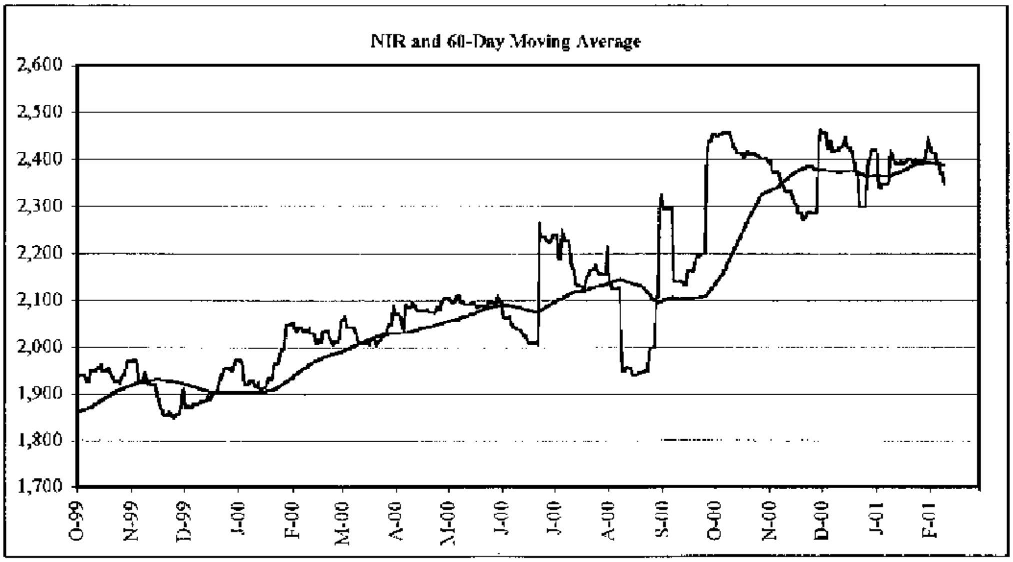
[5] Includes intervened banks. Loans with credit quality problems are those classified as 3-5 out of a ranking from 1-5, where 1 is current and 5 is nonrecoverable.

[6] *Banco de Crédito* is 51 percent owned by the public sector, in part through the BROU, and 49 percent by the private sector. The management, appointed by the public sector, is trying to rehabilitate the bank and shift majority ownership back to the private sector.

Figure 2. Uruguay: Daily Indicators







Source: Central Bank of Uruguay.

10. **Uruguay faced competitiveness shocks with the drop in the Brazilian *real*, weakness in the euro, and higher energy import prices**. In response, policies have been directed at lowering costs in the economy. The staff estimates that by year-end, the real effective exchange rate (based on relative consumer prices) had depreciated by 8 percentage points from the peak in February 1999 (Figure 3).[7] The policy instruments have been fiscal expenditure restraint, tax relief, and wage moderation and deindexation. The government reduced some taxes for the agricultural sector, and lowered employer social security contributions to help reduce labor costs. Average wages dropped by 2 percent in real terms, and by 4 percent in U.S. dollar terms during 2000. Wages in the central government were increased once, in January 2000,[8] and some employers and unions in the private sector agreed to moderate wages in favor of preserving jobs.

11. **The government restarted the structural reform agenda** with (1) a decree containing forty measures to cut red tape in the economy and remove regulatory restrictions, including on travel services and the operation of drug stores; (2) the expansion of private concessions in water and sanitation works; (3) the creation of a regulatory agency for the electricity market; (4) the clearance for auction of two wireless telecom frequencies; and (5) the renouncing of existing contracts in fuels distribution so that this sector can be opened up to competition. The government also obtained legal authorization for (6) private sector participation in the national railway, and (7) to incorporate the Montevideo container wharf as a *sociedad anónima* (SA) under private sector law.[9] Also, the authorities opened up access to foreign investors for cable television and other communication services that can be provided via coaxial cable.

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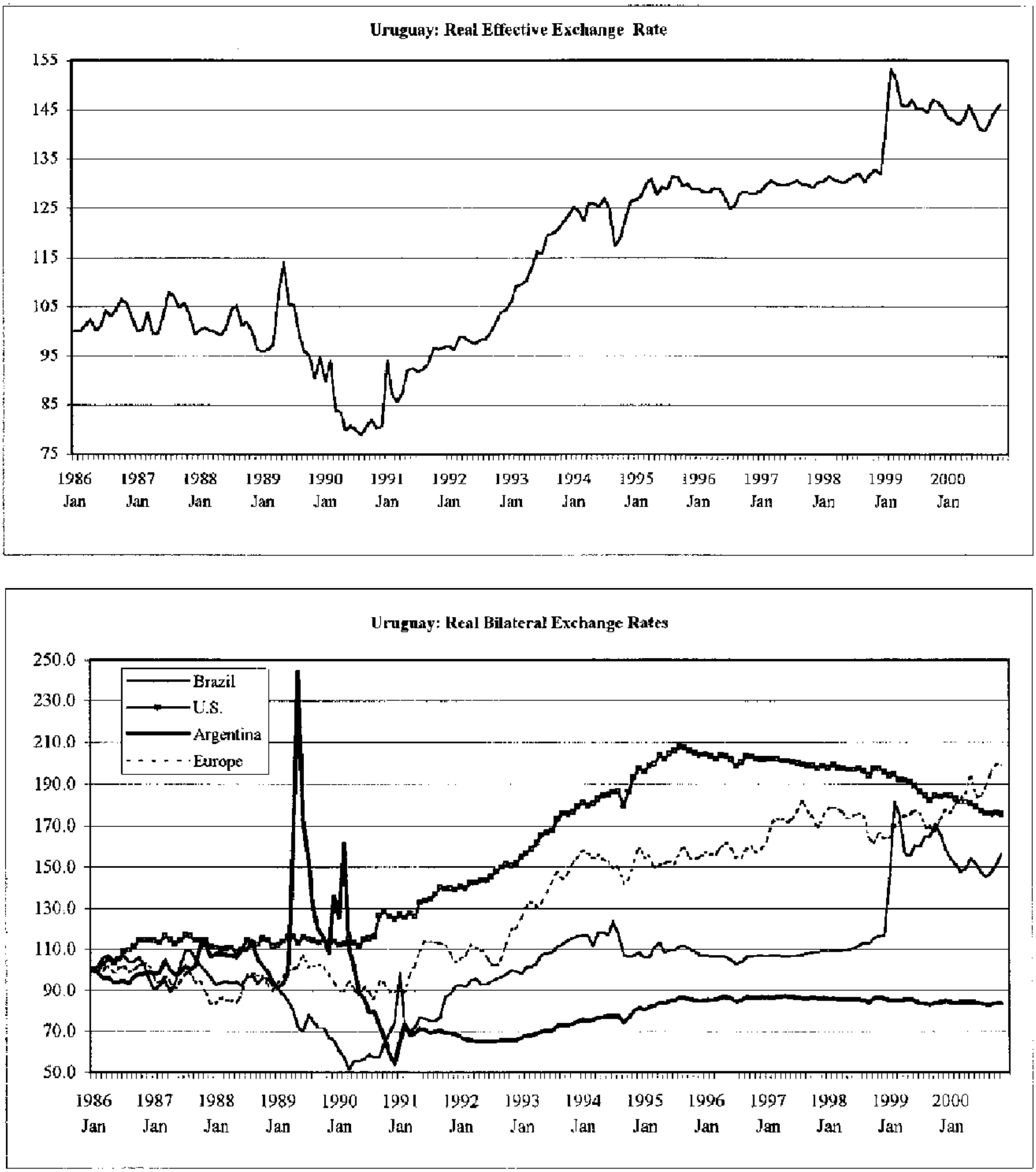
[7] As shown in the accompanying Recent Economic Development's paper (SM/01/26), productivity gains in the manufacturing sector, a small sector in Uruguay, have been strong during the 1990s, and relative unit labor costs in this sector have dropped faster than indicated by competitiveness measures based on the CPI weighted REER.

[8] To reduce indexation, the authorities shifted from wage adjustments in January and July 1999, to a single adjustment in January, from 2000 onward. By law, if inflation returns to above 10 percent, the authorities need to adjust wages again in January and July.

[9] The opposition is seeking a referendum to overturn the reforms in the railway and the port.

Figure 3: Real Exchange Rate Indicators (Jan 1986=100)



Sources: IMF Information Notice System, and staff calculations.

III. Policy Discussions

12. *Uruguay faces important decisions on the framework for medium-term fiscal policy and what role to assign the public sector in restructuring the economy for future growth. With 86 percent of deposits and loans dollarized, and nearly the entire public debt denominated in dollars, Uruguay has little flexibility in monetary and exchange rate policy. Nevertheless, external competitiveness needs to be strengthened, and with limited flexibility in the nominal exchange rate, this leaves fiscal and wage policies and structural reform as the main instruments of economic management. The external environment has become much less benign than it was during the 1990s, and, since end-1998, Uruguay has not had growth, inflation has crept up, and the external current account deficit is close to 3 percent of GDP. While severe negative external shocks have been at play, there remain important problems of a structural nature, including the low private investment ratio, the high rate of unemployment, and a public sector debt ratio that, in the absence of corrective measures, could reach 50 percent of GDP in the medium term.*

13. **The authorities have addressed some of the structural challenges in recent years.** The social security reform made visible the implicit pension liabilities accruing to workers in the new private system, and the public system was put on an actuarially sounder footing. Indeed, the reform costs explain part of the recent increase in the official debt ratio.[10] Also, a beginning was made at restructuring the public sector in the reform of the state; new instruments (such as mutual funds, negotiable obligations, mortgage paper, etc.) were introduced in the capital market to stimulate saving and investment; and measures were adopted to increase transparency in public sector activity and allow more private sector participation in activities hitherto reserved for public sector monopolies.

14. **In other areas, however, progress has been hampered by the electoral and economic cycle or by political opposition**. While fiscal policies have been, on the whole, cautious, the recessions and electoral spending have thrown the deficits off course, requiring fiscal contractions during times of weak economic activity. Also, the intensification of structural reform to **mobilize the private sector** in speeding up investment and job growth, has not yet fully occurred, and the role of the public sector in the economy remains large, both directly through government and state enterprises, and indirectly through public sector banks.

15. **The difficult economic situation in the region calls for caution regarding the short-term outlook.** Barring any further shocks, and with Argentina assumed to grow at 2½ percent, and Brazil at 4 percent in 2001, Uruguay would also emerge from the recession, with real GDP growth subdued during the first half of 2001, and around 2 percent for the year as a whole. Inflation is expected to remain close to 5 percent, with some further easing of

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[10] Between 1.0-1.1 percent of GDP per year in personal contributions is now accruing to worker's own private pension accounts, increasing the measured annual fiscal deficit by an equivalent amount.

domestic costs, offset by the full pass-through in consumer prices of the higher oil and other import costs, and some recovery of margins. The rate of unemployment is likely to hold steady until growth accelerates later in the year.

A. Fiscal and Wage Policies

16. **The framework for medium-term fiscal policy is embedded in the budget for the period 2000-2005 that was just passed by Congress (Box 2). The authorities want to place fiscal policy on a path that permits a reduction in the gross debt-GDP ratio by 2003–04, mainly by controlling expenditure, while introducing structural reforms to assist the supply side of the economy**. The staff supports this strategy as the debt/GDP ratio has been rising rapidly in recent years, to around 46 percent at present, and fiscal restraint is needed to halt the deterioration in the debt indicators for the medium term and preserve Uruguay's investment credit rating.[11] Also, the economy needs to adjust further to some of the external shocks, which are likely to be permanent (e.g., real depreciation in Brazil; higher oil prices; lower domestic demand growth in Mercosur). A stronger fiscal position supports saving in the economy, and wage moderation would support competitiveness, in turn boosting the prospects for exports and private investment-led growth.

17. **For 2001, the discussions on fiscal policy focused on what scope there was for the operation of automatic stabilizers, while providing confidence that the medium-term path of the budget strategy would be observed.** In the program approved by the Board in May 2000, the authorities had proposed an indicative fiscal deficit target for 2001 of 1¼ percent of GDP. However, given the revenue shortfall in 2000, and the sizable output gap relative to potential GDP, adhering to this objective would require large tax increases which would likely impede the resumption of growth. Consequently, the fiscal deficit objective in the program for 2001 was adjusted to 2.6 percent of GDP to recognize the weaker short-term cyclical position, while preserving a declining medium-term deficit path, consistent with the debt/GDP objectives shown in Box 2.

18. **To limit tax increases during the recovery, a significant share of fiscal adjustment needs to come from expenditure restraint.** Primary, or noninterest, expenditure is programmed to drop by 0.6 percentage points of GDP in 2001 to 31.9 percent of GDP. Social security expenditure would drop significantly as this is indexed to average wages, which dropped in real terms in 2000. Social security outlays are also falling as a result of the social security reform which is generating a smaller volume of beneficiaries. The public sector wage bill is programmed to decline slightly as a share of GDP, resulting from a general wage increase in January 2001 of 3 percent, a supplemental wage increase for teachers, university

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[11] These objectives would maintain Uruguay well within the deficit and debt limits recently agreed among Mercosur partners, which call for a fiscal deficit below 3 percent of GDP as of 2002, and a *net* debt-GDP ratio below 40 percent (33 percent of GDP in Uruguay at present).

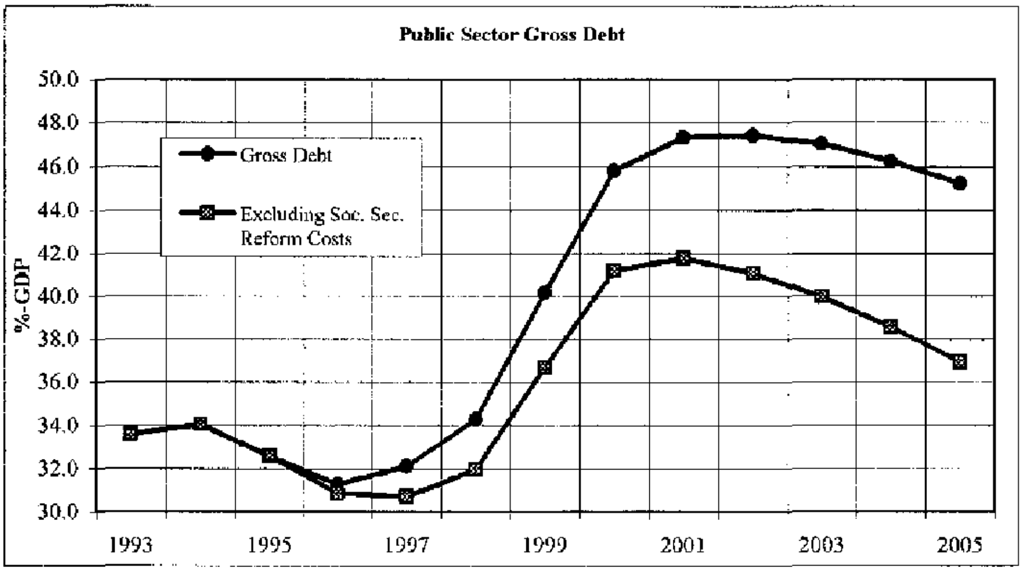
Box 2 Uruguay: Medium Term Fiscal Strategy

The government of President Batlle has recently obtained approval from Congress, with some increases in spending, for its budget covering the period (2000-2005). The budget aims at reducing the fiscal deficit to achieve: (1) **a turnaround in the public debt/GDP ratio**; (2) **an increase in saving and investment** and (3) to support relative price changes to **boost competitiveness and employment**.

The figure below shows that the **public debt/GDP ratio** has increased markedly in recent years, reflecting high fiscal deficits during recent downturns in the economic cycle and during the general elections.1/ The debt ratio since 1996 also reflects the cost of the **social security reform**, which established a private capitalized system alongside the public sector pay-as-you-go system, which led to a shift of 1 percent of GDP a year in revenue from the budget to the private pension funds. A third factor reflects the policy to strengthen the **net international reserves**, both in relation to trade flows, and in recognition of the increase in international capital mobility and of the high degree of deposit dollarization in the economy. As the fiscal balances were not strong enough to obtain the reserves, a part of them were obtained by placing more debt. A last factor has been the sensitivity of the debt/GDP ratio to the **real exchange rate**, which appreciated during the 1990s, thus masking the underlying rise in the debt/GDP ratio (the debt is mostly in dollars). Now that the real exchange rate is depreciating, the debt/GDP ratio is going up.

A stronger structural fiscal balance, as envisaged in the medium-term fiscal strategy, will support saving and investment in the economy. Lower deficits offer higher saving and less crowding out of the private sector. Uruguay has a low population growth rate and a high share of elderly, which limits private saving. During the 1990s, the growth performance was achieved in part by importing saving (building up external debt), and Uruguay has not yet achieved *simultaneously* a low rate of inflation, fast growth, and lower unemployment and debt. To do so, domestic savings need to increase, in part by cutting the structural fiscal deficit.

The authorities medium-term strategy also supports **competitiveness and employment** growth. The budget seeks a gradual decline in current expenditure relative to GDP. The two largest components of current expenditure are the public sector wage bill (7 percent of GDP), and social security transfers (16 percent of GDP) that are indexed to average wages in the economy. The reduction in current expenditure would permit a recovery of (public) investment and lower social security receipts (labor taxes). Both are beneficial for competitiveness and employment.



1/ Even during cyclical peaks, Uruguay has had fiscal deficits.

professors, and the judiciary (including this supplemental wage increase, average public sector wages will rise over 5 percent), and some attrition in the number of public sector employees. Expenditure on goods and services and capital would recover, as these bore the brunt of the expenditure restraint during 2000 (Table 3).

19. In 2001, consolidated **public sector revenue** is projected to increase by 0.6 percentage points of GDP to 31.9 percent. Virtually all of this increase would come from the recovery in the current surplus of the state enterprises, reversing the decline in 2000. Enterprise tariffs will be adjusted in line with average inflation in 2001. Tax increases are being kept to a minimum. A mandated increase in transfers to local governments (see below) will be financed with an increase in the gasoline tax equivalent to 0.2 percentage points of GDP. Also, the reduction in a VAT exemption for health care services (excluding basic health care) is expected to yield 0.1 percentage point of GDP; and the taxation of bank profits is being tightened up in response to a falling yield on bank profit taxes. Regarding tax reductions, the Mercosur 3 percent import tax surcharge was reduced by 0.5 percent on January 1, 2001—more slowly than the authorities would have preferred—and employer social security charges were lowered for new hires in the economy, and for all employees in the construction industry, for the period of one year. The program does not include the potential receipts from the auction of two telecom frequencies, as the timing of these receipts is uncertain, and the authorities prefer to use them for debt reduction.

20. During the budget discussions in Congress, there were **pressures for increased spending, including through larger transfers to local governments under a decentralization scheme** which recently came into effect. The staff noted the difficulties with decentralization schemes in other Latin American countries, and that some were now trying to move in the opposite direction. Moreover, the Uruguayan local authorities are not required to accept any offsetting expenditure responsibilities, nor are they providing adequate data on their fiscal performance to aid the central government in managing the consolidated public sector balance. In the staff's view, the first-best approach would be to offset these expenditure increases with cuts elsewhere. In any event, the budget now includes 0.2 percentage points of GDP a year in new transfers to the local governments, and the authorities need to tighten the borrowing constraint of the local governments where possible, including to prevent them from borrowing against future revenue transfers.

21. **Wage moderation is essential to support the fiscal objectives and help strengthen competitiveness of the economy (Box 3)**. Wage moderation has a multiplicative effect on the fiscal balance and on competitiveness, because social security outlays are indexed to average *take-home* wages in the economy. Thus wage moderation can directly lower costs, and reduce pressures on the fiscal deficit. The authorities are assisting employment through targeted reductions in social security contributions. This policy is understandable under the circumstances, but it needs to be coupled with wage moderation, because a cut in payroll taxes can *increase* take-home pay and boost social security outlays. As noted above, the authorities granted a moderate general wage increase in the central government in 2001, but in addition, as sought by Congress, there will also be the supplemental wage adjustment. This

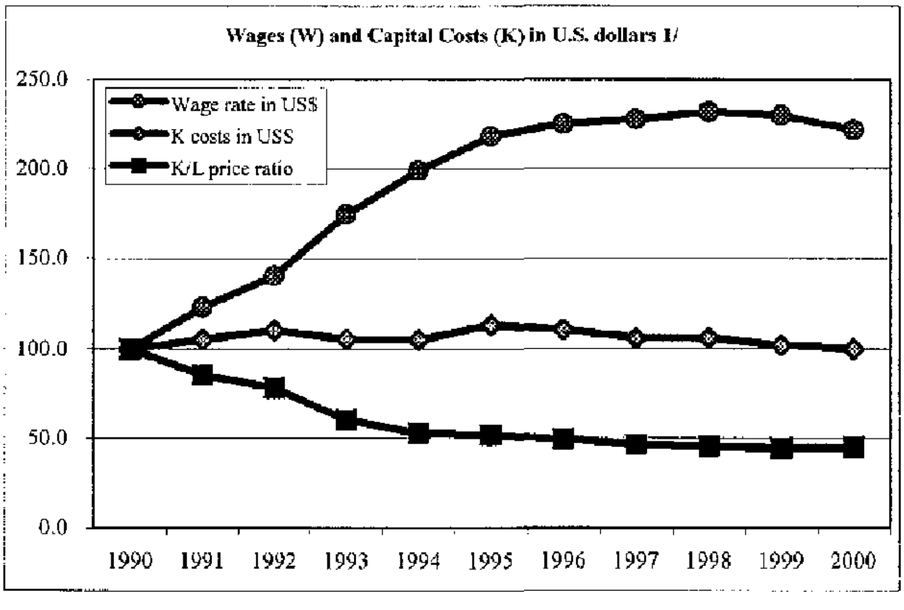
Box 3: The Need for Generalized Wage Moderation

Wage rates have increased by 129 percent in U.S. dollar terms in the 1990s in Uruguay (figure below); a compounded average of 8.7 percent a year. At the same time, the investment ratio was only around 15 percent of GDP, and the stock of net capital available per worker has not risen fast. It is difficult to offset wage increases of this magnitude with productivity gains (unless it is through labor shedding), and, indeed, productivity as measured by real GDP per person employed increased by a more subdued 2.3 percent a year during the 1990s.

As the figure below also shows, the price of machinery and equipment in U.S. dollar terms has hardly changed during the 1990s, causing the relative price of machinery to drop by 55 percent during this period. When relative wages rise so markedly, there are incentives to ration labor, relative to capital, until labor productivity again reflects the higher wage/capital costs. This form of adjustment appears consistent with the facts in Uruguay. Also, when wages rise quickly, consumption becomes an important driver of growth, it draws in imports, and worsens the external current account—this too is consistent with events during the 1990s in Uruguay. Taken together, the case for wage moderation appears strong.

One way to bring wage costs in line with other prices would be to accelerate the rate of adjustment in the nominal exchange rate, but this is not a sound option for Uruguay, which is heavily dollarized and such a step could trigger large adverse balance sheet effects for households, the government, and the financial system. *However, cost control and further productivity gains in the economy can lead to a significant adjustment in the real exchange rate.* In macroeconomic policy terms, this could be supported with generalized wage moderation; cuts in government spending to permit a reduction in the tax burden; and through structural reform to bring in more private sector capital formation.

The required size of adjustment in relative prices is difficult to gauge, even if one had access to a general equilibrium model. For instance, the figure appears quite telling, but wages may have been depressed in 1990 and therefore the increase in dollars might be overstated. Also, Uruguay spent much more income in 1990 on foreign interest than it does today, and some of this gain in disposable income could accrue to labor. Nevertheless, in recent years, Uruguay has confronted simultaneously a current account deficit and high unemployment. This is evidence that relative dollar wages are high in the economy, and that competitiveness needs to be strengthened further to assist in resolving the burden of unemployment.



1/ Capital costs are proxied by the implicit deflator of machinery and equipment.

implies that weighted average public sector wages are expected to rise just above inflation, which is regrettable, as the efforts at wage moderation *in real terms* will thus fall entirely on those in the private sector, including the unemployed.

22. **The Government does not anticipate major difficulties in meeting its financing plan for 2001** (Table 7). The gross borrowing needs are projected to be around US$1,400 million (7 percent of GDP), with net borrowing needs of US$530 million. The plan envisages placing (gross) US$660 million in debt abroad, and US$260 million in bonds domestically, including with the pension funds which receive an annual inflow of US$220 million in contributions. Borrowing from the World Bank and Interamerican Development Bank is projected to be US$97 million, with the remainder related to project financing for state enterprises; a small expansion in currency; and a drop of US$60 million in international reserves (to help reduce a bunching of debt falling due in 2003).

B. Money and Banking Policies

23. **Monetary policy is largely subordinated to the exchange rate regime**, and the authorities do not envisage any changes for 2001 in this regard. Domestic interest rates on dollar instruments, deposits and loans, are well-aligned with those in the international market. Those in the peso market are less well aligned (but spreads are narrowing), reflecting some segmentation, higher costs, and the small size of the peso market. Regarding the monetary aggregates, currency in circulation is projected to rise with nominal GDP, while the BCU's net international reserves are programmed to remain virtually unchanged from their level at end–2000. The projections envisage that broad money will increase by 8–10 percent. This will permit bank credit to the private sector to increase by around 6 percent in real terms.

24. **The authorities are pursuing several efforts to strengthen the banking system.** The BCU has bolstered banking supervision with a permanent presence in the BROU and the BHU; is implementing the phased-in increase in minimum capitalization requirements from 8 percent (in 1998) to 10 percent (by early 2001); is publishing on the BCU web page the banking supervision bulletin, including individual profit and loss statements and balance sheets of the public banks; and is analyzing the results of the independent external audits in the BROU and BHU, which have already yielded important suggestions for strengthening these banks (Box 4). The public banks are reducing their operating costs, including through a reduction from 95 to 75 percent in the indexation of wages in the recently signed collective bargaining contract. Meanwhile, the BHU is now extending new mortgages only in U.S. dollars, to limit the losses from currency mismatches on its balance sheet (mortgages are indexed to wages while deposits are in U.S. dollars).[12] These steps are welcome, and are being strengthened with additional measures. Specifically, the public banks are focusing on three

[12] During the 1990s, when wages were rising in dollar terms, the bank booked valuation gains on its balance sheet. Now that wages are falling in dollar terms, the bank is facing large losses.

Box 4: Preliminary Findings from the Independent External Audits for the Bank of the Republic (BROU) and the National Mortgage Bank (BHU)

As part of the Fund program and the Financial Sector Adjustment Loan from the World Bank, the BROU and the BHU are receiving independent external audits of their operations and balance sheets. The audits are not finished, but preliminary reports on the analysis of the respective loan portfolios already suggest some important findings:

--the management of the **BROU** is not in a position to form a coherent real-time view of the financial state of the bank as different parts of the computer system are unable to communicate;
--credit manuals and procedures have not always been adhered to;
--there are some accounting weaknesses in the bank; and
--the loan portfolio has a larger-than-expected incidence of nonperformance, with about half of private sector credits incurring some form of arrears, while local governments also sometimes incur costly payment delays.

Management of the bank has begun a process, with outside technical assistance, to reform the bank's information system; to restructure the bank to recognize those activities of a purely commercial nature versus those governed by development, or public policy, objectives; to identify quasi-fiscal activities in the bank; to reinforce the adherence to credit manuals and procedures; to recognize the larger amount of nonperforming assets in official statistics; and to harden budget constraints for clients of the bank, including through charging interest to the Treasury for its overdrafts in the BROU, something that had not been common practice.

The challenges for the **BHU** are also considerable:
--there is a currency mismatch on the books of the bank. Nearly all liabilities are denominated in U.S. dollars, whereas the bulk of mortgages on the asset side are denominated in Adjustable Units (UR), an index of average wages in the economy (designed to protect families against valuation changes relative to their earning capacity). During the 1990s, when wages in dollar terms were rising, the value of the UR appreciated in real terms and the bank recorded substantial valuation gains in its capital. However, the value of mortgages also rose above the underlying value of the real estate, nearly all traded in U.S. dollars, and mortgage holders had an incentive to fall into arrears. This behavior was rewarded at end-1998 when the Congress imposed a law to reschedule overdue mortgage loans at favorable terms and the bank lost US$175 million as a result. Moreover, now that the real exchange rate is depreciating and wages are lagging in U.S. dollar terms, the bank is incurring valuation losses on its portfolio.
--the bank is not only the dominant saving and loan institution in Uruguay, but also has responsibilities to stimulate the construction market and is the largest (speculative) developer in the country. The rules and regulations in place do not permit a distinction between the two main type of activities of the bank and cloud accounting and accountability;
--the bank does not have updated assessments of its properties in the country, nor on the real estate underlying its outstanding stock of mortgage loans; and
--the spreads the bank is achieving from its deposit and lending activities are small, in part because of usury legislation and in view of its mandate to encourage home-ownership in Uruguay.

In response to these findings, the BHU has stopped providing mortgages in URs and now only extends new mortgages in U.S. dollars. The bank is also considering with the BCU and the auditors what regulations can be adopted to reflect the dual nature of its mandate as a mortgage institution and a real estate developer. It is investigating mechanisms to re-asses the many thousands of pieces of real estate and real-estate loans on its books, a task that will take time. Also, management is becoming more open about the undesirability of unilateral political action to pardon arrears on payments to the BHU.

issues: (1) strict adherence to credit manuals and procedures and the elimination of political interference in this process; (2) upon finishing the external audits, a reckoning of the nonperforming loan portfolio through the collection of collateral, where this exists, together with a one-off write-down against capital of truly unrecoverable assets ("sinceramiento"); and (3) the identification and publication of the quasi-fiscal activities now imposed on the banks, so that these can be discussed in Congress and shifted to the appropriate fiscal authorities.[13]

[13] FAD is assisting the authorities in documenting and quantifying the quasi-fiscal operations in the public enterprises and banks. The study is targeted to be completed by mid–2001.

The authorities have requested a Financial Sector Assessment Program (FSAP) from the Fund and the World Bank, prior to the next Article IV consultation, to help them identify additional steps.

25. **The Central Bank is also adopting measures to guard the financial system against money laundering**. The authorities stressed that the integrity of Uruguay's banking activity is paramount in view of the country's role as a regional deposit taking system. The BCU has created an internal working group with access to confidential bank records, and the power to inform the courts about suspicious transactions. Moreover, in October 2000, the BCU issued two circulars, turning previously *recommended* banking procedures into *obligatory* banking procedures (record keeping, proper identification of depositors, soliciting and verifying information about the origin of funds, personnel training to detect illicit activities, etc.). In addition, banks are now also required to extend these procedures to their branches abroad; to establish regular internal auditing on issues pertaining to money laundering (with semi-annual reports to the external auditors); and to appoint a Compliance Officer (from senior management) responsible for all activities in this area.

C. External Policies

26. **The government intends to reduce gradually the pace of adjustment in the exchange rate band in the medium term but, for the time being, it will continue adjusting the band at 7½ percent a year**. Some observers in Uruguay argued that the pace needed to be slowed already in 2001, because they viewed the adjustment in the band as the guide for pricing behavior in the whole economy. While it is true that tradable goods prices closely follow those in world markets, adjusted for the devaluation in the exchange rate band, the absence of wage pressures (there is no formal indexation either to prices or the exchange rate), and the weakness in domestic demand, are likely to hold back domestic costs and the prices of nontradables in the economy—thus inducing a moderation in *average* prices in the economy. This should offer room to maintain the current pace of adjustment of the band and support the recovery of competitiveness.

27. **The external current account deficit is expected to narrow to around 2.5 percent of GDP in 2001.** With the resumption of output growth in the region and the lowering of domestic costs, merchandise exports are expected to rebound by 7-9 percent in dollar terms, while imports would increase by 4-6 percent. Based on WEO projections and local forecasts, the terms of trade are expected to be mildly favorable for Uruguay in 2001. The surplus in the **financial account** is expected to drop slightly, in part as some of the US$300–400 million in nonresident deposits that flowed in, in 2000, mainly during the recent uncertainties in the region, are likely to flow out again in 2001. Net foreign direct investment is expected to remain in the range of US$180–200 million (1 percent of GDP) until there is more significant progress in structural reform. Net portfolio inflows could increase to US$460 million, reflecting larger foreign bond placements by the government.

28. **The risks to Uruguay's short-term external financing position are related to regional developments**. Capital flows are dominated by government bond placements, and

variations in private deposits. If confidence in the region does not recover, and/or the budget deficit in Uruguay is not reduced, the public sector would need to continue tapping domestic saving, crowding out the private sector and limiting output growth. However, if the budget deficit is reduced as planned, the deficit can be covered by external borrowing, and lending to the private sector could grow substantially. The largest risk would be associated with another regional shock, because this could hinder the recovery again, and begin to limit Uruguay's hitherto favorable access to the international capital markets.

29. **Uruguay's trade policy reflects its membership in the Mercosur.** There are no quantitative restrictions on trade of any kind, but there is a special regime for automobiles, and sugar, in Mercosur, and there are occasional significant trade disruptions of varying duration. As Uruguay has been negatively affected by these disruptions, the authorities favor setting up a formal dispute resolution body within Mercosur. Uruguay has been a persistent, but so far unsuccessful, voice for tariff reduction and trade liberalization in Mercosur. The average common external tariff is 13.5 percent, including the remaining 2.5 percent import surcharge. The common external tariff for the Mercosur automobile regime is 35 percent for passenger cars, the highest permitted under WTO rules, with certain transition features for Uruguay through 2006. The sugar regime was liberalized in Uruguay at end-2000, including with the elimination of minimum export prices. In general, Uruguay has a liberal trading system, and its membership in Mercosur has worsened somewhat the degree of free trade, as reflected in the slippage from 1 to 2 in the Fund's index of aggregate trade restrictiveness. At the same time, however, these calculations do not reflect Uruguay's prohibition of trade in areas reserved for public sector monopolies, a feature that the staff strongly recommends be liberalized soon, and which the authorities have undertaken in their program to remove by 2001.

D. Structural Reforms

30. **Structural reforms offer some of the most promising opportunities for productivity enhancement, competitiveness gains, and higher output growth.** Uruguay's investment ratio of around 14–15 percent is low, and the inflow of FDI is meager. This is partly related to allowing the large public sector enterprises to operate in reserved monopolistic markets, or, conversely, by restricting the emergence of scale economies in private companies (for example, there are restrictions on large retail companies, to protect small shop owners).[14] To bring out the full potential for investment and develop Uruguay's competitive advantage requires strong economic and legal institutions with minimal distortion, appropriate regulation, and **room for the private sector to "crowd in" and develop such activities.** The thrust of this government's structural reform policy intention is to shift from

[14] The apparent hesitancy to allow private enterprise in competition with public facilities is a recurring theme in Uruguay. A private sector consortium recently offered to build and operate a new airport to accommodate direct (tourist) flights of wide-bodied jets from Europe and the U.S. The project was not allowed and the objections to it were not made clear.

direct public sector involvement in the economy, toward emphasizing the appropriate regulatory framework, reducing monopolies, and promoting a freer play of market forces.

31. **For 2001, the authorities will pursue deregulation and demonopolization of the main public sector enterprises**. Specifically, they intend to revoke the state monopoly, and open up to competition (1) the importation, distribution, and sale of asphalt and its by-products; and (2) the importation, distribution, and sale of natural gas. They will also (3) remove the monopoly status of the State Insurance Bank (BSE) on insurance needs of public sector entities; (4) permit competition in the telecommunications sector for international long distance service, cellular telephony[15], and all telecommunications services offered through new technology (but excluding domestic fixed-line service which remains the monopoly of ANTEL); (5) open up for concessions the management of state-owned hospitals; and (6) allow the establishment of private ports. Two further measures, which have been included as **structural benchmarks under the program for 2001** call for (7) the submission to Congress of legislation to revoke the monopoly on oil imports, (8) and on oil refining, both held by the state petroleum company ANCAP.

32. **With pending deregulation, the public enterprises argue in favor of large new investment spending to compete in a more open market**. The telephone company has launched an ambitious project to become an internet content provider; and the petroleum company has expanded with a (so far ill-fated) purchase of a chain of service stations in Argentina, and has begun to expand the refinery in Montevideo at a substantial cost. The staff argued that if these projects have economic viability, the private sector would be willing to undertake them, if permitted, and in the process bring in needed foreign direct investment.

E. Medium-Term Scenario

33. Beyond 2001, the authorities' medium term scenario assumes a reduction in inflation to industrial country levels, lower public sector deficits, and continued reforms to enhance competitiveness of the economy (Table 8). Uruguay has the potential to maintain relatively high rates of economic growth, especially if the diversification of exports to extra-Mercosur markets proceeds vigorously. After a recovery of growth to 4 percent a year in 2002–03, real GDP growth should settle down at 3–3½ percent thereafter (nearly 3 percent per capita).

34. National saving would increase from 11.6 percent of GDP in 2000 to over 14 percent in 2004-05, reflecting restraint on public sector expenditure, and the effects of sustained GDP growth on private saving. Investment would increase by nearly 2 percentage points to over 16 percent of GDP by 2004–05, as restructuring of the economy continues and enterprises respond to growth opportunities in a more open investment climate. The current account deficit would be expected to be around 2 percent of GDP, with export and import volume growth of between 6-8 percent, twice as fast as output growth. Uruguay's debt service

[15] A provision in the budget approved the sale of up to forty percent of the cellular telephone company, now fully owned by ANTEL, to the private sector.

obligations to the Fund would remain small, reaching a peak of 2 percent of exports of goods and services in 2002. The staff believes that Uruguay should not encounter difficulties in fulfilling its debt service obligations to the Fund.

F. Performance Criteria for 2001 and Other Issues

35. With continued economic uncertainties in the region, it is difficult to project how fast the economic rebound will be. In this context, the proposed program establishes quantitative performance criteria for end-March and end-June 2001, with indicative quantitative targets for end-September and end-December. The latter would be converted to performance criteria on the occasion of the second review of the program expected in June/July 2001.

36. **Uruguay has made good progress during 2000 in improving transparency and publishing statistical information on current economic developments, and economic statistics are generally adequate for the assessment and monitoring of macroeconomic policies.** The Central Bank and the Institute of Statistics (INE) have developed web pages with broad-based economic and financial information on the economy, including, in cooperation with the Ministry of Economy, monthly data on tax receipts, revenue and expenditure of the Central Government and the public social security administration; on the operations of the public enterprises, and the quasi-fiscal result of the Central Bank. The data on local government finances need to be strengthened and made current. Uruguay is on track to subscribe to the SDDS by end–2001; FAD has completed a Report on Observance of Standards and Codes (ROSC) on fiscal transparency; and STA is finalizing a ROSC on data dissemination practices.

IV. Staff Appraisal

37. **Following the recession in 1999, the Uruguayan economy confronted another difficult year in 2000**. Several **external shocks** and weak confidence in view of regional economic uncertainties contributed to a second year of declining real GDP, and a sharp rise in the unemployment rate. Under these adverse conditions, which resulted in a significant slowing in revenue, the authorities were not able to meet the deficit and debt objectives for end–2000. Nevertheless, **the government made a substantial adjustment effort**, meeting the expenditure, international reserves, and domestic credit objectives under the program, and narrowing the primary fiscal deficit by 0.9 percentage points of GDP. Nearly all structural reform benchmarks under the program were met.

38. **The economy is showing clear signs of adjustment which should permit Uruguay to rebound from the lengthy recession.** The structure of aggregate demand has changed considerably. While domestic demand contracted, the net foreign balance is contributing strongly to growth, which offers prospects for a sustainable recovery. Competitiveness is improving, with the real effective exchange rate depreciating, and wages and other costs in the economy gradually declining in real and U.S. dollars terms, and exporters diversifying their

export markets. The authorities have restarted the agenda for structural reforms to increase economic efficiency. It is important that these developments continue in the medium term.

39. **In the economic program for 2001, real GDP is expected to expand by 2 percent, mostly during the second half of the year.** A return to growth is bound to lift confidence in the economy. Nevertheless, the policy challenges remain substantial as the public debt/GDP ratio has increased sharply in recent years, and competitiveness needs to be strengthened further to bolster growth and employment. Also, the long recession has weakened the public sector banks, which need to be reformed.

40. **Fiscal policy in 2001 will aim at lowering the deficit by just over one percentage point of GDP to 2.6 percent of GDP, and in the medium-term budget plan just approved in Congress the deficit will be reduced further to achieve a turnaround in the debt/GDP ratio by 2003–04.** The staff welcomes the authorities strong emphasis on current expenditure restraint as the backbone of the medium-term fiscal strategy, as this will permit a gradual increase in public investment spending while leaving some room for targeted tax cuts, including those to lower labor costs and strengthen competitiveness. In this regard, it will be important that new expenditure priorities, such as the increase in transfers to local governments, and the special wage increase for selected public sector employees mandated by Congress during the recent budget discussions, be absorbed primarily through offsetting expenditure cuts elsewhere, rather than increasing the tax pressure on the private sector.

41. **Generalized wage restraint needs to be an integral part of the economy's competitiveness rebound as wages in U.S. dollar terms had risen considerably during the 1990s.** Wage restraint has immediate benefits for external competitiveness, and it plays an important role in controlling budgetary pressures as the large social security expenditures are indexed to wages in the economy. Wages in the private sector, in the banking system, and in the state enterprises are expected to increase in the range of 2¾–3½ percent in 2001, slightly below the rate of inflation. However, those in government will increase by over 5 percent on average, owing to the special wage increases. The reason for the special wage increase (in education and the judiciary) is understandable, but the burden of wage moderation now is not equally shared by the public and the private sector, which is regrettable.

42. **Performance indicators for the banking system have slipped with the recession, as may have been expected.** Financial entities in the private sector are holding up well, but the public banks are showing a faster deterioration. The authorities are undertaking a diagnosis of the operational weakness in the public banks, with the aid of external audits, and the challenge now is to adapt banking policies to strengthen performance and limit further slippage. The management teams of the banks are addressing internal policies related to monitoring credit quality, credit guidelines, and personnel and information technology issues. However, it is also important that political interference with the banks be eliminated, and that any subsidies to particular sectors of the economy be covered explicitly through expenditures in the fiscal budget, not with offsetting tax exemptions or other special rules for public banks, which cause distortions in the financial system and in the allocation of resources. The banks have an adequate liquidity position, but the need for fiscal resources can not be excluded in

future if the banks do not become more efficient and profitable. The staff welcomes the authorities' request for an FSAP exercise prior to the next Article IV consultation, which should provide further options for improving operational efficiency in the public banks.

43. **The adjustable exchange rate band system is working well and the authorities intend to continued with it.** The staff supports the authorities' intention to maintain the rate of depreciation of the band at 7½ percent in 2001, slightly faster than inflation. There is spare capacity in the economy, and costs are being managed carefully, and this rate of devaluation should not pose major strains on overall prices in the economy. Uruguay enjoys an investment credit rating from international rating agencies, and tends to receive a substantial flow of deposits from nonresidents. Taken together, this indicates that the exchange regime, in combination with the thrust of domestic policies, enjoys confidence. A medium-term fiscal path that targets declining debt/GDP, and policies to maintain a sound banking structure, are central to maintaining this stable external position.

44. **In 2001, the authorities will pursue substantial progress on structural reforms, aimed at stimulating investment in the economy, and accelerating output growth.** The staff strongly supports the government's efforts at demonopolization of domestic markets, and generally placing public and private firms, domestic and foreign, on a level playing field in well-regulated and contested markets. The staff also supports the authorities' increasing efforts at using transparency to help enforce market discipline, such as publishing quarterly annotated reports, promoting annual independent external audits, and requiring and publishing independent corporate credit ratings. This effort has been extended to providing detailed statistical information on the central government finances on the web page of the BCU, and now also needs to be extended to the finances of the local governments.

45. The authorities are requesting a waiver for the nonobservance of the end–2000 fiscal deficit and debt performance criteria. The staff supports this request in view of the adverse external shocks that affected the economy, and hence fiscal revenues, and the substantial efforts at expenditure restraint the authorities undertook to keep the program on track. It is recommended that Uruguay remain on the standard 12–month cycle.

Table 1. Uruguay: Economic and Financial Indicators

	Average 1990-96	1997	1998	1999	2000 Prog.	2000 Prel.	2001 Prog.
	(Percentage change)						
Output, prices, and wages							
Real GDP	3.7	4.9	4.6	-3.2	2.0	-1.0	2.0
Consumer prices (average)	64.6	19.8	10.8	5.7	5.2	4.8	5.0
(end of period)	60.9	15.2	8.6	4.2	5.8	5.1	4.7
Public sector wages (end of period)	58.3	18.7	11.7	6.9	3.2	2.9	5.1
Unemployment rate (percent, end of period)	9.4	10.3	10.3	11.4	...	14.4	13.4
GDP (Ur$ billions)	72.2	204.9	235.4	238.8	255.8	244.3	265.6
GDP (US$ billions)	15.1	21.5	22.5	21.0	21.2	20.2	20.5
Monetary indicators							
Currency issued	65.9	22.0	13.8	6.9	9.0	-3.9	8.7
M-2 1/	58.3	20.7	10.3	4.2	9.4	6.0	8.8
M-4* 2/	54.4	26.4	17.5	12.1	9.5	5.6	8.9
Credit to the private sector 3/	59.6	29.6	22.4	10.1	10.6	8.4	11.5
Prime interest rates (percent, average)							
Foreign currency loans	8.1	8.5	8.5	8.3	...	8.0	...
Domestic currency loans	70.3	39.2	30.6	24.4	...	19.0	...
	(In percent of GDP, unless otherwise indicated)						
Public sector operations 4/							
Revenue	30.5	30.3	32.7	32.1	32.5	31.3	31.9
Noninterest expenditure	29.0	29.8	31.8	34.2	32.1	32.4	31.8
Primary balance	1.5	0.5	0.9	-2.1	0.4	-1.2	0.0
Interest bill	3.0	2.0	1.9	2.0	2.2	2.5	2.7
Overall balance	-1.5	-1.4	-1.0	-4.1	-1.8	-3.7	-2.6
Contributions to AFAPs 6/	-3.0	-1.5					
Savings and investment							
Gross domestic investment	15.0	15.1	15.6	15.2	14.4	14.5	15.2
Public	3.4	2.7	2.9	3.2	3.8	3.0	3.3
Private	11.6	12.4	12.7	12.0	10.5	11.5	11.9
Gross national savings	14.3	13.7	13.5	12.7	11.9	11.6	12.7
Public 5/	2.7	2.4	3.2	0.2	2.0	-0.3	1.3
Private	11.6	11.3	10.3	12.5	9.9	11.9	11.4
Foreign savings	0.7	1.4	2.1	2.5	2.5	2.9	2.5
External indicators							
Merchandise exports, fob (US$ millions)	1,879	2,793	2,829	2,289	2,627	2,354	2,564
Merchandise imports, fob (US$ millions)	-2,189	-3,498	-3,601	-3,186	-3,424	-3,289	-3,420
Terms of trade (NA goods & nonfactor services)	...	1.2	5.1	-2.2	...	-7.5	...
Current account balance	-0.7	-1.4	-2.1	-2.5	-2.5	-2.9	-2.5
Overall balance of payments	0.8	1.5	1.6	0.1	0.0	0.9	-0.3
Public sector total debt	32.9	32.1	34.3	40.2	43.7	45.8	47.3
Nonfinancial public sector external debt	28.5	22.6	24.3	25.7	28.8	28.4	29.4
Gross official reserves (US$ millions)	1,273	2,068	2,589	2,602	2,602	2,762	2,702
In months of imports of goods and services	5.2	5.7	6.9	7.8	7.2	8.0	7.6
Ratio to short-term debt 6/	...	0.29	0.32	0.35	0.33	0.37	0.36
Ratio of financial system foreign assets to short-term deb	...	0.95	1.01	1.15	1.11	1.19	1.19
Central bank short-term for. liab. (US$ millions)	...	3	162	159	150	149	149
Central bank external debt (US$ millions)	...	860	963	944	953	837	950
REER (percentage depreciation -, e.o.p.)	35.1 7/	1.8	1.3	10.2	...	-3.5	...

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

1/ Currency plus demand and savings deposits in domestic currency.

2/ M-2 plus foreign currency deposits of residents (valued at end-of-period exchange rate) and deposits in the Mortgage Bank.

3/ Flows of credit in foreign currency are valued at end-of-period exchange rates.

4/ Includes extrabudgetary operations (Fondos de Libre Disponabilidad) from 1998.

5/ Public sector total revenue minus current expenditure

6/ Includes nonresident deposits in the banking system.

7/ Cumulative change.

Table 2. Uruguay: Performance Under the 2000 Economic Program

	31-Dec-00		
	Outturn	Target	Margin (+)
A: Quantitative Performance Criteria			
(Cumulative flows from December 31, 1999; millions of Uruguayan pesos)			
1. Combined public sector balance (floor)	-9,176	-4,700	-4,476
2. General government expenditure (ceiling)	27,135	28,000	865
3. Change in the net domestic assets of the BCU (ceiling)	-825	650	1,475
(Cumulative flows from December 31, 1999; millions of U.S. dollars)			
4. Net international reserves of the BCU (-decrease) (floor)	44	0	44
5. Public sector debt denominated in foreign currency and UR (ceiling)			
a. All maturities	8,494	8,080	-414
b. Less than 1 year	200	200	0
B: Structural Benchmarks			
1. Complete portfolio analysis of the BROU and the BHU.			Observed
2. Submit law to Congress to revoke ICOME by January 1, 2001.			Observed
3. Submit law to Congress to eliminate the social security surcharge for public enterprises in 12 quarters.			Observed
4. Initiate a study of the quasi-fiscal operations of all public sector institutions.			Observed
5. Start publishing monthly data on the public sector finances with lags no more than 60 days.			Observed
6. Reduce the BROU and BHU reporting lags of monetary data to the BCU equivalent to private banks.			Observed 1/
7. Publish quarterly reports for the public sector financial and nonfinancial enterprises for the third quarter 2000.			Not observed 2/

Sources: Data provided by the authorities; and staff calculations.

1/ Observed with a small delay.

2/ Rescheduled for end-March 2001.

Table 3. Uruguay: Public Sector Operations

	1995	1996	1997	1998	1999	2000 1/ Prog.	2000 1/ Prel.	2001 Prog.
	(In millions of pesos)							
Revenue	**36,997**	**49,057**	**62,140**	**76,985**	**76,735**	**83,123**	**76,392**	**84,766**
Taxes	23,471	32,190	42,737	50,500	50,294	54,920	50,785	56,102
VAT and excise taxes	13,376	17,992	23,677	27,447	27,030	29,914	27,292	30,627
On income and profits	4,243	6,606	8,660	10,785	11,973	12,738	12,687	12,884
On foreign trade	1,212	1,564	2,155	2,577	2,242	2,639	1,968	2,757
On property and other	4,640	6,028	8,245	9,691	9,050	9,629	8,838	9,834
Social security contributions 2/	8,548	10,492	12,183	14,286	15,010	15,764	14,920	15,563
Nontax revenue 3/	1,539	2,156	2,383	6,352	6,505	6,067	5,857	6,571
Current surplus of public enterprises 4/	3,440	4,220	4,837	5,846	4,925	6,372	4,830	6,530
Noninterest expenditure	**36,108**	**48,263**	**61,072**	**74,770**	**81,692**	**82,125**	**79,328**	**84,705**
Current	31,384	42,556	53,606	64,901	71,385	72,072	70,901	74,441
Wages 3/	7,605	10,876	13,290	16,007	17,026	17,096	17,236	18,184
Goods and services 3/	5,231	6,237	7,923	11,493	12,948	12,457	11,238	13,155
Social security benefits 2/	17,116	23,299	30,390	35,621	39,526	40,667	41,005	41,565
Other	1,432	2,145	2,003	1,779	1,885	1,852	1,422	1,536
Capital (Government and enterprises) 3/	4,724	5,707	7,467	9,869	10,307	10,052	8,427	10,264
Primary balance	**889**	**794**	**1,067**	**2,215**	**-4,957**	**998**	**-2,936**	**61**
Interest	2,593	3,187	3,998	4,463	4,867	5,625	6,224	7,061
Overall balance	**-1,704**	**-2,393**	**-2,930**	**-2,247**	**-9,825**	**-4,627**	**-9,160**	**-7,000**
	(In percent of GDP)							
Revenue	**30.2**	**30.1**	**30.3**	**32.7**	**32.1**	**32.5**	**31.3**	**31.9**
Taxes	19.2	19.7	20.9	21.5	21.1	21.5	20.8	21.1
VAT and excise taxes	10.9	11.0	11.6	11.7	11.3	11.7	11.2	11.5
On income and profits	3.5	4.1	4.2	4.6	5.0	5.0	5.2	4.9
On foreign trade	1.0	1.0	1.1	1.1	0.9	1.0	0.8	1.0
On property and other	3.8	3.7	4.0	4.1	3.8	3.8	3.6	3.7
Social security contributions 2/	7.0	6.4	5.9	6.1	6.3	6.2	6.1	5.9
Nontax revenue 3/	1.3	1.3	1.2	2.7	2.7	2.4	2.4	2.5
Current surplus of public enterprises 4/	2.8	2.6	2.4	2.5	2.1	2.5	2.0	2.5
Noninterest expenditure	**29.5**	**29.6**	**29.8**	**31.8**	**34.2**	**32.1**	**32.5**	**31.9**
Current	25.6	26.1	26.2	27.6	29.9	28.2	29.0	28.0
Wages 3/	6.2	6.7	6.5	6.8	7.1	6.7	7.1	6.8
Goods and services 3/	4.3	3.8	3.9	4.9	5.4	4.9	4.6	5.0
Social security benefits 2/	14.0	14.3	14.8	15.1	16.6	15.9	16.8	15.6
Other	1.2	1.3	1.0	0.8	0.8	0.7	0.6	0.6
Capital (Government and enterprises) 3/	3.9	3.5	3.6	4.2	4.3	3.9	3.4	3.9
Primary balance	**0.7**	**0.5**	**0.5**	**0.9**	**-2.1**	**0.4**	**-1.2**	**0.0**
Interest	2.1	2.0	2.0	1.9	2.0	2.2	2.5	2.7
Overall balance (deficit -)	**-1.4**	**-1.5**	**-1.4**	**-1.0**	**-4.1**	**-1.8**	**-3.7**	**-2.6**
GDP (millions of pesos)	122,521	163,077	204,938	235,393	238,820	255,785	244,279	265,621

Sources: Ministry of Finance; and Fund staff estimates.

1/ Program figures were adjusted to include extra budgetary operations.

2/ Excluding contributions that are transferred to the private pension funds.

3/ Includes extrabudgetary revenue (Fondos de Libre Disponibilidad) from 1998.

4/ Before interest expenditures.

Table 4. Uruguay: Summary Accounts of the Banking System

	End of Period						
					2000		2001
	1996	1997	1998	1999	Prog. 1/	Proj.	Prog.
	(In millions of Ur$)						
	I. Central Bank						
Net foreign Assets	**10,312**	**13,951**	**19,733**	**22,948**	**25,217**	**27,641**	**29,721**
Net international reserves 2/	16,338	20,741	26,254	28,373	30,432	32,705	34,265
Other net foreign assets	-6,026	-6,790	-6,521	-5,425	-5,215	-5,064	-4,544
Net domestic assets	**-3,675**	**-5,852**	**-10,514**	**-13,094**	**-14,477**	**-18,168**	**-19,427**
Net domestic assets	**-2,511**	**-4,392**	**-8,686**	**-10,787**	**-12,005**	**-15,497**	**-16,555**
Credit to public sector	2,243	549	-3,128	881	192	-3,685	-4,146
Credit to financial system	-6,052	-7,346	-8,406	-13,992	-15,076	-18,071	-16,304
Credit to the private sector	360	411	434	458	460	487	658
Credit to the private sector	-804	-1,048	-1,394	-1,849	-2,012	-2,184	-2,214
Other	938	1,993	2,414	1,866	2,419	5,772	3,237
Monetary liabilities	**7,801**	**9,559**	**11,046**	**12,161**	**13,212**	**12,144**	**13,166**
Currency issued	6,637	8,099	9,219	9,853	10,740	9,473	10,294
Currency outside banks	5,171	6,423	7,084	7,639	8,386	7,345	7,987
Vault cash	1,467	1,676	2,135	2,215	2,354	2,125	2,311
Private sector deposits	1,164	1,460	1,827	2,307	2,472	2,671	2,872
Demand deposits (local currency)	0	0	0	0	0	0	3
Time deposits & other liabilities (LC)	20	50	71	71	77	51	51
Resident's foreign currency deposits	1,143	1,410	1,756	2,236	2,395	2,621	2,818
	II. Public and Private Banks 3/						
Net foreign assets 2/	**-270**	**-1,686**	**-3,240**	**-3,174**	**-3,992**	**-7,377**	**-4,591**
(in U.S.$ million)	-31	-168	-300	-273	-320	-589	-341
Net domestic assets	**58,896**	**76,463**	**91,085**	**102,773**	**113,047**	**118,569**	**126,551**
Credit to the public sector	4,316	4,166	4,831	4,919	5,155	8,578	7,603
Credit to financial system	5,998	7,225	7,704	11,262	11,546	11,299	9,926
Credit to the private sector	67,560	87,606	107,288	118,105	130,695	127,987	142,621
Other	-18,978	-22,534	-28,737	-31,513	-34,349	-29,295	-33,599
Liabilities to private sector	**58,627**	**74,777**	**87,845**	**99,599**	**109,055**	**111,192**	**121,960**
Local currency liabilities	13,956	17,096	18,578	19,242	21,023	21,029	22,852
Residents' foreign currency liabilities 4/	44,671	57,681	69,267	80,357	88,032	90,163	99,108
	III. Banking System 3/						
Net foreign assets 2/	**10,042**	**12,265**	**16,492**	**19,774**	**21,225**	**20,264**	**25,130**
(in U.S.$ million)	1,153	1,222	1,525	1,702	1,704	1,618	1,867
Net domestic assets	**54,919**	**70,394**	**80,264**	**89,771**	**98,689**	**100,944**	**107,686**
Credit to the public sector	6,559	4,715	1,703	5,800	5,347	4,893	3,457
Credit to rest of financial system	-1,520	-1,797	-2,838	-4,945	-5,884	-9,589	-8,688
Credit to the private sector	67,919	88,017	107,721	118,564	131,155	128,474	143,279
Of which: Local currency	29,384	35,618	41,530	46,125	49,999	48,185	52,634
Of which: Foreign currency	38,536	52,399	66,191	72,439	81,156	80,289	90,645
Other	-18,040	-20,541	-26,323	-29,647	-31,930	-22,834	-30,362
Broad money (M3*)	**64,961**	**82,659**	**96,756**	**109,545**	**119,914**	**121,209**	**132,816**
Currency outside banks	5,171	6,423	7,084	7,639	8,386	7,345	7,987
Local currency deposits	13,976	17,145	18,650	19,313	21,100	21,080	22,903
Residents' foreign currency liabilities 4/	45,814	59,091	71,022	82,593	90,427	92,784	101,926
	(Annual percentage change)						
Credit to the private sector	34.1	29.6	22.4	10.1	10.6	8.4	11.5
Currency issued	26.6	22.0	13.8	6.9	9.0	-3.9	8.7
Total deposits held by residents	35.6	27.5	17.6	13.6	9.4	11.7	9.6
Local currency	29.0	22.7	8.8	3.6	9.3	9.1	8.7
Foreign currency 4/	37.8	29.0	20.2	16.3	9.5	12.3	9.9
Consumer price index (e.o.p.)	24.3	15.2	8.6	4.2	5.8	5.1	4.7
Memorandum:							
Nonresidents' f/c deposits (US$ million)	2,720	3,071	3,367	4,663	4,772	5,190	4,940

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

1/ Program figures and projections are not comparable because of some revisions in the base. However, the 2000 projections and 2001 program figures are comparable.

2/ Gold valued at market prices

3/ The Bank of the Republic (BROU), the National Mortgage Bank (BHU), private banks and cooperatives.

4/ Includes indexed deposits

Table 5. Uruguay: Banking Soundness Indicators 1/

	December						Sept.
	1994	1995	1996	1997	1998	1999	2000
Profitability ratios 2/							
(Percent of average total assets)							
Operating revenue	38.0	35.5	31.0	25.6	20.4	30.8	21.6
Operating expenses	29.2	26.5	23.5	19.2	14.8	25.4	16.9
Operating margin	8.8	9.0	7.5	6.5	5.6	5.4	4.7
from interest	7.8	8.0	6.4	5.4	4.6	4.3	3.8
from fees	1.0	1.0	1.1	1.0	1.0	1.0	0.9
Overhead expenses (including labor costs)	5.2	5.4	5.5	5.2	4.9	5.2	4.7
Pre-tax profits (nominal)	6.0	5.2	4.3	2.4	1.3	1.2	0.8
After-tax profits (adjusted for inflation)	0.8	1.4	1.2	0.7	0.9	1.2	-0.9
(Percent of equity)							
Pre-tax return on equity (nominal, percent)	31.2	26.8	23.1	12.8	7.3	7.8	5.5
After-tax return on equity (adjusted for inflation, percent)	4.1	7.2	6.1	3.7	5.0	7.5	-6.2
Private banks, excluding intervened banks	6.6	11.5	14.5	11.4	13.6	11.7	6.0
BROU	2.5	8.0	4.0	1.7	6.4	7.0	-0.3
BHU	6.3	4.9	2.2	-2.3	2.4	0.3	-21.1
Asset quality ratios							
Nonperforming loans/total loans (percent) 3/	8.4	10.6	10.4	9.3	10.7	16.1	16.4
Loans with qualification "1 or 2" (percent of total loans) 3/ 4/ 5/	...	...	...	89.3	88.5	83.5	82.2
BROU and BHU	...	...	...	82.9	81.1	71.7	68.8
Private banks 4/	...	92.9	93.4	94.0	93.8	91.9	91.4
Loans with qualification "3 - 5" (percent of total loans) 3/ 5/	...	...	...	10.7	11.5	16.5	16.6
BROU and BHU	...	...	...	17.1	18.9	28.3	31.2
Private banks 6/	...	7.1	6.6	6.0	6.2	8.1	8.6
Loan provisions/total loans (percent)	...	5.2	6.4	6.5	6.1	5.9	6.5
Uncovered nonperforming loans/total loans (percent) 3/	...	5.4	4.0	2.8	4.6	10.1	9.9
Loan provisions/past-due loans (percent) 3/	7.3	48.1	58.4	61.1	62.8	46.3	38.3
Liquidity ratios							
Total loans/total deposits (percent)	97.7	103.8	99.9	98.3	100.4	102.1	99.4
Total liquid assets/total deposits (percent)	18.5	16.7	19.0	18.8	16.6	15.5	18.1
Capital adequacy ratios							
Capital/assets (percent)	19.9	19.1	18.0	16.3	15.5	15.3	15.0
Capital/risk-adjusted asssets (percent) 7/	31.2	29.7	28.2	25.2	25.3	22.2	22.8
Private banks	13.3	13.0	13.4	11.3	11.2	10.2	12.3
BROU	28.1	25.3	22.0	16.1	24.1	18.2	20.6
BHU	54.7	53.4	52.9	50.7	45.3	42.4	40.9
Capital/(assets plus contingencies) (percent) 8/	4.7	4.6	4.5	4.5	5.2	5.8	5.7
Deposits/capital = leverage (percent)	378.7	398.3	432.9	479.4	514.4	517.1	534.8
Memorandum items:							
Private banks' share of total assets (percent)	50.3	49.5	51.9	54.5	55.8	59.0	59.9
BROU and BHU share of total assets	49.7	50.5	48.1	45.5	44.2	41.0	40.1

Source: Central Bank of Uruguay - Banking Superintendency.

1/ Comprising private banks; Bank of the Republic and National Mortgage Bank; and two intervened banks.
2/ September 2000 figures are annualized.
3/ Loan classifications in the BROU and BHU have recently been revised in light of the independent audits underway for year 2000. As a result, the figures on NPL prior to 1999 are not strictly comparable with (tend to be lower than) those for 1999 and 2000. Also, public banks tend to take more time to write down unrecoverable assets, leading to a larger cumulation of the stock of these assets in the balance sheet. In this context, it may also be noted that public banks tend to maintain about twice as much capital on their books relative to risk-adjusted assets, than private banks.
4/ Loans with 1 rating are highest quality, 5 are lowest quality.
5/ September 2000 figures correspond to June 2000 for these items.
6/ Includes intervened banks.
7/ Minimum is 8.5 percent, to increase to 10 percent by early 2001.
8/ Minimum requirement is 4 percent.

Table 6. Uruguay: Summary Balance of Payments

	1996	1997	1998	1999	2000 Prog.	2000 Prel.	2001 Prog.
(In millions of U.S. dollars)							
Current account balance	-233	-298	-476	-528	-521	-576	-504
Trade Balance	-687	-704	-772	-897	-797	-935	-856
Exports, f.o.b.	2,449	2,793	2,829	2,289	2,627	2,354	2,564
Imports, f.o.b.	-3,135	-3,498	-3,601	-3,186	-3,424	-3,289	-3,420
Nonfactor services	560	525	437	469	456	513	530
Exports, f.o.b.	1,399	1,417	1,307	1,264	1,372	1,342	1,395
Imports, f.o.b.	-839	-892	-870	-795	-916	-830	-865
Factor services (net)	-189	-193	-199	-174	-247	-220	-245
Transfers (net)	83	74	59	73	67	67	67
Financial account	225	539	697	506	521	711	444
Foreign direct investment	137	113	155	229	240	180	200
Portfolio investment	276	174	419	128	120	273	457
Inflows	285	299	419	280	240	575	660
Outflows	8	125	0	152	120	302	203
Other investment	-189	252	123	150	161	258	-213
Commercial credit	-17	44	38	-55	44	8	44
Other net inflows	-172	208	85	204	117	250	-257
Inflows	1,147	917	924	1,030	910	1,107	1,031
General government	31	170	163	272	160	105	97
Banks	1,066	711	752	758	750	1,002	750
Other sectors	50	36	9	1	0	0	183
Outflows	1,319	709	840	826	793	857	1,288
General government	0	0	0	0	0	0	124
Banks	1,221	682	755	660	655	715	1,005
Other sectors	97	27	85	166	138	142	159
Errors and omissions	153	73	140	35	0	35	0
Change in international reserves (- increase)	-144	-314	-362	-13	0	-171	60
(In percent, unless otherwise indicated)							
Memorandum items							
Current account/GDP	-1.1	-1.4	-2.1	-2.5	-2.5	-2.9	-2.5
Financial account/GDP	1.1	2.5	3.1	2.4	2.5	3.5	2.2
Nonfinancial public external debt/GDP	23.3	22.6	24.3	25.7	28.8	28.4	29.4
Gross official reserves (In million of US$)	1,909	2,068	2,589	2,602	2,602	2,762	2,702
In percent of short-term debt							
Including nonresident deposits	29.4	28.6	32.4	34.5	33.1	36.6	35.5
Excluding nonresident deposits	50.7	49.6	56.1	90.4	89.8	106.2	92.6
In months of imports of goods and services	5.8	5.7	6.9	7.8	7.2	8.0	7.6

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

Table 7. Uruguay: Public Sector Financing Plan for 2001

(In millions of U.S. dollars)

	1999	2000	2001	2001, quarterly distribution Q1	Q2	Q3	Q4
Gross borrowing needs	**1,745**	**1,565**	**1,409**	**382**	**469**	**284**	**274**
Public sector deficit (+)	906	759	530	121	292	82	35
Central government	848	698	572	124	234	103	111
Local governments	73	30	0	0	0	0	0
Public enterprises	-56	-45	-97	-20	36	-34	-79
Quasi-fiscal balance BCU	41	76	55	17	22	13	3
Amortization	839	806	879	261	177	202	239
Central government	349	416	452	172	54	80	146
Amortization M&LT debt	174	197	255	130	4	31	90
WB, IDB, other official lenders	121	204	124	30	30	34	30
Other	54	15	73	12	20	15	26
Enterprises	274	188	279	19	80	80	100
BCU	216	202	148	70	43	42	-7
Gross financing	**1,745**	**1,565**	**1,409**	**382**	**469**	**284**	**274**
Placement of M&LT bonds	990	972	950	320	210	310	110
WB, IDB, other official lenders	348	244	97	32	22	22	21
Borrowing by enterprises	195	198	183	40	44	46	53
Base money	90	61	61	-113	34	-57	197
Use of NIR (+)	-13	-171	60	114	87	-67	-74
Deposits and other	135	261	58	-11	72	30	-33
		(In percent of GDP)					
Borrowing requirement	**8.3**	**7.7**	**6.9**	...	...	...	...
Public sector deficit	4.3	3.7	2.6	...	...	...	...
Amortization	4.0	4.0	4.3	...	...	...	...
Gross financing obtained	**8.3**	**7.7**	**6.9**	...	...	...	...
Bonds	4.7	4.8	4.6	...	...	...	...
WB, IDB, enterprises	2.6	2.2	1.4	...	...	...	...
Other, net	1.0	0.7	0.9	...	...	...	...

Source: Ministry of Economy.

Table 8. Uruguay: Medium-Term Macroeconomic Framework

	1997	1998	1999	2000	2001	2002	2003	2004	2005
				Projections					
	(In percent of GDP)								
Gross domestic investment	**15.1**	**15.6**	**15.2**	**14.5**	**15.2**	**15.5**	**15.8**	**16.1**	**16.4**
Public sector, excluding public enterprises	2.7	2.9	3.2	3.0	3.3	3.3	3.3	3.4	3.4
Private sector	12.4	12.7	12.0	11.5	11.9	12.2	12.5	12.7	13.0
Gross national saving	**13.7**	**13.5**	**12.7**	**11.6**	**12.7**	**13.4**	**13.7**	**14.1**	**14.5**
Public sector	2.4	3.2	0.2	-0.3	1.3	2.1	2.7	2.9	3.3
Private sector	11.3	10.2	12.5	11.9	11.4	11.3	11.0	11.2	11.2
Foreign saving	**1.4**	**2.1**	**2.5**	**2.9**	**2.5**	**2.1**	**2.1**	**2.0**	**1.9**
Total external debt (excl. nonres. deposits)	**42.6**	**44.6**	**41.0**	**44.8**	**45.1**	**45.2**	**45.1**	**44.5**	**43.5**
Total external debt (incl. nonres. deposits)	**57.4**	**60.5**	**63.2**	**66.6**	**67.2**	**67.2**	**67.1**	**66.5**	**65.5**
Public sector	26.0	27.6	28.6	30.7	31.8	32.1	32.0	31.7	31.2
Non Financial Private sector	2.1	2.2	2.0	1.9	2.0	2.0	2.0	2.0	2.0
Financial System (incl. nonres. deposits)	29.3	30.7	32.6	34.0	33.4	33.1	33.0	32.7	32.4
Public sector finances									
Revenue	31.6	32.7	32.1	31.3	31.9	31.7	31.6	31.7	31.6
Of which: taxes	20.9	21.5	21.1	20.8	21.1	21.1	21.3	21.4	21.3
Social security contributions	5.9	6.1	6.3	6.1	5.9	5.7	5.5	5.4	5.4
Expenditure	31.1	31.8	34.2	32.5	31.9	30.9	30.2	30.2	29.9
Of which: wages	6.8	6.8	7.1	7.1	6.9	6.6	6.4	6.3	6.2
Social security benefits	14.8	15.1	16.6	16.8	15.6	14.7	14.3	14.1	13.9
Primary balance (deficit -)	0.5	0.9	-2.1	-1.2	0.1	0.8	1.4	1.5	1.7
Interest	2.0	1.9	2.0	2.5	2.7	2.8	2.8	2.8	2.7
Overall balance (deficit -)	**-1.4**	**-1.0**	**-4.1**	**-3.7**	**-2.6**	**-2.0**	**-1.4**	**-1.3**	**-1.0**
Public sector total debt	**32.1**	**34.3**	**40.2**	**45.8**	**47.3**	**47.4**	**47.0**	**46.2**	**45.2**
	(In millions of U.S. dollars)								
Current account balance	**-298**	**-476**	**-528**	**-575**	**-504**	**-453**	**-474**	**-472**	**-467**
Exports	2,793	2,829	2,289	2,354	2,564	2,802	3,063	3,308	3,573
Imports	-3,498	-3,601	-3,186	-3,289	-3,420	-3,663	-4,005	-4,310	-4,644
Nonfactor services (net)	525	437	469	513	530	612	692	773	858
Factor services (net)	-193	-199	-174	-220	-245	-270	-290	-310	-320
Transfers (net)	74	59	73	67	67	67	67	67	67
Financial account	**612**	**837**	**541**	**746**	**444**	**502**	**593**	**622**	**617**
Foreign direct investment	113	155	229	180	200	200	200	210	220
Portfolio investment	174	419	128	273	457	250	250	250	225
Other investment 1/	325	263	185	293	-213	52	143	162	172
Increase (-) in official reserves	**-314**	**-362**	**-13**	**-171**	**60**	**-50**	**-120**	**-150**	**-150**
	(Annual percentage change)								
Real GDP	4.9	4.6	-3.2	-1.0	2.0	4.0	4.0	3.1	3.1
Consumer prices (end-of-period)	15.2	8.6	4.2	5.1	4.7	4.0	2.8	2.5	2.0
Merchandise export prices	-1.9	-1.1	-7.3	-4.4	0.9	0.9	1.2	1.1	1.1
Export volume	16.3	2.4	-12.7	7.6	7.9	8.3	8.0	6.8	6.8
Merchandise import prices	-3.1	-5.9	-5.2	3.3	0.0	0.0	1.0	1.0	1.1
Import volume	15.1	9.4	-6.7	-0.1	4.0	7.1	8.3	6.5	6.6
Merchandise terms of trade	1.2	5.1	-2.2	-7.5	0.9	0.9	0.2	0.1	0.0
	(In percent of exports of GNFS)								
Total external debt (excl. nonres. deposits)	220.2	242.0	242.9	254.9	241.7	230.3	221.5	212.5	202.5
Total external debt (incl. nonres. deposits)	296.6	328.3	374.5	378.9	360.1	342.4	329.6	317.6	304.8
Nonfinancial public sector debt service	16.5	15.6	25.2	27.3	25.3	24.4	23.6	22.8	21.7
Of which: interest payments	8.3	9.0	10.7	11.4	12.4	11.9	11.5	11.1	10.4
Outstanding Fund credit	0.0	3.5	3.2	2.9	2.6	1.2	0.0	0.0	0.0
Fund charges and repurchases	0.2	0.0	0.2	0.2	0.3	2.0	1.8	0.1	0.0

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

1/ Includes errors and omissions.

Table 9. Uruguay: Net Position in Foreign Currency and External Debt and Debt-Service Indicators

A. Net Position in Foreign Currency on June 30, 2000; in millions of U.S. dollars

	Assets	Liabilities			Net Liabilities
		Total	L. Term	S. Term	
Public Sector	3,135	6,323	5,969	353	3,188
NFPS	0	5,486	5,165	321	5,486
BCU	3,135	837	804	32	-2,298
Private sector	0	401	36	365	401
Financial sector	5,862	7,011	184	6,827	1,149
Total	8,997	13,735	6,188	7,545	4,738

B. External Debt and Debt-Service Indicators

	1996	1997	1998	1999	Jun 2000
	(In millions of U.S. dollars)				
External debt	11,595	12,486	13,583	13,307	13,734
Public sector	5,618	5,654	6,192	6,018	6,322
Medium and long term	5,052	5,280	5,715	5,640	5,969
NFPS	4,141	4,383	4,720	4,802	5,165
BCU	911	897	995	838	804
Short term	566	374	477	378	353
NFPS	541	371	475	376	321
BCU	25	3	2	2	32
Financial system (excl. BCU)	5,580	6,367	6,905	6,876	7,011
Medium and long term	25	32	28	86	184
Short term	5,555	6,335	6,877	6,790	6,827
Nonfinancial private sector	397	465	486	413	401
Medium and long term	30	32	33	39	36
Short term	367	433	453	374	365
Total debt service	1,364	1,049	1,017	1,296	1,427
Principal 1/	751	347	270	522	582
Interest	613	702	747	774	845
Debt service NFPS	1,079	696	644	895	990
Principal 1/	749	345	270	517	576
Interest	329	351	374	379	414
	(In percent of GDP)				
External debt	56.5	57.4	60.5	63.2	66.6
Public sector	27.4	26.0	27.6	28.6	30.7
Financial system	27.2	29.3	30.7	32.6	34.0
Nonfinancial private sector	1.9	2.1	2.2	2.0	1.9
	(In percent of exports of goods and services)				
External debt	301.3	296.6	328.3	374.5	378.9
Public sector	146.0	134.3	149.7	169.4	174.4
Financial system	145.0	151.3	166.9	193.5	193.4
Nonfinancial private sector	10.3	11.0	11.7	11.6	11.1
Total debt service	35.5	24.9	24.6	36.5	39.4
Principal 1/	19.5	8.2	6.5	14.7	16.1
Interest	15.9	16.7	18.1	21.8	23.3
Debt service NFPS	28.0	16.5	15.6	25.2	27.3
Principal 1/	19.5	8.2	6.5	14.5	15.9
Interest	8.6	8.3	9.0	10.7	11.4
Memorandum items					
Total short term external debt (US$ millions)	6,488	7,142	7,807	7,542	7,545
Gross international assets in the financial system (US$ millions) 2/	6,050	6,798	7,884	8,666	8,997
Liabilities to the Fund					
In millions of U.S. dollars	8.6	0.0	160.8	156.7	152.7
In percent of quota	2.7	0.0	50.8	37.2	37.2
Debt service to the Fund					
In millons of U.S. dollars	12.2	8.2	0.0	5.5	7.9
In percent of NFPS debt service	1.1	1.2	0.0	0.6	0.8
In percent of exports	0.3	0.2	0.0	0.2	0.2

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

1/ Excluding short term debt.
2/ In the Central Bank, BROU, and private banks.

Table 10. Uruguay: Vulnerability Indicators

	1996	1997	1998	1999	Prel. 2000	Prog. 2001
(Annual percentage change, unless otherwise indicated)						
Financial sector indicators						
Broad money	34.4	27.2	17.1	13.2	10.2	10.5
Credit to the private sector	34.1	29.6	22.4	10.1	7.6	10.1
Share of nonperforming loans in total loans (in percent)	10.4	9.3	10.7	16.1	16.4	...
Prime interest rates (percent, average) - domestic loans	48.2	39.2	30.6	24.4	19.0	...
Prime interest rates, real (percent, average) - domestic loans	15.5	16.2	17.9	15.1	12.7	...
External Indicators						
Merchandise exports (in US$)	14.0	14.1	1.3	-19.1	2.8	8.9
Merchandise imports (in US$)	15.6	11.6	2.9	-11.5	3.2	4.0
Merchandise terms of trade	-3.4	1.2	5.1	-2.2	-7.5	0.9
REER appreciation (+)	-0.5	1.8	1.3	10.2	-3.5	...
(In percent of GDP, unless otherwise indicated)						
Current account balance	-1.1	-1.4	-2.1	-2.5	-2.9	-2.5
Capital and financial account balance	1.1	2.5	3.1	2.4	3.5	2.2
Of which: Net foreign direct investment	0.7	0.5	0.7	1.1	0.9	1.0
Inward portfolio investment (securities etc.)	1.4	1.4	1.9	1.3	2.8	3.3
Other net inflows (deposits, loans, trade credits, etc.)	-0.9	1.2	0.6	0.7	1.3	-1.1
Total external debt including nonresident deposits	56.7	57.4	60.5	63.2	66.6	67.2
Of which: Public sector	26.3	26.0	27.6	28.6	30.7	31.8
Foreign currency deposits (nonresidents)	13.3	14.8	15.9	22.2	21.8	22.1
In percent of exports GNFS	301.4	296.6	328.3	374.5	378.9	360.1
External interest payments to exports GNFS (in percent)	15.9	16.7	18.1	21.8	23.3	24.3
External amortization payments to exports GNFS (in percent)	19.5	8.2	6.5	14.7	16.1	16.0
(In millions of U.S. dollars, unless otherwise indicated)						
Central Bank short-term foreign liabilities	34	3	162	159	149	149
Central Bank foreign currency exposure	-302	-187	-198	-473	-526	...
Short term foreign assets of the financial sector	6,488	7,142	7,807	7,542	7,545	7,400
Short term foreign liabilities of the financial sector	5,555	6,336	6,877	6,790	7,128	6,950
Gross official reserves	1,909	2,068	2,589	2,602	2,762	2,702
In months of imports GNFS	5.8	5.7	6.9	7.8	8.0	7.6
In percent of total debt service	140.1	197.2	254.6	200.8	193.6	184.0
In percent of base money	217.4	217.0	217.0	305.9	363.8	351.1
In percent of broad money	25.6	25.1	28.4	27.6	28.4	27.3
In percent of short-term external debt incl. deposits 2/	29.4	28.6	32.4	34.5	36.6	35.5
In percent of short-term external debt excl. deposits 2/	50.7	49.6	56.1	90.4	106.2	92.6
Financial Market Indicators						
Foreign currency debt rating (Moody's)				Baa3	Baa3	...
Foreign currency debt rating (S&P)				BBB-	BBB-	..
Spread of benchmark bonds (basis points, end of period) 3/			257	194	290	...
Exchange rate (per US$, period average)	7.97	9.44	10.47	11.34	12.15	...

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

1/ Excludes Central Bank.

2/ By remaining maturity.

3/ Ten-year bond.

Table 11. Uruguay: Proposed Availability of Purchases

Availability	Amount in Millions of SDRs	Conditions
February 28, 2001	74.0	Completion of review
May 31, 2001	19.0	Compliance with end-March performance criteria
August 31, 2001	19.0	Compliance with end-June performance criteria, and completion of review.
November 30, 2001	19.0	Compliance with end-Sept. performance criteria
February 28, 2002	19.0	Compliance with end-Dec. performance criteria
Total access	150	
Percent of quota	48.9	
Annual access (in percent)	26.7	

Montevideo, Uruguay
January 30, 2001

Dear Mr. Kohler:

For the first review of the 22–month stand-by arrangement from the Fund, which was approved by the Executive Board on May 31, 2000, the attached policy memorandum and annexes describe recent developments under the economic program for 2000, and the policies and objectives of the Government of Uruguay for 2001. The arrangement is in the amount of SDR 150 million, and the government is treating it as precautionary. In 2000, the Uruguayan economy did not recover as had been envisaged in the economic program, in part because several new external shocks contributed to a drop in national income for the second year in a row. In view of these adversities, the Government is requesting a waiver for the nonobserved performance criteria of the program for end-December 2000. The Government believes that the policies for 2001, described below, will promote the recovery of sustainable growth of output and employment in conditions of low inflation and external viability, improve efficiency in the economy in general and in the public sector in particular, and address priority social needs.

During the period of the arrangement, the authorities of Uruguay will maintain close relations with the Fund and consult on the adoption of any measures that may be needed, in accordance with the Fund's practices on such consultations. The second review of the program will be carried out with the Fund no later than July 2001.

Sincerely,

/s/
César Rodríguez-Batlle
President
Central Bank of Uruguay

/s/
Alberto Bensión
Minister of Economy
and Finance

Mr. Horst Kohler
Managing Director
International Monetary Fund
Washington D.C. 20431

Attachment:
Memorandum of Economic Policies

Memorandum of Economic Policies

I. Developments under the Program in 2000

1. **Following a downturn in economic activity in 1999, Uruguay continued to face unexpectedly difficult economic conditions in 2000.** After the competitiveness shock incurred with the devaluation of the Brazilian *real* in January 1999, the output contraction appeared to be coming to an end when Uruguay registered a slight expansion in seasonally adjusted real GDP in the last quarter of 1999 and the first quarter of 2000. However, the recovery was not sustained in the second quarter, nor did economic activity accelerate in the second half of the year, as was expected under the program. As a result, real GDP is now estimated to have declined by more than 1 percent in 2000. Consumer price inflation ended the year at 5 percent, slightly below program assumptions, but the unemployment rate increased from 11 percent at end–1999 to 14½ percent in recent months, reflecting the delay in the economic recovery, and some distortions in the labor market, such as the high health care premium for labor market entrants.

2. **A number of adverse factors help to explain these economic difficulties.** Uruguay experienced a sharp drop, for the second year in a row, in the terms of trade as the economy faced a large increase in oil import prices, while prices for most of our (agricultural) export commodities remained weak. Moreover, demand for Uruguayan products in Europe was depressed by the 22 percent depreciation of the euro against the U. S. dollar during 2000. There were also some interruptions in access for products from Uruguay (rice, dairy products, bicycles, etc.) to the countries in the region, which are now being resolved, but nevertheless caused some export losses. Moreover, economic activity in Argentina has been weaker than envisaged, and has affected consumer confidence and demand. Lastly, the availability of manufacturing exports of agricultural origin was limited early in the year by adverse weather conditions, while a localized outbreak of foot and mouth disease interrupted meat exports in November and December 2000 (meat exports account for 21 percent of total merchandise exports). Consumers and investors have been concerned about these shocks, and they maintained cautious spending plans. For the second year in a row, domestic demand fell in real terms, which limited output growth. Regarding producers in Uruguay, we believe that some of the shocks noted above imply a new relative price equilibrium in the economy, and that producers and suppliers will need additional time and effort to adjust their own costs and prices accordingly.

3. **Notwithstanding the challenges, Uruguay also made important progress in several economic areas in 2000.** Competitiveness is on the rebound. By end–2000, a significant share of the sharp appreciation in the real effective exchange rate of January 1999 had been reversed, but, as noted above, costs must continue to fall in U.S. dollar terms for Uruguayan producers and exporters. Exporters made significant progress in reducing their costs and diversifying their markets, especially in the NAFTA countries and in Asia, while maintaining adequate volume growth in our traditional markets (albeit at lower prices). Also, as implied above, the structure of aggregate demand is changing, toward stronger net exports with more subdued domestic absorption, which is a more sustainable balance of output growth. Finally, the economic difficulties have stimulated an important debate about the need for structural reform in Uruguay to make the economy more agile, and better able to respond to external shocks, and the

government has restarted the structural reform agenda. This debate is important as the government is not in a position to take unilateral decisions on structural reform in Uruguay's consensus-based culture, and it is working with Congress to implement appropriate reform measures in 2001, as described below.

4. **With the exception of the fiscal deficit and public sector overall debt targets, the quantitative objectives agreed with the Fund through end-December 2000 were met.** The consolidated public sector deficit reach 3.7 percent of GDP, compared with a program target of 1.8 percent. The larger-than-programmed deficit corresponds mainly to a drop in public sector revenue, and is broadly consistent with the operation of automatic stabilizers on the deficit, considering lower-than-expected output growth, and the particular weakness in domestic demand which, through consumption based taxation, is the largest revenue base in Uruguay. Notably, the public sector expenditure target under the program was met with a margin exceeding 3 percent, despite the adverse conditions, and the government continues to view the containment of public sector expenditure as the anchor of its medium-term fiscal strategy. The structural reform benchmarks under the program have been observed, except for the publication of the quarterly annotated reports of the public sector banks and enterprises; this benchmark was rescheduled for the end-March 2001 program period.

5. **The government did not experience major difficulties in financing the larger deficit in 2000, and developments under the exchange rate regime and with interest rates were as envisaged in the program.** The government placed three international bond issues (in June, September, and November) for a total of around US$640 million at an average spread of 290 basis points over corresponding U.S. Treasury bonds, and it placed the remaining financing requirement in the domestic market. In mid–2000, international credit rating agencies confirmed Uruguay's investment credit rating. The adjustable band exchange rate regime continued to work well in 2000. The band is 3 percent wide and currently is adjusted at an annual pace of 7.5 percent, slightly faster than inflation. The position of the exchange rate on average remained within the most appreciated half of the band. There were no substantial changes in interest rate policies of the BCU, which are largely subordinated to the exchange rate regime.

6. **The external current account deficit is estimated to have widened slightly to 2.9 percent of GDP in 2000 (some US$600 million).** Merchandise exports increased by around 3 percent in U.S. dollar terms (over 8 percent in volume); imports also increased by 3 percent in value, and dropped slightly in volume terms. The merchandise and services terms of trade were very weak, declining by 7.5 percent in the year, after declining by over 2 percent in 1999. Nonfactor services, especially tourism, held up well in 2000, in part as Argentines continued to come to Uruguay, and there were more visitors from Europe and the United States. In the capital account, net foreign direct investment was around US$200 million, with inflows mostly directed towards the hotel sector, retailing, and forestry. Portfolio inflows, dominated by the placement of government bonds abroad, remained sound, and there were renewed inflows of nonresident deposits into the Uruguayan banking system. The overall balance of payments registered a surplus in 2000, with net international reserves stronger than had been expected in the program.

II. The Economic Objectives for 2001

7. The Government's first priority is to foster a sustainable recovery in output while preserving low inflation. The resumption in output growth is needed to reduce unemployment. The policy measures will focus on assuring sound public sector finances to bolster national saving and limit indebtedness, and intensifying structural reform to help increase exports and private sector investment, which we believe need to be the engine of growth. The structural reforms are crucial to improve competitiveness of domestic production, and make the economy more responsive to foreign shocks, within the framework of the adjustable-band exchange rate system. These objectives will require cost containment, deregulation, and increased competition.

III. The Macroeconomic Framework

8. **Emerging from the recession has taken longer than was envisaged.** While at first the government anticipated an acceleration in growth in the second half of 2000, we now project that the rebound in output growth will gain strength towards the middle of 2001. The recovery of economic activity in Brazil has taken hold and, with a quarter of our merchandise exports sold in Brazil, this will begin to support growth in Uruguay as well. While Argentina is undergoing a difficult adjustment process, it has made substantial progress in recent time, and the prospects for the region as a whole are now becoming more favorable. We believe that international interest rates will decline somewhat further, while petroleum prices are expected to ease from their sharp runup to well above US$30 a barrel in 2000. At the same time, since costs in the economy are falling, and with ample capacity available for output growth, Uruguay could rebound quickly, especially if commodity prices turn somewhat more favorable. For now, the Government expects **real GDP growth of around 2 percent in 2001**, led by continued strength in the foreign balance and a gradual recovery in private investment and consumption, including with some recovery in the terms of trade. The rate of **inflation is likely to be in a range of 3½–5½ percent**, mainly because of slightly higher overall import prices, offset by the absence of domestic price pressures. Employment is expected to increase, but **unemployment initially is expected to drop only moderately** as participation rates typically also rebound with a recovery. With improved competitiveness and modest domestic absorption, **the external current account deficit is projected to narrow to about 2½ percent of GDP**.

IV. Economic Policies

9. **The economic policies for 2001 are part of the medium-term effort to restore competitiveness and resume high output growth.** The Government submitted to Congress a medium term budget for the Presidential term (2000–2005), based on expenditure restraint and which envisages achieving a turnaround in the public sector gross debt-GDP ratio by 2003. In December 2000, the budget was approved by Congress broadly in line with these deficit and debt objectives, but with slightly higher expenditures and taxes than those sought by the government.

10. **The Government aims to cut the fiscal deficit from 3.7 percent of GDP in 2000 to 2.6 percent in 2001**, equivalent to a reduction in the primary (noninterest) deficit of the public sector by about 1¼ percentage point of GDP. The indicative economic program for 2001 agreed with the Fund at the time of approval of the stand-by arrangement in May 2000, envisaged a deficit in 2001 of 1¼ percent of GDP. However, we believe that maintaining this target would not be realistic in view of the delayed recovery, as it would have required a large increase in taxation that could impede the resumption of growth. Instead, the government considers sustained expenditure moderation the key instrument of its medium term fiscal and competitiveness strategy, while tax increases should be minimized in view of the still fragile recovery in economic activity.

11. **Noninterest expenditures are programmed to drop from 32.5 percent of GDP in 2000 to 31.9 percent in 2001**. The general wage increase in the central government, already announced in January, was 3 percent. However, during the budget negotiations in Congress, it was also agreed that members of the judiciary, university professors, and teachers will receive a complementary *one-time* salary adjustment in 2001 equivalent to about 2½ percent of the total wage bill. These measures combined, and a small drop in public sector employment due to retirements, are projected to permit a small decline in the public sector wage bill in relation to GDP. More significant savings are expected from a drop in social security expenditure from 16.8 percent of GDP in 2000 to 15.6 percent in 2001. This reflects, on one hand, the gradual moderation in labor costs in the economy, as social security benefits are indexed to average private and public sector wages, and, on the other hand, the effects of the social security reform as the number of beneficiaries in the public system has recently started falling at a rate of 0.7 percent a year. Capital outlays are programmed to increase from their depressed level in 2000. Most of the expenditure adjustments are expected to take place in the central government, whereas local governments, which have limited access to financing, are curtailing their own expenditures. Their taxes have shrunk in the recession of 1999-2000, but local governments will receive 0.2 percentage points of GDP in additional transfers in 2001 in the context of political commitments to support greater decentralization which recently went into effect (see ¶13).

12. **Moderating labor costs is essential to help bolster competitiveness and improve prospects for employment growth.** The public sector indexation law that was adopted in Congress at end–1997 stipulates that if 12–month inflation remains below 10 percent since the last public sector general wage adjustment, the government can increase public sector wages only once a year. As this condition has been met, the general wage increase in government will be limited to the one granted in January, noted above. Private sector wages dropped by around 2 percent in real terms in 2000, and some contracts even had small reductions in nominal wages to preserve jobs. Private sector wages are expected to increase by around 3 percent in 2001.

13. **Consolidated public sector revenues are projected to increase from 31.3 percent of GDP in 2000 to 31.9 percent of GDP in 2001.** The largest component of this increase, 0.5 percentage points of GDP, is expected from the recovery of the operating result of the public enterprises, which had a difficult year in 2000. Input costs are falling as the total wage costs in real terms are declining and petroleum import prices are expected to be lower on average

compared with 2000. The average tariffs of the public enterprises will be adjusted in line with overall inflation. Other revenue gains are small in proportion: receipts from import taxes are expected to increase with the rebound in imports, and the government has removed a VAT exemption for private healthcare providers (expected to yield 0.1 percentage point of GDP each). Also, as agreed with Congress, the mandated increase in transfers to local governments will be financed with an increase in gasoline taxes, equivalent to 0.2 percentage points of GDP. Employer social security contributions were lowered slightly to help reduce labor costs and promote employment.

14. **Monetary policy is subordinated to the exchange rate regime.** During 2001, currency in circulation is projected to rise about in line with nominal GDP, while the BCU's net international reserves are expected to remain virtually unchanged from their relatively high level at end–2000. Broad money is envisaged to increase by 8–10 percent, reflecting the growth in deposits, and with nearly all of the public sector deficit financed abroad (see below), this will permit banking system credit to the private sector to expand by around 6 percent in real terms.

15. **The government is taking steps to improve the efficiency of the financial system.** The emphasis is on improving the performance of the public sector institutions. In the banking area, the **Bank of the Republic (BROU)** is receiving an independent external audit and analysis of its operations. The preliminary conclusions of these audits point out the need for additional reforms in the computer systems; to update the accounting systems in some parts of the bank; to fully implement the credit manuals, and to make more transparent the costs for the bank in its functions as a development institution. Management is already following up on these issues, and working with external experts to improve the efficiency of the bank. The external audit is expected to be completed by March 2001.

16. The **National Mortgage Bank (BHU)** also is receiving an independent external audit and analysis of its operations. So far, the preliminary results of the audit suggest a need to obtain an assessment of the properties on the books of the bank and for which mortgages have been extended, as existing assessments are out of date. The bank is taking measures to bolster its ongoing operations. Most importantly, it is reducing its balance sheet currency mismatch. Liabilities of the bank are denominated in U.S. dollars, but most mortgages are denominated in Adjustable Units (UR) which is an index linked to average wages in the economy. As wages have increased somewhat below the pace of depreciation of the exchange rate recently, the bank is experiencing valuation losses on its mortgage portfolio. To help limit these losses, the bank is extending new mortgages denominated in U.S. dollars only. Lastly, the bank is establishing reserve requirements at the BCU, as is required of any other bank in Uruguay. The **State Insurance Bank (BSE)** is being put on a more level playing field with private sector competitors in the insurance industry as taxes on its activities and income are being equalized to that of private sector insurance companies. Finally, the **supervisory office** of the BCU has strengthened its on-site presence in the BROU and the BHU, and has started publishing the individual balance sheet and profit and loss positions of these banks (as well as for all other banks in the system) on the BCU internet page, and is working with banks to shorten the time lag in which this information is made available. To gain further assistance with these efforts, the government has

request a Financial Sector Assessment Program (FSAP) for the next Article IV consultation with the Fund.

17. **The government will continue to adjust the exchange rate band at an annual rate of 7.5 percent.** There is no wage pressure in the economy and supply constraints are virtually absent, while the depreciation of the currency just in excess of domestic inflation will support the export oriented growth model. There may be some further pass-through of oil costs in the near term but, on balance, the government does not believe that inflation pressures will be strong. Confidence in the adjustable exchange rate band mechanism has been strong in Uruguay, with the peso fluctuating close to the most appreciated limit of the band, and international reserves steadily growing in recent years. As the level of economic activity regains strength and unemployment eases, the government intends to resume slowing the pace of adjustment of the band, and complete the transition of inflation down to industrial country levels.

18. **The gross borrowing needs of the government for 2001 are projected to be around US$1,400 million, and the net financing needs at US$530 million.** The government envisages placing US$700 million (net) in long-term foreign currency denominated bonds (most of it abroad). These placements would permit some amortization of domestic bank debt, and an early repurchase of some medium-term notes, which is desirable to ease a projected bunching of amortizations of these notes falling due in 2003. The average maturity of the bonded debt in Uruguay will remain over seven years, and the government has little short-term debt.

19. **Structural reforms are important to help increase private sector investment in the economy, and to improve productivity and competitiveness**. The guiding principle is to place public and private enterprises on a level playing field, in **a demonopolized, appropriately regulated, and transparent market**. In 2000, the Government already has expanded private sector concessions in water and sanitation works; created a regulatory agency to implement the new legislation for the electricity market (with free competition in electricity generation); cleared for auction two telecommunications frequencies; renounced existing contracts in fuels distribution so that this sector can now be opened up to competition; obtained legal authorization to open up the national railway to private sector participation, and to incorporate the Montevideo container wharf as a *sociedad anónima* (SA) under private sector law; and eliminated a bias in pension funds against investments in private sector securities. In 2001, the government has already obtained legislative approval for a new regulatory agency for telecommunications and mail services, and it intends to seek equivalent legislative approval to establish a regulatory agency for the other public sector utilities. Also, in January, the market for cable television was opened up to foreign investment. Moreover, the government will eliminate the monopoly for ANCAP on imports and sales of asphalt and its by-products; eliminate the monopoly for the BSE on insurance needs for the government, the public enterprises, and the public sector banks; eliminate the monopoly status on imports and commercialization of natural gas; open up competition in the telecommunications sector for international long distance service, cellular telephony, and all telecommunications services offered through new technology (not including basic domestic fixed-line services which remain the monopoly of ANTEL); open up for concessions the management of state-owned hospitals; allow the establishment of private ports; and a number of smaller deregulation measures intended to cut red tape and bureaucracy in the

economy. Moreover, the government intends to introduce a bill in Congress for the removal of the monopoly on imports and sales of petroleum and its derivatives, and of the refining of petroleum. Lastly, the government does not believe that it can finish all the requisite legislative work for submitting the reform of the special pension funds to Congress by March, 2001, so this benchmark was delayed slightly to end-June 2001.

20. **The government intends to maintain Uruguay's exchange rate system free of restrictions on payments and transfers for current international transactions.** Uruguay has implemented on schedule all customs tariff reductions as agreed under the Mercosur convention, and the government has lowered on January 1, 2001 the surcharge on the common external tariff, as agreed with Mercosur partners. The "special sugar regime" that is allowed for countries under Mercosur, expired at the end of December 2000, implying the elimination of minimum reference prices and quantitative restrictions, and a significant reduction in protectionism. The proposed common external Mercosur tariff for sugar is 35 percent, and remaining (quantitative) trade restrictions within the Mercosur would be phased out in coming years.

22. **Improving the accuracy, timeliness, and comprehensiveness of statistical data on the economy is an ongoing effort.** A project to revise and expand national accounts statistics is on track and is expected to be finalized in 2001 and, together with other efforts, Uruguay intends to subscribe to the Fund's SDDS by the end of the year. Much progress has already been achieved with data dissemination on the internet, and the government remains committed to providing additional timely information on the operation of the government, and its financial and nonfinancial enterprises, to the public, as described in the attached Annex of structural benchmarks.

23. **The economic program for 2001 establishes quantitative performance criteria for end-March and end-June, with indicative quantitative targets for the second half of the year.** The region remains subject to economic risks, and it is difficult to project how quickly the level of economic activity will rebound. The government proposes to consult with the Fund and establish the quantitative performance criteria for the third and fourth quarter of 2001 on the occasion of the second review of the program in June/July 2001.

Uruguay: Quantitative Limits and Targets for the 2000-01 Economic Program 1/ 2/

	Dec. 31 2000	Jan-Mar 2001	Jan-Jun 2001	Jan-Sep 2001	Jan-Dec 2001
(In millions of Uruguayan pesos)					
1. Combined public sector balance (floor)		-2,150	-5,000	-6,100	-7,000
2. General government expenditure (ceiling)		7,250	14,900	22,100	29,600
3. Change in the net domestic assets of the BCU (ceiling)		1,060	2,325	875	1,325
(In millions of U.S. dollars)					
4. Net international reserves of the BCU (-decrease) (floor)		-140	-220	-150	-60
(Stock of debt at the end of the period; in millions of U.S. dollars)					
5. Combined public sector debt (ceiling)					
a. All maturities	9,431	9,575	9,740	9,980	10,050
b. Less than one year		200	200	200	200

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

1/ As defined in the Technical Memorandum of Understanding.

2/ Targets for Sept. 30 and Dec. 31 2001 are indicative at present, to be substituted by performance criteria during the second review of the program expected for June/July 2001.

Structural Reform Benchmarks

Before end-March 2001

1. Publish *quarterly reports* for the three month period ending December 31, 2000, for the public sector financial and nonfinancial enterprises (BROU, BHU, BSE, ANCAP, UTE, ANTEL, OSE, AFE, ANP). The reports to include annotated summary tables of the results of operations, cash flow, and balance sheet. Subsequent quarterly reports to be published with a lag not exceeding 10 weeks from the end of the relevant calendar quarter.

2. Complete independent external audit of BROU, BHU, and BSE.

3. Complete independent external audit of ANCAP, UTE, ANTEL, OSE, AFE, and ANP.

Before end-June 2001

4. Submit law to Congress to reform special pension funds (Cajas Especiales) for the banking sector, university professionals, notaries, police, and the military.

5. Finish the study on quasi-fiscal operations of all public sector financial institutions and other entities. The result of this study to be discussed during the second review of the program.

6. Publish *annual reports* of BROU, BHU, BSE, ANCAP, UTE, ANTEL, OSE, AFE, and ANP, approved by independent external auditors. The reports to include summary tables of results of operations, cash flow, and balance sheet. Subsequent audited annual reports to be published with a lag not exceeding four months.

Before end-September 2001

7. All banks to obtain and publish a corporate credit rating, or place debentures in the capital market equivalent to at least 2 percent of their deposit base.

Before end-December 2001

8. Submit to Congress legislation to eliminate the petroleum import monopoly.

9. Submit to Congress legislation to eliminate the petroleum refining monopoly

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents a detailed definition of the variables included in the quantitative performance criteria annexed to the Policy Memorandum.

1. **Cumulative balance of the Combined Public Sector.** The Combined Public Sector comprises the Central Administration (including as defined in "Article 220" of the Constitution, *Salto Grande*, and the funds managed directly in the ministries (*Fondos de Libre Disponibilidad*), the social security system (*Banco de Previsión Social*), the local governments (*Intendencias*), the public enterprises (ANCAP, ANTEL, UTE, OSE, AFE, ANP, INC and ANCO), and the quasi-fiscal balance of the Central Bank (BCU). The public sector balance will be measured from below the line on the basis of information provided by the BCU on: (a) combined public sector debt (defined below), including all short-term debt, in foreign currency and pesos; (b) bank borrowing and bank deposits in foreign currency and pesos; and (c) net asset transactions of the combined public sector. The result of the BCU is defined as interest earnings on gross international reserves, as defined below, and on domestic assets minus operating expenses and interest paid on domestic and foreign debt administered by the BCU. The limit on the balance of the combined public sector will be adjusted *downward* (*upward*), i.e., the deficit would be allowed to widen (narrow), by the amount that the actual social security contributions to the private pension system exceeds (falls short) the projected amount in the program (which is Ur$2,741 million).

2. **Cumulative ceiling on general government expenditure.** This ceiling applies to total (current and capital) noninterest expenditure of the central administration and social security system, excluding outlays on pensions and internal transfers. The limit will be adjusted *upward* (*downward*) by the amount that the actual social security contributions transferred to the private pension system exceeds (falls short) the projected amount in the program.

3. **Cumulative changes in net domestic assets (NDA) of the BCU**. NDA of the BCU is defined as the difference between currency in circulation (i.e., currency held outside banks) and net international reserves (NIR) of the BCU as defined in 4. below. The flow of NIR will be valued at the average exchange rate projected in the program for the corresponding quarter.

4. **Cumulative changes in net international reserves (NIR) of the BCU**. NIR is defined as the difference between the gross international reserves and BCU reserve liabilities. Gross international reserves include all foreign exchange assets that are in the direct effective control of the BCU and are readily available for such purposes of the BCU as intervention or the direct financing of payment imbalances. Such assets may be in any of the following forms, provided that they meet the test of effective control and ready availability for use: currency, bank deposits in nonresident institutions and government securities and other bonds and notes issued by non-residents (with a rating not below "A" in the classification of Fitch IBCA and Standard and Poor's or "A2" in the classification of Moody's). In addition, holdings of SDRs or of monetary gold would be included under gross reserves assets (provided they meet the test of effective control and ready availability of use) as would the reserve position in the IMF.

Excluded from the definition of gross international reserves are all foreign currency claims arising from off-balance sheet transactions (such as derivatives instruments), claims on residents, capital subscriptions in international financial institutions, any assets in nonconvertible currencies, claims on any nonresident Uruguay-owned institutions, or any amounts (in all components of assets, including gold) that have been pledged in a direct or contingent way.

Gross reserve liabilities include all foreign currency-denominated liabilities of the BCU with original maturity of one year or less to residents and nonresidents, the use of Fund resources, any net position on foreign exchange derivatives with both residents and nonresidents undertaken directly by the BCU or by other financial institutions on behalf of the BCU. For the purpose of the NIR calculation, (a) the gold holdings of the BCU will be valued at the accounting rate of US$42 per troy ounce; (b) liabilities to the IMF will be valued at US$/SDR rate of December 31, 2000; (c) gains or losses from gold-swaps and other operations will be excluded; and (d) non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollars at the market exchange rates of the respective currencies as of December 31, 2000. Regarding valuation effects for NIR operations during the year, such flows will be valued at the exchange rate at which the operation took place.

5. **Combined Public Sector stock of debt**. This refers to (a) the outstanding stock of debt in foreign currency owed or guaranteed by the combined public sector; and (b) debt in URs ("Unidades Reajustables").[1] Debt will be measured on a disbursement basis; it excludes nonresident deposits and other short-term liabilities of the BROU and the BHU. Debt in the form of leases will be calculated as the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.[2] The overall limit will be adjusted *upward (downward)* by (1) the upward (downward) revisions made to the actual debt stock at end–2000; (2) the difference between the actual and projected amount of social security contributions that are transferred to private pension funds; (3) the overperformance with respect to the targets on the BCU's net international reserves up to a limit of US$250 million; (4) any upward (downward) changes in the amount of export prefinancing in the BCU in relation to the level of December 31, 2000 (also for short-term debt); and (5) by any amount equivalent to the increase (decrease) in the sum of free and required foreign currency deposits up to US$200 million of the BROU, BHU, private banks, AFAPs and investment funds, in the BCU from their level of December 31, 2000. Certificates of deposit issued by the BCU to banks and/or their

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[1] The term "debt" has the meaning set forth in point No.9 of the Fund's Guidelines on Performance Criteria with Respect to Foreign Debt (Decision of August 24,2000).

[2] All lease contracts of ANTEL with foreign equipment providers (Ericsson, NEC) signed prior to end-December 2000 are expensed under goods and services as rental outlays and do not involve a residual financial claim or transfer of property at the end of the lease term. Therefore, these lease contracts are excluded from the calculation of the public sector debt.

substitute Treasury instrument (treasury bills of maturity longer than one year) are included in medium and long-term debt.

URUGUAY-FUND RELATIONS
(As of December 21, 2000)

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

A. A. Financial Relations

II. **General Resources Account**:	In millions of SDRs	In percent of Quota
Quota	306.50	100.0
Fund holdings of currency	385.03	125.6
Reserve position in the Fund	35.67	11.6

III. **SDR Department**:	In millions of SDRs	Percent of Allocation
Net cumulative allocation	49.98	100.0
Holdings	0.36	0.7

IV. **Outstanding Purchases and Loans**:	In millions of SDRs	In percent of quota
Stand-by arrangements	114.20	37.3

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	SDR Millions Amount Approved	SDR Millions Amount Drawn
Stand-by	5/31/00	3/31/02	150.00	0.0
Stand-by	3/29/99	3/28/00	70.00	0.00
Stand-by	6/20/97	3/19/99	125.00	114.20

VI. **Projected Obligations to Fund:** (SDR millions; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	11/30/2000	2001	2002	2003	2004
Principal			57.1	57.1	
Charges/interest		8.2	7.2	4.3	2.2
Total	**----**	**8.2**	**64.3**	**61.4**	**2.2**

B. Nonfinancial Relations

VII. **Exchange Rate Arrangement**: The currency is the Uruguayan peso (Ur$), which replaced the new Uruguayan peso (NUr$) at a ratio of 1,000 to 1 on March 31, 1993. Since November 2, 1982, Uruguay has followed a crawling peg system within a band whereby the Central Bank announces periodically its intervention buying and selling rates. On December 31, 2000 buying and selling interbank rates for the U.S. dollar, the intervention currency, were Ur$12.510 and Ur$12.515 respectively. Uruguay's exchange system is free of restrictions on payments and transfers for current international transactions and there is no parallel market for foreign exchange.

VIII. **Last Article IV Consultation:** The 1999 Article IV Consultation was concluded by the Executive Board on July 27, 1999 (EBS/99/117). Uruguay is on the standard 12–month cycle.

IX. **Technical Assistance**: A multisector STA mission took place in November 1999 which developed an overall action plan for statistics management in Uruguay, including detailed recommendations for bringing Uruguay's data dissemination policies and practices into line with the Fund's SDDS. A STA mission on money and banking statistics took place in March 1999, which reviewed the currentness, coverage, and classification of the data reported for publication in *IFS* and made recommendations for improvement. The mission also proposed a unified reporting system for WHD and STA. Technical assistance in the areas of tax and customs administration had been provided by the Fiscal Affairs Department in 1996.

X. **Resident Representative**: The Fund Resident Representative post in Uruguay was closed in July 1995.

Relations with the World Bank

In the past, Bank project lending has been focused on infrastructure and agriculture development. In addition, in the late 1980s, the Bank began providing support through structural adjustment lending. The first SAL 1987 was aimed at supporting export growth through incentives and tariff reform; strengthening public finances and the social security system; improving public investment programming; and strengthening the banking sector. A subsequent SAL in 1989 focused on restructuring/privatization of domestic banks intervened by the Government in early 1980s, as well as other structural reforms, including strengthening the central bank's regulatory and supervisory role, improving public sector management and investment programming revamping the revenue collection unit of the social security administration and additional reforms in the social security system. A stand-alone debt and debt service reduction operation (DDSR) was also approved in 1991.

The Bank's recent lending has continued to support the social sectors and selected infrastructure investment, with a focus on reforming public enterprises and the regulatory system. The two most recent loans approved were a Financial Sector Adjustment Loan (FSAL)—that supported actions to strengthen the framework for the functioning of the financial system—a Water Sector Adaptable Program Loan. Based on recent programming discussions, further lending for public enterprise reform, the social sectors and natural resource management is anticipated.

Financial Relations with the World Bank Group
(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disbursements	Undisbursed Amount
I. IBRD Operations (as of September 30, 2000)			
Sectors			
Agricultural and rural development, and natural resources management	260.2	254.2	6.0
Industrial credit	34.3	34.3	0.0
Power	337.6	240.8	96.7
Transport and telecommunications	361.5	282.4	79.1
Education	68.0	49.1	18.9
Health	10.6	8.1	2.5
Refinery	24.4	24.4	0.0
SAL I and TAL I	80.9	80.9	0.0
SAL II and TAL II	145.5	145.5	0.0
Contractual savings	100.0	100.0	0.0
Water supply	22.2	22.2	0.0
Debt and debt service reduction	65.0	65.0	0.0
Public enterprise reform	6.6	6.6	0.0
Private sector development	0.0	0.0	0.0
Financial Sector Adjustment	80.9	80.4	0.5
Total	**1,597.7**	**1,394.0**	**243.0**
Repayments (includes repayments third parties)		828.8	
Total outstanding (due IBRD) 1/		565.1	

II. IFC Operations (as of October 31, 2000)

	Loans	**Equity**	**Quasi**	**Participation**
Held	5.38	5.98	6.41	4.55
Disbursed	5.38	5.98	6.41	4.55

III. IBRD Loan Transactions (calendar year)

	1992	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**
Disbursements	173.9	40.5	37.0	31.7	38.7	50.4	143.9	66.3	131.3
Repayments	44.5	49.2	56.2	77.8	69.7	67.9	64.1	63.2	43.2
Net lending	129.5	-8.7	-19.2	-46.1	-31.0	-17.5	79.7	3.1	88.1

Source: World Bank (IBRD data); and WEB (IFC data).

1/ Uruguay's total obligations to the IBRD, including exchange adjustment, amount to US$552.3 million.

STATISTICAL ISSUES

The statistical database in Uruguay is generally adequate for the assessment and monitoring of macroeconomic policies. The multisector mission of November 10–24,1999 developed an action plan that includes recommendations for bringing Uruguay's data dissemination policies and practices into line with the Fund's Special Data Dissemination Standard (SDDS). The authorities have made significant progress in implementing the mission's recommendations, both with respect to timeliness of dissemination of the SDDS data categories, and in terms of methodological changes to improve data quality. During the recent annual meetings in Prague, the Uruguayan delegation reiterated their commitment to subscribe to the SDDS in the near future.

1. Real sector

National account statistics have a number of shortcomings, including the use of an outdated benchmark year, limited coverage of the enterprise survey, long publication lags, inadequate information on the informal economy, and incomplete quarterly accounts. The November 1999 multisector mission recommended a range of improvements including the completion of the revision of data and methods that had already been partially carried out, introduction of annually chained volume measures, incorporation of new benchmark survey data, and compilation of quarterly estimates of GDP at current prices.

The authorities do not provide trade price and volume indices for publication in the *IFS*.

Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *IFS*. The consumer price index has a base period of December, 1985=100, and the wholesale price index has a base of 1988=100. No producer price index has been reported for publication in the *IFS*.

2. Government finances

Official data on the central administration, the state enterprises and the social security system are complete and current, but there are problems with the currentness of the data on the local governments; there are also problems with the currentness of the financing and debt data reported for inclusion in the Fund's statistical publications. The multisector mission that visited Uruguay in November 1999 reviewed the sources used for the compilation of central government financing and identified sources of information for local governments. The mission made recommendations for the compilation of these data and their reporting to STA. The information reported for publication in the Government Finance Statistics Yearbook 2000 included, in addition to the usual data on central government revenues and expenditures, some data on central government financing and on selected aggregates for local governments. Dissemination of fiscal data has improved significantly over the past year.

3. Monetary accounts

Two STA money and banking statistics missions visited Montevideo in July 1998 and March 1999. The missions reviewed with the authorities the currentness, coverage, and classification of the monetary accounts for the banking system and developed a unified system for reporting data to the Fund. The multisector mission that visited Uruguay in November 1999 continued previous missions' work on improving the basic source data and the methodology for compiling monetary statistics. The mission developed a database that contains the data needs for publication in *IFS* and for operational uses by WHD.

The Central Bank of Uruguay (CBU) has adopted the new presentation of the monetary accounts for the central bank and a new call report form for the other depository corporations. The multisector mission recommended adopting the new reporting system which is based on these tables. STA has already received a submission of data based on the new reporting system for the central bank, however, the timeliness of the data for the other depository corporations is hampered because the Bank of the Republic (BROU) has not yet sent data to the CBU using the new call report form. The BROU is upgrading its information systems and will not be able to adopt the new call report form until this process is completed in the second quarter of this year. The BROU will provide preliminary balance sheet data until it is able to provide data in the new call report form.

4. Balance of payments

Balance of payments statements are compiled and published on a quarterly basis. Data are compiled following the recommendations of the Balance of Payments Manual (5th edition). However, data are published with less detail and with a different classification than the one recommended in BPM5. The authorities have made significant progress in implementing the mission recommendations in order to improve the coverage and quality of the balance of payments estimates. The directory of direct investment enterprises have been updated and measures have been introduced to improve the survey on inward investment; quarterly surveys have been introduced in the case of services, and other activities not currently covered; the coverage of reserve assets has been revised to exclude certain assets that are not available to finance balance of payments needs. Uruguay compiles and reports to STA annual data on the international investment position (IIP). The new surveys would also allow for improved coverage of the private sector in the international investment position.

URUGUAY: Core Statistical Indicators

as of January 31, 2001

	Exchange Rates	International Reserves	Reserve/base money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Public Debt
Date of latest observation	12/00	12/00	12/00	12/00	11/00	11/29/00	11/00	9/00(X) 10/00 (M)	6/00	9/00	6/00	8/00
Date received	1/00	1/00	1/00	1/00	1/00	11/30/00	11/6/00	10/00	9/00	11/00	9/00	11/00
Frequency of data	Daily	Daily	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Monthly
Frequency of reporting	Daily	Daily	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Monthly
Source of data	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Central Bank	Institute of Statistics	Central Bank	Central Bank	Ministry of Finance	Central Bank	Central Bank
Mode of reporting	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail/ Web	E-mail/ Web	E-mail/ Web	E-mail/ Web	E-mail/ Web	Web
Confidentiality	None	None	None	None	None	None	None	None	None	None	None	None
Frequency of Publication	Daily	Daily	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

SAFEGUARD ASSESSMENTS—SUMMARY OF CONCLUSIONS

Under its current arrangement with the Fund, Uruguay is subject to the transitional procedures governing safeguard assessments. These procedures require the Central Bank of Uruguay to demonstrate, by providing certain documentation to Fund staff, that it publishes annual financial statements that are independently audited in accordance with internationally accepted standards (the "external audit mechanism"). The Central Bank of Uruguay cooperated fully in providing Fund staff with the required documentation.

The staff has reviewed the documentation and noted that the Central Bank of Uruguay publishes annual financial statements that are audited by the National Court of Auditors in accordance with the standards of the International Organization of Supreme Audit Institutions (INTOSAI). However, the usefulness and relevance of the financial statements are potentially impaired by the long delay in publishing the audited financial statements—the 1999 and 1998 audit opinions were issued 8 months and 13 months respectively after the financial year-end. **The staff's overall conclusion is that the Central Bank of Uruguay's external audit mechanism meets internationally accepted standards, but should continue to be monitored for the duration of the Fund arrangement.** The Central Bank of Uruguay is expected, therefore, to provide Fund staff with its 2000 and 2001 financial statements and related audit reports as soon as they become available.

INTERNATIONAL MONETARY FUND
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EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/23
FOR IMMEDIATE RELEASE
March 14, 2001

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

IMF Concludes Article IV Consultation with Uruguay

On February 26, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Uruguay.[1]

Background

After a recession in 1999, Uruguay continued to face difficult economic conditions in 2000. A number of strong adverse shocks plagued the economy, which were quantified as having caused a loss of national income equivalent to US$800 million, or 4 percent of GDP. Continued regional economic uncertainties negatively influenced expectations, contributing to a sharp drop in domestic demand; the devaluation of the Brazilian *real* and of the euro depressed export earnings from these markets, while weak agricultural commodity prices and the sharp jump in oil import costs implied a merchandise terms of trade drop of 7.5 percent (after dropping by 2.2 percent in 1999); international interest rates rose; and there were some interruptions of Uruguayan exports (rice, milk, bicycles, wines) as a result of trade actions in the neighboring countries. Also, toward the end of the year, meat exports were temporarily halted following a local outbreak of foot-and-mouth disease (since contained). With these adverse developments, the expansion in output in the first quarter of the year could not be sustained, and real GDP is estimated to have contracted for the second year in a row. The 12-month rate of consumer price inflation was contained at 5 percent, and unemployment increased to some 14½ percent.

However, Uruguay is showing clear signs of adjustment. Competitiveness is being addressed, unit labor costs are declining both in peso and U.S. dollar terms, and by end-2000 a

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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. 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. This PIN summarizes the views of the Executive Board as expressed during the February 26, 2001 Executive Board discussion based on the staff report.

significant share of the appreciation in the real effective exchange rate of early 1999 had been reversed. Moreover, to reduce their dependence on Mercosur, exporters have made good progress in diversifying their markets, while maintaining adequate volume growth in the traditional markets, albeit at moderate prices. Also, the structure of aggregate demand is changing, resulting in a strong contribution to growth from the foreign balance which offers prospects for sustainable growth.

With national income, and hence revenue, much weaker than expected, the government did not meet the fiscal objectives under the economic program for 2000. The overall deficit was reduced from 4.1 percent of GDP in 1999 to 3.7 percent of GDP in 2000. However, under these difficult circumstances, the primary, or noninterest, public sector deficit was still reduced substantially, by almost a percentage point of GDP. The larger-than-programmed deficit corresponded mainly to a drop in revenue for the central and local governments, and the government expenditure target for the year was observed. Nevertheless, the public sector enterprises turned in a weaker-than-expected performance. The government observed virtually all structural benchmarks under the program, except for the publication of annotated quarterly reports of the public enterprises and banks, which is now expected before end-March 2001.

The banking system saw some erosion in its soundness indicators, as was expected from the recession. The private banks saw their profitability ratios halved from previous years, and the ratio of nonperforming loans increased. The public banks had a more difficult time, especially the Banco Hipotecario (BHU). The public banks are undertaking an independent external audit of their operations which already has yielded important suggestions for improving the operations of the banks in the area of upgrading the computer systems, adhering closely to credit manuals, improving and enforcing the internal accounting systems, and lowering operating costs. Also, the BHU has taken steps to limit its losses which stem in part from a currency mismatch in the bank (mortgages are indexed to wages and deposits are in dollars, which, if these adjust at a different rate, can cause valuation fluctuations in the bank's capital). Recently, the BHU began granting new mortgages exclusively in dollars, thus eliminating the mismatch in currencies for new mortgages.

Exchange rate and interest rate policies held steady in 2000. The adjustable band exchange rate system continued to work well and, on average, the peso remained in the most appreciated half of the band. Once again, Uruguay received some deposits from abroad, and the regime has not been subject to major pressures. The Central Bank (BCU) lowered its call interest rate from 12 to 9½ percent in July 1999, in view of the slowing economy, and has maintained largely passive interest rate policies since then.

The external current account deficit widened slightly to 2.9 percent of GDP in 2000 (US$580 million). Merchandise exports increased by 8 percent in volume (3 percent in value) while imports were flat in volume (also some 3 percent increase in value). Oil import costs were more than 0.7 percent of GDP higher in 2000, and capital imports fell, reflecting the downturn in domestic investment. The services balance has held up well, generating a surplus of over US$500 million. The financial account of the balance of payments, and international reserves, turned out stronger than had been expected. However, foreign direct investment remained low.

The government restarted the structural reform agenda with a decree to cut red tape in the economy and remove some outdated regulatory restrictions; granted new concessions in water and sanitation works; created a regulatory agency for the deregulated electricity market; cleared for auction two wireless telecom frequencies; began to free up the distribution of fuels so that this sector can be opened up to competition; obtained legal authorization for private participation in the rail ways, and in the Container Wharf of Montevideo; and opened up to foreign investment the cable TV industry.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They observed that Uruguay's economic performance has been generally sound over the past decade, although the economy has been hit by the economic downturn and prolonged recession of the past two years. Directors noted that notwithstanding the authorities' efforts, the economy has not yet recovered from the recession, largely owing to another round of adverse external shocks in 2000. At the same time, developments in the external sector generally, and the diversification of export markets in particular, as well as the moderation of labor costs and the containment of inflation in the context of a moderate real depreciation of the peso, have established a welcome basis for an economic recovery in 2001.

Looking ahead, Directors considered that the main challenges facing the authorities are to promote sustainable growth with low inflation and high employment. This will require fiscal discipline, improved competitiveness, and measures to strengthen the performance of public enterprises.

On fiscal policy, Directors noted that the public sector revenue for 2000 fell short of initial expectations, as automatic stabilizers were allowed to operate partially. They considered that the revised fiscal deficit objective for 2001, relative to the initial, and much tighter, indicative target is warranted by the delay in economic recovery. At the same time, Directors cautioned that further sustained increases in the public debt-to-GDP ratio should be contained. Accordingly, they generally agreed that the revised target for 2001 should be seen as part of a medium-term plan to begin progressively lowering the debt-to-GDP ratio from 2003-2004, thereby helping to preserve Uruguay's good standing in international capital markets. Directors noted the authorities' emphasis on current expenditure restraint as the backbone of the medium-term fiscal strategy, which is designed to allow gradual increase in public investment spending, while leaving some room for targeted tax cuts, including those to lower labor costs and strengthen competitiveness.

Directors noted the importance of wage moderation to help Uruguay revive exports and investment-led growth. In this context, while the special wage increases granted by the central government were dedicated to important areas in the public sector, including education and the judiciary, Directors cautioned that such special increases are best kept to a minimum, and preferably offset with cuts elsewhere in the budget, so as to reinforce the public sector contribution to overall cost containment. In general, Directors emphasized the importance of preserving fiscal discipline at all levels of government.

Some Directors noted the weakness in financial soundness indicators of the public sector banks and called for further efforts to improve their efficiency and profitability. Directors urged the authorities to clean the balance sheets of the banks by recognizing those assets that cannot be recovered while collecting collateral where this exists; to strengthen the soundness of public banks by fully enforcing the prudential regulations in place; and to improve the allocation of credit in the economy. Directors welcomed the authorities' intention to participate in the Financial Sector Assessment Program (FSAP) exercise prior to the next Article IV consultation, which should help the authorities identify additional ways of improving efficiency in public sector banks.

On the external sector, Directors welcomed Uruguay's continued commitment to trade liberalization, both in a regional and multilateral context. They welcomed the projected narrowing of the current account deficit to 2.5 percent of GDP in 2001. Directors noted that Uruguay is one of the few emerging market economies to be given an investment grade rating by the main credit rating agencies, and that it should have little difficulty in meeting its external financing needs. Continued perseverance with the structural reform and fiscal consolidation agenda will be essential in this regard.

Directors noted that the adjustable band exchange rate system experienced little pressure during 2000. Directors generally supported the authorities' policy to maintain, in the short run, the rate of depreciation of the band, and in the medium term to facilitate convergence of the rate of inflation to international levels. For the longer term, some Directors considered that further reflection on exchange rate policies for small, open and highly dollarized economies, such as Uruguay's, would be helpful.

Directors considered that an acceleration of structural reforms is essential to improve productivity and supply-side conditions in the economy, so as to boost economic efficiency, competitiveness, private sector activity, and employment. They encouraged the authorities to forge ahead quickly with their plans to remove the monopoly status of public sector enterprises, to increase disclosure with the publication of quarterly financial reports for state enterprises and banks, and to support transparency and market-based discipline with annual audits and the disclosure of independent corporate credit ratings. Directors welcomed the reform of the social security system.

Directors observed that Uruguay's economic statistics are generally adequate for the assessment and monitoring of macroeconomic policies. They welcomed the substantial progress that has been made in the timely publication of fiscal and monetary accounts on the internet, and considered that these efforts should now be extended to the budgetary performance of the local governments as well. Directors welcomed the authorities' intention to subscribe to the SDDS by the end of 2001.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Uruguay: Selected Economic Indicators

	1997	1998	1999	2000 (Prel.)	2001 (Prog.)
Real GDP (change in percent)	4.9	4.6	-3.2	-1.0	2.0
Inflation (CPI, end-of-period)	15.2	8.6	4.2	5.1	4.7
Unemployment (in percent)	10.3	10.3	11.4	14.2	...
Fiscal balance (percent of GDP)	-1.4	-1.0	-4.1	-3.7	-2.6
Primary fiscal balance (percent of GDP)	0.5	0.9	-2.1	-1.2	0.0
Gross domestic investment (percent of GDP)	15.1	15.6	15.2	14.5	15.2
Gross national saving (percent of GDP)	13.7	13.5	12.7	11.6	12.7
External current account deficit (percent of GDP)	1.4	2.1	2.5	2.9	2.5
External current account (In millions of US$)	-298	-476	-528	-576	-504
Change in NIR (+ increase) (In millions of US$)	314	362	13	171	-60
GDP (In billions of Ur$)	205	235	239	244	266
GDP (In billions of US$)	21.5	22.5	21.0	20.2	20.5

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

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International Monetary Fund
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Washington, D. C. 20431 USA

IMF Completes Uruguay First Review

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Uruguay's performance under a 22-month, SDR 150 million (about US$ 193 million) stand-by credit approved on May 31, 2000 (see Press Release 00/35). As a result, Uruguay will be able to draw, if needed, up to the equivalent of SDR 74 million (about US$ 95 million) from the IMF. The Uruguayan authorities have indicated that they intend to continue treating the credit as precautionary.

In commenting on the Executive Board discussion, Eduardo Aninat, Deputy Managing Director and Acting Chairman said: "Following the recession in 1999, the Uruguayan economy faced a second difficult year in 2000, with a series of new adverse external economic shocks, and the level of economic activity did not rebound as was anticipated in the program. However, while the delayed recovery lowered fiscal revenue and led to a larger-than-expected overall fiscal deficit for the year, the authorities made considerable adjustment efforts to place the economy on a sound footing—especially by maintaining cautious public sector expenditures, while making complementary efforts to lower costs and improve competitiveness in the economy.

"The economy is showing clear signs of benefiting from the adjustment efforts, which bodes well for a recovery of economic activity in 2001. The external balance is making a strong contribution to growth; costs are declining in the economy; the real effective appreciation of the exchange rate that occurred following the devaluation of the Brazilian *real* in early 1999 has been substantially reversed; and there is progress in diversifying Uruguay's export markets. These efforts need to be sustained in the medium term.

"In recognition of the delayed recovery, the economic program for 2001 envisages a fiscal deficit of 2.6 percent of GDP. While this is larger than was anticipated originally, it recognizes partially the impact of automatic stabilizers on fiscal policy, while striking a balance with the need to maintain prudent debt indicators in the medium term. Indeed, the program for 2001 is an integral part of the authorities' effort to lower the public debt/GDP ratio from 2003–04, and to preserve Uruguay's good standing in international capital markets.

"Uruguay has made a good beginning at wage moderation and lowering overall costs in the economy to boost employment, promote private sector activity, and improve competitiveness—and this process is expected to continue in 2001. To build on these developments, the structural reform program should continue to be implemented as envisaged, including the de-monopolization of public sector enterprises, and the steps to enhance the soundness of public sector banks. In addition, disclosure should be strengthened with the publication of quarterly annotated financial reports on state enterprises and banks, while market-based transparency and discipline should be supported by annual audits and the disclosure of independent corporate credit ratings," Aninat said.