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Uruguay: 2003 Article IV Consultation and Third Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria—Staff Report; Staff Supplement; Staff Statement; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Uruguay

Under the 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 2003 Article IV consultation with Uruguay and third review under the Stand-By Arrangement and request for modification and waiver of applicability of performance criteria, the following documents have been released and are included in this package:

- the staff report for the combined 2003 Article IV Consultation and third review under the Stand-By Arrangement and request for modification and waiver of applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on June 3, 2003, 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 June 27, 2003**. 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.
- the staff supplement of **June 27, 2003** for the third review under the Stand-By Arrangement and request for modification and waiver of applicability of performance criteria—Report on the 2002 Banking Crisis.
- a staff statement of **July 11, 2003** updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release summarizing the **views of the Executive Board as expressed during its July 11, 2003 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the Executive Director for Uruguay.

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

Letter of Intent sent to the IMF by the authorities of Uruguay*
Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding by the authorities of Uruguay*

*May also be included in Staff Report

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

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

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URUGUAY

Staff Report for the 2003 Article IV Consultation

Prepared by the Staff Representatives for the 2003 Consultation with Uruguay

Approved by Markus Rodlauer and Liam P. Ebrill

June 27, 2003

- **Previous Article IV consultation:** The last consultation was concluded in February 2001. At that time, Executive Directors considered that promoting sustainable economic growth in a low-inflation and high-employment environment was the main medium-term challenge. Fiscal discipline, strengthening the performance of public enterprises, and reforms to boost competitiveness and private sector activity were seen as the main policy objectives that needed to be pursued (Box 1).

- **2003 Article IV consultation:** The consultation was postponed because of the 2002 financial crisis. Discussions were initiated in September 2002, but Board consideration was deferred because of delays in concluding the second program review. Discussions continued in January-February 2003, and were completed in May. The staff met with Economy and Finance Minister Atchugarry, Central Bank President de Brun, Planning and Budget Director Davrieux, Agriculture Minister Gonzalez, Industry Minister Abreu, other senior officials, and representatives of the private sector and civil society, including the Catholic church and trade unions.

- **Program reviews**: The second review under the Stand-By Arrangement (SBA) was completed on March 17, 2003 together with a one-year extension of the current SBA, and a rephasing of purchases over the extended period. Board discussion of the third review is proposed to take place together with the 2003 Article IV consultation.

- **Staff teams:** The Article IV consultation missions were led by M. Figuerola (September 2002) and G. Terrier (October 2002, and 2003). The staff teams included, at various times, B. Braumann, K. Honjo, H. Ma, and O. Williams (all WHD), C. Lee, J. Cayazzo, and S. Seelig (all MFD), M. de Bolle (PDR), M. Gonzalez (FAD), and P. Breuer and R. Thorne (ICM). The missions were assisted by A. Bauer, the Resident Representative in Montevideo. M. Rodlauer (WHD) joined the October mission for a few days.

- **Article VIII status**: Uruguay has accepted the obligations of Article VIII, Sections, 2, 3, and 4 and maintains an exchange system free of restrictions on current international transactions except for one restriction related to the reprogrammed bank deposits, for which approval is proposed.

- **Staff reports**: Companion papers to this report address issues for the third review under the Stand-By Arrangement, including debt sustainability and developments and lessons of Uruguay's banking crisis.

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Main Websites for Uruguay and Data

Data in the Staff Report reflect information received by June 26, 2003. In some cases more recent data can be obtained directly from the following internet sources:

Uruguayan Statistical Institute (INE)....................................http://www.ine.gub.uy

Central Bank of Uruguay (BCU)..http://www.bcu.gub.uy

EXECUTIVE SUMMARY

Background

- **During 1990–98 Uruguay enjoyed relatively high rates of growth, averaging 3.9 percent a year, mostly driven by private consumption.** Regional integration fueled a significant expansion of trade with neighboring countries. An exchange rate-based stabilization effort reduced inflation from over 100 percent to close to 10 percent, although at the cost of some loss of competitiveness. In 1999, Uruguay's economy fell into a recession, following a series of external shocks that were compounded by domestic fragilities. A major financial crisis in 2002 caused the economy to contract by nearly 11 percent.

- **The recent crisis has wiped out most of the per-capita GDP gains that had been achieved during the 1990s**, and has led to a significant increase in poverty. Public debt dynamics also deteriorated significantly, but were addressed in a comprehensive debt exchange in May 2003.

Policy discussions

The Article IV policy discussions focused on medium-term growth prospects and policies. The potential growth rate is currently estimated at 2½–3 percent a year. To reach this potential would take time and crucially depend on supportive policies, notably in the structural area. These policies should focus on facilitating a reallocation of resources toward higher-productivity sectors and addressing systemic vulnerabilities to make the economy more resilient to external shocks.

- **Sustained fiscal consolidation** is critical, and will require a strengthening of the revenue effort, including through tax reform, as well as addressing expenditure rigidities.

- Continuation of a **flexible exchange rate policy** will be key to reducing vulnerability, together with a transparent monetary policy framework. The framework is currently anchored on a base money target and the authorities' intention is to move in due time toward inflation targeting.

- **Competition and the room for private sector activity must be expanded to promote growth.** Further steps should also be taken to address balance sheet fragilities in the economy and improve the soundness of the financial system.

- Uruguay's **political institutions** have proven robust, and have been able to cope with the difficult measures required in the face of the financial crisis. However, consensus building can also lead to delays in enacting important reforms.

- Significant progress has also been made in improving **data transparency**.

Box 1. Uruguay: Effectiveness of Past Fund Advice During Article IV Consultations

In previous Article IV consultations, Directors emphasized the following points:

- Promoting **sustainable growth** with low inflation and high employment would require fiscal discipline, improved competitiveness, and measures to strengthen the performance of public enterprises.

- Increases in the **public debt-to-GDP ratio** should be contained. Over the medium term, fiscal consolidation was needed to progressively reduce the debt ratio and to help preserve Uruguay's standing in international capital markets.

- Although the **adjustable exchange rate band** system was considered adequate, Directors encouraged further reflection on exchange rate and monetary policies for Uruguay, a small, open, and highly dollarized economy.

- **Wage moderation**, particularly in the public sector, was necessary to boost competitiveness and revive export- and investment-led growth.

- Weaknesses in **financial soundness** indicators of the public banks called for strong efforts to improve their efficiency and profitability.

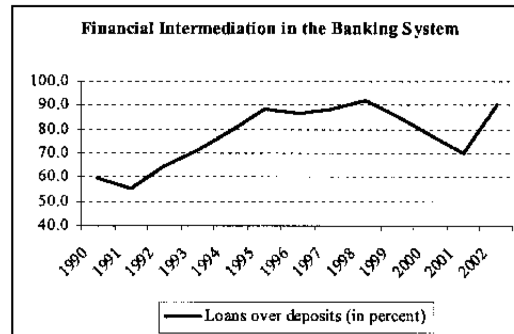
- Continued perseverance with the **structural reform** and fiscal consolidation agenda, particularly the removal of the monopoly positions of the public sector, was considered essential to boost economic efficiency and growth.

- Further efforts in ensuring transparency and **market discipline** were needed through the publication of quarterly financial reports for state enterprises and banks, as well as annual audits and the disclosure of independent corporate credit ratings.

In recent years, opportunities to advance fiscal consolidation were largely missed, despite the introduction of measures to strengthen public enterprises. Also, progress lagged in several other areas, including the strengthening of public banks, implementation of reforms to remove the monopoly positions of the public sector, and improving information disclosure for state enterprises and banks. Although the financial crisis of 2002 was largely driven by external shocks, lack of progress in these areas contributed to the severity of the recession. To restore Uruguay's growth capacity, structural reform efforts will need to be stepped up.

I. Background and Recent Developments

1. **Uruguay experienced relatively high economic growth during most of the 1990s (Appendix I)**. This expansion followed a long period of adjustment in the aftermath of the 1982 crisis, and was underpinned by significant stabilization gains and trade liberalization. Inflation fell sharply and regional integration fueled a significant expansion of trade with neighboring countries and triggered healthy productivity growth. At the same time, however, important structural weaknesses remained (such as an oversized public sector), and new vulnerabilities emerged, including increasing financial dollarization, currency overvaluation, and growing dependence on the region. Beginning in 1999, the economy entered into a prolonged recession, driven to a large extent by exogenous shocks and contagion. The impact of these shocks on the domestic economy was compounded by the structural weaknesses that had remained unaddressed during the period of solid economic performance (Box 2). There are signs that activity bottomed out in early 2003, and the economy is expected to recover gradually in the months ahead.



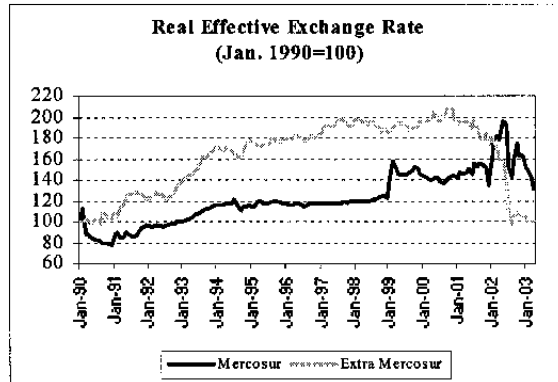
A. Economic Expansion in 1990–98

2. **Uruguay's economy grew by 3.9 percent a year on average during 1990-98, significantly above long-term trends** (2 percent during 1960–2000). Growth was fueled by domestic demand, mainly consumption, while the contribution of net exports was negative (Table 1).[1] Private consumption was boosted by strong credit growth in the wake of economic stabilization, as bank intermediation recovered from a severe depression in the previous decade. Credit to the private sector doubled as a share of GDP, to 50 percent in 1998. Export performance benefited from strong rates of growth in Brazil and Argentina and from the creation of the Mercosur. Although Uruguay's exports of goods and services rose by 90 percent during the period, imports rose twice as fast (170 percent).

[1] Gross domestic investment also rose significantly, but from a low level and thus contributed relatively little to GDP growth. In addition, important improvements in human capital took place, with an increase in the average education level of the labor force.

Box 2. Uruguay: Structural Weaknesses and Systemic Risks

Although Uruguay grew well above historical averages during most of the 1990s, a number of fragilities built up that made the economy increasingly vulnerable to exogenous shocks.



- **The economy had become highly exposed to the region.** The Mercosur treaty opened growth opportunities for the economy, but heightened the dependence of Uruguay's tradable sectors on Brazil (traditional exports) and Argentina (nontraditional exports and services). Much of the trade involved regional goods (e.g., fresh products and tourism), with limited scope for demand substitution from countries outside Mercosur. These links heightened the contagion risks from lower growth or exchange rate adjustments in neighboring countries. In addition, the redirection of exports towards other markets after Brazil's devaluation in 1999 was hindered by the real appreciation of the peso against non-Mercosur currencies.

- **The large and heavily regulated public sector has been a drag on competitiveness and has limited the ability of the economy to adjust to external shocks.** Expenditure by the nonfinancial public sector is close to 40 percent of GDP; total public sector employment represents almost one quarter of total employment; and about 60 percent of total deposits and half of total credit are intermediated by public financial institutions.

- **Currency mismatches accumulated in corporate, household, and public sector balance sheets.** Dollarization of bank lending grew from 58 percent of total lending in 1995 to 87 percent in 2002, thus creating significant currency risks in households and corporations with local currency earnings. Similarly, the public sector's financing relied almost exclusively on issuance of foreign currency instruments. While this enabled the government to benefit from low financing costs after Uruguay obtained an investment grade rating in 1997, it also increased exposure to currency risk. For instance, the public mortgage bank BHU was seriously exposed to currency and interest rate risk as it funded its long-term local currency lending with short-term foreign currency deposits.

- **Weak banking regulations contributed to the crisis of the domestic banking sector.** Some private banks accumulated large exposures to Argentina. At the same time, while nonresident deposits had risen sharply, the regulatory framework did not establish stringent liquidity requirements. The public sector banks' balance sheets had been weakened by high nonperforming loan ratios and quasi-fiscal activities, accommodated by regulatory forbearance.

- **The scope for active fiscal and monetary policy responses to shocks was severely constrained.** Persistent fiscal deficits had contributed to substantial public sector borrowing requirements and a rising debt burden, increasing dependence on capital market access. The high degree of dollarization of bank deposits (90 percent in 2002) seriously limited the lender-of-last-resort capacity of the central bank, and large currency mismatches in private and public sector balance sheets constrained the scope for exchange rate flexibility.

Table 1: GDP Growth 1990-2002

	Average Annual Growth Rate (percent)			Growth Contribution (percentage points)		
	1990-98	1999-2001	2002	1990-98	1999-2001	2002
GDP at market prices	3.9	-2.6	-10.8	3.9	-2.6	-10.8
Total domestic expenditure	5.4	-3.0	-18.0	5.7	-3.4	-20.1
Consumption	4.9	-1.7	-16.1	4.3	-1.6	-15.6
Public sector	2.4	-0.9	-9.4	0.3	-0.1	-1.2
Private sector	5.3	-1.8	-17.1	4.0	-1.5	-14.4
Gross domestic investment	9.4	-10.7	-31.1	1.4	-1.8	-4.5
Fixed capital formation	8.4	-10.2	-32.4	1.1	-1.6	-4.2
Changes in inventories	0.2	-0.3	-0.3	0.2	-0.3	-0.3
Balance of trade and nonfactor services	-1.8	0.9	9.3	-1.8	0.9	9.3
Exports of goods and nonfactor services	7.9	-3.2	-10.9	2.4	-1.2	-3.8
Imports of goods and nonfactor services	11.9	-4.3	-28.3	-4.2	2.1	13.1

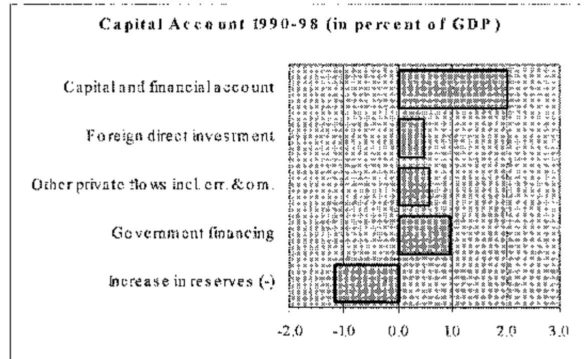
3. **Growth was concentrated in services.** Regional trade integration and strong private consumption boosted the demand for financial services, tourism, and retail trade. As a result, the share of services in GDP grew from 58 percent of GDP in 1990 to 65 percent in 1998. Manufacturing declined considerably, in part reflecting the loss of competitiveness associated with a significant appreciation of the peso in real effective terms during this period. The primary sector's share remained broadly stable, at about 10 percent of GDP (Table 2 and Appendix II). Despite the strong economic growth, unemployment remained relatively high throughout the period, at almost 10 percent on average.

Table 2: Sectoral Composition of Real GDP Growth

	Average Annual Growth Rate (percent)			Growth Contribution (percentage points)		
	1990-98	1999-2001	2002	1990-98	1999-2001	2002
Real GDP	3.9	-2.6	-10.8	3.9	-2.6	-10.8
Primary activities	3.8	-5.9	5.9	0.4	-0.6	0.6
Agriculture, livestock, and forestry	3.7	-5.8	6.7	0.4	-0.6	0.6
Fishing	3.0	-8.1	8.2	0.0	0.0	0.0
Mining	12.5	-6.6	-21.0	0.0	0.0	-0.1
Secondary activities	1.6	-4.5	-12.3	0.4	-1.2	-3.1
Manufacturing	0.4	-6.0	-13.8	0.0	-1.1	-2.4
Construction	6.7	2.2	-0.6	0.2	0.1	0.0
Utilities	5.1	-3.6	-21.2	0.2	-0.1	-0.7
Services	4.0	0.4	-8.2	2.4	0.2	-5.4
Commerce, restaurants, and hotels	6.5	-4.0	-24.7	0.8	-0.5	-3.3
Transport and communications	9.0	1.8	-9.3	0.8	0.2	-1.1
Finance, insurance, and real estate	2.6	3.4	-2.0	0.5	0.8	-0.5
Other services	1.8	-1.1	-3.4	0.3	-0.2	-0.5
Indirect taxes and subsidies				0.7	-1.0	-2.9

4. **The strong growth performance was supported by an exchange rate-based stabilization effort.** Beginning in 1992, the authorities allowed the domestic currency to move within a crawling currency band that was depreciated at a declining rate. This policy helped anchor inflationary expectations and brought inflation down from over 100 percent in 1990 to 11 percent in 1998. However, it also contributed to an appreciation of the peso in real effective terms, particularly in the early stages of the currency band. Although the appreciation was less than in neighboring Mercosur countries, it contributed to a sharp rise in imports.

5. **The opportunity to deepen fiscal consolidation was largely missed.** Although the overall deficit of the combined public sector was moderate, averaging 1.4 percent of GDP during 1990-98, the fiscal stance was expansionary in most years (Appendix III). Expenditure rigidities rose significantly, including through the indexation of pension benefits to wages and the transition costs of pension reform.[2] Overall, noninterest expenditure grew by 5 percent of GDP. In response, the authorities raised the (already quite high) tax burden on the private sector. The public sector deficit was financed to a significant extent from abroad, both through bonds and IFI loans. This helped free domestic resources which, however, fueled mainly consumption growth, while adding to vulnerabilities by increasing the share of public sector debt in foreign currency. Other net capital inflows, including FDI, were relatively modest during the period (½ percent of GDP on average) as important sectors of the economy remained reserved for the public sector.



6. **Progress on the structural front was mixed.** Significant trade liberalization had taken place in the second half of the 1980s, contributing to strong productivity growth in the 1990s. In addition to the pension reform noted above, the authorities took partial steps to allow private sector participation in sectors previously reserved to the state, including in the markets for cement, cellular phone services, mortgages, insurance, port management, and the construction and management of toll roads. However, more decisive attempts to privatize failed after a law for the partial privatization of the state telecommunications company Antel was repealed by referendum in 1992. As a result, important parts of the economy remained reserved for, or dominated by, the state.

B. Recession and Financial Crisis in 1999–2002

7. **The strong growth performance stopped in the late 1990s, when the economy was exposed to a series of shocks.** The devaluation of the Brazilian *real* and the recession in Argentina depressed Uruguay's exports and domestic investment, and the primary sector suffered from the impact of a severe drought and a sharp decline in international prices for several of its export products. As a result, the economy entered into recession in early 1999, with private consumption following soon thereafter as unemployment surged. An incipient recovery of economic activity in early 2001 was halted by the outbreak of foot-and-mouth disease, which led to the closing of important meat export markets. At the same time, the deepening crisis in Argentina further weakened business and consumer confidence. Uruguay's

[2] In 1996, the government introduced a complementary second pension pillar based on fully funded individual savings accounts, which are administered by private pension funds.

real GDP declined by a cumulative 7½ percent during 1999–2001, and the deficit of the consolidated public sector rose to 4 percent of GDP as revenue suffered from the economic downturn while structural rigidities limited the scope for expenditure reduction.

8. **In 2002, real GDP contracted further by 10.8 percent as the country experienced a severe financial crisis.** The impact of external shocks affecting Uruguay during 1998-2002 may have been magnified by growing internal disequilibria, particularly the changing structure of bank balance sheets as a result of large inflows of nonresident deposits. Following the imposition of a deposit freeze and capital controls in neighboring Argentina, cash-strapped Argentine depositors began to withdraw their funds from Uruguay's banking system. The run on deposits rapidly extended to resident depositors, after problems developed in two large private banks with strong links to Argentina. Uruguay's sovereign debt rating suffered successive downgrades, and access to foreign capital markets was lost. The loss of reserves, driven by deposit outflows, forced the authorities to float the peso in June. A package of fiscal, monetary, and banking reform measures was adopted in early August, that helped stabilize the situation together with large financial support from IFIs (more details are presented in the companion report on the 2002 banking crisis).

9. **The steep contraction in output was partly due to a severe credit crunch associated with the banking crisis.** The liquidity squeeze resulting from sustained deposit outflows prevented banks from lending: in U.S. dollar terms, credit to the private sector fell by 31 percent during 2002. Economic activity declined in all sectors, except agriculture.[3] Investment dropped by one-third in real terms. Private consumption also fell sharply, with private savings rising by 4 percentage points of GDP.[4] Net exports, in turn, contributed positively to GDP growth, with a sharper contraction in import volumes (28 percent) than in exports (11 percent).

10. **The increase in inflation following the float of the peso was moderate.** During 2002, consumer prices rose by 26 percent while the peso depreciated by 85 percent against the U.S. dollar. The moderate price increases reflected the weakness of domestic demand and the lack of wage pressures—wages rose by only 3 percent in nominal terms during 2002. In real effective terms, the peso depreciated by 13 percent, as Uruguay's regional trading

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[3] Growth in the agricultural sector mainly reflected a recovery of beef exports (15 percent of total exports) from the impact of foot-and-mouth disease and a strong expansion in the cattle population.

[4] Households experienced sharply negative income and wealth effects as real wages declined by 20 percent, unemployment rose to almost 20 percent, real estate prices plummeted, and bank deposits were reprogrammed.

partners experienced sharper rates of depreciation.[5] In early 2003, the peso depreciated further by about 18 percent in real effective terms, reflecting mostly the appreciation of other regional currencies and the weakening of the U.S. dollar.

11. **Public debt dynamics deteriorated significantly in 2002, raising concerns about sustainability**. The debt-to-GDP ratio of the consolidated public sector jumped from 54 percent in 2001 to 94 percent in 2002, reflecting the sharp depreciation of the peso against the U.S. dollar, the cost of government assistance to stabilize the banking system, and the fiscal deficit. In addition, the government faced a bunching of debt amortization in 2003–07 without reasonable prospects for regaining access to international markets. To address these problems, the authorities undertook a comprehensive debt exchange in May 2003, which extended the average maturity of virtually all market debt by about five years while maintaining the low interest rates contracted in previous years when Uruguay enjoyed investment grade ratings.[6]

12. **Developments in 1999–2002 highlighted the presence of a number of macroeconomic and structural weaknesses that made the Uruguayan economy vulnerable to external shocks**. These fragilities included: heightened dependence on the Mercosur region; large and rising asset and liability dollarization of the banking system and a significant increase in nonresident deposits; weak bank regulations and balance sheet weaknesses; insufficient fiscal consolidation; and vulnerabilities associated with the crawling peg exchange rate regime (see Box 2). These weaknesses left the country highly vulnerable to the sharp deterioration in the external environment that occurred during 1998–2002.

II. Policy Discussions

13. **The authorities and staff concurred that, under current policies, the output gap would gradually narrow while medium-term potential growth would be lower than during the 1990s, at 2½–3 percent a year**. This outlook is based on the recognition that, while successful stabilization will allow the economy to recover from the sharp recession, a number of structural and external conditions will likely be less favorable than during the past decade. In particular, Uruguay is expected to face a less supportive external environment and weaker contributions of labor and capital accumulation to growth.

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[5] While the peso depreciated by some 30 percent in real terms vis-à-vis the U.S. dollar and the euro, it lost only 17 percent vis-à-vis the Brazilian *real* and appreciated by 70 percent vis-à-vis the Argentine peso.

[6] Further details on the debt exchange and its economic implications are presented in the accompanying staff report for the third review under the Stand-By Arrangement.

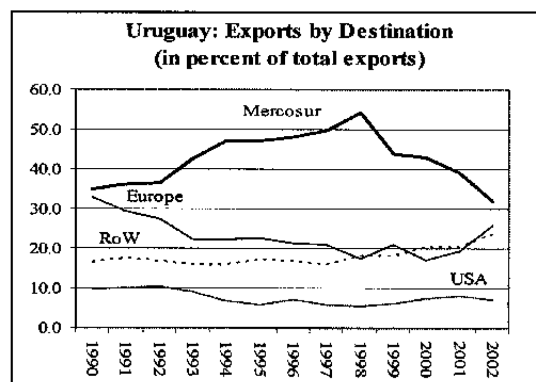
14. **Against this background, the discussions centered on the kind of policies and reforms needed to achieve higher and less volatile economic growth over the medium term**. There was broad agreement between the staff and the authorities on the need for policies to stimulate productivity growth by promoting the reallocation of resources toward more productive uses, and to reduce financial and structural vulnerabilities in order to improve resilience to shocks. To achieve these goals, the staff encouraged the authorities to build political support for a comprehensive reform agenda that would seek to promote sound macroeconomic policies; encourage private sector development through a reduction of the size of the state; and further strengthen Uruguay's institutional framework and investment climate.

A. Constraints to Economic Growth

Less supportive external environment

15. **Uruguay's external environment will likely be more challenging in the period ahead than in the 1990s.** Economic conditions in the Mercosur region are expected to be less supportive than during the last decade. Developing new sources of growth will be all the more challenging as private capital flows to Latin America—FDI particularly—are expected to be lower, with foreign investors focusing on other regions of the world. It is thus likely that regional demand for Uruguay's exports (a mainstay of growth in the 1990s) will remain subdued. Similarly, the financial sector's ability to mobilize and intermediate savings will likely recover only gradually, and it will probably not regain its position as a main engine of growth, at least for some time.

16. **Uruguay therefore needs to diversify its export base.** The Mercosur agreement had resulted in a reorientation of exports to the region, with Brazil becoming the most important destination for Uruguay's agricultural goods, and Argentina the main client for Uruguay's key service industries (tourism and banking) and nontraditional exports (manufactured goods). While exports to Mercosur increased from 35 percent of total exports in 1990 to 55 percent in 1998, exports to Europe, the second largest destination for Uruguayan products, declined from 33 percent to 18 percent. Although the relative importance of exports outside Mercosur has risen again in recent years, this has been mostly due to the reduction in exports to Mercosur rather than increased exports to other markets. In recent months, the strengthening of the euro has boosted competitiveness vis-à-vis Europe, but export growth to this region is limited by binding quotas for Uruguay's chief agricultural exports, particularly beef.



17. **Further trade liberalization will be key to product and market diversification for exports, as well as FDI and technology transfer**. The authorities are pursuing free trade negotiations, within the framework of Mercosur, with the United States and the European

Union, and bilaterally with Mexico. The staff supported these efforts, noting that trade integration with industrialized countries should accelerate the structural modernization of the economy through its links to innovation, FDI, and the transfer of technology. The staff encouraged the authorities to also play an active role in the multilateral trade discussions under the Doha Round.[7]

18. **The authorities noted that recent improvements in external competitiveness should support a broad-based recovery in exports.** Extra-Mercosur competitiveness has improved sharply since the floating of the peso in mid-2002. Nevertheless, improvements in export performance to markets outside Mercosur have so far been concentrated in agricultural goods (traditional exports), which benefited in part from a relaxation of health controls on Uruguayan beef. Further market expansion in these products will face persistent obstacles in the form of quotas, competition with other Mercosur exports, and nontariff barriers for many products (dairy products, rice, meat). The staff also noted that, moreover, while competitiveness outside the Mercosur region has improved markedly, the same has not been observed within the region, where more depreciated exchange rates may constrain Uruguay's export buoyancy.

Adverse demographic trends

19. **Uruguay's population is ageing and the contribution of labor to growth will be less important than in the 1990s.** Uruguay has the oldest population in Latin America, with the ageing trend continuing, including because of increased emigration in recent years (Box 3). The labor force grew somewhat faster during the 1990s than in the previous decades, due to increased participation rates for women. This trend is believed to have reached a limit and, as a result, the growth of the active population is expected to remain relatively low compared with other countries in the region, at 0.7 percent a year on average. This development takes into account emigration flows, which have increased sharply in recent years, due to the high unemployment rates and falling real wages.

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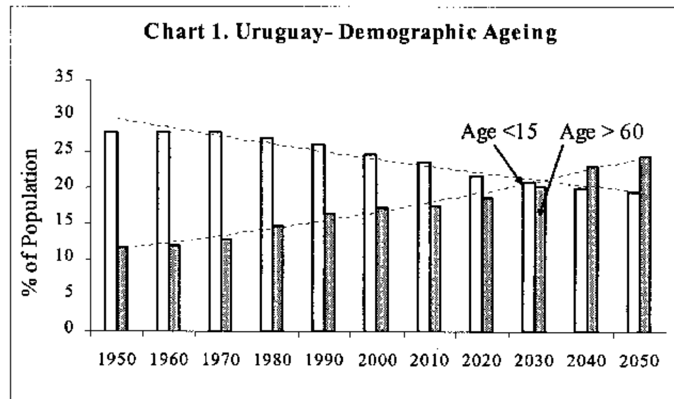
[7] Uruguay has a liberal trading system, as reflected by its rating of 2 in the Fund's index of aggregate trade restrictiveness. In keeping with its tradition of trade liberalization, Uruguay has persistently urged tariff reduction and liberalization within Mercosur. Although there are no quantitative trade restrictions within Mercosur, occasional trade disruptions have occurred when the region experienced economic difficulties. There have been no major recent changes in the status of Uruguay's trade regime.

Box 3. Uruguay: Trends in Demography and Migration

Uruguay has the oldest population in Latin America. Official estimates show that 17½ percent of the population is 60 years or older, compared with 8 percent on average in Latin America, while 24 percent of the population is 15 years or younger, compared with a regional average of 31 percent. Projections by the U.N. Economic Commission for Latin America and the Caribbean suggest that the population below 15 years of age will fall to nearly 20 percent by 2030, while that over 60 will rise to 20 percent.



Uruguay's ageing process has been led for some time by declining birth and mortality rates and, more recently, by emigration. Statistics from the U.S. Immigration and Naturalization Service show that the number of Uruguayan immigrants to the United States has risen sharply in recent years, after having fallen during the second half of the 1990s. Data on the number of nationals entering and exiting the country in 2002 through the international airport of Carrasco point to a net exodus of about 1 percent of the country's population. Anecdotal evidence suggests that emigration is primarily toward the United States, Europe, and Mexico.

20. **Uruguay's active population remains well qualified, an important asset for growth.** Education levels are high, and income distribution is more even than in other Latin American countries. However, the recent wave of emigration may impact the quality of the labor force and put further strain on the social security system, as there are indications that emigrants are on average younger and with higher education levels than the population at large. In addition, the surge in child poverty and youth unemployment registered in recent years could lead to a deterioration of Uruguay's human capital base if not addressed in time through well-targeted policies.

Constraints to capital accumulation

21. **With bank credit expected to remain depressed and access to international capital markets limited, the staff noted that it would also take time before capital accumulation could again support GDP growth.** Although the existence of spare capacity after the long recession can initially provide room for a recovery in economic activity, several years of high investment growth would be needed to reverse the contraction in the capital

stock of the past years. The investment outlook is constrained by low domestic savings (related partly to the ageing population), the weakened banking system, and challenges to attracting FDI. In particular, the capacity of the banking system to intermediate savings will recover only gradually, as capital positions and confidence in the banking system need to improve before broad-based credit growth can be expected to resume.

22. **Informal financing is expected to be available for certain sectors, but its cost will likely remain high**. The creation of direct vehicles of intermediation, such as specialized investment funds, could help speed-up a recovery of credit. In this context, the staff noted that prompt congressional approval of the draft law on trust funds and warrants would establish a legal framework for the operation of such vehicles. The staff also encouraged the authorities to accelerate the disposal of remaining assets from liquidated banks, to prevent the deterioration of credit culture and maximize the government's recovery of previous financial assistance to these banks.

B. Policies to Enhance Growth Prospects

23. **In the near term, growth will be guided chiefly by traditional sources, mainly production and exports of agricultural goods.** This will be supported by the maintenance of sound financial policies and progress in banking system reform. The banking system is still recovering from the 2002 financial crisis, and remains fragile, due to weaknesses in the public banks. Hence, the reform of the BHU needs to be stepped up, particularly given its links to BROU's financial soundness. Furthermore, the authorities concurred with staff that moving ahead with the reform of the public bank BROU is crucial to re-starting private sector credit and boosting economic activity.[8]

24. **The medium-term scenario envisages a return to moderate growth, with a reduced debt burden and enhanced financial stability**. As noted in the staff report for the third review, output is projected to grow at 2½-3 percent a year over the medium term, predicated on the maintenance of sound economic policies and the firm implementation of structural reforms, discussed below. The external current account would be in surplus over the medium term, but this surplus would gradually narrow as the economy recovers (Table 16). Gross reserves are targeted to rise significantly over the next few years, to provide some cushion against shocks and improved coverage for future debt service payments. Although debt servicing needs appear manageable over the next few years, they will start rising substantially over the medium term. Moreover, a sensitivity analysis[9] shows that debt sustainability is highly vulnerable to deviations from the assumed macroeconomic framework. Taken together, these factors illustrate that there is little room for policy deviations in the medium term.

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[8] This issue is dealt with in greater detail in the accompanying staff report for the third review under the Stand-By Arrangement.

[9] See the staff report for the third review, paragraph 23 and appendix III.

Sound financial policies

25. **The authorities and the staff agreed that, over the medium term, fiscal consolidation was crucial to achieving strong economic growth while reducing vulnerability**. The primary surplus of the combined public sector is projected to rise gradually to about 4 percent of GDP and to remain at that level over the medium term. Sustaining these surpluses will help keep the government's near-term financing needs manageable, ensure medium-term fiscal sustainability, and avoid crowding out of credit to the private sector. Over time, the composition of fiscal adjustment will need to shift from expenditure compression to efficiency gains on both the revenue and expenditure sides.

26. **The authorities are committed to reforming the tax system to improve its efficiency and buoyancy**. Following a recent FAD technical assistance mission, they are finalizing revisions to draft legislation that will broaden the tax base and rationalize the tax system. The staff urged the authorities to build the necessary consensus to ensure rapid congressional approval of this reform, which should include broadening the VAT base while avoiding adjustments in the VAT rates that might generate a revenue loss; eliminating several low-yielding taxes to incorporate them into the main excise tax; and extending the corporate income tax to all sectors of the economy. The authorities also agreed with the staff that revenue administration needed significant further strengthening.

27. **Uruguay's large social safety net needs to be reformed.** The staff commended the authorities' efforts to protect priority social programs from budget cuts. Nevertheless, poverty is estimated to have risen sharply in recent years, from 11 percent in 1999 to almost 24 percent in 2002, with half of the children less than 6 years old living below the poverty line. The authorities recognized the need to streamline social spending and redirect it to the poorest.[10] The mission encouraged the authorities to quickly implement the social protection reforms supported by the World Bank and the IDB, including an overhaul of the unemployment insurance scheme, a restructuring of national health funding instruments, and measures to improve the management of the educational sector.

28. **The staff welcomed the introduction of a transparent monetary policy framework based on money targets**. The authorities saw the new framework as an important tool for anchoring public expectations and building a track record for monetary policy credibility. Nevertheless, they noted that conducting active monetary policy in a highly dollarized environment poses particular challenges, especially as the links between monetary aggregates and inflation are not yet well established. There was agreement between the authorities and staff that it would be desirable to move toward an inflation targeting

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[10] According to a 2001 World Bank report, the incidence of social spending in Uruguay varies, with expenditure in health and education being relatively progressive (except for tertiary education). However, social security outlays are quite regressive because access is largely limited to those working in the formal sector.

framework over the medium term, once monetary transmission channels become more robust. This, however, will require reducing the degree of fiscal dominance and strengthening the operational autonomy of the central bank, broadening the range of monetary policy instruments, and developing the secondary market for government debt.

29. **The staff stressed the importance of maintaining the floating exchange rate regime**. The floating exchange rate regime introduced in 2002 has served Uruguay well, particularly in helping to restore external competitiveness. As Uruguay is a small open economy, this exchange rate regime seems best suited for dealing with the frequent external shocks to which the economy is subject and for facilitating structural change. Nevertheless, the authorities noted that Uruguay is likely to remain highly dollarized in the near term; for this reason the system could bring undue volatility at times. Hence, limited central bank intervention may occasionally be warranted to avoid excessive fluctuations in the exchange rate.

30. **Further steps need to be taken to address balance sheet risks in the economy**. In this context, the staff advised the authorities to further strengthen the regulatory framework for the banking sector to better account for the risks stemming from dollarization and nonresident liabilities. The mission also encouraged the authorities to continue promoting the development and use of peso instruments in the financial sector, including through broader issuance of inflation-indexed government securities. While this strategy will necessarily take time and could—at least initially—result in higher domestic lending rate premia, the authorities agreed that it was an essential component in the reduction of vulnerabilities.

Increasing the role of the private sector

31. **Reducing the size of the public sector and improving its efficiency will play a critical role in making the economy more competitive**. The staff urged the authorities to consider opening activities currently reserved for the state to the private sector to help create new investment opportunities. While the authorities recognized the benefits associated with expanding private sector activity through concessions and privatizations, they noted that the experience with concessions had been mixed and that there remains strong domestic opposition to the sale of public assets and to private involvement in public enterprises.[11] Instead, the authorities are pursuing a strategy to gradually deregulate and open these sectors to competition. They agreed with the staff that such a strategy required the creation of strong independent regulatory institutions and significant improvements in governance, autonomy, and incentive structures of public enterprises (Box 4). Efforts to create strong regulatory agencies are being supported by the World Bank, in the context of its SAL II operation.

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[11] Currently, the political opposition is seeking a referendum to prevent the state oil company ANCAP from entering into strategic partnerships with the private sector.

Box 4. Uruguay: Restrictions and Policy Directives to Public Enterprises

State-owned enterprises (SOEs) are subject to management restrictions and policy directives in pricing, investment, and employment that do not allow them to compete at the same level with the private sector:

- **The central government controls the SOEs most relevant economic and financial decisions, including planning, budgeting, and indebtedness.** With some exceptions, SOEs' purchases must follow the same procedures as those of the central administration. Price increases need to be approved by the central government for those enterprises not subject to competition.
- **Board appointments are based on political affiliation.** SOEs are required to follow managerial procedures desired to facilitate supervision by the central authorities, but which are often cumbersome and outdated.
- **SOEs face strong legal restrictions to seeking strategic partnerships with the private sector**. They are also required to operate within the public sector realm, by: (i) maintaining all their accounts at the public bank BROU; (ii) channeling at least 10 percent of their public announcements through state media; and (iii) being subject to more cumbersome regulations for direct purchases from private enterprises than from other public enterprises.
- **Employees have the same legal status as civil servants.** In particular, most hiring and lay-off restrictions applying to the civil service also apply to SOE's.

32. **Measures to improve the efficiency of public expenditure and reduce its rigidity need to be stepped up**. Close to 75 percent of government expenditure is for wages and social security payments. Steps have been taken to achieve a gradual but lasting decline in the wage bill.[12] In addition, the authorities expect a decline in pension benefits over the medium term due to savings generated under the 1996 pension reform. Measures have also been taken to improve the efficiency of public procurement by creating centralized purchase mechanisms for medical supplies and foodstuffs. The staff welcomed the progress achieved, and urged more decisive steps to modernize the public sector and reduce surplus employment. The staff also noted that there may be room for a second-generation reform of the generalized pension system, including by further increasing the regular retirement age from 60 to 65 years and reducing the replacement rate for advanced-age pensions.

[12] These measures included setting limits to public sector wages; early retirement schemes in public enterprises and the central administration; enforcing mandatory retirement ages in public financial institutions; extending the prohibition of new permanent hires; and introducing fixed-term labor contract similar to the private sector.

Further improving the institutional framework and investment climate

33. **The prominent role of consensus in the decision-making process may delay the adoption of critical measures needed to improve growth prospects.** Without any doubt, Uruguay's strong political institutions constitute a major asset and, in recent months, both the government and congress have shown a capacity to take decisive action to address the crisis. However, consensus-building on major political decisions, while ensuring that all sectors have a voice, also sometimes leads to substantial delays in enacting important reforms. In December 1992, a privatization bill, which would have opened important sectors of the economy to private sector investment, was rejected in a referendum. It is difficult to envisage faster medium-term growth without the opening of opportunities for private sector investment through greater liberalization and privatization.

34. **The quality of the legal framework and governance are perceived as being relatively strong.** Perceived corruption is relatively low compared to other countries in the region, although pockets of corruption are sporadically exposed.[13] Local experts agree that Uruguay's legal framework provides for strong protection of property rights and well-established insolvency procedures. The judiciary is generally perceived as independent, but actual enforcement of property rights, including the possession of collateral by secured creditors, can be time-consuming due to lengthy court proceedings. The authorities are firmly committed to combating the laundering of proceeds from crime and the financing of terrorism.

35. **The authorities are pursuing active policies to generate favorable investment conditions.** A "one-stop-window" was recently created for accessing benefits under the country's investment promotion law, intended to limit the processing time to no more than 60 days.[14] One remaining problem is FDI promotion, which lacks a clear strategy and focus since it is split among several institutions. In addition, the authorities have not implemented plans to set up an investors' relations office.

36. **The authorities are committed to subscribe to the Special Data Dissemination Standard (SDDS) in the near future.** The staff considers data provided to the Fund to be broadly adequate for surveillance purposes. There are, however, several areas in need of improvement, including: (i) the timeliness of financial data submission by the BROU and BHU to the central bank; (ii) the coverage of public sector operations (above line) to include local governments; and (iii) data collected on the private sector corporate debt.

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[13] Uruguay ranked 32 out of 102 countries in the 2002 Corruption Perception Index compiled by Transparency International, with the second-best ranking in Latin America.

[14] The investment promotion law provides generous tax benefits to local and foreign investors in the agricultural, industry and tourism sectors, including VAT exemption and a 50-percent rebate on import duties for inputs, a 10-year exemption from the asset tax, and accelerated depreciation for the corporate income tax.

III. Staff Appraisal

37. **The protracted recession and the financial crisis in 2002 were triggered mainly by external shocks, but their impact on the economy was compounded by weaknesses in the domestic economy**. Growth had become increasingly dependent on the region, and rigidities in the economy did not allow prompt adjustment to adverse shocks. The banking system was highly vulnerable from currency mismatches in the balance sheets of households, corporations, and the public sector, and the large nonresident deposit base became a channel of contagion, especially from Argentina. At the same time, little room existed for countercyclical policies due to the weakened fiscal position and the high degree of dollarization in the economy, which also constrained timely exchange rate adjustment.

38. **While progress has been made in recent months in containing the crisis and stabilizing the economy, there is no room for complacency**. Fiscal adjustment, stabilization of the banking system, and successful completion of a comprehensive debt exchange have been important steps towards restoring confidence and growth. However, the financial sector remains fragile, the pickup in economic activity is still tentative, and social indicators have worsened. Strict adherence to the economic program supported under the Stand-By Arrangement will, therefore, be essential to consolidate the stabilization gains and set the basis for a durable recovery.

39. **Conducting the Article IV discussions in the current post-crisis environment posed special challenges in light of the overwhelming short term pressures facing the authorities.** Nevertheless, they concurred with staff on the challenges facing Uruguay over the next several years and the need to continue the implementation of sound policies and structural reforms.

40. **A return to sustained economic growth will take time and depend on continued structural reforms**. Policies should focus on measures to facilitate the reallocation of resources toward higher-productivity sectors and the reduction of systemic vulnerabilities to make the economy more resilient to shocks. These policies, coupled with better targeting of social support and institutional capacity, would significantly help improve living standards. Nonetheless, building political support for the implementation of such a strategy will be a challenge in the context of the approaching presidential elections and persistent differences among the main political parties on the appropriate scope and pace of reforms. The challenge of building political support in this context and avoiding delays in moving ahead with key reforms will be particularly acute in light of Uruguay's consensus-based decision processes.

41. **Fiscal discipline must be a cornerstone of any economic strategy**. An important permanent strengthening of the primary balance will be needed to ensure sustainable debt dynamics, support a competitive exchange rate, avoid crowding out of credit to the private sector, and regain the capacity to undertake counter-cyclical policies. This will require a strengthening of the revenue effort, including through a tax reform to streamline the tax system and improve revenue administration. Expenditure rigidities will need to be reduced,

especially in wages and pensions, and efficiency increased. The strong commitment of the authorities to fiscal responsibility is welcome and will be particularly important in the forthcoming election year.

42. **The introduction of a clear and consistent monetary policy framework is welcome.** Base money targets will provide an anchor to inflationary expectations in the context of the floating exchange rate regime, which should be maintained. The staff supports the authorities' intention to move, over time, to inflation targeting. To achieve this objective, the central bank will need to broaden the range of monetary instruments, further build technical capacity, and strengthen its operational and administrative autonomy.

43. **Competition and the room for private sector activity in the economy should be expanded to promote growth.** Further efforts towards trade diversification will be key in this regard. In addition, the staff urges the authorities to work toward achieving a domestic consensus for further opening to private activity those sectors of the economy that are currently reserved for the state, including through privatization. These measures would help improve resource allocation, raise the level of investment, and increase the flexibility to adjust to changing economic circumstances.

44. **While progress has been made in stabilizing the banking system, further work is needed to address balance sheet vulnerabilities in the economy and restore a sound financial system.** The prudential supervisory framework for the financial sector should be applied rigorously to all institutions, including those owned by the state. Further steps should be considered to foster the creation of local currency-denominated financial instruments and credit that could provide balance sheet hedges to households and corporations. The government can make a strong contribution in this area by broadening the use of inflation-indexed government debt instruments.

45. **Although reform efforts in different areas of the economy should help the government in attaining its medium term objectives, the outlook carries significant risks.** As a small open economy in a turbulent region, Uruguay will continue to be vulnerable to a wide array of financial and real shocks. Moreover, the ability to conduct active fiscal policy over the next few years will be constrained by a heavy debt burden. For these reasons, the need for vigilance and vigorous movement on structural reforms cannot be over-emphasized.

46. **Uruguay's political institutions have proven effective in dealing with the financial crisis.** The steadfast commitment to safeguard the rule of law and private contracts is commendable and will contribute to the recovery of confidence. Now that the situation has stabilized, it will be crucial for both the executive and the legislative powers to maintain the consensus on prudent macro policies and move forward with the structural reform agenda.

47. **The staff commends the progress made by Uruguay in improving data transparency.** The commitment of the authorities in this area is underscored by their

intention soon to subscribe to the SDDS. The staff welcomes the steps taken to improve anti-money laundering and combat terrorist financing.

48. **The staff also recommends approval of the exchange restriction under Article VIII arising from the reprogramming of deposits in public banks,** given that this measure is temporary and non-discriminatory. It is proposed that the next Article IV consultation be held in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002.

Table 1. Uruguay: National Accounts at Current Prices

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1999-2002
	(In millions of Uruguayan pesos)														
GDP at market prices	**10,875**	**22,610**	**38,954**	**59,125**	**88,140**	**122,521**	**163,546**	**204,561**	**234,267**	**237,143**	**243,027**	**249,231**	**261,987**	**104,955**	**247,847**
Total domestic expenditure	**10,284**	**21,970**	**38,634**	**59,381**	**88,683**	**122,648**	**163,854**	**204,541**	**235,977**	**240,144**	**245,317**	**252,753**	**256,561**	**105,108**	**248,694**
Consumption	**8,957**	**18,550**	**32,641**	**50,133**	**74,693**	**103,771**	**138,929**	**173,711**	**198,799**	**204,231**	**211,397**	**218,684**	**224,474**	**88,909**	**214,696**
Public sector	1,316	2,705	4,512	7,199	10,464	14,505	20,952	25,324	29,357	30,871	32,070	33,837	33,621	12,926	32,600
Private sector	7,641	15,845	28,128	42,934	64,230	89,265	117,977	148,387	169,442	173,360	179,327	184,847	190,853	75,983	182,097
Gross domestic investment	**1,327**	**3,420**	**5,993**	**9,248**	**13,989**	**18,878**	**24,925**	**30,830**	**37,178**	**35,913**	**33,920**	**34,069**	**32,087**	**16,199**	**33,997**
Fixed capital formation	1,320	3,038	5,531	8,724	12,820	16,573	22,835	29,244	35,522	34,377	32,029	30,963	26,620	15,068	30,997
Public sector	304	859	1,225	2,325	3,608	3,789	4,674	5,455	6,555	8,021	8,074	7,917	6,564	3,199	7,644
Construction	264	630	979	1,877	2,899	3,282	3,871	4,444	5,742	7,232	6,830	7,010	5,878	2,665	6,737
Machinery and equipment	40	229	247	447	709	507	803	1,010	813	790	1,244	908	685	534	907
Private sector	1,016	2,179	4,306	6,399	9,212	12,785	18,161	23,790	28,967	26,355	23,955	23,045	20,057	11,868	23,353
Construction	477	1,062	1,991	3,274	5,018	6,589	9,167	11,998	14,053	14,246	13,289	12,355	11,105	5,959	12,749
Land improvements	28	81	112	186	338	534	684	819	997	1,062	879	939	957	420	959
Machinery and equipment	512	1,036	2,203	2,939	3,856	5,661	8,311	10,972	13,917	11,047	9,788	9,751	7,995	5,490	9,645
Changes in stocks	7	382	462	524	1,169	2,304	2,089	1,585	1,657	1,536	1,891	3,106	5,467	1,131	3,000
Balance of trade and nonfactor services	**591**	**640**	**320**	**-256**	**-542**	**-127**	**-308**	**21**	**-1,710**	**-3,001**	**-2,290**	**-3,521**	**5,425**	**-152**	**-847**
Exports of goods and nonfactor services	2,559	4,679	7,965	11,308	17,423	23,275	32,169	42,109	46,511	42,758	48,703	46,353	56,547	20,889	48,590
Imports of goods and nonfactor services	-1,968	-4,038	-7,645	-11,564	-17,965	-23,403	-32,478	-42,088	-48,222	-45,758	-50,993	-49,875	-51,121	-21,041	-49,437
	(In percent of GDP)														
GDP at market prices	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Total domestic expenditure	**94.6**	**97.2**	**99.2**	**100.4**	**100.6**	**100.1**	**100.2**	**100.0**	**100.7**	**101.3**	**100.9**	**101.4**	**97.9**	**99.2**	**100.4**
Consumption	**82.4**	**82.0**	**83.8**	**84.8**	**84.7**	**84.7**	**84.9**	**84.9**	**84.9**	**86.1**	**87.0**	**87.7**	**85.7**	**84.1**	**86.6**
Public sector	12.1	12.0	11.6	12.2	11.9	11.8	12.8	12.4	12.5	13.0	13.2	13.6	12.8	12.1	13.2
Private sector	70.3	70.1	72.2	72.6	72.9	72.9	72.1	72.5	72.3	73.1	73.8	74.2	72.8	72.0	73.5
Gross domestic investment	**12.2**	**15.1**	**15.4**	**15.6**	**15.9**	**15.4**	**15.2**	**15.1**	**15.9**	**15.1**	**14.0**	**13.7**	**12.2**	**15.1**	**13.8**
Fixed capital formation	12.1	13.4	14.2	14.8	14.5	13.5	14.0	14.3	15.2	14.5	13.2	12.4	10.2	14.0	12.6
Public sector	2.8	3.8	3.1	3.9	4.1	3.1	2.9	2.7	2.8	3.4	3.3	3.2	2.5	3.2	3.1
Construction	2.4	2.8	2.5	3.2	3.3	2.7	2.4	2.2	2.5	3.0	2.8	2.8	2.2	2.7	2.7
Machinery and equipment	0.4	1.0	0.6	0.8	0.8	0.4	0.5	0.5	0.3	0.3	0.5	0.4	0.3	0.6	0.4
Private sector	9.3	9.6	11.1	10.8	10.5	10.4	11.1	11.6	12.4	11.1	9.9	9.2	7.7	10.8	9.5
Construction	4.4	4.7	5.1	5.5	5.7	5.4	5.6	5.9	6.0	6.0	5.5	5.0	4.2	5.4	5.2
Land improvements	0.3	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Machinery and equipment	4.7	4.6	5.7	5.0	4.4	4.6	5.1	5.4	5.9	4.7	4.0	3.9	3.1	5.0	3.9
Changes in stocks	0.1	1.7	1.2	0.9	1.3	1.9	1.3	0.8	0.7	0.6	0.8	1.2	2.1	1.1	1.2
Balance of trade and nonfactor services	**5.4**	**2.8**	**0.8**	**-0.4**	**-0.6**	**-0.1**	**-0.2**	**0.0**	**-0.7**	**-1.3**	**-0.9**	**-1.4**	**2.1**	**0.8**	**-0.4**
Exports of goods and nonfactor services	23.5	20.7	20.4	19.1	19.8	19.0	19.7	20.6	19.9	18.0	20.0	18.6	21.6	20.3	19.6
Imports of goods and nonfactor services	-18.1	-17.9	-19.6	-19.6	-20.4	-19.1	-19.9	-20.6	-20.6	-19.3	-21.0	-20.0	-19.5	-19.5	-20.0

Source: Central Bank of Uruguay.

Table 2. Uruguay: National Accounts at Constant Prices

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1999-2002
						(In millions of 1983 pesos)									
GDP at market prices	**212,840**	**220,372**	**237,851**	**244,172**	**261,951**	**258,159**	**272,559**	**285,836**	**299,311**	**290,791**	**286,599**	**276,898**	**247,079**	**254,783**	**275,342**
Total domestic expenditure	**204,593**	**220,277**	**248,055**	**262,186**	**285,647**	**280,097**	**297,889**	**314,734**	**338,269**	**329,195**	**318,732**	**308,302**	**252,782**	**272,416**	**302,253**
Consumption	**180,814**	**188,749**	**212,000**	**222,784**	**241,207**	**233,601**	**251,859**	**264,894**	**282,388**	**278,813**	**274,891**	**268,471**	**225,342**	**230,922**	**261,879**
Public sector	30,073	30,413	30,877	31,163	32,565	32,626	34,263	35,034	36,424	36,636	36,531	35,486	32,166	32,604	35,205
Private sector	150,741	158,336	181,123	191,621	208,642	200,975	217,596	229,860	245,964	242,177	238,360	232,985	193,176	198,318	226,675
Gross domestic investment	**23,779**	**31,528**	**36,055**	**39,402**	**44,440**	**46,496**	**46,030**	**49,840**	**55,881**	**50,382**	**43,841**	**39,831**	**27,440**	**41,495**	**40,374**
Fixed capital formation	22,942	27,819	32,745	37,476	39,851	37,869	41,723	45,959	49,499	45,493	39,541	35,797	24,197	37,320	36,257
Public sector	5,889	8,855	7,884	10,904	12,291	8,794	8,970	9,181	9,631	11,190	10,200	9,054	6,173	9,155	9,154
Construction	4,886	5,839	5,821	7,753	8,226	6,533	6,291	6,223	7,476	8,926	7,946	7,529	5,331	6,561	7,433
Machinery and equipment	1,003	3,016	2,063	3,151	4,065	2,261	2,679	2,958	2,155	2,264	2,254	1,525	842	2,595	1,721
Private sector	17,053	18,964	24,861	26,572	27,560	29,075	32,753	36,778	39,868	34,303	29,341	26,743	18,024	28,165	27,103
Construction	7,983	9,002	11,209	12,384	12,904	12,235	12,877	13,820	14,563	14,076	12,627	11,185	8,696	11,886	11,646
Land improvements	691	1,126	1,119	1,139	1,603	2,015	2,034	2,107	2,266	2,243	1,737	1,741	1,554	1,567	1,819
Machinery and equipment	8,379	8,836	12,533	13,049	13,053	14,825	17,842	20,851	23,039	17,984	14,977	13,817	7,774	14,712	13,638
Changes in inventories	837	3,709	3,310	1,926	4,589	8,627	4,307	3,881	6,382	4,889	4,300	4,034	3,243	4,174	4,117
Balance of trade and nonfactor services	**8,247**	**95**	**-10,204**	**-18,014**	**-23,696**	**-21,938**	**-25,330**	**-28,898**	**-38,958**	**-38,404**	**-32,133**	**-31,404**	**-5,703**	**-17,633**	**-26,911**
Exports of goods and nonfactor services	62,795	64,504	70,387	76,459	88,038	86,403	95,287	107,695	108,055	100,099	106,467	97,180	86,544	84,403	97,573
Imports of goods and nonfactor services	-54,548	-64,409	-80,591	-94,473	-111,734	-108,341	-120,617	-136,593	-147,013	-138,503	-138,600	-128,584	-92,247	-102,035	-124,484
						(Percentage change)									
GDP at market prices	**0.3**	**3.5**	**7.9**	**2.7**	**7.3**	**-1.4**	**5.6**	**4.9**	**4.7**	**-2.8**	**-1.4**	**-3.4**	**-10.8**	**3.9**	**-4.6**
Total domestic expenditure	**-3.4**	**7.7**	**12.6**	**5.7**	**8.9**	**-1.9**	**6.4**	**5.7**	**7.5**	**-2.7**	**-3.2**	**-3.3**	**-18.0**	**5.4**	**-6.8**
Consumption	**-2.7**	**4.4**	**12.3**	**5.1**	**8.3**	**-3.2**	**7.8**	**5.2**	**6.6**	**-1.3**	**-1.4**	**-2.3**	**-16.1**	**4.9**	**-5.3**
Public sector	2.0	1.1	1.5	0.9	4.5	0.2	5.0	2.3	4.0	0.6	-0.3	-2.9	-9.4	2.4	-3.0
Private sector	-3.6	5.0	14.4	5.8	8.9	-3.7	8.3	5.6	7.0	-1.5	-1.6	-2.3	-17.1	5.3	-5.6
Gross domestic investment	**-8.6**	**32.6**	**14.4**	**9.3**	**12.8**	**4.6**	**-1.0**	**8.3**	**12.1**	**-9.8**	**-13.0**	**-9.1**	**-31.1**	**9.4**	**-15.8**
Fixed capital formation	-7.5	21.3	17.7	14.4	6.3	-5.0	10.2	10.2	7.7	-8.1	-13.1	-9.5	-32.4	8.4	-15.8
Public sector	-29.3	50.4	-11.0	38.3	12.7	-28.5	2.0	2.4	4.9	16.2	-8.8	-11.2	-31.8	4.7	-8.9
Construction	-35.4	19.5	-0.3	33.2	6.1	-20.6	-3.7	-1.1	20.1	19.4	-11.0	-5.2	-29.2	2.0	-6.5
Machinery and equipment	30.9	200.7	-31.6	52.7	29.0	-44.4	18.5	10.4	-27.1	5.1	-0.4	-32.3	-44.8	26.6	-18.1
Private sector	3.6	11.2	31.1	6.9	3.7	5.5	12.7	12.3	8.4	-14.0	-14.5	-8.9	-32.6	10.6	-17.5
Construction	4.8	12.8	24.5	10.5	4.2	-5.2	5.2	7.3	5.4	-3.3	-10.3	-11.4	-22.3	7.7	-11.8
Land improvements	-18.1	63.0	-0.6	1.8	40.7	25.7	0.9	3.6	7.5	-1.0	-22.6	0.2	-10.7	13.8	-8.5
Machinery and equipment	4.7	5.5	41.8	4.1	0.0	13.6	20.4	16.9	10.5	-21.9	-16.7	-7.7	-43.7	13.0	-22.5
Changes in inventories /1	-0.2	1.3	-0.2	-0.6	1.1	1.5	-1.7	-0.2	0.9	-0.5	-0.2	-0.1	-0.3	0.2	-0.3
Balance of trade and nonfactor services	**3.7**	**-3.8**	**-4.7**	**-3.3**	**-2.3**	**0.7**	**-1.3**	**-1.3**	**-3.5**	**0.2**	**2.2**	**0.3**	**9.3**	**-1.8**	**3.0**
Exports of goods and nonfactor services	13.7	2.7	9.1	8.6	15.1	-1.9	10.3	13.0	0.3	-7.4	6.4	-8.7	-10.9	7.9	-5.2
Imports of goods and nonfactor services	-0.7	18.1	25.1	17.2	18.3	-3.0	11.3	13.2	7.6	-5.8	0.1	-7.2	-28.3	11.9	-10.3

Source: Central Bank of Uruguay.

1/ Contribution to GDP growth

Table 3. Uruguay: Gross Domestic Product at Current Prices

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1999-2002
	(In millions of Uruguayan pesos)														
GDP at market prices	**10,875**	**22,610**	**38,954**	**59,125**	**88,140**	**122,521**	**163,546**	**204,561**	**234,267**	**237,143**	**243,027**	**249,231**	**261,987**	**104,955**	**247,847**
Import rights minus finance charge	-585	-982	-1,153	-3,249	-2,631	-3,753	-4,705	-4,777	-5,516	-9,610	-11,751	-14,382	-15,564	-3,039	-12,827
GDP at factor cost	**11,460**	**23,592**	**40,107**	**62,374**	**90,772**	**126,274**	**168,251**	**209,338**	**239,783**	**246,753**	**254,778**	**263,613**	**277,551**	**107,994**	**260,674**
Primary activities	1,018	1,960	3,509	4,484	7,144	10,834	13,478	15,982	17,066	14,164	15,856	15,788	25,238	8,386	17,761
Agriculture, livestock, and forestry	979	1,846	3,351	4,268	6,848	10,385	12,895	15,118	15,857	13,029	14,650	14,710	23,898	7,950	16,572
Fishing	23	76	83	87	138	171	215	319	448	320	438	409	724	173	473
Mining	17	38	75	128	159	277	368	545	762	815	767	669	616	263	716
Secondary activities	3,750	7,999	12,695	17,411	24,518	35,154	46,317	57,314	66,144	64,048	65,403	64,671	69,307	30,145	65,857
Manufacturing	3,041	6,401	9,655	12,476	16,639	24,130	31,505	38,688	43,125	39,546	41,036	40,284	45,621	20,629	41,622
Utilities	301	636	1,105	1,584	2,781	4,525	6,131	7,772	9,308	9,394	9,997	10,920	12,567	3,794	10,720
Construction	409	962	1,935	3,351	5,097	6,500	8,681	10,854	13,711	15,109	14,369	13,467	11,118	5,722	13,516
Services	6,691	13,633	23,903	40,479	59,110	80,286	108,456	136,042	156,573	168,541	173,519	183,154	183,006	69,464	177,055
Commerce, restaurants, and hotels	1,678	3,416	6,107	9,931	15,011	18,660	24,025	29,877	33,026	33,259	32,357	34,072	31,975	15,748	32,916
Transport and communications	742	1,544	2,718	4,128	6,290	8,904	12,301	16,066	18,903	20,942	22,013	22,514	23,860	7,955	22,332
Finance and insurance	1,216	2,151	3,290	6,426	7,420	9,342	12,992	16,848	19,541	23,066	24,902	29,318	29,149	8,803	26,608
Real estate	1,208	2,557	5,023	8,485	13,302	19,438	26,293	32,763	38,456	41,389	42,689	43,799	44,215	16,392	43,023
General Government	993	1,981	3,299	5,373	7,699	10,724	15,828	19,030	21,716	22,727	23,592	25,214	25,465	9,627	24,249
Other personal and social services	854	1,984	3,465	6,136	9,388	13,217	17,018	21,458	24,930	27,158	27,966	28,237	28,342	10,939	27,926
	(In percent of GDP at factor cost)														
GDP at factor cost	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Primary activities	**8.9**	**8.3**	**8.8**	**7.2**	**7.9**	**8.6**	**8.0**	**7.6**	**7.1**	**5.7**	**6.2**	**6.0**	**9.1**	**8.0**	**6.8**
Agriculture, livestock, and forestry	8.5	7.8	8.4	6.8	7.5	8.2	7.7	7.2	6.6	5.3	5.8	5.6	8.6	7.6	6.3
Fishing	0.2	0.3	0.2	0.1	0.2	0.1	0.1	0.2	0.2	0.1	0.2	0.2	0.3	0.2	0.2
Mining	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.3
Secondary activities	**32.7**	**33.9**	**31.7**	**27.9**	**27.0**	**27.8**	**27.5**	**27.4**	**27.6**	**26.0**	**25.7**	**24.5**	**25.0**	**29.3**	**25.3**
Manufacturing	26.5	27.1	24.1	20.0	18.3	19.1	18.7	18.5	18.0	16.0	16.1	15.3	16.4	21.2	16.0
Utilities	2.6	2.7	2.8	2.5	3.1	3.6	3.6	3.7	3.9	3.8	3.9	4.1	4.5	3.2	4.1
Construction	3.6	4.1	4.8	5.4	5.6	5.1	5.2	5.2	5.7	6.1	5.6	5.1	4.0	5.0	5.2
Services	**58.4**	**57.8**	**59.6**	**64.9**	**65.1**	**63.6**	**64.5**	**65.0**	**65.3**	**68.3**	**68.1**	**69.5**	**65.9**	**62.7**	**68.0**
Commerce, restaurants, and hotels	14.6	14.5	15.2	15.9	16.5	14.8	14.3	14.3	13.8	13.5	12.7	12.9	11.5	14.9	12.7
Transport and communications	6.5	6.5	6.8	6.6	6.9	7.1	7.3	7.7	7.9	8.5	8.6	8.5	8.6	7.0	8.6
Finance and insurance	10.6	9.1	8.2	10.3	8.2	7.4	7.7	8.0	8.1	9.3	9.8	11.1	10.5	8.6	10.2
Real estate	10.5	10.8	12.5	13.6	14.7	15.4	15.6	15.7	16.0	16.8	16.8	16.6	15.9	13.9	16.5
General Government	8.7	8.4	8.2	8.6	8.5	8.5	9.4	9.1	9.1	9.2	9.3	9.6	9.2	8.7	9.3
Other personal and social services	7.5	8.4	8.6	9.8	10.3	10.5	10.1	10.3	10.4	11.0	11.0	10.7	10.2	9.5	10.7

Source: Central Bank of Uruguay

Table 4. Uruguay: Gross Domestic Product at Constant Prices

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1990-99
	(In millions of 1983 pesos)														
GDP at market prices	**212,840**	**220,372**	**237,851**	**244,172**	**261,951**	**258,159**	**272,559**	**285,836**	**299,311**	**290,791**	**286,599**	**276,898**	**247,079**	**254,783**	**275,342**
Indirect taxes minus subsidies	-9,215	-6,835	-3,108	794	4,582	3,106	4,512	6,222	6,987	1,402	310	-1,789	-9,749	783	-2,457
GDP at factor cost	**222,055**	**227,207**	**240,959**	**243,378**	**257,369**	**255,053**	**268,047**	**279,614**	**292,324**	**289,389**	**286,289**	**278,687**	**256,828**	**254,001**	**277,798**
Primary activities	23,822	24,689	27,560	26,010	29,060	30,724	33,596	31,737	33,557	31,048	30,056	27,927	29,573	28,973	29,651
Agriculture, livestock, and forestry	23,256	23,991	26,851	25,250	28,266	29,791	32,623	30,592	32,170	29,853	28,884	26,841	28,633	28,088	28,553
Fishing	276	346	305	311	313	352	348	382	400	265	324	282	305	337	294
Mining	290	352	404	449	481	581	625	763	987	930	848	804	635	548	804
Secondary activities	68,287	69,359	72,483	68,698	71,206	69,346	71,641	75,619	79,036	75,084	73,390	68,879	60,373	71,742	69,432
Manufacturing	54,750	54,464	55,296	50,328	52,361	50,877	52,918	56,023	57,330	52,514	51,424	47,537	40,954	53,816	48,107
Utilities	7,457	8,110	9,340	9,203	8,896	9,547	9,962	10,628	11,855	11,839	12,428	12,635	12,560	9,444	12,366
Construction	6,080	6,785	7,847	9,167	9,949	8,922	8,761	8,968	9,851	10,731	9,538	8,707	6,859	8,481	8,959
Services	129,946	133,159	140,916	148,670	157,103	154,983	162,810	172,258	179,731	183,257	182,843	181,881	166,882	153,286	178,716
Commerce, restaurants, and hotels	24,419	26,547	30,137	35,199	39,074	35,314	37,434	40,732	41,710	40,300	38,165	36,946	27,815	34,507	35,807
Transport and communications	15,367	16,498	18,428	20,810	24,669	26,197	28,283	29,991	31,330	32,479	32,958	33,063	29,980	23,508	32,120
Finance, insurance, and real estate	51,573	51,279	52,216	52,100	52,631	52,908	55,655	58,671	62,684	66,672	68,157	69,324	67,969	54,413	68,031
Other services	38,587	38,835	40,135	40,561	40,729	40,564	41,438	42,864	44,007	43,806	43,563	42,548	41,118	40,858	42,759
	(Percent change)														
GDP at market prices	**0.3**	**3.5**	**7.9**	**2.7**	**7.3**	**-1.4**	**5.6**	**4.9**	**4.7**	**-2.8**	**-1.4**	**-3.4**	**-10.8**	**3.9**	**-4.6**
GDP at factor cost	1.2	2.3	6.1	1.0	5.7	-0.9	5.1	4.3	4.5	-1.0	-1.1	-2.7	-7.8	3.3	-3.1
Primary activities	**-2.0**	**3.6**	**11.6**	**-5.6**	**11.7**	**5.7**	**9.3**	**-5.5**	**5.7**	**-7.5**	**-3.2**	**-7.1**	**5.9**	**3.8**	**-3.0**
Agriculture, livestock, and forestry	-1.5	3.2	11.9	-6.0	11.9	5.4	9.5	-6.2	5.2	-7.2	-3.2	-7.1	6.7	3.7	-2.7
Fishing	-14.8	25.4	-11.8	2.0	0.6	12.5	-1.1	9.8	4.7	-33.8	22.3	-13.0	8.2	3.0	-4.1
Mining	-21.8	21.4	14.8	11.1	7.1	20.8	7.6	22.1	29.4	-5.8	-8.8	-5.2	-21.0	12.5	-10.2
Secondary activities	**-0.7**	**1.6**	**4.5**	**-5.2**	**3.7**	**-2.6**	**3.3**	**5.6**	**4.5**	**-5.0**	**-2.3**	**-6.1**	**-12.3**	**1.6**	**-6.4**
Manufacturing	-1.5	-0.5	1.5	-9.0	4.0	-2.8	4.0	5.9	2.3	-8.4	-2.1	-7.6	-13.8	0.4	-8.0
Construction	11.6	8.8	15.2	-1.5	-3.3	7.3	4.3	6.7	11.5	-0.1	5.0	1.7	-0.6	6.7	1.5
Utilities	-6.4	11.6	15.7	16.8	8.5	-10.3	-1.8	2.4	9.8	8.9	-11.1	-8.7	-21.2	5.1	-8.0
Services	**2.9**	**2.5**	**5.8**	**5.5**	**5.7**	**-1.3**	**5.1**	**5.8**	**4.3**	**2.0**	**-0.2**	**-0.5**	**-8.2**	**4.0**	**-1.8**
Commerce, restaurants, and hotels	0.6	8.7	13.5	16.8	11.0	-9.6	6.0	8.8	2.4	-3.4	-5.3	-3.2	-24.7	6.5	-9.1
Transport and communications	5.5	7.4	11.7	12.9	18.5	6.2	8.0	6.0	4.5	3.7	1.5	0.3	-9.3	9.0	-1.0
Finance, insurance, and real estate	3.1	-0.6	1.8	-0.2	1.0	0.5	5.2	5.4	6.8	6.4	2.2	1.7	-2.0	2.6	2.1
Other services	3.1	0.6	3.3	1.1	0.4	-0.4	2.2	3.4	2.7	-0.5	-0.6	-2.3	-3.4	1.8	-1.7

Source: Central Bank of Uruguay.

Table 5. Uruguay: Savings and Investment

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1999-2002
	(In percent of GDP)														
GDP at market prices	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Domestic expenditure	**94.6**	**97.2**	**99.2**	**100.4**	**100.6**	**100.1**	**100.2**	**100.0**	**100.7**	**101.3**	**100.9**	**101.4**	**97.9**	**99.2**	**100.4**
Consumption	**82.4**	**82.0**	**83.8**	**84.8**	**84.7**	**84.7**	**84.9**	**84.9**	**84.9**	**86.1**	**87.0**	**87.7**	**85.7**	**84.1**	**86.6**
Public sector	12.1	12.0	11.6	12.2	11.9	11.8	12.8	12.4	12.5	13.0	13.2	13.6	12.8	12.1	13.2
Private sector	70.3	70.1	72.2	72.6	72.9	72.9	72.1	72.5	72.3	73.1	73.8	74.2	72.8	72.0	73.5
Gross domestic investment	**12.2**	**15.1**	**15.4**	**15.6**	**15.9**	**15.4**	**15.2**	**15.1**	**15.9**	**15.1**	**14.0**	**13.7**	**12.2**	**15.1**	**13.8**
Fixed capital formation	12.1	13.4	14.2	14.8	14.5	13.5	14.0	14.3	15.2	14.5	13.2	12.4	10.2	14.0	12.6
Public sector	2.8	3.8	3.1	3.9	4.1	3.1	2.9	2.7	2.8	3.4	3.3	3.2	2.5	3.2	3.1
Private sector	9.3	9.6	11.1	10.8	10.5	10.4	11.1	11.6	12.4	11.1	9.9	9.2	7.7	10.8	9.5
Changes in stocks	0.1	1.7	1.2	0.9	1.3	1.9	1.3	0.8	0.7	0.6	0.8	1.2	2.1	1.1	1.2
Gross national savings	**14.2**	**15.5**	**15.3**	**14.0**	**13.4**	**14.3**	**14.1**	**13.7**	**13.7**	**12.7**	**11.1**	**10.8**	**13.8**	**14.3**	**12.1**
Public sector 1/	0.7	2.5	3.8	3.0	2.9	1.8	1.5	1.9	3.1	0.5	-0.6	-0.5	-1.9	2.4	-0.6
Private sector	13.5	13.0	11.6	11.0	10.5	12.5	12.6	11.8	10.6	12.2	11.8	11.3	15.7	11.9	12.7
Current account balance	**2.0**	**0.4**	**-0.1**	**-1.6**	**-2.5**	**-1.1**	**-1.1**	**-1.3**	**-2.1**	**-2.4**	**-2.8**	**-2.8**	**1.6**	**-0.8**	**-1.6**

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

1/ Defined as overall balance of the public sector plus capital expenditures; private savings is residual.

Table 6. Uruguay: Consolidated Public Sector

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1999-2002
							(In millions of Uruguayan pesos)								
Revenue	**3,096**	**6,695**	**12,065**	**17,784**	**26,463**	**36,997**	**48,688**	**61,740**	**76,593**	**76,428**	**75,944**	**80,738**	**81,138**	**32,236**	**78,562**
Current revenue	2,824	6,044	10,824	16,161	24,326	33,557	44,468	56,902	70,746	71,503	71,098	73,510	75,943	29,539	73,014
Tax revenue	1,941	4,180	7,586	11,187	16,814	23,471	31,821	42,334	50,044	50,030	50,164	54,007	57,832	21,042	53,008
Social security contributions	779	1,621	2,815	4,199	6,214	8,548	10,491	12,185	14,350	14,967	15,085	14,381	12,836	6,800	14,318
Nontax revenue	103	243	423	775	1,298	1,539	2,156	2,383	6,352	6,505	5,849	5,122	5,274	1,697	5,688
Operating surplus of public enterprise	272	651	1,241	1,622	2,137	3,440	4,220	4,837	5,846	4,925	4,845	7,227	5,196	2,696	5,548
Expenditure	**3,399**	**6,899**	**11,939**	**18,582**	**29,047**	**38,702**	**51,081**	**64,671**	**78,839**	**86,059**	**85,867**	**91,064**	**93,229**	**33,684**	**89,055**
Current expenditure	3,006	6,090	10,550	15,928	24,609	33,978	45,374	57,204	68,995	75,949	77,438	81,981	86,816	29,526	80,546
Wages and salaries	744	1,485	2,490	3,993	5,582	7,605	10,876	13,290	16,016	17,026	17,219	18,074	18,158	6,898	17,619
Goods and services	418	906	1,703	2,051	3,730	5,231	6,237	7,923	11,510	13,120	11,298	12,833	12,057	4,412	12,327
Interest payments	488	732	972	1,315	1,726	2,593	3,187	3,998	4,463	4,867	6,308	7,276	12,163	2,164	7,654
Transfers	1,357	2,967	5,386	8,570	13,572	18,548	25,074	31,994	37,007	40,936	42,613	43,797	44,437	16,053	42,946
Social security transfers	1,152	2,520	4,557	7,482	11,763	17,116	23,299	30,391	35,622	39,558	41,120	41,907	42,818	14,878	41,351
Other transfers	205	447	829	1,088	1,809	1,432	1,775	1,603	1,385	1,378	1,493	1,891	1,619	1,175	1,595
Capital expenditure	393	809	1,389	2,653	4,438	4,724	5,707	7,467	9,845	10,110	8,430	9,083	6,413	4,158	8,509
Overall balance 1/	**-303**	**-204**	**126**	**-798**	**-2,584**	**-1,704**	**-2,394**	**-2,931**	**-2,247**	**-9,631**	**-9,924**	**-10,326**	**-12,091**	**-1,449**	**-10,493**
							(In percent of GDP)								
Revenue	**28.5**	**29.6**	**31.0**	**30.1**	**30.0**	**30.2**	**29.8**	**30.2**	**32.7**	**32.2**	**31.2**	**32.4**	**31.0**	**30.7**	**31.7**
Current revenue	26.0	26.7	27.8	27.3	27.6	27.4	27.2	27.8	30.2	30.2	29.3	29.5	29.0	28.1	29.5
Tax revenue	17.8	18.5	19.5	18.9	19.1	19.2	19.5	20.7	21.4	21.1	20.6	21.7	22.1	20.0	21.4
Social security contributions	7.2	7.2	7.2	7.1	7.1	7.0	6.4	6.0	6.1	6.3	6.2	5.8	4.9	6.5	5.8
Nontax revenue	1.0	1.1	1.1	1.3	1.5	1.3	1.3	1.2	2.7	2.7	2.4	2.1	2.0	1.6	2.3
Capital revenue	2.5	2.9	3.2	2.7	2.4	2.8	2.6	2.4	2.5	2.1	2.0	2.9	2.0	2.6	2.2
Expenditure	**31.3**	**30.5**	**30.6**	**31.4**	**33.0**	**31.6**	**31.2**	**31.6**	**33.7**	**36.3**	**35.3**	**36.5**	**35.6**	**32.1**	**35.9**
Current expenditure	27.6	26.9	27.1	26.9	27.9	27.7	27.7	28.0	29.5	32.0	31.9	32.9	33.1	28.1	32.5
Wages and salaries	6.8	6.6	6.4	6.8	6.3	6.2	6.6	6.5	6.8	7.2	7.1	7.3	6.9	6.6	7.1
Goods and services	3.8	4.0	4.4	3.5	4.2	4.3	3.8	3.9	4.9	5.5	4.6	5.1	4.6	4.2	5.0
Interest payments	4.5	3.2	2.5	2.2	2.0	2.1	1.9	2.0	1.9	2.1	2.6	2.9	4.6	2.1	3.1
Transfers	12.5	13.1	13.8	14.5	15.4	15.1	15.3	15.6	15.8	17.3	17.5	17.6	17.0	15.3	17.3
Capital expenditure	3.6	3.6	3.6	4.5	5.0	3.9	3.5	3.7	4.2	4.3	3.5	3.6	2.4	4.0	3.4
Overall balance	**-2.8**	**-0.9**	**0.3**	**-1.3**	**-2.9**	**-1.4**	**-1.5**	**-1.4**	**-1.0**	**-4.1**	**-4.1**	**-4.1**	**-4.6**	**-1.4**	**-4.2**

Source: Ministry of Finance.

1/ Financing balance after 1994. Discrepancy added to goods and services.

Table 7. Uruguay: Central Government 1/

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
					(In millions of Uruguayan pesos)								
Revenue	**1,712**	**3,714**	**6,789**	**10,109**	**15,320**	**21,392**	**29,186**	**38,540**	**49,127**	**49,451**	**49,379**	**51,316**	**61,203**
Current revenue	1,712	3,714	6,789	10,109	15,320	21,392	29,186	38,540	49,127	49,451	49,379	51,316	61,203
Tax revenue	1,618	3,491	6,402	9,388	14,104	19,690	27,184	36,347	42,837	42,987	43,572	46,239	49,548
Goods and service taxes	1,081	2,346	4,205	6,299	9,394	13,376	17,976	23,677	27,447	26,985	27,409	29,437	29,708
Income and profit taxes	249	542	1,169	1,828	3,296	4,243	6,606	8,667	10,785	12,063	12,640	12,911	14,597
Foreign trade tax	227	424	668	706	1,062	1,212	1,564	2,155	2,577	2,242	1,968	2,428	2,730
Property and other taxes	61	179	360	555	352	859	1,037	1,849	2,028	1,697	1,555	1,462	2,513
Nontax revenue	94	223	387	721	1,216	1,702	2,003	2,193	6,289	6,464	5,807	5,078	11,654
Capital revenue	0	0	0	0	0	0	0	0	0	0	0	0	0
Expenditure	**1,715**	**3,637**	**6,505**	**10,646**	**17,116**	**23,588**	**31,858**	**41,347**	**51,765**	**58,546**	**58,186**	**62,615**	**74,163**
Current expenditure	1,522	3,291	5,908	9,343	14,910	20,997	29,052	37,552	46,191	52,394	53,661	58,140	70,512
Wages and salaries	518	1,029	1,705	2,900	3,958	5,359	7,627	9,413	11,526	12,242	12,433	13,056	13,189
Goods and services	255	571	1,119	1,207	2,462	3,418	4,148	5,234	8,272	9,808	8,223	9,568	8,335
Interest payments	175	342	510	769	1,055	1,678	2,080	2,845	3,092	4,162	5,014	6,149	10,846
Transfers	574	1,349	2,574	4,467	7,435	10,542	15,197	20,060	23,301	26,182	27,991	29,367	38,143
To social security	443	1,034	1,981	3,723	6,258	9,155	13,656	17,894	20,659	23,703	24,898	26,501	28,850
Other transfers	131	315	593	744	1,177	1,387	1,541	2,166	2,642	2,479	3,093	2,866	9,292
Capital expenditure	193	346	597	1,303	2,206	2,591	2,806	3,795	5,574	6,152	4,525	4,475	3,652
Overall balance 2/	**-3**	**77**	**284**	**-537**	**-1,796**	**-2,196**	**-2,672**	**-2,807**	**-2,639**	**-9,095**	**-8,807**	**-11,299**	**-12,961**
					(In percent of GDP)								
Revenue	**15.7**	**16.4**	**17.4**	**17.1**	**17.4**	**17.5**	**17.8**	**18.8**	**21.0**	**20.9**	**20.3**	**20.6**	**23.4**
Current revenue	15.7	16.4	17.4	17.1	17.4	17.5	17.8	18.8	21.0	20.9	20.3	20.6	23.4
Tax revenue	14.9	15.4	16.4	15.9	16.0	16.1	16.6	17.8	18.3	18.1	17.9	18.6	18.9
Goods and service taxes	9.9	10.4	10.8	10.7	10.7	10.9	11.0	11.6	11.7	11.4	11.3	11.8	11.3
Income and profit taxes	2.3	2.4	3.0	3.1	3.7	3.5	4.0	4.2	4.6	5.1	5.2	5.2	5.6
Foreign trade tax	2.1	1.9	1.7	1.2	1.2	1.0	1.0	1.1	1.1	0.9	0.8	1.0	1.0
Property and other taxes	0.6	0.8	0.9	0.9	0.4	0.7	0.6	0.9	0.9	0.7	0.6	0.6	1.0
Nontax revenue	0.9	1.0	1.0	1.2	1.4	1.4	1.2	1.1	2.7	2.7	2.4	2.0	4.4
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**15.8**	**16.1**	**16.7**	**18.0**	**19.4**	**19.3**	**19.5**	**20.2**	**22.1**	**24.7**	**23.9**	**25.1**	**28.3**
Current expenditure	14.0	14.6	15.2	15.8	16.9	17.1	17.8	18.4	19.7	22.1	22.1	23.3	26.9
Wages and salaries	4.8	4.6	4.4	4.9	4.5	4.4	4.7	4.6	4.9	5.2	5.1	5.2	5.0
Goods and services	2.3	2.5	2.9	2.0	2.8	2.8	2.5	2.6	3.5	4.1	3.4	3.8	3.2
Interest payments	1.6	1.5	1.3	1.3	1.2	1.4	1.3	1.4	1.3	1.8	2.1	2.5	4.1
Transfers	5.3	6.0	6.6	7.6	8.4	8.6	9.3	9.8	9.9	11.0	11.5	11.8	14.6
Capital expenditure	1.8	1.5	1.5	2.2	2.5	2.1	1.7	1.9	2.4	2.6	1.9	1.8	1.4
Overall balance	**0.0**	**0.3**	**0.7**	**-0.9**	**-2.0**	**-1.8**	**-1.6**	**-1.4**	**-1.1**	**-3.8**	**-3.6**	**-4.5**	**-4.9**

Source: Ministry of Finance.

Table 8. Uruguay: Social Security (BPS)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
	(In millions of Uruguayan pesos)												
Revenue	**757**	**2,132**	**4,643**	**7,193**	**11,639**	**16,697**	**23,866**	**30,510**	**35,749**	**39,466**	**40,616**	**41,116**	**42,497**
Current revenue	757	2,132	4,643	7,193	11,639	16,697	23,866	30,510	35,749	39,466	40,616	41,116	42,497
Contributions	834	1,734	2,987	4,484	6,697	9,541	12,854	15,981	18,996	20,123	20,258	19,318	18,632
Transfers from central government	-77	398	1,656	2,709	4,942	7,157	11,013	14,529	16,753	19,344	20,358	21,797	23,865
Capital revenue	0	0	0	0	0	0	0	0	0	0	0	0	0
Expenditure	**755**	**2,139**	**4,648**	**7,196**	**11,586**	**16,863**	**23,756**	**30,550**	**35,668**	**39,516**	**40,630**	**41,081**	**42,595**
Current expenditure	755	2,139	4,648	7,196	11,586	16,863	23,756	30,499	35,540	39,516	40,630	41,081	42,595
Wages and salaries	28	58	100	225	328	441	775	754	850	898	914	940	841
Goods and services	40	83	144	218	328	311	498	507	423	745	578	651	879
Interest payments	0	0	0	0	0	0	0	0	0	0	0	0	0
Transfers	687	1,998	4,404	6,753	10,930	16,111	22,483	29,239	34,267	37,873	39,137	39,491	40,876
Social security	632	1,884	4,208	6,404	10,311	14,958	19,952	25,212	29,235	32,280	33,290	33,842	34,353
Other transfers	55	114	196	349	619	1,153	2,531	4,027	5,033	5,593	5,847	5,648	6,523
Capital expenditure	0	0	0	0	0	0	0	51	128	0	0	0	0
Overall Balance 1/	**2**	**-7**	**-5**	**-3**	**53**	**-166**	**110**	**-40**	**81**	**-49**	**-13**	**35**	**-99**
	(In percent of GDP)												
Revenue	**7.0**	**9.4**	**11.9**	**12.2**	**13.2**	**13.6**	**14.6**	**14.9**	**15.3**	**16.6**	**16.7**	**16.5**	**16.2**
Current revenue	7.0	9.4	11.9	12.2	13.2	13.6	14.6	14.9	15.3	16.6	16.7	16.5	16.2
Contributions	7.7	7.7	7.7	7.6	7.6	7.8	7.9	7.8	8.1	8.5	8.3	7.8	7.1
Transfers from central government	-0.7	1.8	4.3	4.6	5.6	5.8	6.7	7.1	7.2	8.2	8.4	8.7	9.1
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**6.9**	**9.5**	**11.9**	**12.2**	**13.1**	**13.8**	**14.5**	**14.9**	**15.2**	**16.7**	**16.7**	**16.5**	**16.3**
Current expenditure	6.9	9.5	11.9	12.2	13.1	13.8	14.5	14.9	15.2	16.7	16.7	16.5	16.3
Wages and salaries	0.3	0.3	0.3	0.4	0.4	0.4	0.5	0.4	0.4	0.4	0.4	0.4	0.3
Goods and services	0.4	0.4	0.4	0.4	0.4	0.3	0.3	0.2	0.2	0.3	0.2	0.3	0.3
Interest payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transfers	6.3	8.8	11.3	11.4	12.4	13.1	13.7	14.3	14.6	16.0	16.1	15.8	15.6
Capital expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0
Overall Balance	**0.0**	**0.0**	**0.0**	**0.0**	**0.1**	**-0.1**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**

Source: Ministry of Finance.

1/ Financing balance after 1994. Discrepancy added to goods and services.

Table 9. Uruguay: Public Enterprises

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
	(In millions of Uruguayan pesos)												
Revenue	**1,465**	**2,890**	**4,849**	**6,867**	**10,287**	**15,019**	**21,254**	**26,397**	**29,726**	**32,357**	**36,732**	**38,642**	**40,965**
Current revenue	1,463	2,869	4,826	6,845	10,209	14,913	21,069	26,185	29,428	31,932	36,413	38,293	40,488
Sales	1,419	2,778	4,665	6,600	9,839	14,397	20,293	25,358	28,653	30,951	35,371	36,582	38,752
Other current revenue	34	71	126	191	287	401	575	632	601	774	756	1,373	1,331
Transfers from CG	10	20	36	55	82	115	201	194	174	207	286	338	404
Capital revenue	2	21	23	22	78	106	185	212	298	425	318	349	477
Expenditure	**1,412**	**2,742**	**4,471**	**6,704**	**10,546**	**13,798**	**20,209**	**25,783**	**28,462**	**31,726**	**36,452**	**36,613**	**39,363**
Current expenditure	1,230	2,299	3,728	5,441	8,400	11,788	17,468	22,376	24,569	28,008	32,749	32,132	36,638
Wages and salaries	196	405	717	1,090	1,642	2,291	2,833	3,684	3,791	3,921	4,107	4,179	4,366
Goods and services	540	832	1,032	1,929	2,956	3,298	6,632	7,764	7,743	9,522	12,515	11,313	13,939
Interest payments	39	81	143	218	328	458	588	682	851	759	834	845	765
Transfers	455	980	1,835	2,204	3,473	5,740	7,415	10,247	12,185	13,806	15,294	15,795	17,568
Capital expenditure	182	443	743	1,263	2,146	2,010	2,741	3,407	3,892	3,718	3,702	4,481	2,724
Overall balance 1/	**53**	**148**	**378**	**163**	**-259**	**1,221**	**1,045**	**614**	**1,265**	**631**	**280**	**2,030**	**1,602**
	(In percent of GDP)												
Revenue	**13.5**	**12.8**	**12.4**	**11.6**	**11.7**	**12.3**	**13.0**	**12.9**	**12.7**	**13.6**	**15.1**	**15.5**	**15.6**
Current revenue	13.5	12.7	12.4	11.6	11.6	12.2	12.9	12.8	12.6	13.5	15.0	15.4	15.5
Capital revenue	0.0	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.2
Expenditure	**13.0**	**12.1**	**11.5**	**11.3**	**12.0**	**11.3**	**12.4**	**12.6**	**12.1**	**13.4**	**15.0**	**14.7**	**15.0**
Current expenditure	11.3	10.2	9.6	9.2	9.5	9.6	10.7	10.9	10.5	11.8	13.5	12.9	14.0
Wages and salaries	1.8	1.8	1.8	1.8	1.9	1.9	1.7	1.8	1.6	1.7	1.7	1.7	1.7
Goods and services	5.0	3.7	2.6	3.3	3.4	2.7	4.1	3.8	3.3	4.0	5.1	4.5	5.3
Interest payments	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.3	0.4	0.3	0.3	0.3	0.3
Transfers	4.2	4.3	4.7	3.7	3.9	4.7	4.5	5.0	5.2	5.8	6.3	6.3	6.7
Capital expenditure	1.7	2.0	1.9	2.1	2.4	1.6	1.7	1.7	1.7	1.6	1.5	1.8	1.0
Overall balance	**0.5**	**0.7**	**1.0**	**0.3**	**-0.3**	**1.0**	**0.6**	**0.3**	**0.5**	**0.3**	**0.1**	**0.8**	**0.6**

Source: Ministry of Finance.

1/ Financing balance after 1994. Discrepancy added to goods and services.

Table 10. Uruguay: Quasi-Fiscal Operations of the Central Bank

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
	(In millions of Uruguayan Pesos)												
Revenue	**50**	**79**	**96**	**180**	**267**	**948**	**1,282**	**1,586**	**1,646**	**2,106**	**2,346**	**2,691**	**3,109**
Current revenue	50	79	96	180	267	948	1,282	1,586	1,646	2,106	2,346	2,691	3,109
Interest on net foreign assets	40	58	67	124	187	392	577	667	851	1,051	1,491	1,922	1,275
Interest on domestic assets m/n	2	5	16	39	72	516	698	883	782	1,004	701	721	1,212
Interest on domestic assets m/e	8	16	13	17	8	40	7	36	13	50	154	48	622
Capital revenue	0	0	0	0	0	0	0	0	0	0	0	0	0
Expenditure	**397**	**525**	**632**	**623**	**768**	**1,635**	**2,128**	**2,539**	**2,594**	**2,576**	**3,261**	**3,498**	**3,876**
Current expenditure	397	525	632	623	768	1,635	2,128	2,539	2,594	2,576	3,261	3,498	3,876
Wages and salaries	61	115	183	105	146	201	297	430	504	473	421	484	402
Goods and services	15	29	46	26	37	62	74	107	-13	118	105	121	100
Interest payments	321	382	404	492	586	1,372	1,757	2,002	2,102	1,985	2,735	2,893	3,374
Transfers	0	0	0	0	0	0	0	0	0	0	0	0	0
Capital expenditure	0	0	0	0	0	0	0	0	0	0	0	0	0
Overall balance 1/	**-347**	**-446**	**-536**	**-443**	**-501**	**-687**	**-846**	**-953**	**-947**	**-470**	**-914**	**-807**	**-767**
	(In percent of GDP)												
Revenue	**0.5**	**0.3**	**0.2**	**0.3**	**0.3**	**0.8**	**0.8**	**0.8**	**0.7**	**0.9**	**1.0**	**1.1**	**1.2**
Current revenue	0.5	0.3	0.2	0.3	0.3	0.8	0.8	0.8	0.7	0.9	1.0	1.1	1.2
Capital revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure	**3.7**	**2.3**	**1.6**	**1.1**	**0.9**	**1.3**	**1.3**	**1.2**	**1.1**	**1.1**	**1.3**	**1.4**	**1.5**
Current expenditure	3.7	2.3	1.6	1.1	0.9	1.3	1.3	1.2	1.1	1.1	1.3	1.4	1.5
Wages and salaries	0.6	0.5	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Goods and services	0.1	0.1	0.1	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Interest payments	3.0	1.7	1.0	0.8	0.7	1.1	1.1	1.0	0.9	0.8	1.1	1.2	1.3
Transfers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	**-3.2**	**-2.0**	**-1.4**	**-0.7**	**-0.6**	**-0.6**	**-0.5**	**-0.5**	**-0.4**	**-0.2**	**-0.4**	**-0.3**	**-0.3**

Source: Ministry of Finance.

1/ Financing balance after 1994. Discrepancy added to goods and services.

Table 11. Uruguay: Monetary Survey 1/

	1994	1995	1996	1997	1998	1999	2000	2001	2002
			(In millions of Uruguayan pesos)						
Net foreign assets	**438**	**2,900**	**4,136**	**3,803**	**5,951**	**2,629**	**4,077**	**-3,077**	**-31,044**
Central Bank	3,834	7,535	10,312	13,951	19,733	22,948	27,773	40,358	-4,741
Commercial banks	-3,396	-4,634	-6,176	-10,149	-13,782	-20,318	-23,695	-43,435	-26,303
Net short-term assets	10,429	12,208	17,581	20,736	22,675	33,919	42,508	54,246	42,434
Non-resident deposits	-13,825	-16,843	-23,757	-30,884	-36,456	-54,238	-66,203	-97,681	-68,737
Net domestic assets	**41,298**	**59,404**	**78,159**	**98,498**	**116,616**	**138,355**	**142,816**	**170,519**	**276,129**
Credit to the public sector (net)	5,636	6,003	6,465	4,621	1,495	5,638	4,713	6,458	66,797
Central government	2,172	2,414	2,557	235	-1,944	1,531	-550	-324	55,446
Social security	-303	-395	-417	-427	-702	-643	-590	-882	-692
Local government	1,464	1,969	2,340	2,832	2,874	3,516	1,578	1,675	1,631
Public enterprises	2,303	2,015	1,985	1,981	1,268	1,235	4,274	5,990	10,412
Credit to the private sector	35,662	53,401	71,694	93,877	115,121	132,717	138,104	164,060	209,332
Other items (net)	**-7,099**	**-14,359**	**-17,817**	**-20,267**	**-26,631**	**-32,270**	**-27,254**	**-24,058**	**-79,803**
Interbank flow	-348	131	-749	-571	-1,498	-1,842	-4,753	-428	-101
Other net assets minus capital	-6,751	-14,490	-17,068	-19,696	-25,134	-30,428	-22,501	-23,629	-79,701
Broad money incl. forex. deposits (M3	**34,636**	**47,945**	**64,478**	**82,034**	**95,936**	**108,715**	**119,639**	**143,384**	**165,283**
Broad money (M2)	10,337	14,825	18,855	23,239	25,415	26,648	27,498	27,646	25,983
Currency in circulation	3,278	4,253	5,171	6,423	7,084	7,639	7,284	7,095	7,713
Resident deposits in m/n	7,059	10,571	13,684	16,816	18,331	19,009	20,214	20,551	18,270
Resident deposits in m/e	24,299	33,121	45,623	58,794	70,521	82,067	92,142	115,738	139,300
			(percentage change)						
M3 growth		**38.4**	**34.5**	**27.2**	**16.9**	**13.3**	**10.0**	**19.8**	**15.3**
Contribution to M3 growth:									
Net foreign assets		7.1	2.6	-0.5	2.6	-3.5	1.3	-6.0	-19.5
Net domestic assets		52	39	32	22	23	4	23	74
Public sector credit (net)		1.1	1.0	-2.9	-3.8	4.3	-0.9	1.5	42.1
Private sector credit		51.2	38.2	34.4	25.9	18.3	5.0	21.7	31.6
Dollarization of deposits (in percent) 2/	70.2	69.1	70.8	71.7	73.5	75.5	77.0	80.7	84.3
Dollarization of loans (in percent)	56.5	58.4	60.3	63.1	65.0	66.0	69.9	75.1	83.4
Loans over deposits (in percent)	78.9	88.2	86.3	88.2	91.9	85.5	77.3	70.1	92.5

Source: Central Bank of Uruguay, IFS.

1/ IFS definitions. Foreign currency items are evaluated at end-of-period exchange rate.

Table 12. Uruguay: Central Bank Balance Sheet 1/

	1994	1995	1996	1997	1998	1999	2000	2001	2002
	(In millions of Uruguayan pesos)								
Assets	**28,348**	**43,413**	**53,935**	**66,411**	**83,893**	**92,481**	**102,664**	**92,017**	**216,151**
Foreign assets	11,345	16,851	21,624	26,350	35,969	39,381	44,342	56,838	102,773
Reserve assets	8,492	12,970	16,632	20,766	28,008	30,220	34,776	45,772	21,000
Other foreign assets	2,853	3,881	4,992	5,584	7,961	9,161	9,567	11,067	81,773
Domestic assets	17,003	26,561	32,311	40,061	47,924	53,100	58,322	35,179	113,378
Public sector credit	11,478	15,700	18,932	22,209	27,297	30,925	38,563	12,838	80,206
Central government	8,251	11,585	14,083	16,696	22,044	25,926	33,861	8,161	72,765
BPS	0	0	0	0	0	0	0	0	0
Local governments	0	0	0	0	0	0	0	0	1
Public enterprises	3,227	4,114	4,849	5,512	5,253	4,998	4,702	4,677	7,440
Credit to banks	4,028	5,478	6,856	9,068	10,258	10,803	10,447	11,928	33,030
Private sector credit	258	364	360	411	434	458	484	284	2,163
Other assets	1,238	5,020	6,164	8,373	9,935	10,914	8,828	10,128	-2,021
Liabilities	**28,348**	**43,413**	**53,935**	**66,411**	**83,893**	**92,481**	**102,664**	**92,017**	**216,151**
Foreign liabilities	7,511	9,317	11,312	12,399	16,236	16,433	16,570	16,480	107,513
Reserve liabilities	485	399	294	25	1,754	1,847	1,879	2,119	26,373
Other foreign liabilities	7,026	8,918	11,018	12,374	14,482	14,586	14,691	14,361	81,140
Domestic liabilities	20,836	34,096	42,623	54,012	67,656	76,048	86,094	75,537	108,637
Public sector deposits	8,825	12,370	16,689	21,659	30,425	30,044	39,576	16,292	38,286
Central government	8,247	11,007	14,159	18,414	26,234	26,301	38,626	16,028	38,147
BPS	0	0	1	1	3	0	3	12	20
Local government	0	0	0	0	376	136	0	0	0
Public enterprises	578	1,362	2,529	3,244	3,812	3,608	946	251	119
Currency	3,955	5,241	6,637	8,099	9,219	9,854	9,470	9,449	10,001
Deposits of banks	7,158	9,571	12,779	16,320	18,361	23,583	27,103	36,699	36,429
Private sector deposits	343	519	1,167	1,463	1,830	2,310	2,682	3,203	1,716
Central bank papers	325	1,755	1,039	1,363	1,368	1,883	520	532	914
Other liabilities	2,125	3,259	3,359	5,161	5,136	6,989	6,568	8,740	17,433
Capital	-1,895	1,381	953	-53	1,317	1,386	176	624	3,858
	(Percentage change)								
Base money growth		**33.3**	**31.1**	**25.8**	**12.9**	**21.2**	**9.4**	**26.2**	**0.6**
Currency growth		32.5	26.6	22.0	13.8	6.9	-3.9	-0.2	5.8
Contribution to currency growth:									
Net foreign assets		93.6	53.0	54.8	71.4	34.9	49.0	132.9	-477.3
Net domestic assets		-9.0	-68.1	-49.2	-60.2	-12.2	-62.1	-119.1	742.0
Credit to the public sector (net)		17.1	-20.7	-25.5	-45.4	43.5	-19.2	-25.8	480.2
Credit to banks (net)		-24.4	-34.9	-20.0	-10.5	-50.7	-39.3	-85.7	226.2
Central bank papers		36.1	-13.7	4.9	0.1	5.6	-13.8	0.1	4.0
Velocity of currency (level)	22.3	23.4	24.6	25.3	25.4	24.1	25.7	26.4	26.2

Source: Central Bank of Uruguay, IFS.

Table 13. Uruguay: Balance Sheet of Commercial Banks 1/

	1994	1995	1996	1997	1998	1999	2000	2001	2002
	(In millions of Uruguayan pesos)								
Assets	**77,734**	**104,801**	**140,950**	**182,086**	**213,851**	**243,163**	**264,766**	**320,256**	**342,046**
Foreign assets	15,281	19,270	27,522	35,819	43,187	49,541	60,656	73,452	70,066
Domestic assets	62,453	85,531	113,428	146,267	170,664	193,622	204,109	246,804	271,980
Public sector credit	6,071	6,715	9,101	10,898	13,671	11,265	10,848	15,589	36,236
Central government	4,064	3,993	5,653	6,917	9,070	6,055	7,465	11,259	28,493
BPS	0	0	0	0	0	0	0	0	466
Local governments	1,585	2,191	2,804	3,322	3,692	3,984	1,857	2,082	2,086
Public enterprises	423	531	644	659	908	1,225	1,527	2,248	5,192
Credit to BCU	7,731	10,699	13,966	17,249	18,462	22,860	23,818	37,872	39,982
Interbank flow	38	153	96	322	389	433	851	742	828
Private sector credit	35,403	53,037	71,334	93,466	114,687	132,259	137,619	163,776	207,169
Private sector credit m/n	15,485	22,191	28,367	34,510	40,248	45,030	41,480	40,734	32,974
Private sector credit m/e	19,918	30,846	42,968	58,956	74,439	87,229	96,139	123,041	174,194
Other assets	13,210	14,927	18,931	24,333	23,455	26,805	30,973	28,825	-12,235
Liabilities	**77,734**	**104,801**	**140,950**	**182,086**	**213,851**	**243,163**	**264,766**	**320,256**	**342,046**
Foreign liabilities	18,677	23,904	33,697	45,967	56,969	69,860	84,352	116,887	96,369
Short-term foreign liabilities	4,852	7,061	9,941	15,083	20,513	15,622	18,148	19,206	27,633
Non-resident deposits	13,825	16,843	23,757	30,884	36,456	54,238	66,203	97,681	68,737
Domestic liabilities	59,056	80,897	107,252	136,118	156,882	173,303	180,414	203,369	245,677
Public sector deposits	3,088	4,042	4,880	6,826	9,048	6,507	5,123	5,677	11,359
Central government	1,895	2,157	3,021	4,964	6,824	4,150	3,249	3,715	7,665
BPS	303	394	416	426	698	643	586	870	1,138
Local governments	120	223	464	490	443	333	279	407	456
Public enterprises	770	1,268	979	946	1,082	1,381	1,008	685	2,100
Deposits of BCU	4,309	5,639	7,421	9,213	10,110	10,140	10,580	11,919	35,224
Private sector deposits, residents	31,016	43,173	58,141	74,148	87,022	98,766	109,674	133,086	155,854
Capital and other liabilities	20,643	28,042	36,811	45,932	50,703	57,890	55,038	52,687	43,240
Memorandum:									
Currency in banks	677	988	1,467	1,676	2,135	2,215	2,186	2,354	2,288

Source: Central Bank of Uruguay, IFS.

Table 14. Uruguay: Balance of Payments

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Average 1990-98	Average 1999-2002
						(In millions of U.S. dollars)									
Current account	**186**	**42**	**-9**	**-244**	**-438**	**-213**	**-233**	**-287**	**-476**	**-508**	**-566**	**-533**	**191**	**-186**	**-354**
Trade balance	426	61	-122	-387	-706	-563	-687	-704	-772	-897	-927	-771	61	-384	-633
Exports	1,693	1,605	1,801	1,732	1,918	2,148	2,449	2,793	2,829	2,291	2,384	2,144	1,934	2,107	2,188
Imports	-1,267	-1,544	-1,923	-2,118	-2,624	-2,711	-3,135	-3,498	-3,601	-3,187	-3,311	-2,915	-1,872	-2,491	-2,821
Services (net)	73	174	272	282	469	502	560	536	436	459	394	324	135	367	328
Export	466	596	830	1,028	1,331	1,359	1,399	1,424	1,319	1,262	1,276	1,132	727	1,084	1,099
Transport	170	199	335	351	393	399	394	343	253	261	374	337	253	315	306
Travel	238	333	381	447	632	611	717	759	695	653	713	611	351	535	582
Other	58	65	114	230	306	349	288	322	371	348	189	185	123	234	211
Import	-393	-422	-559	-746	-862	-858	-839	-889	-884	-802	-882	-808	-592	-717	-771
Transport	-175	-218	-285	-362	-376	-376	-446	-426	-362	-317	-400	-364	-253	-336	-333
Travel	-111	-100	-104	-129	-234	-236	-192	-264	-265	-280	-281	-252	-178	-182	-248
Other	-106	-104	-170	-256	-251	-245	-201	-199	-256	-206	-201	-192	-161	-199	-190
Factor income	-321	-232	-187	-192	-243	-227	-189	-193	-198	-144	-61	-114	-76	-220	-98
Credit	258	235	225	250	283	404	461	547	608	736	27	827	455	363	511
Debit	-580	-467	-412	-443	-525	-631	-649	-740	-806	-879	-842	-941	-530	-584	-798
Transfers	8	40	29	53	41	76	83	74	59	74	27	28	70	51	50
Credit	16	50	36	61	49	84	91	83	75	78	48	48	84	61	65
Debit	-8	-10	-7	-8	-8	-8	-8	-9	-16	-5	-21	-20	-13	-9	-15
Capital and financial account	**-181**	**-398**	**-43**	**214**	**527**	**412**	**222**	**600**	**705**	**147**	**772**	**794**	**-1,710**	**229**	**1**
Capital transfers	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Direct investment	0	0	0	102	155	157	137	113	155	235	274	319	91	91	230
Portfolio investment	108	47	83	29	158	289	180	210	419	84	296	553	230	169	291
Government securities	108	47	83	29	158	289	180	210	419	84	294	324	31	169	183
Other sectors	0	0	0	0	0	0	0	0	0	0	2	229	198	0	107
Financial derivatives													14	...	...
Other investment	-289	-445	-127	83	214	-34	-95	278	131	-172	202	-78	-2,030	-32	-520
Loans	-272	-322	102	96	82	-324	207	341	123	426	437	-1,041	1,383	4	301
Non-financial public sector	35	146	156	120	134	19	20	97	169	261	158	182	633	100	308
Financial public sector (BCU, FSB	-210	-289	-70	-31	-7	-72	-22	-40	123	-137	-42	-61	883	-69	161
Other sectors	-97	-179	17	7	-46	-270	209	284	-169	302	321	-1,162	-148	-27	-172
Deposits	-98	-131	-158	-1	131	291	41	-76	270	-614	-34	1,004	-975	30	-155
Other flows	80	9	-72	-13	2	0	-342	13	-262	16	-201	-41	-2,438	-65	-666
Banks	0	0	0	0	0	0	-342	13	-223	12	34	-9	-133	-61	-24
Non-financial private sector	80	9	-72	-13	2	0	0	0	-38	4	-235	-31	-818	-3	-270
Foreign currency held outside banks											0	0	-1,487	...	...
Reserve Assets	**-40**	**-113**	**-186**	**-179**	**-99**	**-218**	**-141**	**-392**	**-515**	**110**	**-167**	**-302**	**2,322**	**-209**	**491**
Errors and Omissions	**36**	**469**	**238**	**209**	**10**	**19**	**152**	**79**	**285**	**251**	**-39**	**41**	**-804**	**166**	**-138**
						(In percent of GDP)									
Current account	2.0	0.4	-0.1	-1.6	-2.5	-1.1	-1.1	-1.3	-2.1	-2.4	-2.8	-2.8	1.6	-0.8	-1.6
Financial account	-1.6	0.6	1.5	2.8	3.1	2.2	1.8	3.1	4.4	1.9	3.6	4.5	-20.7	2.0	-2.7
Private sector (incl. errors & om.)	-0.9	1.5	0.2	2.0	1.4	1.0	1.0	1.9	1.2	0.9	1.6	2.1	-33.5	#REF!	-7.2
Public sector	-0.7	-0.9	1.3	0.8	1.6	1.2	0.9	1.2	3.2	1.0	2.0	2.4	12.8	1.0	4.5
Change in reserves	-0.4	-1.0	-1.4	-1.2	-0.6	-1.1	-0.7	-1.8	-2.3	0.5	-0.8	-1.6	19.1	-1.2	4.3
Memorandum item:															
GDP in millions of U.S. dollars	9,299	11,206	12,878	15,002	17,475	19,298	20,515	21,665	22,371	20,913	20,086	18,712	12,136	16,634	17,962

Source: Central Bank of Uruguay

Table 15. Uruguay: Public Debt 1/

	1999	2000	2001	2002
	(In millions of U.S. dollars)			
	I. Gross Debt by Debtor			
Combined public sector	**8,526**	**9,132**	**10,072**	**11,377**
Nonfinancial public sector	6,300	6,979	7,823	10,153
Central government	5,347	6,202	7,012	9,418
Public enterprises 2/ 8/	541	554	588	538
Local governments 3/	413	234	233	195
Other 4/	-1	-11	-10	1
Central bank	2,226	2,154	2,249	1,224
	II. Gross Debt by Creditor			
Total	**8,526**	**9,132**	**10,072**	**11,377**
Official creditors	2,388	2,511	2,525	4,751
Multilateral 5/	1,919	2,108	2,218	4,494
Bilateral	468	403	307	257
Private creditors	6,138	6,648	7,547	6,594
Financial sector	5,764	6,271	6,620	5,845
Commercial banks	2,129	2,103	2,142	1,451
Other 6/	3,635	4,168	4,478	4,394
Nonfinancial sector	374	376	927	749
Providers	96	121	80	85
Other 7/	278	256	847	664
Other	0	-26	0	32
	III. Gross Debt by Instrument			
Total	**8,526**	**9,132**	**10,072**	**11,377**
Public titles	4,465	5,073	5,677	5,744
Titles	3,774	4,439	5,210	5,304
Brady bonds	691	634	467	440
International loans	2,470	2,579	2,661	4,939
Providers	96	73	80	85
Net deposits	1,282	1,240	1,459	608
Other	213	168	195	1
	IV. Gross Assets and Net Debt			
Total assets	**-2,933**	**-3,106**	**-3,478**	**-3,281**
Nonfinancial public sector	-72	-106	-116	-1,601
With nonresidents	-62	-95	-85	-632
Securities	-56	-91	-84	-129
Deposits	-6	-3	0	-503
With residents	-9	-11	-31	-969
Securities	-9	-11	-31	0
Otros	0	0	0	-969
Central bank	-2,861	-3,000	-3,362	-1,680
With nonresidents	-2,861	-3,000	-3,362	-1,059
Reserve assets	-2,606	-2,742	-3,099	-777
Other	-255	-258	-263	-282
With residents	0	0	0	-621
Funds	0	0	0	-250
Financial assistance	0	0	0	-371
Net debt	7,819	8,180	8,843	9,321
Nonfinancial public sector	8,454	9,026	9,956	9,776
Central bank	-635	-846	-1,113	-455
	(In percent of GDP)			
	I. Gross Debt by Debtor			
Combined public sector	**40.8**	**45.5**	**53.8**	**93.7**
Nonfinancial public sector	30.1	34.7	41.8	83.7
Central government	25.6	30.9	37.5	77.6
Public enterprises 2/ 8/	2.6	2.8	3.1	4.4
Local governments 3/	2.0	1.2	1.2	1.6
Other 4/	0.0	-0.1	-0.1	0.0
Central bank	10.6	10.7	12.0	10.1

Table 15. Uruguay: Public Debt 1/

	1999	2000	2001	2002
	II. Gross Debt by Creditor			
Total	**40.8**	**45.5**	**53.8**	**93.7**
Official creditors	11.4	12.5	13.5	39.1
Multilateral 5/	9.2	10.5	11.9	37.0
Bilateral	2.2	2.0	1.6	2.1
Private creditors	29.4	33.1	40.3	54.3
Financial sector	27.6	31.2	35.4	48.2
Commercial banks	10.2	10.5	11.4	12.0
Other 6/	17.4	20.8	23.9	36.2
Nonfinancial sector	1.8	1.9	5.0	6.2
Providers	0.5	0.6	0.4	0.7
Other 7/	1.3	1.3	4.5	5.5
Other	0.0	-0.1	0.0	0.3
	III. Gross Debt by Instrument			
Total	**40.8**	**45.5**	**53.8**	**93.7**
Public titles	21.3	25.3	30.3	47.3
Titles	18.0	22.1	27.8	43.7
Brady bonds	3.3	3.2	2.5	3.6
International loans	11.8	12.8	14.2	40.7
Providers	0.5	0.4	0.4	0.7
Net deposits	6.1	6.2	7.8	5.0
Other	1.0	0.8	1.0	0.0
	IV. Gross Assets and Net Debt			
Total assets	**-14.0**	**-15.5**	**-18.6**	**-27.0**
Nonfinancial public sector	-0.3	-0.5	-0.6	-13.2
With nonresidents	-0.3	-0.5	-0.5	-5.2
Securities	-0.3	-0.5	-0.5	-1.1
Deposits	0.0	0.0	0.0	-4.1
With residents	0.0	-0.1	-0.2	-8.0
Securities	0.0	-0.1	-0.2	0.0
Otros	0.0	0.0	0.0	-8.0
Central bank	-13.7	-14.9	-18.0	-13.8
With nonresidents	-13.7	-14.9	-18.0	-8.7
Reserve assets	-12.5	-13.7	-16.6	-6.4
Other	-1.2	-1.3	-1.4	-2.3
With residents	0.0	0.0	0.0	-5.1
Funds	0.0	0.0	0.0	-2.1
Financial assistance	0.0	0.0	0.0	-3.1
Net debt	**37.4**	**40.7**	**47.3**	**76.8**
Nonfinancial public sector	40.4	44.9	53.2	80.6
Central bank	-3.0	-4.2	-5.9	-3.8
Memorandum Item:				
GDP (in millions of U.S. dollars)	20,913	20,086	18,712	12,136

Source: Central Bank of Uruguay.

1/ Official figures are only available since 1999 due to a change in the methodology to calculate the debt stock.

2/ Includes: AFE, ANCAP, ANAP, ANCO, ANTEL, INC, OSE y UTE.

3/ Includes Intendencia de Montevideo and other intendencias.

4/ Includes BPS and BSE

5/ Includes IDB, World Bank and IMF.

6/ Includes AFAPs, stock exchange, investment funds, Caja de Notarios, Caja de Empleados Bancarios, private insurance companies, IFEs and CND. It also includes bond holdings by non-resident financial institutions.

7/ Includes holdings of public bonds by non-residents.

8/ In 2002, includes US$32 million from ANCAP's advanced sale.

Table 16. Uruguay: Medium-Term Outlook

	2002	2003	2004	2005	2006	2007	2008
	Est.			Projections			
	1. Output and prices (Percent change)						
Real GDP	-10.8	-1.0	4.5	4.0	4.0	3.0	3.0
Real domestic demand	-18.0	-3.3	4.4	4.8	4.6	3.7	3.5
Of which: consumption	-16.1	-1.9	3.8	3.6	3.3	2.9	3.1
Consumer prices (end-of-period)	25.9	20.0	14.0	11.9	10.1	7.4	5.3
Merchandise export prices	-7.9	1.5	0.0	0.0	0.0	0.0	0.0
Export volume	-3.3	8.5	9.0	9.0	8.5	8.0	7.5
Merchandise import prices	-12.1	1.5	2.4	0.0	0.0	0.0	0.0
Import volume	-26.4	-2.7	7.5	10.0	9.0	9.0	8.0
Merchandise terms of trade	4.8	0.0	-2.3	0.0	0.0	0.0	0.0
	2. Savings and investment (Percent of GDP)						
Gross domestic investment	12.2	11.8	12.2	12.7	13.3	13.6	13.5
Gross national savings	13.8	13.8	13.6	13.8	14.4	14.5	14.3
Foreign savings	1.6	2.1	1.5	1.1	1.0	0.9	0.8
	3. Public sector operations (Percent of GDP)						
Overall balance	-4.6	-3.7	-2.5	-2.1	-1.7	-1.0	-0.6
Primary balance	0.0	3.0	3.2	3.3	3.4	3.9	3.9
	4. Reserve adequacy						
Gross official reserves							
In months of imports of goods and services	3.8	7.3	8.7	7.6	5.7	4.1	3.6
In percent of short-term debt							
excluding nonresident deposits	33.3	64.5	82.7	78.7	63.2	49.1	46.2
including nonresident deposits	19.7	38.4	48.3	44.6	34.5	25.7	23.2
	5. Balance of payments and other external indicators (In millions of U.S. dollars)						
Current account balance	191	219	170	144	146	140	124
Trade Balance	61	280	285	291	304	304	313
Exports, f.o.b.	1,934	2,129	2,320	2,529	2,744	2,964	3,186
Imports, f.o.b.	1,872	1,849	2,035	2,239	2,440	2,660	2,873
Nonfactor services	135	82	70	49	27	1	-25
Exports, f.o.b.	727	668	702	744	788	836	886
Imports, f.o.b.	592	586	632	695	761	834	910
Factor services (net)	-76	-186	-230	-240	-230	-210	-210
Transfers (net)	70	43	45	45	45	45	45
Financial account	-1,710	486	272	-202	-488	-475	-190
Foreign direct investment	91	105	200	200	250	250	250
Portfolio investment	230	-153	-96	-32	-15	-4	-43
Other investment	-2,030	534	168	-370	-724	-721	-397
Errors and omissions	-804	0	0	0	0	0	0
Overall balance	-2,323	705	443	-58	-342	-335	-66
Reserve Assets (- increase)	2,323	-705	-443	58	342	335	66
	(In percent of GDP)						
Current account deficit	1.6	2.1	1.5	1.1	1.0	0.9	0.8
Financial account	-14.1	4.6	2.3	-1.6	-3.5	-3.1	-1.2
Total external debt (excl. nonres. deposits)	84.8	101.1	98.0	88.1	76.5	67.5	60.0
	(In percent of exports of goods and nonfactor services)						
Total external debt (excl. nonres. deposits)	386.7	382.2	376.3	341.6	303.4	269.7	238.4
Total external debt (incl. nonres. deposits)	447.2	438.0	431.3	397.0	360.3	327.9	297.6
Debt service	55.7	51.9	46.3	48.4	62.5	57.7	43.4
Of which: interest payments	25.1	20.3	17.6	16.8	16.0	15.0	13.8

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

Table 17. Uruguay: Vulnerability Indicators

				Projection	
	2000	2001	2002	2003	2004
(Percent change, unless otherwise indicated)					
Financial sector indicators					
Broad money	10.2	19.6	15.8	11.9	...
Credit to the private sector (const. exch. Rate)	0.3	-3.8	-17.6	-5.3	...
Share of nonperforming loans in total loans (in percent)	16.4	17.0	36.3	...	...
Prime interest rates (percent, average) - domestic loans 1/	20.7	24.7	...	...	...
Prime interest rates, real (percent, average) - domestic loans 1/	14.9	20.4	...	...	...
External Indicators					
Merchandise exports (in U.S. dollars)	4.1	-10.1	-9.8	10.1	9.0
Merchandise imports (in U.S. dollars)	3.9	-12.0	-35.8	-1.3	10.1
Overall terms of trade	-6.6	-0.7	4.8	0.0	-2.3
REER appreciation (+)	-0.7	-5.3	-13.2	...	...
(Percent of GDP, unless otherwise indicated)					
Current account balance	-2.8	-2.9	1.6	2.1	1.5
Capital and financial account balance	3.8	4.3	-14.1	4.6	2.3
Of which: Net foreign direct investment	1.4	1.7	0.7	1.0	1.7
Portfolio investment (securities etc.)	1.5	3.0	1.9	-1.4	-0.8
Other net inflows (deposits, loans, trade credits, etc.)	1.0	-0.4	-16.7	5.0	1.4
Total external debt including nonresident deposits	72.7	85.4	98.1	115.9	112.3
Of which: Public sector excl. nonresident deposits	30.3	31.2	67.0	85.4	81.1
Foreign currency deposits (nonresidents)	28.4	37.6	13.3	14.8	14.3
In percent of exports GNFS	399.1	487.4	447.2	438.0	431.3
Total external debt excluding nonresident deposits	44.3	47.8	84.8	101.1	98.0
In percent of exports GNFS	243.0	272.8	386.7	382.2	376.3
External interest payments to exports GNFS (in percent)	21.7	24.6	25.1	20.3	17.6
External amortization payments to exports GNFS (in percent)	14.4	18.8	30.6	31.6	28.8
(US$ million, unless otherwise indicated)					
Central Bank reserve liabilities	150	144	970	1,651	...
Short term foreign assets of the financial sector	7,367	7,695	5,152	6,838	...
Short term foreign liabilities of the financial sector	6,504	7,547	4,151	4,753	...
Gross official reserves	2,779	3,099	776	1,481	1,924
In months of imports GNFS	8.0	10.0	3.8	7.3	8.7
In percent of total debt service	210.2	217.8	52.4	102.1	137.5
In percent of broad money	27.8	28.6	10.0	25.3	...
In percent of base money	365.9	483.0	203.8	338.7	...
In percent of short-term external debt incl. deposits 2/	33.6	31.8	19.7	38.4	48.3
In percent of short-term external debt excl. deposits 2/	108.9	114.7	33.3	64.5	82.7
Financial Market Indicators					
Foreign currency debt rating (Moody's) 3/	Baa3	Baa3	B3	B3	...
Foreign currency debt rating (S&P) 3/	BBB-	BBB-	B-	B-	...
Spread of benchmark bonds (basis points, end of period) 3/	326.0	251.0	1,609.0	750.0	...
Exchange rate (per U.S. dollar, period average)	12.1	13.3	21.6	...	...

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

1/ Due to the liquidation of several banks in the survey sample, this data series is no longer available.

2/ By remaining maturity.

3/ For 2003, as of mid-June.

4/ For 2000, the data reported are the spread of the 2009 bond; for 2001-02, the 2012 bond; and for 2003, the 2033 bond.

Data for 2003 are as of end-June.

Table 18. Uruguay: Basic Data

I. Social and Demographic Indicators

Area (sq. km)	176,320
Arable land (percent of land area)	7.2
Population (2002, estimate)	
Total (million)	3.36
Rate of growth, in percent	0.7
Density (per sq. km.)	19.1
GDP per capita (US$), (2002)	3,612
Population characteristics (2001)	
Life expectancy at birth (years)	74.0
Crude birth rate (per thousand)	16.0
Crude death rate (per thousand)	10.0
Infant mortality (per thousand live births)	14.0
Poverty and income distribution (2002)	
Population below poverty line (percent)	23.7
Highest 10 percent of households	33.8
Lowest 40 percent of households	23.3
Gini coefficient	32.2
Distribution of labor force, in percent (2002)	
Agriculture	13.0
Industry and mining	27.0
Services	60.0

Nutrition (2000)		
Undernourishment in percent of population		3
Health (2000)		
Physicians per 1000		3.7
Hospital beds per 1000		4.4
Electricity Consumption (2000)		
Yearly per person (KwH)		1,924
Access to safe water (2000)		
Percent of population		
Urban		98
Rural		93
Education (in percent)		
Adult literacy rate (2001)		97
Gross enrollment rates (2000)		
Primary education		109
Secondary education		98
Tertiary education		36
GDP (2002)	Ur$ billion	262
	US$ million	12,136

II. Economic Indicators, 1999–2003

	1999	2000	2001	2002	Program 2003
	(percentage change, unless otherwise indicated)				
National accounts and prices					
Real GDP	-2.8	-1.4	-3.4	-10.8	-1.0
Real GDP per capita	-3.6	-2.2	-4.1	-11.5	-1.7
GDP deflator	4.2	4.0	6.1	17.8	22.7
Consumer prices, average	5.7	4.8	4.4	14.0	22.5
Unemployment rate (in percent, end-year)	11.4	14.4	14.9	18.6	...
	(in percent of GDP)				
Gross domestic investment	15.1	14.0	13.7	12.2	11.7
Gross national savings	12.6	11.1	10.8	13.8	13.7
Current account balance	2.5	2.8	2.8	-1.6	-2.0
Public finances					
Public sector revenues	32.2	31.2	32.4	31.0	31.1
Public sector expenditures	36.3	35.3	36.5	35.6	34.8
Primary balance	-2.0	-1.5	-1.2	0.0	3.0
Overall balance	-4.1	-4.1	-4.1	-4.6	-3.6
	(12-month percentage changes)				
Money, credit and external prices					
Currency	6.9	10.2	19.6	15.8	11.9
Credit to the private sector (constant exch. rate)	8.4	6.7	1.8	-9.6	18.3
Terms of trade (merchandise)	-4.7	-6.6	-0.7	4.8	0.0
Real effective exchange rate	10.2	-0.7	-5.3	-13.2	...
Dollarization of loans (in percent)	66.0	69.9	75.1	83.4	84.2
International reserves and debt					
Gross official reserves, in US dollar millions	2,602	2,779	3,099	776	1,481
in months of imports	7.8	8.0	10.0	3.8	7.3
Public debt, in percent of GDP	40.8	45.5	53.8	93.7	108.7
Debt service ratio, in percent of GDP	7.0	7.4	8.3	11.3	13.2

IMF data (as of June 30, 2003)

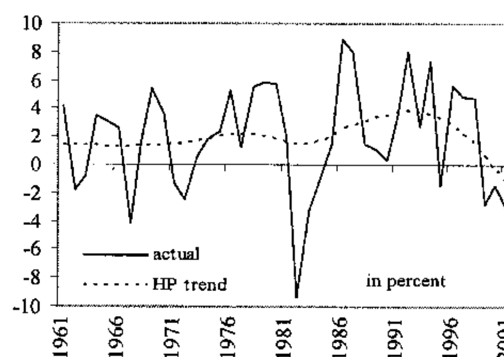
Membership status:	Article VIII
Intervention currency and rate	U.S. dollar at Ur$26.65 per U.S. dollar
Quota	SDR 306.5 million
Outstanding Fund credit	SDR 1,523 million
in percent of quota	497 percent

Sources: BCU, Ministry of Finance; and Fund staff estimates.

URUGUAY—SOURCES OF GROWTH[1]

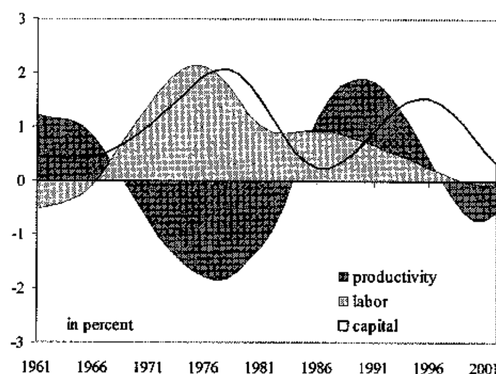
1. **Over the past 40 years, economic growth in Uruguay has been relatively low, averaging 1.7 percent a year over 1960–2001.** In per-capita terms growth averaged only 1 percent a year. Annual growth rates fluctuated widely, and expansions rarely lasted more than two consecutive years. Indeed, the most significant events in Uruguay's growth record are two long and deep recessions, the first in 1982–83, and the second from 1999 to the present. Compared with other countries in the region, in 1970–2001, Uruguay's real per capita income grew by 55 percent less than in Brazil and 45 percent less than in Chile, although it still outperformed Argentina.

Chart 1: Real GDP Growth 1960-2001 (in percent)



2. **The long-run stagnation in per-capita output was largely due to a lack of productivity growth and little factor accumulation.** During 1960–2001, capital and labor grew at average annual rates of just 2 percent and 1.6 percent respectively. Total factor productivity (TFP) did not improve at all during this period. The contribution of these factor inputs to growth varied considerably. The accumulation of labor and capital contributed significantly to growth during the 1970s. However, during the same period TFP growth was negative.[2] On the other hand, during the 1990s growth was driven to a significant extent by TFP and, in the latter part, by capital accumulation.

Chart 2: Input Factor Contribution to Real GDP Growth 1960-2001

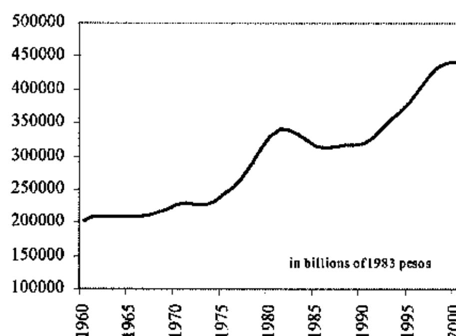


[1] Prepared by Benedikt Braumann (WHD)

[2] During the spurt of activity in 1976–81, GDP growth resulted mainly from higher capital and labor inputs. Investment in particular responded to a financial bubble, but bore little relation to long-term business projects. A construction boom, largely in the Punta del Este resort area, actually *reduced* total factor productivity in the economy. Thus, from an efficiency point of view, this growth pattern was not sustainable.

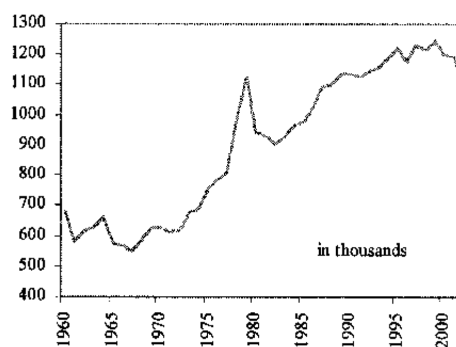
3. **Episodes of strong capital accumulation were generally short and followed periods of economic reform and low inflation.** A first spurt in investment took place in the late 1970s after the country opened its capital account and implemented a program of exchange-rate based stabilization (the *tablita*). However, the crisis of the mid-1980s abruptly ended this boom. Investment remained subdued during the rest of the decade. Capital accumulation only recovered in the 1990s, after the country integrated into Mercosur and brought inflation under control. This time, investment was directed toward machinery, improving efficiency in manufacturing, and stimulating the reallocation of resources towards the service sector.

Chart 3: Capital Stock 1960-2001



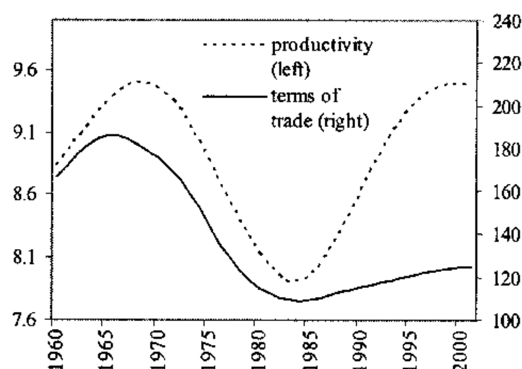
4. **The contribution of labor to GDP growth has generally been small and declining.** Population growth has traditionally been low in Uruguay compared to other countries in the region, averaging 0.7 percent over the last 40 years. However, the labor force grew at about twice this pace due to increasing participation rates, especially among women. The rise of the share of women into the workforce probably also contributed to an improvement in the human capital endowment of labor.[3] However, this process may have reached its limits, and future labor force growth should be expected to be more subdued.

Chart 4: Labor Force 1960-2001



5. **TFP stands no higher today than in the 1960s.** Uruguay's high level of TFP during the 1960s and early 1970s, and its subsequent decline was closely linked to the evolution of the terms of trade. However, the gains in productivity during the 1990s appear to reflect true

Chart 5: Productivity and Terms of Trade



[3] Due to data limitations, the impact of human capital endowment is not being captured separately in the growth accounting framework on which the analysis in this Appendix is based (see Box 1).

improvements in efficiency, since the terms of trade were rather weak during this period.[4]

6. **Growth prospects for Uruguay appear to hinge on a new productivity boost.** The current recession is causing a decline in both the capital stock and TFP. While the latter is partly driven by cyclical slack, investment may remain depressed for some time, particularly since the financial sector has severely shrunk. In these circumstances, TFP growth must be revived through structural reforms, aimed at repeating the growth pattern of the early 1990s, when higher factor productivity led to increased profits, and over time to a recovery of capital accumulation. In contrast, the existing demographic trends suggest that labor cannot be expected to play a large role in a future upturn.

Box 1. Growth Accounting

The analysis in this Appendix is based on a simple *growth accounting* framework, which tracks long-run changes in the production function and helps to identify different sources of growth based on data for employment and the capital stock.

Since Uruguay does not produce official data on the capital stock, it was estimated using the *perpetual inventory method* using long time-series data on real investment. The perpetual inventory method starts with the computation of an initial capital stock. It then accumulates real investment data and assumes a fixed rate of depreciation (here 7.5 percent). The initial capital stock is constructed by using the fact that over the long run (in the steady state), the growth rates of output and capital tend to be equal. Using the real GDP value for 1960, an average investment share of 14.1 percent of GDP (1960-2001) and an average growth rate of 1.7 percent per year, yields an initial capital stock of around 200 billion Pesos in constant prices of 1983.

The estimate of TFP is obtained by subtracting employment and the capital stock from real GDP (the *Slow residual*). The calculation assumes an income share of capital of 0.55, in accordance with the long-run average in national account statistics on the cost components of GDP. This value is significantly higher than in industrialized countries, where the capital share is typically around 0.25. In general, a negative correlation is found between the capital share and per-capita income.

[4] During the late 1980s, Uruguay's economy picked up cyclical slack and filled spare capacities. A more lasting increase in productivity began in the early 1990s, which was likely related to the opening of the economy that took place. Import competition marginalized uncompetitive firms, most notably in manufacturing. Productivity more than doubled in this sector during the 1990s, while it increased by 45 percent in services. This led to a rapid improvement of profits. The net operating surplus, a measure of profits in the national accounts, increased from 43 to 47 percent of GDP between 1986 and 1992. Higher profits accelerated capital accumulation, which took over as the main engine of growth towards the end of the 1990s.

URUGUAY—THE RISE OF THE SERVICE ECONOMY[1]

1. **Uruguay experienced a substantial shift toward a service-based economy in the past two decades.** The share of services in GDP (at factor cost) rose from 54 percent to 70 percent between 1985 and 2001, while the share of manufacturing declined from 27 percent to 15 percent. As a result, the service sector generated over 80 percent of total GDP growth during the last 20 years. The most dynamic subsector was real estate, which increased from 10 percent to 17 percent of GDP, followed by transport and communication and tourism. The restructuring was accompanied by a general increase in unemployment, as capital and specialized skills in manufacturing became obsolete.

Chart 1: Sectoral contribution to real GDP growth (in percentage points)

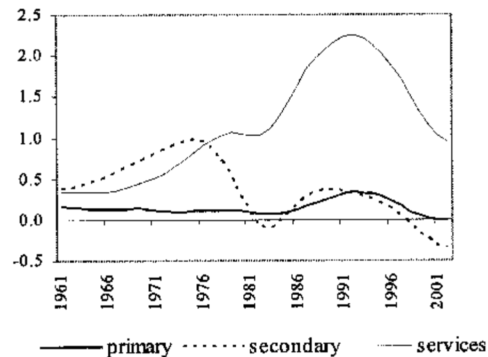
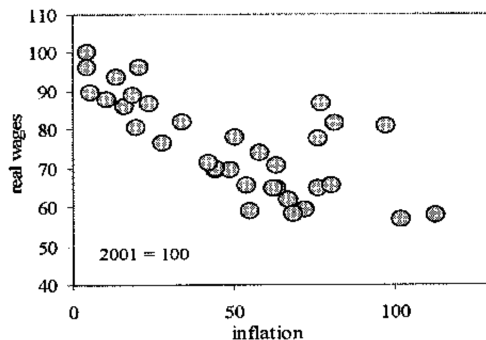


Chart 2: Real Wages and Inflation



2. **High inflation favored production in labor intensive sectors.** High inflation in the 1980s made credit scarce and expensive, but also led to a decline in real wages. With relatively cheaper labor, firms shifted to more labor-intensive production, fostering the expansion of the service sector.

3. **Regional trade integration and a shift in domestic consumption patterns boosted the demand for skill-intensive services.** Trade protection declined significantly in the second half of the 1980s and the early 1990s, and average tariff rates dropped from 17 percent in 1986 to 4½ percent in 2002. With a relatively inexpensive but highly educated labor force, Uruguay enjoyed a comparative advantage in high-skill services. Finance, tourism and transport attracted growing regional demand, especially from Argentina. In addition, the emergence of credit cards and other instruments of consumer credit stimulated domestic demand for services. Overall, these factors led to an increase in the price of services relative to manufacturing by more than 30 percent as measured by sectoral GDP deflators during the 1990s, stimulating the observed structural change on the supply side.

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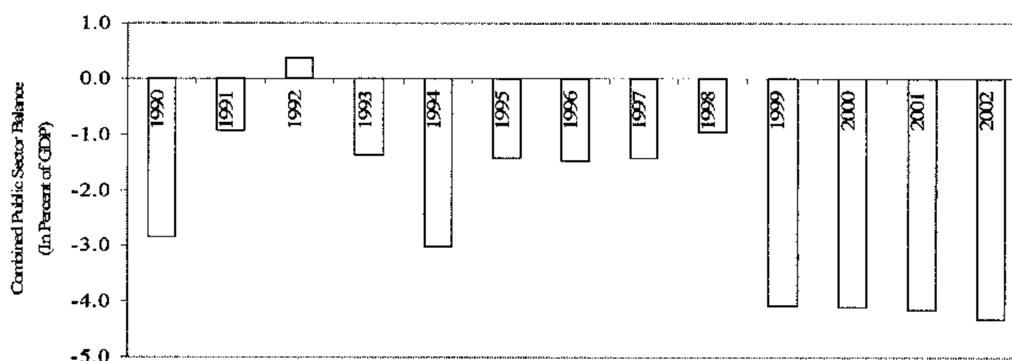
[1] Prepared by Benedikt Braumann (WHD).

Fiscal Policy Stance During the 1990s[1]

A. Introduction

1. **Uruguay's public sector registered small deficits for most of the past decade, but larger ones in recession years. However, the overall public sector balance may not be the best indicator of a country's fiscal policy.** This is due to the presence of *automatic stabilizers*, which move in a countercyclical fashion even without any government action. Thus, estimating an economy's "true" fiscal stance requires decomposing the deficit into a *cyclically adjusted balance*, which moves passively in line with output, and a balance that reflects the policymakers' discretionary actions.

Figure 1. Uruguay: Fiscal Performance



2. **Applying this analysis to Uruguay suggests that fiscal policy was procyclical during the 1990s.** There was some tendency to implement expansionary policies during election periods, regardless of the state of the economic cycle. More important, however, fiscal policy was procyclical as a result of constrained access to market debt financing. Because of the significant risks that such policies pose to long-term sustainability, the staff have advised the authorities to pursue a structural strengthening of budgetary institutions.

B. Methodology

3. **A standard decomposition method calculates the *fiscal stance* and the *fiscal impulse*.** The fiscal stance is a measure of discretionary fiscal policy. This indicator can be extracted from the public sector balance after purging from it the components linked to output trend and cycle. A positive fiscal stance is expansionary, a negative one is contractionary. A measure of the impact of fiscal policy on economic activity is the *fiscal impulse*, which is calculated as the change in the fiscal stance. The fiscal impulse provides a measure of the initial stimulus to aggregate demand arising from fiscal policy.

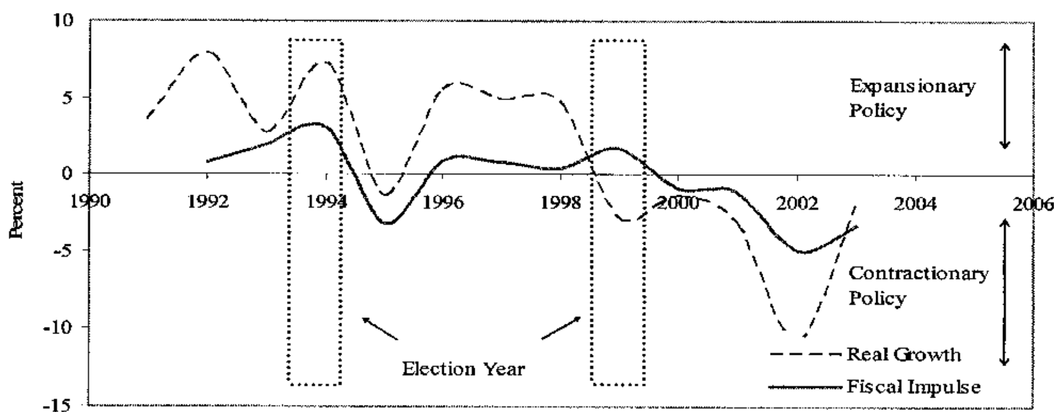
[1] Prepared by Maria González (FAD).

4. **The above methodology was applied to Uruguay to estimate its fiscal stance during the 1990s.** Potential output was calculated by applying the Hodrick-Prescott filter to real GDP in 1960-2008, with 1992 set as the base year for the calculation of the structural expenditure and revenue parameters for the cyclically adjusted balance.[2] In addition, two adjustments were made to account for the impact of structural reforms that took place during the 1990s: (i) the tax increases of 1995 and 1997 (particularly, for the VAT and the wage and pension tax rates); and (ii) the reform of the social security system in1996, to reflect the forgone social security contributions to the private pension funds.

C. Analytical Results

5. **The results suggest that, during the 1990s, fiscal policies were procyclical.**[3] In all years except 1999, the fiscal impulse moved in line with output. The fiscal expansion during the recession year of 1999 may have been related tothe presidential election campaign (fiscal policy had also been largely expansionary in the previous election year, 1994[4]). The procyclicality of fiscal policies exacerbated the recession in 2000-02. In 2002, the fiscal impulse became contractionary, to compensate for the large fall in revenues. Program policies envisage a further negative fiscal impulse in 2003, given the need to achieve medium-term sustainability.

Figure 2. Uruguay: Cyclicality of Fiscal Policy



6. **Evidence suggests that fiscal procyclicality in Uruguay is linked to the country's market access.** Using Uruguay's ranking by Standard & Poor's as a proxy for financing

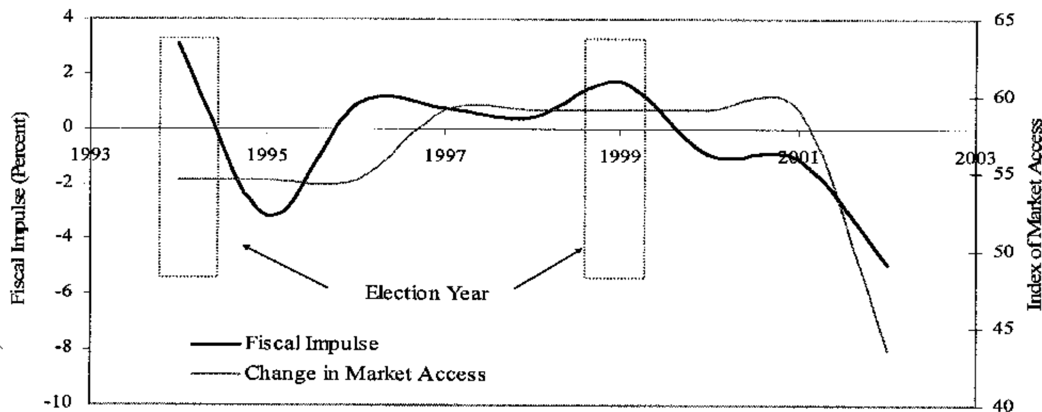
[2] The parameters were estimated as the ratios of the relevant revenue and primary expenditure items to GDP in that year; actual interest payments were used in the computation.

[3] The correlation index between the fiscal impulse and real GDP growth between 1992 and 2008 is 78 percent.

[4] See *Cyclically Adjusted Fiscal Balance in Uruguay,* by K, Honjo, Uruguay—Recent Economic Developments, International Monetary Fund, SM/01/26, February 2001.

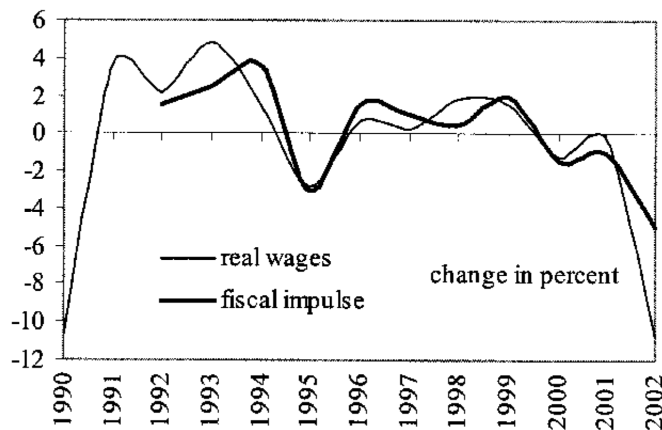
constraints, it was found that this index is correlated with the fiscal impulse. As the chart suggests, Uruguay's fiscal policies tended to be expansionary when it was easy to obtain market financing, but were adjusted drastically when access to markets was closed.

Figure 3. Uruguay: Fiscal Policy and Access to International Markets



7. **An important part of public expenditure is indexed to nominal wages.** Benefits under the old pay-as-you go pension system were indexed to average wage increases in the economy. Together with public salaries, they made up almost 60 percent of public expenditure on average during the last decade. This contributed significantly to the procyclical behavior of the fiscal impulse, as real wages were highly procyclical.

Figure 4. Fiscal Impulse and Real Wages



D. Policy Guidelines for the Medium Term

8. **The procyclical behavior of fiscal policy appears to be closely related to the availability of resources for budget financing.** While governments would ideally pursue countercyclical policies to soften the impact of exogenous shocks on economic activity, they are often unable to do so due to the volatile nature of market financing, which tends to decrease during economic downturns. Under a tight budget constraint, fiscal adjustment can be seen as a signal of continued commitment to sound policies, and a means to recover market access in the future.

9. **While procyclical adjustment may be the best response in the face of liquidity constraints, its pursuit during economic upturns may increase fiscal vulnerability.** Deficits during upturns tend to enlarge public sector indebtedness, and highten exposure to exchange rate risk and other exogenous shocks, while creating structural rigidities (e.g. through tax reductions or spending programs) that become hard to reverse during a downswing. Procyclicality may also contribute to macroeconomic volatility and uncertainty.

10. **Several elements are required to create a resilient fiscal structure with strong budgetary institutions.** These are mostly related to reforms to improve the revenue and expenditure institutions and the targeting of discretionary policy. In particular:

- **Strengthening tax policy and revenue administration**, to reduce revenue volatility. Generally, revenue capacity should not be fully utilized to leave enough room for responding to negative shocks, whether permanent or transitory.

- **Reducing structural expenditure rigidities**, so that budget expansions that are deemed necessary during downturns can be easily reversed as real output reaches the high part of the cycle. This mainly includes measures such as: (i) reducing the wage and pension bills, and (ii) ensuring that a well-targeted social safety net is in place. In particular, pension benefits should be indexed to prices instead of wages, to remove an important part of the procyclical behavior that is structurally built into the Uruguayan fiscal sector.

11. **In the case of Uruguay, near-term program policies follow a procyclical pattern,** reflecting the financing constraint as well as the need to signal the authorities' commitment to a sustainable fiscal stance. However, the program also supports fiscal reforms that focus on the achievement of a budgetary structure that in the longer term can operate in a moderately countercyclical manner.

URUGUAY-FUND RELATIONS
(As of May 30, 2003)

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

E. Financial Relations

II. **General Resources Account**:

	In millions of SDRs	In percent of Quota
Quota	306.50	100.0
Fund holdings of currency	1,829.53	596.9

III. **SDR Department**:

	In millions of SDRs	Percent of Allocation
Net cumulative allocation	49.98	100.0
Holdings	19.68	39.38

IV. **Outstanding Purchases and Loans**:

	In millions of SDRs	In percent of quota
Stand-by arrangements	1,523.03	496.91

V. **Financial Arrangements**:

			SDR Millions	
Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
Stand-by	4/01/02	3/31/04	2,128.30	1,330.20
Of which SRF	6/25/02	8/08/02	128.70	128.70
Stand-by	5/31/00	5/31/02	150.00	150.00
Stand-by	3/29/99	3/28/00	70.00	0.00

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

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	42.83	128.70	226.63	648.44	449.13
Charges/interest	37.57	50.53	43.61	26.24	7.22
Total	80.4	179.23	270.24	674.68	456.34

F. Nonfinancial Relations

VII. **Safeguards Assessment:** Under the Fund's safeguards policy, the Central Bank of Uruguay (BCU) was subject to a safeguards assessment with respect to Uruguay's current Stand-By Arrangement (approved on April 1, 2002). An on-site assessment of the BCU was conducted in July 2002, and the final safeguards assessment report was approved by management on January 16, 2003. The assessment identified a need to strengthen the control and oversight framework within the BCU, in particular in the external audit area. To this end, staff recommended the establishment of an audit committee and the hiring of a private audit firm with international affiliation and a strong expertise in commercial or central bank audits to perform a financial audit of the BCU in accordance with International Standards on Auditing. In addition, it was recommended that similar external audit procedures be established for the FSBS. The authorities are committed to the implementation of all the safeguards recommendations, including the completion of an external audit of the FSBS by September 30, 2003.

VIII. **Exchange Rate Arrangement**: The currency is the Uruguayan peso (Ur$). Uruguay follows an independently floating exchange rate regime. On June 26, 2003, buying and selling interbank rates for the U.S. dollar, the intervention currency, were Ur$26.40 and Ur$26.45 respectively. Uruguay's exchange system is mostly free of restrictions on payments and transfers for current international transactions. The reprogramming through December 2005 of time deposits at BROU and BHU gives rise to an exchange restriction under Article VIII, as it prevents nonresidents affected by the reprogramming from transferring abroad proceeds of recent current international transactions. Staff has recommended approval of the exchange restriction, given that this measure is temporary and does not discriminate among Fund members.

IX. **Article IV Consultation:** The 2001 Article IV consultation was concluded by the Executive Board on February 14 (EBS/01/17). Uruguay is on the standard 12-month cycle. Discussions for the 2002 Article IV consultation were initiated in September 2002, deferred because of delays in concluding the program review, continued in January-February 2003, and completed in May.

X. **FSAP participation, ROSCs, and OFC Assessments:** The ROSC-module on fiscal transparency was published on March 5, 2000. A ROSC-module on data dissemination practices was published on October 18, 2001. The authorities have requested participation in an OFC assessment for early 2002. The FSAP exercise started in November 2001; its completion has been delayed until the situation stabilizes.

XI. **Technical Assistance**: A STA mission on money and banking statistics took place in March 1999. 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. Technical assistance in the areas of tax and customs administration had been provided by the FAD in 1996. In June 2000 and May 2001, FAD

provided technical assistance in the area of quasi-fiscal activities in the public sector. In December 2001, STA provided technical assistance to help Uruguay subscribe to the SDDS. In September 2002, FAD provided technical assistance in the areas of tax policy and revenue administration to prepare a comprehensive tax reform. In April 2003, STA provided technical assistance on adequate recording of the loans funded by the FSBS.

XII. **Resident Representative**: Mr. Andreas Bauer

RELATIONS WITH THE WORLD BANK GROUP

In the past, Bank project lending has been focused on infrastructure and agriculture developments. In addition, in the late 1980s, the Bank began providing support through structural adjustment lending. The first SALs of 1987 and 1989 supported 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 stand-alone debt and debt service reduction operation (DDSR) was also approved in 1991.

In the 1990s, the Bank continued to support infrastructure development oriented towards exports of natural resource-based goods (e.g., forestry). In addition, the Bank supported programs in basic education and institutional development of the health sector. An adjustment loan supported reforms that established the multi-pillar social security system.

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. During 2000, two loans were approved: a Financial Sector Adjustment Loan (FSAL) - that supported actions to strengthen the framework for the functioning of the financial system – and a Water Sector Adaptable Program Loan. In early 2001, a technical assistance loan was approved to help establish a public utility regulatory department. In end-July 2001, the Board approved the Foot and Mouth Disease Emergency Recovery Project, financing livestock vaccinations. In October 2002, the Bank approved a $300 million SAL /SSAL operation. A second SAL /SSAL for $250 million focusing on improving public services was approved on April 8, 2003.

The last Portfolio Performance Review took place in December 2002. At that time, the portfolio comprised eight investment projects for a total of US$382 million in commitments (of which US$182.9 million are undisbursed) in addition to one SAL and SSAL. The investment projects concentrate primarily in the infrastructure sector, with five out of eight projects totaling an amount of US$293.5 million in commitments (or 76.7 percent of the portfolio). In addition, the portfolio of investment projects comprises two operations in the education sector, and one emergency project in the agriculture sector. The portfolio exhibited a marked fall in disbursements in 2002, indicating growing difficulties in project implementation, due to budgetary constraints.

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

	Commitments (Net of Cancellations)	Undisbursed Disbursements	Amount
I. IBRD Operations (as of April 30, 2003)			
Sector			
Agriculture	18.5	12.2	
6.3			
Central Government and Administration	555.6	280.6	275.0
Telecommunication	6.0	0.4	
5.6			
Education	70.0	28.4	
	41.6		
Power	125.0	66.5	
	58.5		
Transportation	135.5	96.5	
	39.0		
Water Supply	27.0	2.7	
	24.3		
Total	**937.6**	**437.3**	
	450.3		

II. IFC Operations (as of May 31, 2003)

	Loans	Equity	Quasi	Participation
Held	31.8	6.0	15.9	1.8
Disbursed	15.1	6.0	15.9	1.8

III. IBRD Loan Transactions (calendar year)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Disbursements	37.0	31.7	38.7	50.4	143.9	66.3	134.2	64.7	233.5	81.6
Repayments	56.2	77.8	69.7	67.9	64.1	63.2	57.9	72.5	75.3	24.9
Net Lending	-19.2	-46.1	-31.0	-17.5	79.8	3.1	76.3	-7.8	158.2	56.8

Sources: World Bank (IBRD data); and IFC (IFC data).

Relations with the Inter-American Development Bank

The most recent IDB Country Strategy for Uruguay focuses on the following priority areas for the Bank's action, by providing support to: (i) initiatives that enhance the regional and international competitiveness of domestic output and encourage private investment, where production is based on the country's comparative advantages and the use of modern technology, in order to foster healthy competition and allow for integration with both the regional and international markets; (ii) the further reform of the State, its modernization and improvements in governance, with a view to diminishing the role of the State in the economy; increase its efficiency; rationalize expenditure and target its interventions; and reduce its role in the production of domestic goods and services; and (iii) improving social welfare and increasing equity, particularly to those families and children living in poverty, allowing them to participate in the development process; reforming education and the health sectors, as well as developing social safety nets for families at risk, particularly in the poorest sectors. Support will also continue to be given to ongoing actions in the fields of citizen safety, housing, sanitation and potable water supply.

In 2002, the IDB approved four loans: (i) in the competitiveness strategic area, a Multisector Global Credit Program for US$180 million, providing medium and long term financing for investment by private enterprises; (ii) in the public sector reform area, a loan for Improvement in Municipal Management (IMM), for US$3 million; and (iii) in the welfare and equity, a loan for Infancy, Adolescents and Families at Risk, for US$40 million. In addition, the special operation for Social Protection and Sustainability was approved in August 2002, for US$500 million, thus supporting the financial package provided by the multilateral organizations. The Lending Program for 2003 anticipates a Financial Sector Loan for US$200 million, in support of reforms in the sector, as well as a Development and Management Program for the Municipalities for US$60 million.

As of June 15, 2003 the Bank's active portfolio in Uruguay includes 20 loans for the financing of investment projects; two sector loans, for Health Reforms and for Modernization of Public Management respectively; and 27 nonreimbursable technical cooperations. The lending portfolio amounts to US$1,282.4 millions, of which US$427.1 million are pending disbursements.

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

I. IDB Active Portfolio[1]
(US$ million)

Strategic Lending Areas	Approved	Disbursed	Undisbursed
Competitiveness and Regional Integration	638	486	152
Reform of the State and Governance	163	113	50
Social Welfare and Equity[2]	481	256	225
Total	**1,282**	**855**	**427**
G. Total outstanding debt (due IDB)			***1,988***

II. IDB Net Flows of Convertible Currency
(US$ million)

	1996	1997	1998	1999	2000	2001	2002	2003[3]
Disbursements	92.2	178.7	150.8	358.5	162.9	214.2	558.6	360.0
Amortization	35.4	45.7	48.3	57.0	59.4	60.7	73.1	87.0
Net Loan Flows	**56.8**	**133.0**	**102.5**	**301.5**	**103.5**	**153.5**	**485.5**	**273.0**

Source: Inter-American Development Bank.

1/ As of June 15, 2003
2/ Excludes Program for Social Protection and Sustainability
3/ Bank estimates for the year, as of June 15, 2003

URUGUAY: 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 a staff visit to Montevideo (April 5–6, 2001) to present the findings of the data module of the Report on Observance of Standards and Codes (ROSC), the Uruguayan authorities reiterated their commitment to subscribe to the SDDS in the near future. An SDDS mission visited Montevideo (December 5–14, 2001) to assist the authorities in finalizing their work toward subscription to the SDDS. A key pending issue for subscription to the SDDS is the dissemination of the template on international reserves and foreign currency liquidity. Recently, however Uruguay submitted the Template on International Reserves and Foreign Currency Liquidity for review to STA.

Real sector

National account statistics have a number of shortcomings, including the use of an outdated benchmark year 1983, limited coverage of the enterprise survey, long publication lags, inadequate information on the informal economy, and incomplete quarterly accounts. The BCU compiles and disseminates annual GDP estimates in current and constant prices by production and expenditure approach, as well as quarterly constant price GDP estimates by production and expenditure approach. Gross national income, gross disposable income and gross savings are also available annually. 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 March 1997 =100, and the wholesale price index has a base of January 1988=100. The coverage of the CPI is limited to the capital city.

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* includes data on the central government; however, annual central government debt data have not been reported for periods after 1994 and data on local governments have not been reported for periods after 1997.

Monetary accounts

Two STA money and banking statistics missions visited Montevideo in July 1998 and March 1999. The missions reviewed 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 1999 multisector mission continued work on improving the basic source data and the methodology for compiling monetary statistics, and recommended a new reporting system, which has since been adopted by the Central Bank. The mission developed a database that contains the data needs for publication in *IFS* and for operational use by WHD.

The STA mission that visited Montevideo in April 2003 provided recommendations for the adequate recording of the loans funded from the Fund for the Stabilization of the Banking System in the Central Bank's balance sheet. The mission's recommendations have been implemented and were reflected in the *IFS* June 2003 issue.

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). 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 balance of payments and the international investment position (IIP). The new surveys would also allow for improved coverage of the private sector in the IIP.

URUGUAY: Core Statistical Indicators

as of May 30, 2003

	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	5/29/03	5/28/03	5/24/03	4/03	1/03	5/29/03	4/03	2/03(X) 3/03 (M)	1/03	1/03	Q1 03	12/02
Date received	5/29/03	5/29/03	5/29/03	5/21/03	5/01/03	5/29/03	5/02/03	4/03	4/03	4/03	5/03	4/03
Frequency of data	Daily	Daily	Daily	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Quarterly
Frequency of reporting	Daily	Daily	Daily	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Quarterly
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	Web	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

INTERNATIONAL MONETARY FUND

URUGUAY

Third Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria

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

Approved by Markus Rodlauer and Liam P. Ebrill

June 27, 2003

- **Stand-By Arrangement**. The current arrangement was approved in March 2002 for a 24-month period in an amount equivalent to SDR 594.1 million (193.8 percent of quota). It was augmented in June and August 2002 to SDR 2,128.3 million (694.4 percent of quota). On March 17, 2003, the Executive Board completed the second review, extended the period of the arrangement to March 2005, rephased the undisbursed amount (SDR 1,016.6 million), and converted the repurchase obligations under the SRF arising in 2003 (SDR 128.7 million) to an obligations basis. A purchase of SDR 145.7 million is to become available upon completion of this review.

- **Discussions**. The review discussions were held in Montevideo during May 22-June 3, concurrently with further discussions for the 2003 Article IV consultation. The mission met with Minister of Economy and Finance Atchugarry, Central Bank President de Brun, other senior officials, and representatives of the private sector. The staff team comprised Mr. Terrier (Head), Ms. Honjo, Messrs. Braumann and Ma (all WHD), Ms. de Bolle (PDR), Ms. González (FAD), Messrs. Thorne and Breuer (ICM), and Messrs. Lee and Cayazzo (MFD). The mission was assisted by Mr. Bauer (Resident Representative), and overlapped with an FAD technical assistance mission on tax policy.

- **Program**. In the accompanying Letter of Intent and Supplement to the Memorandum of Economic and Financial Policies, the authorities describe their economic program for the remainder of 2003.

- **Economic and policy developments**. The debt exchange has eliminated the projected residual financing needs for 2003-05. The near-term outlook has improved somewhat, with a smaller GDP decline and lower inflation projected for 2003. Fiscal policy is on track toward a revised primary surplus objective of 3 percent of GDP in 2003. However, the banking system, especially the public bank BROU, remains fragile. The authorities intend to step up the restructuring of BROU and the disposal of assets of the liquidated banks. Progress in structural reforms will also be accelerated to ensure timely IFI disbursements.

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EXECUTIVE SUMMARY

Background

At end-May, Uruguay successfully completed a comprehensive and voluntary exchange covering most of its market debt. A series of factors explain the high participation rate (93 percent overall) in the exchange, including the risks of default, the authorities' explicit warnings that holdouts might not be fully repaid, and changes in the regulatory framework.

Although financial indicators have continued to improve, the situation remains vulnerable. There are signs that the economy has bottomed out and, following a 10.8 percent decline in 2002, real GDP (seasonally adjusted) registered a small positive growth during the first quarter. The main risks are in the banking system and the continuing challenges to meeting the primary surplus targets required for debt sustainability.

The fiscal program was broadly on track at end-March, and the government has regained some access to the domestic financial markets. However, progress in structural reforms has been slow, particularly with the disposal of the remaining assets of liquidated banks. The success of the debt exchange has bolstered financial market confidence in the government's economic program, but pressure to relax efforts has increased in congress.

Policy discussions and staff appraisal

The macroeconomic framework has been revised, taking into account lower inflation and somewhat more favorable growth prospects. Given the high participation rate in the debt exchange, including for short-dated bonds, the expectations for cash flow relief established at the last review have been met. Firm implementation of the other components of the program is now critical:

- Achievement of the **primary surplus targets** is key to the return to debt sustainability. In 2003, the government is committed to keeping a tight rein on expenditure, particularly wages and discretionary spending.

- The **banking system** needs to be further strengthened, and reestablishing stability and confidence is crucial to restoring credit flows. Specific steps are programmed to advance the resolution process of liquidated banks and strengthen the financial position of the public bank BROU. The authorities will need to proceed cautiously with the repayment of reprogrammed deposits.

- The authorities are committed to pressing ahead with their **structural reform program,** to ensure timely disbursement of programmed World Bank and IDB support.

- Assuming full use of the remaining access under the arrangement, **debt service to the Fund** will be high, particularly in 2006-07, and continued Fund involvement may be necessary beyond the present arrangement.

I. Background and Recent Developments

1. **On May 29, Uruguay successfully completed a comprehensive and voluntary debt exchange.** The exchange covered almost all of Uruguay's market debt in foreign currency (US$5.4 billion). The overall participation rate reached 93 percent, well above the 80-percent threshold established for completion, and was particularly high for domestically-issued bonds (99 percent). The exchange lengthened the maturity of the bonds by about five years while roughly maintaining coupon rates, thus reducing the net present value of participating bonds by about 20 percent on average.[1] These results are consistent with the program projections at the time of the second review (EBS/03/27, Supplement 2). Following completion of the exchange, several credit rating agencies upgraded Uruguay's sovereign rating.

2. **There are signs that the economy has bottomed out.** While real GDP contracted by 10.8 percent in 2002, it recovered slightly (½ percent, quarter-on-quarter, seasonally adjusted) during the first quarter of 2003. Leading indicators point to a stronger increase in activity during the second quarter, driven by an improvement in exports (Tables 1-2). During the remainder of this year, Uruguay is expected to benefit further from improvements in the regional environment and the reopening of the North American markets to beef exports. Unemployment fell from a peak of 19.8 percent in November to 18.9 percent in April.

Uruguay: Selected Macroeconomic Indicators
(12-month percent change, unless otherwise indicated)

	2001	2002					2003	
		Q1	Q2	Q3	Q4	Year	Q1	April 1/
Real GDP	-3.4	-10.8	-5.5	-13.6	-13.1	-10.8	-9.1	...
(q/q, s.a.)		-4.6	2.3	-8.6	-3.4		0.5	...
Unemployment (average; percent)	15.2	14.7	15.3	17.0	19.5	16.7	18.1	18.9
CPI (average)	4.4	4.6	7.1	18.9	25.0	14.0	27.9	26.2
Merchandise exports	-10.1	-24.1	1.9	-8.9	-4.7	-9.8	10.1	17.0
Merchandise imports	-12.0	-34.3	-22.9	-42.8	-43.2	-35.8	-1.3	-17.6
CERES leading indicator (q/q, s.a.)		-8.6	-8.9	-10.9	-2.9		-0.6	1.2

1/ Except for CPI and merchandise imports, which are for May.

[1] Using a discount factor of 16 percent, close to implied yields at the beginning of the exchange period.

3. **Although financial indicators have continued to improve, the situation remains vulnerable.** After registering net outflows at the beginning of this year, pr ivate sector deposits have increased by about US$400 million since end-February, nearly returning to their end-July 2002 level, when a bank holiday was declared. In the immediate future, the main risk is that of a loss of confidence which could reignite a bank run and, in turn, quickly deplete reserves and threaten the economic recovery. Reflecting the reflow of deposits as well as sizeable IFI disbursements,[2] gross official reserves have more than doubled since mid-March, to US$1 billion in late June (5 months of imports of goods and services). Even so, non-borrowed reserves (which exclude bank and pension fund deposits at the central bank) are still close to zero.[3] The end-March NIR and NDA performance criteria were observed (Table 3).

Uruguay: Changes in Dollar Deposits
(in US$ million)

	2002			2003	
	Jan-Jul	Aug-Dec	Year	Jan-Feb	Mar-June
Total	-5,846	-303	-6,149	-151	408
Public banks	-1,317	-102	-1,418	-42	96
Private local banks	-1,501	-350	-1,851	-13	22
Foreign banks	-3,029	149	-2,880	-96	290
Subsidiaries	-1,573	-90	-1,664	-10	71
Branches	-1,455	239	-1,216	-86	219

4. **In nominal terms, the peso has recently appreciated against the U.S. dollar, broadly returning to its level at the end of last year.** During January-May, the peso had depreciated by close to 18 percent in real effective terms, reflecting mostly the appreciation of the Argentine peso and the Brazilian real. While base money growth has been in line with program projections, inflation has come down faster than programmed, averaging 1.2 percent a month during January-May (2.1 percent in the program). The demand for money has been higher than anticipated and, with NIR on track, the central bank has recently curtailed its purchases of foreign exchange, putting upward pressure on the peso.

5. **Fiscal developments have remained broadly on track with the program.** Central government tax collections were somewhat stronger than programmed during the first quarter of 2003, mostly due to buoyant VAT revenue and wage and pension tax collections, but the current surplus of public enterprises was lower than anticipated (Tables 4-5).[4] While wage

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[2] Disbursements included US$303 million from the Fund in March; US$77 million from the World Bank in April; and US$160 million from the IDB in May.

[3] Reserves do not include the liquid resources of the Fund for the Stability of the Bank System (FSBS), which amounted to US$370 million in mid-June.

[4] A US$40 million forward sale in March 2003 by the state oil company ANCAP, previously booked as revenue, needed to be classified as a financing item. Similar operations from 2002, amounting to US$39 million, are being unwound during May-December 2003, thus broadly offsetting the fiscal impact of the March transaction.

and pension outlays were kept under control, spending on goods and services exceeded program projections. The end-March performance criterion on the primary surplus of the combined public sector was not observed by a small amount.

6. **The government has regained some access to the domestic financial market, with net placements of short-term paper of US$340 million through mid-June.** One-fourth of these placements have been in U.S. dollar bills, carrying interest rates of about 5 percent. However, most of the remainder was in peso Treasury bills, of relatively short duration (three months on average) and at high, albeit declining, interest rates (about 40 percent in early June, down from 50 percent in February). To reduce the interest burden, the authorities are seeking to improve debt management, including by issuing longer-term instruments in indexed units, which carry lower interest rates.

7. **Progress in the reform of the banking system has been slow.** The new bank (NBC—*Nuevo Banco Comercial*) created in March with the assets of three liquidated banks has been able to attract moderate amounts of new deposits (US$60 million). However, the end-March structural benchmark on the completion of a strategic plan for the disposal of the remaining assets of the liquidated banks was missed. Regarding the fourth liquidated bank (*Banco de Crédito*), the government reached agreement in early June with the former minority shareholder, under which the latter will cancel loans extended by the bank, mostly with government bonds. Restructuring of the state mortgage institution BHU has been delayed; about one third of its workforce is to be laid off but, to minimize social tensions, most of them will be rehired by BROU, the central bank, and the government.

8. **Financial market confidence in the economic program has firmed up, but political pressure to relax efforts has mounted**. Pressures have arisen in congress to provide relief on bank loans in foreign currency, suspend foreclosures, and roll back recent increases in the tariffs charged by public utilities. As the October 2004 presidential election approaches, political opposition is likely to mount, making it harder for the government to maintain congressional support for its economic program.

II. Policy Discussions

9. **The authorities were very pleased with the results of the debt exchange.** They noted that participation exceeded the targets they had set when launching the exchange. Principal on medium and long-term debt due for the remainder of 2003 has been reduced from US$469 million to US$23 million, and for the period 2003-07, from US$2.1 billion to US$300 million. As a result, the authorities were confident that the overall deficit of the combined public sector could be financed by disbursements from international financial institutions and moderate access to the domestic financial market for the remainder of the period covered by the SBA (2003-05). The authorities attributed the success of the exchange to a variety of factors, including the risk of default, the authorities' explicit warnings about holdouts, and changes in the regulatory framework (Box 1 and Appendix II).

Box 1. Uruguay: Key Factors in the Success of the Debt Exchange

Several factors help explain the high participation rate of 93 percent:

- ***Default risk***. There was widespread appreciation by investors that Uruguay's existing debt service needs were not manageable. The authorities explicitly warned that, if unable to meet all debt service obligations, they would service the new debt in preference to the old. The relatively modest NPV reduction probably facilitated investor's agreement.

- ***Credibility***. Uruguay's debt problem was seen as largely caused by an external shock, and the authorities retained credibility with investors over their economic policies. On the domestic leg of the exchange, participation among retail holders may have been encouraged by patriotic considerations.

- ***Legal features***. Holders exchanging the external bonds were asked to approve exit consents which would reduce the ability of holders of the old bonds to enforce debt service payments. The new bonds contained cross-default clauses triggered by failure to service any of the new bonds, but not by default on the old bonds.

- ***Liquidity***. Investors were attracted by the greater liquidity of the new benchmark domestic and external bonds (over US$2 billion of the new bonds qualify for the EMBI indices, or four times more than before the exchange).

- ***Regulatory incentives***. Participation by domestic banks was encouraged by the announcement that the old bonds would no longer be traded and would, therefore, be subject to a 100 percent risk weighting in the computation of bank's capital adequacy ratios. The central bank also announced that it would not accept old bonds as collateral for liquidity assistance. The announced delisting of the old bonds also spurred pension funds to participate, as they are not allowed to hold unlisted securities.

- ***Support of domestic financial intermediaries***. The apparent conviction that the success of the exchange was crucial for the health of the Uruguayan financial system, bolstered by the incentive-compatible fee structure, fostered participation of domestic financial institutions and stimulated their efforts to reach out to the (typically inert) retail sector.

- ***Fund conditionality and support***. The perception that the exchange was necessary was bolstered by the fact that completion of the third review was conditional on achievement of the cash flow and debt sustainability objectives contemplated for the exchange. The Fund also provided support in the form of the Managing Director's letter to the financial community.

- ***Rally in bond markets***. Emerging market securities rallied during the offer period, with the EMBI+ index of spreads falling by around 100 basis points between early April and mid-May. This buoyed expectations of the exchange's success, and raised the mark-to-market losses that holdouts would face if the old debt were not paid.

10. **The authorities concurred that, after the success of the debt exchange, firm implementation of the other components of the program was critical.** In particular, they shared the staff's view that achieving the primary surplus targets of the program was key to ensuring the return to debt sustainability. Achieving these targets will require an enhanced revenue effort and continued expenditure restraint. The authorities are fully aware that further strengthening of the banking system is crucial, and they have agreed to accelerate the asset disposal of liquidated banks and take steps to strengthen the public bank BROU. In line with

developments so far this year, the macroeconomic outlook for 2003 has been revised, to take into account lower inflation (year-end inflation is projected at 20 percent instead of 26 percent) and somewhat better growth prospects (a decline in real GDP of one percent instead of two percent).

A. Fiscal and Monetary Policies

11. **The authorities are firmly committed to achieving a primary surplus of 3 percent of GDP in 2003.** The primary surplus objective has been reduced by 0.2 percent of GDP to accommodate the impact on primary spending of the one-off commissions and fees related to the debt exchange, which had not been included in the original program. To meet the primary surplus target against the backdrop of lower inflation (and thus lower projected tax revenue), expenditure targets have been revised downward, while the operating surplus of public enterprises has been raised, taking into account performance so far this year. During the second half of 2003, the authorities plan to set electricity and telephone tariffs broadly in line with program targets, and to increase the prices charged by the state oil company ANCAP if world oil prices move above their early-June level. The authorities are committed to adopting additional measures if tax collections in the second half of this year turned out to be weaker than contemplated because of a further slowdown of inflation.

12. **The government is committed to keeping a tight rein on expenditure.** Social security and pension outlays (which are adjusted with the economy-wide wage index) have been revised downward, owing to lower-than-anticipated increases in the wage index (so far this year, wages have risen by only 2.6 percent, and revised projections are based on wage increases of about 10 percent in 2003, instead of 18 percent in the original program). Other current expenditures, which have been running somewhat above program, will be reined in through reductions in cash allocations for discretionary outlays (Paragraph 6 of the MEFP) to better align them with program targets.

13. **The authorities are committed to advancing with tax reform, but cautioned that the lack of consensus in congress may delay its approval.** With technical assistance from the Fund, a revision to the draft tax reform package pending in congress will be submitted by end-June (a structural performance criterion). Reforms are aimed at enhancing revenue through a rationalization and simplification of the tax system, including a broadening of the VAT base; eliminating low-yielding taxes and incorporating them into the main excise tax; and broadening the coverage of the corporate income tax. The staff advised the authorities against reducing VAT rates as envisaged, as this would lead to a revenue loss over the medium term of about 1½ percent of GDP. Technical assistance from the Fund to help strengthen tax administration will also be provided in coming weeks.

14. **The authorities reaffirmed their commitment to a floating exchange rate regime, with base money as the intermediate target.** As noted, inflation to date has been lower than programmed, reflecting higher real money demand. Despite lower inflation prospects, the

increase in base money envisaged in the original monetary program for 2003 (25 percent) has been retained to accommodate this ongoing remonetization of the economy (Table 6). To improve the implementation of monetary policy, the central bank will continue to strengthen open market operations, including through fostering a deeper and more liquid market for peso-denominated and inflation-indexed instruments. The current monetary policy framework is designed to help build a track record that would facilitate a future move to inflation targeting.

B. Bank Restructuring

15. **As explained in detail in the companion paper on the 2002 banking crisis, the banking system needs to be further strengthened.** Reestablishing stability and confidence will be key to restoring credit flows, and the discussions thus focused on measures to strengthen the financial position of the public bank BROU, advance the resolution process of the four liquidated banks, and restructure the state mortgage company BHU.

16. **The authorities shared the staff's concerns about the financial position of BROU.** With about half of total bank assets, BROU has a dominant position in Uruguay's banking system and, hence, its restructuring has to be the immediate priority to restore the banking system's functioning and to limit contingent fiscal costs. The authorities are preparing a comprehensive restructuring plan for BROU, which is to be completed by end-August (a structural benchmark), aimed at improving corporate governance, reducing and rationalizing operating costs, and strengthening risk management.

17. **The staff advised the authorities to proceed cautiously with the repayment of reprogrammed deposits.** Under the initial plan adopted in August 2002, reprogrammed deposits are to be repaid in three tranches, with the first tranche (US$560 million, or 25 percent of the total) to be repaid over the 12-month period beginning in August 2003. While BROU currently has enough liquidity to cover this first tranche, its position could become extremely tight if a large proportion of deposits were to shift to other banks or leave the banking system. The authorities were considering advancing the release of the entire first tranche to June, and the staff advised them to proceed cautiously, pointing out the potential negative impact of an early release on both BROU's liquidity and the central bank's gross reserves.

18. **The authorities agreed that the disposal of the assets of the liquidated banks needed to be accelerated.** While the liquidation of the four banks took place several months ago, delays have been registered in the disposal of their assets, leading to a deterioration of value. The authorities intend to finalize an action plan for the disposal of the remaining assets of three liquidated banks as a prior action for this review. To expedite the process, they also plan to outsource the disposal of assets in at least two asset groups by end-July (a structural performance criterion). Regarding *Banco de Crédito*, the authorities have agreed that use of new public funds to subsidize depositors would be limited to US$40 million in government bonds (face value).

19. **Restoring a functioning and viable banking system will require action in several other areas.** To help ensure confidence in the banking system, the authorities agreed with the staff on the need to continue using the FSBS as originally intended.[5] The authorities also agreed that it will be necessary to maintain the 100-percent reserve requirement on new sight and savings deposits in the two banks owned by the government until confidence has fully returned. The mission urged the authorities to proceed with the long-delayed restructuring of BHU, as agreed with the World Bank under the SAL I operation.

III. Financing Assurances and Medium-Term Outlook

20. **Structural reforms will need to be accelerated to avoid jeopardizing the flow of programmed disbursements from the World Bank and the IDB.** Assuming that World Bank and the IDB disbursements (US$360 million) materialize on time, residual financing needs would be fully covered during the second half of 2003 without net recourse to domestic financing. The staff urged the authorities to coordinate closely with multilaterals and ensure that the structural reforms supported by these loans are implemented in a timely manner. If, however, moderate shortfalls were to materialize, they could be accommodated through Treasury bill issues in the domestic financial market. Market financing needs projected for 2004-05 are relatively modest, at US$430 million a year on average, and can be met through domestic placements of Treasury bills and bonds.

21. **The medium-term scenario envisages a return to moderate growth, with a reduced debt burden and enhanced financial stability.** The economy is projected to gradually recover from the current large output gap and to grow by about 4 percent a year during 2004-05 (Table 7). Over the medium term, output would grow at a rate of 2½-3 percent, closer to

[5] The authorities are committed to implementing the recommendations that followed from the 2002 Safeguards Assessment of the central bank. In particular, an external audit of the FSBS will be conducted by end-September (a structural benchmark).

Uruguay's estimated long-term potential. As discussed in the companion Article IV staff report, this outlook is predicated on the maintenance of sound economic policies and the firm implementation of structural reforms. The external current account would be in surplus over the medium term, but this surplus would gradually narrow as the economy recovers. Gross reserves are targeted to rise significantly over the next few years, to provide some cushion against shocks and for improved coverage for future debt service payments.

22. **The projections assume continued large primary surpluses and, under this scenario, Uruguay's medium-term market financing needs appear manageable.** As noted, the authorities plan to raise the primary surplus to close to 4 percent of GDP by 2007, and to keep it at that level over the medium term (Appendix III). This will require sustained expenditure restraint and a further strengthening of the revenue effort. Over the medium term, World Bank and IDB disbursements would be sufficient to maintain net exposure levels. Given the large repayments to the Fund from 2006 onward, the scenario assumes that—contingent on the normal applicable requirements for Fund support, including a satisfactory policy stance—Fund financial support to Uruguay would continue for some time after the end of the current arrangement, albeit on a gradually declining scale. The debt–to-GDP ratio would fall from 105 percent in 2003 to less than 60 percent by 2012.

23. **The medium-term projections are highly sensitive to changes in the macroeconomic framework.** If growth rates turned out to be lower than envisaged by one percentage point, the debt-to-GDP ratio would increase by 7 percentage points of GDP by 2012 relative to the baseline scenario. Alternatively, if primary surpluses over the medium term were to be only 3 percent of GDP, the debt-to-GDP ratio would be higher by 9 percentage points by 2012. Finally, if the real exchange rate vis-à-vis the U.S. dollar were to recover to 65 percent of its 2001 value over the medium term instead of 75 percent as assumed in the baseline scenario, the debt-to-GDP ratio would be close to 80 percent by 2012, instead of 57 percent. An adverse scenario, in which all three shocks would be combined, would bring the debt-to-GDP ratio to 95 percent by 2012.

IV. Program Modalities and Risks

A. Program Monitoring

24. **Quantitative performance criteria and reviews.** In the attached Letter of Intent (Appendix I), the authorities request a modification of the end-June floor on the primary surplus of the combined public sector and the end-June ceiling on the stock of nonfinancial public sector debt. These changes reflect: (i) the payment of commissions on the debt exchange operation (US$24 million); and (ii) treatment below the line of the US$40 million forward sale of petroleum derivatives by the public oil company ANCAP in March 2003. These adjustments do not affect the fiscal adjustment effort, because the commissions are a one-time payment that had not been factored in the original program, and the revenue shortfall from the oil sale registered in the first half of this year will be recovered in the

second half. Indicative targets for end-September and end-December have been converted to performance criteria for NIR, NDA, the primary balance of the combined public sector, and the debt stock of the nonfinancial public sector. A performance criterion on non-interest expenditure of the general government has also been established, to keep expenditure constrained even if revenue were to turn out to be more buoyant than currently envisaged. Finally, indicative targets through end-2003 for the overall balance of the combined public sector and the monetary base have been established. Quarterly reviews will continue during the remainder of the program (Table 8).

25. **Prior action and structural performance criterion**. The end-March structural benchmark on the completion of an action plan for the disposal of the low-quality assets of the four suspended banks was not observed and, as noted, was converted to a prior action for the third review. An end-July structural performance criterion has been established for the outsourcing to third parties of the disposal of at least two asset groups of the liquidated banks.

B. Capacity to Repay the Fund

26. **Full use of the remaining access under the arrangement would contribute to a high debt service profile to the Fund, particularly in 2006-07.** Debt service obligations to the Fund would peak at 7.4 percent of GDP in 2006, equivalent to about 30 percent of exports of goods and services, or close to half of Uruguay's external debt service (Table 9). These numbers indicate considerable risks to the Fund and imply that continued Fund involvement may be necessary beyond the present arrangement, while providing for a reduction in the Fund's exposure in order to safeguard resources. To balance these risks, the program includes measures to strengthen financial policies and ensure timely approval of the structural reforms needed to enhance growth prospects over the medium term. The program also provides for close monitoring of Uruguay's performance to ensure prompt corrective action in case of shocks or policy slippages.

C. Program Risks

27. **Following the successful completion of the debt exchange, vulnerability has decreased but risks to the program remain significant.** In particular, while confidence in the banking system has gradually returned, it could be easily lost again in the event of unfavorable external shocks or domestic developments (such as policy slippages that would cast doubt on the program's sustainability). Gross international reserves have increased, but the ability of the central bank to provide assistance to banks remains limited, and any loss in confidence could jeopardize the ability of the government to roll over its short-term borrowings. Similarly, challenges to fiscal sustainability persist, including in the form of contingent fiscal liabilities associated with the possible need to recapitalize BROU. Accordingly, BROU's restructuring will be a major focus of the next review. Finally, spending pressures could arise, especially as the 2004 elections approach, while adoption of the tax reform could be held up in congress.

D. Data Issues

28. **The authorities intend to subscribe to the SDDS by end-September (a structural benchmark), with technical assistance from STA.** In addition, they have begun publishing monthly bank balance sheet data, albeit partial, with a lag of no more than two months (a continuous structural benchmark). With respect to fiscal data, problems have recently arisen with the central bank's computer system for collecting data on the fiscal deficit below the line, and steps are being taken to address this problem.

V. Staff Appraisal

29. **The Uruguayan authorities' firm pursuit of sound economic policies is beginning to show positive results.** Despite difficult circumstances, the authorities have maintained prudent fiscal and monetary policies and have preserved the integrity of legal contracts. This commitment has significantly contributed to the success of its landmark debt exchange and to the recent improvement in economic and financial indicators.

30. **Nevertheless, major vulnerabilities remain and vigilance together with steadfast implementation of the program are essential.** As the 2004 elections approach, political pressures to relax efforts could increase, including through easing expenditure restraints and slowing structural reforms. The debt exchange has addressed near-term risks associated with financing assurances and helped improve confidence. However, the other components of the program in the fiscal, banking, and structural areas are equally essential in restoring growth and ensuring the return to medium-term debt sustainability.

31. **In 2003, the authorities will need to devote full attention to ensuring compliance with the primary surplus objective of the program.** The staff commends the authorities for their commitment to this ambitious objective and welcomes the inclusion of a performance criterion on non-interest spending in the program. The authorities should be ready to adjust spending further if needed, including in the event that revenue falls short of the program objectives because of a lower-than-anticipated inflation rate. Achievement of the program objective will also depend on timely adjustments of public enterprise tariffs.

32. **Over the medium term, systematic implementation of a strong fiscal policy will be crucial to minimizing potential risks to debt sustainability**. A sustained improvement in the fiscal accounts will require both expenditure restraint and a strengthened tax effort. These, in turn, call for structural expenditure reform and improvements in tax policy and administration. The staff encourages the authorities to promote a broad debate in congress and civil society with a view to fostering adoption of a revenue-enhancing reform of the tax system and streamlining of the public sector.

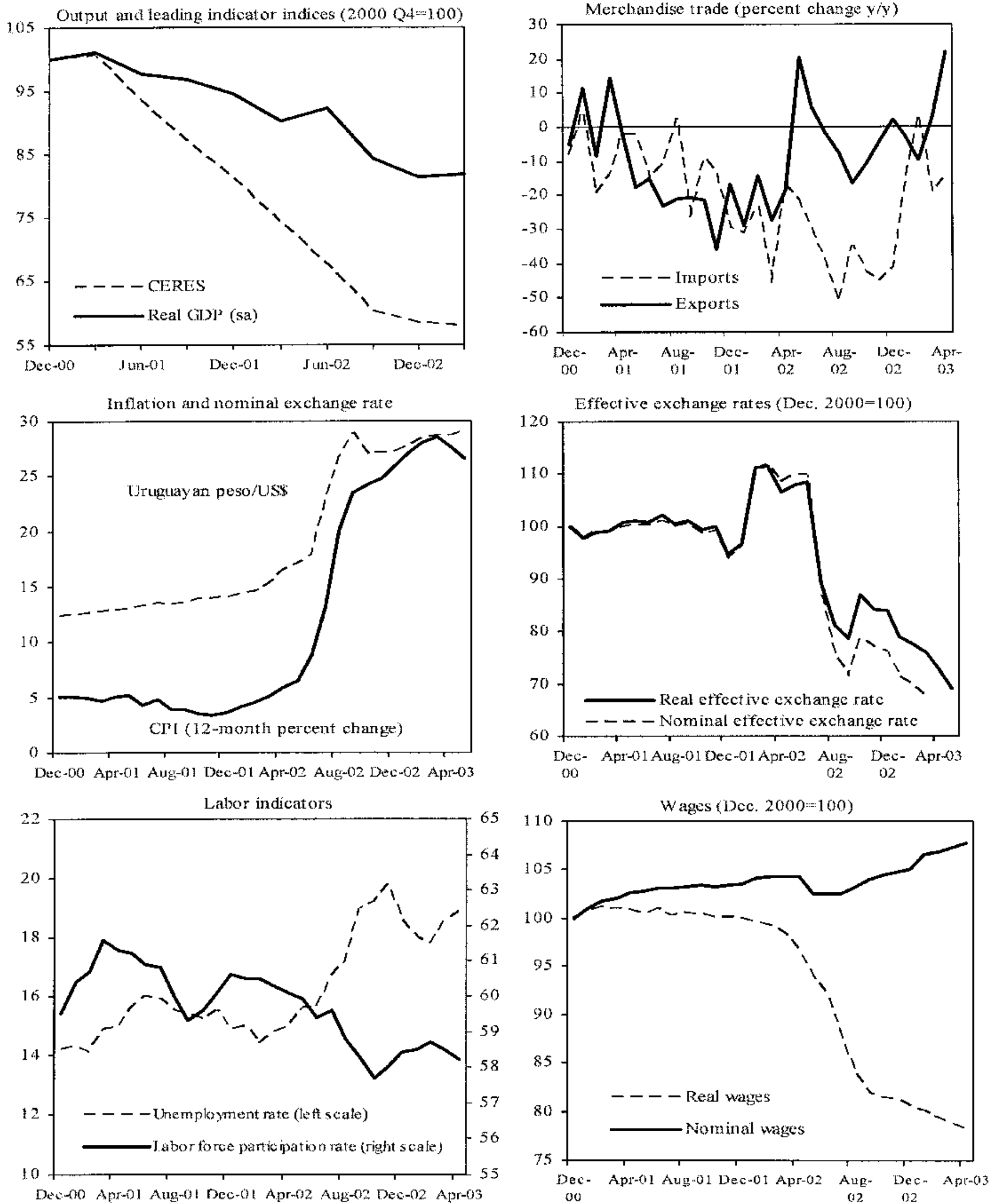
33. **To fully restore financial stability, it is critical to step up the restructuring of public banks and finalize the resolution of liquidated banks.** Close monitoring of the

financial situation of the public bank BROU is warranted, especially with the gradual freeing of reprogrammed deposits. BROU's restructuring needs to be stepped up, to foster the resumption of credit flows and avert contingent fiscal costs. Until the health of the banking system is assured, the 100-percent reserve requirement on new sight and savings deposits at the two government-owned banks should be maintained.

34. **Close monitoring of the program remains essential.** Quarterly reviews will continue under the program, and the staff urges the authorities to closely monitor developments and take prompt corrective action when needed.

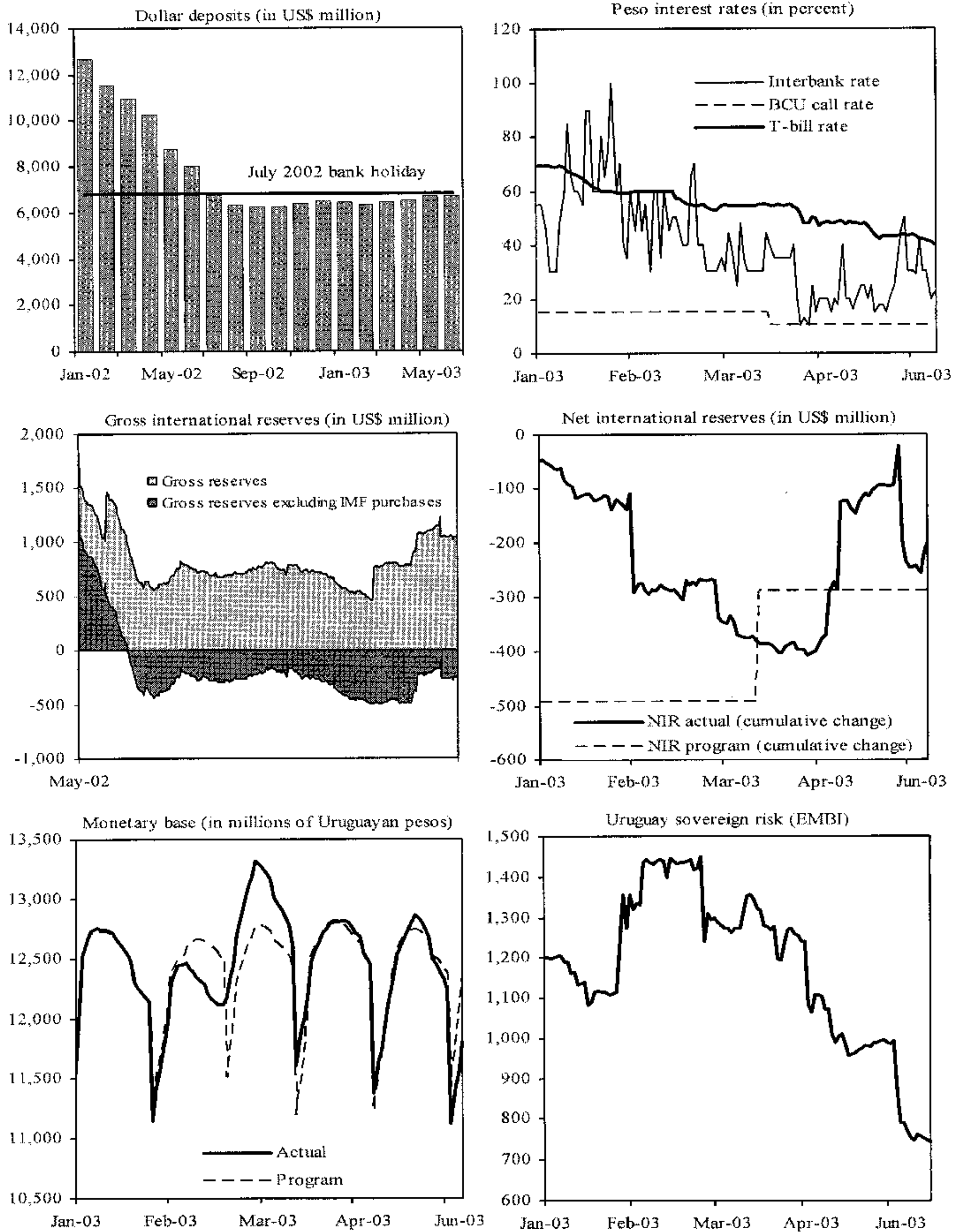
35. **Notwithstanding the risks to the program, the staff recommends completion of the third review and approval of the authorities' request for waivers.** The staff also supports the authorities' request for a modification of the end-June performance criteria. Policy implementation is on track, and the authorities have demonstrated and reaffirmed their strong commitment to the program objectives for 2003. Together with continued strong program implementation, the successful debt exchange provides appropriate financing assurances for the program.

Figure 1. Uruguay: Output and Prices



Source: Central Bank of Uruguay; Ministry of Economy and Finance; CERES; and Fund Staff estimates

Figure 2. Uruguay: Financial Indicators



Source: Central Bank of Uruguay; Ministry of Economy and Finance; and Fund Staff estimates

Table 1. Uruguay: Selected Economic and Financial Indicators

	2000	2001	2002	2003		2004
			Est.	Orig.	Rev. Prog.	Proj.
		(Percent change)				
Output, prices, and wages						
Real GDP	-1.4	-3.4	-10.8	-2.0	-1.0	4.5
GDP deflator	4.0	6.1	17.8	31.2	22.9	17.2
CPI inflation						
Average	4.8	4.4	14.0	27.9	22.5	18.1
End of period	5.1	3.6	25.9	26.3	20.0	14.0
Exchange rate change (Ur$/US$)						
Average	6.7	10.1	62.1	…	…	…
End of period	7.7	18.0	84.5	…	…	…
Public sector wage rates (end of period)	2.9	5.1	0.5	7.2	7.2	…
GDP						
In Ur$ billions	243.0	249.2	262.0	337.0	318.8	390.3
In US$ billions	20.1	18.7	12.1	11.0	10.5	11.6
Monetary indicators 1/						
Currency issued	-3.9	-0.2	5.8	19.8	18.3	…
M-2	3.5	0.7	-5.2	14.9	19.9	…
M-3	10.2	19.6	15.8	35.8	11.9	…
Credit to the private sector (constant exch. rate)	0.3	-3.8	-17.6	-2.4	-5.3	…
		(Percent of GDP, unless otherwise indicated)				
Public sector operations						
Revenue	31.2	32.4	31.0	30.4	31.1	31.3
Non-interest expenditure (incl. discrepancy)	32.7	33.6	30.9	27.2	28.1	28.0
Primary balance	-1.5	-1.2	0.0	3.2	3.0	3.2
Interest	2.6	2.9	4.6	6.3	6.6	5.7
Overall balance	-4.1	-4.1	-4.6	-3.1	-3.6	-2.5
Savings and investment						
Gross domestic investment	14.0	13.7	12.2	12.1	11.8	12.2
Public	3.3	3.2	2.5	3.0	2.8	2.7
Private	10.6	10.5	9.7	9.1	8.9	9.4
Gross national savings	11.1	10.8	13.8	14.4	13.9	13.6
Public	-0.6	-0.5	-1.9	-0.1	-1.0	-0.1
Private	11.8	11.3	15.7	14.5	14.8	13.7
Foreign savings	2.8	2.8	-1.6	-2.3	-2.1	-1.5
External indicators						
Merchandise exports, fob (US$ millions)	2,384	2,144	1,934	2,082	2,129	2,320
Merchandise imports, fob (US$ millions)	3,311	2,914	1,872	1,873	1,849	2,035
Merchandise terms of trade (percentage change)	-6.6	-0.7	4.8	-1.3	0.0	-2.3
Current account balance (US$ millions)	-566	-533	191	251	219	170
Overall balance of payments (US$ millions) 2/	167	302	-2,323	646	705	443
Public debt (in percent of GDP) 3/	45.5	53.8	93.7	105.8	108.7	101.4
External debt (in percent of GDP) 4/	0.0	0.0	0.0	97.9	0.0	0.0
Of which: External public debt	30.3	31.2	67.3	84.2	86.2	81.4
Gross official reserves (US$ millions)	2,779	3,099	776	1,422	1,481	1,924
In months of imports of goods and services	8.0	10.0	3.8	6.8	7.3	8.7
Ratio to short-term debt 5/	1.1	1.1	0.3	0.6	0.6	0.8
REER (percentage depreciation -, e.o.p.)	-0.7	-5.3	-13.2	…	…	…

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

1/ Evaluated at the accounting exchange rate of Ur$29/US$ for 2003.

2/ Defined as changes in reserve assets.

3/ Defined for combined public sector.

4/ Excludes nonresident deposits.

5/ Residual maturity. Does not include nonresident deposits.

Table 2. Uruguay: Summary Balance of Payments

(In millions of U.S. dollars)

	2000	2001	2002	2003						Proj.
				Orig.	Est.	Projection				
				Prog.	Q1	Q2	Q3	Q4	Year	2004
Current account	**-566**	**-533**	**191**	**251**	**83**	**-17**	**82**	**71**	**219**	**170**
Goods and services	**-533**	**-447**	**196**	**389**	**117**	**17**	**119**	**109**	**362**	**355**
Goods	**-927**	**-771**	**61**	**209**	**-4**	**30**	**132**	**122**	**280**	**285**
Exports	2,384	2,144	1,934	2,082	449	557	558	565	2,129	2,320
Imports	3,311	2,914	1,872	1,873	454	527	425	443	1,849	2,035
Services	**394**	**324**	**135**	**179**	**121**	**-12**	**-13**	**-14**	**82**	**70**
Exports	1,276	1,132	727	806	253	137	134	144	668	702
Transportation	374	337	253	280	69	63	66	57	255	267
Travel	713	611	351	356	149	42	38	61	289	304
Other	189	185	123	171	35	32	30	26	124	130
Imports	882	808	592	627	132	149	147	157	586	632
Transportation	399	364	253	290	65	66	66	61	258	277
Travel	281	252	178	171	26	44	39	51	161	174
Other	201	192	161	166	41	38	42	46	167	181
Income	**-61**	**-114**	**-76**	**-181**	**-50**	**-45**	**-45**	**-45**	**-186**	**-230**
Current transfers	**27**	**28**	**70**	**43**	**16**	**11**	**8**	**8**	**43**	**45**
Financial account	**772**	**794**	**-1,710**	**396**	**-72**	**187**	**225**	**146**	**486**	**272**
Direct investment, net	**274**	**319**	**91**	**150**	**30**	**25**	**25**	**25**	**105**	**200**
Portfolio investment, net	**296**	**553**	**230**	**-268**	**-136**	**-19**	**0**	**11**	**-144**	**-96**
Government securities	294	324	31	-268	-136	-19	0	11	-144	-96
Issues	538	716	484	0	28	43	17	17	105	17
Amortization	244	392	452	268	164	62	17	6	249	112
Banks	2	229	198	0	0	0	0	0	0	0
Public banks	-5	-42	117	0	0	0	0	0	0	0
Private banks	6	272	81	0	0	0	0	0	0	0
Other investment, net	**202**	**-78**	**-2,030**	**514**	**34**	**181**	**201**	**110**	**526**	**168**
Loans	**437**	**-1,041**	**1,383**	**764**	**233**	**194**	**297**	**160**	**883**	**244**
Nonfinancial public sector	158	182	633	453	-48	184	64	167	367	69
Disbursements	287	351	792	707	11	250	126	235	622	316
Amortization	129	169	159	254	59	67	62	67	255	247
Other, net (fin. derivative)	0	0	14	0	0	0	0	0	0	0
BCU / use of IMF resources	-46	-58	883	678	280	-20	308	108	678	325
Of which: FSBS resources	0	0	-716	0	0	0	0	0	0	0
Banks	325	-1,166	-148	-366	0	30	-75	-116	-161	-150
Public banks	4	-4	12	0	0	0	0	0	0	0
Private banks	321	-1,162	-159	-366	0	30	-75	-116	-161	-150
Deposits	**-34**	**1,004**	**-975**	**-134**	**-96**	**13**	**-97**	**-50**	**-230**	**-88**
Public banks	47	302	300	-65	0	0	-65	0	-65	0
Of which: nonresident deposit flows	77	335	-362	-65	0	0	-65	0	-65	0
Private banks	-81	701	-1,275	-69	-96	13	-32	-50	-165	-88
Of which: nonresident deposit flows	716	941	-3,840	-9	0	0	0	-50	-50	100
Other flows, net	**-201**	**-41**	**-2,438**	**-116**	**-102**	**-26**	**0**	**0**	**-128**	**12**
Banks	34	-9	-133	0	0	0	0	0	0	0
Public banks	37	-10	-80	0	0	0	0	0	0	0
Private banks	-3	0	-52	0	0	0	0	0	0	0
Nonfinancial private sector	-235	-31	-818	-10	0	-26	0	0	-26	-188
Foreign currency held outside banks	0	0	-1,487	-106	-102	0	0	0	-102	200
Errors and omissions	**-39**	**41**	**-804**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Overall balance	**167**	**302**	**-2,323**	**646**	**11**	**170**	**307**	**217**	**705**	**443**
Reserve assets (- increase)	**-167**	**-302**	**2,323**	**-646**	**-11**	**-170**	**-307**	**-217**	**-705**	**-443**
Memorandum items:										
Current account in percent of GDP	-2.8	-2.8	1.6	2.3					2.1	1.5
Financial account in percent of GDP	3.8	4.3	-14.1	3.6					4.6	2.3
Gross international reserves	2,779	3,099	776	1,422	787	957	1,264	1,481	1,481	1,924
In months of imports of GNFS	8.0	10.0	3.8	6.8					7.3	8.7

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

Table 3a. Uruguay: Performance Under the 2002 Economic Program 1/

	September 30, 2002			November 30, 2002				December 31, 2002			
	Prog.	Actual	Margin (+)	Prog.	Adj. Prog	Actual	Margin (+)	Prog.	Adj. Prog	Actual	Margin (+)
A. Quantitative performance criteria											
				(In millions of Uruguayan pesos)							
1. Combined public sector balance (cumulative floor) 2/	-9,600	-9,310	**290**	...	...	...	...	-10,950	-11,060	-12,091	**-1,031**
2. General government expenditure (cumulative ceiling) 2/	23,700	21,878	**1,822**	29,600	29,600	27,136	**2,464**	32,900	32,900	29,878	**3,022**
3. Change in the net domestic assets of the central bank (ceiling) 3/ 4/	26,100	24,082	**2,018**	24,235	26,815	24,813	**2,002**	28,400	31,625	24,616	**7,009**
4. Change in currency issue (ceiling) 5/ 3/	755	765	**-10**	985	985	661	**324**	2,650	2,650	1,976	**674**
				(In millions of U.S. dollars)							
5. Net international reserves of the central bank (-decrease) 3/ 4/	-1,010	-933	77	-930	-1,033	-966	**67**	-1,030	-1,159	-906	**253**
				(Stock of debt at the end of the period; in millions of U.S. dollars)							
6. Nonfinancial public sector gross debt (ceiling) 4/ 6/	8,025	7,143	**882**	8,025	8,025	...	...	8,025	8,030	7,972	**58**

	Date	Status
B. Structural performance criterion		
1. Congressional approval for the extension of the May tax measures.	Oct 31	Observed
C. Structural benchmarks		
1. Weekly publication of banking data with a one-week lag.	Aug 31	Not observed
2. Evaluation of the adequacy of BROU's current regularization plan and development of a plan of compliance with all prudential regulations.	Aug 31	Observed
3. Presentation to congress of pension reforms:		
Military	Oct 31	Observed with delay
Bank employees	Dec 31	Not observed
4. Presentation to congress of a comprehensive reform to rationalize and simplify the tax system.	Dec 31	Observed
5. Presentation to Congress of legislation to foster competition in the telecommunications sector.	Dec 31	Not observed
6. Presentation to Congress of legislation to foster competition in the oil sector.	Dec 31	Not observed

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

1/ As defined in the Technical Memorandum of Understanding.
2/ Cumulative from end-December 2001.
3/ Cumulative from end-June 2002.
4/ Adjusted for upward4/downwards for any increase/decrease in disbursements from the World Bank and IDB.
5/ Indicative target.
6/ All maturities. Adjusted for debt issued for recapitalization of banks.

Table 3b. Uruguay: Performance Under the 2003 Economic Program Through March 1/

	March 31, 2003			
	Target	Adj. Target	Actual	Margin (+)
A. Quantitative performance criteria				
		(In millions of Uruguayan pesos)		
1. Combined public sector primary balance (cumulative floor) 2/ 3/ 4/	2,170	2,123	1,880	**-243**
2. Change in the net domestic assets of the BCU (ceiling) 2/	14,000	14,000	10,738	**3,262**
		(In millions of U.S. dollars)		
3. Net international reserves of the BCU (- decrease) (cumulative floor) 2/ 5/	-490	-490	-380	**110**
4. Nonfinancial public sector gross debt (ceiling) 3/ 4/ 6/	8,915	8,786	8,381	**405**
B. Indicative targets				
		(In millions of Uruguayan pesos)		
1. Combined public sector overall balance (cumulative floor) 2/ 3/ 4/ 7/	-3,385	-3,467	-3,710	**-243**
2. Change in the monetary base (ceiling) 8/	165	165	393	**-228**

	Date	**Status**
C. Prior action		
1. Obtain and present to staff evidence of adequate financing assurances to meet financing needs for the 2003 program.		Observed
D. Structural performance criterion		
1. No banks will be opened or reopened unless they are viable and meet all prudential norms.	Continuous	Observed
E. Structural benchmarks		
1. Issuance of decree or regulations to foster competition in the telecommunications sector.	March 31	Observed
2. Prepare a strategy document for disposal of remaining assets of suspended banks.	March 31	Not observed

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

1/ As defined in the Technical Memorandum of Understanding (EBS/03/27).

2/ Cumulative changes from end-December 2002.

3/ Adjusted upward/downward for changes in social security contributions, as defined in the TMU.

4/ Preliminary figures.

5/ Adjusted upward/downward for changes in program disbursements from the World Bank and IDB, as defined in the TMU.

6/ All maturities. The 2002 base includes US$294 million of unsecuritized debt arising from an agreement between the Ministry of Economy and Finance and BROU. For September and December, the debt ceiling will be adjusted upwards to reflect the transfer of Brady bonds from the central bank to the government (at end-May 2003, these transfers amounted to US$237 million).

7/ Adjusted upward/downward for changes in interest payments, as defined in the TMU.

8/ Cumulative change from December 2002 average.

Table 4. Uruguay: Public Sector Operations

					2003						
			2002		Orig.	Est.	Revised Program				Proj.
	2000	2001	Prog.	Est.	Prog.	Q1	Q2	Q3	Q4	Year	2004
					(In millions of Uruguayan pesos)						
Revenue	**75,944**	**80,738**	**89,425**	**81,138**	**102,389**	**22,767**	**24,200**	**25,693**	**27,185**	**99,845**	**122,159**
Taxes	50,164	54,007	64,090	57,832	71,946	16,715	16,293	16,949	18,521	68,478	84,540
VAT and excise taxes	27,409	29,437	32,390	29,708	38,141	8,951	8,837	8,897	9,809	36,494	45,230
On income and profits	12,640	12,719	15,672	14,302	17,180	3,886	3,695	4,011	4,110	15,701	19,503
On foreign trade	1,968	2,428	4,556	2,730	4,221	780	921	934	968	3,603	4,170
On property and other	8,147	9,424	11,472	11,091	12,404	3,098	2,840	3,107	3,634	12,679	15,638
Social security contributions 1/	15,085	14,381	12,726	12,836	13,509	2,930	3,193	3,490	3,244	12,857	16,984
Nontax revenue 2/	5,849	5,122	5,243	5,274	6,970	1,349	1,362	1,733	1,743	6,187	7,214
Current surplus of public enterprises 3/	4,845	7,227	7,366	5,196	9,964	1,773	3,352	3,521	3,678	12,324	13,420
Noninterest expenditure	**79,560**	**83,788**	**85,308**	**81,066**	**91,648**	**20,887**	**23,905**	**22,141**	**23,281**	**90,215**	**109,476**
Current 3/	71,130	74,705	76,824	74,653	81,374	18,271	21,177	19,402	21,345	80,196	97,288
Wages	17,219	18,074	18,439	18,158	20,114	4,553	5,226	4,657	5,453	19,889	25,583
Goods and services	11,298	12,833	13,001	12,057	13,031	3,033	3,997	3,541	3,758	14,331	17,259
Social security benefits 3/	41,120	41,907	41,561	42,818	45,436	10,711	10,815	11,127	11,642	44,294	51,496
Other	1,494	1,891	3,823	1,619	2,794	-26	1,138	77	492	1,682	2,951
Capital (government and enterprises) 2/	8,430	9,083	8,484	6,413	10,274	2,615	2,728	2,739	1,936	10,019	12,188
Primary balance	**-3,616**	**-3,050**	**4,117**	**72**	**10,740**	**1,880**	**295**	**3,552**	**3,904**	**9,631**	**12,683**
Interest	6,308	7,276	15,016	12,163	21,220	5,590	5,340	5,672	4,641	21,243	22,262
Overall balance	**-9,924**	**-10,326**	**-10,900**	**-12,091**	**-10,480**	**-3,710**	**-5,045**	**-2,120**	**-737**	**-11,612**	**-9,579**
					(In percent of GDP)						
Revenue	**31.2**	**32.4**	**29.9**	**31.0**	**30.4**	**31.2**	**32.1**	**32.5**	**29.1**	**31.1**	**31.3**
Taxes	20.6	21.7	21.5	22.1	21.3	22.9	21.6	21.5	19.8	21.4	21.7
VAT and excise taxes	11.3	11.8	10.8	11.3	11.3	12.3	11.7	11.3	10.5	11.4	11.6
On income and profits	5.2	5.1	5.2	5.5	5.1	5.3	4.9	5.1	4.4	4.9	5.0
On foreign trade	0.8	1.0	1.5	1.0	1.3	1.1	1.2	1.2	1.0	1.1	1.1
On property and other	3.4	3.8	3.8	4.2	3.7	4.3	3.8	3.9	3.9	4.0	4.0
Social security contributions 1/	6.2	5.8	4.3	4.9	4.0	4.0	4.2	4.4	3.5	4.0	4.4
Nontax revenue 2/	2.4	2.1	1.8	2.0	2.1	1.9	1.8	2.2	1.9	1.9	1.8
Current surplus of public enterprises	2.0	2.9	2.5	2.0	3.0	2.4	4.4	4.5	3.9	3.8	3.4
Noninterest expenditure	**32.7**	**33.6**	**28.6**	**30.9**	**27.2**	**28.7**	**31.7**	**28.0**	**24.9**	**28.1**	**28.0**
Current 3/	29.3	30.0	25.7	28.5	24.1	25.1	28.1	24.6	22.9	25.0	24.9
Wages	7.1	7.3	6.2	6.9	6.0	6.2	6.9	5.9	5.8	6.2	6.6
Goods and services	4.6	5.1	4.4	4.6	3.9	4.2	5.3	4.5	4.0	4.5	4.4
Social security benefits 3/	16.9	16.8	13.9	16.3	13.5	14.7	14.3	14.1	12.5	13.8	13.2
Other	0.6	0.8	1.3	0.6	0.8	0.0	1.5	0.1	0.5	0.5	0.8
Capital (government and enterprises) 2/	3.5	3.6	2.8	2.4	3.0	3.6	3.6	3.5	2.1	3.1	3.1
Primary balance	**-1.5**	**-1.2**	**1.4**	**0.0**	**3.2**	**2.6**	**0.4**	**4.5**	**4.2**	**3.0**	**3.2**
Interest	2.6	2.9	5.0	4.6	6.3	7.7	7.1	7.2	5.0	6.6	5.7
Overall balance	**-4.1**	**-4.1**	**-3.6**	**-4.6**	**-3.1**	**-5.1**	**-6.7**	**-2.7**	**-0.8**	**-3.6**	**-2.5**
Memorandum item:											
Augmented Balance 4/	**-9,924**	**-10,326**	**...**	-56,106	**-10,480**	**-3,710**	**-5,045**	**-2,120**	**-737**	**-11,612**	**-9,579**
In percent of GDP	-4.1	-4.1	...	-21.4	-3.1	-5.1	-6.7	-2.7	-0.8	-3.6	-2.5
GDP (millions of pesos)	243,027	249,231	298,637	261,987	337,036	72,775	75,429	79,030	93,423	320,656	390,306

Sources: Ministry of Finance; and Fund staff estimates.

1/ Excludes contributions that are transferred to the private pension funds.

2/ Includes extrabudgetary operations from 1998.

3/ Includes transfers central government transfers to BPS, Caja Militar and Caja Policial.

4/ In 2002, includes bank assistance of the central bank and the central government through Articles 36, 47, the CND, overdrafts and the FSBS.

Table 5. Uruguay: Nonfinancial Public Sector Cash Flow

(In millions of U. S. dollars)

	2000	2001	2002	2003						Proj.
				Original	Revised Program					
				Program	Q1	Q2	Q3	Q4	Year	2004
A. Needs	**1,182.3**	**1,698.2**	**1,826.1**	**1,367.1**	**696.1**	**813.7**	**623.6**	**567.1**	**2,700.5**	**1,258.9**
Interest payments, NFPS 1/	**179.3**	**531.2**	**532.6**	**631.8**	**190.7**	**202.1**	**143.3**	**115.0**	**651.0**	**621.3**
Amortization requirements	**1,003.0**	**1,167.0**	**1,293.4**	**735.3**	**505.4**	**611.6**	**480.3**	**452.1**	**2,049.4**	**637.6**
Market debt, including commercial loans	749.0	1,070.0	1,057.2	480.3	446.3	544.8	418.3	385.0	1,794.5	389.8
Medium and long term instruments	749.0	1,070.0	613.4	344.5	326.9	176.9	10.7	12.0	526.5	56.9
External bonds	207.0	100.0	75.0	19.1	0.0	0.0	0.0	10.7	10.7	0.0
Domestic bonds	0.0	150.0	243.4	217.0	196.8	7.8	1.7	1.3	207.6	33.9
Treasury Bills	501.0	667.0	264.0	91.8	97.5	169.1	2.7	0.0	269.2	10.3
Brady Bonds 3/	41.0	153.0	31.1	16.6	32.6	0.0	6.3	0.0	38.9	12.7
Short term instruments	0.0	0.0	400.0	80.0	115.7	298.3	389.6	356.5	1,160.0	311.8
BROU	...	...	0.0	70.0	70.0	70.0	105.0	105.0	350.0	28.4
Market	...	...	0.0	10.0	42.0	158.6	266.5	235.0	702.1	283.4
Cash advances	...	...	...	41.0	0.0	59.0	-5.4	0.0	53.6	-10.3
Other market, including commercial loans	0.0	0.0	43.8	14.8	3.7	10.7	23.5	16.5	54.4	31.4
Official (World Bank, IDB and Bilaterals)	254.0	97.0	236.2	255.0	59.1	66.7	62.0	67.1	255.0	247.8
B. Available financing	**1,747.6**	**1,877.3**	**1,859.8**	**995.7**	**625.4**	**798.6**	**503.8**	**436.0**	**2,363.8**	**838.5**
Placement of bonds and bills	**1,460.0**	**1,915.1**	**1,088.0**	**249.0**	**297.8**	**527.0**	**453.5**	**424.0**	**1,702.4**	**423.0**
Medium and long term instruments	1,460.0	1,915.1	290.6	75.0	0.0	13.3	33.0	29.0	75.3	63.5
Central Bank	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private pension Funds (AFAPs)	...	...	46.0	75.0	0.0	13.3	33.0	29.0	75.3	0.0
BROU	...	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Market	...	...	244.6	0.0	0.0	0.0	0.0	0.0	0.0	63.5
Short term instruments	...	...	178.2	174.0	297.8	513.7	420.5	395.0	1,627.0	359.5
Central Bank	...	...	521.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private pension Funds (AFAPs)	...	...	98.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
BROU	...	...	69.1	70.0	70.0	105.0	105.0	35.0	315.0	0.0
Market	...	...	109.1	104.0	227.8	408.7	315.5	360.0	1,312.0	359.5
Official (World Bank, IDB and Bilaterals)	**320.0**	**349.3**	**103.3**	**706.9**	**11.4**	**250.4**	**125.6**	**234.5**	**621.9**	**315.5**
World Bank	...	...	...	250.8	0.0	76.0	0.0	175.0	251.0	147.5
IDB	...	...	...	322.6	0.0	160.0	104.6	39.0	303.6	167.5
Project loans 4/	...	...	...	133.5	11.4	14.4	21.0	20.5	67.3	0.5
Other international loans	**0.0**	**0.0**	**189.8**	**0.0**	**40.0**	**0.0**	**0.0**	**0.0**	**40.0**	**0.0**
Net credit from the banking system	**-32.4**	**-387.1**	**478.7**	**0.0**	**276.2**	**21.2**	**-75.3**	**-222.5**	**-0.5**	**0.0**
Asset recovery	**...**	**...**	**...**	**39.6**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**100.0**
C. Primary surplus, NFPS	**-565.3**	**-179.1**	**-33.7**	**371.4**	**70.7**	**15.1**	**119.8**	**131.1**	**336.7**	**420.5**
D. Gap (A-B-C)	**...**	**...**	**...**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum Items										
Balance, combined public sector	**-820.2**	**-771.3**	**-605.0**	**-347.8**	**-131.6**	**-172.2**	**-68.8**	**-23.4**	**-396.0**	**-284.8**
NFPS	-744.6	-710.3	-566.3	-260.4	-120.0	-187.0	-23.5	16.1	-314.4	-200.9
BCU	-75.6	-61.0	-38.6	-87.4	-11.6	14.8	-45.3	-39.5	-81.7	-84.0

1/ Includes US$87 million in accrued interest on old bonds participating in the exchange and US$24 million on the commission to advisors.

2/ Excludes IMF; includes amortization on project loans to World Bank and IDB.

3/ As paid by BCU.

4/ Includes disbursements from official and bilateral creditors, including project loans from IDB and WB.

Table 6. Uruguay: Summary Accounts of the Banking System 1/

(In millions of Uruguayan pesos)

	Dec.	Dec.	2002				2003			
							Est.	Projection		
	2000	2001	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sept.	Dec.
1. Central Bank of Uruguay										
Net foreign Assets	27,773	40,358	26,448	4,850	-13,407	-18,747	-30,188	-24,796	-24,839	-21,679
(in US$ million)	2,219	2,733	1,692	262	-497	-689	-1,045	-855	-857	-748
Net international reserves	32,897	43,652	29,458	8,567	-6,262	-5,374	-13,786	-8,036	-8,079	-4,919
(in US$ million)	2,629	2,956	1,885	463	-232	-198	-477	-277	-279	-170
Other net foreign assets	-5,124	-3,294	-3,010	-3,717	-7,146	-13,373	-16,402	-16,759	-16,759	-16,759
(in US$ million)	-409	-223	-193	-201	-265	-492	-568	-578	-578	-578
Net domestic assets	-15,624	-27,707	-15,136	6,234	25,193	30,464	41,097	35,913	35,865	35,103
Credit to public sector	-1,013	-3,454	-3,830	2,846	2,740	41,919	67,109	66,257	66,257	66,257
Credit to financial system	484	284	295	330	437	2,163	2,052	2,060	2,060	2,060
Credit to the private sector	0	0	0	0	0	0	0	0	0	0
Other	12,149	12,651	11,312	11,084	11,785	11,717	10,909	11,117	11,027	13,424
Monetary liabilities	7,284	7,095	6,003	5,920	6,285	7,673	7,026	7,206	7,115	9,513
Currency issued	2,186	2,354	2,291	2,106	2,505	2,328	2,306	2,322	2,322	2,322
Currency in circulation	2,678	3,203	3,018	3,059	2,996	1,716	1,577	1,589	1,589	1,589
Vault cash	0	0	0	0	0	0	2	7	7	7
Private sector deposits	57	35	45	36	27	48	44	75	75	75
2. Public and Private Banks 2/										
Net foreign assets	0	0	0	0	0	0	0	0	0	0
(in US$ million)	117,853	144,429	135,695	130,972	150,170	142,908	144,004	144,972	145,225	146,490
Net domestic assets	13,752	25,880	18,096	-298	-6,179	4,601	16,659	19,926	20,413	20,964
Credit to the public sector	124,044	133,636	137,712	148,126	185,855	171,869	174,423	171,090	170,756	171,370
Credit to financial system	-25,877	-25,169	-29,902	-27,448	-38,182	-44,416	-44,872	-44,959	-44,959	-44,959
Credit to the private sector	0	0	0	0	0	0	0	0	0	0
Other	110,803	134,116	130,459	125,949	151,405	157,903	163,309	169,877	172,469	176,146
Liabilities to private sector	90,255	113,183	111,708	108,768	134,502	138,991	142,091	149,600	151,710	153,797
3. Banking System										
Net foreign assets	0	0	0	0	0	0	0	0	0	0
(in US$ million)	100,043	114,369	118,268	135,101	172,858	171,044	182,795	178,562	178,768	179,271
Net domestic assets	-6,611	-3,653	351	-3,094	13,631	-7,067	-6,959	-6,049	-6,126	-6,325
Credit to the public sector	124,529	133,920	138,007	148,456	186,293	174,032	176,475	173,150	172,817	173,430
Credit to rest of financial system	42,830	42,037	41,191	39,080	37,396	36,325	39,109	39,979	40,946	42,847
Credit to the private sector	81,699	91,883	96,815	109,376	148,897	137,707	137,366	133,171	131,871	130,584
Of which: Local currency	0	0	0	0	0	0	0	0	0	0
Of which: Foreign currency	-22,795	-22,526	-26,050	-23,699	-38,481	-48,695	-51,624	-53,711	-53,194	-53,206
Other	120,766	144,414	139,480	134,928	160,686	167,292	171,912	178,672	181,173	187,249
Broad money (M3) 3/	20,605	20,969	18,796	17,217	16,931	18,960	21,263	20,359	20,841	22,431
(12-month percent change)										
Currency issued	10.2	19.6	10.8	0.6	19.3	15.8	23.3	32.4	12.8	11.9
Broad money (M2=currency + peso deposits)	0.3	-3.8	-4.5	-9.2	-13.8	-17.6	-19.9	-17.8	-12.4	-5.3
Broad money (M3=M2 + res. US$ deposits)	11.4	21.0	11.5	1.0	20.0	16.2	23.5	32.9	12.7	11.3
Credit to private sector (const. exch. rate)	6.7	1.8	-10.7	-20.9	-20.1	-9.6	13.1	18.2	23.1	18.3
Total deposits held by residents	12.5	25.3	16.3	5.4	27.9	20.9	25.2	35.2	11.5	10.4
Local currency	5.1	3.6	5.1	8.9	23.5	25.9	28.5	27.9	16.9	20.0
Foreign currency and indexed deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Consumer price inflation (e.o.p.)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Nonresident f/c deposits (US$ million) 2/	22	6	8	9	8	8	0	9	11	22
Currency/Deposit ratio	2,052.16	...	...	...	...	...	...	...	...	...
Exchange rate of presentation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Presentation used for program monitoring. Differs from presentation in IFS.
2/ Banco de la Republica Oriental del Uruguay, Banco Hipotecario de Uruguay (mortgage institution), private banks, and cooperatives.
3/ Excluding nonresident deposits.

Table 7. Uruguay: Medium-Term Outlook

	2002	2003	2004	2005	2006	2007	2008
	Est.	Projections					
				1. Output and prices (Percent change)			
Real GDP	-10.8	-1.0	4.5	4.0	4.0	3.0	3.0
Real domestic demand	-18.0	-3.3	4.4	4.8	4.6	3.7	3.5
Of which: consumption	-16.1	-1.9	3.8	3.6	3.3	2.9	3.1
Consumer prices (end-of-period)	25.9	20.0	14.0	11.9	10.1	7.4	5.3
Merchandise export prices	-7.9	1.5	0.0	0.0	0.0	0.0	0.0
Export volume	-3.3	8.5	9.0	9.0	8.5	8.0	7.5
Merchandise import prices	-12.1	1.5	2.4	0.0	0.0	0.0	0.0
Import volume	-26.4	-2.7	7.5	10.0	9.0	9.0	8.0
Merchandise terms of trade	4.8	0.0	-2.3	0.0	0.0	0.0	0.0
				2. Savings and investment (Percent of GDP)			
Gross domestic investment	12.2	11.8	12.2	12.7	13.3	13.6	13.5
Gross national savings	13.8	13.9	13.6	13.8	14.4	14.5	14.3
Foreign savings	-1.6	-2.1	-1.5	-1.1	-1.0	-0.9	-0.8
				3. Public sector operations (Percent of GDP)			
Overall balance	-4.6	-3.6	-2.5	-2.1	-1.7	-1.0	-0.6
Primary balance	0.0	3.0	3.2	3.3	3.4	3.9	3.9
				4. Reserve adequacy			
Gross official reserves							
In months of imports of goods and services	3.8	7.3	8.7	7.6	5.7	4.1	3.6
In percent of short-term debt							
excluding nonresident deposits	33.3	64.5	82.7	78.7	63.2	49.1	46.2
including nonresident deposits	19.7	38.4	48.3	44.6	34.5	25.7	23.2
				5. Balance of payments and other external indicators (In US$ million)			
Current account balance	191	219	170	144	146	140	124
Trade Balance	61	280	285	291	304	304	313
Exports, f.o.b.	1,934	2,129	2,320	2,529	2,744	2,964	3,186
Imports, f.o.b.	1,872	1,849	2,035	2,239	2,440	2,660	2,873
Nonfactor services	135	82	70	49	27	1	-25
Exports, f.o.b.	727	668	702	744	788	836	886
Imports, f.o.b.	592	586	632	695	761	834	910
Factor services (net)	-76	-186	-230	-240	-230	-210	-210
Transfers (net)	70	43	45	45	45	45	45
Financial account	-1,710	486	272	-202	-488	-475	-190
Foreign direct investment	91	105	200	200	250	250	250
Portfolio investment	230	-153	-96	-32	-15	-4	-43
Other investment	-2,030	534	168	-370	-724	-721	-397
Errors and omissions	-804	0	0	0	0	0	0
Overall balance	-2,323	705	443	-58	-342	-335	-66
Reserve Assets (- increase)	2,323	-705	-443	58	342	335	66
				(In percent of GDP)			
Current account balance	1.6	2.1	1.5	1.1	1.0	0.9	0.8
Financial account	-14.1	4.6	2.3	-1.6	-3.5	-3.1	-1.2
Total external debt (excl. nonres. deposits)	85.0	101.4	98.2	88.4	76.8	67.7	60.2
				(In percent of exports of goods and nonfactor services)			
Total external debt (excl. nonres. deposits)	387.9	383.3	377.3	342.6	304.3	270.5	239.2
Total external debt (incl. nonres. deposits)	448.5	439.2	432.3	398.0	361.2	328.8	298.4
Debt service	55.7	52.1	46.5	48.5	62.7	57.9	43.5
of which: interest	25.1	20.3	17.6	16.8	16.0	15.0	13.8

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

Table 8. Uruguay: Proposed Availability of Purchases 1/

Augmented, extended, and rephased SBA			
SBA (April 2002 to February 2005)	**SDR**	**% quota**	
April 4, 2002	122.6	40.0	Program approval
June 25, 2002	386.1	126.0	First augmentation approval
August 8, 2002	603.0	196.7	Second Augmentation approval, completion of the first review, and observance of end-June 2002 performance criteria. 2/
March 17, 2003	218.5	71.3	Completion of the second review and observance of end-December 2002 performance criteria.
July 14, 2003	145.7	47.5	Completion of the third review and observance of end-March 2003 performance criteria.
September 2003	93.2	30.4	Completion of the fourth review and observance of end-June 2003 performance criteria.
November 2003	93.2	30.4	Completion of the fifth review and observance of end-September 2003 performance criteria.
Febuary 2004	93.2	30.4	Completion of the sixth review and observance of end-December 2003 performance criteria.
May 2004	93.2	30.4	Completion of the seventh review and observance of end-March 2004 performance criteria.
August 2004	93.2	30.4	Completion of the eighth review and observance of end-June 2004 performance criteria.
November 2004	93.2	30.4	Completion of the ninth review and observance of end-September 2004 performance criteria.
February 2005	93.2	30.4	Completion of the tenth review and observance of end-December 2004 performance criteria.
Total access	2,128.3	694.4	
Average annual access	709.4	231.5	

Source: Fund staff estimates.

1/ Of which, SDR128.7 million under the SRF.

Table 9. Uruguay: Projected Payments to the Fund and Indicators of Capacity to Repay the Fund 1/

	2003	2004	2005	2006	2007	2008
Cumulative payments (existing and prospective; in SDR million)						
Principal (repurchases)	42.8	128.7	226.6	678.3	685.1	384.9
Charges and interest 2/	30.8	74.2	79.1	61.2	29.0	10.2
On Fund credit	30.6	73.7	78.6	60.7	28.5	9.7
On use of SDRs	0.2	0.5	0.5	0.5	0.5	0.5
Total obligations	73.6	202.9	305.7	739.5	714.1	395.1
(percent of quota)	33.8	67.3	100.5	248.1	233.6	123.5
Fund repurchases and charges						
In millions of SDRs	73.6	202.9	305.7	739.5	714.1	395.1
In millions of U.S. dollars	102.8	285.3	428.9	1,035.7	997.8	550.4
In percent of exports of goods and NFS	3.7	9.4	13.1	29.3	26.3	13.5
In percent of GDP	1.0	2.5	3.4	7.4	6.6	3.4
In percent of quota	24.0	66.2	99.7	241.3	233.0	128.9
In percent of overall external debt service	7.1	20.3	27.0	46.8	45.4	31.1
In percent of foreign reserves 1/	6.9	14.8	23.0	68.0	83.9	49.0
Fund credit outstanding (end of period)						
In millions of SDRs	1,812.3	2,056.4	1,923.0	1,244.7	559.6	174.7
In millions of U.S. dollars	2,531.8	2,891.1	2,697.7	1,743.2	781.9	243.4
In percent of exports of goods and NFS	90.5	95.7	82.4	49.3	20.6	6.0
In percent of GDP	24.1	24.9	21.3	12.4	5.2	1.5
In percent of quota	591.3	670.9	627.4	406.1	182.6	57.0
In percent of public sector external debt	27.9	30.6	29.2	19.9	9.4	3.1
In percent of overall external debt	23.6	25.4	24.1	16.2	7.6	2.5
In percent of foreign reserves	170.9	150.3	144.6	114.4	65.8	21.7
Memorandum items (In millions of U.S. dollars unless otherwise noted):						
Exports of goods and NFS	2,797.0	3,022.0	3,273.0	3,532.6	3,799.4	4,071.8
Quota (Millions of SDRs)	306.5	306.5	306.5	306.5	306.5	306.5
GDP	10,508.4	11,606.1	12,691.3	14,003.8	15,172.2	16,164.7
U.S. dollar per SDR (WEO projection)	1.3970	1.4059	1.4029	1.4005	1.3973	1.3930
Public sector external debt	9,063.2	9,446.2	9,236.4	8,757.0	8,301.8	7,776.8
Overall external debt service	1,456.5	1,405.1	1,588.6	2,214.1	2,198.8	1,771.3
Overall external debt	10,721.2	11,402.9	11,213.1	10,748.7	10,278.6	9,738.6
Foreign reserves	1,481.3	1,923.8	1,865.9	1,523.7	1,189.2	1,123.2

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

1/ Assuming all scheduled purchases are made and that repurchases under the SBA and SRF are made on an obligations basis.

2/ Projections are based on current rates of charge, including burden-sharing where applicable, for purchases in the GRA. The current SDR interest rate is assumed for net use of SDRs.

Table 10. Uruguay: Vulnerability Indicators

	2000	2001	2002	Projection 2003	2004
	(Percent change, unless otherwise indicated)				
Financial sector indicators					
Broad money	10.2	19.6	15.8	11.9	...
Credit to the private sector (const. exch. Rate)	0.3	-3.8	-17.6	-5.3	...
Share of nonperforming loans in total loans (in percent)	16.4	17.0	36.3	...	...
Prime interest rates (percent, average) - domestic loans 1/	20.7	24.7	...	...	...
Prime interest rates, real (percent, average) - domestic loans 1/	14.9	20.4	...	...	...
External Indicators					
Merchandise exports (in U.S. dollars)	4.1	-10.1	-9.8	10.1	9.0
Merchandise imports (in U.S. dollars)	3.9	-12.0	-35.8	-1.3	10.1
Merchandise terms of trade	-6.6	-0.7	4.8	0.0	-2.3
REER appreciation (+)	-0.7	-5.3	-13.2	...	...
	(Percent of GDP, unless otherwise indicated)				
Current account balance	-2.8	-2.8	1.6	2.1	1.5
Capital and financial account balance	3.8	4.2	-14.1	4.6	2.3
Of which : Net foreign direct investment	1.4	1.7	0.7	1.0	1.7
Portfolio investment (securities etc.)	1.5	3.0	1.9	-1.4	-0.8
Other net inflows (deposits, loans, trade credits, etc.)	1.0	-0.4	-16.7	5.0	1.4
Total external debt including nonresident deposits	44.3	47.8	85.0	101.4	98.2
Of which: Public sector excl. nonresident deposits	30.3	31.2	67.3	86.2	81.4
Foreign currency deposits (nonresidents)	0.0	0.0	0.0	0.0	0.0
In percent of exports GNFS	399.1	487.4	448.5	439.2	432.3
Total external debt excluding nonresident deposits	27.0	26.8	73.6	88.5	85.8
In percent of exports GNFS	243.0	272.8	387.9	383.3	377.3
External interest payments to exports GNFS (in percent)	0.0	0.0	4.7	5.1	9.1
External amortization payments to exports GNFS (in percent)	36.1	43.4	46.9	34.4	27.4
	(US$ million, unless otherwise indicated)				
Central Bank reserve liabilities	150	144	970	1,651	...
Short term foreign assets of the financial sector	7,367	7,695	5,152	6,838	...
Short term foreign liabilities of the financial sector	6,504	7,547	4,151	4,753	...
Gross official reserves	2,779	3,099	776	1,481	1,924
In months of imports GNFS	8.0	10.0	3.8	7.3	8.7
In percent of total debt service	9,779.2	8,243.9	5,840.1	10,023.7	13,434.6
In percent of broad money	27.8	28.6	10.0	25.3	...
In percent of base money	365.9	483.0	203.8	338.7	...
In percent of short-term external debt incl. deposits 2/	33.6	31.8	19.7	38.4	48.3
In percent of short-term external debt excl. deposits 2/	108.9	114.7	33.3	64.5	82.7
Financial Market Indicators					
Foreign currency debt rating (Moody's) 3/	Baa3	Baa3	B3	B3	...
Foreign currency debt rating (S&P) 3/	BBB-	BBB-	B-	B-	...
Spread of benchmark bonds (basis points, end of period) 3/	326.0	251.0	1,609.0	750.0	...
Exchange rate (per U.S. dollar, period average)	12.1	13.3	21.6	...	...

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

1/ Due to the liquidation of several banks in the survey sample, this data series is no longer available.

2/ By remaining maturity.

3/ For 2003, as of mid-June.

4/ For 2000, the data reported are the spread of the 2009 bond; for 2001-02, the 2012 bond; and for 2003, the 2033 bond.

Data for 2003 are as of end-June.

Montevideo, Uruguay
June 27, 2003

Dear Mr. Köhler:

1. Following the successful completion of Uruguay's comprehensive and voluntary debt exchange, the government of Uruguay intends to continue implementing policies aimed at fostering the resumption of growth. To that effect, the government is committed to achieving a primary fiscal surplus of 3.2 percent of GDP in 2003, excluding the one-off expenses paid on account of the debt exchange. The fiscal effort is supported by expenditure restraint and the continued implementation of structural reforms. These measures are described in the attached Supplement to the Memorandum of Economic and Financial Policies.

2. In support of these efforts, the Government of Uruguay requests: (i) completion of the third review under the Stand-by Arrangement, allowing a purchase of SDR 145.7 million upon approval by the Fund's Executive Board; (ii) waivers of applicability for the end-June performance criteria on the cumulative primary balance of the combined public sector and the overall nonfinancial public sector debt ceiling, given that the data to monitor these performance criteria will not yet be available at the time of Board consideration of this review; and (iii) modifications of the performance criteria for end-June on the cumulative primary balance of the combined public sector and the overall nonfinancial public sector debt ceiling.

3. We are confident that the policies set out in the attached supplement to the Memorandum of Economic and Financial Policies and the continued support of the international financial institutions will provide the needed stability for the resumption of economic growth. The government stands ready, in consultation with the Fund, to take any additional measures necessary to ensure the success of the program.

Sincerely yours,

/s/
Julio de Brun
President
Central Bank of Uruguay

/s/
Alejandro Atchugarry
Minister of Economy and Finance
Republic of Uruguay

Mr. Horst Köhler
Managing Director
International Monetary Fund
700, 19th Street, N.W.
Washington, D.C. 20431

Attachments:
Supplement to the Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

SUPPLEMENT TO THE MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES FOR 2003

I. BACKGROUND AND MACROECONOMIC FRAMEWORK

1. Uruguay's economic and political situation has improved significantly in recent months. Following the completion of the second review under the Stand-By Arrangement in March, market sentiment has improved, and private sector deposits continued to increase in April and May. Reflecting these reflows, as well as sizeable IFI disbursements, gross international reserves have nearly doubled since mid-March, to about US$1 billion at mid-June (5 months of imports of goods and services).

2. There are signs that the economy has bottomed out. While real GDP contracted by 10.8 percent in 2002, indicators show an increase in activity during the first quarter of 2003, supported by an incipient recovery in export performance. The unemployment rate has fallen somewhat in March, and inflation has been under control, averaging 1.2 percent a month during the first five months of the year, somewhat below program projections. Against this background, we have revised slightly our macroeconomic framework. Consistent with developments in recent months, we expect that the economy will continue to gradually recover, and that real GDP will only contract by 1 percent for the year as a whole, while inflation should be somewhat lower than initially envisaged, at about 20 percent by year-end.

II. DEBT EXCHANGE

3. In 2002, the debt-to-GDP ratio of the consolidated public sector doubled, to 94 percent. This increase reflected a sharp depreciation of the peso against the U.S. dollar, the cost of government assistance to stabilize the banking system, and the fiscal deficit. While Uruguay faced tight liquidity conditions associated with a large concentration of debt amortization in 2003-07, the deterioration in debt dynamics also raised uncertainty about fiscal sustainability. To address these problems, the government launched a comprehensive and voluntary debt exchange in April 2003. The exchange aimed at extending the average maturity of virtually all international and domestic market debt by about five years, while broadly maintaining the low average interest rates on the debt contracted in previous years, under investment grade rating conditions.

4. In May, the government successfully completed the debt exchange, based on strong support from bondholders. The debt exchange received 93 percent participation by investors, well above the minimum 80 percent acceptance rate. Participation was particularly strong for domestically-issued bonds, at nearly 100 percent, while participation in the internationally-issued bonds was close to 90 percent. This debt exchange was a crucial step to ensure sufficient financing to meet immediate needs and address medium-term debt sustainability through a cooperative approach with creditors. The strong support expressed by private sector investors is a key component of Uruguay's efforts to restore the economy to sustained growth and financial stability.

III. Fiscal Policies

5. The government is firmly committed to achieving the primary surplus objectives of the program. These objectives remain broadly unchanged, at 3.2 percent of GDP in 2003,[1] 3.3 percent on average in 2004-05, and about 4 percent over the medium term. Attaining these surpluses will help address Uruguay's immediate and medium-term financing needs, provide a realistic path toward fiscal sustainability, and avoid crowding out credit to the private sector. Under this path, the debt-to-GDP ratio is projected to decline to about 60 percent by 2010, consistent with the objectives of the debt exchange.

6. In 2003, steps are being taken to adjust expenditure in order to offset revenue shortfalls associated with lower projected inflation. Although the fiscal program is on-track for the year as a whole, the end-March performance criterion on the cumulative primary balance of the combined public sector was not observed due to the reclassification of an operation involving the state oil company ANCAP.[2] So far this year, the government has maintained a tight grip on discretionary spending, and the nominal growth of general government non-interest expenditure was contained to 4 percent during the first four months of 2003. In May, the government issued two decrees aimed at placing lower limits on central government spending during 2003, with a view to bringing them in line with revised program projections. Full-year projections for social security outlays, including pensions, have been revised downward owing to moderate increases in private sector wages. During the remainder of this year, tariffs charged by public enterprises will continue to be adjusted in line with the program, to fully reflect operating costs.

7. Tax reform is important in achieving the medium-term primary surplus objectives of the program and promoting high sustainable rates of growth. With technical assistance from the Fund, the government is preparing a revised tax reform to be submitted to congress by end-June and expected to become effective in 2004. The revised tax reform is aimed at enhancing revenue collections through rationalization and simplification of the tax system, which include broadening the VAT base; elimination of low-yielding taxes and their incorporation into the main excise tax; and a broadening of the coverage of corporate income tax. The improved tax structure will facilitate the strengthening of tax administration, for which the government has also requested technical assistance from the Fund.

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[1] This figure excludes one-off expenses of US$24 million, or 0.2 percent of GDP, paid on account of the debt exchange completed in May.

[2] In March, ANCAP made forward sales of petroleum products amounting to US$40 million. Although this operation was initially recorded as revenue in the fiscal accounts, it has now been reclassified as a financing item, affecting observance of the end-March performance criterion on the cumulative primary balance of the combined public sector. This operation is being offset during the second half of 2003, as similar transactions conducted in 2002 are unwound.

IV. The Banking System

8. The government is committed to taking all necessary steps to further strengthen the banking system. Significant progress has been made in enhancing confidence. On March 24, 2003, a new bank (*Nuevo Banco Comercial*—NBC) was opened with assets of three liquidated banks, after the Superintendency of Banks had declared it to be viable and in full compliance with prudential norms.

9. In the coming months, the government's restructuring agenda includes a swift resolution of the fourth liquidated bank, the disposal of the remaining assets of all liquidated banks, and the ongoing reform of public banks.

- A trust fund has been created to facilitate the disposal of the assets of the fourth liquidated bank (*Banco de Crédito*). As part of the resolution process, the government will contribute a maximum of US$40 million (face value) in government bonds if the proceeds from the auctioned assets of this bank are insufficient to cover depositors.

- As a prior action to Board consideration of the third review under the Stand-By Arrangement, the Central Bank will complete a strategy document for disposal of the remaining assets of the liquidated banks and establish a central liquidation steering committee to facilitate implementation of the strategy. To promote timely recovery of resources, it will outsource to third parties the disposal of assets in at least two asset groups by end-July (structural performance criterion). In addition, the Superintendency of Banks will issue regulations requiring that all foreclosed bank debtors, including remaining debtors in the liquidated banks, be registered in the credit bureau (*Central de Riesgo*). This will include the requirement that the loan classification in any bank reflect the distressed conditions of these debtors.

- The ongoing reform of the BHU will be accelerated. The government is currently working in close collaboration with the World Bank on a comprehensive plan to restructure the BHU and reduce its operational costs, to be finalized by end-September.

10. Reestablishing stability and confidence in the banking system is key to restoring credit flows. As the banking system remains in the early stages of recovery, the 100 percent reserve requirement on new sight and savings deposits of the public bank BROU and NBC will be maintained until confidence is solidified. In this respect, the liquidity position of BROU is being closely monitored to ensure the smooth repayment of reprogrammed deposits scheduled to begin in August. Also, BROU will continue with its efforts to improve efficiency and bring its operations in line with modern practices. In this connection, it will adopt a reform plan, in agreement with the central bank and the government, aimed at: (i) overhauling corporate governance to ensure operational independence; (ii) rationalizing operating costs; (iii) strengthening credit risk administration and control; and (iv) improving the bank's capital adequacy ratio.

V. Exchange Rate and Monetary Policies

11. The government remains committed to a floating exchange rate policy. The new framework for the conduct of monetary policy adopted in late 2002, using monetary base targets, has served Uruguay well. So far in 2003, the monetary base has moved in line with the program, though inflation has been lower due to higher real money demand. Accordingly, for the remainder of the year, to accommodate the ongoing remonetization of the economy, we have retained the original monetary program, which targets a 25 percent increase in the monetary base by year-end. The government intends to maintain this framework as a means of anchoring inflationary expectations, building a track record for monetary policy credibility, and laying the groundwork for future adoption of inflation targeting. The Central Bank is committed to creating a deeper and more liquid market for peso instruments by expanding further the available range of peso instruments for liquidity management and by promoting market acceptance of inflation-indexed instruments.

VI. Structural Reforms

12. In addition to banking system restructuring, the government is implementing comprehensive reforms in other areas of the economy. In this context, it is committed to advancing the structural reforms envisaged in the Fund-supported program, and recognizes the need to expedite implementation in some areas to prevent delays in IFI disbursements. In this regard, two laws on utility regulations (natural gas and water), tied to the World Bank SAL II, are currently being considered by Congress, for which the government intends to seek approval by end-September. In addition, the government is committed to pursuing the reform of the specialized pension funds originally envisaged under the program, particularly for the police, military, and bank employees. The government will give continued priority to social spending toward programs that are targeted at the most vulnerable groups. The Fund for the Stability of the Banking System will continue to operate as originally envisaged, and an external audit will be conducted by end-September.

VII. Financing Assurances and Other Issues

13. The successful completion of the debt exchange has served to eliminate any residual financing needs in the near term, and projected disbursements from the IFIs will help to ensure that the program is adequately financed through the end of 2004.

14. Significant progress has been made in improving data reporting and transparency in Uruguay. To further improve information disclosure, the government is working toward early subscription to the SDDS, with assistance from the Fund's Statistics Department, to be finalized by end-September (structural benchmark). In addition, the government is committed to promptly resolving the long reporting delays in BROU's banking data to the central bank, so as to publish, without further delay, monthly bank balance sheet data with a two-month lag, consistent with the program.

Table 1. Uruguay: Performance Criteria and Indicative Targets Under the 2003 Economic Program 1/

	Dec. 2002	March 31, 2003				June 30	Sept 30	Dec 31
	Base	Target	Adj. Target	Actual	Margin (+)		Targets	
A. Quantitative performance criteria								
		(In millions of Uruguayan pesos)						
1. Combined public sector primary balance (cumulative floor) 2/ 3/		2,170	2,123	1,880	-243	2,176	5,727	9,631
2. Combined public sector overall balance (cumulative floor) 2/ 3/ 4/ 5/		-3,385	-3,467	-3,710	-243	-7,864	-9,982	-10,720
3. General government non-interest expenditure (cumulative ceiling) 2/		...	...	...	...	...	25,821	35,125
4. Change in the net domestic assets of the Central Bank of Uruguay (ceiling) 2/		14,000	14,000	10,738	3,262	9,000	7,600	6,600
5. Change in the monetary base (ceiling) 4/ 6/		165	165	393	-228	790	1,175	2,325
		(In millions of U.S. dollars)						
6. Net international reserves of the Central Bank of Uruguay (- decrease) (cumulative floor) 2/ 7/		-490	-490	-380	110	-290	-245	-130
		(Stock of debt at the end of the period; in millions of U.S. dollars)						
7. Nonfinancial public sector gross debt (ceiling) 3/ 8/	8,788	8,915	8,786	8,381	405	9,010	9,088	9,100

	Date
B. Structural performance criteria	
1. Presentation to Congress of revised tax reform legislation	End-June
2. No banks to be opened or reopened unless they are viable and meet all prudential norms	Continuous
3. Outsource to third parties the disposal of the assets of the liquidated banks in at least two asset groups	End-July

1/ As defined in the Technical Memorandum of Understanding.

2/ Cumulative changes from end-December 2002.

3/ Adjusted upwards/downwards for changes in social security contributions, as defined in the TMU.

4/ Indicative target.

5/ Adjusted upwards/downwards for changes in interest payments, as defined in the TMU.

6/ Cumulative change from December 2002 average.

7/ Adjusted upwards/downwards for changes in program disbursements from the World Bank and IDB, as defined in the TMU.

8/ All maturities. The 2002 base includes US$294 million of unsecuritized debt arising from an agreement between the Ministry of Finance and BROU. For September and December, the debt ceiling will be adjusted upward to reflect the transfer of Brady bonds from the central bank to the government (at end-May 2003, these transfers amounted to US$237 million).

Table 2. Uruguay: Prior Action and Structural Benchmarks under the 2003 Economic Program

A. Prior actions

1. Complete strategy document for disposal of the remaining assets of the liquidated banks and establish a central liquidation steering committee to faciliate implementation of the strategy.

B. Structural benchmarks

1. Publication of monthly bank balance sheets with a two month lag	Continuous 1/
2. Approval by Congress of the reform of pension funds for the police	September 15
3. Agreement between the BROU, the government, and the central bank on a reform plan for BROU	August 31
4. Approval by Congress of the reform of the pension funds for the military	September 30
5. Completion of the external audit of the FSBS	September 30
6. Submission of data to the SDDS for publication	September 30
7. Presentation to Congress of the reform of the pension system for bank employees	December 31
8. Issuance of decree or regulations to foster competition in the oil sector	December 31

1/ Beginning with data for March 31.

URUGUAY – TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents the definitions of the variables included in the quantitative performance criteria and quantitative benchmarks annexed to the Memorandum of Economic and Financial Policies.

1. **Cumulative Primary 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 Prevision 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 primary balance, excluding valuation adjustments, will be calculated as the overall balance measured from below the line *minus* interest payments measured from above the line.

- The below the line overall balance will be measured on the basis of information provided by the BCU on: (i) the change in the nonfinancial public sector debt (defined below), including all short term debt, in foreign currency and pesos; (ii) change in net bank credit to the nonfinancial public sector in foreign currency and pesos; (iii) other nonbank financing including privatization; and (iv) the quasi-fiscal balance of the BCU (defined below).

- The limit on the primary balance of the combined public sector will be adjusted *downward* (*upward*), i.e., the limit on the surplus would narrow (widen), by the amount by which the actual social security contributions to the private pension system exceeds (falls short of) the projected amounts in the program, specified in Schedule A.

Schedule A
(in millions of Uruguayan pesos)

	Mar-03	Jun-03	Sep-03	Dec-03
Projected social security contributions 1/	704	1,386	2,142	2,826

1/ Cumulative basis

2. **Cumulative Balance of the Combined Public Sector (indicative target).** The combined public sector balance is calculated as the sum of the primary balance of the combined public sector described in 1 and interest payments. Interest payments are defined to exclude commissions and fees. The limit on the balance of the combined public sector will be adjusted *downward* (*upward*), i.e., the limit on the deficit would widen (narrow), by the amount that the interest payments exceed (fall short of) the projected amounts in the program, specified in Schedule B for end-March, end-June, and end-September, and end-December.

Schedule B
(in millions of Uruguayan pesos)

	Mar-03	Jun-03	Sep-03	Dec-03
Projected interest payments 1/	5,552	10,038	15,709	20,350

1/ Cumulative basis

3. **The quasi-fiscal balance of the BCU** is defined as interest earnings on gross international reserves, as defined below, and other earnings including those on other foreign and domestic assets minus operating expenses, commissions paid, and interest paid on domestic and foreign debt administered by the BCU.

4. **Cumulative ceiling on general government expenditure** applies to total (current and capital) noninterest expenditure of the central administration (includes *Fondos de Libre Disponibilidad* but excludes transfers to the social security system and automatic transfers to the private pension funds (AFAPs), and the social security system (BPS).

5. **Cumulative changes in net domestic assets (NDA) of the BCU** is defined as the difference between end-of-period monetary base and net international reserves (NIR) of the BCU as defined in 5 and 6 below. The flow of NIR will be valued at the accounting exchange rate of Ur$29 pesos per US$. The limit on the change in the NDA will be adjusted by the difference between actual program loan disbursements by the World Bank and IDB and scheduled loan disbursements as reflected in Schedule C:

- The NDA ceiling at end-June, end-September, and end-December will be adjusted *upward* in the event of shortfalls compared with projected program loan disbursements, up to a limit of US$75 million.
- The NDA ceiling will be adjusted *downward* in the event of excesses over projected program loan disbursements by their full amount.

Schedule C
(in millions of U.S. dollars)

	Mar-03	Jun-03	Sep-03	Dec-03
Total program disbursements 1/	**0**	**285**	**390**	**554**
World Bank	0	125	125	250
IDB	0	160	265	304

1/ Cumulative basis

6. **Monetary base (indicative target)** is defined as the sum of (i) currency issue; (ii) nonremunerated and remunerated peso sight deposits of BROU, BHU, private banks, and other institutions defined below at the BCU; and (iii) call deposits of BROU, BHU, private banks and other institutions at the BCU. Other institutions include pension funds (AFAPs), local governments, public enterprises, trust funds of the liquidated banks (FRPB), investment

funds, off-shore institutions (IFEs), insurance companies, exchange houses, stock brokers, and the nonfinancial private sector. The monetary base excludes central government deposits held at BROU subject to a 100 percent reserve requirement. The indicative target is defined as the cumulative change calculated using the monthly averages relative to the base month average.

7. **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 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 nonresidents (with a rating not below "A" in the classification of Fitch and 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 international reserves (provided they meet the test of effective control and ready availability of use) as would the reserve position in the IMF.

- Excluded from gross international reserves are all foreign currency claims arising from off-balance sheet transactions (such as derivatives instruments), claims on residents, capital subscriptions to 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.

- Also excluded from gross international reserves are foreign exchange assets in the escrow account at the BCU created to provide backing to sight and savings deposits at the public banks and the closed domestic banks (the escrow account at the BCU). Funds not used to support banks will be invested in highly liquid and secure international assets to be reported daily to the International Monetary Fund and will be subject to periodic special audits.

- BCU 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 either residents or nonresidents undertaken directly by the BCU or by other financial institutions on behalf of the BCU.

- For the purpose of the NIR calculation, (i) the gold holdings of the BCU will be valued at the accounting rate of US$42 per troy ounce; (ii) liabilities to the IMF will be valued at US$/SDR rate of December 31, 2002; (iii) gains or losses from gold swaps and other operations will be excluded; and (iv) 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, 2002.

8. **The NIR floor will be adjusted** by the difference between actual program loan disbursements by the World Bank and IDB, and scheduled loan disbursements by the World Bank and IDB as reflected in Schedule C, in the following manner:

- The NIR floor at end-June, end-September, and end-December will be adjusted *downward* in the event of shortfalls compared with projected program loan disbursements, up to a limit of US$75 million.
- The NIR floor will be adjusted *upward* in the event of excesses over projected program loan disbursements by their full amount.

9. **The nonfinancial public sector gross debt** refers to (i) the outstanding stock of gross debt in domestic and foreign currency owed or guaranteed by the public sector as defined in (1) above excluding the BCU.[3] 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.[4]

10. **The overall nonfinancial public sector debt ceiling will be adjusted *upward* (*downward*) by** (i) the upward (downward) revisions made to the actual nonfinancial public sector gross debt stock at end-2002;[5] (ii) the difference between the actual and projected amount of social security contributions that are transferred to private pension funds according to schedule A, i.e. the debt ceiling will be adjusted upwards (downwards) by the amount that social security contributions exceed (fall short of) those specified in Schedule A; (iii) the difference between the actual and projected interest payments, specified in Schedule B for end-March, end-June, and end-September, and end-December, i.e. the debt ceiling would be adjusted upwards (downwards) by the amount that interest payments exceed (fall short of) those specified in Schedule B; (iv) the difference between actual and scheduled program disbursements by the World Bank and IDB as reflected in schedule C below, i.e. the debt ceiling will be adjusted upwards (downwards) by the amount that program loan disbursements exceed (fall short of) those in Schedule C; and (v) the debt ceiling will be

[3] 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 No. 6230-(79/140, August 3, 1979), as amended).

[4] The suppliers' contracts of ANTEL with equipment providers Ericsson and NEC, which predate the Fund's consideration of lease contracts for programming purposes, are expensed under goods and services as rental outlays and, therefore, excluded from the definition of nonfinancial public sector gross debt for program purposes.

[5] The debt stock at end-2002 includes US$294 million of unsecuritized debt from an agreement between the Ministry of Finance and BROU.

adjusted upwards to reflect overperformance with respect to the targets on the BCU's net international reserves up to a limit of US$250 million. For September and December 2003, the debt ceiling will be adjusted upwards to reflect the transfer of Brady bonds from the central bank to the government (at end-May 2003, these transfers amounted to US$237 million).

11. **The data for assessing compliance with the quantitative performance criterion** on net international reserves will be provided by the BCU no later than one week after each test date. The data for the assessment of all other quantitative performance criteria and indicative targets will be provided by the BCU no later than two months after each test date.

URUGUAY: AN ASSESSMENT OF THE DEBT EXCHANGE OPERATION

1. **On May 29, Uruguay completed a sovereign debt exchange operation encompassing all foreign currency denominated bonds.** The exchange covered both international-law and domestic-law bonds, with a total principal amount of US$5.4 billion eligible to be exchanged. The only instruments not eligible in the exchange were those in domestic currency or with an initial maturity of less than 12 months (US$0.6 billion in total). The exchange restructured nearly half of Uruguay's total sovereign debt for debt of longer maturity (Table 1).

2. **The debt exchange had two main purposes.** First, it aimed at providing sufficient cash flow relief to fully eliminate any residual financing needs during 2003-05. Secondly, it aimed at improving upon the debt and debt service profile over the medium term, to ensure that it was sustainable under the program's macroeconomic assumptions. These objectives were to be attained by extending maturities approximately at par while broadly preserving the average existing coupon rates on outstanding debt.

I. DESIGN OF THE DEBT EXCHANGE

3. **The authorities emphasized the voluntary nature of the exchange**. The offer was designed by the Uruguayan authorities in close collaboration with their legal advisor—Cleary, Gottlieb, Steen & Hamilton—and their financial advisor—Citigroup. The main incentive for investors to participate was the improvement the exchange would make in Uruguay's capacity to pay. The exchange also offered investors the opportunity to improve the liquidity of their holdings by exchanging their bonds for new benchmark international and domestic bonds of larger aggregate size.

4. **The exchange encompassed nearly all market debt or about half of the total sovereign debt, excluding only domestic currency denominated instruments.**[1] The exchange consisted of three concurrent offers divided according to the national jurisdiction under which the bonds had been issued. Eligible securities comprised: (i) forty six domestically-issued bonds and Treasury bills, accounting for US$1.6 billion in principal; (ii) eighteen international bonds issued under foreign law, accounting for US$3.5 billion; and (iii) one Samurai bond issued in Japan, accounting for about US$250 million. Domestic-law bonds could be exchanged through a custodian or a broker, or directly at the central bank. foreign law bonds could be exchanged by submitting applications to a password-protected internet site maintained by Citigroup. The Samurai bond's terms were to be changed at a bondholders' meeting. Eligible bonds were primarily denominated in U.S. dollars, and

[1] Uruguayan peso denominated debt included short-term bills and an inflation indexed bond, accounting for 4.9 percent of market debt and 2.7 percent of overall debt.

ranged in remaining maturity from a few days after the originally scheduled deadline for participation in the exchange to the year 2027.[2]

Investor Consultation and Communication Strategy

5. **From early on, the authorities actively sought to involve bondholders in an informal consultation process.** The authorities saw this extensive consultation as an important element of their cooperative and market-friendly approach. After announcing, on March 11, their intention to conduct a debt exchange, they developed specific details for the exchange during consultations with investors in a roadshow in the United States, Europe, and Uruguay. This dialogue allowed the authorities to explain their economic and financial situation to bondholders while listening to their suggestions and concerns.[3] The consultation also provided the authorities with assurances that their proposal had a reasonable chance of acceptance.

6. **Communication was further enhanced after the official launch of the exchange.** The authorities organized a second roadshow after the official launch on April 10, to explain the details of the exchange proposal and emphasize that the exchange was needed to close their financing gaps. In support of the exchange, the Fund's Managing Director released a letter to members of the financial community supporting the authorities' economic program and noting that high participation would be needed in the exchange for it to achieve the financing objectives required for completing the next review. The authorities published the Staff Report for the Second Review, to provide further information to the public on their economic and financial program. They also stepped up their communication efforts through interviews and advertisements in the local media while remaining in close contact with key investors and analysts.

7. **The treatment of the bonds that would not participate in the exchange was the subject of particular interest to investors.** The authorities clarified that, although they remained committed to servicing all their debt in full if possible, they would direct their funds to pay the new bonds in preference to the old bonds in the event that their resources were not sufficient to meet all debt service needs. This explanation was seen by many analysts as providing an important incentive for investors to participate in the exchange.

Time Line

8. **The exchange process spanned a period of approximately two and a half months.** The authorities announced their intention to conduct a debt exchange and filed preliminary securities documentation for a debt exchange with the U.S. Securities

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[2] Some bonds were denominated in euros, pound sterling, and Chilean Pesos.

[3] The dialogue took place in groups as well as individual meetings.

and Exchange Commission (SEC) on March 11. Following active consultations with investors and the detailed design of the exchange, the formal offer period started on April 10 when the final exchange terms were filed with the SEC. The offer was to expire on May 14 for the domestically-issued bonds and on May 15 for the international offer (the meeting of Samurai bondholders was also scheduled for May 15). On May 16, the authorities announced that the exchange would be completed but, to maximize participation, they extended the offer through May 22. Settlement took place on May 29, when the old bonds were cancelled and the new bonds were issued. On June 10, the central bank announced that it would continue to accept domestic bonds that had not yet been submitted.

Financial Terms

9. **In response to investors' suggestions made during the consultation process, the exchange offered most bondholders a choice between two options, both involving approximately a par-for-par exchange :**[4]

- ***Maturity extension option.*** Under this option, each existing bond could be exchanged for a bond with similar coupon and extended maturity (5 years longer, generally), mixed in some cases with a 30-year bond. The 30-year bond capitalized part of the interest earned over the first four years, with a view to reducing the government's near-term cash flow needs. The simplicity of the maturity extension option was intended to appeal primarily to buy-and-hold retail investors.

- ***Benchmark bond option.*** Under this option, investors would receive one of a smaller number of benchmark bonds, longer-dated but more liquid than under the maturity extension option, also mixed in some cases with a 30-year bond. Three external and four domestic benchmark bonds were introduced, with maturities ranging from seven to 30 years. Three of the four domestic benchmarks, created for investors wishing to swap from existing floating-rate bonds, had step-up fixed-rate coupons to parallel the expected increase in floating interest rates. The benchmark bond option was designed to be attractive not only to institutional investors but also to index-tracking funds, assuming the new international bond issues were large enough (at least US$250-500 million depending on the index) to be included in international indices.

10. **The authorities tied completion of the exchange to achieving sufficient participation levels.** They committed themselves to completing the exchange if the aggregate participation rate in the three concurrent exchange offers reached 90 percent, including a 90 percent participation rate for bonds maturing through 2008. The authorities also retained the discretion to complete the exchange if aggregate participation reached at least 80 percent, and announced that the exchange would not be completed if participation

[4] Holders of the Samurai bond, the Global 2027, two Brady bonds, and one domestic bond were not given a choice.

were to be less than 80 percent. This strategy was designed to signal the government's need for very high participation levels, and that investors' attempts to free ride would jeopardize the exchange.

11. **A number of the new bonds were designed to facilitate better debt management.** Some new bonds contain provisions spreading the payment of principal (either by purchases in the market or by amortization) over several years before final maturity so as to smooth the government's cash flow requirements.

Legal Terms

12. **The exchange included several legal features aimed at encouraging participation**:

- ***Exit consents.*** Holders exchanging the external bonds were asked to approve exit consents which would reduce the old bonds' liquidity and their holders' ability to enforce debt service payments. More specifically, the exit consents would: (i) eliminate the ability of holders of the old bonds to attach payments made on new bonds; (ii) delete all cross-default and cross-acceleration provisions in the old bonds; and (iii) remove the requirement to maintain the listing of the old bonds on the Luxembourg Stock Exchange. Approval by holders of at least 50 percent of outstanding bonds was needed for the exit consents to take effect (bondholders were assumed to have approved them unless they opted out).

- ***Cross default clauses.*** The new bonds contained other legal features enhancing their attractiveness, including cross-default clauses triggered by failure to service any other new bonds, but not by default on the old bonds. In addition, the new bonds are issued under a trust indenture, as a way to avoid the risk of attachment from bondholders. Any proceeds resulting from litigation would have to be shared by all bondholders of the specific series of bonds.[5]

- ***Collective action clauses (CACs).*** The new bonds issued under New York securities law include CACs with an aggregation clause.[6] Under these clauses, Uruguay will be able in the future to change the payment terms of any individual bond series with the consent of investors representing at least 75 percent of outstanding principal of that series. Under the aggregation clause, the terms of any individual bond series can be modified with the consent of only two thirds of bondholders, if at least 85 percent of holders of all affected series approve the change. This marked the first time that sovereign bonds included an aggregation clause, as the simultaneous replacement of

[5] Uruguay's old bonds also included a provision requiring sharing of payments.

[6] Uruguay's old bonds under New York law had not included CACs.

most of Uruguay's debt by a set of new issues represented a rare opportunity to have aggregation immediately apply to a large proportion of a sovereign's debt.

- ***Samurai bonds***. The Samurai bonds already contained a CAC, under which changes in the payment terms of the bonds could be agreed upon in a bondholders' meeting with the approval of at least two-thirds of the bonds represented at the meeting and a minimum quorum of 50 percent of outstanding bonds. Uruguay's use of this clause was the first time that the payment terms of a sovereign bond were amended using a CAC in Japan. Worldwide, this represents the third use of CACs by a sovereign in recent years, after Ukraine (2000) and Moldova (2002).[7]

13. **The international exchange offer also contained withdrawal rights.** Any tender for exchange submitted during the exchange period could be withdrawn prior to the May 15 deadline, but not after that date if the exchange was extended. This provision, which was not used, was intended to encourage early participation, which the authorities and their advisors hoped would serve as an early signal that the deal was going well. In practice, however, most investors preferred to present their formal offers only during the last few days of the offer period and did not exercise the withdrawal rights.

Regulatory Incentives

14. **The Uruguayan authorities sought to ensure the participation of domestic financial institutions by providing regulatory incentives.** The Superintendency of Banks announced that the old bonds would become non-tradable securities due to the suspension of stock exchange quotations. As a result, the old bonds would become subject to a 100-percent risk-weighting (instead of a zero weighting) in banks' capital-adequacy ratios. In addition, reduced provisioning requirements or higher credit ceilings would no longer be allowed when the old bonds were used as collateral, and it would not be possible for exchange houses and offshore banks to use these bonds to constitute mandatory deposits at the central bank. A provisioning requirement of at least 50 percent was announced for bonds held in banks' investment books that are rated 'default' or 'selective default', which the authorities expected to be the rating of the old bonds for at least a period after the announcement that the exchange would be completed. The central bank also said that it would not accept old bonds as collateral for liquidity assistance.

15. **Regulatory incentives also encouraged the participation of pension funds and insurance companies.** The announced intention to de-list the old bonds from the Montevideo Stock Exchange acted as a strong incentive, as pension funds are not allowed to hold unlisted securities. In addition, the special rule allowing pension funds to value the old

[7] CACs have also been used in earlier years, including in the restructuring of promissory notes in Nigeria in 1989.

Global 2027 bond at purchase price rather than mark-to-market was transferred to the new benchmark 2033 bond.

16. **The Chilean regulatory authorities facilitated the participation of two Chilean peso-denominated bonds held by the Chilean pension funds.** Under existing Chilean regulations, pension funds were not allowed to acquire speculative grade instruments (Uruguay lost its investment grade status in February 2002). To enable them to participate in the exchange, the Chilean authorities specifically allowed them to *exchange* the bonds without it being treated as an *acquisition* of new bonds.

II. Results of the Debt Exchange

17. **Participation in the debt exchange was exceptionally high**. The principal amount of bonds tendered was US$5.0 billion, amounting to 92.5 percent of eligible bonds.[8] Quite remarkably, the participation rate for shorter-dated bonds (maturing through 2008) was higher than the average, at 93.5 percent (Table 2). Participation reached 89.2 percent of internationally-issued bonds and 98.8 percent of domestically-issued bonds. At the bondholders' meeting of Samurai bonds, holders of 80 percent of bonds were represented (mostly by proxy), and over 99 percent of votes were in favor of amending the payment terms. Under the collective action clause, the remaining holders were bound by the majority decision.

18. **All types of bondholders – institutional and retail, domestic and international – participated strongly in the exchange**. Domestic institutions participated universally in the exchange, typically submitting their own holdings together with those collected from their clients. This avoided the administrative complications of making multiple submissions to the central bank or exchange agent. Domestic retail participation was around 98 percent, bolstered by strong programs by brokers and custodians to contact and obtain answers from all their clients. Although many retail customers indicated to their brokers their support for the exchange fairly early, the majority did not provide their formal acceptances until the final days of the offer period. Acceptances of domestic bonds received by the central bank amounted to only 55 percent of eligible bonds one week before the expiration date and reached 93 percent with only two days remaining (Chart 1)

19. **Participation on international bonds was on average high.**[9] However, it varied from instrument to instrument, with a relatively high degree of non-participation among

[8] During the extension period (May 15-22) an amount of US$150 million of bonds was tendered (all but US$5 million being international bonds), raising the overall participation rate by 2.6 percentage points, to the final figure of 92.5 percent.

[9] Most external institutions, like domestic bondholders, waited until the last day to submit their acceptances.

certain types of investors. Participation rates on U.S. dollar global bonds were generally above 90 percent, indicating widespread support from emerging market funds and other institutional investors. However, the two euro denominated bonds had participation rates below 80 percent, which suggests that European retail participation was lower than the average, possibly because investors were less aware of the background to the exchange than Uruguayan retail investors. Lengthy post-launch registration procedures in Europe also reportedly reduced the time available for marketing by intermediaries.

20. **Participation of Brady bondholders was relatively low, at less than 60 percent on average.** Participation in the New Money Bond issued in 1991 reached only 25 percent and, as a result, the exit consents did not become effective for this bond. Several factors explain the low participation rate on Brady bonds. First, banks which had been holding some of these bonds at book value since the original Brady deal would have had to mark the new bonds to market, causing significant accounting losses. Second, the principal and next three coupon payments of the long-dated Par bonds were collateralized, reducing the potential gain in participating in the exchange.[10] Third, investors drew comfort from the fact that the issuer was the central bank, which they thought was less likely to default than the government (even though debt service payments on the Bradys are ultimately made by the government). Lastly, as Brady bonds were distributed among only a few investors the non-participation by any one party had a larger effect than for bonds with a larger investor base.

21. **Participation was influenced by a number of factors**. The international exchange offer implied significant differences in NPV reduction from bond to bond, and the correlation between the NPV reduction and the degree of non-participation on external bonds was relatively low, at 0.55 (Chart 2). Domestically-issued bonds had a larger NPV reduction than the external bonds, but enjoyed a 10 percentage points higher participation rate, which was almost universal for every bond. Within the externally-issued bonds, the decision to participate may have been somewhat more responsive to the economic loss implied by the exchange than among domestic bonds. In general, external bonds with a higher-than-average NPV reduction, notably the euro-denominated and Brady bonds, tended to have a lower participation rate (Chart 2).[11] However, as noted above, factors other than the size of NPV reduction heavily influenced participation rates.

22. **Nearly two thirds of bondholders chose the benchmark bond option.** This option was preferred by most holders of external bonds, except the euro-denominated bonds and the

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[10] In addition, the rally in U.S. Treasury bonds during the exchange period raised the value of the collateral (in the form of US Treasury bonds) above the cash compensation set at the beginning of the exchange period for the loss of collateral. There was no compensation for the loss of the rolling interest guarantee.

[11] The NPV reduction for each bond is measured for this purpose as the lowest reduction of the "maturity extension" and "benchmark bond" alternatives.

shorter-dated Global 2003 and 2006 (Chart 3). While these bonds have a relatively large share of retail holders who preferred the simplicity of the maturity extension option, the benchmark bond option for the euro-denominated bonds may also have been less attractive as it involved switching away from the original currency to a dollar-denominated bond.

23. **Holders of domestic bonds generally preferred to exchange floating rate bonds for the benchmark bond option and fixed-rate bonds for the maturity extension option.** Holders of floating-rate domestic bonds generally chose the benchmark bond option, even when the maturity extension option appeared to represent a smaller NPV reduction (Chart 4). In many cases, holders may have been attracted by the certainty of fixed step-up coupons in the benchmark bond option, as opposed to the floating coupons of the maturity extension option. Holders of fixed-rate bonds generally preferred the maturity extension option which, in most cases, involved less NPV reduction. As a result, after the exchange approximately 47 percent of Uruguay's debt is at a fixed rate.

24. **Markets reacted positively to the completion of the exchange.** Over the exchange period, the post-exchange yield curve implied by market prices of the old bonds ("exit yield") was fairly flat and declined from around 18 percent in early April to approximately 16 percent in early May. After the results were announced, the spread over U.S. Treasury bonds on the new "when-issued" 2015 bond tightened by another 200 basis points compared to the exit yield just before the exchange. This development reflected the elimination of the risk that the exchange could fail. By mid-June, the yields on the benchmark bonds were around 11 percent, implying spreads of less than 750 basis points.

25. **Some ratings agencies have upgraded Uruguay in response to the completion of the debt exchange.** Standard & Poor's and Fitch both regarded the exchange as an event of default for ratings purposes, as it involved an NPV reduction. Consequently, they lowered their country ratings to just above default when the deal was launched and then to default when the authorities announced that the exchange would be completed. But since then, both ratings agencies also considered the exchange to have improved Uruguay's creditworthiness for the future, and they raised their sovereign rating ceiling to B-. This represents Uruguay's highest rating since January, and both firms assigned Uruguay a stable, as opposed to negative, outlook for the first time since early 2002. Fitch rated the old external bonds CCC, below the new bonds. While Standard & Poor's had rated un-tendered debt equal to tendered debt, reflecting the government's resumption of debt service payments in accordance with the original terms, it withdrew the rating for domestic old bonds after the domestic exchange was re-opened on June 10. Moody's uses a different methodology for concessional restructurings, and has maintained the sovereign rating at B3 throughout.

III. Impact of the Debt Exchange

26. **The operation met the targets for cash flow relief in the program** (see Appendix III). As a result of the exchange, principal on medium and long-term debt due in the remainder of 2003 has been reduced from US$469 million to US$23 million and, for the

period 2003-7, from US$2.1 billion to $300 million (Chart 5). Overall debt service obligations have been reduced from US$3.5 billion to US$1.8 billion over the same period. The debt service burden in subsequent years on the existing debt stock will increase owing to the lengthening of maturities, but the interest costs are expected to be lower than from new market financing. The operation creates a spike in financing needs in 2011 when one of the newly created benchmark bonds will mature.

27. **The operation reduced the NPV of participating bonds by an average of around 20 percent.**[12] The net present value (NPV) of future flows on the new bonds is about 20 percent less than the NPV of the contractual flows on the participating old instruments, when discounted at a common factor (16 percent, the implied yield when the exchange was launched). At a lower discount factor of 12 percent (closer to implied yields at the settlement date) the NPV reduction would be 13 percent. The NPV reduction was achieved by lengthening maturities at the existing coupon of around 7 percent while yields in the market were much higher.

28. **Upfront cash payments were relatively modest, and were mostly for accrued interest on the old bonds.** The government offered small upfront cash payments of principal to investors exchanging securities maturing in 2003 and short-dated Brady bonds amortizing partly in 2003, which were particularly important for the government's short-term financing needs.[13] In addition, all participating investors were to be paid up-front accrued interest on old bonds exchanged, which effectively brought forward part of the government's interest cost over the following six months. Some of these cash outflows were offset by the release of collateral held against Brady bonds and interest payments. Total cash payments made at settlement amounted to US$144 million, including US$31 million in upfront payment of principal, US$89 million in accrued interest on the old bonds exchanged (offset in following months by smaller first coupon payments on the new bonds), and US$24 million in fees.[14]

IV. Lessons from the Debt Exchange

29. **Uruguay's financial constraints, together with the legal features of the exchange, led most investors to conclude that the risks of not participating were high.** Concerns about the prospects for hold-out creditors of not receiving future payments, fostered by the authorities' statements in this regard, and the expected greater liquidity of the new bonds,

[12] The NPV calculation is based on a common discount factor for the cash flow profiles before and after the exchange.

[13] One Treasury bill maturing in March 2004 was also eligible for an upfront cash payment.

[14] The gross upfront principal cash payment amounted to US$106 million, but was offset by US$75 million in the release of collateral no longer required against exchanged Brady bonds.

stemming in part from the exit consents, helped the exchange. More generally, by consulting investors and tailoring the exchange to their preferences Uruguay avoided adversarial relations and focused the debate on the appropriate design of the proposal. In addition, closing the domestic exchange, which may have benefited from a sense of patriotism, one day before the international exchange may also have helped convince international investors to participate once they saw strong support elsewhere.

30. **The offer period coincided with a rally in emerging market securities, increasing optimism about Uruguay's exchange.** Higher prices of Uruguayan bonds increased the potential costs to prospective holdout creditors if their bonds were not serviced after the exchange. Public perception that the exchange was important to close the financing gaps, reinforced by the Fund's conditioning of continued use of Fund resources on achieving the cash flow and debt sustainability objectives contemplated for the exchange, may also have benefited participation. Lastly, the apparent conviction that the success of the exchange was crucial for the health of the Uruguayan financial system, bolstered by the incentive-compatible fee structure, boosted participation of domestic financial institutions and stimulated their efforts to reach out to the typically inert retail sector.

31. **Uruguay was comparatively well placed to extend the maturity of the bonds without lowering coupon rates.** Uruguay had low coupon bonds because it had been rated investment grade as recently as one year before the exchange. Thus, extending maturities without lowering coupon payments made the exchange acceptable to investors while reducing the NPV of the debt. Although achieving investor agreement to a concessional restructuring is not easy, the relatively modest size or the requested haircut might have made a cooperative approach easier to achieve. In turn, the widespread understanding by investors of Uruguay's financial difficulties, seen in large part as caused by an external shock, and of its efforts to find a market-friendly cooperative solution via the exchange led to a view that the exchange offered the only realistic cooperative solution.

32. **The exchange may present a useful example for other countries in some aspects, but it would be premature to try to draw too many generalized lessons from this specific exchange.** In particular, other cases, which might require larger NPV reductions or where the banking system hold large amounts of government debt, may well be more difficult to handle. However, a number of possible lessons can be learned from Uruguay's experience:

- ***Cooperative exchange.*** The deal showed that a cooperative exchange, involving NPV reduction, can achieve high participation across a wide range of investors while avoiding legal default and with the authorities retaining the goodwill of investors. This will only be the case if investors agree on the necessity of debt relief and if the exchange is part of an appropriate economic program (although it should be noted that some investors participated even though they remain skeptical of the authorities' ability to implement the program in the long term). It is unclear, however, whether investors would be ready to agree to much deeper haircuts through such an approach. Similarly, it remains

unclear whether Uruguay's treatment of holdouts will have any impact on how investors evaluate trade offs in deciding whether to participate or not in future exchange offers.

- ***The Fund's role.*** The Fund supported the exchange by conditioning continued use of Fund resources on achieving the cash flow and debt sustainability objectives contemplated for the exchange (it did not condition support on a particular design or the completion of the exchange itself). The Fund thus left the design of the operation to the authorities and their advisers, including their approach to potential or actual hold-outs, while focusing on assurances that financing gaps and debt sustainability were addressed. Staff stayed in close contact with the authorities and their advisers throughout the design and implementation of the exchange.

- ***Design of instruments.*** Preserving principal and, to a large extent, coupon rates greatly helped increase investor acceptance, especially by retail holders. In this respect, Uruguay benefited from the low interest rates on the old bonds, secured at a time when it was investment grade. Other emerging market borrowers may not be able to match Uruguay's level of NPV savings simply through an extension in maturities.

- ***Consultation***. Extensive informal consultation helped build consensus and allowed investor input in the detailed design of the exchange. It also provided the authorities with assurances that their proposal had a reasonable chance of acceptance. The relatively long initial offer period (five weeks) proved necessary because of the large numbers of retail investors involved, though a long offer period does increase the risk of negative market news occurring which could derail the operation.

- ***Legal innovation***. Exit consents for the old bonds and CACs in the new bonds were accepted by the great majority of investors, despite vocal opposition from a minority at the outset. Many investors wishing to exchange welcomed the use of exit consents as a means of reducing the risks of disruption by potential hold-outs. Over 90 percent of participants in the exchange approved the use of exit consents. Only one small Brady bond did not reach the minimum approval rate of 50 percent of bonds outstanding necessary to activate the exit consents. Some of the innovations in the terms of the CACs, such as the requirements for information provision by the issuer in advance of a bondholders' meeting and the wider definition of bonds controlled by the government of Uruguay which would be excluded from a CAC vote, were well received by investors and may be used in future sovereign issues.

- ***Retail intermediaries***. Near-universal participation by domestic retail demonstrates that brokers, banks, and other intermediaries were able to mobilize a widely dispersed retail base. These intermediaries actively sought a high participation not only in order to earn fees but also because of the importance of a successful exchange for the financial system and hence their own firms' health. However, it may not be feasible to fully repeat the success of Uruguay, a small and socially cohesive country, in other emerging market

economies. The lower participation in the Euro-denominated bonds confirms that very high participation by *international* retail holders remains a challenge.

- ***Brady bonds.*** Special consideration may have to be given to Brady bonds in future restructurings due to their underlying collateral and the characteristics of their investor base.

33. **Despite the success of the operation a few vulnerabilities stemming from it remain.** First, there remains a small risk that holders of the old bonds may challenge Uruguay's use of the exit clauses. Second, exit consents were not approved for one Brady bond issue, due to the low participation of these bonds, which implies that holders of this bond could seek to attach payments. As the cross-default clause will not have been removed on these bonds, default on other old bonds would trigger default on this Brady bond. Finally, the authorities' future treatment of non-participating bonds could affect investor perception of the fairness of treatment of participants relative to non-participants, and might influence hold-out behavior in any future sovereign debt restructurings.

Table 1: Uruguay. Structure of Public Sector Debt as of end-2002 1/

	U.S. dollar millions		Share of total debt			U.S. dollar millions	Share of total debt
Total	**10,770**						
					Currency composition		
Market debt	5,737		53.3%		U.S. dollars 2/	7,664	71.2%
International bonds		3,253		30.2%	Euros	443	4.1%
Domestic bonds		1,508		14.1%	Yen	253	2.4%
Domestic US dollar bills		256		2.9%	Pounds sterling	43	0.4%
Domestic peso bills		109		1.0%	Chilean pesos	292	2.7%
UI-indexed bonds		178		1.7%	Uruguayan pesos	288	2.7%
Brady bonds		432		3.9%	SDRs	1,786	16.6%
Multilateral loans	4,494		41.7%		**Residence of holder 3/**		
IMF		1,786		16.5%	Total debt		
World Bank		718		6.7%	Nonresident	6,932	64.4%
IDB		1,949		18.0%	Resident	3,838	35.6%
Others		41		0.4%	*Of which:* market debt		
					Nonresident	2,528	44.1%
Bilateral loans	257		2.4%		Resident	3,209	55.9%
Others	282		2.6%		**Interest rate composition**		
					Fixed	4,622	42.9%
					Floating 4/	5,677	52.7%
					Inflation-indexed	471	4.4%

Sources: Central Bank of Uruguay and Fund staff estimates.

1/ Includes the central bank but excludes state banks from the definition of "public sector". Excludes deposit liabilities of the public sector.

2/ Assumes that all multilateral loans (apart from IMF), bilateral loans and "other" debt are in US dollars.

3/ Assumes that all domestic securities are held by residents, unless reported as held in custody by domestic custodians for non-residents. Also assumes that one-third of the international securities for which the residence of the owner is not reported are held by residents, and two-thirds by nonresidents. (This differs from the balance of payments classification which makes the stylized assumption that all securities for which the residence of the holder is not reported are held by non-residents. Under the balance of payments classification, residents' share of market debt is 41.4 percent.)

4/ Assumes that all multilateral, bilateral and "other" debt is floating.

Table 2. Uruguay--Participation in Debt Exchange, Bond-by-Bond.
(In millions of U.S. dollars)

Bond	Maturity date	Coupon	Currency	Total exchanged	Maturity Option	Liquidity Option	Participation rate	Remaining hold-outs
Total (including yen)				*4981.9*	*1608.4*	*3373.6*	*92.5%*	*408.2*
Maturing up to 2008				*2436.5*	*1203.0*	*1233.5*	*93.5%*	*151.5*
External (excluding yen)				*3126.6*	*664.5*	*2462.1*	*89.2%*	*388.4*
Domestic (eligible bonds)				*1599.3*	*687.8*	*911.5*	*98.8%*	*19.8*
International Bonds								
Global 2003	11/18/03	7.875	US$	180.8	88.0	92.8	94.42%	10.7
Global 2006	9/26/06	8.375	US$	95.1	60.8	34.4	97.59%	2.4
Global 2008	4/7/08	7	US$	228.7	63.3	165.3	95.42%	11.0
Global 2009	5/4/09	7.25	US$	225.3	39.0	186.3	93.31%	16.1
Global 2010	6/22/10	8.75	US$	264.6	66.7	197.9	96.63%	9.2
Global 2012	1/20/12	7.625	US$	404.2	68.5	335.7	98.58%	5.8
Global 2027	7/15/27	7.875	US$	476.9	0.0	476.9	93.50%	33.1
Euro 2005	9/26/05	7	euro	193.7	107.8	85.9	74.23%	67.3
Euro 2011	6/28/11	7	euro	167.3	135.3	32.0	71.58%	66.4
Global 2009	3/25/09	7.875	US$	245.9	25.0	220.9	99.04%	2.4
Yen 2006	3/14/06	2.5	JPY	256.1	256.1	0.0	100.00%	0.0
CLP 2007	5/29/07	7	CLP07	124.5	0.0	124.5	100.00%	0.0
CLP 2011	3/15/11	6.375	CLP11	132.7	2.2	130.5	100.00%	0.0
NMB	2/19/06	libor	US$	6.7	1.7	5.0	25.48%	19.6
DCB	2/19/07	libor	US$	43.6	6.1	37.5	79.29%	11.4
GB DCB	2/19/07	GBPlibor	GBP	25.8	0.0	25.8	66.03%	13.3
Par A	2/19/21	6.75	US$	138.1	0.0	138.1	55.20%	112.1
Par B	3/21/21	6.75	US$	22.8	0.0	22.8	74.78%	7.7
Float 2007	4/26/07	libor	US$	150.0	0.0	150.0	100.00%	0.0
Domestic Bonds								
Float 06/03 s.32	6/15/2003	libor	US$	37.8	32.9	4.9	96.32%	1.4
Float 09/03 s.33	9/22/2003	libor	US$	36.6	13.9	22.6	96.44%	1.4
Float 12/03 s.34	12/27/2003	libor	US$	39.0	15.9	23.1	97.26%	1.1
Float 03/04 s.35	3/22/2004	libor	US$	37.4	13.5	23.9	92.61%	3.0
Float 06/04 s.36	6/27/2004	libor	US$	24.8	3.8	21.0	97.37%	0.7
Float 09/04 s. 37	9/27/2004	libor	US$	28.9	5.6	23.3	97.55%	0.7
Float 11/04 s.38	11/7/2004	libor	US$	12.0	3.1	8.9	98.68%	0.2
Float 12/04 s.39	12/20/2004	libor	US$	28.6	4.2	24.4	98.23%	0.5
Float 03/05 s.40	3/27/2005	libor	US$	34.7	3.3	31.4	99.21%	0.3
Float 06/05 s. 41	6/23/2005	libor	US$	52.6	11.0	41.7	97.69%	1.2
Float 09/05 s.42	9/29/2005	libor	US$	31.1	9.4	21.7	99.51%	0.2
Float 12/05 s.43	12/22/2005	libor	US$	25.4	3.7	21.7	99.09%	0.2
Float 04/06 s. 44	4/8/2006	libor	US$	35.0	8.5	26.5	99.60%	0.1
Float 06/06 s. 45	6/12/2006	libor	US$	50.1	7.5	42.6	98.83%	0.6
Float 08/06 s. 46	8/20/2006	libor	US$	128.1	10.7	117.4	99.21%	1.0
Float 12/06 s.47	12/2/2006	libor	US$	48.1	7.2	40.9	98.87%	0.6
UGB 75/8 (fixed s.02)	3/5/2007	7.625	US$	108.2	98.0	10.2	99.74%	0.3
Float 5/09 s.48	5/15/2009	libor	US$	31.8	2.5	29.2	98.19%	0.6
Float 02/10 s.52	2/25/2010	libor	US$	82.4	4.1	78.3	99.43%	0.5
UGB 8 (fixed s.03)	2/25/2010	8	US$	46.0	40.6	5.4	99.66%	0.2
Float 03/11s.53	3/23/2011	libor	US$	10.6	3.4	7.2	97.24%	0.3
Float 05/13 s.54	5/29/13	libor	US$	105.4	0.0	105.4	100.00%	0.0
UGB 71/2 (fixed s.30)	3/23/2011	7.5	US$	297.9	244.4	53.5	99.57%	1.3
UGB 9 3/4 (fixed s.31)	2/28/2012	9.75	US$	39.9	21.9	17.9	99.70%	0.1
Float 06/12 s.49	6/30/2012	libor	US$	47.6	3.2	44.4	99.10%	0.4
Float 08/12 s.50	8/15/2012	libor	US$	28.4	2.0	26.4	99.94%	0.0
Float 08/12 s.51	9/22/2012	libor	US$	33.9	2.7	31.2	98.93%	0.4
UGB 7 (fixed s.29)	12/16/2005	7.5	US$	25.0	25.0	0.0	100.00%	0.0

Source: Central Bank of Uruguay

Chart 1. Uruguay Debt Exchange--Acceptances of Domestic Bonds Received by the Central Bank over Exchange Period

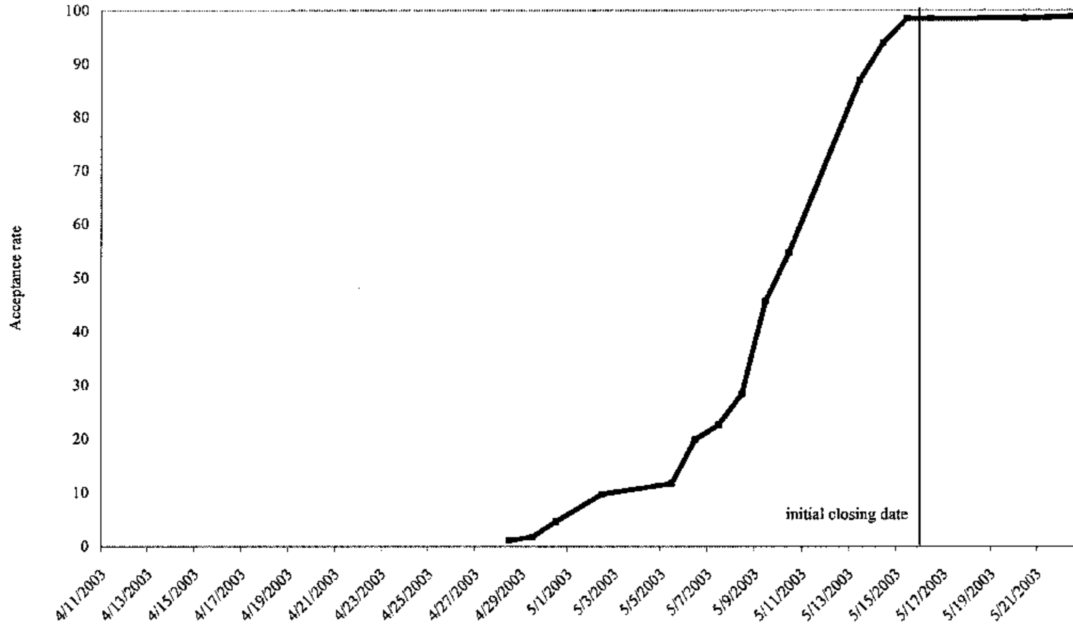


Chart 2. Uruguay Debt Exchange--Non-Participation Relative to NPV Reduction, External Bonds.

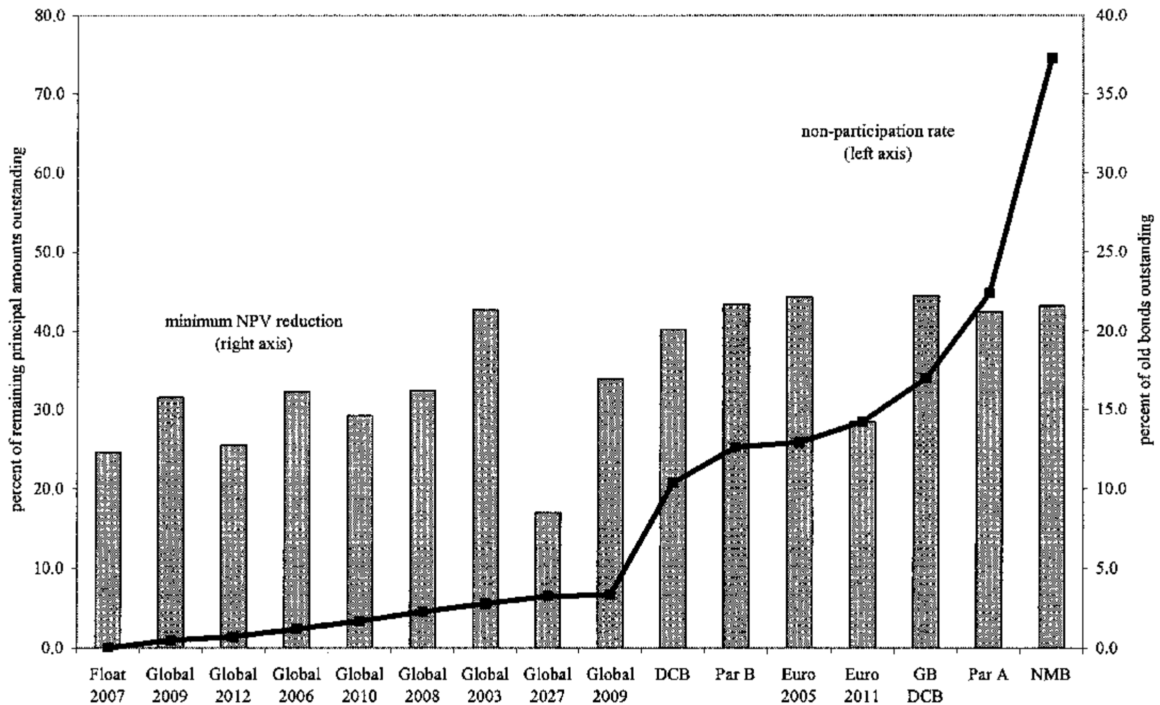


Chart 3. Uruguay Debt Exchange--Alternative Chosen, External Bonds

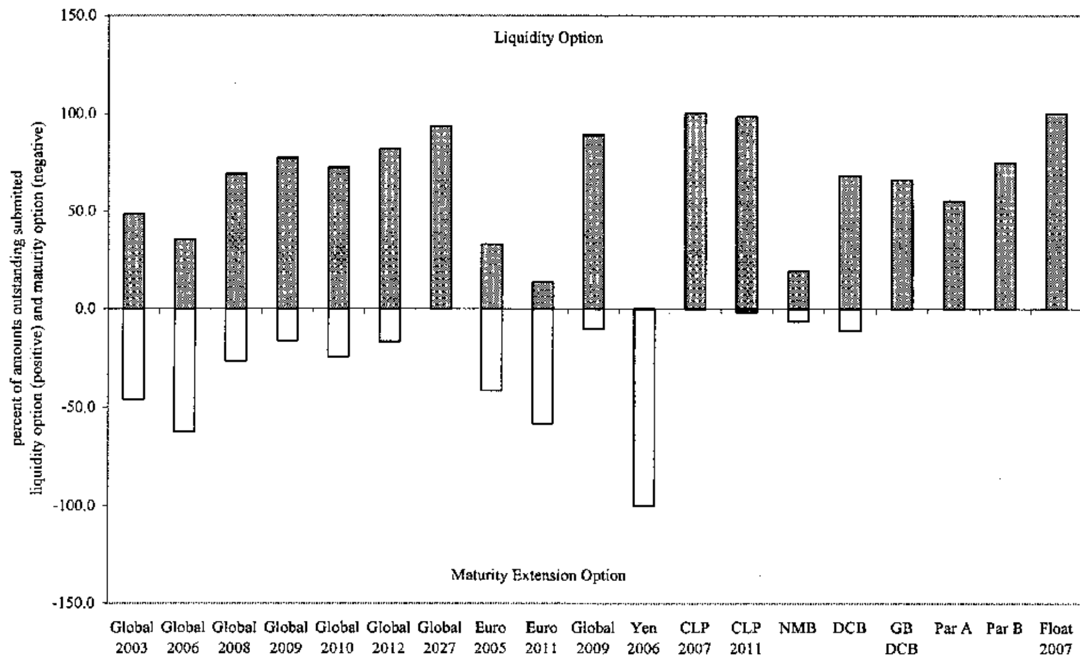


Chart 4. Uruguay Debt Exchange--Alternative Chosen Relative to NPV Differential, Domestic Bonds

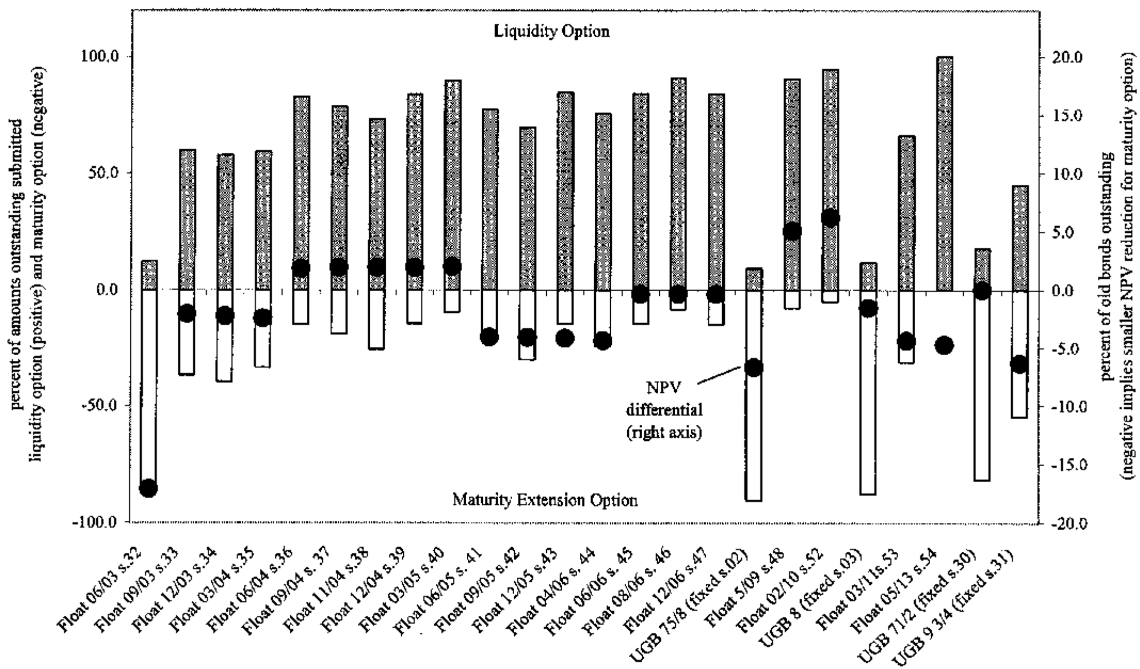
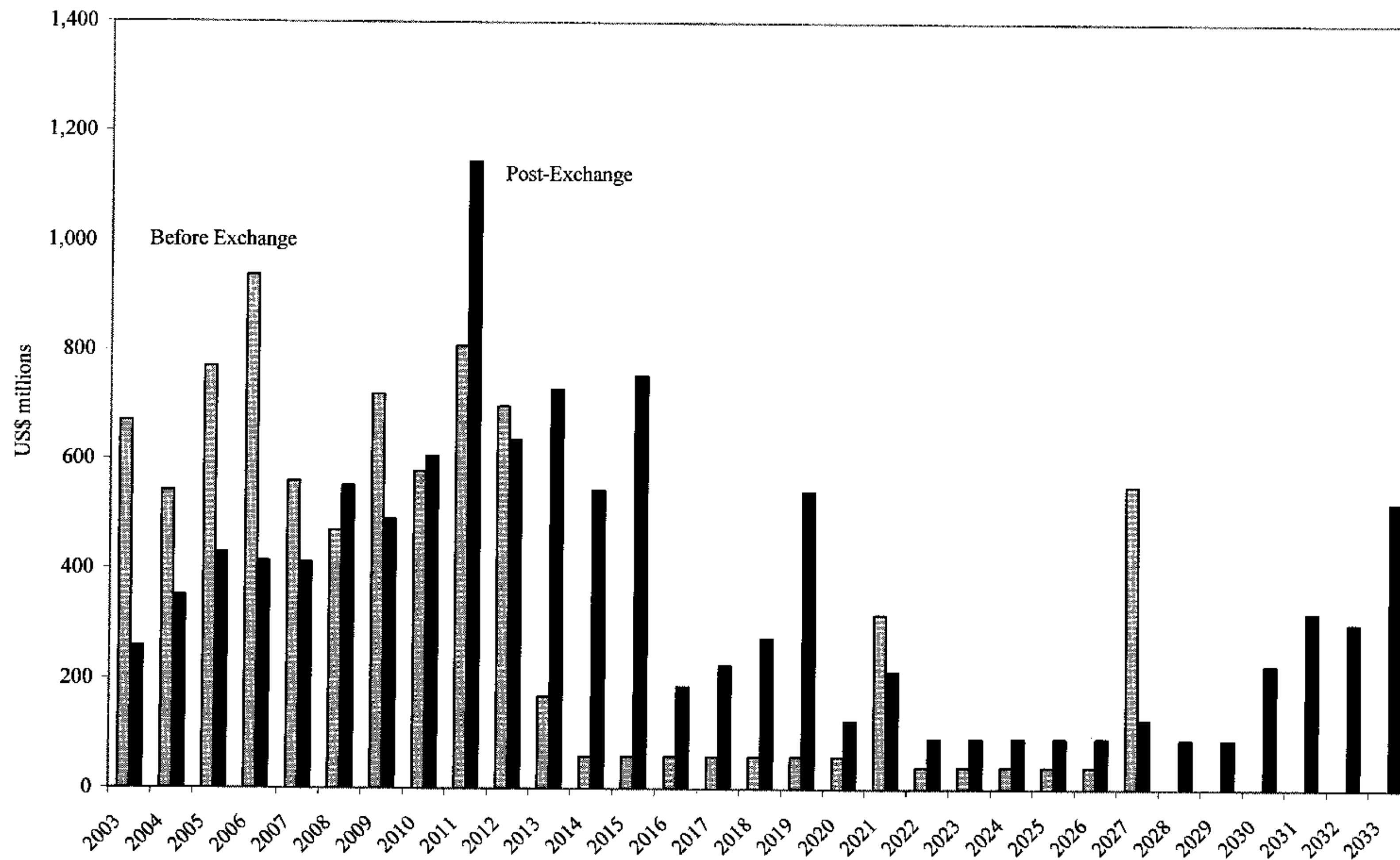


Chart 5. Uruguay Debt Exchange--Debt Service Payments Pre-and Post Exchange

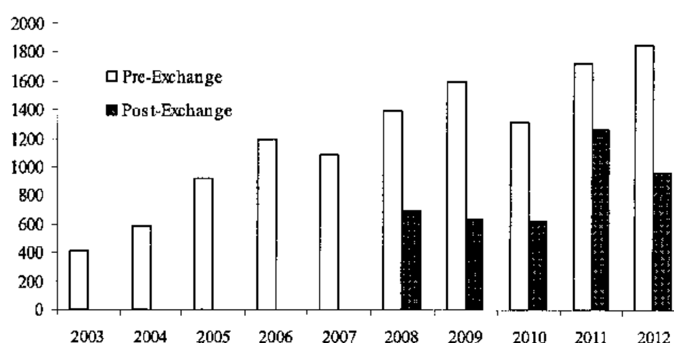


Debt Sustainability Analysis

1. **In early 2003, Uruguay's medium-term sustainability outlook presented severe vulnerabilities.** The debt-to-GDP ratio nearly doubled in 2002, to 90 percent by year-end,[1] because of the contraction in economic activity, a sharp depreciation of the peso vis-à-vis the U.S. dollar, and financial support provided by official creditors to stabilize the domestic banking system (totaling 18 percent of GDP). This resulted in very high gross financing needs for the NFPS, while generating a debt profile that would have remained above 65 percent of GDP for nearly a decade.

2. **The successful debt exchange has helped sharply reduce the financing needs of the nonfinancial public sector and lower the debt profile.** The residual financing needs, which before the exchange averaged 6.4 percent of GDP during 2003-07, have been eliminated (Figure 1). Similarly, during the period 2008-12 the residual financing needs have been reduced from 8.8 percent of GDP a year on average to 4.7 percent.

Figure 1. Uruguay: Residual Financing Needs
US$ million



3. **The post-exchange debt sustainability analysis (DSA) is based on strong and sustained fiscal consolidation, a steady recovery of real GDP, and on moderate recovery of the value of the peso against the U.S. dollar in real terms:**

- Economic growth is projected to recover from the current depressed levels to about 4 percent a year in 2005-06, and to average 2½-3 percent a year subsequently.

- The primary surplus of the nonfinancial public sector is projected to rise from 3 percent of GDP in 2003 to 3.8 percent of GDP by 2007, and to remain at that level in subsequent years.

[1] Defined as the debt of the nonfinancial public sector and the Brady bonds held by the central bank. Does not include the liabilities of the central bank but includes borrowing by the Fund for the Stabilization of the Banking System (FSBS).

- Over the medium term, the peso is projected to recover gradually from its sharp recent depreciation in real terms against the U.S. dollar, to about 75 percent of its 2001 level.

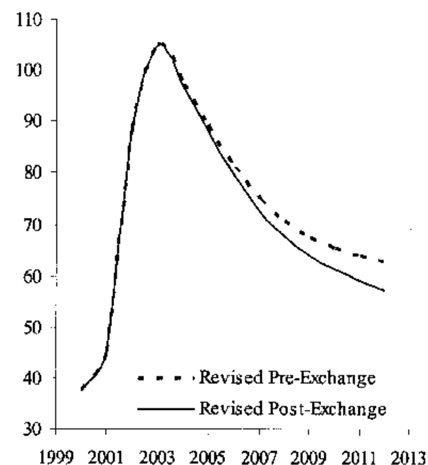
- Interest rate spreads are projected to decline from 1,200 basis points in 2003 to 500 basis points in 2008.

- The DSA includes, as non-debt financing, privatization proceeds equivalent to ¼ percent of GDP from 2004 onwards, as well as US$500 million in asset recovery from the banking sector during 2004-07.

4. **Under these assumptions, the debt-to-GDP ratio would fall to about 57 percent over the medium term.** Under the pre-exchange scenario, the debt-to-GDP ratio would have reached 63 percent by 2012, or five percentage points more than in the post-exchange scenario (Figure 2). The improvement is explained primarily by the lower cost of new market financing, which is pushed out by about five years along a declining yield curve.

5. **Sensitivity analysis on the post-exchange scenario shows that vulnerabilities persist.** In particular, the debt-to-GDP ratio is largely affected by real GDP growth, the real exchange rate path, and fiscal consolidation (Panel 1):

Figure 2. Uruguay: NFPS Debt
(In percent of GDP)

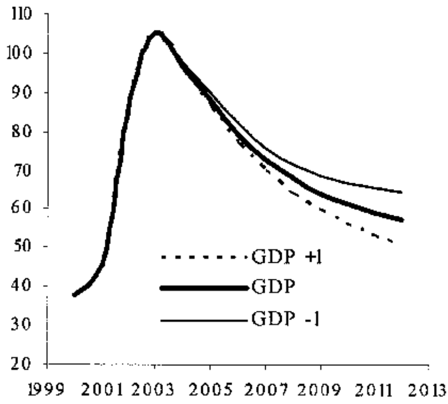


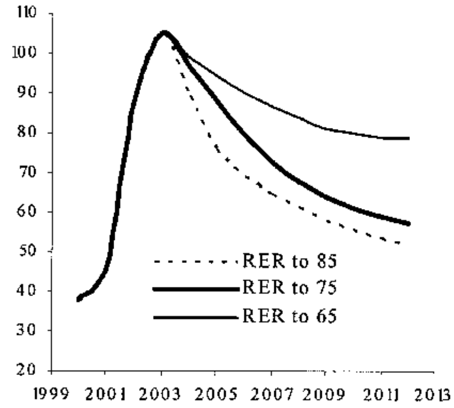
- ***Growth rate.*** If projected growth rates were lower than in the baseline scenario by 1 percentage point, the debt-to-GDP ratio would exceed baseline figures by 7 percentage points of GDP by 2012.

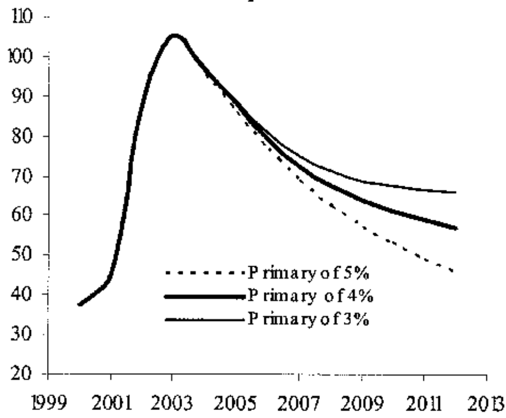
- ***Real exchange rate.*** If the real exchange rate against the U.S. dollar were to recover to only 65 percent of its average level in 2001 (instead of 75 percent as assumed in the baseline scenario), the debt-to-GDP ratio would be significantly higher, at 79 percent by 2012 (instead of 57 percent).

- ***Fiscal consolidation.*** If the primary surplus were to converge to 3 percent of GDP over the medium term (instead of close to 4 percent) the debt-to-GDP ratio would be higher by 9 percentage points of GDP by 2012.

Panel 1. Sensitivity Analysis to the Post-Exchange Scenario







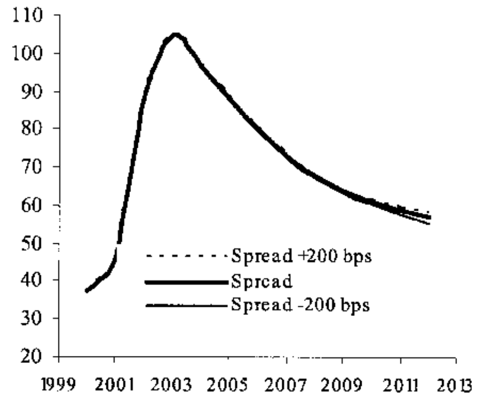


Table 1. Uruguay: Public Sector Debt Sustainability. Pre-Exchange.

		Projections										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
			A Assumptions									
Real GDP growth (percent)	-3.1	-10.8	-1.0	4.5	4.0	4.0	3.0	3.0	3.0	2.5	2.5	2.5
Interest rate spread (bps)	284	1400	1200	1000	800	700	600	500	500	500	500	500
Real U.S. dollar exchange rate (change in percent)	-13.8	-26.8	-14.0	3.3	4.6	4.4	4.2	1.4	0.0	0.0	0.0	0.0
Primary balance: Consolidated public sector	**-1.2**	**0.3**	**3.0**	**3.2**	**3.3**	**3.3**	**3.8**	**3.8**	**3.8**	**3.8**	**3.8**	**3.8**
Non-financial public sector	-1.0	0.5	3.2	3.4	3.5	3.5	4.0	4.0	4.0	4.0	4.0	4.0
BCU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Overall Balance: Consolidated public sector	**-4.2**	**-4.7**	**-3.6**	**-3.0**	**-2.6**	**-2.4**	**-1.7**	**-1.4**	**-1.3**	**-1.8**	**-2.1**	**-2.5**
Non-financial public sector	-3.9	-4.4	-2.8	-2.2	-1.8	-1.6	-0.9	-0.6	-0.5	-1.0	-1.3	-1.7
BCU	-0.3	-0.3	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
			B. Debt Dynamics (in percent of GDP)									
Gross non-financial public sector debt	**45**	**89**	**105**	**97**	**89**	**81**	**75**	**71**	**67**	**66**	**64**	**63**
			C. Cash Flow (in millions of U.S. dollars)									
Gross borrowing needs	**2092**	**3443**	**1430**	**1428**	**1754**	**2102**	**1988**	**1745**	**1826**	**1625**	**2074**	**2300**
Public sector deficit	715	532	315	257	228	224	143	100	88	178	232	323
Amortization	1377	2911	1115	1171	1525	1878	1845	1646	1738	1447	1842	1977
Market debt 3/	1208	2675	860	924	1323	1720	1664	1418	1489	1198	1572	1695
IDB/WB and other official debt	169	236	255	247	203	158	180	228	249	249	270	282
Gross Financing	**2092**	**3443**	**1018**	**837**	**830**	**910**	**903**	**351**	**225**	**313**	**353**	**451**
Market debt	1035	1088	396	421	446	567	579	377	396	416	438	463
IDB/WB and other official debt	349	800	622	316	203	158	186	234	255	255	275	288
Other 3/	708	1555	0	100	182	185	138	-260	-425	-358	-360	-300
Securitization ANCAP			0	0	0	0	0	0	0	0	0	0
Privatization proceeds			0	0	32	35	38	40	43	0	0	0
Asset recovery			0	100	150	150	100	0	0	0	0	0
Use of reserves minus IMF amortization			0	0	0	0	0	-300	-468	-358	-360	-300
Residual financing needs	...	...	**412**	**591**	**923**	**1192**	**1085**	**1394**	**1601**	**1313**	**1721**	**1850**
			D. Other Indicators									
Total debt service (in percent of GDP)		11.3	17.6	16.9	19.6	23.9	22.1	16.7	17.4	15.8	16.4	15.9
Residual financing needs (in percent of GDP)		...	3.9	5.1	7.3	8.5	7.2	8.6	9.4	7.4	9.3	9.5
Average interest rate (in percent)		0.6	6.3	5.9	6.0	6.3	6.6	6.6	6.7	7.8	8.4	9.3

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

1/ Inlcudes cash payments to investors in 2003.
2/ On obligation basis.
3/ Includes commercial bank loans, cash payments to investors and bank assistance.
4/ Includes privatization proceeds, asset recovery, and use of reserves minus IMFamortizations.

Table 2. Uruguay: Public Sector Debt Sustainability. Post-Exchange.

		Projections										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					A Assumptions							
Real GDP growth (percent)	-3.1	-10.8	-1.0	4.5	4.0	4.0	3.0	3.0	3.0	2.5	2.5	2.5
Interest rate spread (bps)	284	1400	1200	1000	800	700	600	500	500	500	500	500
Real U.S. dollar exchange rate (change in percent)	-13.8	-26.8	-14.0	3.3	4.6	4.4	4.2	1.4	0.0	0.0	0.0	0.0
Primary balance: Consolidated public sector	**-1.2**	**0.3**	**3.0**	**3.2**	**3.3**	**3.3**	**3.8**	**3.8**	**3.8**	**3.8**	**3.8**	**3.8**
Non-financial public sector	-1.0	0.5	3.2	3.4	3.5	3.5	4.0	4.0	4.0	4.0	4.0	4.0
BCU	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Overall Balance: Consolidated public sector	**-4.2**	**-4.7**	**-3.6**	**-2.5**	**-2.0**	**-1.7**	**-1.0**	**-0.6**	**-0.6**	**-0.9**	**-1.1**	**-1.6**
Non-financial public sector	-3.9	-4.4	-2.8	-1.7	-1.2	-0.9	-0.2	0.2	0.2	-0.1	-0.3	-0.8
BCU	-0.3	-0.3	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
					B. Debt Dynamics (in percent of GDP)							
Gross non-financial public sector debt	**45**	**89**	**105**	**97**	**88**	**79**	**73**	**68**	**64**	**61**	**59**	**57**
					C. Cash Flow (in millions of U.S. dollars)							
Gross borrowing needs	**2092**	**3443**	**1018**	**837**	**830**	**910**	**903**	**1044**	**866**	**939**	**1617**	**1414**
Public sector deficit	715	532	319	202	149	133	25	-28	-37	25	50	151
Amortization	1377	2911	698	635	682	777	878	1072	903	914	1567	1264
Market debt 3/	1208	2675	444	387	479	619	698	844	653	665	1297	981
IDB/WB and other official debt	169	236	255	247	203	158	180	228	249	249	270	282
Gross Financing	**2092**	**3443**	**1018**	**837**	**830**	**910**	**903**	**351**	**225**	**313**	**353**	**451**
Market debt	1035	1088	396	421	446	567	579	377	396	416	438	463
IDB/WB and other official debt	349	800	622	316	203	158	186	234	255	255	275	288
Other 3/	708	1555	0	100	182	185	138	-260	-425	-358	-360	-300
Securitization ANCAP			0	0	0	0	0	0	0	0	0	0
Privatization proceeds			0	0	32	35	38	40	43	0	0	0
Asset recovery			0	100	150	150	100	0	0	0	0	0
Use of reserves minus IMF amortization			0	0	0	0	0	-300	-468	-358	-360	-300
Residual financing needs	**...**	**...**	**0**	**0**	**0**	**0**	**0**	**693**	**640**	**626**	**1264**	**964**
					D. Other Indicators							
Total debt service (in percent of GDP)		11.3	13.2	11.9	12.3	15.4	15.0	12.4	11.7	12.0	13.9	11.3
Residual financing needs (in percent of GDP)		...	0.0	0.0	0.0	0.0	0.0	4.3	3.8	3.5	6.8	5.0
Average interest rate (in percent)		0.6	6.1	5.4	5.3	5.6	5.7	5.6	5.9	6.8	7.3	8.5

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

1/ Inlcudes cash payments to investors in 2003.
2/ On obligation basis.
3/ Includes commercial bank loans, cash payments to investors and bank assistance.
4/ Includes privatization proceeds, asset recovery, and use of reserves minus IMFamortizations.

Table 3. Uruguay: Sensitivity of Nonfinancial Public Sector Debt

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
	(In percent of GDP)										
Sensitivity to GDP growth											
GDP growth higher by 1 percent a year	89	105	96	86	77	70	64	59	56	53	51
GDP growth converges to 2.5 percent a year	89	105	97	88	79	73	68	64	61	59	57
GDP growth lower by 1 percent a year	89	105	98	90	82	76	72	69	67	65	65
Sensitivity to the real exchange rate											
RER converges to 85 (2001 = 100)	89	105	89	76	69	64	61	58	55	53	52
RER converges to 75 (2001 = 100)	89	105	97	88	79	73	68	64	61	59	57
RER converges to 65 (2001 = 100)	89	105	99	94	90	87	84	81	80	79	79
Sensitivity to primary surplus											
Primary surplus of 5 percent of GDP	89	105	96	86	76	68	62	57	53	49	46
Primary surplus of 4 percent of GDP	89	105	97	88	79	73	68	64	61	59	57
Primary surplus of 3 percent of GDP	89	105	97	89	81	75	71	69	67	66	66
Sensitivity to interest rates											
Country risk premium converges to 700 basis points	89	105	97	88	79	73	68	64	62	60	58
Country risk premium converges to 500 basis points	89	105	97	88	79	73	68	64	61	59	57
Country risk premium converges to 300 basis points	89	105	97	88	79	72	67	63	60	58	56

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

URUGUAY-FUND RELATIONS
(As of May 30, 2003)

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

A. Financial Relations

II. **General Resources Account**:

	In millions of SDRs	In percent of Quota
Quota	306.50	100.0
Fund holdings of currency	1,829.53	596.9

III. **SDR Department**:

	In millions of SDRs	Percent of Allocation
Net cumulative allocation	49.98	100.0
Holdings	19.68	39.38

IV. **Outstanding Purchases and Loans**:

	In millions of SDRs	In percent of quota
Stand-by arrangements	1,523.03	496.91

V. **Financial Arrangements**:

Type	Approval Date	Expiration Date	SDR Millions Amount Approved	Amount Drawn
Stand-by	4/01/02	3/31/04	2,128.30	1,330.20
Of which SRF	6/25/02	8/08/02	128.70	128.70
Stand-by	5/31/00	5/31/02	150.00	150.00
Stand-by	3/29/99	3/28/00	70.00	0.00

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

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	42.83	128.70	226.63	648.44	449.13
Charges/interest	37.57	50.53	43.61	26.24	7.22
Total	80.4	179.23	270.24	674.68	456.34

B. Nonfinancial Relations

VII. **Safeguards Assessment:** Under the Fund's safeguards policy, the Central Bank of Uruguay (BCU) was subject to a safeguards assessment with respect to Uruguay's current Stand-By Arrangement (approved on April 1, 2002). An on-site assessment of the BCU was conducted in July 2002, and the final safeguards assessment report was approved by management on January 16, 2003. The assessment identified a need to strengthen the control and oversight framework within the BCU, in particular in the external audit area. To this end, staff recommended the establishment of an audit committee and the hiring of a private audit firm with international affiliation and a strong expertise in commercial or central bank audits to perform a financial audit of the BCU in accordance with International Standards on Auditing. In addition, it was recommended that similar external audit procedures be established for the FSBS. The authorities are committed to the implementation of all the safeguards recommendations, including the completion of an external audit of the FSBS by September 30, 2003.

VIII. **Exchange Rate Arrangement**: The currency is the Uruguayan peso (Ur$). Uruguay follows an independently floating exchange rate regime. On June 26, 2003, buying and selling interbank rates for the U.S. dollar, the intervention currency, were Ur$26.40 and Ur$26.45 respectively. Uruguay's exchange system is mostly free of restrictions on payments and transfers for current international transactions. The reprogramming through December 2005 of time deposits at BROU and BHU gives rise to an exchange restriction under Article VIII, as it prevents nonresidents affected by the reprogramming from transferring abroad proceeds of recent current international transactions. Staff has recommended approval of the exchange restriction, given that this measure is temporary and does not discriminate among Fund members.

IX. **Article IV Consultation:** The 2001 Article IV consultation was concluded by the Executive Board on February 14 (EBS/01/17). Uruguay is on the standard 12-month cycle. Discussions for the 2002 Article IV consultation were initiated in September 2002, deferred because of delays in concluding the program review, continued in January-February 2003, and completed in May.

X. **FSAP participation, ROSCs, and OFC Assessments:** The ROSC-module on fiscal transparency was published on March 5, 2000. A ROSC-module on data dissemination practices was published on October 18, 2001. The authorities have requested participation in an OFC assessment for early 2002. The FSAP exercise started in November 2001; its completion has been delayed until the situation stabilizes.

XI. **Technical Assistance**: A STA mission on money and banking statistics took place in March 1999. 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. Technical assistance in the areas of tax and customs administration had been provided by the FAD in 1996. In June 2000 and May 2001, FAD provided technical assistance in the area of quasi-fiscal activities in the public sector. In

December 2001, STA provided technical assistance to help Uruguay subscribe to the SDDS. In September 2002, FAD provided technical assistance in the areas of tax policy and revenue administration to prepare a comprehensive tax reform. In April 2003, STA provided technical assistance on adequate recording of the loans funded by the FSBS.

XII. **Resident Representative**: Mr. Andreas Bauer

RELATIONS WITH THE WORLD BANK GROUP

In the past, Bank project lending has been focused on infrastructure and agriculture developments. In addition, in the late 1980s, the Bank began providing support through structural adjustment lending. The first SALs of 1987 and 1989 supported 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 stand-alone debt and debt service reduction operation (DDSR) was also approved in 1991.

In the 1990s, the Bank continued to support infrastructure development oriented towards exports of natural resource-based goods (e.g., forestry). In addition, the Bank supported programs in basic education and institutional development of the health sector. An adjustment loan supported reforms that established the multi-pillar social security system.

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. During 2000, two loans were approved: a Financial Sector Adjustment Loan (FSAL) - that supported actions to strengthen the framework for the functioning of the financial system – and a Water Sector Adaptable Program Loan. In early 2001, a technical assistance loan was approved to help establish a public utility regulatory department. In end-July 2001, the Board approved the Foot and Mouth Disease Emergency Recovery Project, financing livestock vaccinations. In October 2002, the Bank approved a $300 million SAL /SSAL operation. A second SAL /SSAL for $250 million focusing on improving public services was approved on April 8, 2003.

The last Portfolio Performance Review took place in December 2002. At that time, the portfolio comprised eight investment projects for a total of US$382 million in commitments (of which US$182.9 million are undisbursed) in addition to one SAL and SSAL. The investment projects concentrate primarily in the infrastructure sector, with five out of eight projects totaling an amount of US$293.5 million in commitments (or 76.7 percent of the portfolio). In addition, the portfolio of investment projects comprises two operations in the education sector, and one emergency project in the agriculture sector. The portfolio exhibited a marked fall in disbursements in 2002, indicating growing difficulties in project implementation, due to budgetary constraints.

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

	Commitments (Net of Undisbursed Cancellations)	Disbursements	Amount
I. IBRD Operations (as of April 30, 2003)			
Sector			
Agriculture	18.5	12.2	6.3
Central Government and Administration	555.6	280.6	275.0
Telecommunication	6.0	0.4	5.6
Education	70.0	28.4	41.6
Power	125.0	66.5	58.5
Transportation	135.5	96.5	39.0
Water Supply	27.0	2.7	24.3
Total	**937.6**	**437.3**	**450.3**

II. IFC Operations (as of May 31, 2003)

	Loans	**Equity**	**Quasi**	**Participation**
Held	31.8	6.0	15.9	1.8
Disbursed	15.1	6.0	15.9	1.8

III. IBRD Loan Transactions (calendar year)

	1994	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**
Disbursements	37.0	31.7	38.7	50.4	143.9	66.3	134.2	64.7	233.5	81.6
Repayments	56.2	77.8	69.7	67.9	64.1	63.2	57.9	72.5	75.3	24.9
Net Lending	-19.2	-46.1	-31.0	-17.5	79.8	3.1	76.3	-7.8	158.2	56.8

Sources: World Bank (IBRD data); and IFC (IFC data).

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

The most recent IDB Country Strategy for Uruguay focuses on the following priority areas for the Bank's action, by providing support to: (i) initiatives that enhance the regional and international competitiveness of domestic output and encourage private investment, where production is based on the country's comparative advantages and the use of modern technology, in order to foster healthy competition and allow for integration with both the regional and international markets; (ii) the further reform of the State, its modernization and improvements in governance, with a view to diminishing the role of the State in the economy; increase its efficiency; rationalize expenditure and target its interventions; and reduce its role in the production of domestic goods and services; and (iii) improving social welfare and increasing equity, particularly to those families and children living in poverty, allowing them to participate in the development process; reforming education and the health sectors, as well as developing social safety nets for families at risk, particularly in the poorest sectors. Support will also continue to be given to ongoing actions in the fields of citizen safety, housing, sanitation and potable water supply.

In 2002, the IDB approved four loans: (i) in the competitiveness strategic area, a Multisector Global Credit Program for US$180 million, providing medium and long term financing for investment by private enterprises; (ii) in the public sector reform area, a loan for Improvement in Municipal Management (IMM), for US$3 million; and (iii) in the welfare and equity, a loan for Infancy, Adolescents and Families at Risk, for US$40 million. In addition, the special operation for Social Protection and Sustainability was approved in August 2002, for US$500 million, thus supporting the financial package provided by the multilateral organizations. The Lending Program for 2003 anticipates a Financial Sector Loan for US$200 million, in support of reforms in the sector, as well as a Development and Management Program for the Municipalities for US$60 million.

As of June 15, 2003 the Bank's active portfolio in Uruguay includes 20 loans for the financing of investment projects; two sector loans, for Health Reforms and for Modernization of Public Management respectively; and 27 nonreimbursable technical cooperations. The lending portfolio amounts to US$1,282.4 millions, of which US$427.1 million are pending disbursements.

FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

I. IDB Active Portfolio[1]
(US$ million)

Strategic Lending Areas	Approved	Disbursed	Undisbursed
Competitiveness and Regional Integration	638	486	152
Reform of the State and Governance	163	113	50
Social Welfare and Equity[2]	481	256	225
Total	**1,282**	**855**	**427**
Total outstanding debt (due IDB)			**1,988**

II. IDB Net Flows of Convertible Currency
(US$ million)

	1996	1997	1998	1999	2000	2001	2002	2003[3]
Disbursements	92.2	178.7	150.8	358.5	162.9	214.2	558.6	360.0
Amortization	35.4	45.7	48.3	57.0	59.4	60.7	73.1	87.0
Net Loan Flows	**56.8**	**133.0**	**102.5**	**301.5**	**103.5**	**153.5**	**485.5**	**273.0**

Source: Inter-American Development Bank.

1/ As of June 15, 2003
2/ Excludes Program for Social Protection and Sustainability
3/ Bank estimates for the year, as of June 15, 2003

URUGUAY: 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 a staff visit to Montevideo (April 5–6, 2001) to present the findings of the data module of the Report on Observance of Standards and Codes (ROSC), the Uruguayan authorities reiterated their commitment to subscribe to the SDDS in the near future. An SDDS mission visited Montevideo (December 5–14, 2001) to assist the authorities in finalizing their work toward subscription to the SDDS. A key pending issue for subscription to the SDDS is the dissemination of the template on international reserves and foreign currency liquidity. Recently, however Uruguay submitted the Template on International Reserves and Foreign Currency Liquidity for review to STA.

Real sector

National account statistics have a number of shortcomings, including the use of an outdated benchmark year 1983, limited coverage of the enterprise survey, long publication lags, inadequate information on the informal economy, and incomplete quarterly accounts. The BCU compiles and disseminates annual GDP estimates in current and constant prices by production and expenditure approach, as well as quarterly constant price GDP estimates by production and expenditure approach. Gross national income, gross disposable income and gross savings are also available annually. 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 March 1997 =100, and the wholesale price index has a base of January 1988=100. The coverage of the CPI is limited to the capital city.

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* includes data on the central government; however, annual central government debt data have not been reported for periods after 1994 and data on local governments have not been reported for periods after 1997.

Monetary accounts

Two STA money and banking statistics missions visited Montevideo in July 1998 and March 1999. The missions reviewed 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 1999 multisector mission continued work on improving the basic source data and the methodology for compiling monetary statistics, and recommended a new reporting system, which has since been adopted by the Central Bank. The mission developed a database that contains the data needs for publication in *IFS* and for operational use by WHD.

The STA mission that visited Montevideo in April 2003 provided recommendations for the adequate recording of the loans funded from the Fund for the Stabilization of the Banking System in the Central Bank's balance sheet. The mission's recommendations have been implemented and were reflected in the *IFS* June 2003 issue.

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). 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 balance of payments and the international investment position (IIP). The new surveys would also allow for improved coverage of the private sector in the IIP.

URUGUAY: Core Statistical Indicators

as of May 30, 2003

	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	5/29/03	5/28/03	5/24/03	4/03	1/03	5/29/03	4/03	2/03(X) 3/03 (M)	1/03	1/03	Q1 03	12/02
Date received	5/29/03	5/29/03	5/29/03	5/21/03	5/01/03	5/29/03	5/02/03	4/03	4/03	4/03	5/03	4/03
Frequency of data	Daily	Daily	Daily	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Quarterly
Frequency of reporting	Daily	Daily	Daily	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Monthly	Quarterly	Quarterly
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	Web	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

INTERNATIONAL MONETARY FUND

URUGUAY

Third Review Under the Stand-By Arrangement and Request for Modification and Waiver of Applicability of Performance Criteria

Supplementary Information—Report on the 2002 Banking Crisis

Prepared by the Monetary and Financial Systems Department

Approved by Stefan Ingves

June 27, 2003

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I. Introduction and Summary

This note summarizes developments in the Uruguayan banking sector during 2002. It discusses the main characteristics of the banking system prior to the onset of the crisis in early 2002. The policy responses of the authorities to the escalating withdrawals of deposits from Uruguayan banks triggered initially by contagion from Argentina and later by a decline in confidence are described. This includes financial support provided by the authorities and an estimation of their likely recovery. Finally, the note assesses the future challenges faced by the banking sector in Uruguay.

II. Structure of the Banking System: Strengths and Vulnerabilities[1]

A. The Banking System Prior to the Crisis

1. **At end-2001, the financial soundness indicators of Uruguay's banking system were mixed.** Overall, capitalization and liquidity of the banking system appeared adequate, but bank earnings were generally negative because of the economic recession. Exposure to the public sector was limited, as the government met its financing needs chiefly through the issuance of debt instruments outside the domestic banking system. At end-2001, bank holdings of government debt amounted to less than 3 percent of total bank assets, and were mainly concentrated in a few banks. Private banks had in general low, though rising, nonperforming loans.

Deposit Structure at end-2001
(In millions of U.S. dollars)

	Total	Resident	Nonresid.
Total 1/	**13,943**	**7,804**	**6,139**
Public banks	4,568	3,918	650
Private banks	9,375	3,886	5,489
Domestic banks	3,090	2,400	690
Foreign banks	6,285	1,486	4,799
Subsidiaries	3,707	506	3,201
Branches	2,578	980	1,598

1/ Includes banks and COFAC (largest cooperative).

Uruguay: Banking Soundness Indicators, 2001
(In percent)

	Total	Public	Private
Asset quality			
NPLs/total loans	17.9	39.1	5.6
Provisions/NPLs	49.7	39.2	91.7
Capital adequacy			
Assets/capital	16.7	12.2	22.3
Capital/risk adjusted assets	11.8	17.5	7.6
Profitability (in percent)			
R.O.A (after-tax)	-2.3	-4.5	-0.9
R.O.E (after tax)	-28.1	-35.4	-16.2
Liquidity			
Loans/deposits	93.2	89.5	96.4
Liquid assets/deposits	15.9	20.9	13.6
Memorandum (in percent)			
Total assets (share)	100.0	40.9	59.1
FX deposit/total deposit	89.1	84.2	92.1
FX loans/total loans	80.6	56.0	93.0

Sources: BCU and Fund staff estimates.

2. **Prudential regulation and banking supervision, although reinforced, remained weak.** In 2001, the capital adequacy ratio was increased from 8 percent of risk-weighted assets to 10 percent, and loan classification regulations were tightened. The Superintendency of Banks lacked specific prudential rules to mitigate the risks associated with the high degree of dollarization of the banking system and the large inflows of non-resident deposits. In particular, there were no special liquidity requirements on such deposits, no direct limits on exposure to

[1] This supplement was prepared by C. S. Lee and S. Seelig (both MFD), in collaboration with M. de Bolle (PDR), and K. Honjo and G. Terrier (both WHD).

currency risk or quantitative limits on foreign currency lending, and no limits on maturity mismatches. Also, the Superintendency has been unable to adequately supervise and sanction the state-owned banks because, under the Constitution of Uruguay, the authority of the central bank over these banks is unclear. State banks suffered persistent delays in their submission of financial reports to the central bank which hampered monitoring of banking system vulnerabilities.

3. **The financial position of the two large state-owned banks was very weak.** State-owned banks were subjected to lending practices motivated by political decisions, as well as legislated bank loan restructuring and other debt relief schemes for distressed bank borrowers. As a result, their balance sheets were weak, with a much higher proportion of nonperforming loans than in the rest of the banking system, higher costs, and lower profits. In addition, the state mortgage bank has a structural imbalance, stemming from a mismatch between liabilities in U.S. dollars and a portfolio of loans in domestic currency indexed to wage developments. The state banks lent primarily to the agricultural and mortgage sectors, which were severely hit by the downturn in economic growth.

Box 1. Main Characteristics of the Banking System at End-2001

- **The banking system was highly segmented.** It was dominated by two large state banks, Banco de la Republica Oriental de Uruguay (BROU) and Banco Hipotecario del Uruguay (BHU), accounting for one third of total deposits. It also included 23 private banks, 9 investment banks, and 6 savings and loans cooperatives.

- **Total bank deposits were relatively high by regional standards**, at close to 85 percent of GDP at end-2001. However, some 44 percent of total deposits were held by nonresidents, mainly Argentines, which was a major source of vulnerability. Foreign banks had 80 percent of non-resident deposits but only 20 percent of resident deposits.

- **Public banks accounted for 33 percent of deposits**, foreign bank branches and subsidiaries for 45 percent, and domestically owned private banks for 22 percent. In addition, off-shore banking catered mainly to clients from Brazil and Argentina, taking advantage of Uruguay's strict bank secrecy provisions and full respect of financial contracts.

- **The degree of dollarization of the banking system was high**, covering 93 percent of deposits. A high proportion of bank loans (70 percent) was also denominated in foreign currency (mainly U.S. dollars), half of which were to borrowers with no dollar earnings. Foreign bank subsidiaries and branches were generally more prudent than public banks, internalizing the potential risk from exchange rate fluctuations and avoiding exposure to the non-tradable sector.

- **The level of freely available international reserves was low.** At US$3.1 billion, the level of gross reserves appeared adequate, equivalent to 200 percent of the monetary base and 8 months of imports. However, freely available reserves (gross reserves net of the deposits of banks and other non-bank holdings at the central bank) amounted to only US$1.4 billion, or about one-tenth of total dollar deposits (compared to 40 percent in other dollarized systems).

- **Uruguay does not have a formal deposit insurance scheme.** However, the government had a history of bailing out depositors in earlier episodes of bank distress. State banks operate under statutory laws that imply that their operations are fully guaranteed by the government.

4. **Among private banks, foreign-owned banks were generally better run that domestically-owned ones.** Foreign bank branches and subsidiaries were generally careful not to lend to domestic residents in U.S. dollars, except if they had well-identified sources of income in foreign currency, including those stemming from trade-related activities. Foreign banks generally held the counterpart to their large holdings of non-resident deposits in liquid assets abroad. In contrast, domestic bank management of liquidity risks and implicit exposure to exchange rate fluctuations was weak or nonexistent. Domestic banks were chief providers of U.S. dollar bank loans, where the dollar lending rates were consistent with international rates and substantially lower than peso lending rates.

B. The 2002 Crisis

5. **The crisis was triggered by contagion affecting the liability side of bank balance sheets.**[2] Following the introduction of a deposit freeze and pesification of bank deposits and assets in Argentina in late 2001, cash-strapped Argentine depositors began withdrawing their funds in Uruguay. At a later stage, contagion was compounded by a sharp decline in confidence due to concerns that the government might be unable to simultaneously service its debt and support distressed banks. The crisis developed in three distinct episodes:

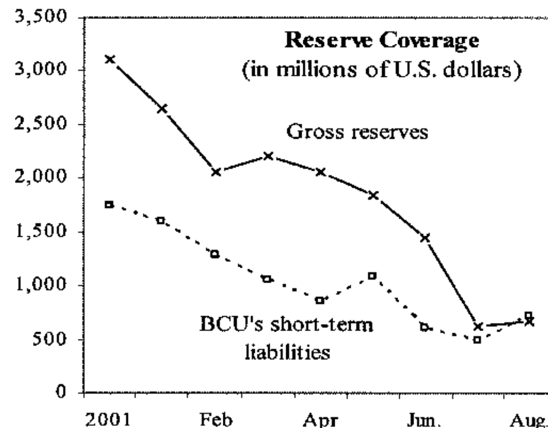
- **A first wave of bank runs started in February-March, during which deposits (mostly non-resident) fell by 12 percent, reflecting contagion from Argentina**. Two banks suffered sharp withdrawal of deposits held by non-resident Argentines: (a) the local subsidiary of an Argentine bank (*Banco de Galicia*); and (b) *Banco Comercial*, a Uruguayan bank with foreign capital. While vulnerabilities in *Banco Galicia* stemmed from restrictions placed on its parent bank and main clients based in Argentina, the problems in the second bank arose from alleged fraudulent practices by its management which depleted its capital. The authorities

Uruguay: Dollar Deposits (changes)
(In millions of U.S. dollars)

	2002				
	Q1	Apr	May	Jun	Jul
TOTAL	**-1,646**	**-731**	**-1,493**	**-761**	**-1,216**
RESIDENT	**-628**	**-327**	**-774**	**-201**	**-677**
Public banks	-3	-130	-408	-134	-297
Private banks	-625	-198	-367	-67	-381
Pri. Local	-488	-139	-217	-63	-231
Foreign banks	-137	-59	-150	-4	-150
Subsid.	-97	-39	-39	-2	-30
Branch	-40	-20	-111	-2	-120
NONRESIDENT	**-1,018**	**-404**	**-718**	**-560**	**-539**
Public banks	-3	-69	-88	-98	-88
Private banks	-1,015	-335	-630	-462	-451
Pri. Local	-95	-42	-92	-63	-71
Foreign banks	-920	-293	-537	-399	-380
Subsid.	-561	-156	-269	-217	-165
Branch	-359	-137	-269	-183	-216

[2] This factor is important in understanding the policy responses and in separating this crisis from earlier episodes in Uruguay and in other countries. Rather than reflecting the weakness and solvency of Uruguayan banks, withdrawals stemmed from a desire of non-resident depositors to protect their savings from regional instability. Thus, some deposits withdrawn from international banks based in Uruguay were redeposited with the same banks in their home country or outside the region.

suspended the operations of the first bank and recapitalized the second which, together with the announcement of a financial program with the Fund, provided temporary respite. In January 2002, the authorities also introduced greater exchange rate flexibility and widened the crawling exchange rate band.



- **A second wave developed in April-May, during which deposits fell by an additional 20 percent, amidst growing uncertainties stemming from a sharp deterioration in market sentiment about Uruguay's prospects and further contagion from Argentina.** Deposit outflows spread to resident depositors, following Uruguay's downgrade from investment grade status, while domestic banks began to experience significant liquidity shortages (mainly *Banco de Montevideo, Caja Obrera,* and *Banco de Crédito*). Market confidence sagged, the exchange rate weakened, and government bond spreads nearly doubled amidst heightened concerns that political turbulence could lead to an Argentina-like scenario.

- **The third wave began in late June, reflecting a further fall in market sentiment and a sharp devaluation of the peso.** By end-July, 42 percent of deposits had been withdrawn and most domestic banks had become insolvent. Gross official international reserves fell to a critically low level (US$0.6 billion) as a result of sizeable liquidity support provided by the central bank and banks' withdrawals of excess reserves. A bank holiday was declared on July 30, and lifted on August 5 after a new policy strategy was put in place.

III. Policy Response

6. **Given that the banking crisis had originated primarily from the liability side of balance sheets, the initial policy response had been the provision of liquidity support.** As expected, the response intensified as the crisis deepened. Initially, acting on the premise that the crisis would be temporary, the authorities urged banks to resort to their own liquid resources and credit arrangements to meet withdrawals. However, as outflows intensified and spread to domestic banks, the central bank began to provide several forms of liquidity

assistance while differentiating between the needs of a core group of domestic banks and those of foreign bank branches and subsidiaries.[3]

- ***Core banks.*** Liquidity assistance was provided to core banks,[4] defined as banks with a critical participation in the payment system, a large branch network and client base, and provision of essential banking services.

- ***Noncore banks.*** No overt discriminatory policies were put in place against non-core banks, but the authorities did intensify their contacts with the management of foreign banks to signal that these banks were expected to use their own resources. Over this period, foreign banks did finance their deposit outflows with liquid assets held abroad and a gradual reduction in their assets, including their loan portfolio.

A. Financial Assistance

7. **The lender-of-last-resort facilities of the central bank quickly became insufficient.** The sheer size of dollar deposits in the system relative to the central bank's international reserves put in question its ability to act as a credible lender of last resort. Moreover, under its Charter, the central bank's ability to provide liquidity support to banks is limited by several safeguards (Box 2). In practice, however, these safeguards were not fully adhered to as affected banks were allowed to maintain large overdrafts with the central bank for prolonged periods of time prior to the bank holiday. As outflows intensified and international reserves declined, it became apparent that the lender of last resort facilities were not sufficient to foster confidence and stop the crisis.

8. **In June 2002, a U.S. dollar facility, the Fund for Fortifying the System of Banks (FFSB), was created, aimed at supplementing the lender-of-last-resort facilities of the central bank.** By June, some banks had also started experiencing solvency problems, and the facility also aimed at providing resources for bank recapitalization. The FFSB was to have an authorized capital of US$2.5 billion, to provide liquidity and equity support to core banks.

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[3] The high degree of dollarization and rapid loss on international reserves circumscribed the policy responses to the crisis in Uruguay (see recent Board papers SM/03/112 and SM/03/126 for details on policy measures for dollarized economies). The Uruguayan authorities made special efforts to distinguish their policy responses relative to those pursued in Argentina. Deposits freeze, pesification, and outright default on contractual obligations were avoided, even though ultimately administrative measures, in the form of a reprogramming of deposits and the suspension of insolvent banks, were implemented. Closure of banks also represented a move away from the previous experience of open bank resolutions.

[4] Core banks comprised the two public banks, four domestic banks (*Comercial, Banco de Montevideo. Caja Obrera,* and *Banco de Crédito),* and some cooperatives, all of which accounted for 55 percent of deposits.

The initial resources of the FFSB came from the first augmentation of the Stand-By Arrangement in June, and additional resources were to be provided by other multilateral institutions and the government in the form of U.S. dollar-denominated bonds. Although the original plans required that legislation would be needed for the establishment of the FFSB, a presidential decree empowered a steering committee to implement the provisions of the FFSB in the period up to legislative approval. In the event, legislation was never passed.

Box 2. Central Bank Lender of Last Resort Facilities

Banks have access to central bank liquidity support under four modalities:

- **Automatic overdraft facility**. This facility can be used to meet settlement requirements in peso and in dollar accounts. This overdraft must be repaid within 24 hours, and carries an interest charge, which is 50 percent above the average annual interest rate in the bank credit market. If overdrafts are not repaid, banks are suspended from payment and referred for intensive supervision to the Superintendent of Banks.

- **Rediscount of central bank CDs.** Banks holding excess CDs issued by the central bank to constitute reserve requirements may discount such CDs, provided they are solvent. The discount rate is the highest of: (a) the average market price for similar treasury instruments plus 200 basis points; (b) the marginal price of similar treasury instruments plus 100 basis points; or (c) the price at the emissions of similar central bank CDs plus 50 basis points.

- **Advances in pesos.** Under Article 37 of the central bank law, solvent banks can obtain advances from the central bank for up to 90 days on the basis of eligible collateral, without exceeding the equity capital of the bank. Eligible collateral includes highly rated commercial paper and government securities. The rate of interest is substantially above prevailing market rates, and banks accessing this liquidity support are subject to intensive supervision by the Superintendency of Banks.

- **Sale of government and central bank paper.** Under Article 36 of the central bank law, solvent banks can sell or rediscount government or central bank paper with a maturity of up to one year. The central bank may also purchase or rediscount high quality commercial paper. The rate of interest is similar to that used under Article 37.

As the crisis intensified, the FFSB also proved insufficient to cover the dollar liquidity needs of the banking system and was finally suspended at end-July, when a bank holiday was imposed. During June-July, it provided US$449 million in liquidity support, and no capital support. The main regulations for the provision of funds by the FFSB are described in Box 3.

9. **With international reserves at critically low levels, the strategy was modified, and the FFSB replaced with the Fund for the Stability of the Banking System (FSBS).** The creation of the FSBS was part of the strategy associated with the lifting of the bank holiday in early August, which included administrative measures to stop deposit withdrawals at the state banks and the restructuring of intervened domestic banks. Liquidity support was

to be provided as a safeguard to the payment system, to reestablish confidence in the Uruguayan banking system. To that effect, no restrictions were placed on dollar and peso sight and savings deposits, which stood at US$2.7 billion. As part of this strategy, foreign bank branches and subsidiaries would continue to seek to secure their liquidity requirements

Box 3. FFSB Rules and Regulations

- ***Liquidity support.*** To obtain liquid resources, banks needed to be solvent and provide a stand-by guarantee from a highly rated international bank, or high-quality collateral in a ratio of 2:1, together with a pledge of an equivalent amount of bank equity shares. The National Development Corporation (CND), an existing government-owned corporation, was the conduit for the provision of liquidity assistance. The interest rate was high, at LIBOR plus 500-800 basis points. In the event, liquidity support was provided to four private domestic banks.

- ***Capital support.*** Working with the Superintendency of Banks, the steering committee was to determine the eligibility of a qualifying bank for capital support. A plan for the restructuring of a qualifying bank to regain viability, agreed with the Superintendency of Banks, was a required condition. The FFSB did not provide capital support to any bank.

- ***Repayment terms***: For liquidity support, repayment was expected to take place over a reasonable period, negotiated on a case-by-case basis. Since banks were expected to be solvent and penalty interest rates charged, this period was expected to be short. Failure to repay would result in the exercising of associated collateral. For capital support, recovery would ensue through the requirement that the FFSB stake had to be divested within two years.

on their own, and they would not be subject to the government-mandated reprogramming applied to public banks. Meanwhile, the operations of four private domestic banks (*Banco Comercial, Banco de Montevideo, Banco La Caja Obrera,* and *Banco de Crédito*) were

Uruguay: Deposit Structure (as of July 29) 1/
(In millions of U.S. dollars)

	US dollar deposits				Peso deposits				Total deposits			
	Sight	Sav.	Time	Total	Sight	Sav.	Time	Total	Sight	Sav.	Time	Total
TOTAL	**827**	**1,558**	**4,409**	**6,793**	**259**	**101**	**342**	**702**	**1,085**	**1,659**	**4,751**	**7,495**
o/w Domestic Core	**302**	**1,094**	**3,056**	**4,451**	**181**	**86**	**245**	**512**	**483**	**1,179**	**3,301**	**4,963**
Public banks	99	889	2,170	3,159	121	69	182	372	220	958	2,352	3,530
Domestic banks	245	257	1,101	1,603	76	23	105	204	321	280	1,206	1,806
4 suspended banks	202	204	886	1,292	60	17	63	140	263	221	949	1,432
Other	42	53	215	310	16	6	42	63	58	59	257	374
Foreign banks	483	411	1,137	2,032	62	10	56	127	545	421	1,193	2,159
Branches	355	288	514	1,157	45	5	33	83	400	293	546	1,239
Subsidiaries	128	123	624	875	17	5	23	44	145	128	647	919

1/ Peso deposits evaluated at Ur$24.9 against U.S. dollar. Excludes Banco Galicia.

suspended except for paying out sight and savings deposits with FSBS funds. After a protracted process, the four banks were placed into liquidation in early 2003 (see the next section on their resolution).

10. The law establishing the FSBS was enacted on August 4, 2002, providing sufficient resources to fully back all U.S. dollar sight and savings deposits at core banks[5] (about US$1.4 billion). The central bank provided peso liquidity assistance, where needed, outside the context of FSBS to sustain the payment system. The FSBS law also provided for the mandatory reprogramming of the maturities of U.S. dollar time deposits of the state-owned banks. No restrictions were placed on peso deposits, the operations of foreign bank branches and subsidiaries, and the remaining domestic banks, mainly cooperatives (Box 4).

Box 4. Operations of the FSBS

- ***Resources***: The approved size of the FSBS was US$1.5 billion, to be provided by multilateral institutions, including the Fund. To date, US$1.4 billion has been paid, sufficient to back total sight and savings deposits of core banks. A cash balance of US$376 million remained in the FSBS at end-May 2003.

FSBS fund - Initial stock
(in millions of US dollars)

Total	**1,373**
IMF (August augmentation)	788
IDB	385
Worldbank	200

- ***Management***: The resources of the FSBS have been kept at the central bank in a separate escrow account managed under the same investment guidelines that apply to the international reserves of the central bank.

- ***Cost recovery:*** Banks are charged an annual interest rate equivalent to the average borrowing cost from the IFIs plus ½ percent (currently about 6 percent), payable monthly. The duration of the loan was to be specified by the Ministry of Finance, and recovery of access by suspended banks would be based on the recovery of proceeds from their resolution.

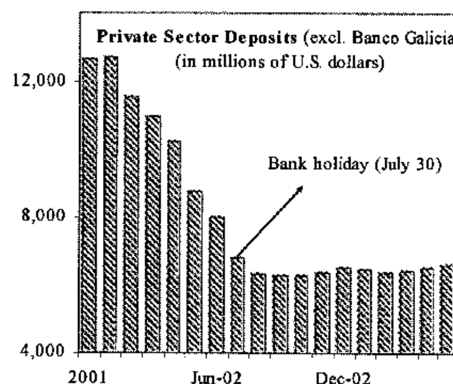
- ***External audit:*** An external audit is scheduled to take place by September 2003 to ascertain appropriate utilization of the resources of the FSBS.

Use of the FSBS
(in millions of U.S. dollars)

	2002		2003		Total	Remain
	Q3	Q4	Q1	Apr	Use	stock
Total	**-710**	**-194**	**-90**	**-4**	**-993**	**376**
Public Banks	**-390**	**-161**	**-93**	**0**	**-645**	**308**
BROU	-264	-161	-96	0	-521	302
BHU	-126	0	3	0	-123	7
Private Banks	**-320**	**-32**	**4**	**-4**	**-352**	**68**
Caja Obrera	-40	-5	0	0	-45	1
Comercial	-153	-8	-2	-2	-165	33
Credito	-65	-5	0	-1	-72	36
Montevideo	-62	-14	6	0	-70	-2
FSBS stock	**663**	**469**	**380**	**376**		

[5] Cooperatives were excluded from access to the FSBS, but the depositors of an intervened cooperative were allowed access after its liquidation.

11. **The creation of the FSBS helped stabilize confidence in the banking system.** By covering 100 percent of the unrestricted dollar deposits in the public banks,[6] while at the same time differentiating between sound and unsound banks, the strategy succeeded in gradually restoring confidence to the banking system. While initially, as expected, sizeable outflows were registered after the bank holiday was lifted, outflows subsided progressively, and a reflow began in October 2002. Most of the eligible deposits with the suspended banks and about two-thirds of eligible deposits with the state banks have been withdrawn to date. Additional policy actions aimed at fostering confidence in the banking system were adopted, including changes in reserve requirements and the establishment of a special 100 percent reserve requirement on all new U.S. dollar sight and savings deposits with the public bank BROU.



B. Reprogramming of U.S. Dollar Time Deposits at Public Banks

12. **The FSBS law mandated the reprogramming of all U.S. dollar time deposits with the state banks, with extended maturities of up to three years.** The total amount of deposits covered by the reprogramming amounted to US$2.2 billion. The terms of the reprogrammed dollar time deposits included repayment of 25 percent of principal amount at the end of the first year, another 35 percent after two years, and the remaining 40 percent by the third year. Reprogrammed time deposits were to carry interest rates slightly above market interest rates for similar maturities and are to be payable quarterly; this rate was set at 6 percent a year. Depositors had the option of converting their claims into CDs or bonds, which would be freely tradable in the secondary market. These securities could also be used to cancel loans (at face value) contracted with BROU and the BHU before July 30, 2002. While there were some initial demands to loosen the terms of the reprogramming for affected groups of depositors (e.g., elderly), no changes have been made. Unlike the situation in Argentina, there has also been no substantial legal challenges to the government's measures thus far.

IV. Official Financial Support Provided

13. **Financial support from the government in response to the financial crisis amounted to US$2.4 billion, equivalent to about 20 percent of 2002 GDP.**[7] This amount includes US$33 million in capitalization of Banco Comercial, US$564 million from the

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[6] Thereby serving as a credible lender of last resort facility for the core banking system.

[7] By comparison, the Asian governments provided assistance in the range of 13-55 percent of GDP in the wake of the Asian crisis, Chile 33 percent of GDP after the early 1980 crisis, and Argentina 6.5 percent of GDP more recently.

central bank, US$449 million from the FFSB, and US$1.4 billion from the FFSB (of which US$370 million remains in the form of cash holdings).

14. **The government is expected to recover only about half of the liquidity extended to the banking system in 2002.** Financial assistance to state banks and private domestic banks was split about evenly and, for the future, it is expected that:

- **Total recovery from the US$1.2 billion extended to public banks could reach US$0.8 billion**, including $370 million of unutilized FSBS balances. An obligation of US$432 million of the public bank BROU to the FSBS was canceled against its claims on the government of an equivalent amount (US$135 million in Treasury bonds and US$297 million in other debt) in December 2002. However, most of the liquidity extended to the state mortgage bank BHU (US$380 million) was turned into long-term subordinated loans as part of its recapitalization, and is unlikely to be recovered.

Total Government Assistance to Banks (as of August 2002) 1/
(in millions of U.S. dollars)

	Total	Public banks	Private banks
Total assistance	**2,419**	**1,211**	**1,208**
o/w: in pesos	33	10	23
Capitalization	33	0	33
Central bank	564	258	306
Article 36/37	391	258	133
Overdraft	173	0	173
FFSB (Jun. 2002)	449	0	449
FSBS (Aug. 2002)	1,373	953	420

1/ Includes assistances in pesos evaluated at Ur$28.8/US$.

- **Recovery of the US$1.2 billion extended to domestic private banks would not exceed US$300 million,** including US$150 million in the form of capital in the newly created state-owned *Nuevo Banco Comercial* (NBC) bank. The government is expected to get some recovery from the disposal of the remaining assets of the failed banks; however, after such a considerable delay the recoverable value of these assets is likely to be small. Amendments introduced in the banking law in December 2002 provided that the claims of the central banks on the liquidated banks would be transferred to the government and used, together with the claims of the government,

Deposit Structure 2001-2003
(In millions of U.S. dollars)

	Dec. 2001			Dec. 2002			Mar. 2003		
	TOTAL	Resident	Nonresid.	TOTAL	Resident	Nonresid.	TOTAL	Resident	Nonresid.
Total 1/	**13,943**	**7,804**	**6,139**	**6,484**	**5,108**	**1,376**	**6,413**	**5,065**	**1,348**
Public banks	4,568	3,918	650	3,150	2,838	312	3,132	2,821	311
Private banks	9,375	3,886	5,489	3,334	2,270	1,064	3,282	2,244	1,038
Domestic banks	3,090	2,400	690	1,239	968	271	1,229	959	270
Foreign banks	6,285	1,486	4,799	2,095	1,302	793	2,053	1,285	768
Subsidiaries	3,707	506	3,201	733	353	381	732	355	377
Branches	2,578	980	1,598	1,362	949	412	1,321	930	391

1/ Includes Galicia in 2001 only, balances of four liquidated banks and COFAP (largest cooperative); dollar deposits.

to improve the recovery of depositors from these banks (estimated to be US$215 million).

V. The Current Structure of the Banking System

15. **By end-2002, banking system dollar deposits were only about half their level at the end of 2001.** Furthermore, if the deposits of liquidated banks (US$$920 million) were excluded, total deposits would amount to only 37 percent of their level at end-2001. Non-residents deposits are only one-fifth of their earlier level, reflecting a loss of about two-thirds of deposits by foreign banks, the largest holders of nonresident deposits. The share of deposits held by foreign banks fell by 13 percentage points to 32 percent at end-2002, despite an increase in their share of resident deposits, suggesting a possible flight to quality and some migration of sight depositors from suspended banks to foreign banks.

16. **The financial performance of the banking system has deteriorated sharply.** Nonperforming loans rose markedly during 2002, almost doubling by year-end (to 36 percent), with private banks suffering a greater deterioration. The banks registered large losses, associated in part with much higher provisioning as nonperforming loans surged and the value of loan collateral fell. However, except for the intervened banks and BHU,[8] all banks continued to comply with prudential capital norms, albeit with much lower margins relative to the requirements. Excluding intervened banks, the risk-weighted capital ratio of private banks was well above the norm of 10 percent by end-2002 while the large deficiency in capital of BHU brought capital below the norm in the group of public banks.

VI. Bank Resolution Policy

17. **The authorities agreed that a prompt and satisfactory resolution of insolvent banks was important to sustain the stability regained by the banking system.** They also introduced the principle that for any new bank to reopen it needed to demonstrate that it had a sound business plan that assures viability under robust conditions, meets all prudential requirements, and does not a pose a potential risk to the rest of the banking system. To underpin future growth prospects, the authorities were also determined to restore banking services in certain areas of the country while ensuring that depositors would not bear all the costs of bank resolution. These considerations led to protracted discussions between the government and the various stakeholders, including depositors and other bank creditors, the powerful bank employees union, politicians, and other interested economic agents. During this lengthy process, unsurprisingly, a sharp deterioration in the value of the recoverable assets of suspended banks has taken place.

[8] The BHU is in the process of being transformed into a nonbank financial intermediary.

Uruguay: Banking Soundness Indicators, 2001-02
(In percent)

	2001			2002		
	Total	Public	Private	Total	Public	Private
Asset quality						
NPLs/total loans	17.9	39.1	5.6	36.3	38.8	33.7
Provisions/NPLs	49.7	39.2	91.7	51.4	43.8	60.4
Capital adequacy						
Assets/capital	16.7	12.2	22.3	-25.8	23.4	-8.2
Capital/risk-adjusted assets 1/	11.8	17.5	7.6	-4.2	8.1	-15.5
Profitability (in percent)						
R.O.A. (after tax)	-2.3	-4.5	-0.9	-17.7	-15.1	-20.4
R.O.E. (after tax)	-28.1	-35.4	-16.2	...	-77.9	...
Liquidity						
Loans/deposits	93.2	89.5	96.4	97.8	99.9	95.0
Liquid assets/deposits	15.9	20.9	13.6	16.6	10.7	24.4
Memorandum (in percent)						
Total assets (share)	100.0	40.9	59.1	100.0	50.4	49.6
FX deposit/total deposit	89.1	84.2	92.1	90.7	87.9	93.2
FX loans/total loans	80.6	56.0	93.0	87.0	79.1	95.2

Sources: BCU and Fund staff estimates.

1/ Excluding the four liquidated banks, the CAR for private banks was 13.3 percent for end-2001 and 18.4 percent end-2002.

A. The December 2002 Banking Law

18. **A new law was passed by congress in December 2002, aimed at modifying various banking laws and facilitating bank resolution.** The new law defines more precisely the role of BCU in the liquidation of banks and establishes guidelines for the utilization of the proceeds of government recovery from bank resolution, which include increasing the recovery of depositors. The new law provides for the establishment of trust funds to manage the assets of each liquidated bank and facilitate recovery for depositors and other creditors. The use of a trust fund mechanism is designed to insulate the asset disposal and sales process from litigation and other residual claims against the legacy banks.

19. **The new law authorized the government to top up the recovery of depositors in the affected banks up to a maximum of US$100,000.** To that effect, the government *de facto* agreed to forego part of the proceeds from its claim from the liquidation process. The restructuring of intervened banks focused on two proposals: (i) the three-in-one proposal aimed at creating a new bank from the assets of three suspended banks (*Banco Comercial, Banco Montevideo* and *Caja Obrera*); and (ii) the reopening of Banco de Crédito (previously

51 percent owned by the government) as a private bank with the former minority shareholder as sole owner. The new bank law approved at end-2002 provides that all state banks will now be subject to the same prudential regulations and sanctions that apply to all other banks.

B. The Resolution of Suspended Banks

20. **In January 2003, the authorities placed the three suspended banks into liquidation, with a view to creating a new bank (*Nuevo Banco Comercial*—NBC), akin to a purchase and assumption model.** Trust funds were established to manage the assets of the liquidated banks, and the government provided the minimum required paid in capital (US$4 million) to charter the new bank. In late February, the NBC purchased packages of assets simultaneously offered by the three individual trust funds in an open competitive bidding process. It also bid on nonperforming loans, but was given a put option that allows it to return to the trust funds any loan that it cannot satisfactorily restructure by the end of 2003. NBC bought the assets by issuing a series of its own CDs—carrying a 2 percent interest rate, and repayable quarterly over a period of up to six years. It is estimated that, to top up the recovery of depositors to value of US$100,000, the government would cede some US$215 million of the proceeds to depositors. The government chose to return its recovery to depositors as part of the political consensus to resolve the insolvent banks and because it felt that reducing the losses suffered by depositors was important for restoring confidence in the banking system.

NBC Opening Balance Sheet
(in millions of U.S. dollars)

Total Assets	**822**
Cash	91
Securities	65
Loans (net)	625
Loans (gross)	780
Provisions	-155
General Provisions 1/	-44
Other Assets	84
Total Liabilities	**698**
Sight Deposits (FESB)	21
CDs	667
Correspondent bank and other	10
Equity Capital	**123**

1/ Difference between the purchase price and the net book value.

21. **The trust funds are to distribute the NBC CDs to all general creditors, including the government, on a pro-rata basis (net of CDs to cover the NPL put back).** Since the government retained its collateralized claims, it received first payment and immediately used a portion of its proceeds (equivalent to about US$120 million) to increase the capital of NBC to the required prudential amount relative to estimated assets of NBC. It is expected that remaining assets in the trust funds will be disposed of quickly and their proceeds distributed on a pro-rata basis.

22. **NBC opened for business on March 24, 2003, after the Superintendency of Banks declared it to be viable and in full compliance with prudential norms.** The new bank was chartered under the commercial bank law with capital provided wholly by the government. Under its business plan, NBC was to open with about 750 employees from the liquidated banks and 43 branches—about half the size of the three liquidated banks combined. The bank opened with a capital-to-assets ratio of about 18 percent (risk-weighted) and total assets of US$822 million, including nonperforming loans with a book value (net of provisions) of US$460 million. Consistent with the requirement placed on BROU, the

Superintendency of Banks has also imposed reserve requirements of 100 percent for all new U.S. dollar sight and savings deposits at NBC.

23. **The fourth intervened bank, *Banco de Credito,* was placed into liquidation in February 2003, when protracted discussions with the minority shareholders of the bank for its reopening failed.** A trust fund was also established under the new banking law to assume the assets of *Banco de Credito* for disposal. This trust fund has recently published a proposal seeking the agreement of depositors and other creditors for the disposal of assets and distribution of the proceeds. It includes the repayment of the debt owed by a related party of the minority shareholders with government bonds at face value. Depositors' agreement was secured at end-May. The government has indicated that it would give up its share of the proceeds in the recovery in favor of depositors. In addition, the proposal also contains a commitment by the government to purchase assets up to a nominal value of US$40 million with government bonds if the proceeds from the sale n the public auction fall short of the amount needed to satisfy the claims of all depositors. Although this runs against the previous policy decision not to provide any additional financial resources for bank resolution, the authorities chose to provide this assistance in part to staunch legal challenges that would have forced the government to do more because it was a majority owner of this bank.

24. **Completion of the bank resolution process requires additional steps to dispose of the remaining loans and other bank assets in the individual trust funds.** Additional recovery from these assets would primarily accrue to the government, whose residual claim would be the largest. A concrete plan needs to be developed to deal with the remaining nonperforming loans and other assets to preserve the value that is left. Completion of this process is critical for maintaining creditor discipline and the repayment culture in the Uruguayan financial sector.

C. Public Bank Restructuring

25. **The public mortgage bank BHU has been transformed into a nonbank entity.** As noted, this bank suffered from a major structural imbalance, as its liabilities were primarily in the form of short-term dollar deposits, while its assets were long-term peso housing loans linked to a wage index. The sharp depreciation of the peso in 2002, together with the economic recession, led to major balance sheet mismatches. The authorities have been working on a reform plan for BHU with financial support from the World Bank. As part of this process, in December 2002, congress approved a new charter transforming the BHU into a non-bank housing institution. This law provided for the transfer of all U.S. dollar deposits, including reprogrammed deposits, to BROU in August 2002. In turn, BROU received bonds issued by BHU with a guarantee of the government. However, in the absence of significant progress in its restructuring plan, BHU has so far been unable to meet its financial commitments to BROU arising from these bonds, representing a fiscal cost, as the government must provide the cover. The restructuring plan being monitored by the World Bank calls for steps to reduce costs, including a halt to construction programs, a freeze on new lending (except if securitized), greater efforts at recovery, and reductions in staff.

26. **The restructuring of the public bank BROU needs additional impetus.** Prior to 2002, with assistance from the World Bank, efforts had been initiated to improve BROU's efficiency and bring its operations and management in line with modern practices. Its loan portfolio was reclassified by end-2002 to fully meet prudential norms, with an increase in provisions, while improvements were made in the information system of the bank. In recent months, BROU has strengthened its process for monitoring repayment and collection of loans, and devoted special attention to assist distressed borrowing customers to reach agreement on repayment terms consistent with their new capacity to repay. These actions set the basis for a plan to accumulate sufficient liquidity to meet the repayment of the first tranche of reprogrammed deposits. Even with these improvements, nonperforming loans have risen sharply and the earnings outlook continues to be alarmingly negative in a situation where BROU's risk-weighted capital is just at the minimum required level of 10 percent.

VII. Challenges to the Banking System

27. **The Uruguayan banking system will need further consolidation.** As it continues to stabilize and recover from the crisis, it is unlikely to return to the level and structure exhibited at the end of 2001. While the banking system benefited from unusually large non-resident deposit inflows in recent years, mainly from Argentina, the perception of a safe haven has now been largely dispelled. It is expected that the banking system will experience a period of consolidation and move away from attracting volatile non-resident banking business. The state-owned BROU, when appropriately restructured, would remain to service the domestic banking needs together with the NBC and cooperatives, and there are indications that some foreign bank subsidiaries and branches will likely consolidate regional operations and relocate. Against this background, restoration of adequate financial intermediation and bank credit in Uruguay may take some time.

28. **The banking crisis has highlighted important shortcomings.** In addition to the limitations to policy responses in a dollarized system, the crisis has shown the importance of effective coordination by a crisis management team in charge of policy implementation on a day-to-day basis and of developing contingency plans. The authorities did very well in claiming ownership on policy initiatives and were very successful in garnering political and social consensus to take actions. However, on balance, this required too much time in a situation where the need for quick decisions and actions were also of great importance. Finally, information on bank deposits and assets from the state banks, which make up more than half of the banking system, continues to suffer from unusual delays, and insufficient coverage.

A. Bank Supervision

29. **Bank supervision needs to be strengthened.** While some of the problems experienced in Uruguay were triggered by external events, they also reflected some weaknesses in the prudential framework for banks. Steps to strengthen bank supervision regulations and procedures will need to include the following:

- **Upgrading the resources devoted by the BCU to bank supervision**. This will require both increasing the number of staff and improving its skills, especially for on-site examinations. Technical assistance will be needed to bring supervision procedures in line with international standards. This assistance could be provided by MFD in close coordination with the Inter-American Development Bank.

- **Adopting regulations requiring banks to internalize foreign exchange risks associated with the high degree of dollarization.** Traditional foreign exchange gap limitations are not sufficient in countries where borrowers in dollars do not have regular flows of income in foreign exchange, and risk-hedging instruments are not available. A more preventive and risk-focused approach is required.

- **Introducing consolidated supervision.** Information from this practice would have helped detect vulnerabilities in *Banco Comercial* and *Banco Montevideo*. External audit of banks should be made mandatory, and controls and regulation on this process strengthened.

- **Prompt corrective actions in dealing with distressed banks**. Inappropriate bank management practices need to be firmly dealt with, and shareholders should not be given too much flexibility to negotiate the capital injection needed to comply with prudential norms.

- **Revising the prudential norms for liquidity,** to reflect the continued instability in the region and ensuring that the risks from foreign exchange and duration mismatches are better managed and covered.

B. Role of Public Banks

30. **Government-owned banks (BROU and NBC) currently account for over 55 percent of total banking system assets**. Given the past history of problems in government owned banks, it is critical that steps be taken to ensure that these banks operate in conformity with all prudential norms and are independent from political interference. The government has indicated that it plans to divest its stake in NBC as soon as conditions permit. To increase the chances for a successful privatization, the following steps need to be taken: (a) the management structure of NBC needs to be improved by having an independent board of directors consisting mostly of qualified nonexecutive directors, and of a sufficient size to ensure proper governance and risk management; (b) annual audits should be performed by an internationally-recognized audit firm; (c) the central bank should monitor its business plan to ensure that the risk profile does not change significantly; and (d) consideration should be given to bringing in a strategic investor, as soon as possible, who would assure good governance and proper banking operations.

31. **BROU should undergo a thorough restructuring.** Its governance structure should be overhauled and, at a minimum: (a) the appointed members of its Board should be subject to normal fit and proper tests; (b) it should meet all prudential norms, and the Board should

be held accountable on the basis of a business plan formulated on commercial criteria and meeting the viability tests of the Superintendency of Banks; and (c) an independent Internal Audit unit should be established to ensure proper financial and operational control of the activities of the bank. The quality of the loan portfolio and other assets must be enhanced, and a well-designed program to reduce the level of nonperforming loans (60 percent at end-March 2003) introduced. The financial outlook of BROU would also be improved if its holdings of BHU securities (US$790 million) were replaced with more liquid securities. Greater efforts to reduce and rationalize the operating costs of BROU are also needed. The size of the bank and its branch network need to be streamlined in accordance with efficiency levels similar to those of private banks operating in Uruguay.

C. Financial Safety Net

32. **Developing a limited deposit insurance scheme will be a challenge.** The current explicit full guarantee for state banks and implicit guarantee for other bank deposits stemming from past behavior during times of crises need to be overhauled. This is needed to restore depositor confidence and reduce uncertainty in the banking system, while strengthening incentives for sound banking business and limiting moral hazard. Given the high degree of dollarization of bank deposits, experience has shown that an explicit guarantee generally cannot be honored because of the lack of foreign exchange resources. Thus, a properly funded limited deposit insurance scheme would serve to shield the government from having to assume most of the cost of the banking crises, which have so far been borne with no explicit pricing for the protection. The challenges are compounded by a highly segmented and concentrated banking system dominated by state-owned banks and slowly emerging from a deep confidence crisis.

33. **A better framework for bank resolution should be developed** to facilitate timely action to resolve distressed and/or insolvent depository institutions. The law passed last December was a stop-gap measure designed for the crisis at hand, and the legal procedures for bank receiverships and liquidation will need to be further enhanced.

Statement by the IMF Staff Representative
July 11, 2003

Since the issuance of the staff reports, the following information on recent developments and policy measures has become available. This information does not alter the thrust of the appraisal.

- **Macroeconomic developments.** In May, the index of leading indicators rose by 1.7 percent (seasonally adjusted, month-on-month), its fourth consecutive increase, and unemployment fell to 18.3 percent. Exports have continued to recover, growing by 17 percent year-on-year in April. Inflation remains in line with program projections and, in June, the CPI rose by 0.2 percent, bringing the 12-month rate to 24.6 percent.

- **Financial indicators.** Since end-May, peso interest rates on government Treasury bills have declined from above 40 percent to below 20 percent, and the Uruguayan peso has appreciated by 4½ percent against the U.S. dollar. Sovereign risk spreads have continued to fall, to a range of 700-750 basis points in recent weeks.

- **Performance criteria**. Data for end-June indicate that the performance criteria on NIR and NDA, as well as the indicative target on the monetary base, were observed with comfortable margins. Gross reserves have risen to about US$1.2 billion in early July, equivalent to almost 6 months of imports of goods and services.

- **Tax reform.** At end-June, the authorities submitted to congress revised tax reform legislation (structural performance criterion). The revised legislation is broadly consistent with staff's recommendations. It no longer contains a calendar for reducing VAT rates, but would instead make such reductions conditional upon achieving the program's fiscal objectives. The draft law also envisages extending the base of the current income tax on industrial and commercial enterprises to other productive sectors (including services).

- **Asset disposal.** The authorities have completed a strategy document providing for disposal of the remaining assets of liquidated banks (a prior action for completion of the third review). They have also established a committee to oversee implementation of the plan.

- **Reprogrammed deposits.** The release of the first tranche of reprogrammed deposits by the public bank BROU has been advanced from August to June. So far, US$140 million have been repaid (out of a total first tranche of US$560 million), and virtually all of these deposits have remained with BROU.

- **Other banking developments**. Total deposits with the banking system have continued to increase (US$100 million since end-May). In coordination with the government and in recognition of borrowers' impaired ability to repay foreign-currency denominated bank loans, banks have recently started renegotiating these loans, on a voluntary and case-by-case basis, by lowering monthly payments and extending repayment periods.

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August 4, 2003

International Monetary Fund
700 19th Street, NW
Washington DC 20431 USA

IMF Concludes 2003 Article IV Consultation with Uruguay

On July 11, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Uruguay.[1]

Background

During 1990-98, Uruguay enjoyed relatively high rates of growth, averaging 3.9 percent a year. In 1999, however, Uruguay's economy fell into a prolonged recession, following a series of external shocks that were compounded by domestic fragilities. These external shocks included: slower economic growth in Argentina and Brazil, two of Uruguay's major export markets; the outbreak of foot-and-mouth disease, which harmed Uruguay's meat exports; and a severe outflow of nonresident deposits, associated with the financial crisis in Argentina. In 2002, the economy contracted by nearly 11 percent, wiping out most of the per-capita GDP gains that had been achieved during the 1990s. The public debt dynamics also deteriorated significantly.

In June and August 2002, Uruguay's existing Stand-By Arrangement was augmented to SDR 2.13 billion (694 percent of quota). In March 2003, at the completion of the second review, the arrangement was extended to March 2005, with a rephasing of purchases.

Uruguay's economy is now showing signs of improvement. In the first quarter of 2003, real GDP grew by ½ percent (quarter-on-quarter, seasonally adjusted), and leading indicators point

[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.

to a stronger increase in activity during the second quarter, led by an improvement in exports. Uruguay is expected to benefit further from the reopening of North American markets to beef exports.

Financial indicators have also improved. Private sector deposits are now almost back to their end-July 2002 level, when a bank holiday was declared. Reflecting the reflow of deposits, as well as sizeable loan disbursements from multilateral organizations, gross official reserves have more than doubled since mid-March, to US$1 billion in late-June (five months of imports of goods and services).

On May 29, Uruguay successfully completed a comprehensive and voluntary exchange, covering almost all of its market debt in foreign currency (US$5.4 billion). Overall participation reached 93 percent, well above the 80-percent threshold established for completion. The exchange reduced the net present value of participating bonds by about 20 percent on average.

Under the Stand-By Arrangement, the primary balance of the combined public sector is programmed to rise from equilibrium in 2002 to 3 percent in 2003, and to 4 percent over the medium term, consistent with debt sustainability. To meet these primary surplus objectives, the government intends to continue restraining expenditure and improving revenue collection.

The government is also implementing measures to restore the functioning and stability of the banking system. Several banks were liquidated during the financial crisis and US$2.2 billion in savings and time deposits in the public banks BROU and BHU were reprogrammed. A new bank has been opened with assets of three liquidated banks.

With the adoption of a flexible exchange rate system, monetary policy has shifted to targeting the monetary base as an intermediate target. So far this year, inflation has come down faster than projected.

In the structural area, several reforms are being adopted, in conjunction with the World Bank and Inter-American Development Bank, to help foster a return to growth. These measures include: deregulation of utilities, reform of the specialized pension systems, and restructuring of the public bank BHU.

Executive Board Assessment

Directors noted that, since the last Article IV consultation with Uruguay, the country has suffered a protracted recession and a deep financial crisis, resulting in a large output loss and a significant increase in poverty. While external shocks have triggered these adverse developments, their impact was compounded by deep-seated weaknesses and rigidities in Uruguay's economy. Directors commended the authorities for the significant progress made in recent months in containing the crisis, stabilizing the economy, and preparing the foundations for a durable recovery. They were encouraged by the recent improvements in economic and financial indicators, and welcomed the exemplary manner in which the authorities have conducted a landmark debt exchange, which has addressed near-term financing needs and helped to improve confidence.

Directors agreed that significant challenges nevertheless still lie ahead, and that returning the economy to a path of lasting growth and stability will require continued sound macroeconomic policies and structural reforms. Decisive progress on fiscal and banking reforms will be critical to further improve confidence, while in the coming years, the Uruguayan economy will need to develop new sources of growth against the backdrop of an external environment which is likely to be less sanguine, an ageing population, and constraints to capital accumulation. To surmount these constraints, Directors urged the authorities to implement policies that promote a shift of resources toward higher-productivity sectors and increase the economy's resilience to shocks. Such policies, coupled with better targeting of social support, will be key to raising economic growth and reducing poverty.

Directors emphasized that a strong fiscal policy will need to remain the cornerstone of the authorities' economic strategy. A permanent strengthening of the primary surplus will be needed to ensure medium-term debt sustainability, regain the capacity for countercyclical policies, and allow room for private sector growth. The challenging fiscal targets to which the authorities have committed themselves are appropriate, but Directors stressed that they will require a sustained reform effort, together with continued readiness to adjust fiscal policies as needed, to achieve them. Directors commended the authorities for their commitment to improve the tax system and strengthen revenue administration. They welcomed the recent submission to congress of a revised tax reform package, and looked forward to its full implementation. On the expenditure side, Directors underscored the need for deep reforms to reduce rigidities, especially in wages and pensions, and to continue enhancing the efficiency of social spending programs.

Directors welcomed the authorities' continued commitment to the floating exchange rate regime, with base money as the intermediate target for monetary policy. They supported the authorities' intention to move over time toward an inflation targeting framework, and noted that to achieve this goal the central bank should continue to broaden the range of monetary instruments, deepen technical capacity, and strengthen its operational and administrative autonomy.

While progress has been made in stabilizing the banking system, Directors stressed the need for further work to address remaining balance sheet vulnerabilities in the economy and restore a sound financial system. They urged the authorities to accelerate the restructuring of the public banks, which will be key to restoring confidence and contain fiscal costs. Looking ahead, Directors underscored that a strong and well-supervised banking sector will be a cornerstone of the strategy to enhance the role of the private sector in the economy. They also encouraged the authorities to continue promoting the development and use of peso instruments, and to work towards the development of a properly funded, limited deposit insurance scheme.

Directors urged the authorities to press ahead with a wide range of structural reforms to promote growth and reduce vulnerabilities. They agreed that further efforts to strengthen competition, governance, and regulatory frameworks, and expand the room for private sector activity in the economy, will be key to improving resource allocation, raising investment, and attracting higher levels of foreign direct investment. In this respect, Directors emphasized the

need to reduce the size of the public sector by improving its efficiency and opening up to private activity those sectors currently reserved for the state. They also encouraged the authorities to take advantage of Uruguay's well-educated population to implement policies aimed at diversifying the country's production and export base, including by pursuing ongoing trade liberalization efforts and streamlining investment procedures. In this regard, a number of Directors also highlighted the importance of further market-opening efforts by Uruguay's trade partners.

Directors were encouraged that Uruguay's political and legal institutions have proved effective in dealing with the recent economic and financial challenges, and that the rule of law and private contracts have been safeguarded in difficult circumstances. They urged the authorities to build on these foundations by continuing to make strong efforts to forge a sufficient consensus and broad ownership that will help them to move forward with their ambitious structural reform agenda. Mobilizing support for the privatization of state-owned enterprises ought to be a priority in this regard.

Directors commended the authorities for the progress in improving the quality and timeliness of data dissemination. They welcomed the authorities' intention to subscribe to the Special Data Dissemination Standard and to implement the recommendations of the safeguards assessment.

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

	2000	2001	2002	2003 Proj.
	(Percent change)			
Output and prices				
Real GDP	-1.4	-3.4	-10.8	-1.0
CPI inflation (end of period)	5.1	3.6	25.9	20.0
Exchange rate change (Ur$/US$; end of period)	7.7	18.0	84.5	...
GDP (in US$ billion)	20.1	18.7	12.1	10.6
Monetary indicators				
Currency issued	-3.9	-0.2	5.8	18.3
Credit to the private sector (constant exchange rate)	0.3	-3.8	-17.6	-5.3
	(Percent of GDP)			
Public sector operations				
Revenue	31.2	32.4	31.0	31.1
Non-interest expenditure	32.7	33.6	30.9	28.1
Primary balance	-1.5	-1.2	0.0	3.0
Interest	2.6	2.9	4.6	6.6
Overall balance	-4.1	-4.1	-4.6	-3.6
	(US$ million)			
External indicators				
Merchandise exports, f.o.b.	2,384	2,144	1,934	2,129
Merchandise imports, f.o.b.	3,311	2,914	1,872	1,849
Current account balance	-566	-533	191	219
(as percent of GDP)	-2.8	-2.9	1.6	2.1
External debt	44.3	47.8	84.8	101.4
of which: external public debt	30.3	31.2	67.0	85.4
Gross official reserves	2,779	3,099	776	1,481
In months of imports GNFS	8.0	10.0	3.8	7.3

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

INTERNATIONAL MONETARY FUND

EXTERNAL RELATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
July 11, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Uruguay Third Review, Approves Request of Applicability of Performance Criteria

The Executive Board of the International Monetary Fund (IMF) completed today the third review under the Stand-By Arrangement for Uruguay, and approved the request for waivers of applicability, until July 22, 2003, of performance criteria for end-June. Upon completion of the review, a disbursement of SDR 145.7 million (about US$204 million) became immediately available.

The current Stand-By Arrangement was initially approved on March 25, 2002 in an amount of SDR 594.1 million (about US$823 million) for a 24-month period (see Press Release No. 02/14). The arrangement was augmented by SDR 1.16 billion (about US$1.6 billion) on June 25, 2002 (see News brief No. 02 /54), and by SDR 376 million (about US$521 million) on August 8, 2002 (see News Brief. No. 02/87).

In commenting on the Executive Board decision, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"Uruguay's performance under the Stand-By Arrangement has been favorable, and commendable progress has been achieved in containing the crisis and stabilizing the economy. The authorities' firm implementation of sound macroeconomic policies and the successful recent debt exchange have contributed to a notable improvement in economic and financial indicators. There are encouraging signs that the economy has bottomed out, bank deposits have continued to increase in recent months, and risk spreads have declined markedly.

"While the debt exchange has addressed the near-term financing needs and improved the medium-term debt profile, important tasks nevertheless still lie ahead. The authorities remain firmly committed to make further strong progress on the implementation of policies in the fiscal, banking, and structural areas, that will be critical to ensuring a return to growth and sustainable debt dynamics.

"For 2003, the authorities are committed to attaining a primary surplus of 3 percent of GDP. To this end, they are exercising continued expenditure restraint, while taking steps to improve the social safety net and to strengthen tax collections. The continued commitment to a floating exchange rate regime is welcome, and base money will remain the intermediate target of

monetary policy until technical and institutional conditions for implementing an inflation-targeting regime are met.

"Fully restoring stability and confidence in the banking system is a key element of the program. Important steps have already been taken and, in the coming months, the authorities will advance the restructuring of the two public banks (BROU and the mortgage bank BHU) and finalize the resolution of the four liquidated banks.

"A return to sustained economic growth will depend on continued prudent macroeconomic policies and further structural reforms. To achieve a permanent improvement of the primary balance, the authorities will further strengthen the revenue effort while reducing rigidities and raising efficiency in spending programs. Structural reforms will focus on strengthening competition, expanding the room for private sector activity, and further diversifying trade. Uruguay's political and legal institutions have proved effective in dealing with the financial crisis, and it is now essential to further build on the consensus already achieved on prudent macroeconomic policies to move forward with an ambitious structural reform agenda that will ensure a durable recovery of Uruguay's living standards," Ms. Krueger stated.

Statement by Guillermo Le Fort, Executive Director for Uruguay
and David Vogel, Advisor to Executive Director
July 11, 2003

Key Points

- *Uruguay is overcoming the shocks and the deep crisis of 2002 with an effective policy response; financial market conditions have significantly improved and economic activity is showing some signs of recovery, following the lead of exports.*

- *While the crisis has been overcome, the authorities believe that there is no room for complacency. They have called on the different political parties to focus efforts on recovering economic activity and strengthening the fiscal position.*

- *In addition to the advances in macroeconomic and financial stabilization, the authorities are promoting new ways to stimulate financial intermediation and access to credit that remains a major constraint to growth. They continue their efforts to address the vulnerabilities of the banking system and remain committed to respect contracts and avoid introducing perverse incentives in the system.*

- *To enhance growth over the medium term, the authorities are focusing on deregulating and opening-up to competition activities previously reserved for the public sector. A draft bill was recently sent to Parliament, proposing a substantial reform in the tax system and administration, mainly directed at simplifying the system, ensuring compliance and correcting distortions.*

Background and Recent Developments

1. It is difficult to find cases in recent economic history in which a country has suffered so much in so little time, like Uruguay in 2002. In seven months, the country went from an investment grade status to one in which it found itself completely closed off from international financial markets; additionally, it lost almost half of its banking system deposits; experienced a sharp depreciation of the *peso*, up to 88 percent, while Treasury bill yields in local currency peaked at 190 percent; and there was a double-digit fall in output. Moreover, the deteriorating macroeconomic conditions and the loss of access to international markets generated serious uncertainties about debt rollover.

2. Finding a more effective response to overcoming the crisis is not easy either. In less than a year, financial markets have stabilized and the process of economic recovery is clearly under way. In this regard, the authorities would like to express their gratitude to the Fund's staff and management for their continuous support, and to the Executive Board for the

approval of significant financing support at a very critical time. Our authorities recognize that without the Fund's support such a quick recovery would not have been possible.

3. The completion of the debt exchange operation has been crucial for the recovery, and since then, financial market conditions have significantly improved. Among the improvements, the country risk has dropped from close to 2,500 basis points to about 700; the Treasury bill yields in local currency are now below 20 percent; deposits have recovered by almost 10 percent from its minimum point; and the inflation rate for 2003, originally projected at 65 percent in the program, is now projected at around 20 percent. The authorities would like to underscore the impressive participation of the domestic creditors in this voluntary debt exchange, which reached 99 percent. As in the process of resolution on the banking crisis, consensus building has been very important, demonstrating that the cohesiveness of the Uruguayan society is an invaluable asset in dealing with major problems.

4. Economic activity has been showing some improvements and, as noted in the staff report, there are signs that the economy has bottomed out and that activity and demand are recovering. As would be expected, exports are being the most dynamic item, despite the fact that pressing domestic and external credit constraints have not let the export sector take full advantage of the depreciation of the Uruguayan peso. The development of some non-traditional credit channels, together with improvements in the prices of Uruguayan commodity exports, the strengthening of the euro, and some correction of the over-shooting in regional exchange rates have recently contributed to a remarkable increase in exports of 17 percent in April, as compared to the same month in the previous year; but the cumulative increase for the first four months of 2003, amounts only to 2 percent. The share of exports to Europe has already been brought in line with that of Mercosur, while the reopening of the beef market to Canada and the U.S. should imply a substantial increase in exports to those markets later this year.

5. On a seasonally adjusted basis, GDP increased at an annual rate of 0.5 percent in the first quarter of 2003, as compared to the last quarter of 2002. The monthly indicator of economic activity increased by 1.4 percent in April 2003, with respect to the previous month. This is one indicator of the gradual pick-up of growth expected for the second quarter of this year, partly due to the better export performance referred to above, but also to a gradual build-up of confidence.

Macroeconomic Policies

6. The government's strategy has been successful in confronting the crisis. However, this is just a starting point, and the Uruguayan authorities are firmly committed to addressing the remaining vulnerabilities as well as the impediments for sustainable growth. Common to other democracies, the political process in Uruguay often exerts a strong influence on economic policies. Nevertheless, the authorities understand that there is no room for complacency and that fiscal discipline is the cornerstone of success of their economic strategy. Thus, they have called on the different political parties to concentrate work over the next year on the country's efforts for a prompt economic recovery, leaving electoral issues for the last part of 2004.

7. Encouraged by the implementation of the fiscal adjustment, broadly on track with the program, and while maintaining a tight grip on discretionary spending, the authorities are working on rationalizing and improving the structure of expenditures. It is the authorities' intention to devote part of the resulting spending cuts on improving the protection to the most vulnerable groups through enhanced social policies. The authorities are working to improve the targeting and effectiveness of social programs, including reforms in the unemployment insurance scheme, as well as in the health and educational sectors. Similarly, the authorities have taken some measures to reduce the size of the public sector, including an early retirement scheme, and a hiring freeze for permanent positions.

8. Tax revenues have increased 5 percent in real terms in the first five months of 2003, as compared with the last five months of 2002. Beyond this improvement, the authorities are committed to reforming the tax system and strengthening tax administration, which, in addition to contributing to the achievement of the fiscal target under the program, will help improve the business environment and investment incentives. In this vein, last June 30th, the authorities sent to Parliament a draft bill that, among other reforms, proposes derogating seven low-yielding taxes, broadening of the VAT base, and extending the corporate income tax to all sectors of the economy. Moreover, the draft bill authorizes the government to reduce the VAT rates in the future, to the extent that such action does not pose a risk for the fiscal targets.

9. Along with smaller fiscal financing needs, a substantial reduction in the expectations of inflation and of *peso* depreciation, have led to a sharp decline in Treasury bill yields in local currency, thus opening an opportunity for the recovery of credit to the private sector. Moreover, in order to favor financial intermediation in domestic currency and a gradual and voluntary de-dollarization of the financial system, the auctions of inflation-indexed Treasury bills, which were temporarily suspended due to uncertainty stemming from the debt exchange process, will be resumed. In addition, at the end of June, the authorities proceeded to reduce the reserve requirements on *peso* denominated deposits by five percentage points. Additionally, the overnight rate of the Central Bank was reduced from 10 percent to 5 percent, while the rate of three-day time deposits at the Central Bank, remunerated with 15 percent, was eliminated. Given that the acceptance of local currency is tied to monetary stability, the authorities plan, for the time being, to continue basing their cautious monetary policy on quantitative targets, while they remain committed to moving towards an inflation-targeting regime as soon as technical and institutional conditions allow it.

Structural Reforms

10. The Uruguayan authorities broadly agree with the staff assessment on the financial system and recognize that bank supervision and regulations need to be strengthened to correct the prevailing weaknesses and vulnerabilities of the system. The banking crisis has highlighted important shortcomings of the system, including a high level of non-performing loans that are mostly, but not only, the result of the considerable *peso* depreciation and the deep recession. It also reflects a strategic behavior of debtors in the face of expectations of refinancing schemes introduced by law. In this regard, the authorities remain firmly committed to avoid intervening in contracts among private agents and are acting against

these types of perverse incentives. Meanwhile, the authorities have reached an agreement with the banks for the provision of relief to debtors, but only on a case by case and voluntary basis.

11. The authorities continue to work on a comprehensive restructuring of the public bank, BROU, aimed at improving corporate governance, reducing and rationalizing operating costs, strengthening credit risk administration, and improving the bank's capital adequacy ratio. The mortgage bank, BHU, has been transformed into a non-bank entity and this has been a critical step. It is important to consider that BHU was seen by the Uruguayan public as an important institution that allowed them to have access to housing. However, the authorities are aware that reforms need to be completed and are working with the World Bank to accelerate them. Regarding the resolution of suspended banks, the Central Bank completed the definition of a strategy for the disposal of the remaining assets of the liquidated banks, to be implemented under the guidance of a steering committee. The authorities concur with the staff and believe that the completion of this process is critical for maintaining creditor discipline and a repayment culture in the Uruguayan financial sector. Being cautious, the authorities believe that an early repayment of the first tranche of reprogrammed deposits will provide a strong positive signal, contributing to eliminate those uncertainties leading to a larger wealth effect, which has been one of the elements affecting private consumption. During the first two weeks after the decision of unfreezing the reprogrammed deposits, the dollar-denominated deposits at the BROU increased.

12. As we have observed, a good portion of the authorities' efforts has been put on recovering confidence in the economy and particularly in the financial system, since the lack of it has been a critical factor for the depth of the crisis and for a massive credit crunch that has been a major obstacle for resuming economic growth. While a greater macroeconomic and financial stability will contribute to alleviating the situation, the government is finding new ways to increase the access to credit. In this regard, the authorities expect approval of the draft law on trust funds and warrants, which will allow an interesting alternative to financial intermediation.

13. Uruguay has a liberal trading system, as reflected by its rating of 2 in the Fund's index of aggregate trade restrictiveness. However, the existence of quotas and subsidies in industrialized countries has imposed significant constraints on Uruguayan export growth, particularly in agricultural goods. Unfair trade practices not only limit global growth and development but also give political groups in developing countries justifications to blame foreign conditions for their own problems, resulting in additional resistance to structural reforms. In this regard, further global trade liberalization would not only generate substantial direct benefits in developing and advanced economies, but also will signal more clearly the road of reforms by showing that open markets and globalization are a common practice and can work to the benefit of all.

14. Civil society's reservations for openness and competition are mirrored in its reluctance to undertake some structural reforms, fearing privatizations may just end up replacing public monopolies with private ones. Therefore, the authorities have chosen to start by focusing on the deregulation and opening-up to competition activities previously

reserved for the public sector. Meanwhile, with support of the World Bank, the authorities are working on the creation of strong regulatory agencies.

15. It is true that sometimes consensus building could lead to delays in enacting important reforms. However, a more active role of the citizens tends to produce better monitoring and control of the work of the politicians and the government. Among other things, such control and monitoring could establish barriers to corruption activities, which have proven to be so detrimental to growth and stability. But, more importantly, reforms with a strong consensual backing are long lasting and less subject to reversals due to changes in political winds, thus contributing to build stronger institutions.