



URUGUAY

January 2022

2021 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR URUGUAY

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2021 Article IV consultation with Uruguay, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 29, 2021 consideration of the staff report that concluded the Article IV consultation with Uruguay.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 29, 2021, following discussions that ended on October 5, 2021, 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 November 11, 2021.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Uruguay.

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

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.



IMF Executive Board Concludes 2021 Article IV Consultation with Uruguay

FOR IMMEDIATE RELEASE

Washington, DC – December 2, 2021: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Uruguay.

The economy is showing strong signs of recovery with growth expected to reach 3.4 percent in 2021 and 3.2 in 2022. After contracting by 5.9 percent in 2020 and suffering a strong COVID wave in the first half of 2021, economic activity is gaining strength following a fast vaccination campaign that allowed for the reopening of contact-intensive sectors. Elevated commodity prices are also supporting a broad-based recovery. Inflation is projected at 7.2 for end 2021 and 5.8 for end 2022. Inflation expectations remain above the target range, although they have been gradually converging to the upper band of the range.

Notwithstanding an effective policy response that mitigated the impact of the crisis, the pandemic amplified some pre-existing structural weaknesses. Public finances deteriorated further. High youth unemployment, and the skill mismatch in the labor force were magnified by the disproportionate impact of the pandemic on young and low-income workers as well as the leap in digitalization. Loss of schooling, although of relative short duration, also added to the pre-pandemic erosion of human capital.

The fiscal balance of the non-financial public sector (NFPS), excluding 'cincuentones', is projected to improve from -4.5 percent of GDP in 2021 to -3.4 in 2022, while targeted fiscal support remains in place. Near term fiscal risks are limited as financing needs are moderate, liquidity buffers are adequate and market access remains at favorable terms, reflecting its investment grade status. The authorities' envisaged consolidation plan is expected to stabilize debt around 70 percent of GDP over the medium term. Monetary policy remains accommodative and is gradually tightening, responding to inflationary pressures and the economic recovery. The banking sector is well capitalized and financial risks remain contained, including because the overall exposure of the financial system to sectors most affected by the pandemic is low.

Executive Board Assessment²

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

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

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities' effective policy response to the pandemic, leveraging on solid health and social welfare systems, and noted that Uruguay has one of the most successful vaccination campaigns worldwide. Directors also positively noted the important enhancements to the country's fiscal and monetary frameworks despite the pandemic. Moving forward and given the uncertain outlook and pre-existing structural weaknesses, Directors emphasized the importance of rebuilding fiscal space while supporting the recovery, addressing inflationary pressures, and moving ahead with structural reforms to achieve higher and inclusive growth.

Directors agreed that near-term policies should continue to support the recovery with targeted measures while shifting towards fiscal consolidation and debt reduction as the recovery takes hold. In that context, they welcomed the continued well-targeted fiscal measures to support employment and the most vulnerable. Directors noted that the introduction of the new fiscal rule would improve fiscal discipline and encouraged the authorities to consider some refinements to the fiscal framework to further strengthen it. The authorities' resolve to reforming the pension system, which is key for fiscal sustainability and inter-generational equity, is commendable.

Directors noted that accommodative monetary policy and temporary regulatory forbearance were key to support firms and maintain financial stability through the downturn. They agreed that, as the economy recovers and uncertainty dissipates, support measures should be phased out. Monetary policy should focus on strengthening credibility by firmly steering inflation and inflation expectations towards the target as the economy recovers. Directors welcomed the ongoing enhancements to the monetary policy framework and noted that durably lowering inflation is key to reducing dollarization, developing domestic capital markets, and bolstering financial intermediation and investment. Efforts to enhance the Central Bank's independence, accountability and transparency should continue.

Directors encouraged the authorities to move forward with structural reforms to address pandemic legacies and boost medium term growth prospects. Supporting young and low-skilled workers, which have been disproportionately impacted by the pandemic, through active labor market policies, retraining and education reform would be particularly important to bolster human capital accumulation. Directors also encouraged the authorities to address labor market rigidities and accelerate reforms of state-owned enterprises to help improve efficiency, reduce costs of doing business and boost investment and growth. Commenting on Uruguay's strong commitment to tackling climate change, Directors noted that investment in green energy, digitalization and infrastructure will be key in sustaining strong growth over the medium to long term.

It is expected that the next Article IV consultation with Uruguay will be held on the standard 12-month cycle.

Selected Economic Indicators

	2019	2020	Projections		
			2021	2022	2023
Output, prices, and employment					
Real GDP (percent change)	0.4	-5.9	3.4	3.2	2.7
Unemployment (in percent, eop)	8.9	10.4	10.2	9.0	8.5
CPI inflation (in percent, end of period))	8.8	9.4	7.2	5.8	5.0
(Percent change, unless otherwise specified)					
Monetary and banking indicators 1/					
M2	6.3	17.2	...	...	...
Bank assets (in percent of GDP)	65.8	76.9	...	...	...
Private credit (in percent of GDP) 2/	25.7	27.8	...	...	...
(Percent of GDP, unless otherwise specified)					
Fiscal sector indicators 3/					
Revenue NFPS	28.3	28.0	27.4	27.5	27.7
excluding <i>cincuentones</i> transactions	27.2	27.4	27.1	27.5	27.7
Primary expenditure NFPS	28.8	30.2	29.4	28.6	27.8
Primary balance NFPS	-0.5	-2.1	-1.8	-1.0	0.1
excluding <i>cincuentones</i> transactions	-1.6	-2.7	-2.2	-1.0	0.1
Overall balance NFPS	-2.9	-4.7	-4.1	-3.4	-2.5
excluding <i>cincuentones</i> transactions	-4.0	-5.2	-4.5	-3.4	-2.5
Gross debt NFPS	60.5	68.1	67.3	68.5	69.7
Gross debt PS	64.3	74.9	81.1	82.3	83.2
Net debt NFPS	51.2	57.8	57.2	58.5	59.8
PS debt net of liquid financial assets 6/	39.9	47.5	52.2	54.3	55.9
PS debt net of total financial assets	32.3	36.8	41.2	43.9	45.5
External indicators					
Merchandise exports, fob (US\$ billions)	11.7	9.9	13.0	14.6	16.0
Merchandise imports, fob (US\$ billions)	8.7	7.8	9.8	10.9	11.5
Terms of trade (percent change)	3.8	7.4	3.3	1.8	0.2
Total external debt + non-resident deposits	74.1	88.0	85.9	85.2	86.3
External debt service (in percent of exports of g&s)	59.0	75.1	67.7	57.7	55.6
Gross official reserves (US\$ billions)	14.5	16.2	17.0	17.2	17.4
In months of imports of goods and services	13.1	17.4	15.1	13.7	13.1
In percent of:					
Short-term external (STE) debt	227	250	298	289	285
STE debt plus banks' non-resident deposits	278	266	263	254	246

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

1/ Percent change of end-of-year data on one year ago.

2/ Includes bank and non-bank credit.

3/ Non-financial public sector (NFPS) includes the Central Government, Banco de Prevision Social, Banco de Seguros del Estado, and Non-Financial Public Enterprises.

4/ Temporary proceeds resulting from the pension reform that allowed workers above 50 years old (and with certain income level) to voluntarily move back to the public pension system. Proceeds are projected to end in 2022.

5/ Total public sector (PS). Includes the NFPS and Banco Central del Uruguay.

6/ Public sector gross debt minus liquid assets. Liquid assets exclude central bank reserves held as counterpart of banks' required reserves on foreign currency deposits.



URUGUAY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

November 11, 2021

KEY ISSUES

Context. Uruguay entered the pandemic with solid institutions and social cohesion but growing macroeconomic imbalances—especially slow economic growth and weak public finances—as the end of the last commodity price boom in 2014 uncovered structural weaknesses. A new government came to power in March 2020 with a mandate to boost growth and restore fiscal sustainability. Legislation setting the foundations for many of the reforms has been passed and implementation is advancing—including on a new fiscal rule, and state-owned enterprise (SOE) and pension reforms.

Recent developments. Activity contracted markedly in 2020—in the context of an already weak economy—reflecting the impact of social distancing on contact-intensive sectors. Leveraging on sound existing social protection and health care systems, and low poverty rates, the authorities deployed an effective policy response, using available policy space while balancing fiscal sustainability objectives. A package of fiscal measures, credit support, highly accommodative monetary policy and regulatory forbearance helped keep firms afloat, sustain employment and mitigate the impact on vulnerable groups. The recovery in early 2021 was sluggish—reflecting the strong COVID wave—and uneven, with primary activities and construction growing robustly while contact intensive sectors lagged. Following a fast vaccination campaign, however, COVID cases slowed to a near halt, allowing the economy to gradually reopen and contact-intensive sectors to accelerate their recovery.

Impact of the pandemic. Young and low-skilled workers were disproportionately affected by the crisis, adding to the pre-existing challenges of high youth unemployment. Skill mismatches in the labor force were also amplified by the leap in digitalization.

Outlook and risks. The recovery is expected to strengthen in late 2021 and 2022 as contact-intensive sectors rebound and elevated commodity prices continue to provide broad support. Near-term risks stem mainly from a resurgence of the virus and weaker commodity prices. Over the medium term, growth will also hinge on whether the effects of the pandemic—especially the amplified skill mismatch in the labor force—are long-lasting, and on progress with fiscal consolidation and the reform agenda.

Policy Recommendations. Near-term policies are appropriately shifting towards rebuilding policy space, while maintaining targeted support for vulnerable groups and the economy. Sustaining growth in the medium term will require moving forward with reforms to address pandemic legacies and lift pre-existing structural barriers to growth. Specifically:

- **Fiscal policy.** The envisaged fiscal consolidation plan is appropriate as the recovery is expected to strengthen in the coming quarters. If downside risks materialize, there is scope for spreading the adjustment over time to limit potential long-lasting effects of the pandemic. As the economy fully recovers, greater fiscal efforts will be needed to place debt on a firm downward path and rebuild fiscal space. Identifying structural measures to underpin the fiscal consolidation would also help ensure its durability. The new fiscal rule is an important step toward securing fiscal discipline, although some refinements would help fully reap the benefits of a rules-based system. Plans to move forward with pension reform—key to fiscal sustainability—are welcome. Accelerating SOE reforms—to improve efficiency and reduce production costs—would support post-pandemic investment.
- **Labor Markets.** The extension of enhanced unemployment benefits and subsidies for employment of vulnerable workers is welcome. Greater offer of (re)training programs is urgently needed to revert the impact of the pandemic on young and low-skill workers. Education reform is also needed to address the pre-pandemic erosion of human capital and adapt the labor force to the demands of the labor market. Decentralizing wage negotiations—including to ensure that wages are aligned with productivity—would support the recovery of lagging sectors and bolster growth of non-commodity sectors.
- **Monetary Policy.** Accommodative monetary policy remains appropriate to support the recovery, although a tightening bias, in line with the recovery, is needed to help solidify credibility gains. Bringing inflation down durably is essential to tackle dollarization and boost investment going forward.
- **Financial Sector.** Financial stability risks appear contained and should continue to be monitored, especially as regulatory forbearance measures are unwound. Credit guarantee programs should be phased out as uncertainty dissipates.

Approved By:
Patricia Alonso-Gamo
(WHD) and Anna
Ilyina (SPR)

Discussions took place virtually during September 23–October 5, 2021. The staff team comprised Gustavo Adler (head), Natasha Che, Chiara Fratto, M. Belen Sbrancia and Jose Torres (all WHD). Ines Bustillo (OED) participated in key meetings. Patricia Alonso-Gamo (WHD) participated in the concluding meeting. Luis Omar Herrera Prada (WHD) provided research assistance. Staff met with Minister of Economy and Finance Arbeleche, Minister of Labor Mieres, Director of the Office of Planning and Budget Alfie, Central Bank President Labat, other senior government officials, as well as representatives of public enterprises, the private sector, unions, and members of other political parties.

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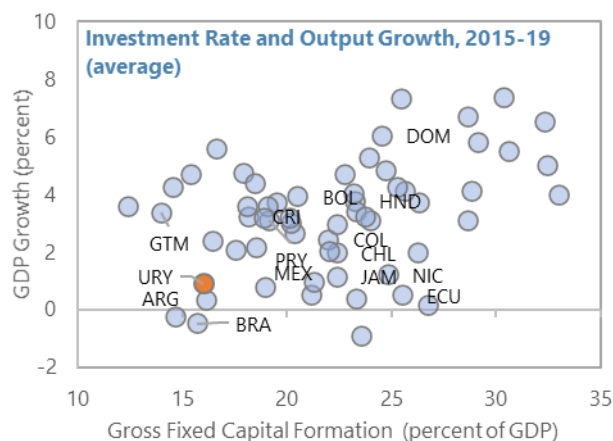
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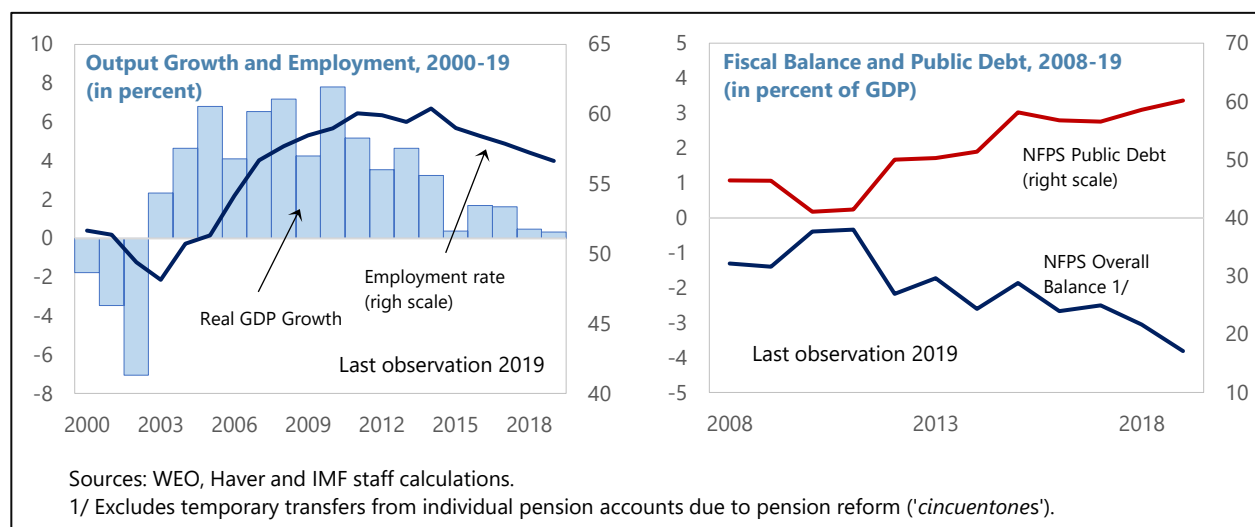
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PRE-PANDEMIC CONTEXT: SOLID INSTITUTIONS BUT GROWING IMBALANCES

1. Uruguay entered the pandemic with solid institutions and a high degree of social cohesion but pre-existing macroeconomic imbalances. The country stands out in the region for its well-functioning institutions, and high degree of social cohesion.¹ Its solid financial sector, ample reserve buffers and investment grade status are also key pillars of its stable economy. However, after the end of the commodity boom in 2014, macroeconomic imbalances emerged, with weakening public finances and low economic growth, amid low investment and declining employment.² Labor market frictions—including wage rigidities and a growing labor force skill mismatch rooted in poor outcomes in basic education—contributed to weak employment and persistently high youth unemployment. Inflation remained consistently above the target range.



Sources: WEO and IMF staff calculations.



2. A new government—with a mandate to boost growth and restore fiscal sustainability—came to power in March 2020. Despite the challenging circumstances—as the pandemic arrived only weeks after the new administration took office—an omnibus law, laying the foundations of its reform program (*'Ley de Urgente Consideracion'*), was passed in July 2020. Among

¹ See IMF Country Report 19/64.

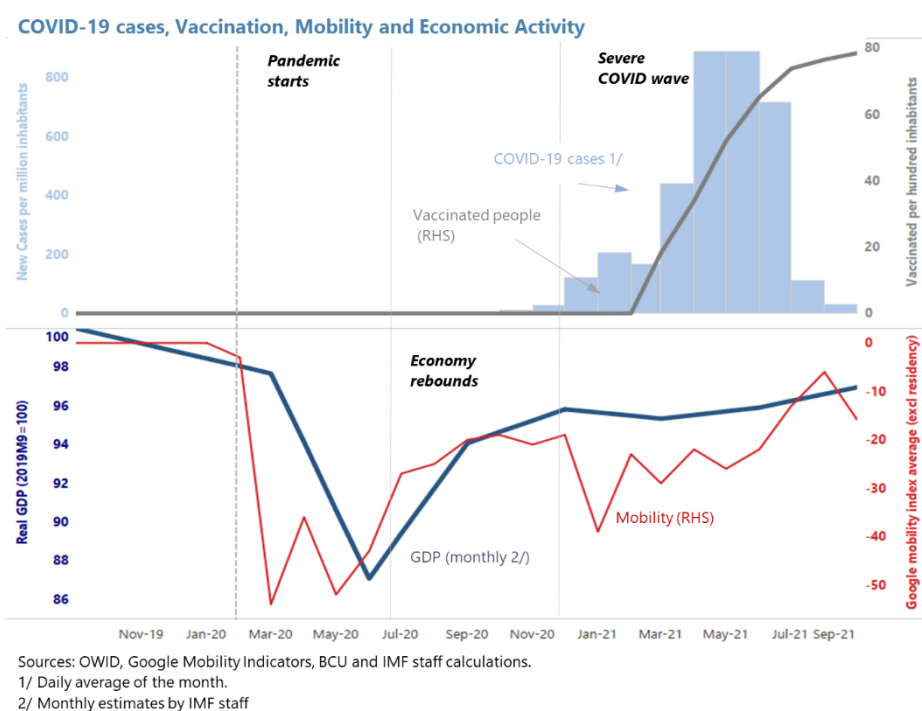
² The sharp slowdown in growth became apparent following the revision to national account statistics, implemented in December 2020.

other things, the law established the basis for a new fiscal framework to strengthen fiscal discipline, reforming state-owned enterprises, reforming the pension system, and giving regulatory agencies greater autonomy, including to set utility rates. Implementation has advanced, although at a slow pace due to the pandemic and, more recently, the prospects of a referendum in 2022H1 to unwind some of the elements of the law.

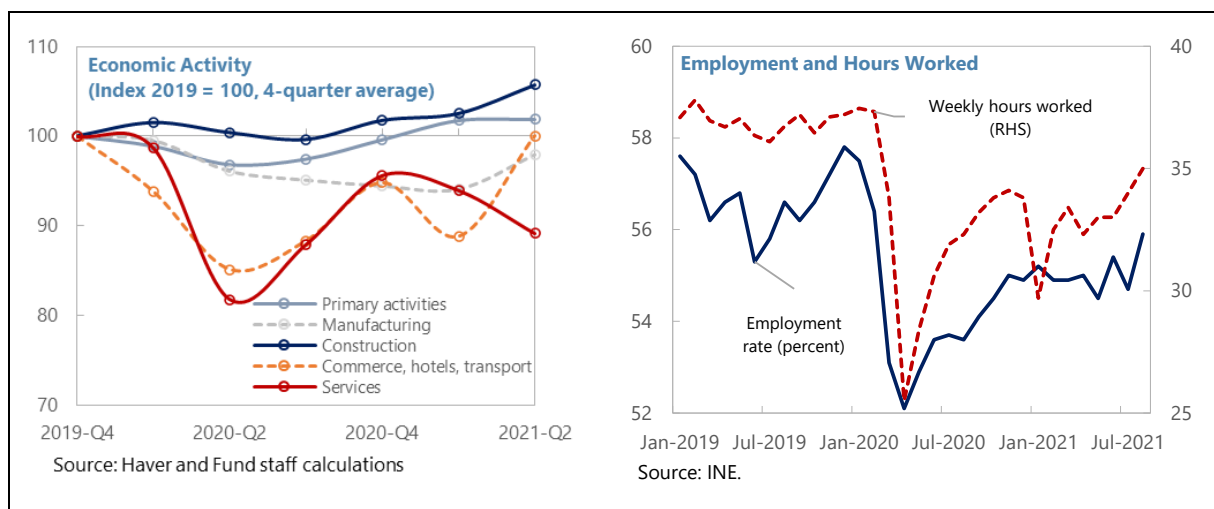
THE PANDEMIC

A. Recent Developments

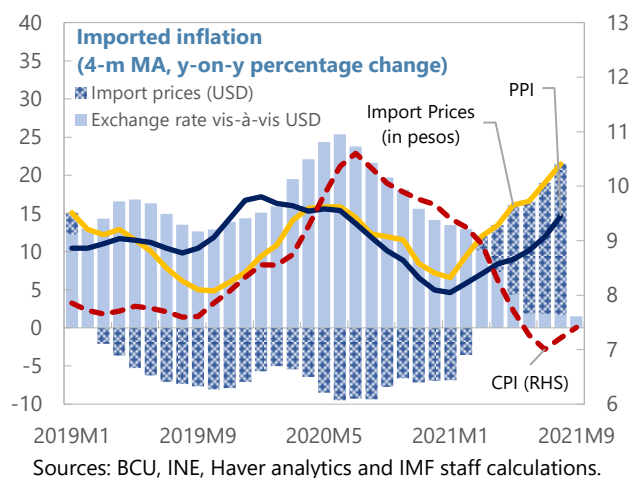
3. The pandemic had markedly distinct phases in Uruguay. Effective containment measures kept the spread of the virus remarkably low throughout most of 2020 (Figure 1) although activity contracted sharply at the onset of the pandemic due to the severe impact of the crisis on mobility and contact-intensive sectors (Figure 2). Growth rebounded strongly in 2020H2 but lost steam in early 2021 as a severe COVID wave took hold. More recently, following a rapid vaccination campaign—one of the fastest in the world—the spread of the virus has come to a near halt, and the recovery has regained speed.



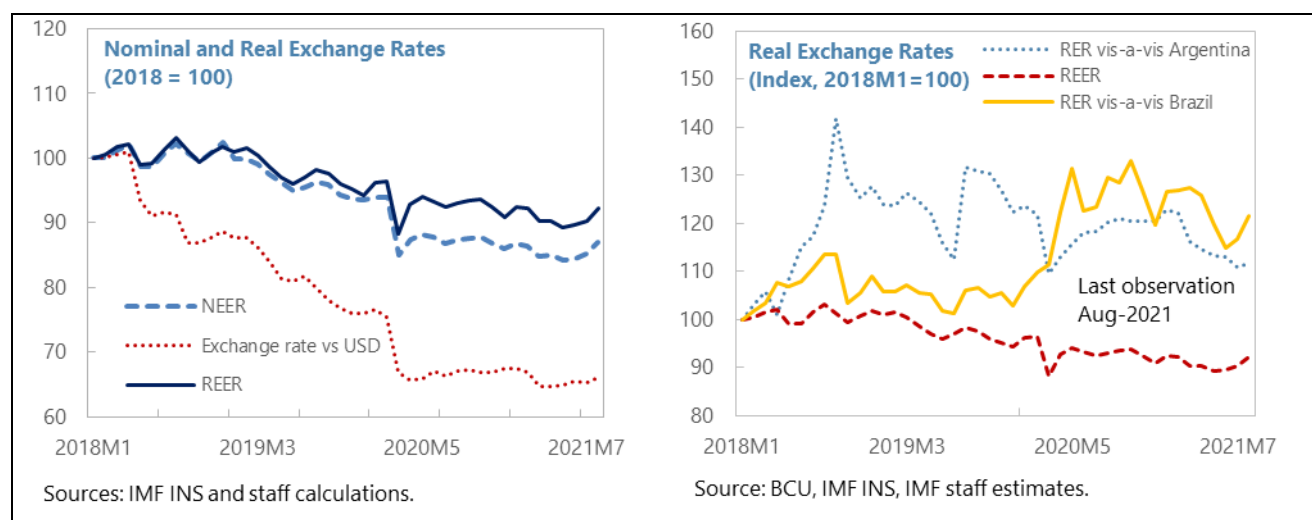
4. The recovery in output has been uneven and employment has lagged. Primary activities and construction rebounded rapidly from the initial contraction—supported by the rebound in external demand, booming commodity prices, and the easing of mobility restrictions—and are already above pre-pandemic levels. Meanwhile, contact-intensive activities were highly affected and recovered more slowly, although high frequency indicators point to a speeding rebound following the recent reopening of the economy. In tandem with aggregate output, employment plateaued below pre-pandemic levels in early 2021—after rebounding rapidly in 2020H2—although there are signs of a further uptick in recent readings.



5. Inflationary pressures subsided in early 2021—after peaking in 2020—although there are signs of new underlying pressures stemming from external prices. Following two years of overshooting the 3–7 percent target range, inflation spiked above 10 percent in mid-2020, due in part to the depreciation of the peso and supply disruptions. In 2021H1, headline and core inflation trended downwards—amid economic slack, mild administrative price changes, and a stable exchange rate—but there are signs of renewed inflationary pressures stemming from food and global inflation. Medium-term inflation expectations have moved closer to the target range, although remaining above it (Figure 5).



6. The exchange rate worked effectively as a shock absorber. Responding to the pandemic, the Uruguayan peso displayed a sizable nominal depreciation in early 2020 and has remained broadly stable since then. After some interventions to mitigate currency pressures in 2020, the exchange rate has floated, displaying some nominal and real appreciation. The real appreciation vis-à-vis Brazil and, most notably, Argentina, pose challenges for sectors that depend heavily on demand from these neighbors, adding to the significant uncertainty about the impact of the reopening of borders.



7. The current account shifted from a 1.6 percent of GDP surplus in 2019 to a 0.6 deficit in 2020. Weak external demand, border closures, and supply chain disruptions drove a decline in exports, only partially offset by lower imports—reflecting shrinking domestic demand—and lower fuel import prices (Figure 4). Despite a strong rebound in exports—driven by agricultural commodities—the current account deficit is expected to widen further in 2021 reflecting the sharp drop in tourism receipts—as the full effect of the pandemic was felt in the 2021 summer season—and large imports related to the UPM pulp mill project. Financial flows were resilient throughout, supported by large FDI inflows (driven by the pulp-mill project and sizeable inter-company loans) which more than offset the domestic banks’ purchases of foreign assets. The 2020 external position was broadly in line with fundamentals (see Annexes I and VI). The authorities intend to maintain the SDR allocation in international reserves.

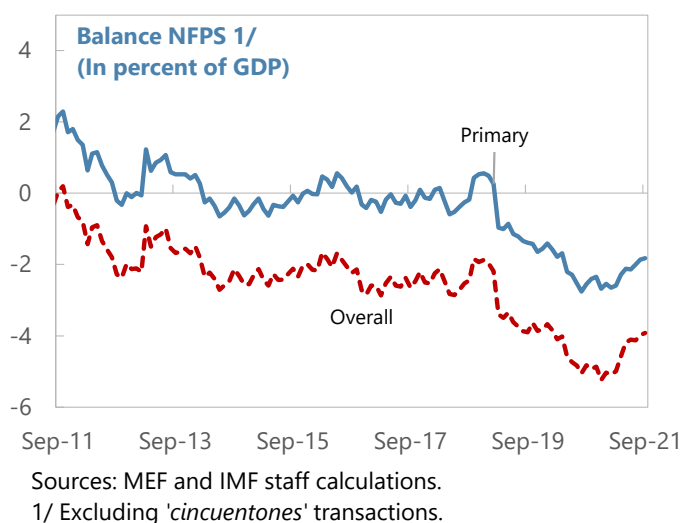
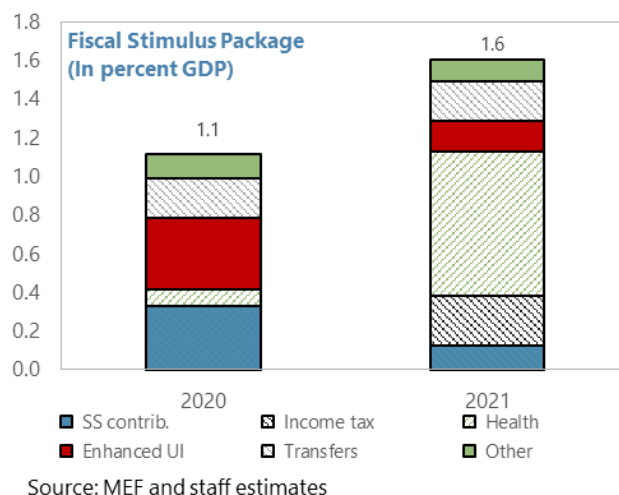
B. Policy Response to the Pandemic

8. A comprehensive policy package was implemented to mitigate the impact of the pandemic.

- Fiscal policy.** A package of about 2.7 percent of GDP for 2020-21 was deployed to meet greater health spending needs, protect the most vulnerable and keep employment and firms afloat, within the boundaries of available fiscal space. The solid existing social protection and health care systems, and low poverty rates limited the necessary resources to tackle the health crisis, especially compared to peer countries. The fiscal package included tax breaks and additional resources for health related-expenses, enhanced unemployment insurance, and transfers to vulnerable households (see Annex II).³ The overall balance of the non-

³ The fiscal costs of COVID-related measures have been earmarked and transparently reported through a COVID Fund (*Fondo Solidario COVID*) to indicate their transitory nature.

financial public sector (NFPS), excluding *'cincuentones'*, weakened from -3.8 percent of GDP in 2019 to -5.2 in 2020 (Figure 6).⁴ The mild fiscal deterioration was aided by revenue resilience as income tax revenues remained unchanged relative to GDP and the fall in social security contributions (due employment losses and tax relief measures) was mostly compensated by a surge in VAT revenues.⁵ Higher spending mostly reflected the support measures, while non-COVID spending contracted somewhat. The fiscal balance is projected to improve to -4.5 percent of GDP in 2021, reflecting the economic recovery and further restraint on discretionary spending. The introduction of a new fiscal framework—aimed at strengthening fiscal discipline and ensuring medium-term sustainability—served to signal the authorities commitment to fiscal consolidation despite the impact of the pandemic on public finances (see Annex III and discussion below).⁶



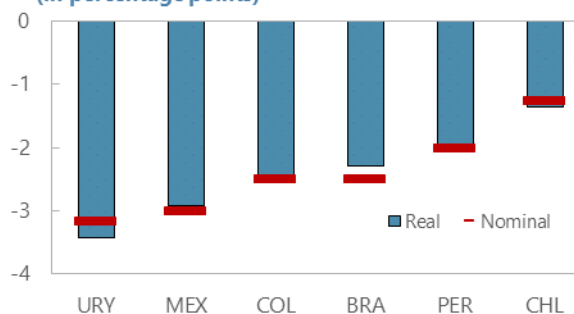
⁴ The *cincuentones* transactions are transitory cash payments from the private to the public pension system reflecting the transfer of individuals over fifty years, who were allowed to voluntarily return to the public system (to compensate them for the possibility of low replacements rates, given that their contributions under the old system were not recognized when the mixed pension system was created). See Box 1 in IMF Country Report 19/64.

⁵ The surge in consumption partly reflected a shift in consumption patterns as unspent income in tourism and recreation was used for purchasing durable goods.

⁶ The rule was introduced with the 2020 Urgent Consideration Law, with further details provided in the 2020-24 Budget and the *'Rendicion de Cuentas y Balance de Ejecucion Presupuestal'* for 2020. It is worth noting that the three indicative targets set for 2020 were met.

- Monetary policy.** At the onset of the pandemic, the BCU deployed ample liquidity support by lowering reserve requirements and rapidly expanding the monetary base (a 40 percent increase from February to August 2020). The shift to the interest rate as main policy instrument, in September 2020, confirmed the highly accommodative stance, leading to deeply negative short-term real rates and a downward shift of the yield curve (Figure 7). More recently, accompanying the recovery, the monetary policy rate has been increased by 125 basis points, bringing the policy rate to 5.75 percent—although the stance remains accommodative with a real rate of about -1 percent (Figure 5). Market expectations on the path of monetary policy have been guided by the BCU’s commitment to support the economy and increase rates as the recovery was underway. Changes to the monetary policy framework (Box 1) and the recent monetary policy tightening have lent support to the BCU’s commitment to bring inflation into the target range going forward, although one-year ahead inflation expectations remain above the target range.
- Financial sector policy.** Regulatory forbearance measures and lower reserve requirements helped avoid financial stress and a contraction of credit (see Annex II). The extension of bank loan repayments up to 180 days for all non-financial corporations and individuals benefited about 45 percent of private loan repayments up to August 2021. In addition, the National System of Guarantees (SIGA) launched three lines of credit guarantees for SMEs, sectors highly impacted by the pandemic, and large companies, with an average guarantee of about 70 percent (covering over 5 percent of private sector loans or 1.4 percent of GDP). Finally, the National Development Agency (ANDE) launched credit lines for small and micro firms, resulting in loans for US\$29 million (0.05 percent of GDP).

Change in Interest Rates Jan20-Jan21 1/
(In percentage points)



Source: Haver, BCU, Consensus Forecast.

1/ One-month rate on Letras de Regulacion Monetaria, reported for Uruguay. Policy rates for other countries. 12-month ahead inflation expectations is used to compute real rates.

Box 1. An Enhanced Monetary Policy Framework

The central bank introduced various changes to its monetary policy framework with the goal of strengthening credibility and lowering the cost of its disinflation plan. After several years of overshooting the inflation target range, the new administration presented a new 5-year strategic plan¹ with significant changes to its monetary policy framework, mainly along 3 dimensions:

- *Monetary policy objective.* The plan reaffirmed price stability as its primary monetary objective and clarified that smoothing short-term financial market volatility, including of the exchange rate, “will be carried out as long as it does not collide with the main targets of monetary policy.”
- *Policy instrument.* The policy instrument shifted from the growth rate of M1+ to the short-term interest rate.^{2,3}
- *Disinflation path.* It announced a reduction of the upper band of the range from 7 to 6 percent, effective September 2022, along with the intention to converge to a target centered around 3 percent over the medium term.

Additional efforts are underway to enhance the central bank’s independence, accountability, and transparency. The meeting of the Macroeconomic Coordination Committee (MCC)—created to facilitate coordination between the BCU and the Ministry of Finance—were decoupled from the Monetary Policy Committee (COPOM) meetings, reducing the frequency of the first and doubling the frequency of the latter. The BCU introduced new communication and transparency practices in line with international standards, including publishing minutes of the meetings and strengthening existing reports to clearly link the policies and the objectives as well as discussing expected future monetary policy actions to guide market expectations. The central bank is also working on improving its survey of inflation expectations as a step towards gaining a better understanding of the process of expectation and price formation, has recently undergone a Central Bank Transparency Review⁴ and is seeking technical assistance on central bank communications (a mission is planned for late November 2021).

The new BCU authorities are committed to reducing dollarization and promoting local currency debt markets, which would increase the effectiveness of monetary policy. A multipronged approach has been developed, with initiatives aimed at addressing *financial* (banking system and public debt) dollarization as well as *price* dollarization. In coordination with the Ministry of Economy and Finance, the BCU plans to develop secondary markets for debt instruments, increase the liquidity and depth along the yield curve,

¹ Labat D., Licandro G., 2021, “Towards a quality currency.”

² The BCU introduced monetary aggregates as its policy instrument in 2013—switching from a short-term interest rate instrument—with the objective of facilitating the deflation process by gradually reducing M1 growth (see IMF, 2015). This responded to the view that monetary policy transmission via interest rates was weak in the context of a highly dollarized banking system. Inflation remained above the upper band of the target range, except in 2017, and short-term interest rates exhibited a high degree of volatility.

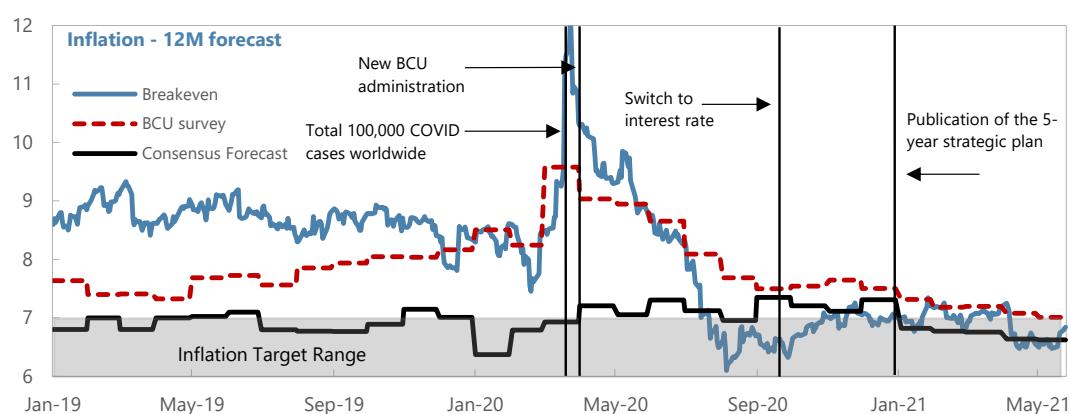
³ The one-day interest rate in the money market is the key policy rate to implement the announced policy with standing facilities and remuneration of excess reserves in line with the policy rate.

⁴ The Review assessed that the BCU is implementing transparency practices that are broadly aligned with international practices and it has developed a comprehensive communication framework. However, further improvements are advisable in the communication strategy on monetary policy and FX interventions, including clearly communicating to the public rationales, objectives, and evaluation of their impact.

Box 1. An Enhanced Monetary Policy Framework (concluded)

increase the issuance of peso sovereign debt,⁵ and allow for greater access by non-residents to peso instruments through Euroclear. Some measures to promote bank credit to the private sector in pesos have been deployed—like the recent reduction in reserve requirements on peso deposits—and others under consideration. The BCU is also actively engaging key price-setting players to better understand and tackle the root causes of price dollarization.⁶

Gains in credibility from the reforms are apparent. Soon after the change in the policy instrument, the interest rate on 1-month monetary policy instruments (*Letras de Regulación Monetaria*) converged to the announced policy rate, reducing its volatility, and indicating the effective working of the new intermediate policy target. Notwithstanding the spike in inflation and inflation expectations at the onset of the pandemic, the different measures of inflation expectations have moved closer to the target range in relation to pre-pandemic levels, although remaining above the range. A decreased dispersion of inflation expectations across different actors also points to some gains in anchoring expectations.



Source: INE, BEVSA, Consensus Forecast. IMF staff estimates.

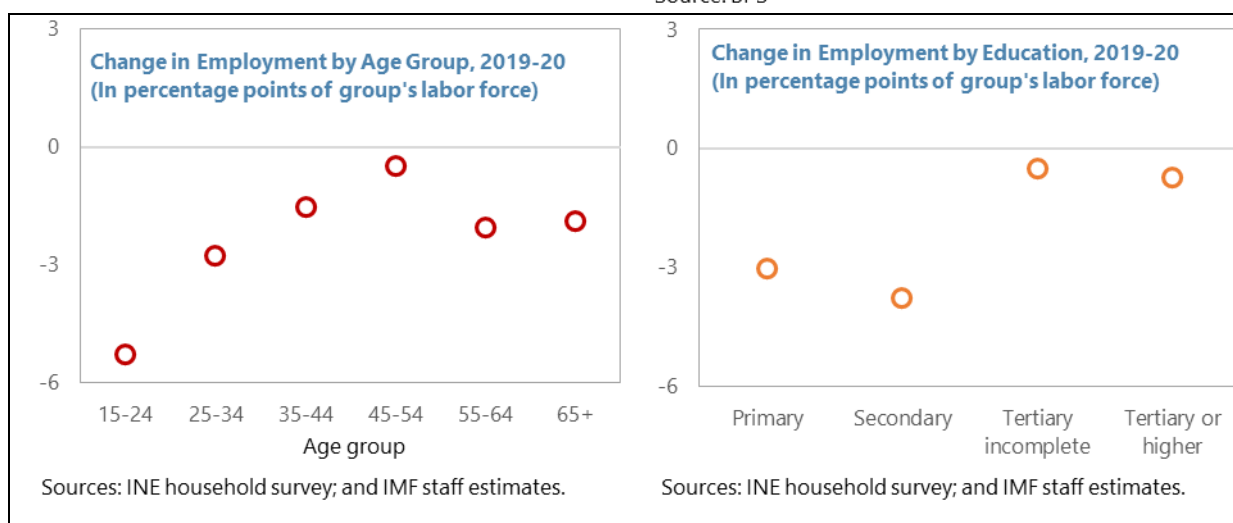
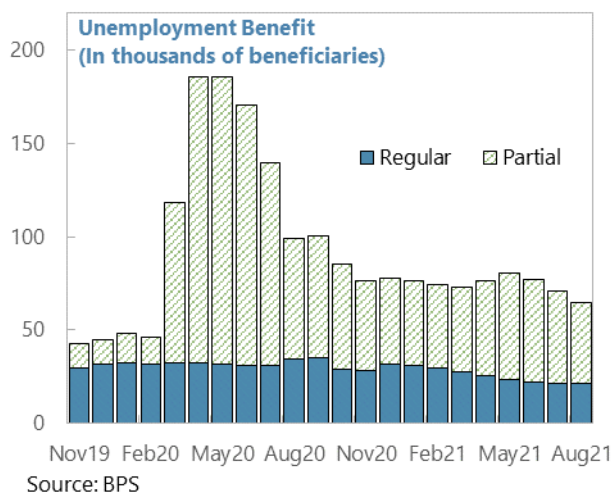
⁵ The government has set a goal of reaching 50 percent of total debt denominated in local currency by 2024.

⁶ Some structural features may also play a role in inflation outcomes in Uruguay. For example, improving labor market flexibility, strengthening central bank institutions and fiscal responsibility can serve to lower equilibrium inflation. See the accompanying Selected Issues Paper on structural determinants of inflation.

C. Social Impact of the Pandemic

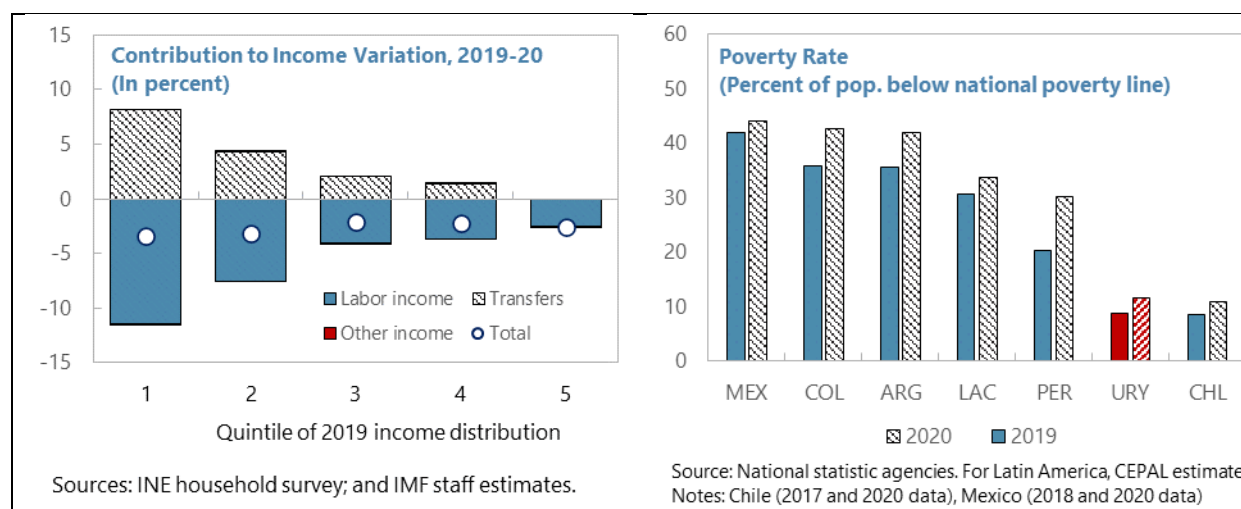
9. The authorities' response package was effective in mitigating the impact of the crisis, although pre-existing structural issues in the labor market were exacerbated by the pandemic. While the pandemic inevitably caused a contraction of contact-intensive sectors, the existing social safety net and the additional support measures helped contain the impact on workers and firms. The enhancements to unemployment insurance (especially the new partial unemployment benefit) were instrumental in containing employment losses and facilitating a quick recovery (by maintaining employer-employee relationships), helping Uruguay to display smaller employment losses than peer countries (Figure 3). Young and low-earning workers were disproportionately

affected by the crisis, partly reflecting their greater concentration in contact-intensive sectors. The leap in digitalization prompted by remote work added to pre-existing issues of skill mismatch in the labor force as a significant share of unemployed workers lack highly-demanded IT skills. Loss of schooling, although of relative short duration, also added to the pre-pandemic erosion of human capital (and to the pre-existing elevated school dropout rates).



10. The robust social protection system already in place and new policies helped to protect low-income groups. While workers at the low end of the earnings distribution were particularly affected by the pandemic, well-targeted social assistance—through unemployment benefits for formal workers and reinforced transfer programs for formal and informal ones—largely offset the loss of labor income. Poverty rates hedged up moderately relative to other countries, from a low base.

11. The authorities broadly agreed with the staff's assessment on the strength of the recovery and the impact of the pandemic. They stressed that Uruguay's economy and employment contracted less than other countries in the region. Authorities also highlighted that the recovery has broadened to contact-intensive sectors—after a rapid and effective vaccination campaign—and expected that approximately 70 percent of the employment losses during the pandemic would be reverted by end-2021. They also highlighted that, despite the pandemic, Uruguay was able to advance an ambitious structural reform agenda including a new fiscal institution, placing environmental objectives at the center of the planning and design of economic policies, a new mechanism for setting fuel prices, and the creation of the commission that is studying the reform of social security system, among others.

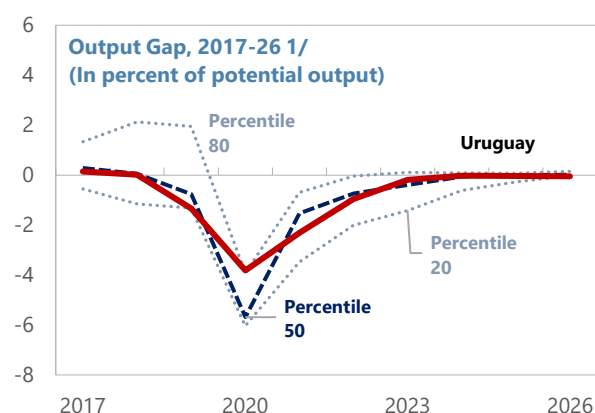


OUTLOOK AND RISKS

12. The recovery is expected to gain strength in late 2021 and 2022. As the economy continues to normalize, following the marked drop in COVID-19 cases, contact-intensive sectors are expected to rebound, while elevated commodity prices continue to provide broad support to the recovery. Risks to growth are broadly balanced. Prospects of a partial rebound in tourism poses upside risks, although there is considerable uncertainty about the speed of normalization of tourism flows, including because of the weak currencies of neighboring countries. Downside risks stem from a resurgence of the pandemic, weaker commodity prices and capital outflows, as inflationary pressures in the US could trigger a sudden rise in interest rates (Annex IV). Risks to inflation stem primarily from food and global inflation.

13. Medium-term growth will hinge on the recovery from the pandemic, commodity prices, and progress with structural reforms. Growth is expected to remain above pre-pandemic levels over the medium term and help close the output gap by 2023, supported by the recovery from the pandemic and elevated commodity prices. The pandemic is expected to have some long-lasting effects on output—preventing a full return to the pre-crisis trend levels—mainly due to the further erosion of human capital (as a result of schooling losses) and persistent exit of workers from the labor

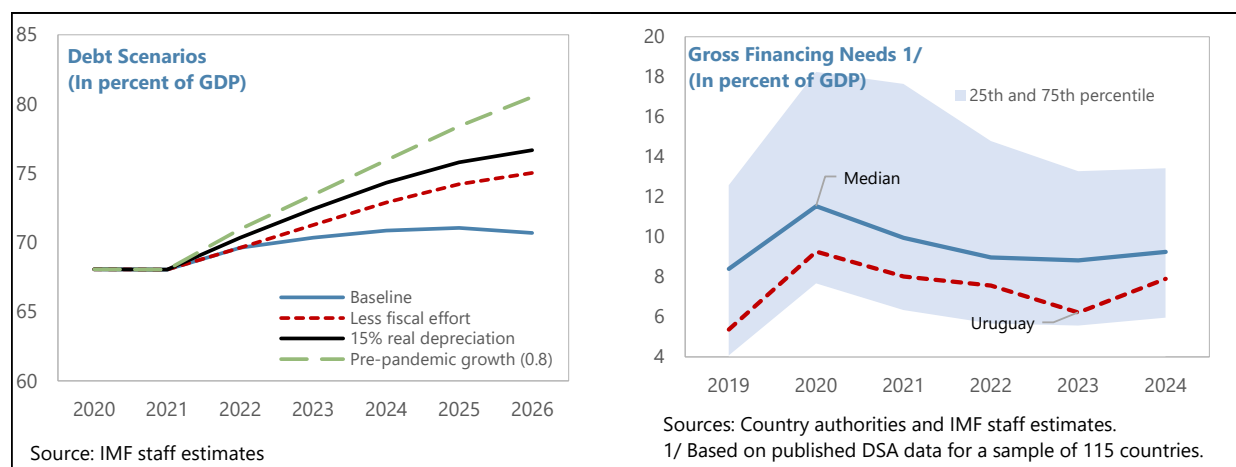
force. On the other hand, the increase in labor productivity associated with the leap in digitalization, also visible in other countries, may be an important offsetting factor. If sustained, high commodity prices may also support medium-term growth, fostering employment and investment, as in the last



Sources: WEO and IMF staff calculations.
1/ Percentiles 20, 50 and 80 of distribution of 14 Latin American economies are reported.

commodity price boom.⁷ Structural reforms could further support investment and growth over the medium term. Downside risks to medium-term growth stem primarily from lack of progress with structural reforms and insufficient fiscal discipline.

14. Weakened fiscal accounts pose medium-term risks, although short-term risks remain contained (see public DSA in Annex V). The path of NFPS gross debt—½ of which is denominated in foreign-currency—is highly dependent on fiscal efforts and stable macroeconomic conditions. For example, under plausible scenarios—1 percent of GDP smaller fiscal effort, 15 percent real depreciation, or GDP growing at its pre-pandemic average—the debt-to-GDP ratio would continue to rise over the medium term, leaving limited room to respond to future shocks and potentially weakening investor confidence. However, short-term financing needs are moderate—reflecting a healthy maturity structure of public debt—and can be met with stable local funding, liquidity buffers and contingent credit lines from multilaterals. Also, access to international markets remains at low rates, with spreads below those of other investment grade countries in the region.⁸



15. Risks to financial stability also remain contained (Figure 8). Banks are well capitalized and non-performing loans—at 3.3 percent of total loans as of 2021Q2—remain low. The overall exposure of the financial system to sectors most affected by the pandemic (i.e., tourism and hospitality) is low, at about 2.5 percent of total private sector credit. Moreover, BCU estimates indicate that only about 7.8 percent of private sector loans could become problematic in an adverse scenario—once support measures are withdrawn—and banks would remain viable. Bank profitability has declined—reflecting squeezed interest rate margins and weaker demand for credits—but recent stress tests indicate the banking sector can withstand major recession scenarios.

⁷ See accompanying Selected Issues Paper on Uruguay's potential growth.

⁸ Uruguay also ranks high among emerging market economies in terms of Environmental, Social and Governance (ESG) score. This is an additional source of strength, as institutions investors are increasingly demanding sovereign debt with high ESG scores.

SUPPORTING THE RECOVERY AND BOOSTING POTENTIAL GROWTH

A. Rebuilding Policy Space while Supporting the Recovery

16. The authorities' planned fiscal consolidation, while maintaining targeted support, is welcome. The envisaged plan would reduce the NFPS deficit by 2 percent of GDP over the next two years—from about 4.5 percent of GDP in 2021 (excluding '*cincuentones*') to about 2.5 in 2023—as COVID-related measures are unwound, growth strengthens, and restraint on real public sector wages and discretionary spending continues. The plan adequately focuses on rebuilding fiscal space while maintaining targeted support to facilitate the recovery, including with continued COVID-related health spending and the extension of measures to support employment. There is also scope for spreading the adjustment more evenly between 2022 and 2023 if the recovery disappoints, including to limit long-lasting effects. Underpinning the consolidation with structural measures—for example, by undertaking a civil service reform, streamlining ministries or government's agencies, or adopting measures to raise spending efficiency—would help ensure the durability of the consolidation efforts, as restraint on discretionary spending are more difficult to sustain. Once the economy has recovered, a greater fiscal effort will be needed to put debt on a firm downward path and restore fiscal space—that is, the room for discretionary fiscal policy without endangering debt sustainability, currently at risk.⁹ Pension reform is also key to ensure fiscal sustainability, although associated fiscal savings may take time to materialize (Annex VII).¹⁰

17. The authorities remain strongly committed to their fiscal consolidation plan and pension reform. They noted that, despite the pandemic, significant efforts were made to improve the efficiency of public spending, and indicated that the new work of the Monitoring and Evaluation Office would help identify further areas to improve spending efficiency. They also stressed their commitment to stabilizing the debt-to-GDP ratio over the medium term. The authorities remain committed to moving forward with the pension reform, following the recommendations from the commission of experts.

18. Greater emphasis on policies that foster employment and facilitate labor reallocation would bolster the recovery. Spending is appropriately shifting from preserving jobs and keeping firms afloat to supporting job creation, including with the implementation of a temporary employment subsidy for vulnerable groups (and the associated training programs). The extension of the enhanced unemployment insurance (especially the partial unemployment benefit) is adequate to provide further support to under and unemployed workers, although it should be gradually phased out to incentivize a full return to work and facilitate labor reallocation, where needed, especially as

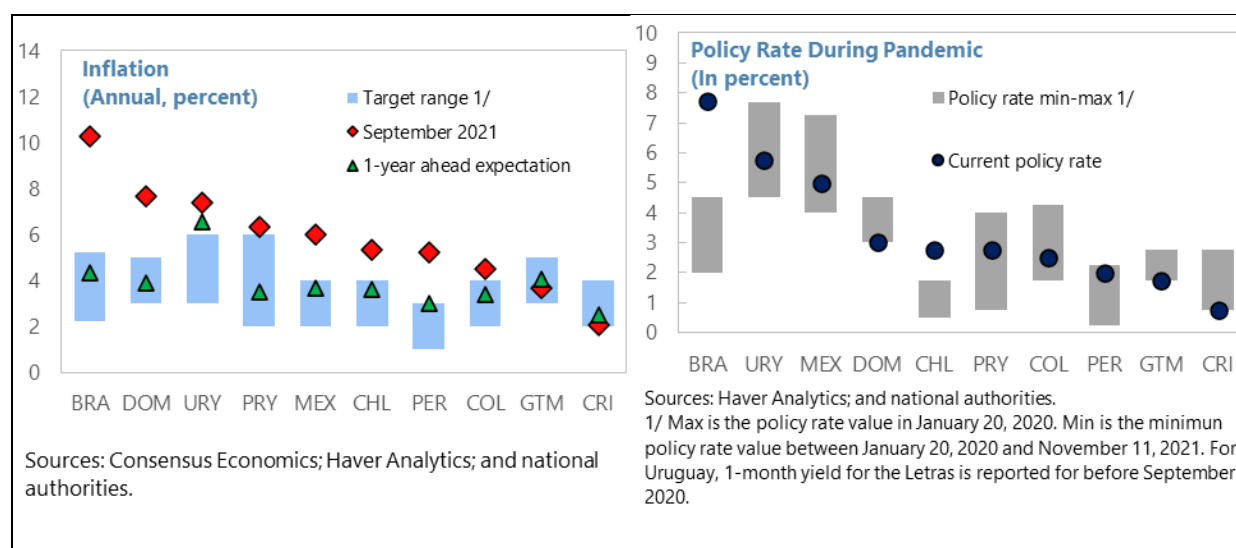
⁹ Which means that at most only marginal fiscal loosening is possible compared to the baseline given clear but not imminent risks to fiscal sustainability. The assessment considers the level of debt, its rising trend, its sensitivity to changes in macroeconomic and financing conditions, gross financing requirements, share of debt held by non-residents and the required consolidation to stabilize the debt-to-GDP ratio over the medium term.

¹⁰ The reform is also needed to promote both the intra and intergenerational fairness of the system.

economic uncertainty dissipates. Wage increases should continue striking a balance between supporting the recovery in employment and protecting workers' purchasing power. The differentiated wage-setting guidelines are welcome in this regard.

19. The authorities broadly concurred with staff's assessment on the importance of the measures taken to boost employment. They noted that the extension of the enhanced unemployment insurance, the new subsidy for employment of vulnerable groups, and the prudent wage guidelines—that differentiated between recovered and lagging sectors— have been effective in the recovery of employment. They noted that education reforms are expected to have a positive impact in terms of improving the human capital.

20. Maintaining a tightening bias in monetary policy will be key to solidify credibility gains. Amid challenging circumstances, monetary policy adequately supported the economy through the pandemic while gradually steering inflation and inflation expectations towards the target range. The central bank is appropriately unwinding monetary support, balancing the need to support the economic recovery and mitigating inflationary pressures. As the recovery takes hold, additional carefully-calibrated tightening of monetary policy will likely be needed to ensure that inflation falls within the target range in 2022; key to build further credibility. In the meantime, a well-communicated policy strategy—that signals the expected path of monetary policy—should help sustain recent gains in re-anchoring inflation expectations. Continuing to allow the exchange rate to float would support the disinflation process. Foreign exchange intervention should be limited to addressing disorderly market conditions and the rationale of any operation clearly communicated to the public to avoid misperceptions about the BCU's policy objectives.



21. The authorities reaffirmed their commitment to bringing down inflation. They stressed that, despite the extraordinary challenges of the pandemic, the BCU was able to steer inflation expectations towards the target range—thanks to the enhanced monetary policy framework.

22. Timely phasing out credit support measures—while monitoring financial risks closely—is key to limiting capital misallocation and fiscal costs. The targeted extension of SIGA

guarantee lines will adequately support companies in still-affected sectors. As uncertainty about the recovery dissipates, however, tightening eligibility criteria and conditions will be key to prevent misallocation of capital and to limit potential fiscal costs. Although risks to financial stability remain contained, continued close monitoring will be key as support measures are phased out. Significant exposures of specific banks to highly impacted sectors also should be identified and monitored closely.

23. The authorities expect financial stability risks to remain limited. They pointed to their continuous monitoring of risks and the low level of NPLs throughout the pandemic. Authorities also noted that, even under very adverse scenarios the banking system would remain sufficiently capitalized.

B. Boosting Medium-Term Growth

Boosting potential growth requires addressing legacies of the pandemic and pre-pandemic macroeconomic imbalances. Ensuring fiscal sustainability, addressing labor market frictions, and reforming state-owned enterprises are key priorities.

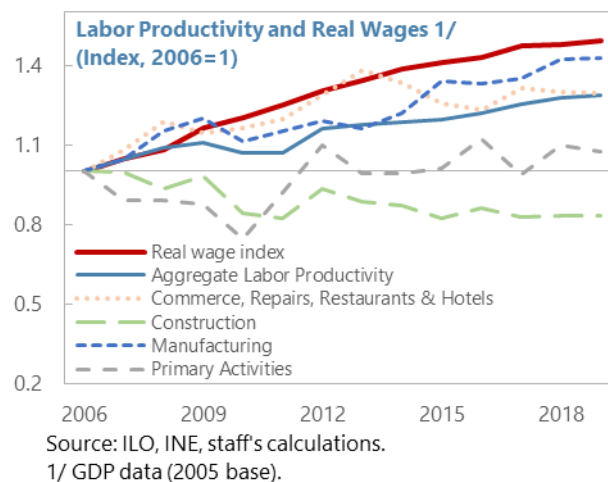
Key Priorities

24. Further strengthening the fiscal framework would bolster the credibility of the medium-term fiscal plan. Amid public finances that have been weakened by the pandemic, the new fiscal rule is an important step towards ensuring fiscal discipline. The recent establishment of the independent *Advisory Fiscal Council* is also a key development, as it is expected to help in calibrating the targets, establishing a rigorous and transparent methodology for estimating the structural deficit, discussing policy tradeoffs, alerting of biases and inconsistencies in fiscal projections and advocating for improved policies.¹¹ Further refinements to the framework—for example, moving to 5-year rolling limits, introducing an explicit medium-term debt target, and formalizing escape clauses with correction mechanisms (Annex III)—would help ensure that the new rule delivers fiscal discipline over time and across administrations. Anchoring fiscal targets on stochastic debt sustainability analysis would help better identify risks and calibrate targets.

25. Greater labor market flexibility and policies to foster human capital would boost employment and growth. Durably decentralizing wage negotiations and reducing the role of the government in the (currently tri-partite) wage negotiations, in line with ILO recommendations, could help ensure that wages are aligned with firms' conditions and productivity, helping increase competitiveness and promote employment, especially in non-commodity sectors. There is also scope for increasing flexibility in labor contracts, while protecting worker's rights, by allowing for more flexible work schedules, wider definitions of job duties and increased intra-company mobility.

¹¹ It is expected that inputs from the *Committee of Experts* will be requested for the first time at the end of the fiscal year, for the re-estimation of potential output.

The pandemic's disproportionate impact on young and low-skilled workers, and the accentuated skill mismatch highlight the urgency of policies to foster human capital, including effective (re)training programs to facilitate a rapid re-insertion into the labor market, and broad education reform to tackle the elevated school dropout rates and ensure that formal education is adapted to the needs of an increasingly IT-based economy.



26. Boosting growth also requires reforming SOEs.^{12, 13} SOEs play an important

role in Uruguay but are prone to inefficient activities partly due to simultaneous supervision by entities with conflicting objectives.¹⁴ They are required to be profitable but also to pursue social policies—such as subsidies for water, electricity, and gas for vulnerable populations—and undertake unprofitable investments, without commensurate budget funding. Inefficiencies and significant cross subsidies raise the cost of doing business. The new formula linking the domestic fuel price to the international oil price plus a gradually-falling 'x-factor' (to cover the cost of social programs and SOE inefficiency) is a welcome development although the path for the latter and the policies to generate the necessary cost reductions should be announced.¹⁵ Broader SOE reform is also needed to separate commercial and social objectives (while providing explicit budget financing for the latter) and to improve SOE independence and governance to shield them from political interference, with a clear separation between the state's ownership and regulation functions.¹⁶

27. The authorities stressed that the new fiscal framework significantly improves the credibility and sustainability of public finances.

They noted that, while other countries invoked escape clauses during the pandemic in 2020, they introduced a new fiscal framework and complied with it. Despite this, all the necessary expenditures to address the health, social and economic situation were made available through the creation of the Covid-19 Solidarity Fund which allowed as well for

¹² A 1992 referendum and recent opinion polls showed strong support for public ownership, although, the entry of private investors in the telecommunications and finance sectors has stimulated competition with the state-owned incumbents.

¹³ The public sector has a strong footprint in the oil, electricity, telecommunications, financial, water and infrastructure sectors. The largest SOEs include the petroleum, cement, and alcohol company (ANCAP), telecommunications (ANTEL), electricity (UTE, although private electricity generation is allowed), water (OSE), and the largest bank (BROU).

¹⁴ SOEs are supervised by the Planning Office, Ministry of Finance, line ministries and regulatory entities.

¹⁵ The x-factor covers idiosyncratic costs related to regulations, cross-subsidies, inefficiencies, unprofitable investments, social policy, etc.

¹⁶ See more details in Box 2 in IMF Country Report 20/51.

transparent accounting of resources. Authorities also highlighted that the Fiscal Advisory Council will further help improve the methodologies and enhance the quality of the discussions.

28. The authorities also concurred that the ambitious agenda of structural reforms is important to improve efficiency and bolster competitiveness. They highlighted the adoption of the new mechanism for setting fuel prices as a relevant advance. In addition, reforms to improve the business climate are another key aspect of the proposed advances.

A Broader Reform Agenda to Strengthen the Economy

29. The authorities' policy agenda on capital markets, trade integration and climate change could also help boost medium-term growth. Given the lack of dynamism of the banking system, the development of domestic capital markets is a recent initiative that could help re-energize financial intermediation and contribute to boosting investment. Access to external markets is also key for Uruguay—given the relatively small size of its economy—and ongoing trade integration efforts on various fronts are important elements of Uruguay's growth strategy.¹⁷ The authorities' strong commitment to climate change policies (Box 2)—which build on the countries' important strides in environmental goals (Figure 9)—also provides an opportunity for boosting growth by investing in green energy and infrastructure.

30. The authorities highlighted initiatives to develop financial markets, pursue greater trade integration and advance its climate change agenda as key elements of their pro-growth reforms. They noted that initiatives to develop the domestic financial market, especially the capital market, could help re-energize domestic credit and boost investment. They stressed that, given Uruguay's small domestic market, pursuing greater trade integration through new trade agreements is of the essence to boost growth. They also emphasized the high priority that their administration has given to climate policies having incorporated the Helsinki Principles explicitly in the Budget Law.

31. Dollarization also remains an obstacle to investment and growth (Figure 8). Private credit remains low, partly because financial intermediation remains highly dollarized (½ of private sector loans are in US dollars) and firms tend to be under-leveraged and under-invest because of the lack of peso credit. Achieving low and stable inflation—a clear priority for the current authorities—is essential to encourage local currency savings, reduce dollarization and, in turn, foster local currency credit and investment.

32. The authorities agreed on the need to continue promoting de-dollarization. They emphasize that the BCU is committed to maintaining the Uruguayan peso as a high-quality currency, which will help address dollarization over time. They concurred that durably lowering inflation is instrumental for the process of de-dollarization—which should help boost credit and investment.

¹⁷ See also accompanying Selected Issues Paper on Uruguay's scope for export product diversification.

Box 2. Environmental and Climate Change Policies

The administration has an extensive agenda on environmental policies as a key aspect of their sustainable development objectives. This includes:

- The recent creation of a new Ministry of the Environment.
- Explicitly incorporating climate objectives and the assessment of the environmental impact of economic policies in the budget.
- Developing modeling tools to assess the macroeconomic impact of climate change and environmental policies on the economy, and to estimate the economic value of the country's grasslands and wetlands.
- Introducing climate-related tax incentives and advancing the greening of public transport infrastructure. The government will modify the fuel excise (IMESI) and link it to carbon emissions. It is also exploring tax incentives for purchasing electric cars and buses, and to discourage single-use plastic.
- Exploring the issuance of sustainability-linked sovereign bonds. The government is currently designing the framework and identifying the appropriate indicators that could serve as benchmarks.
- Playing an active role in several international climate change initiatives. In 2020, the BCU joined the Network for Greening the Financial System, and the Ministry of Economy and Finance joined the Coalition of Finance Ministers for Climate Action and the Regional Platform of Ministries of Finance for Climate Change.
- Developing a strategy for producing green hydrogen. This public-private initiative is partially financed by the UN Sustainable Development Goals Fund.
- Finalizing Uruguay's Long Term Climate Strategy, with an aspirational goal of net-zero CO₂ emissions by 2050 under the Paris Agreement.

STAFF APPRAISAL

33. Past Fund Advice. Uruguay's policies during 2020/21 focused on addressing the pandemic and strengthening institutional frameworks. Some of these measures were in line with previous Fund advice. While the response to the pandemic led to an increase in public debt, the authorities implemented measures to limit the increase in current expenditures in real terms, and introduced a consolidation plan and a new fiscal rule aimed at strengthening fiscal discipline and debt sustainability. Also, with some elements in line with Fund advice, the authorities advanced with a pension reform proposal, currently under discussion and expected to be sent to Congress by 2022H1. In addition, the "*Ley de Urgente Consideración*" laid the foundations for key SOE reforms and progress has been made to link domestic fuel prices to its international cost. Steps were also taken to improve the monetary framework, in line with past Fund advice, including by shifting to the use of the interest rate as policy instrument and introducing enhancements to central bank communications. Differentiated wage guidelines implemented during the pandemic also constitute an important step toward wage flexibility, in line with previous staff advice.

34. The authorities' policy response to the pandemic was effective in mitigating its impact while prudently balancing fiscal sustainability objectives. The strong existing health care and social protection systems, along with low poverty rates were key in limiting the need for additional fiscal resources to directly address the health crisis. Deployed fiscal resources were adequately targeted, helping to contain the impact on vulnerable groups and to sustain employment. Monetary

and financial sector policies prevented a credit contraction and financial stresses. Notwithstanding the effective policy response and the ongoing recovery, the pandemic exacerbated pre-existing imbalances and structural problems, most notably the weakening public finances, the erosion of human capital and the labor market skill mismatch.

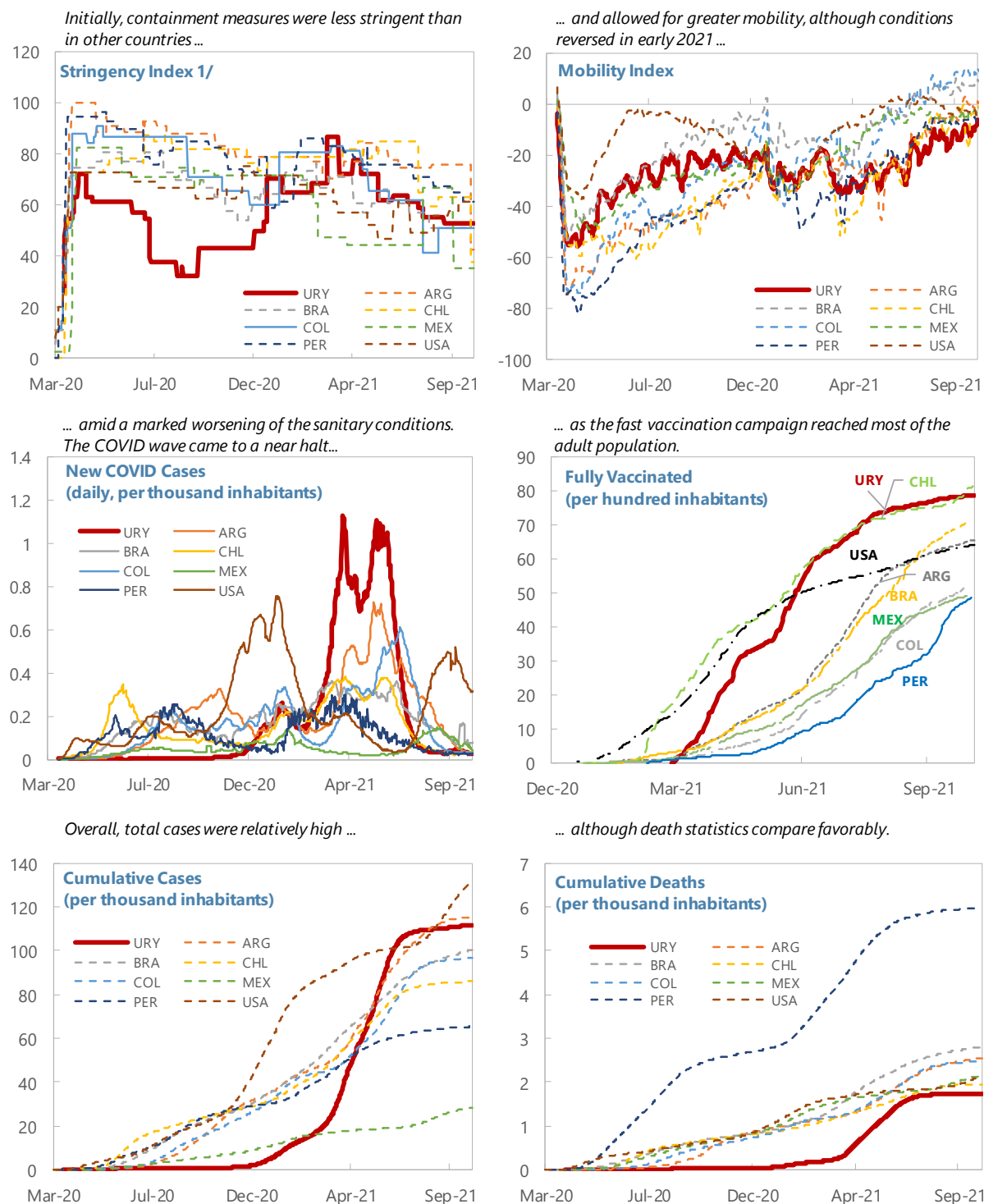
35. As the economy recovers, policies should normalize while maintaining targeted support to lagging sectors and vulnerable groups. The envisaged withdrawal of fiscal support—in line with the expected recovery—and the shift from sustaining employment and income to fostering job creation are appropriate. Continued targeted support for firms in lagging sectors and vulnerable workers is welcome and should be phased out only gradually—including to incentivize a return to work and facilitate factor reallocation where needed—as uncertainty about the economy dissipates. At the same time, greater supply of (re)training programs is needed to address the labor force skill mismatch and high youth unemployment, and facilitate a rapid re-entry of unemployed workers into the labor market. As inflation remains above target, monetary policy will need to maintain a tightening bias to build further credibility. A well-communicated policy strategy—that clearly signals the path of monetary policy and the central bank’s objectives—will be key to continue guiding expectations, while the exchange rate should continue to float. Credit guarantee lines should be phased out as uncertainty dissipates, and financial stability risks monitored closely as regulatory forbearance measures are unwound.

36. Over the medium term, policies should focus on further strengthening public finances and ensuring continued prudent fiscal policies going forward. While the authorities’ current goal of stabilizing the debt-to-GDP ratio over the medium term is commendable, greater efforts would be desirable to put public debt on a downward trajectory, especially if elevated commodity prices continue to support the economy with (temporarily) high external income. Structural measures to underpin the consolidation efforts would also be desirable. Moreover, ensuring that fiscal discipline is preserved over time and across administrations may require refinements to the new fiscal framework. Pension reform is also a key element both for intergenerational equity and fiscal sustainability.

37. Reform efforts should focus on tackling labor market rigidities and improving efficiency in SOEs. Addressing the erosion of human capital and the heightened skill mismatch in the labor force—through retraining programs and education reform—are instrumental to boosting growth and employment. Greater flexibility in labor conditions and wage negotiations at the firm level would also help improve competitiveness—and increase resilience—especially in non-commodity sectors. Fostering investment and growth also requires moving forward with SOE reforms—which is key to increase efficiency and reduce production costs. Finally, the authorities’ initiatives to energize domestic financial intermediation—including by developing domestic capital markets—and on climate change also provide an opportunity to boost investment.

38. Staff proposes that the next Article IV consultation with Uruguay takes place on the standard 12-month cycle.

Figure 1. Uruguay: COVID-19 Developments

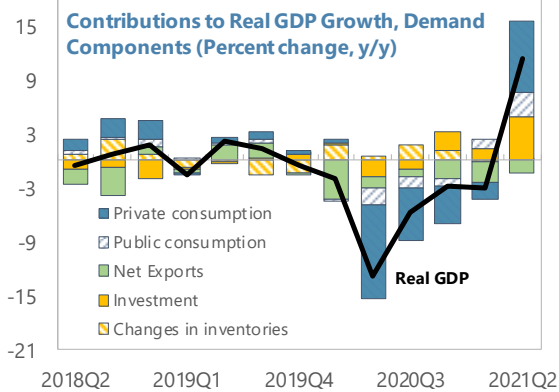


Sources: Google, OWID, John Hopkins University. IMF staff calculations.

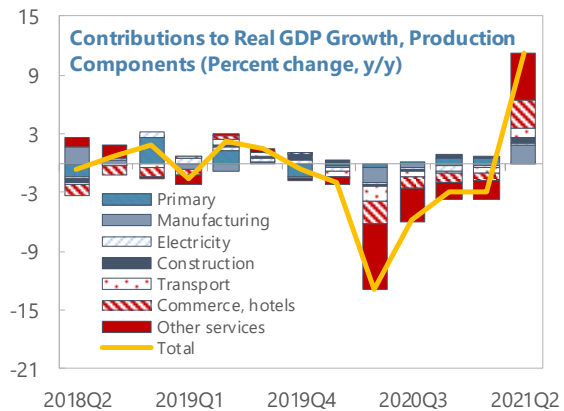
1/ Hale, T., N. Angrist, R. Goldszmidt, B. Kira, A. Petherick, T. Phillips, S. Webster, E. Cameron-Blake, L. Hallas, S. Majumdar, and H. Tatlow. (2021). "A global panel database of pandemic policies (Oxford COVID-19 Government Response Tracker)." Nature Human Behaviour.

Figure 2. Uruguay: Real Activity

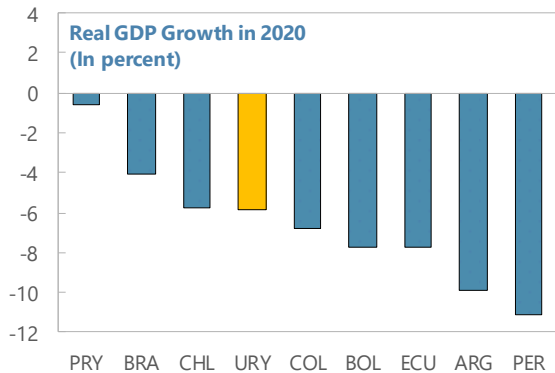
The downturn and rebound were driven by consumption, amid resilient investment...



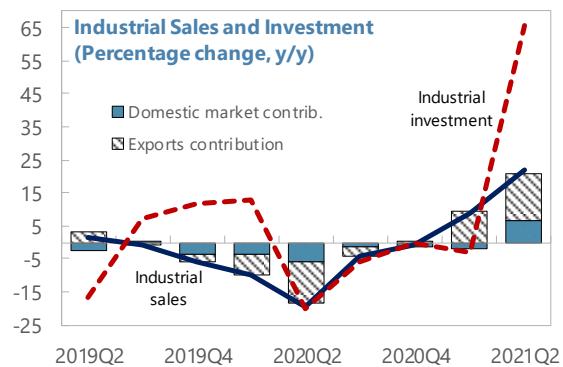
...and the dynamics in (contact-intensive) service sectors.



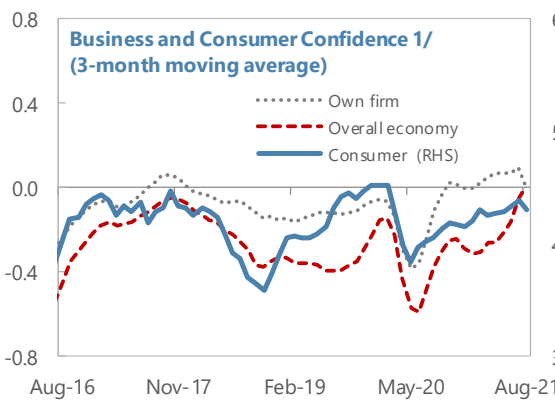
The overall contraction was larger in other peer economies.



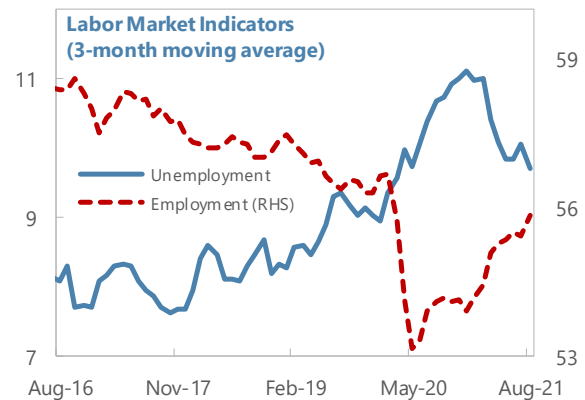
External demand for manufactures is supporting the recovery...



...and confidence has improved markedly...



... although the recovery in the labor market is lagging somewhat

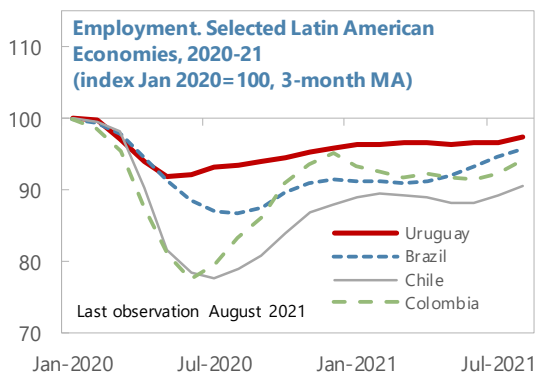


Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadística, Bloomberg L.P., and IMF staff estimates and calculations.

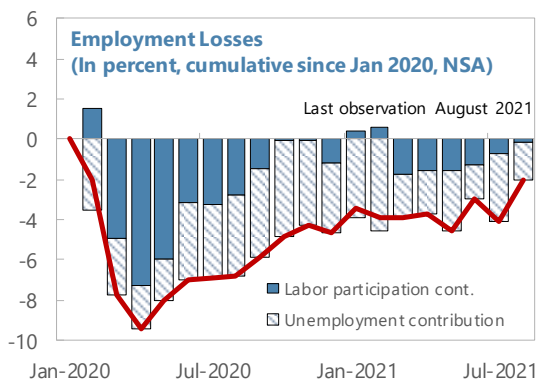
1/ Consumer confidence values above 50 indicate positive/optimistic expectations and values below 50 are negative/pessimistic expectations. For businesses, the chart shows the difference between the respondents with positive expectations on the economy or their own firm, and those with negative expectations.

Figure 3. Uruguay: Labor Market

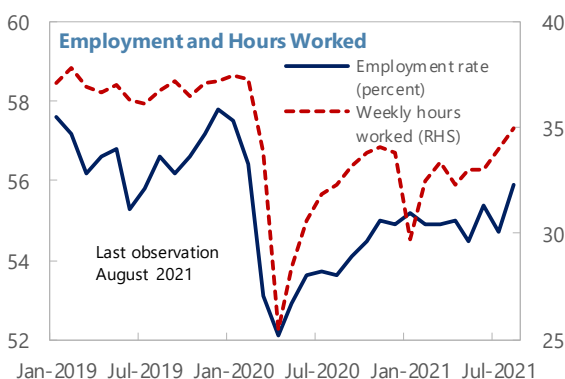
Employment losses were comparatively lower in Uruguay...



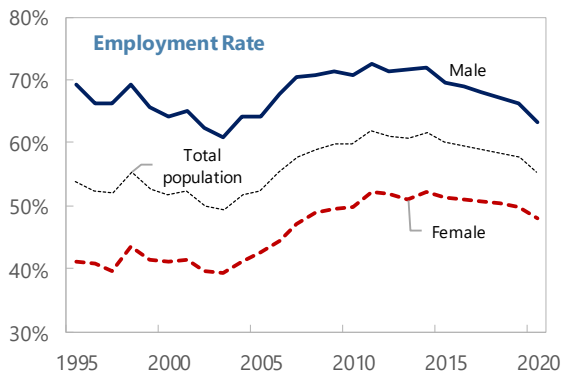
... although employment and...



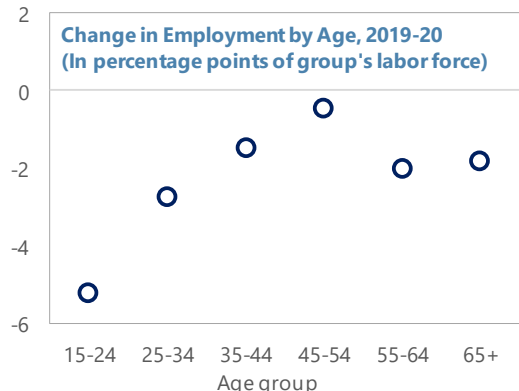
... hours worked remain below pre-pandemic levels.



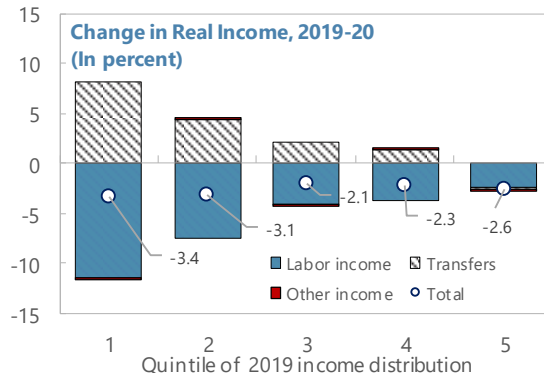
While the impact on employment appears to have been even across men and women...



... young workers appear to have been affected disproportionately



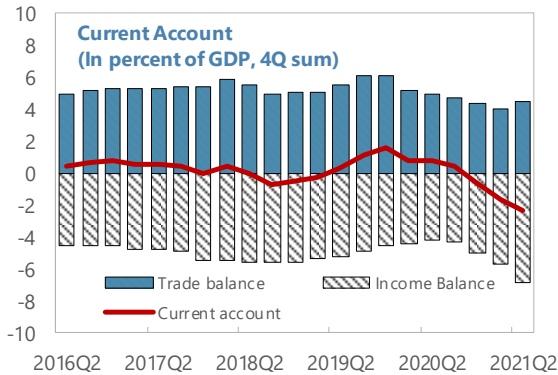
Social assistance played a significant role in mitigating the impact on vulnerable groups.



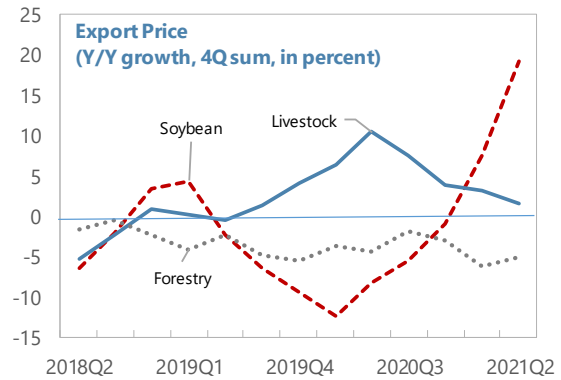
Sources: Haver, ILOSTAT, Instituto Nacional de Estadística, and IMF staff calculations.

Figure 4. Uruguay: External Accounts

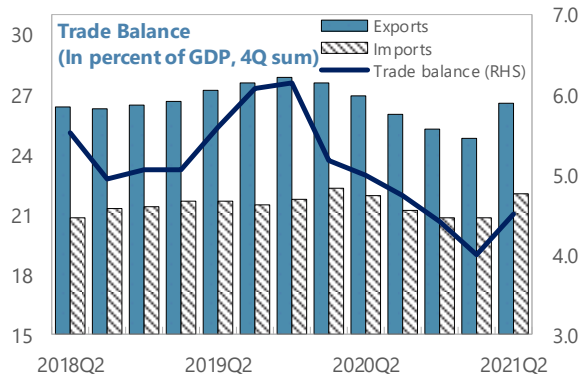
The current account turned in deficit in 2020 driven by both weaker trade and income balances...



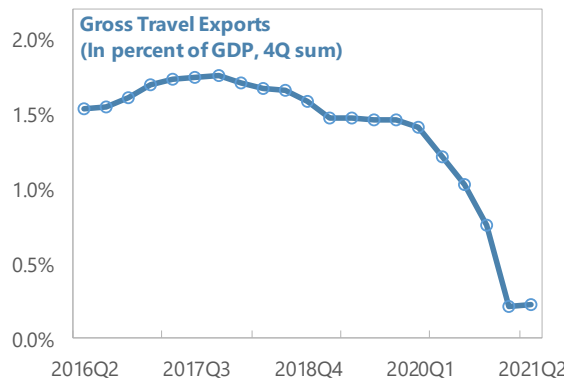
...with the rapid recovery in agricultural prices...



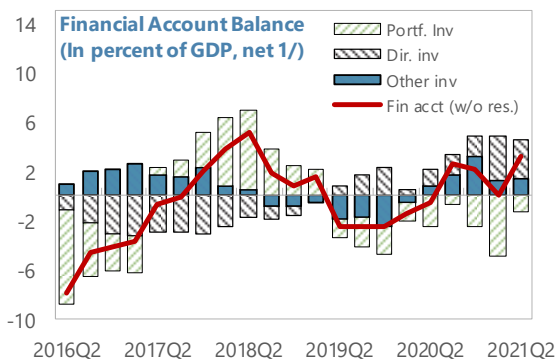
...and contracting imports helping to offset the weaker export volumes...



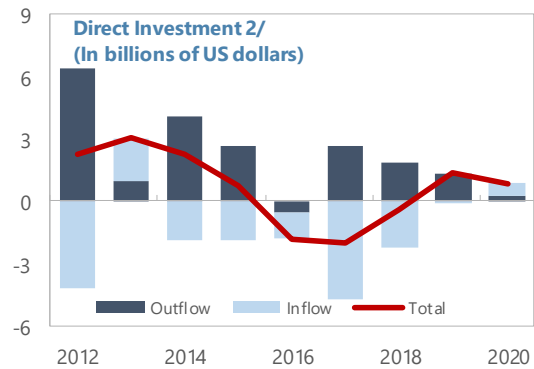
...and the sharp fall in tourism revenues.



Financial flows proved resilient, with portfolio outflows fully offset by large FDI inflows...



... boosted by the large UPM pulp mill investment.



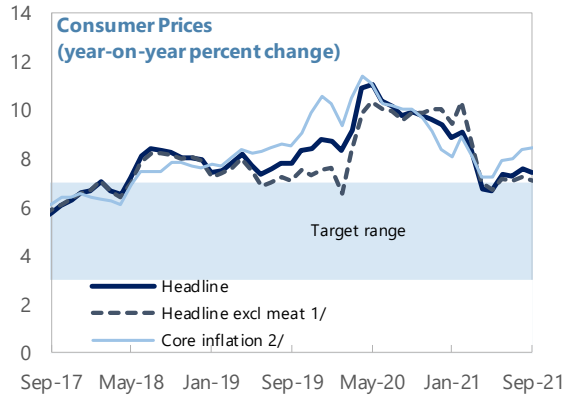
Sources: Banco Central de Uruguay (BCU), World Economic Outlook, Instituto Nacional de Estadística, Haver Analytics, and IMF staff calculations.

1/ Positive means inflow.

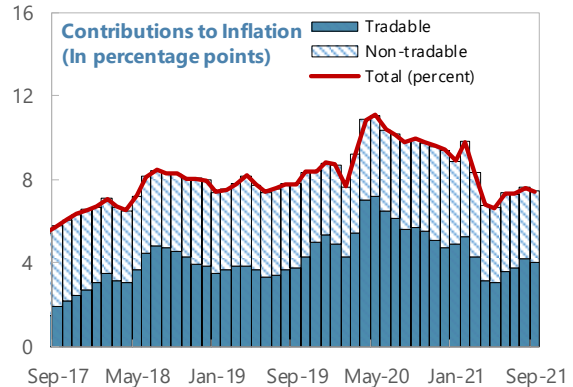
2/ Positive means FDI inflow.

Figure 5. Uruguay: Inflation

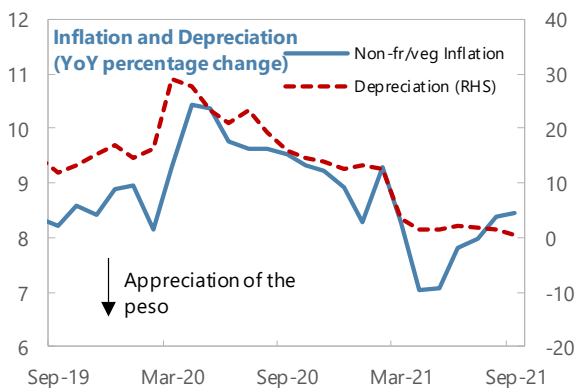
After a sharp increase at the onset of the pandemic, inflation is again around the upper band of the range...



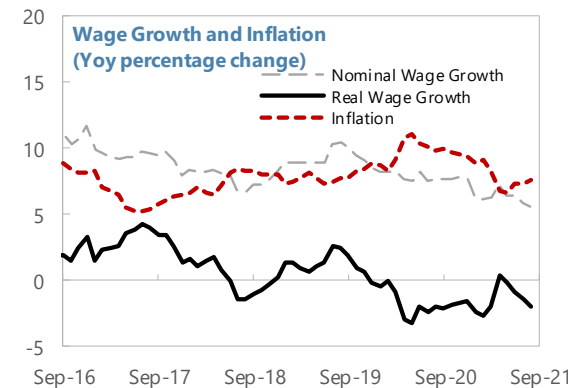
... with recent fluctuations mostly driven by tradable good prices...



... partly reflecting exchange rate pass-through...



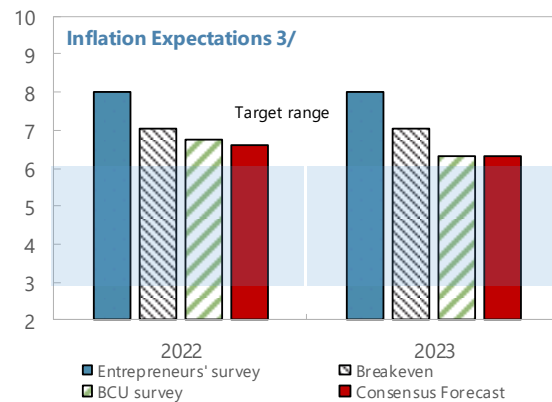
... while wages have grown below inflation.



Inflation expectations have converged towards the target ceiling...



...although there is still considerable heterogeneity among agents.



Sources: World Economic Outlook, Haver Analytics, Banco Central del Uruguay (BCU), Instituto Nacional de Estadística, Bloomberg L.P., and IMF staff estimates and calculations.

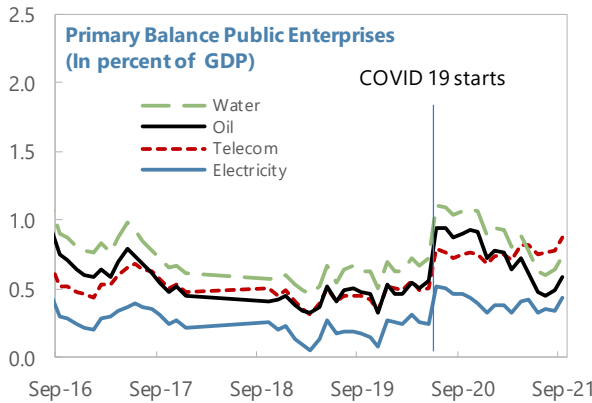
1/ Excluding meat and meat products.

2/ Excludes administered prices, and prices of fruits and vegetables, in line with the BCU's definition.

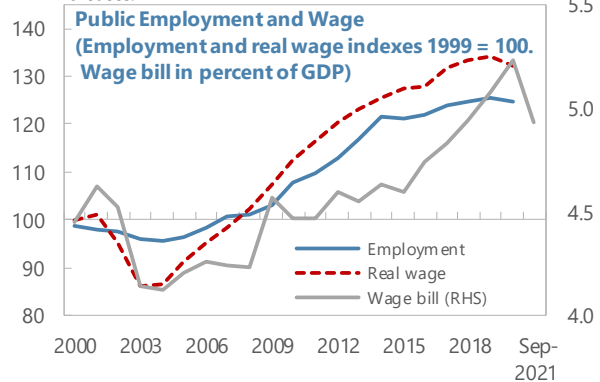
3/ As of September 2021.

Figure 6. Uruguay: Fiscal Developments

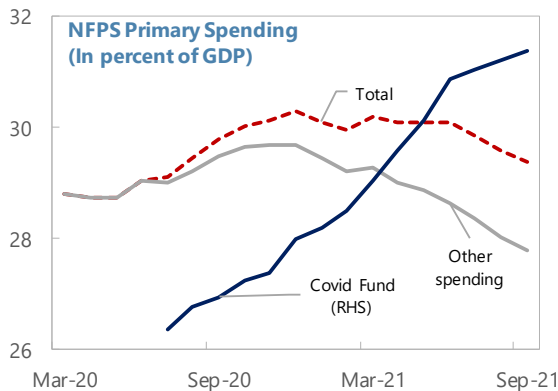
The balance of SOEs remains healthy despite some pandemic induced volatility.



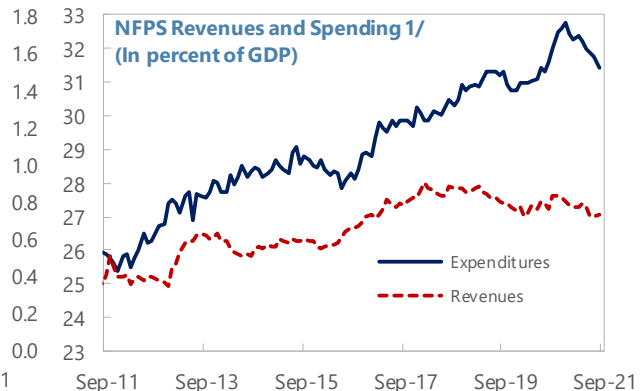
The wage bill has started to moderate thanks to a slight reduction in public employment and moderate wage increases.



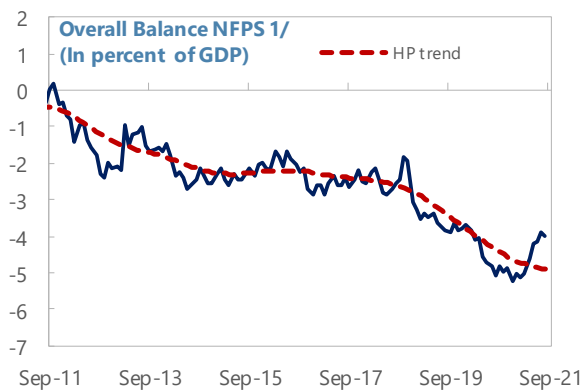
Despite some restraint in non-pandemic spending...



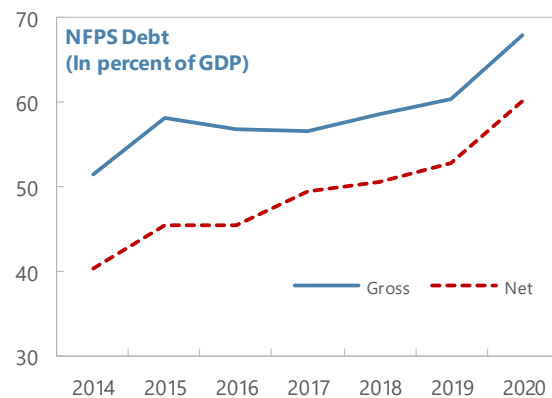
...the economic downturn and stimulus measures...



... led to a further deterioration of fiscal accounts...



... and an increase in indebtedness.

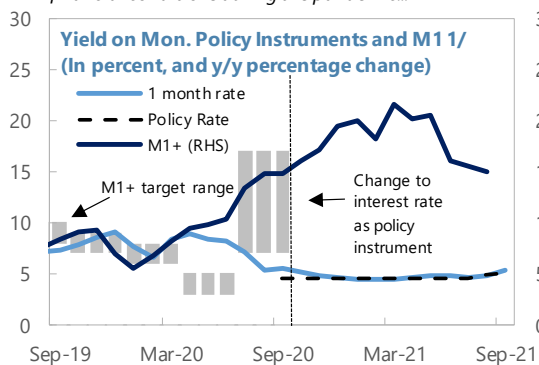


Sources: BCU, INE, MEF, CGN and IMF staff calculations.

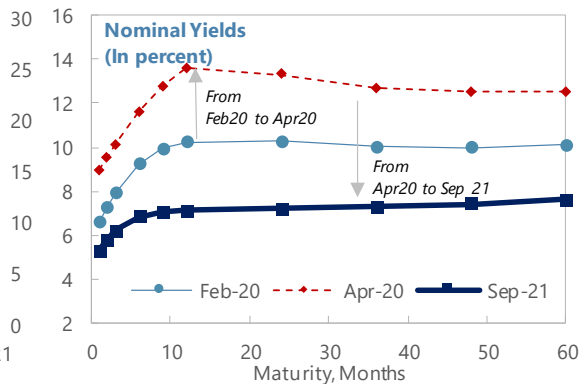
1/ Excluding cincuentones transactions.

Figure 7. Uruguay: Monetary Policy

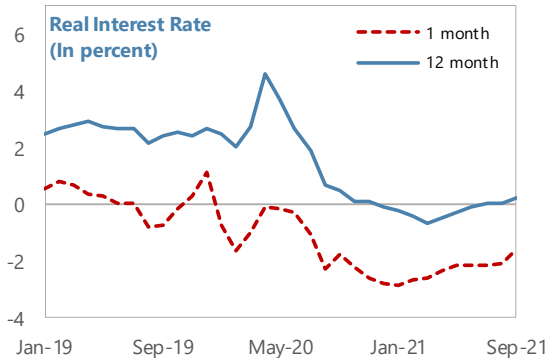
Expansionary monetary policy helped ease domestic financial conditions during the pandemic...



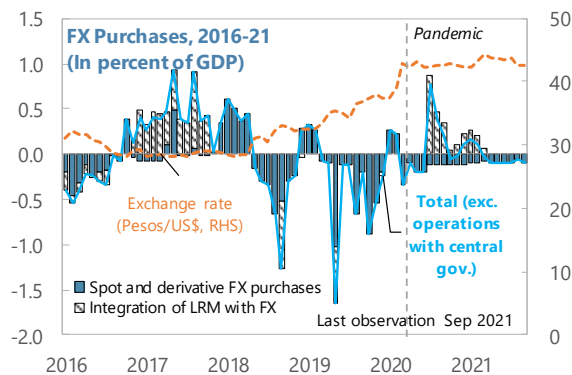
... with marked effects throughout the yield curve.



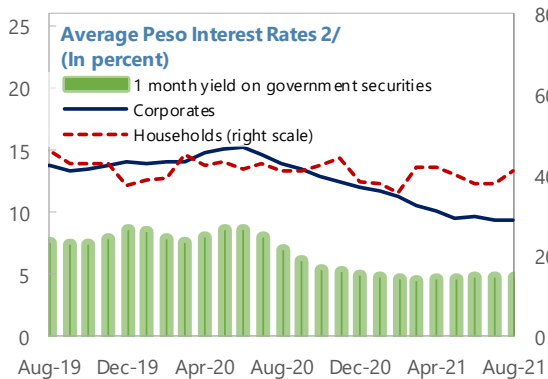
... bringing short-term real rates further into negative territory...



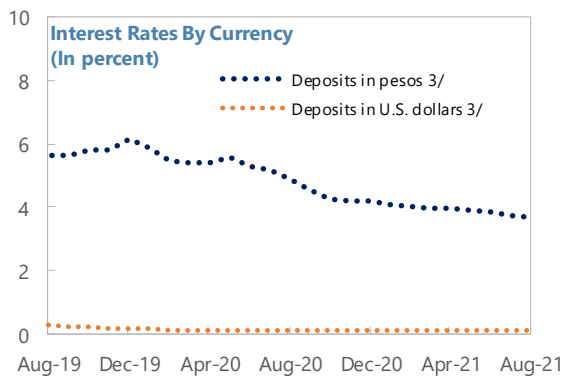
... amid limited FX intervention.



The transmission to credit loan rates was gradual...



...although the transmission to deposit rates was more rapid.



Sources: IMF, World Economic Outlook; Banco Central del Uruguay (BCU); and IMF staff estimates and calculations.

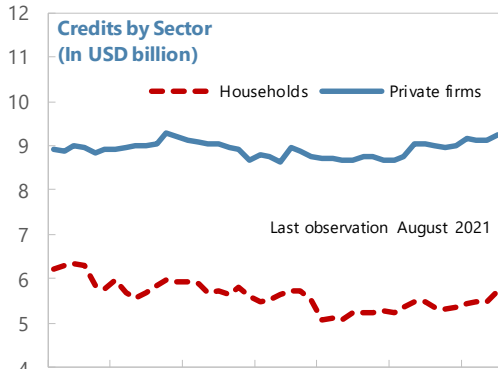
1/ Yields on BCU paper issued in nominal pesos (Letras de Regulación Monetaria).

2/ Average interest rates on new peso loans of up to one year.

3/ Weighted average rate on totality of fixed term deposits.

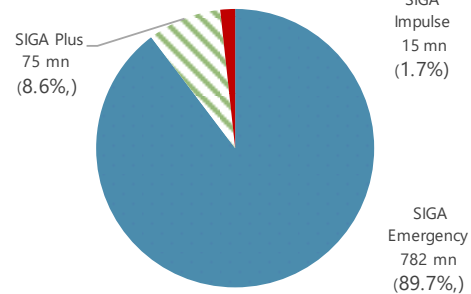
Figure 8. Uruguay: Credit and Banking

Credit to households and, especially, corporates has been slowly recovering...



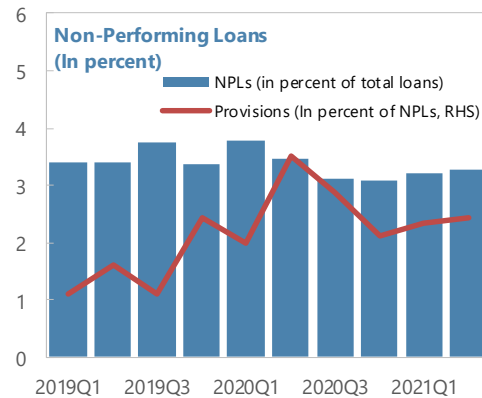
... supported by the SIGA guarantee programs.

Credits through SIGA Guarantee Funds (In USD)

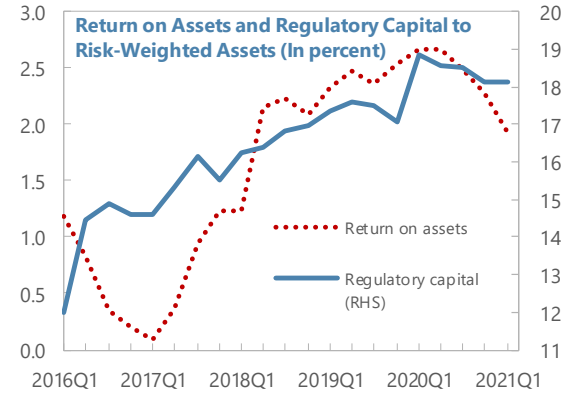


Jan-18 Jul-18 Feb-19 Sep-19 Mar-20 Oct-20 May-21

Non-performing loans remained low, amid increased provisioning...

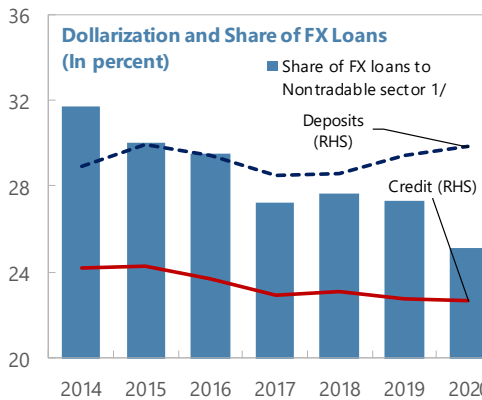


... and banks remain well-capitalized and profitable (although partly reflecting regulatory forbearance).

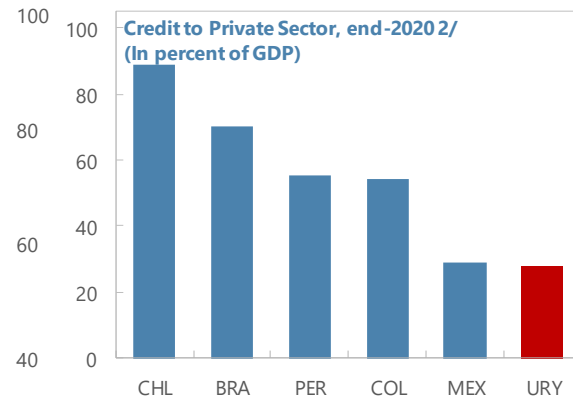


2019Q1 2019Q3 2020Q1 2020Q3 2021Q1

Dollarization, especially for deposits, remains high...



... amid low financial intermediation.



Sources: IMF, World Economic Outlook; Banco Central del Uruguay (BCU); and IMF staff estimates and calculations.

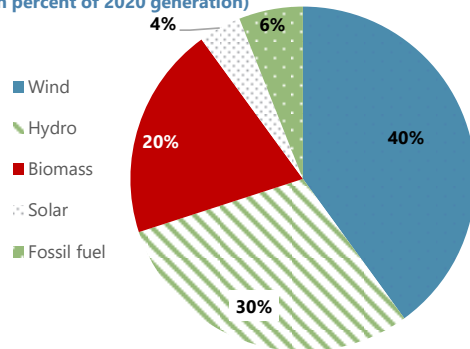
1/ For 2018, data as of Q3; and for 2019, as of Q2.

2/ Data for Peru is from the World Bank.

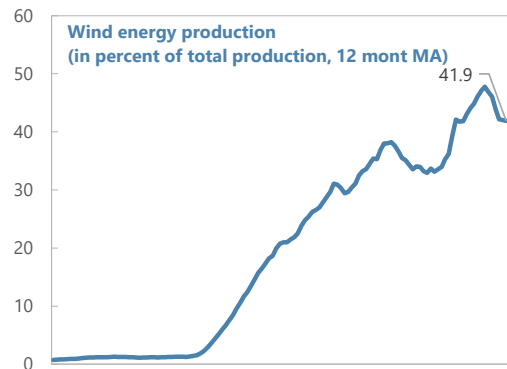
Figure 9. Uruguay: Climate

Most Uruguay's energy production comes from renewable sources...

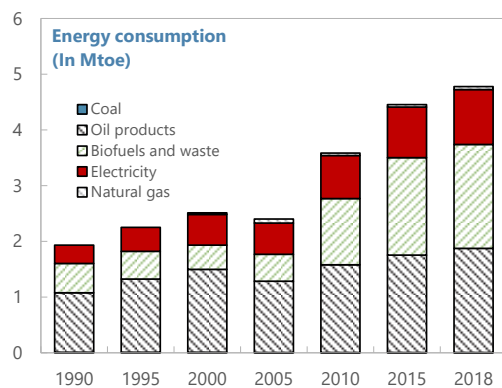
Electric generation by source
(In percent of 2020 generation)



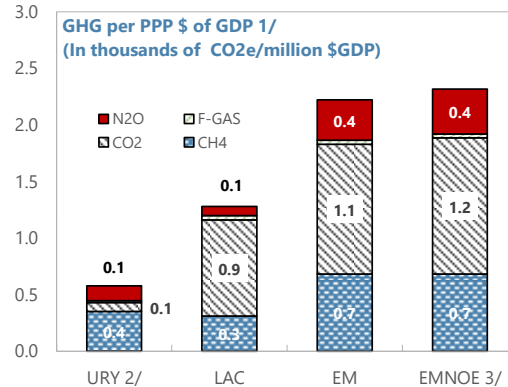
... partly reflecting the fast progress with wind energy, ...



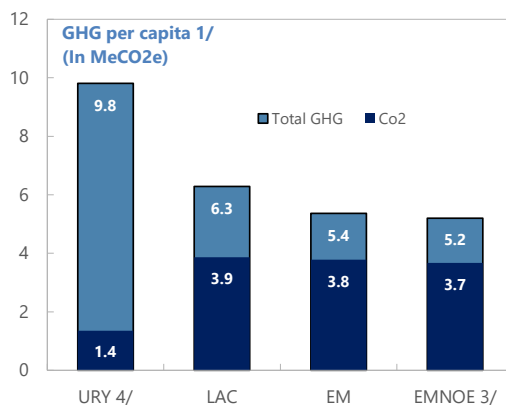
... as does energy consumption.



GHG emissions are lower than in peers in terms of per GDP unit ...

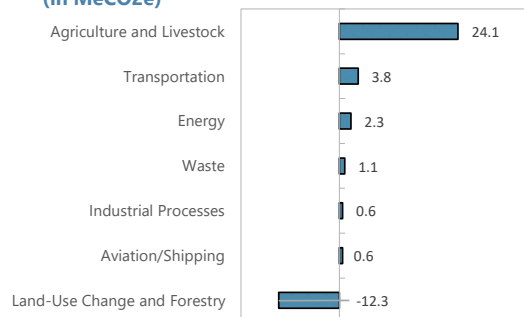


... although higher in per capita terms.



GHG emissions are concentrated in agriculture.

GHG emissions by sector, 2017
(in MeCO2e)



Sources: UNFCCC, WRI CAIT, Ministerio de Industria, Energía y Minería, WEO, IEA, INGEI.

1/ GHG emissions including LUCF for 2018 or latest available year as reported by source.

2/ The INGEI reports GHGs emissions for Uruguay net of carbon absorption from grasslands and wetlands. For 2017, the value is 0.4 thousand of CO2e per million US\$ PPP-GDP. This metric is not comprehensively available across countries.

3/ EMNOE = Emerging markets non-oil exporting economies.

4/ The INGEI's net GHGs value is 6.2 MeCO2e per capita for Uruguay for 2017.

Mtoe stands for millions of tons of oil equivalent. A ton of oil equivalent is a unit defined as the amount of energy released by burning one ton of crude oil. MCO2e stands for millions of tons of carbon dioxide equivalent. CO2e is defined as the equivalent of each different greenhouse gas in terms of the amount of CO2 that would create the same amount of global warming impact.

Table 1. Uruguay: Selected Economic Indicators

	2016	2017	2018	2019	2020	Projections					
						2021	2022	2023	2024	2025	2026
Output, prices, and employment											
Real GDP (percent change)	1.7	1.6	0.5	0.4	-5.9	3.4	3.2	2.7	2.5	2.2	2.2
GDP (US\$ billions)	57.2	64.2	64.5	61.2	53.6	60.1	63.9	65.8	68.5	71.5	74.4
Unemployment (in percent, eop)	7.8	7.9	8.3	8.9	10.4	10.2	9.0	8.5	8.2	8.0	8.0
Output gap (percent of potential output)	-0.3	0.1	0.0	-1.3	-3.8	-2.3	-1.0	-0.2	0.0	0.0	0.0
CPI inflation (in percent, end of period)	8.1	6.6	8.0	8.8	9.4	7.2	5.8	5.0	4.5	4.5	4.5
Exchange rate (UY\$/US\$, average)	30.2	28.7	30.7	35.3	42.0	...	...	...	...	...	...
Real effective exchange rate (percent change, eop)	-8.5	5.9	1.8	-2.1	-0.2	...	...	...	...	...	...
(Percent change, unless otherwise specified)											
Monetary and banking indicators 1/											
Base money	9.7	3.6	-6.5	27.2	18.4	...	...	...	...	...	...
Broader M1 (M1 plus savings deposits)	8.4	15.2	5.5	8.3	18.4	...	...	...	...	...	...
M2	14.4	13.4	9.7	6.3	17.2	...	...	...	...	...	...
Growth of credit to households (in real pesos)	-0.5	2.5	1.2	1.7	-0.6	...	...	...	...	...	...
Growth of credit to firms (in US\$)	1.5	-4.2	2.4	-3.7	1.1	...	...	...	...	...	...
Bank assets (in percent of GDP)	63.3	59.9	61.3	65.8	76.9	...	...	...	...	...	...
Private credit (in percent of GDP) 2/	25.9	24.2	23.7	25.7	27.8	...	...	...	...	...	...
(Percent of GDP, unless otherwise specified)											
Fiscal sector indicators 3/											
Revenue NFPS	27.0	27.6	28.9	28.3	28.0	27.4	27.5	27.7	27.8	27.9	27.9
excluding <i>cincuentones</i> transactions	27.0	27.6	27.7	27.2	27.4	27.1	27.5	27.7	27.8	27.9	27.9
<i>Cincuentones t</i> transactions 4/	0.0	0.0	1.2	1.1	0.6	0.3	0.0	0.0	0.0	0.0	0.0
Primary expenditure NFPS	27.3	27.7	28.3	28.8	30.2	29.4	28.6	27.8	27.6	27.6	27.6
Primary balance NFPS	-0.2	-0.1	0.56	-0.5	-2.1	-1.8	-1.0	0.1	0.4	0.4	0.5
excluding <i>cincuentones</i> transactions	-0.2	-0.1	-0.6	-1.6	-2.7	-2.2	-1.0	0.1	0.4	0.4	0.5
Primary balance BCU	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest NFPS	2.5	2.5	2.6	2.4	2.6	2.3	2.5	2.5	2.6	2.7	2.9
Interest BCU	0.6	0.6	0.7	0.4	0.5	0.9	0.6	0.5	0.5	0.5	0.6
Overall balance NFPS	-2.7	-2.6	-2.0	-2.9	-4.7	-4.1	-3.4	-2.5	-2.3	-2.3	-2.4
excluding <i>cincuentones</i> transactions	-2.7	-2.6	-3.2	-4.0	-5.2	-4.5	-3.4	-2.5	-2.3	-2.3	-2.4
Overall balance PS 5/	-3.4	-3.2	-2.7	-3.2	-5.2	-5.0	-4.0	-3.0	-2.8	-2.8	-3.0
excluding <i>cincuentones</i> transactions	-3.4	-3.2	-3.9	-4.3	-5.7	-5.4	-4.0	-3.0	-2.8	-2.8	-3.0
Gross debt NFPS	56.8	56.5	58.6	60.5	68.1	67.3	68.5	69.7	70.2	70.6	70.4
Gross debt PS	57.0	60.8	62.8	64.3	74.9	81.1	82.3	83.2	83.0	82.4	81.3
Net debt NFPS	45.6	45.7	47.9	51.2	57.8	57.2	58.5	59.8	60.4	60.9	60.8
PS debt net of liquid financial assets 6/	32.9	33.6	36.4	39.9	47.5	52.2	54.3	55.9	56.5	56.8	56.5
PS debt net of total financial assets	27.4	29.6	31.0	32.3	36.8	41.2	43.9	45.5	46.2	46.6	46.3
External indicators											
Merchandise exports, fob (US\$ billions)	10.6	11.1	11.6	11.7	9.9	13.0	14.6	16.0	17.0	18.2	19.5
Merchandise imports, fob (US\$ billions)	8.6	9.1	9.3	8.7	7.8	9.8	10.9	11.5	12.5	13.5	14.5
Terms of trade (percent change)	3.9	0.8	-0.3	3.8	7.4	3.3	1.8	0.2	0.8	1.5	2.2
Current account balance	0.8	0.0	-0.4	1.6	-0.6	-2.1	-1.8	-1.8	-1.8	-1.7	-1.5
Total external debt + non-resident deposits	72.5	66.9	67.1	74.1	88.0	85.9	85.2	86.3	86.5	86.0	85.8
Of which: External public debt	29.1	27.9	30.1	33.5	39.9	37.5	37.7	38.4	39.2	39.3	39.8
External debt service (in percent of exports of g&s)	82.8	66.8	62.7	59.0	75.1	67.7	57.7	55.6	54.4	52.2	50.2
Gross official reserves (US\$ billions)	13.5	15.9	14.4	14.5	16.2	17.0	17.2	17.4	17.6	17.8	18.0
In months of imports of goods and services	13.0	14.3	12.5	13.1	17.4	15.1	13.7	13.1	12.2	11.4	10.8
In percent of:											
Short-term external (STE) debt	190	228	221	227	250	298	289	285	280	274	269
STE debt plus banks' non-resident deposits	208	314	287	278	266	263	254	246	243	240	237

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

1/ Percent change of end-of-year data on one year ago.

2/ Includes bank and non-bank credit.

3/ Non-financial public sector (NFPS) includes the Central Government, Banco de Previsión Social, Banco de Seguros del Estado, and Non-Financial Public Enterprises.

4/ Temporary proceeds resulting from the pension reform that allowed workers above 50 years old (and with certain income level) to voluntarily move back to the public pension system. Proceeds are projected to end in 2022.

5/ Total public sector (PS). Includes the NFPS and Banco Central del Uruguay.

6/ Public sector gross debt minus liquid assets. Liquid assets exclude central bank reserves held as counterpart of banks' required reserves on foreign currency deposits.

Table 2. Uruguay: Balance of Payments and External Sector Indicators

	2016	2017	2018	2019	2020	Projections					
						2021	2022	2023	2024	2025	2026
(In billions of U.S. dollars, unless otherwise indicated)											
Balance of Payments											
Current account	0.5	0.0	-0.3	1.0	-0.3	-1.3	-1.2	-1.2	-1.2	-1.2	-1.1
Trade balance	2.0	2.0	2.3	3.1	2.0	3.3	3.7	4.5	4.5	4.7	5.0
Exports of goods	10.6	11.1	11.6	11.7	9.9	13.0	14.6	16.0	17.0	18.2	19.5
Imports of goods	8.6	9.1	9.3	8.7	7.8	9.8	10.9	11.5	12.5	13.5	14.5
Of which: Fuel products	0.7	0.9	1.2	1.0	0.8	1.3	1.5	1.6	1.7	1.9	2.1
Of which: Non-fuel products	7.8	8.2	8.2	7.7	7.1	8.4	9.4	9.9	10.8	11.6	12.5
Services balance	1.0	1.5	1.0	0.7	0.3	-0.4	-0.6	-0.6	-0.7	-0.8	-0.8
Exports, f.o.b.	4.9	5.7	5.5	5.3	3.7	3.4	3.6	3.8	4.1	4.3	4.6
Imports, f.o.b.	3.9	4.2	4.5	4.7	3.4	3.7	4.1	4.5	4.8	5.1	5.5
Income balance	-2.6	-3.5	-3.6	-2.8	-2.7	-4.2	-4.3	-5.1	-5.0	-5.1	-5.3
Financial and capital account balance	0.3	1.2	-0.9	0.1	0.5	-1.2	-1.0	-1.1	-1.1	-1.1	-1.0
Foreign direct investment	1.8	2.0	0.4	-1.4	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Portfolio investment	1.7	-1.8	-1.5	1.4	1.4	0.4	1.1	1.0	0.8	0.9	0.9
Financial derivatives and other investments (net)	-1.2	-1.5	0.6	1.5	-1.7	-1.4	-1.4	-1.4	-1.2	-1.3	-1.1
Change in reserve assets	-2.2	2.4	-0.4	-1.1	1.6	0.8	0.2	0.2	0.2	0.2	0.2
Net errors and omissions	-0.3	1.2	-0.7	-0.2	0.7	0.0	0.0	0.0	0.0	0.0	0.0
Reserve Adequacy and External Indicators											
Gross official reserves (stock)	13.5	15.9	14.4	14.5	16.2	17.0	17.2	17.4	17.6	17.8	18.0
In months of imports of goods and services	13.0	14.3	12.5	13.1	17.4	15.1	13.7	13.1	12.2	11.4	10.8
In percent of short-term debt	190.3	227.6	221.0	226.7	250.0	298.4	288.8	285.4	279.7	274.0	269.3
(As percent of GDP)											
Balance of Payments											
Current account	0.8	0.0	-0.4	1.6	-0.6	-2.1	-1.8	-1.8	-1.8	-1.7	-1.5
Trade balance	3.6	3.1	3.6	5.0	3.8	5.4	5.8	6.8	6.6	6.6	6.7
Exports of goods	18.5	17.3	18.0	19.2	18.4	21.7	22.9	24.3	24.8	25.5	26.2
Imports of goods	-15.0	-14.2	-14.5	-14.1	-14.6	-16.2	-17.1	-17.5	-18.3	-18.9	-19.5
Of which: Fuel products	1.3	1.4	1.8	1.6	1.4	2.2	2.3	2.5	2.6	2.6	2.8
Of which: Non-fuel products	13.7	12.8	12.7	12.5	13.2	14.0	14.7	15.0	15.7	16.3	16.8
Services balance	1.8	2.4	1.5	1.1	0.6	-0.6	-0.9	-1.0	-1.1	-1.1	-1.1
Exports	8.6	8.9	8.5	8.7	6.9	5.6	5.6	5.8	5.9	6.1	6.2
Imports	6.8	6.5	7.0	7.6	6.3	6.2	6.4	6.8	7.0	7.2	7.4
Income balance	-4.5	-5.4	-5.5	-4.5	-5.0	-6.9	-6.8	-7.7	-7.3	-7.2	-7.1
Financial and capital account balance	0.4	1.9	-1.4	0.1	1.0	-1.9	-1.6	-1.6	-1.6	-1.5	-1.3
Foreign direct investment	3.2	3.2	0.7	-2.2	-1.6	-1.7	-1.5	-1.4	-1.4	-1.4	-1.4
Portfolio investment	3.0	-2.8	-2.4	2.3	2.6	0.7	1.7	1.5	1.2	1.3	1.2
Financial derivatives and other investments (net)	-2.1	-2.3	0.9	2.5	-3.1	-2.3	-2.2	-2.1	-1.8	-1.8	-1.5
Change in reserve assets	-3.8	3.8	-0.6	-1.8	3.0	1.3	0.3	0.3	0.3	0.3	0.3
Total external debt	72.5	66.9	67.1	74.1	88.0	85.9	85.2	86.3	86.5	86.0	85.8
Of which: Short-term debt (residual maturity)	12.4	10.9	10.1	10.5	12.1	9.5	9.3	9.3	9.2	9.1	9.0
Of which: External public debt	29.1	27.9	30.1	33.5	39.9	37.5	37.7	38.4	39.2	39.3	39.8
(As percent of annual exports of goods and services)											
External Debt											
Total external debt (including non-resident deposits)	267	255	253	265	347	315	299	287	281	273	264
Debt service	82.8	66.8	62.7	59.0	75.1	67.7	57.7	55.6	54.4	52.2	50.2
Of which: Interest payments	1.2	1.2	1.4	1.3	1.4	1.5	1.6	1.7	1.8	1.8	1.9
(Annual percent changes)											
External Trade											
Exports of goods in US\$	-7.2	4.8	4.6	1.0	-15.8	31.8	12.3	9.3	6.4	7.0	7.1
Imports of goods in US\$	-15.2	6.8	2.1	-7.2	-9.5	24.5	11.9	5.3	8.9	8.1	7.5
Export prices in US\$	-3.5	3.1	1.9	1.1	0.8	18.4	4.3	-0.2	1.4	2.4	3.1
Import prices in US\$	-3.6	3.4	4.2	-0.3	-3.7	11.7	2.7	0.7	1.2	1.4	1.2
Terms of trade for goods	3.9	0.8	-0.3	3.8	7.4	3.3	1.8	0.2	0.8	1.5	2.2
Export volume (goods and non-factor services)	-3.8	1.7	2.6	-0.1	-16.5	11.3	7.8	9.5	4.9	4.5	3.9
Import volume (goods and non-factor services)	-10.1	2.8	-2.9	-6.0	-3.4	8.3	9.2	5.3	8.1	7.1	6.7
Export volume (goods)	-3.8	1.7	2.6	-0.1	-16.5	11.3	7.8	9.5	4.9	4.5	3.9
Import volume (goods)	-10.1	2.8	-2.9	-6.0	-3.4	8.3	9.2	5.3	8.1	7.1	6.7
Of which: Non-fuel products	-9.6	2.9	-2.7	-6.4	-5.0	9.0	8.0	4.1	7.4	6.5	6.0
Of which: Fuel products	-15.3	2.6	-4.0	-3.5	13.0	8.5	16.0	13.5	12.5	11.0	11.0

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

Table 3. Uruguay: Main Fiscal Aggregates

	2016	2017	2018	2019	2020	Projections					
						2021	2022	2023	2024	2025	2026
	(In billions of pesos, unless otherwise indicated)										
I. Primary balance NFPS (A+B+C)	-4	-2	11	-11	-47	-47	-27	3	12	15	18
excluding <i>cincuentones</i> transactions	-4	-2	-12	-34	-60	-56	-27	3	12	15	18
A. Primary balance of CG, BPS and NFPE 1/ 2/	-6	-2	13	-12	-49	-51	-31	-2	7	10	12
Revenues	466	508	573	610	631	705	770	822	877	935	995
Taxes CG	299	335	365	390	416	480	527	558	593	630	668
VAT and excise taxes	174	193	204	221	238	275	300	317	337	359	381
On income and profits	107	129	143	154	164	190	207	219	233	248	263
Other	19	13	18	14	15	15	20	22	23	23	24
Non tax CG	24	26	32	29	30	30	33	35	37	39	42
Social security (BPS)	119	132	163	175	163	175	185	198	210	224	238
of which: <i>cincuentones</i> transactions	0	0	23	23	13	9	0	0	0	0	0
Primary balance NFPE	24	16	13	17	22	19	25	31	37	42	47
Primary expenditures	472	510	560	622	680	756	801	824	869	925	983
Current	433	474	520	573	635	712	753	774	816	868	923
Wages	82	89	98	110	118	129	134	136	145	154	164
Goods and services	59	63	70	78	89	113	115	110	110	117	125
Social security benefits	270	302	329	359	402	442	473	496	527	561	596
Other	23	20	23	26	26	29	31	32	34	36	38
Capital	39	35	41	49	45	44	48	50	54	57	61
B. Primary balance of local governments	1	1	1	-1	2	3	3	3	3	3	4
C. Primary balance of BSE 3/	1	-2	-3	3	0	1	1	1	2	2	2
II. Primary balance of the BCU 4/	-1	-1	-2	-1	0	-1	-1	-1	-1	-1	-1
III. Primary balance of the PS (I+II)	-6	-4	10	-12	-48	-48	-28	2	11	14	17
IV. Interest of the PS	53	58	66	61	69	82	85	92	100	110	123
A. NFPS 4/	43	46	51	52	58	59	69	75	83	91	103
B. BCU 4/	10	12	15	9	11	23	16	16	17	18	20
V. Overall balance of the PS (III+IV)	-58	-59	-53	-70	-116	-130	-112	-89	-89	-95	-106
A. NFPS 4/	-47	-48	-40	-63	-105	-106	-96	-73	-71	-76	-86
excluding <i>cincuentones</i> transactions	-47	-48	-64	-86	-118	-115	-96	-73	-71	-76	-86
B. BCU 4/	-12	-13	-16	-10	-11	-24	-16	-17	-18	-19	-20
VI. Overall balance PS excluding <i>cincuentones</i> transactions	-58	-59	-77	-93	-129	-138	-112	-89	-89	-95	-106
	(In percent of GDP, unless otherwise indicated)										
I. Primary balance NFPS (A+B+C)	-0.2	-0.1	0.6	-0.5	-2.1	-1.8	-1.0	0.1	0.4	0.4	0.5
excluding <i>cincuentones</i> transactions	-0.2	-0.1	-0.6	-1.6	-2.7	-2.2	-1.0	0.1	0.4	0.4	0.5
A. Primary balance of CG, BPS and NFPE 1/ 2/	-0.3	-0.1	0.7	-0.6	-2.2	-2.0	-1.1	-0.1	0.2	0.3	0.3
Revenues	27.0	27.6	28.9	28.3	28.0	27.4	27.5	27.7	27.8	27.9	27.9
excluding <i>cincuentones</i> transactions	27.0	27.6	27.7	27.2	27.4	27.1	27.5	27.7	27.8	27.9	27.9
Taxes CG	17.3	18.2	18.4	18.1	18.5	18.7	18.8	18.8	18.8	18.8	18.8
VAT and excise taxes	10.1	10.5	10.3	10.2	10.5	10.7	10.7	10.7	10.7	10.7	10.7
On income and profits	6.2	7.0	7.2	7.2	7.3	7.4	7.4	7.4	7.4	7.4	7.4
Other	1.1	0.7	0.9	0.7	0.7	0.6	0.7	0.7	0.7	0.7	0.7
Non tax CG	1.4	1.4	1.6	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2
Social security (BPS)	6.9	7.1	8.2	8.1	7.2	6.8	6.6	6.7	6.7	6.7	6.7
of which: <i>cincuentones</i> transactions	0.0	0.0	1.2	1.1	0.6	0.3	0.0	0.0	0.0	0.0	0.0
Primary balance NFPE	1.4	0.9	0.7	0.8	1.0	0.7	0.9	1.1	1.2	1.2	1.3
Primary expenditures	27.3	27.7	28.3	28.8	30.2	29.4	28.6	27.8	27.6	27.6	27.6
Current	25.1	25.8	26.2	26.5	28.2	27.7	26.9	26.1	25.9	25.9	25.9
Wages	4.7	4.8	4.9	5.1	5.2	5.0	4.8	4.6	4.6	4.6	4.6
Goods and services	3.4	3.4	3.5	3.6	4.0	4.4	4.1	3.7	3.5	3.5	3.5
Social security benefits	15.6	16.4	16.6	16.6	17.8	17.2	16.9	16.7	16.7	16.7	16.7
Other	1.4	1.1	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.1	1.1
Capital	2.2	1.9	2.1	2.3	2.0	1.7	1.7	1.7	1.7	1.7	1.7
B. Primary balance of local governments	0.1	0.1	0.0	-0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
C. Primary balance of BSE 3/	0.0	-0.1	-0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
II. Primary balance of the BCU 4/	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
III. Primary balance of the PS (I+II)	-0.3	-0.2	0.5	-0.6	-2.1	-1.9	-1.0	0.1	0.4	0.4	0.5
IV. Interest of the PS	3.1	3.1	3.3	2.8	3.0	3.2	3.0	3.1	3.2	3.3	3.5
A. NFPS	2.5	2.5	2.6	2.4	2.6	2.3	2.5	2.5	2.6	2.7	2.9
B. BCU 4/	0.6	0.6	0.7	0.4	0.5	0.9	0.6	0.5	0.5	0.5	0.6
V. Overall balance of the PS (III+IV)	-3.4	-3.2	-2.7	-3.2	-5.2	-5.0	-4.0	-3.0	-2.8	-2.8	-3.0
A. NFPS	-2.7	-2.6	-2.0	-2.9	-4.7	-4.1	-3.4	-2.5	-2.3	-2.3	-2.4
excluding <i>cincuentones</i> transactions	-2.7	-2.6	-3.2	-4.0	-5.2	-4.5	-3.4	-2.5	-2.3	-2.3	-2.4
B. BCU 4/	-0.7	-0.7	-0.8	-0.5	-0.5	-0.9	-0.6	-0.6	-0.6	-0.6	-0.6
VI. Overall balance PS excluding <i>cincuentones</i> transactions	-3.4	-3.2	-3.9	-4.3	-5.7	-5.4	-4.0	-3.0	-2.8	-2.8	-3.0
Memorandum Items:											
Real revenues growth (in percent)	2.7	3.8	5.3	-1.9	-6.7	1.2	3.4	3.7	2.8	2.4	2.4
Real primary spending growth (in percent)	3.5	2.8	2.2	2.1	0.6	3.6	-0.2	-2.5	0.8	1.9	1.7
GDP (in billions of pesos)	1,726	1,842	1,982	2,159	2,253	2,570	2,801	2,964	3,149	3,352	3,562

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

1/ Banco de Prevision Social (BPS).

2/ Non-financial public enterprises (NFPE).

3/ Banco de Seguros del Estado (BSE).

4/ Banco Central del Uruguay (BCU).

Table 4. Uruguay: Public Sector Debt and Financial Assets 1/

	2016	2017	2018	2019	2020	Projections					
						2021	2022	2023	2024	2025	2026
(In billions of U.S. dollars, unless otherwise indicated)											
Public Sector Debt											
Gross debt of the public sector	33.5	38.9	38.4	37.2	39.9	48.3	51.8	54.2	56.4	58.4	59.8
of which:											
Non-financial public sector debt	33.4	36.1	35.8	35.0	36.2	40.1	43.1	45.4	47.7	50.0	51.8
Central bank debt	5.6	8.3	7.5	6.4	7.0	11.9	12.6	12.8	12.9	12.7	12.6
External debt of the public sector	17.1	17.9	18.4	19.4	21.2	22.3	23.8	25.0	26.6	27.9	29.3
Domestic debt of the public sector	16.4	21.0	20.0	17.8	18.6	26.0	28.1	29.2	29.7	30.5	30.5
Public Sector Financial Assets											
Gross financial assets of the public sector	17.4	19.9	19.5	18.5	20.3	23.7	24.2	24.5	25.0	25.4	25.8
of which:											
Financial assets of the non-financial public sector	6.6	6.9	6.5	5.4	5.4	6.0	6.3	6.5	6.7	6.9	7.1
Financial assets of the central bank	14.4	16.9	16.6	15.6	17.5	17.7	17.9	18.1	18.3	18.5	18.7
Liquid financial assets of the central bank 2/	7.6	10.4	9.6	8.7	9.2	11.2	11.3	11.3	11.3	11.2	11.1
Liquid financial assets of the public sector 2/	14.2	17.3	16.1	14.1	14.6	17.2	17.6	17.8	18.0	18.1	18.2
Net Public Sector Debt											
Gross debt minus liquid financial assets 2/	19.3	21.5	22.3	23.1	25.3	31.1	34.2	36.4	38.4	40.3	41.6
Public sector debt net of total financial assets	16.1	18.9	18.9	18.7	19.6	24.6	27.6	29.6	31.4	33.0	34.1
(In percent of GDP, unless otherwise indicated) 1/											
Public Sector Debt											
Gross debt of the public sector	57.0	60.8	62.8	64.3	74.9	81.1	82.3	83.2	83.0	82.4	81.3
of which:											
Non-financial public sector debt	56.8	56.5	58.6	60.5	68.1	67.3	68.5	69.7	70.2	70.6	70.4
Central bank debt	9.6	12.9	12.3	11.0	13.1	19.9	20.0	19.6	18.9	18.0	17.1
External debt of the public sector	29.1	27.9	30.1	33.5	39.9	37.5	37.7	38.4	39.2	39.3	39.8
Domestic debt of the public sector	27.9	32.8	32.7	30.8	35.0	43.6	44.6	44.8	43.8	43.1	41.4
Public Sector Financial Assets											
Gross financial assets of the public sector	29.5	31.1	31.8	32.0	38.2	39.8	38.4	37.7	36.8	35.8	35.0
of which:											
Financial assets of the non-financial public sector	11.2	10.8	10.7	9.3	10.2	10.1	10.0	9.9	9.8	9.7	9.6
Financial assets of the central bank	24.5	26.5	27.1	26.9	32.9	29.7	28.4	27.8	26.9	26.1	25.4
Liquid financial assets of the central bank 2/	12.9	16.3	15.7	15.1	17.2	18.8	18.0	17.4	16.7	15.8	15.1
Liquid financial assets of the public sector 2/	24.1	27.1	26.4	24.4	27.4	28.9	28.0	27.3	26.5	25.6	24.7
Net Public Sector Debt											
Gross debt minus liquid financial assets 2/	32.9	33.6	36.4	39.9	47.5	52.2	54.3	55.9	56.5	56.8	56.5
Public sector debt net of total financial assets	27.4	29.6	31.0	32.3	36.8	41.2	43.9	45.5	46.2	46.6	46.3
Memorandum Items											
GDP (in billions of pesos)	1,726	1,842	1,982	2,159	2,253	2,570	2,801	2,964	3,149	3,352	3,562
GDP (in billions of USD)	57.2	64.2	64.5	61.2	53.6	60.1	63.9	65.8	68.5	71.5	74.4

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

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

2/ Excludes central bank reserves held as counterpart of banks' required reserves on foreign currency deposits.

Table 5. Uruguay: Statement of Operation of the Central Government 1/

	2014	2015	2016	2017	2018	2019	2020
	(In percent of GDP, based on the 2001 GFS Manual)						
Revenue	26.6	28.0	38.1	35.2	37.1	36.5	37.5
Taxes	17.1	17.0	21.8	18.3	18.6	18.2	18.5
Social contributions	7.8	9.5	9.7	10.0	10.0	10.1	9.8
Grants	0.0	0.0	4.8	5.2	5.3	5.3	6.7
Other revenue	1.7	1.4	1.7	1.8	3.2	3.0	2.6
Expense	27.4	29.3	40.2	36.8	37.6	37.9	41.4
Compensation of employees	6.8	6.8	11.5	8.1	8.1	8.4	8.7
Use of goods and services	3.4	3.1	3.6	3.4	3.5	3.6	3.9
Consumption of fixed capital	0	0	0	0	0	0	0
Interest	2.1	2.1	2.5	2.5	2.6	2.5	2.8
Subsidies	0.2	0.3	0.4	0.2	0.2	0.2	0.2
Grants	0.0	0.0	4.8	5.2	5.3	5.3	6.7
Social benefits	12.2	14.1	14.5	14.5	14.8	14.9	16.2
Other expenses	2.7	3.1	2.9	2.9	3.0	3.0	2.9
Net acquisition of nonfinancial assets	1.3	1.1	1.3	1.2	1.4	1.3	1.3
Gross operating balance	-0.8	-1.4	-2.1	-1.6	-0.5	-1.5	-3.8
Net operating balance	-0.8	-1.4	-2.1	-1.6	-0.5	-1.5	-3.8
Net lending (+) borrowing (-)	-2.1	-2.5	-3.4	-2.8	-1.9	-2.8	-5.1
Net acquisition of financial assets	0.2	2.0	-1.6	-0.4	-0.7	-1.4	0.8
<i>By instrument</i>							
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.6	1.7	-0.9	-0.4	-0.8	-1.5	0.8
Debt securities	0.0	-0.1	-0.1	-0.1	0.2	0.2	0.1
Loans	-0.4	0.4	-0.6	0.0	0.0	0.0	-0.1
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>By residency</i>							
Domestic	0.2	2.0	-1.7	-0.4	-0.7	-1.5	0.9
External	0.0	0.0	0.0	0.0	0.0	0.1	-0.1
Net incurrence of liabilities	2.3	4.7	2.8	2.4	1.3	1.4	5.8
<i>By instrument</i>							
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	2.1	4.5	2.1	2.4	0.9	1.4	3.6
Loans	0.2	0.1	0.7	0.0	0.4	0.0	2.2
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>By residency</i>							
Domestic	0.1	2.7	4.0	1.7	-0.2	-0.3	2.1
External	2.3	1.9	-1.2	0.7	1.5	1.7	3.7
Memorandum items:							
Public sector net lending (+) borrowing (-)	-3.2	-3.1	-3.4	-3.2	-2.7	-3.2	-5.2
Public sector primary balance	-0.6	0.2	-0.3	-0.2	0.5	-0.6	-2.1

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

1/ Central government and Social Security Bank.

Table 6. Uruguay: Central Government Stock Positions 1/

	2012	2013	2014	2015	2016	2017	2018	2019	2020
	(In percent of GDP, based on the 2001 GFS Manual)								
Net financial worth	-30.9	-31.1	-32.5	-38.4	-38.0	-37.4	-40.0	-43.3	-51.9
Financial assets	9.1	8.2	8.4	8.7	8.6	8.2	8.9	9.5	10.9
<i>By instrument</i>									
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	6.0	4.3	4.9	5.3	6.0	5.2	4.7	3.9	4.3
Debt securities	2.3	2.0	2.1	2.0	2.0	2.0	3.2	4.3	5.2
Loans	0.4	1.6	1.1	1.2	0.5	0.8	0.8	1.1	1.2
Equity and shares	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.1
<i>By residency</i>									
Domestic	9.1	8.2	8.3	8.7	8.6	8.2	8.9	9.4	10.7
External	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.1
Liabilities	40.0	39.3	40.8	47.1	46.7	45.6	49.0	52.8	62.8
<i>By instrument</i>									
SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	31.6	32.3	34.0	40.7	40.3	40.8	43.5	46.9	54.2
Loans	8.3	7.0	6.8	6.4	6.4	4.8	5.4	5.9	8.6
Equity and shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>By residency</i>									
Domestic	17.8	15.5	15.5	17.9	21.1	21.0	21.7	22.5	26.3
External	22.1	23.8	25.3	29.2	25.6	24.6	27.2	30.3	36.5

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

1/ Central government and Social Security Bank.

Table 7. Uruguay: Monetary Survey

	2015	2016	2017	2018	2019	2020
	(End of period, in billion of pesos)					
Banco Central del Uruguay (BCU)						
Net foreign assets	458	399	461	565	560	710
Gross international reserves	467	394	459	546	542	687
Net domestic assets	-353	-285	-330	-443	-413	-536
Net credit to the public sector	31	60	104	112	108	113
Net credit to the financial system	-250	-202	-176	-272	-284	-323
Credit to the private sector	1	1	1	1	1	1
Securities issued by the BCU	-126	-125	-250	-222	-205	-280
Other	-49	-55	-56	-162	-105	-119
Peso monetary liabilities 1/	105	113	131	122	147	174
Public and Private Banks 2/						
Net foreign assets	144	177	168	318	281	395
Net domestic assets	615	611	633	735	757	837
Net credit to the public sector	38	39	36	62	56	51
Net credit to the financial system	251	250	285	339	351	378
Credit to the private sector	438	445	445	548	554	586
Other	-112	-123	-133	-214	-204	-178
Liabilities to the private sector (residents)	760	788	801	1,051	1,038	1,232
Banking System (Central, Private, and Public Banks)						
Net foreign assets	603	575	629	883	841	1,105
Net domestic assets	177	236	197	195	230	226
Credit to the public sector	69	98	140	174	164	164
Credit to the rest of financial system	-44	-6	50	70	24	52
Credit to the private sector	440	447	446	470	555	627
Other	780	811	826	1,078	1,070	1,330
Broad money (M-3)	780	811	826	925	1,070	1,330
	(In percent of total private credit) 3/					
Composition of Credit						
Credit to firms	61.3	60.9	57.3	56.7	57.9	59.5
Credit to households	38.7	39.1	42.7	43.3	42.1	40.5
Consumption	46.9	46.6	45.8	44.5	44.2	56.4
Car loans	0.0	0.0	0.0	0.0	0.3	3.5
Mortgages	26.1	25.9	25.8	25.1	25.4	40.2
	(Percentage change) 3/					
Memorandum Items:						
Base money	7.2	9.7	3.6	-6.5	27.2	18.4
M-1	5.2	6.6	10.6	2.5	8.8	15.7
Broader M1 (M1 plus savings deposits)	5.6	8.4	15.2	5.5	8.3	18.4
M-2	9.0	14.4	13.4	9.7	6.3	17.2
M-3	23.7	3.9	1.9	30.4	-0.7	24.3
Credit to firms (in US\$)	2.8	1.5	-4.2	2.4	-3.7	1.1
Credit to households (in real pesos) 4/	6.3	-0.5	2.5	1.2	1.7	-0.6

Source: Banco Central del Uruguay.

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

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

3/ Percentage change from previous year. In pesos, unless otherwise indicated.

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

Table 8. Uruguay: Medium-Term Macroeconomic Framework

	2016	2017	2018	2019	2020	Projections					
						2021	2022	2023	2024	2025	2026
(Annual percent change, unless otherwise indicated)											
National Accounts											
Real GDP	1.7	1.6	0.5	0.4	-5.9	3.4	3.2	2.7	2.5	2.2	2.2
Total domestic demand	1.4	1.9	1.0	-0.3	-4.0	4.1	3.6	1.9	3.2	2.7	2.8
Final consumption expenditure	1.3	3.2	2.2	0.6	-6.2	3.3	3.8	1.8	2.9	2.4	2.5
Private final consumption expenditure	0.5	3.6	2.1	0.5	-6.2	3.0	5.1	2.6	3.5	2.6	2.7
Public final consumption expenditure	4.7	1.3	2.6	1.1	-6.4	4.6	-0.9	-1.5	0.3	1.5	1.3
Gross capital formation	1.6	-3.5	-4.8	-5.2	8.0	7.7	2.8	2.5	4.5	4.5	4.5
Gross fixed capital formation	1.9	0.4	-9.0	0.8	-0.5	9.4	4.1	2.5	4.5	4.5	4.5
Private fixed capital formation	-1.4	0.4	-9.0	0.8	-0.5	11.0	4.0	2.4	4.5	4.5	4.5
Public fixed capital formation	81.2	0.4	-9.0	0.8	-0.5	-11.4	5.5	4.2	4.4	4.6	4.6
Change in inventories (contribution to growth)	-0.1	-0.7	0.7	-0.9	1.3	-0.2	-0.2	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	0.7	-0.2	-0.5	0.7	-2.1	-0.6	-0.3	0.8	-0.6	-0.5	0.0
Consumer Prices											
CPI inflation (average)	9.6	6.2	7.6	7.9	9.8	7.5	6.1	5.4	4.7	4.5	4.5
CPI inflation (end of period)	8.1	6.6	8.0	8.8	9.4	7.2	5.8	5.0	4.5	4.5	4.5
Balance of Payments											
Current account balance (percent of GDP)	0.8	0.0	-0.4	1.6	-0.6	-2.1	-1.8	-1.8	-1.8	-1.7	-1.5
Exports of goods and services (volume)	-6.8	4.2	-2.3	-3.5	-23.2	4.6	6.1	8.0	4.3	4.1	3.6
Export of goods (volume)	-3.8	1.7	2.6	-0.1	-16.5	11.3	7.8	9.5	4.9	4.5	3.9
Imports of goods and services (volume)	-10.3	3.8	-0.6	-3.4	-12.7	7.9	8.4	5.4	7.2	6.3	6.1
Imports of goods (volume)	-10.1	2.8	-2.9	-6.0	-3.4	8.3	9.2	5.3	8.1	7.1	6.7
Terms of trade (goods)	0.2	-0.3	-2.3	1.4	4.6	6.0	1.5	-0.8	0.2	1.1	1.9
(In percent of GDP, unless otherwise indicated)											
Public Sector Finance											
Primary balance NFPS 1/	0.2	-0.2	-0.1	0.6	-0.5	-2.1	-1.8	-1.0	0.1	0.4	0.4
excluding cincuentones transactions	0.2	-0.2	-0.1	-0.6	-1.6	-2.7	-2.2	-1.0	0.1	0.4	0.4
Revenue	26.7	27.0	27.6	28.9	28.3	28.0	27.4	27.5	27.7	27.8	27.9
of which: cincuentones transactions	0.0	0.0	0.0	1.2	1.1	0.6	0.3	0.0	0.0	0.0	0.0
Primary expenditure	26.4	27.3	27.7	28.3	28.8	30.2	29.4	28.6	27.8	27.6	27.6
Cyclically adjusted primary balance	-0.6	-0.8	-1.0	-1.2	-1.6	-1.5	-0.7	0.1	0.4	0.5	0.5
Overall balance NFPS	-1.9	-2.7	-2.6	-2.0	-2.9	-4.7	-4.1	-3.4	-2.5	-2.3	-2.3
excluding cincuentones transactions	-1.9	-2.7	-2.6	-3.2	-4.0	-5.2	-4.5	-3.4	-2.5	-2.3	-2.3
Primary balance PS 2/	0.2	-0.3	-0.2	0.5	-0.6	-2.1	-1.9	-1.0	0.1	0.4	0.4
excluding cincuentones transactions	0.2	-0.3	-0.2	-0.7	-1.6	-2.7	-2.2	-1.0	0.1	0.4	0.4
Overall balance PS	-3.1	-3.4	-3.2	-2.7	-3.2	-5.2	-5.0	-4.0	-3.0	-2.8	-2.8
excluding cincuentones transactions	-3.1	-3.4	-3.2	-3.9	-4.3	-5.7	-5.4	-4.0	-3.0	-2.8	-2.8
Gross NFPS debt	56.8	56.5	58.6	60.5	68.1	67.3	68.5	69.7	70.2	70.6	70.4
NFPS financial assets	11.2	10.8	10.7	9.3	10.2	10.1	10.0	9.9	9.8	9.7	9.6
Net NFPS debt (gross debt minus financial assets)	45.6	45.6	45.7	47.9	51.2	57.8	57.2	58.5	59.8	60.4	60.9
Gross PS debt	59.8	57.0	60.8	62.8	64.3	74.9	81.1	82.3	83.2	83.0	82.4
Financial assets of the PS	29.5	31.1	31.8	32.0	38.2	39.8	38.4	37.7	36.8	35.8	35.0
Liquid financial assets of the PS 3/	31.1	24.1	27.1	26.4	24.4	27.4	28.9	28.0	27.3	26.5	25.6
Net PS debt (gross debt minus liquid financial assets)	28.7	32.9	33.6	36.4	39.9	47.5	52.2	54.3	55.9	56.5	56.8
External Debt											
Gross external debt	72.5	66.9	67.1	74.1	88.0	85.9	85.2	86.3	86.5	86.0	85.8
NFPS gross external debt	29.1	27.9	30.1	33.5	39.9	37.5	37.7	38.4	39.2	39.3	39.8
PS gross external debt	31.1	29.9	32.0	35.7	41.9	40.1	40.3	41.6	42.1	42.2	42.5
Gross international reserves (US\$ billions)	13.5	15.9	14.4	14.5	16.2	17.0	17.2	17.4	17.6	17.8	18.0
Saving and Investment											
Gross domestic investment	17.5	15.8	15.0	14.6	17.0	17.2	16.9	16.6	16.6	16.6	16.6
Public sector gross investment	3.5	3.4	3.1	3.2	3.4	2.9	2.9	2.9	2.9	2.9	2.9
Private sector gross investment	14.0	12.5	11.9	11.5	13.6	14.3	14.0	13.7	13.7	13.7	13.7
Gross national saving	18.3	15.9	14.5	16.3	16.4	15.1	15.0	14.8	14.8	14.9	15.1
Public sector gross saving	-0.4	-0.6	0.2	-0.5	-2.7	-2.4	-1.7	-0.8	-0.6	-0.6	-0.7
Private sector gross saving	18.7	16.5	14.3	16.7	19.1	17.5	16.7	15.5	15.4	15.4	15.8
Unemployment and Output Gap											
Population (Mil)	3.5	3.5	3.5	3.5	3.5	3.5	3.6	3.6	3.6	3.6	3.6
Labor force participation (percent)	63.4	62.9	62.5	62.2	60.5	61.0	62.2	62.2	62.2	62.2	62.2
Employment growth (percent)	-0.2	-0.6	-0.8	-0.7	-3.9	1.2	3.7	0.9	0.7	0.5	0.3
Unemployment rate (percent)	7.9	7.9	8.4	8.9	10.4	10.2	9.0	8.5	8.2	8.0	8.0
Output gap (percent of potential output)	-0.3	0.1	0.0	-1.3	-3.8	-2.3	-1.0	-0.2	0.0	0.0	0.0

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

1/ The non-financial public sector (NFPS) includes the Central Government, Banco de Prevision Social, Banco de Seguros del Estado, local governments and Non-Financial Public Enterprises.

2/ Total public sector (PS). Includes the NFPS and Banco Central del Uruguay.

3/ Excludes central bank reserves held as counterpart of banks' required reserves on foreign currency deposits.

Table 9. Uruguay: Selected Financial Soundness Indicators

	2013	2014	2015	2016	2017	2018	2019	2020	2021 1/
Currency composition									
Dollar loans in percent of total loans	56.3	55.5	57.9	54.4	51.9	50.5	49.1	49.2	50.5
Loan dollarization (constant exchange rate, January 2013) 2/	51.4	49.6	44.9	43.3	40.9	38.6	34.3	31.1	30.8
Dollar deposits in percent of total deposits	69.6	72.7	76.5	72.9	68.8	69.2	71.9	73.6	74.6
Deposit dollarization (constant exchange rate, January 2013) 2/	67.2	68.4	68.6	66.7	62.9	60.7	60.9	60.1	61.3
Credit cycle									
Private sector credit in percent of GDP 3/	20.8	22.7	24.8	25.5	23.3	23.4	24.1	26.6	25.7
Private sector credit growth in percent	17.3	8.8	1.5	1.9	2.7	0.5	-2.0	-0.4	6.5
Bank soundness									
Regulatory capital in percent of risk-weighted assets	13.2	13.4	12.8	14.6	15.5	17.0	17.0	18.1	17.3
<u>Asset quality</u>									
Non-performing loans in percent of total loans	1.5	1.6	2.1	3.5	3.9	3.7	3.4	3.1	2.7
Specific loan-loss provisions in percent of non-performing loans	52.6	62.2	61.7	55.5	57.6	50.8	60.1	58.9	63.5
<u>Profitability</u>									
Return on assets	1.3	1.4	1.1	0.6	0.7	1.9	2.4	2.3	1.6
Return on equity	13.1	15.6	12.5	6.4	6.6	18.4	23.0	21.9	15.9
Operating costs in percent of gross income	80.7	84.0	84.8	79.4	66.4	78.1	71.9	73.2	80.5
<u>Liquidity</u>									
Liquidity ratio 4/	49.3	51.8	54.5	51.3	48.5	73.0	75.9	78.7	79.7
Non-resident deposits in percent of total deposits	13.7	13.4	15.1	11.5	9.2	9.2	9.7	9.6	9.3
Deposits/Loans ratio in national currency 2/	1.0	0.9	0.8	0.8	0.9	0.8	0.8	0.8	0.9
Deposits/Loans ratio in foreign currency 2/	2.0	2.0	2.0	2.4	2.4	2.3	2.4	2.9	3.2

Sources: Banco Central del Uruguay, IMF Global Financial Stability Report, and Fund staff calculations.

1/ Data as of July, unless otherwise specified.

2/ For 2021, data as of April.

3/ Data as 2021Q1

4/ Liquid assets with maturity up to 30 days in percent of total liabilities expiring within the same period.

Annex I. External Sector Assessment

The 2020 external position was broadly in line with fundamentals and desirable medium-term policies according to the External Balance Assessment (EBA) current account model and the EBA external sustainability approach. The EBA-Lite¹ real effective exchange rate (REER) model points to a 3 percent gap, also consistent with a broadly-in-line position. External stability risks remain contained given Uruguay's broadly-in-line external position and sizable reserve buffers.

1. The current account weakened in 2020. After the onset of the pandemic, the rapid contraction in external demand and transportation disruptions adversely affected goods exports. These were partially offset by the strong increase in commodity prices in the second half of the year. Following a slow tourism season in 2020Q1 (due to weak demand from Argentina), tourism proceeds came to a near halt with the border closures, though the peak summer tourism season was mostly done before the containment measures were put in place. The impact of these factors on the trade balance was partly countered by lower imports, mainly reflecting lower fuel prices, while other import components contracted more tepidly as a shift in consumption patterns toward tradable goods offset the contraction in domestic demand. Overall, exports contracted close to 20 percent in value during 2020, while imports contracted around 15 percent. The current account balance dropped from a 1.3 percent of GDP surplus in 2019 to a 0.6 percent deficit.

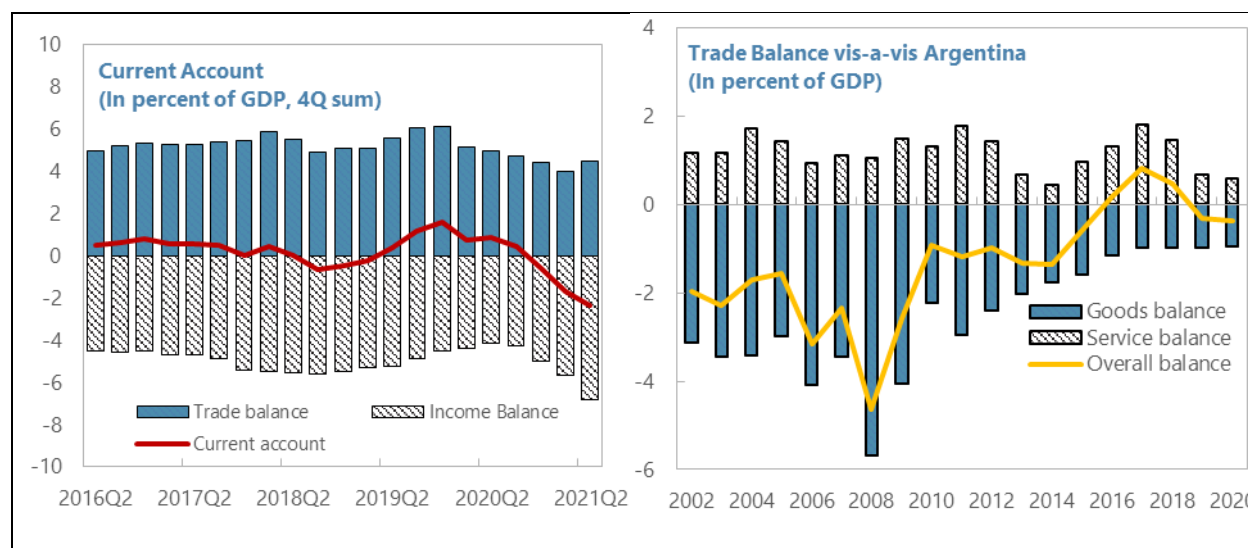
Merchandise Trade Balance (In percent of GDP)							
	2014	2015	2016	2017	2018	2019	2020
Trade balance	3.0	2.3	3.6	3.1	3.6	5.0	3.8
Exports	22.4	19.8	18.5	17.3	18.0	19.2	18.4
Imports	19.4	17.5	15.0	14.2	14.5	14.1	14.6
Fuel	2.8	1.8	1.3	1.4	1.8	1.6	1.4
Non-fuel	16.6	15.7	13.7	12.8	12.7	12.5	13.2
Capital	3.4	3.1	2.7	1.7	1.7	1.7	1.8
Consumption	4.7	4.6	4.4	4.4	4.4	4.3	4.6
Intermediary	7.6	6.8	5.8	5.5	5.5	5.4	5.7

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

2. The current account is expected to deteriorate further in 2021 and hover around a 1.5-2.0 percent of GDP deficit over the medium term. Both exports and imports are recovering as global demand bounces back and Uruguay's economy gradually reopens. However, service exports continue to be severely impacted by the pandemic (the 2021 summer season bore the brunt of the drop in tourism and borders are only gradually reopening) while imports continue to be supported by the new pulp plant construction by UPM (and associated large infrastructure projects) and strong demand for tradable goods (resulting from a shift in consumption pattern from non-tradable

¹ EBA REER models do not include Uruguay.

services to tradables). These drivers are contributing to a widening of the current account deficit to about 2.1 percent of GDP in 2021. Over the medium term, and as borders fully reopen, the bilateral trade balance vis-a-vis Argentina is expected to weaken towards the previous long-run equilibrium (around 1.5 percent of GDP deficit), as tourism exports gradually normalize. Exports as well as primary income outflows are expected to be boosted by the new paper pulp project from UPM. Imports are projected to recover in tandem with economic growth. Strong demand for and prices of commodities (especially meat) present upside risks to the current account, although a greater deterioration of the trade balance with Argentina pose downside risks.



3. The EBA current account model indicates that the 2020 external position was broadly in line with fundamentals and desirable policy settings. The estimated current account norm of -2.2 percent of GDP and the cyclically-adjusted current account balance of -0.7 percent of GDP point to a current account gap of about 1.5 percent of GDP. However, the 2020 cyclical-adjusted current account requires further adjustments to account for factors not captured by the model:

- Fuel imports are estimated to have been 0.4 percent of GDP lower than expected over the medium term due to the COVID-related drop in fuel prices and quantities.
- Consumption shifted towards tradable goods, leading to higher goods imports relative to the expected contraction in the EBA model. This effect is estimated to amount to 0.2 percent of GDP.
- Exports of medical supplies were also higher than usual, requiring an adjustor of 0.1 percent of GDP.

Adjusting for these temporary factors brings the CA balance to -0.9 percent of GDP. It is also necessary to adjust for expected normalization of the bilateral trade balance with Argentina—which has been significantly higher than the historical balance in recent years, mainly reflecting the appreciation of the Argentinean peso in 2015–17. With Argentinian peso reverting the appreciation in vis-à-vis the Uruguayan peso in recent years, as trade normalizes over time, the bilateral trade

balance is expected to gradually weaken towards the historical level. Considering this effect, the cyclically-adjusted CA balance is estimated at -1.7 percent of GDP, implying a staff-assessed CA gap of about 0.5 percent of GDP.

4. The EBA external sustainability (ES) approach assesses the REER as in line with fundamentals, as the projected current account deficit for 2026 (1.5 percent of GDP) is at the level required to stabilize the stock of NFA at its current level (a deficit of about 1.5 percent of GDP).

5. The EBA-Lite REER model also assesses the REER to be in line with fundamentals, pointing to a 3 percent gap. This reflects a 3 percent REER appreciation in 2020. However, REER movements hide differing underlying trends across key trading partners as the real exchange rate vis-à-vis Brazil appreciated by 16 percent, while the real exchange rate with respect to Argentina and the US depreciated by 1.5 and 4 percent respectively.

2020 External Sector Assessment						
	CA		CA		Proj -	REER gap
	norm 1/	proj. 1/	norm 1/	proj. 1/	Norm	(in %) 4/
I. EBA - Current Account model 2/ 3/						
Baseline	-2.2	-0.7			1.5	
Applying COVID-19 adjustments	-2.2	-0.9			1.3	
Adjusting for trade with Argentina	-2.2	-1.7			0.5	-2.3
II. External Sustainability (ES) approach 3/						
	-1.5	5/	-1.5	6/	0.0	0.0
III. EBA-lite REER model						
						2.9

Source: Fund staff calculations

1/ Cyclically adjusted.

2/ Based on the June 2021 EBA results.

3/ Using a CA elasticity of 0.20 (see RES EBA CA and EBA ES results for Uruguay).

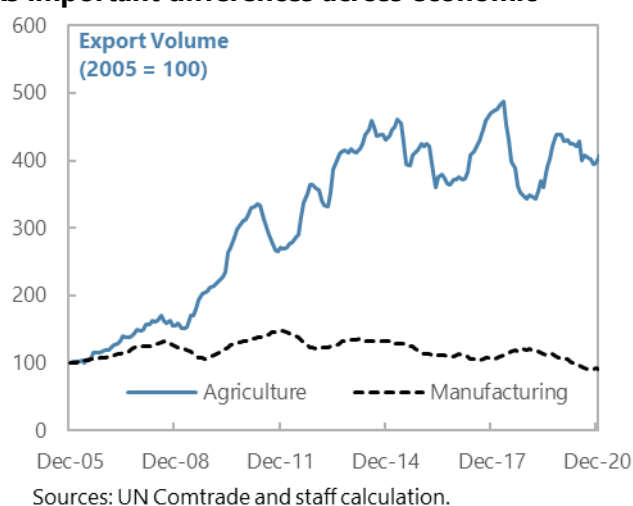
4/ Positive values indicate overvaluation.

5/ CA balance required to stabilize NFA in the medium-term.

6/ 2026 projection.

6. The external assessment for 2020 masks important differences across economic

sectors. Over the past two 15 years, agricultural commodities have taken up the lion's share of Uruguay's exports, following the commodity price boom that ended in 2014. The REER appreciated significantly during the commodity price boom and has not seen significant downward adjustment since then. Over this period, the non-commodity tradable sectors—which are typically more sensitive to REER movements than commodities—have remained stagnant.



7. External stability risks remain

contained. Gross reserves increased by over 13 percent in 2020—boosted by the authority's international bond issuance and the policy to allow for purchases of monetary policy instruments with foreign currency. Reserves remain above the upper bound of the IMF reserve adequacy metric range. Reserve buffers are also adequate when considering other prudential indicators that take into account Uruguay's high degree of deposit dollarization and commercial banks' foreign currency exposure. Given the level of reserves, external stability risks are contained.

Gross International Reserves

In billions of U.S. dollars (projection for end 2021)	17.0
In months of imports (2021)	15.1
In percent of:	
GDP (2021) 1/	28.3
Short-term external (STE) debt (2021)	531.5
STE debt and foreign currency deposits (2021)	73.1
STE debt and nonresident deposits (2021)	262.9
M2 (latest)	183.4
M3 (latest)	54.1
<u>Memo items:</u>	
IMF's new reserve adequacy metric range in US\$, billions (2019) 2/	8.1 to 12.1
Banks' gross foreign assets (US\$, billions, 2021Q1)	15.0
Ratio of gross reserves plus banks' foreign assets to STE debt and foreign currency deposits (percent)	137.8

Sources: Banco Central del Uruguay and Fund staff calculations.

1/ Reserves-to-GDP ratio calculated after converting GDP to U.S. dollars.

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

Annex II. Main COVID-Related Policy Measures

Financial and Credit Support Measures 1/		
Measure	Description	Impact
The National System of Guarantees (SIGA) launched 3 lines of credit guarantees: <i>SIGA Emergency</i> , <i>SIGA Impulse</i> and <i>SIGA Plus</i> , for SMEs, the tourism sector, and large companies, respectively.	The credit guarantees functioned as a collateral for loans taken by companies affected by the pandemic (up to 80% of the loan value). The government expanded the existing budget for SIGA from US\$50 million to US\$500 million (0.9 percent of GDP) for 2020 to fund the new programs. These SIGA guarantees were launched in March 2020 and are expected to remain open until September 2021.	As of April 2021, 20,761 credit operations from 15,420 companies, with a total loan value of US\$ 872 million (close to 6 percent of total private sector credit), were covered by SIGA, of which: <ul style="list-style-type: none"> - SIGA Emergency: US\$782 million, - SIGA Plus: US\$75 million, - SIGA Impulse US\$15 million.
BCU authorized the extension of loans repayments up to 12 months.	This extension covers loans to all non-financial corporations and individuals, with a repayment deadline between February 2020 and August 2021. Financial institutions were allowed to give extensions of up to 12 months for loan amounts below UI 140,000, and up to 180 days for other loans, without a new loan assessment or changes to its risk exposure report to the BCU.	About 45 percent of private sector loan repayments were given the extension.
The National Development Agency (ANDE) launched a credit line through the direct credit program (programa de crédito dirigido, PCD) called Working Capital 1%.	This ongoing credit line, launched in February 2020, finances working capital up to US\$100,000 with an interest rate of 1 percent and a grace period of 12 months.	As of March 2021, ANDE's total credit lines amounted to around US\$29 million, with over 6000 loans given.
ANDE authorized the refinancing of existing PCD loans.	This measure gave existing borrowers a grace period of 12 months for principal repayments and 6 months for interest payments for all outstanding PCD loans.	
ANDE launched a credit line in February 2021 for MSMEs in the pandemic-affected sectors with a 0 percent interest rate.	For micro and small enterprises in sectors affected by COVID (e.g., tourism) with up to 19 employees, this credit line offered a maximum of \$25,000 with a repayment period of 12 months and 0 percent interest.	10,386 companies were authorized to access the loan.
BCU reduced banks' reserve requirements for national currency.	From April 2020 to June 2021, minimum reserve requirements were reduced by 3 to 7 percentage points (to 2-15 percent), depending on credit maturity. Subsequently BCU has made the reduction of reserve requirements in national currency permanent, to encourage peso lending.	The measure aimed to encourage credit creation in the local currency.
BCU issued a decree allowing banks to use their reserves for additional lending.	From April 2020 to June 2021, banks were allowed to reduce their reserves in national currency and indexed units deposited at the central bank, if they increased lending to the private sector by the same amount.	This measure allowed commercial banks to increase their lending portfolio without having to meet the minimum reserve requirement.
1/ The list is not necessarily exhaustive.		

Measure	Description	Impact
Social programs implemented by MIDES.	<p>Different programs aimed at increasing social transfers for vulnerable households and informal workers.</p> <p>Doubling amount of cash transfers through Tarjeta Uruguay Social</p> <p>Doubling of family allowances</p> <p>Food baskets</p> <p>Subsidy for vulnerable independent workers</p> <p>New shelters for homeless</p> <p>Prevention of domestic abuse</p> <p>Creation of an emotional support line</p>	The different programs benefit about 1 million people.
Enhanced unemployment insurance and health coverage.	<p>Was allowed to also cover workers with suspended contracts or with a reduction of hours.</p> <p>Temporary flexible access to unemployment benefits including for partial unemployment</p> <p>Extension of unemployment benefits</p> <p>Sick leave benefit for workers over 65 years</p> <p>Temporary health coverage for the unemployed</p> <p>Increased health coverage for health workers</p>	At its peak in April 2020 about 186 thousand persons were being covered, which now stands at about 75 thousand.
Tax credits, exemptions, deferrals, and suspension of social security contributions, for employers in most affected sectors and for independent workers.	<p>The degree of support varied by sector depending on how affected they were with the pandemic and mobility restrictions.</p> <p>Tax credits for companies rehiring workers</p> <p>Partial exemption and deferral of contributions from independent workers and owners of personal companies</p> <p>Exemptions on employer contributions to sectors particularly affected by social distancing measures</p> <p>Import taxes waiver for specific medical supplies</p> <p>Tax exemptions to support tourism</p>	

Annex III. Uruguay's New Fiscal Rule

In 2020, the new administration introduced a fiscal rule for the central government and social security administration with the objective of stabilizing the debt burden over the medium term while allowing for counter-cyclical policy. The new framework aims at reinforcing the predictability of fiscal policy and strengthening the authorities' commitment to their consolidation plan. This describes the key elements of the new framework and discusses possible refinements to fully reap the benefits of a rules-based system.

A. Key Features of the New Rule

1. The rule sets indicative constraints to public finances with the objective of stabilizing the debt burden in the medium term. Introduced with the 2020 Urgent Consideration Law and further detailed in the 2020-24 Budget Law¹, the rule entails three indicative limits on fiscal accounts:

- **An indicative structural deficit limit** for the headline deficit of the central government and social security administration—corrected for the effect of the business cycle and extraordinary developments (one-offs)—such that the debt-to-GDP ratio stabilizes over the medium term.²
- **A net-indebtedness ceiling** for the net annual debt issuance in US dollars of the central government (effectively limiting the headline deficit) with the possibility of invoking an escape clause that allows for an increase of up to 30 percent (relative to the budgeted amount) under exceptional circumstances.³
- **An indicative real spending limit** for the real primary spending growth of the of the central government and social security administration not to exceed the estimated potential growth (including one-offs).^{4 5}

2. These key features aim at ensuring debt sustainability while allowing for counter-cyclical policy. They reinforce the predictability and credibility of fiscal policy and bolster the

¹ There is no overarching public financial management law in Uruguay. Various Constitutional provisions and the Accounting and Financial Administration Annotated Text, the Five-Year Budget Law, as well as administrative laws govern budgeting and financial management.

² Extraordinary revenues include those arising from: *cincuentones* transactions, energy stabilization fund, SOEs profits, asset-liability management operations, sale of public assets or licenses. Extraordinary outlays include those arising from: crisis mitigation (e.g., drought, health crisis), unusual SOEs losses, judicial settlements, and election spending.

³ While the net-borrowing limit for 2021 was initially set at US\$2.3bn, the escape clause was then activated to accommodate unanticipated pandemic-related spending.

⁴ The Ministry of Finance currently estimates potential growth at 2.3 percent of GDP (based on a production function approach) although the estimation may be revised as it is expected that the Committee of Experts, once established, will provide inputs for the estimation of this key parameter and the Advisory Council will provide feedback on the methodology.

⁵ The authorities estimate real spending using average inflation, although an explanation is not included in official documents.

authorities' commitment to reaching their fiscal consolidation targets and putting public finances on a sustainable path. Specifically:

- The structural balance limit can ensure convergence towards a certain (unadjusted) fiscal balance over the medium term (when output is expected to be at potential), while allowing for automatic stabilizers to play a countercyclical role. By focusing on a measure of the fiscal balance that also excludes one-off spending and revenues measures, this indicative target also provides space for using fiscal resources to address temporary shocks, as done during the pandemic.
- The spending limit tied to potential growth complements the structural balance cap, effectively leading to fiscal savings when revenues are growing faster than potential (e.g., when commodity prices are booming).
- The net debt issuance ceiling provides an overall envelop—i.e., a limit on counter-cyclical policy and one-off spending—to ensure that public debt stays on a sustainable path.

3. The law also introduces auxiliary institutions aimed at shaping and monitoring the implementation of the rule. In September 2021, an *Advisory Council*, was established, to monitor the compliance with the rule and contribute to the policy debate regarding the sustainability of public finances.⁶ By the end of 2021, a *Committee of Experts* will be summoned for the first time to provide technical inputs for the estimation of potential output. These auxiliary institutions are intended to be technical and independent, and they will be critical to the successful implementation of the rule.⁷

B. Considerations for Strengthening the Fiscal Framework

4. International best practices point to possible refinements to Uruguay's rule. A fiscal rule is normally understood as a lasting constraint (binding for at least three years) on fiscal policy to promote fiscal discipline and mitigate the deficit bias (IMF 2018a). A rule is successful if it: i) ensures sustainability; ii) avoids procyclical policies (builds buffers during good times to be used during bad times); iii) provides clear guidance for the budgeting process; and iv) is easily understood and monitored (IMF 2018b). There is scope for further refining Uruguay's framework to follow international best practices more closely and reap greater benefits from the rules-based framework. In particular:

- a. *Time horizon.* The current framework provides indicative targets for the current and following year only, without specifying when constraints can be changed. If limits can be

⁶ Legislation calls for the *Advisory Council* to be composed of three members of recognized academic or professional trajectory, who are nominated by the President and will serve for up to four years, that can be renewed. However, in order to have a staggered system, two of the initial members will only serve for two years and three years.

⁷ The *Committee of Experts* is designated by the Executive branch and will be composed of a minimum of seven to a maximum of 15 experts or representatives of prestigious institutions.

changed annually in the *Rendición de Cuentas*, the rule becomes undistinguishable from traditional annual budget ceilings and medium-term budgetary targets.^{8, 9} If binding targets were instead announced several years in advance this could significantly strengthen the medium-term guidance provided by the rule.

- b. *Legal limits and slippages.* The framework does not stipulate corrective procedures or actions in case of slippages. For example, in case the targets are not met, there is no requirement to present an updated plan to reach the intended objectives.¹⁰ Establishing such mechanisms are especially important because, if targets are indicative only, then there is no legal basis to enforce compliance.
- c. *Multiplicity of targets.* Having three concurrent constraints may render the system unnecessarily intricate, potentially complicating policymaking, creating communicational challenges, and weakening the guidance for the budgeting process. The three indicative constraints could potentially compete with each other and not be necessarily binding at the same time.¹¹ This could imply that the short-term guidance of fiscal policy becomes blurred, as it is unclear which of the targets (if any) has a primacy over others and whether corrective measures are needed if one or more of the targets are missed. Moreover, calibrating these three limits is difficult for an economy with large TOT shocks, where some of the limits may be breached more often which could undermine the framework.
- d. *Fiscal anchor.* A desirable feature of a fiscal rule is the combination of i) a fiscal anchor tightly linked to the final objective of fiscal policy (normally, debt sustainability), and ii) operational rules on fiscal aggregates to provide short-term guidance (Andrle and others 2015). The new Uruguayan framework mainly provides short-term policy guidance which could be conducive but may not guarantee debt sustainability (which is the government's desired intention) as it does not specify a target debt-to-GDP ratio or alternative medium-term anchor. Thus, the framework allows for fiscal slippages without corrective actions. While recognizing that there is no unique debt threshold, a drifting debt path would likely increase the probability of distress and eventually require a larger fiscal effort to stabilize public finances. The authorities could consider setting multi-year targets along with the introduction of an offsetting mechanism for slippages, which could have similar stabilization properties as a debt anchor. Other anchors could be considered, such as the path and medium-term objective for the primary surplus or a cap to the debt service (which would need to carefully estimate the effective interest cost of public debt, taking into consideration

⁸ Although the *Rendición de Cuentas* includes five-year Rolling forecasts they are not targets. In fact, official communications and explanations never refer to the forecasts as signaling any commitment or constraint.

⁹ The spending cap of the new fiscal rule may effectively provide a multi-year limit as it is tied to the estimated potential growth, provided that those estimates do not materially change from year to year.

¹⁰ Explanations about compliance with the rule are provide twice per year. At the beginning of the year in a presentation by the Minister to present the fiscal outturn and mid-year in the *Rendición de Cuentas*.

¹¹ Creating the possibility that a future administration could choose only to comply with "easier" targets and argue that compliance with one or two out of three targets is good enough.

the heterogeneity of debt instruments and liability-management operations that affect cash flows).

- e. *Escape clause.* The current escape clause for the net indebtedness ceiling allows for a temporary suspension under exceptional circumstances without weakening fiscal credibility (as suggested by Gbohoui and Medas, 2020). Moreover, it appropriately determines (in advance) which exceptional circumstances are allowable as they are considered to be beyond the control of the government (e.g., sharp recessions, large natural disasters, or national emergency), and what are the activation procedures for triggering the temporary suspension. However, it does not specify what are the subsequent procedures to return to the rule and more importantly there is no requirement to introduce offsetting mechanisms to recoup fiscal space. Moreover, the current escape clause does apply to deviations from the structural balance and/or spending limits (provided that the net indebtedness ceiling is met).
- f. *Structural adjustment.* A cyclically-adjusted balance (CAB) rule has a great theoretical appeal, as it allows for countercyclical policy (and provides guidance on the fiscal stance). However, such rule does not always yield satisfactory results, mainly because real-time estimates of the output gap are often unreliable, especially in countries experiencing structural changes, and often lead to overestimation of potential output.¹² Moreover, an additional complication for commodity-exporting countries is that an adequate structural adjustment would require determining whether observed changes in commodity prices are temporary or permanent, which is often highly uncertain. These pitfalls could be mitigated with rigorous and transparent methodologies for estimating potential output, which may need to explicitly err on the conservative side and contemplate correction mechanisms.^{13, 14}
- g. *Risk disclosure.* The 2021 Budget included a sensitivity analysis for public debt projections to changes in the exchange rate and growth assumptions, as a first step towards producing stochastic simulations for the debt path that take into account the historical correlation of macroeconomic shocks.¹⁵ Such simulations provide valuable information on the probability of deviating from the projected path, which should be taken into account in the fiscal plans

¹² For example, Eyraud and Wu (2015) estimate that the CAB rule allowed EU countries to run deficits that were 0.5 percent of GDP higher than their ex-post estimates. Similar experiences occurred in Chile and Peru, where the structural balance rule did not preclude very large increases in the net debt over the past decade.

¹³ For example, Tereanu et. al. (2014) based on potential growth revisions for the European Union, propose a rule of thumb that 1/3 of the changes in observed growth capture changes in potential output. Which corrects for the tendency of policymakers to assume positive growth shocks are permanent and negative shocks are temporary.

¹⁴ Once the auxiliary institutions become operational, disclosing the details of the rule is necessary to improve communication and ensure replicability of estimates. For example, making Excel files with the necessary inputs and estimations (data, parameters, assumptions, formulas, computation etc.) publicly available would allow that the rule and its merits are well understood by the public.

¹⁵ The results show that relatively small changes to growth or exchange rate projections lead to non-stationary debt trajectories.

(and fiscal rule limits).¹⁶ Moreover, a comprehensive fiscal risk report should be introduced (as an annex to the budget) that discloses all possible risks (including state contingencies, guarantees, PPP contracts, etc.) as this would help ensure that these risks are correctly identified, quantified, and managed.¹⁷

- h. *Auxiliary institutions.* The *Advisory Council* and *Committee of Experts* have a key role to play in helping monitor the implementation of the rule and elevating the quality of the discussions by explaining policy tradeoffs, alerting of biases or inconsistencies in the projections, and advocating for improved policy decisions. The experience from other countries suggests that these institutions are only effective if they are delinked from political discussions and have adequate access to data and resources, including adequate remuneration of its members (to make them truly independent).¹⁸

C. Conclusion

5. The new fiscal framework is an important step towards ensuring fiscal discipline, as it provide key elements and infrastructure for a well-functioning rules-based full system.

6. Some refinements would help reap greater benefits of such system. Shifting from single to multi-year targets, establishing a debt (or related) anchor, and defining corrective actions in case of deviations would be particularly valuable as these would provide greater medium-term guidance and help enforce fiscal discipline. Ensuring that the new auxiliary institutions become well-functioning and independent is also key to ensure the credibility of the new framework. Building on the reforms made so far, these changes would bolster Uruguay's fiscal framework and help ensure that fiscal discipline is maintained over time and across administrations.

¹⁶ For example, fiscal plans should consider whether targets under the baseline projections allow for the buildup of sufficient fiscal buffers (fiscal space) to allow for counter-cyclical policy in case of a bad shock. Similarly, authorities should consider if the additional fiscal effort that would be necessary to sustain a higher debt burden (after the occurrence of a bad shock) would be feasible or if more restraint would be needed in the baseline scenario to accommodate such shocks without distress.

¹⁷ This would be in line with the third pillar of the IMF's Fiscal Transparency Code.

¹⁸ The staggered design of the members of the *Advisory Council* seems appropriate to isolate it from the political cycle.

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Annex IV. Risk Assessment Matrix¹

Source of Risks	Likelihood	Impact	Horizon	Policy Advice
External Risk				
Global resurgence of the Covid-19 pandemic. Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.	Medium	High	ST	Maintain accommodative monetary policy stance and, if necessary, use fiscal policy space to delay the consolidation, to continue supporting the most vulnerable, limit scarring and bolster the recovery.
De-anchoring of U.S. inflation expectations leads to rising core yields and risk premia. A fast recovery in demand (supported by excess savings and stimulus), combined with supply constraints, leads to sustained above-target inflation and de-anchoring expectations. The Fed signals a need to tighten earlier than expected. Leads to a front-loaded tightening of financial conditions and higher risk premia, for credit, equities, and emerging market currencies.	Medium	Medium	ST	Allow the exchange rate to act as a shock absorber; provide liquidity to support credit to SMEs.
Widespread social discontent and political instability. Social tensions erupt as a withdrawal of pandemic-related policy support results in unemployment and, amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).	Medium	Medium	ST, MT	Continue supporting the most vulnerable, limit scarring and bolster the recovery. Implement envisaged structural reforms to increase potential growth.
Rising commodity prices amid bouts of volatility. Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.	Medium	Medium	ST	Allow the exchange rate to act as shock absorber. Maintaining fiscal policy within the boundaries of the fiscal rule.
Domestic Risk				
Insufficient fiscal adjustment or lack of credibility of plan to regain fiscal sustainability. Leading to sovereign-rating downgrade and higher yields.	Medium	Medium	ST,MT	Recalibrate plans to introduce a credible adjustment plan underpinned by concrete fiscal measures.
Delayed progress in structural reforms. Growth remains anemic amid competitiveness problems.	Medium	Medium	ST,MT	Implement envisaged structural reforms (to education, labor market, business environment, SOEs) which are urgently needed to raise potential growth.

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex V. Public Sector Debt Sustainability Analysis

A gradual rise of the debt-to-GDP ratio for the non-financial public sector (NFPS) is projected. Debt would exceed 70 percent of GDP over the medium term despite the authorities' planned fiscal consolidation efforts, leaving debt dynamics vulnerable to shocks and market sentiment. However, investment-grade status, low spreads, long average maturity (13 years) and substantial liquid assets mitigate short-term risks.

1. At end-2020, gross NFPS debt was 68 percent of GDP. It has increased rapidly over the last decade—by almost 30 percentage points between 2011 and 2020—due to a continuous increase in spending which was exacerbated in 2020 by the economic downturn and stimulus measures in response to the pandemic. The debt includes:

- *Central government's debt:* 58 percent of GDP, with 13-year average maturity, and about ½ denominated in local currency and ⅓ indexed to CPI.
- *Debt from other public corporations:* 4 percent of GDP (includes public enterprises and local governments).
- *Central bank capitalization bonds:* 6 percent of GDP.¹

2. The NFPS holds assets amounting to 10 percent of GDP and has access to contingent credit lines from multilateral institutions for about 3 percent of GDP.

- *Financial assets of the central government:* 5 percent of GDP, mostly held in liquid instruments (e.g., securities and deposits), in line with the government's prefunding policy of holding enough liquid assets to cover at least 12 months of debt service.
- *Contingent credit lines:* 3 percent of GDP, with World Bank, IDB, FLAR and CAF.
- *Holdings of BCU bonds and deposits at the BCU:* About 5 percent of GDP.²

3. NFPS net debt was 58 percent of GDP in 2020.

Scenarios

4. Baseline scenario. Under the baseline projection, the gross debt ratio is expected to gradually increase over the projection period and stabilize over the medium run. The negative impact of the fiscal deficits, rising interest rates, relatively high inflation, and nominal depreciation, is

¹ The first capitalization bond was issued in 2008 and further issuances were made in 2010, 2011, 2012 and 2013. At end 2018, all debt was consolidated into a single 30-year inflation-linked bond. This debt is not market based, its transactions do not involve cash and does not pay amortizations. In the previously used public sector coverage, this debt was netted out from the consolidated debt numbers as it is an asset of the central bank and a liability of the central government.

² These are assets of the NFPS and liabilities of the central government.

partly offset by the expected recovery in economic growth. If real GDP growth, real interest rates, and other debt-creating flows remain at their projected level for 2026, the debt-stabilizing primary balance is estimated at 0.9 percent of GDP compared to a projected primary balance of 0.5 percent of GDP.

5. Historical scenario. The historical scenario yields a slightly higher debt ratio, mainly because GDP growth was weaker, on average, in the previous decade. It should be noted, however, that during that period Uruguay experienced three contrasting stages. Until 2014, it had very high growth and exchange rate appreciation as it benefited from a positive terms-of-trade (TOT) shock. From 2014 to 2019, the TOT shock unraveled, and growth was stagnant. In 2020 the pandemic induced a sizeable downturn in economic activity.

Risks

6. Short-term risks are manageable. The share of debt held by non-residents is above the risk benchmark, but refinancing risks are limited given the sizable liquid financial assets and available contingent credit lines (5 and 3 percent of GDP, respectively). Short-term debt at original maturity is negligible (0.3 percent of GDP), reflecting the authorities' long-standing preference for long maturities to minimize roll-over risk and, more recently, for locking-in possibly historically favorable rates. Gross financing needs are 8.6 percent of GDP, of which 2.2 percent corresponds to the primary deficit, 2.3 percent to interest payments, and 2.8 to amortizations of loans and securities.

7. Standardized risk scenarios show that debt dynamics are sensitive to shocks, particularly to growth and exchange rate variations, with lower sensitivity to interest rate changes and the primary balance. Fan charts of the projected debt distribution confirm that debt dynamics remain manageable under historical statistical distributions of combined shocks. Gross debt would remain below 80 percent of GDP in 90 percent of cases under symmetric shocks, and 75 percent of cases with asymmetric shocks. At the same time, with nearly 50 percent probability debt under symmetric shocks (and 75 percent probability under asymmetric shocks) would hover above 70 percent of GDP, a level that could potentially raise market concerns, affecting sovereign spreads and the ability to roll over debt.

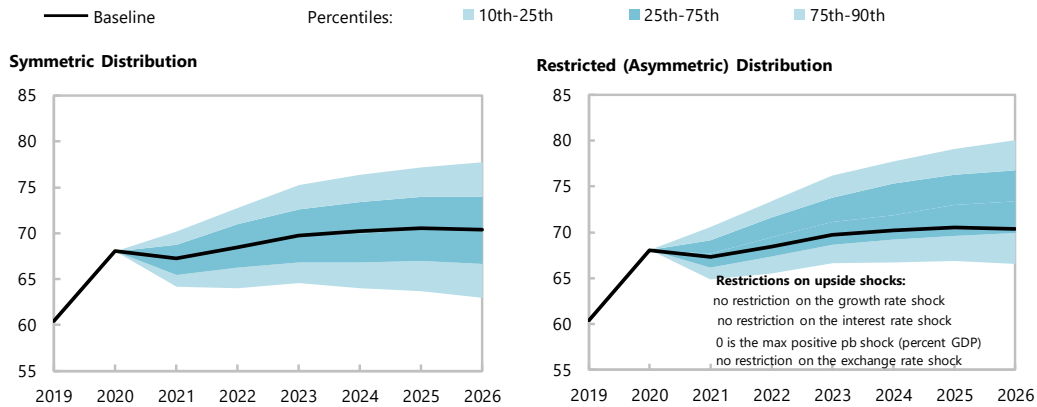
Figure 1. Uruguay: NFPS DSA Risk Assessment
(Nonfinancial Public Sector Debt)

Heat Map

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

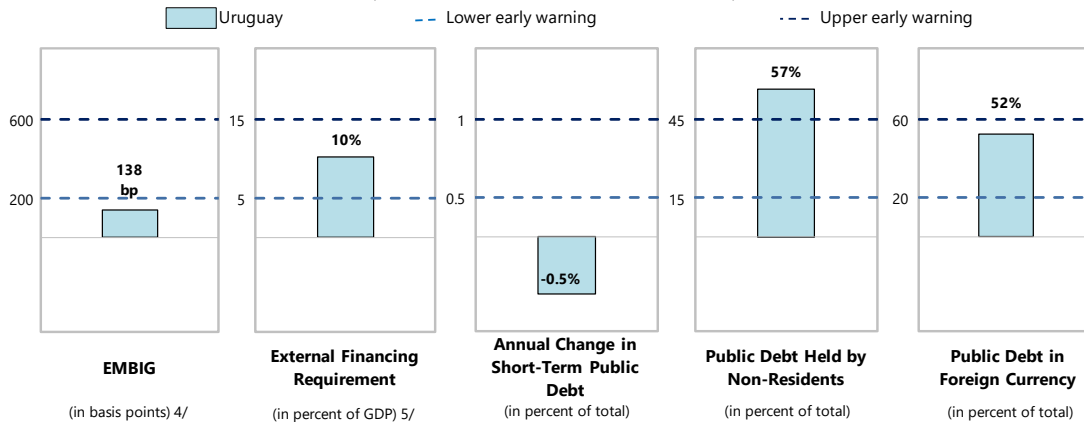
Evolution of Predictive Densities of Gross Debt NFPS

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2020)



Source: IMF staff.

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

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

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

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

4/ EMBIG, an average over the last 3 months, 08-Jul-21 through 06-Oct-21.

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

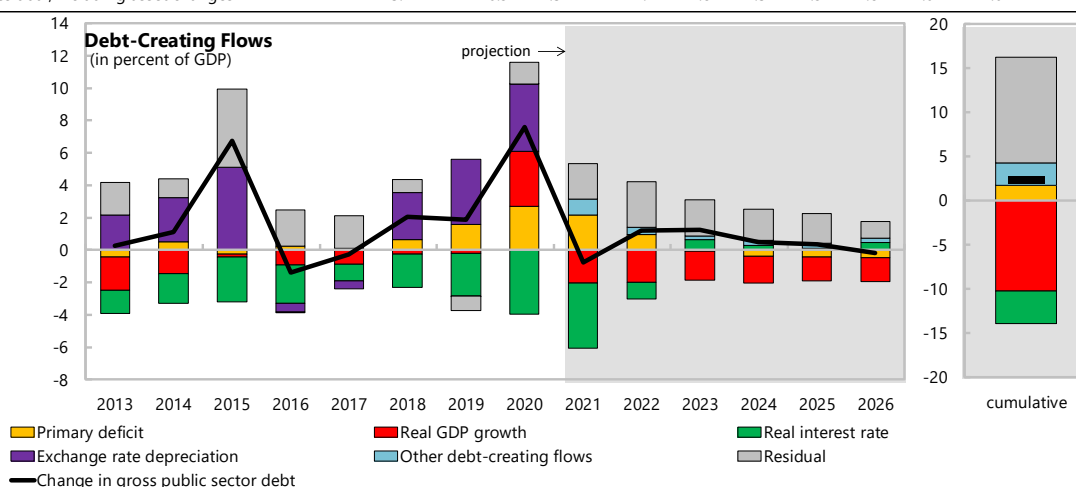
Figure 2. Uruguay: NFPS DSA—Baseline Scenario
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators^{1/}

	Actual			Projections						As of October 06, 2021		
	2010-2018 ^{2/}	2019	2020	2021	2022	2023	2024	2025	2026	Sovereign Spreads		
Nominal gross public debt	51.6	60.5	68.1	67.3	68.5	69.7	70.2	70.6	70.4	EMBIG (bp) 3/ ^{3/} 142		
Public gross financing needs	4.8	6.1	9.2	8.6	7.0	6.3	8.1	8.6	9.5	5Y CDS (bp) 72		
Real GDP growth (in percent)	3.2	0.4	-5.9	3.4	3.2	2.7	2.5	2.2	2.2	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	7.6	8.5	10.9	10.3	5.6	3.0	3.7	4.2	4.0	Moody's	Baa2	Baa2
Nominal GDP growth (in percent)	11.0	8.9	4.4	14.1	9.0	5.8	6.3	6.4	6.3	S&Ps	BBB	BBB
Effective interest rate (in percent) ^{4/}	4.5	3.6	3.4	3.9	4.1	4.1	4.2	4.4	4.7	Fitch	BBB-	BBB-

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2010-2018	2019	2020	2021	2022	2023	2024	2025	2026		
Change in gross public sector debt	1.4	1.9	7.6	-0.8	1.2	1.3	0.5	0.3	-0.2	2.3	
Identified debt-creating flows	-1.9	2.8	6.3	-2.9	-1.6	-1.0	-1.4	-1.5	-1.2	-9.7	
Primary deficit	-0.3	1.6	2.7	2.5	1.0	-0.1	-0.4	-0.4	-0.5	2.1	0.9
Primary (noninterest) revenue and grants	26.8	27.2	27.4	27.1	27.4	27.7	27.7	27.7	27.7	165.2	
Primary (noninterest) expenditure	26.5	28.8	30.1	29.2	28.4	27.6	27.3	27.2	27.2	167.0	
Automatic debt dynamics ^{5/}	-1.6	1.2	3.6	-6.1	-3.0	-1.1	-1.3	-1.3	-1.0	-13.9	
Interest rate/growth differential ^{6/}	-2.9	-2.8	-0.6	-6.1	-3.0	-1.1	-1.3	-1.3	-1.0	-13.9	
Of which: real interest rate	-1.5	-2.7	-4.0	-4.1	-1.1	0.6	0.3	0.1	0.5	-3.6	
Of which: real GDP growth	-1.3	-0.2	3.4	-2.0	-2.0	-1.7	-1.6	-1.4	-1.5	-10.3	
Exchange rate depreciation ^{7/}	1.3	4.0	4.2	...	...	...	...	...	...	...
Other identified debt-creating flows	0.0	0.0	0.0	1.0	0.4	0.2	0.3	0.3	0.3	2.5	
Net privatization proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt flows (incl. asset purchases)	0.0	0.0	0.0	1.0	0.4	0.2	0.3	0.3	0.3	2.5	
Residual, including asset changes ^{8/}	3.2	-0.9	1.3	2.2	2.8	2.3	1.9	1.8	1.0	12.0	



Source: IMF staff.

1/ Public sector is defined as non-financial public sector.

2/ Based on available data.

3/ EMBIG.

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

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

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

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

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

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

Figure 3. Uruguay: NFPS DSA—Composition of Debt and Alternative Scenarios

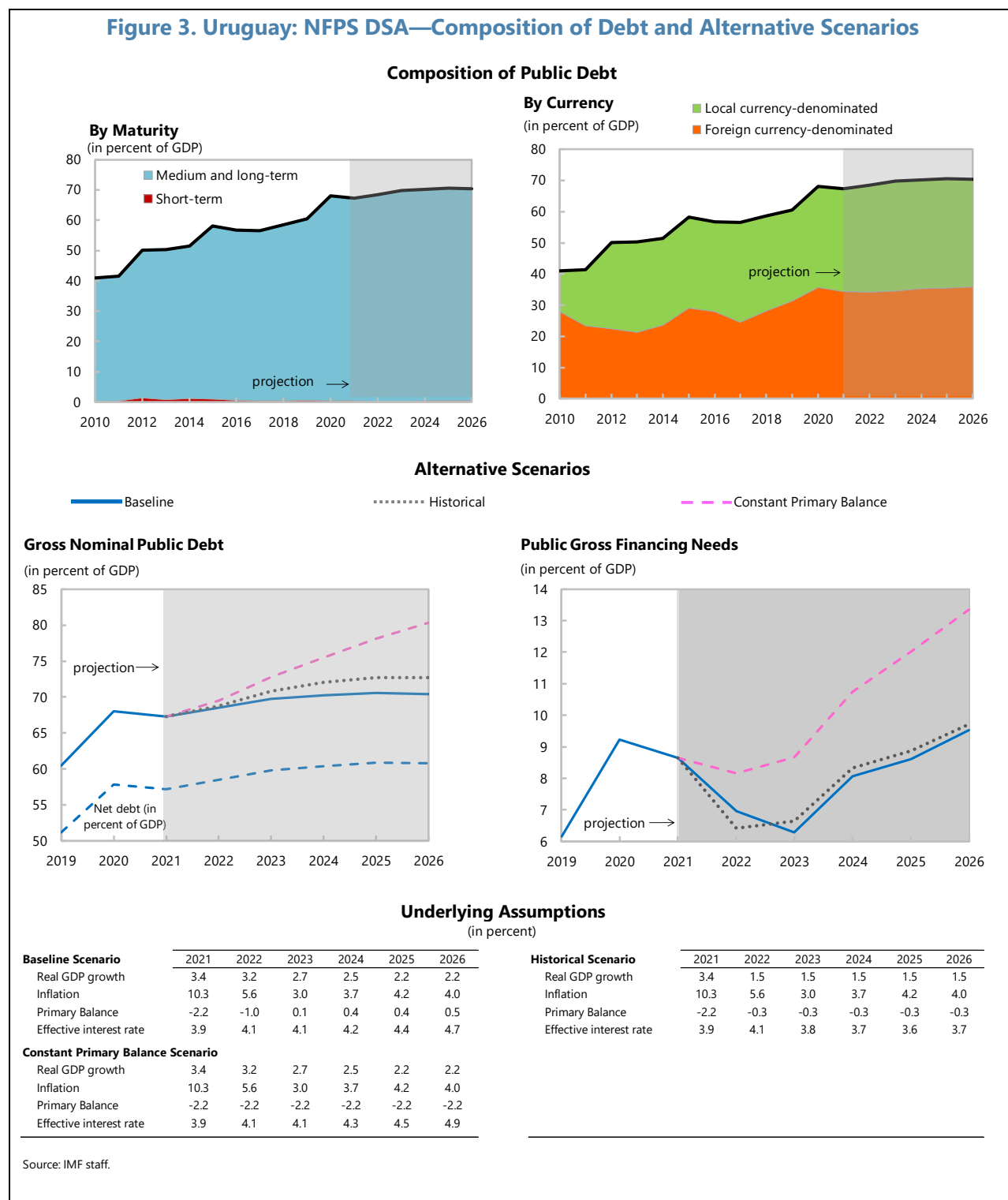
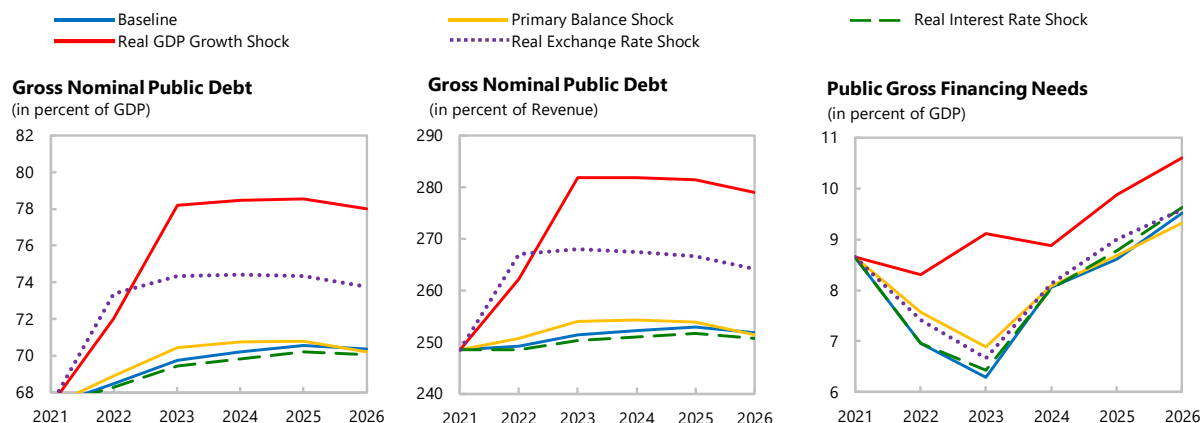
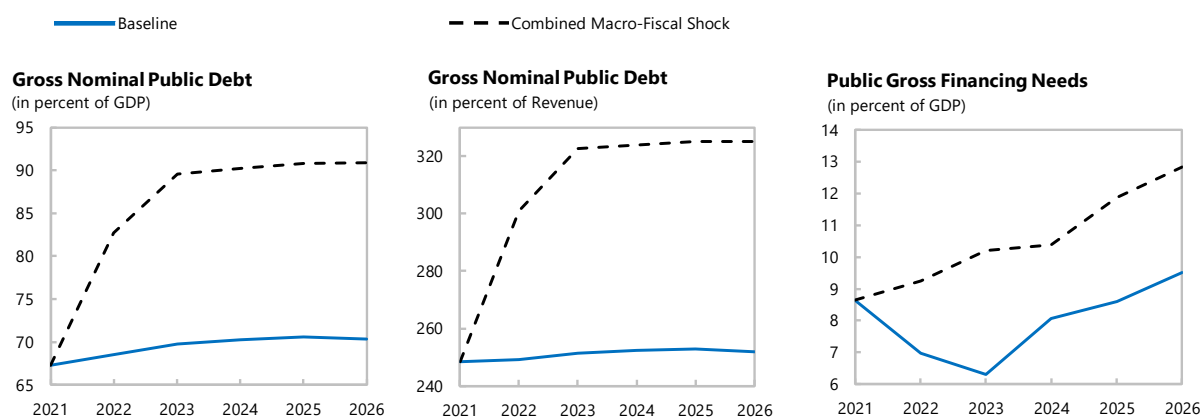


Figure 4. Uruguay: NFPS DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



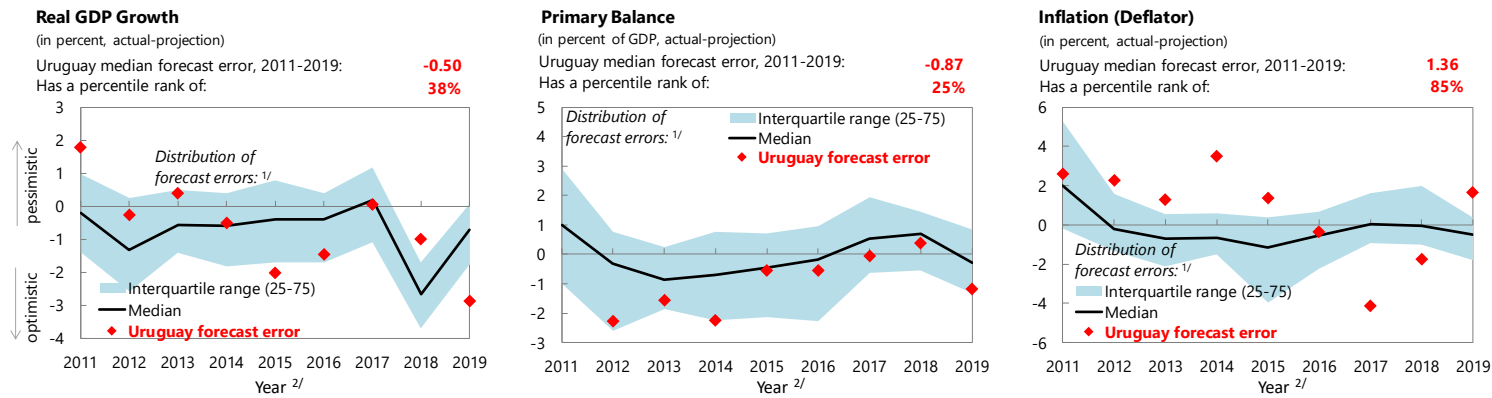
Underlying Assumptions
(in percent)

	2021	2022	2023	2024	2025	2026		2021	2022	2023	2024	2025	2026
Primary Balance Shock							Real GDP Growth Shock						
Real GDP growth	3.4	3.2	2.7	2.5	2.2	2.2	Real GDP growth	3.4	0.1	-0.4	2.5	2.2	2.2
Inflation	10.3	5.6	3.0	3.7	4.2	4.0	Inflation	10.3	4.8	2.2	3.7	4.2	4.0
Primary balance	-2.2	-1.6	-0.4	0.2	0.4	0.5	Primary balance	-2.2	-2.1	-2.1	0.4	0.4	0.5
Effective interest rate	3.9	4.1	4.1	4.3	4.5	4.8	Effective interest rate	3.9	4.1	4.1	4.4	4.6	4.8
Real Interest Rate Shock							Real Exchange Rate Shock						
Real GDP growth	3.4	3.2	2.7	2.5	2.2	2.2	Real GDP growth	3.4	3.2	2.7	2.5	2.2	2.2
Inflation	10.3	5.6	3.0	3.7	4.2	4.0	Inflation	10.3	13.2	3.0	3.7	4.2	4.0
Primary balance	-2.2	-1.0	0.1	0.4	0.4	0.5	Primary balance	-2.2	-1.0	0.1	0.4	0.4	0.5
Effective interest rate	3.9	4.1	4.3	4.6	5.0	5.5	Effective interest rate	3.9	4.7	4.1	4.2	4.4	4.7
Combined Shock													
Real GDP growth	3.4	0.1	-0.4	2.5	2.2	2.2							
Inflation	10.3	4.8	2.2	3.7	4.2	4.0							
Primary balance	-2.2	-2.1	-2.1	0.2	0.4	0.5							
Effective interest rate	3.9	4.7	4.3	4.7	5.1	5.5							

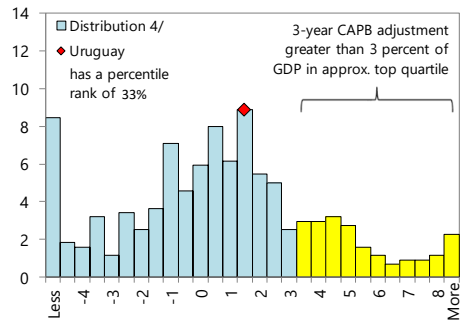
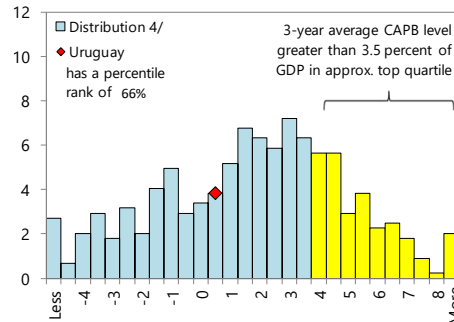
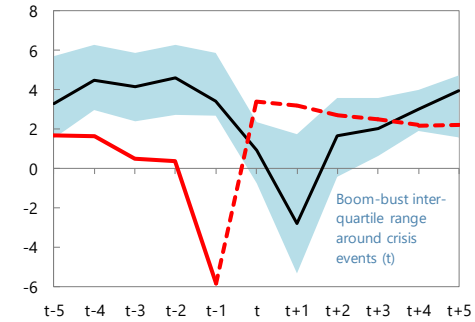
Source: IMF staff.

Figure 5. Uruguay: NFPS DSA—Realism of Baseline Assumptions

Forecast Track Record, versus surveillance countries



Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
(Percent of GDP)Boom-Bust Analysis^{3/}Real GDP growth
(in percent)

Source: IMF Staff.

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

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

3/ Uruguay has had a positive output gap for 3 consecutive years, 2018-2020. For Uruguay, t corresponds to 2021; for the distribution, t corresponds to the first year of the crisis.

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

Annex VI. External Debt Sustainability Analysis

- 1. External debt in Uruguay rose to 88 percent of GDP in 2020 reverting a downward trend observed in previous years (see Table).** The increase is primarily driven by a sharp contraction in GDP due to the Covid-19 crisis and the recent external government bond issuance in the context of rising fiscal needs for combating the pandemic. About 49 percent of the external debt is owed by the public sector, and 92 percent of the external debt is denominated in foreign currency.
- 2. Gross external debt is projected to hover around 85-86 percent of GDP over the medium term.** This reflects relatively positive non-interest current account surpluses and favorable automatic debt dynamics that offset external debt interest payments.
- 3. Gross external financing requirements are expected to remain at manageable levels,** with moderating debt repayment needs and an improving current account balance, also supported by real GDP growth. However, estimates of gross financing needs should be treated with caution, as they rely on assumptions on the residual maturity structure of private external debt (on which data are limited). A mitigating factor is that about 75 percent of the non-financial external private debt are inter-company loans (often accompanied by greater external asset holdings).
- 4. Stress tests indicate that the interest rate shock would have a limited impact on external debt.** Shocks to growth, the non-interest current account and a combined shock (to the real interest rate, growth, and current account) would have a greater, but still moderate, impact.
- 5. The main risk to Uruguay's external debt sustainability is an exchange rate depreciation.** A counterfactual 30 percent exchange rate depreciation would increase the external debt-to-GDP ratio by 19 percentage points, other things being equal (see Figure).
- 6. Overall, risks to external debt sustainability have risen since the pandemic but remain contained.** Given Uruguay's sizeable gross international reserves and liquidity buffers, risks to external debt sustainability remain manageable barring substantial additional shocks.

Table 1. Uruguay: External Debt Sustainability Framework, 2014–2026

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						Debt-stabilizing non-interest current account 7/ -0.6	
	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026		
Baseline: External debt 1/	69.3	78.2	72.5	66.9	67.1	74.1	88.0	85.9	85.2	86.3	86.5	86.0	85.8		
Change in external debt	5.1	8.9	-5.7	-5.6	0.2	6.9	13.9	-2.1	-0.7	1.1	0.2	-0.5	-0.2		
Identified external debt-creating flows	-1.5	0.8	-2.2	5.2	-6.6	-4.2	10.6	-5.6	-1.4	0.3	-0.4	-0.6	-0.4		
Current account deficit, excluding interest payments	1.1	-1.9	-3.0	-2.0	-1.8	-3.7	-2.0	-0.3	-0.7	-0.8	-0.8	-0.9	-1.1		
Deficit in balance of goods and services	-2.9	-3.9	-5.4	-5.4	-5.1	-6.1	-4.4	4.8	4.9	5.9	5.5	5.5	5.6		
Exports	30.4	28.7	27.1	26.2	26.5	27.9	25.3	27.3	28.5	30.1	30.8	31.5	32.5		
Imports	-27.4	-24.9	-21.7	-20.8	-21.4	-21.8	-20.9	-22.5	-23.5	-24.2	-25.3	-26.1	-26.9		
Net non-debt creating capital inflows (negative)	3.6	1.3	-3.2	-3.2	-0.7	2.2	1.5	1.6	1.4	1.3	1.3	1.3	1.3		
Automatic debt dynamics 2/	-6.2	1.4	4.0	10.3	-4.1	-2.7	11.1	-6.9	-2.2	-0.3	-1.0	-1.0	-0.7		
Contribution from nominal interest rate	1.5	2.0	2.2	2.4	2.0	1.9	2.6	2.5	2.5	2.6	2.6	2.6	2.6		
Contribution from real GDP growth	-1.8	-0.3	-1.4	-1.3	-0.3	-0.2	4.8	-2.7	-2.6	-2.2	-2.1	-1.8	-1.8		
Contribution from price and exchange rate changes 3/	-5.9	-0.3	3.1	9.2	-5.8	-4.3	3.7	-6.7	-2.1	-0.6	-1.5	-1.8	-1.5		
Residual, incl. change in gross foreign assets 4/	6.5	8.0	-3.5	-10.7	6.8	11.2	3.4	3.5	0.7	0.8	0.6	0.1	0.3		
External debt-to-exports ratio (in percent)	228.3	272.1	267.4	255.2	253.3	265.4	347.4	315.1	299.3	286.8	281.1	272.7	264.5		
Gross external financing need (in billions of US dollars) 5/	12.7	12.5	11.1	10.0	9.6	7.8	9.1	10.9	10.1	10.5	10.9	11.2	11.3		
in percent of GDP	20.5	21.7	19.4	15.6	14.8	12.7	17.0	18.1	15.8	16.0	15.9	15.6	15.2		
Scenario with key variables at their historical averages 6/								92.1	93.7	95.5	97.2	98.3	99.7	3.0	
Key Macroeconomic Assumptions Underlying Baseline								7-Year Historical Average	7-Year Standard Deviation						
Real GDP growth (in percent)	3.2	0.4	1.7	1.6	0.5	0.4	-5.9	1.3	2.9	3.4	3.2	2.7	2.5	2.2	2.2
GDP deflator in US dollars (change in percent)	10.1	0.5	-3.8	-11.3	9.6	6.9	-4.8	-1.5	7.4	8.2	2.4	0.7	1.7	2.1	1.7
Nominal external interest rate (in percent)	2.7	2.9	2.7	3.0	3.3	3.0	3.1	3.0	0.2	3.2	3.1	3.1	3.1	3.1	3.1
Growth of exports (US dollar terms, in percent)	2.6	-11.9	-6.7	8.6	1.5	-0.1	-20.5	-1.0	9.9	20.6	11.0	8.9	6.4	7.0	7.1
Growth of imports (US dollar terms, in percent)	-1.9	-15.6	-13.5	7.2	3.6	-3.6	-15.9	-5.7	9.4	20.4	11.3	6.1	8.6	7.8	7.3
Current account balance, excluding interest payments	-1.1	1.9	3.0	2.0	1.8	3.7	2.0	1.9	1.5	0.3	0.7	0.8	0.8	0.9	1.1
Net non-debt creating capital inflows	-3.6	-1.3	3.2	3.2	0.7	-2.2	-1.5	-0.2	2.7	-1.6	-1.4	-1.3	-1.3	-1.3	-1.3

1/ External debt includes non-resident deposits.

2/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.3/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

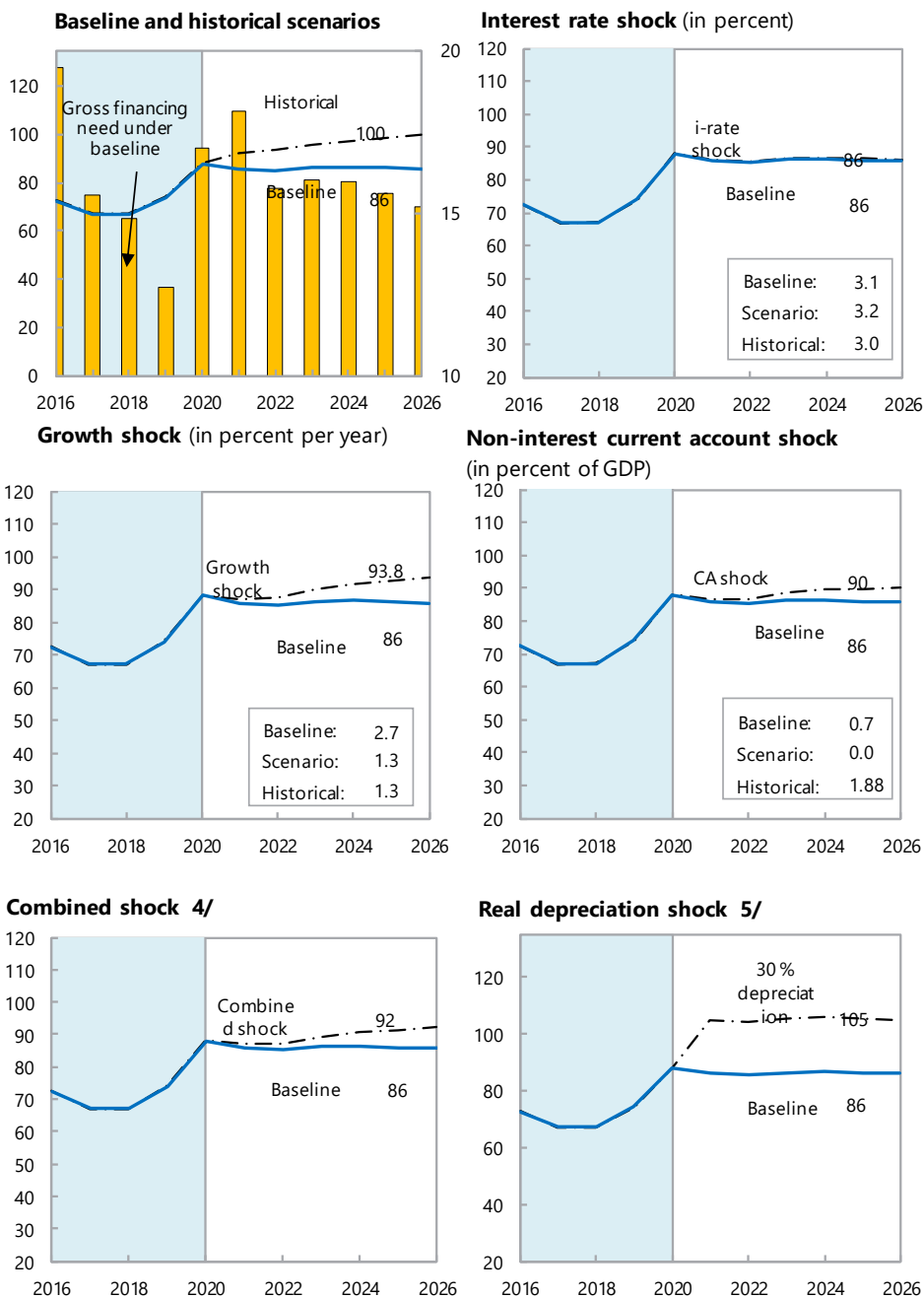
4/ For projection, line includes the impact of price and exchange rate changes.

5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period. Projections assume that 10% of long-term private debt is amortized every year and 10% of total private debt stock is short-term debt.

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

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

Figure 1. Uruguay: External Debt Sustainability: Bound Tests 1/ 2/ 3/
(External debt in percent of GDP)

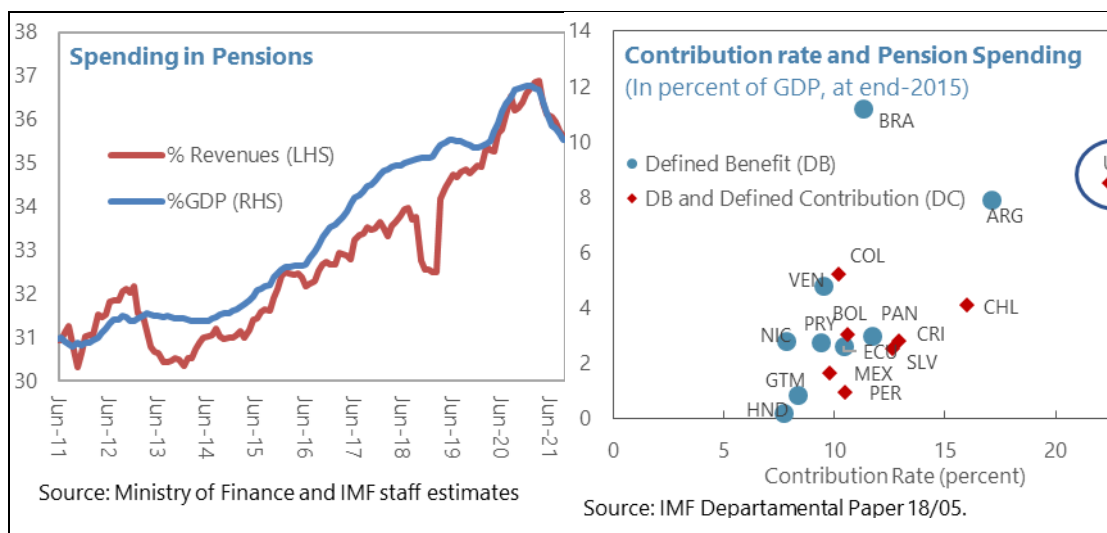


Sources: International Monetary Fund, Country desk data, and staff estimates.
 1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Six-year historical average for the variable is also shown.
 2/ For historical scenarios, the historical averages are calculated over the six-year period, and the information is used to project debt dynamics five years ahead.
 3/ External debt includes non-resident deposits.
 4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
 5/ One-time real depreciation of 30 percent occurs in 2021

Annex VII. Pension Reform in Uruguay

1. Uruguay has an impressive pension system.¹ The system provides ample coverage—to about 90 percent of the elderly and 80 percent of workers—and benefits—with an average replacement rate of about 60 percent. This is reflected in an elderly poverty rate of only about 2 percent, compared to a child poverty rate of 20 percent.

2. However, the system demands increasing fiscal resources and needs to be reformed. Public pension spending has risen rapidly over the last decade reaching 10 percent of GDP or almost 40 percent of fiscal revenues (Box Figure 1). This reflects not only comprehensive coverage and a relatively older population (compared to peer countries) but also the generosity of the system (Box Figure 2), especially reflected in the low retirement age (60 years for both men and women) and a constitutional mandate to index pensions to average wages (thus benefitting retirees from past high real wage increases and economy-wide productivity increases).



3. Currently, workers' contributions only finance about ½ of costs of the social security administration (BPS).² About ¼ of the financing comes from earmarked taxes (7 percentage points of VAT revenues, revenues from lotteries and a special tax to support pensions) and ¼ from direct fiscal support (transfers from general taxation). Further increases in revenues are unlikely given an already elevated tax burden and competing

¹ The pension system is highly fragmented. It includes a universal defined-benefit public pillar (which covers more than 90 percent of contributors and pensioners), a complementary mandatory individual savings accounts pillar (for monthly earnings above US\$1,500 which are managed by pension fund administrators, AFAPs) and a public insurance company (BSE) that provided lifetime annuities. In addition, there are five separate special regimes for banking employees, university professionals, public notaries, the military, and the police, with vastly different rules and benefits.

² About ¾ of these costs correspond to pensions.

spending needs (in health, education, and infrastructure). Population aging³ and technological change—which could shift labor demand towards workers with higher skills—are expected to put further pressure on the system. There is general consensus that a reform is needed to guarantee sustainability and promote both the intra and intergenerational fairness of the system.

4. A Commission of Experts has been appointed to prepare a reform proposal.⁴

The government is committed to presenting a bill to Congress in the coming months based on the recommendations of the Commission. The main recommendations from the draft proposal currently under consideration by the Commission include:

- a. Introducing a base zero pillar, to be financed from general taxation, that guarantees a minimum pension (of about US\$300 per month) and complements the years of contributions up to a maximum pension (of about US\$900 per month).
- b. Maintaining contribution rates as they are considered to be relatively high.⁵
- c. Unifying the criteria across regimes for new workers (although allowing for an earlier retirement age for activities with an elevated physical toll). For existing workers, the benefits would be computed as a weighted average that considers the number of years of contributions under the old and new (unified) regimes.
- d. Increasing the number of years considered in the computation of the reference wage (to the best 25 years, instead of the last ten or the best twenty) to make the pension more actuarially fair.
- e. Lowering accrual rates from 1.5 percent per year to a range between 1.1-1.35 which increases with age.
- f. Gradually raising the retirement age and linking it to life expectancy (thus allowing for more automatic updates going forward), while protecting rights of workers close to retirement age. This means fiscal savings will take considerable time to materialize.
- g. Tightening qualification criteria for disability pensions (which are high in Uruguay) and of the use of witnesses for missing contribution records.

³ The old-age dependency ratio (based on the current retirement age of 60) is expected to increase from below 33 percent in 2015 to 50 percent in 2050.

⁴ A draft proposal was unveiled by 9 of the 15 members of the commission in October but can still be adjusted as it is discussed with the other members of the Commission. Once the proposal is approved by a majority it will then be presented to the government.

⁵ Contribution rates vary across sub-systems and sectors. In the manufacturing and retail sectors, contribution reach 15 percent for workers and 7.5 percent for employers. This is considerably higher than in other countries in the region and the 18 percent average mandatory pension contribution rate across OECD countries.

- h. Creating incentives to foster voluntary savings, such as the possibility of automatically transferring 2 percentage points of VAT for electronic payments.
- i. For the individually-funded pillar, changing the minimum profitability regulation, increasing the number of portfolios and allowable investment options (to raise exposure to variable income and foreign investments, to prevent excessive bunching into government bonds while increasing the risk exposure of young workers to increase average returns during the accumulation phase).

5. Some additional reforms would be desirable. It would be desirable to equalize the contribution rates for all regimes and sectors of the economy. Revisiting the indexation formula to inflation (to preserve the real purchasing power) instead of the average wage (which allows retirees to benefit from economy-wide productivity increases). Finally, AFAPs' fees could be lowered by translating the book-keeping function to the BPS



URUGUAY

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

November 11, 2021

Prepared By

Western Hemisphere Department (in consultation with other departments)

CONTENTS

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FUND RELATIONS

(As of October 21, 2021)

Membership Status: Joined: March 11, 1946; Article VIII

General Resources Account:	SDR Million	%Quota
Quota	429.10	100.00
IMF's Holdings of Currency (Holdings Rate)	316.89	73.85
Reserve Tranche Position	112.21	26.15

SDR Department:	SDR Million	%Allocation
Net cumulative allocation	704.53	100.00
Holdings	632.81	73.14

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jun 08, 2005	Dec 27, 2006	766.25	263.59
Stand-By	Apr 01, 2002	Mar 31, 2005	1,988.50	1,988.50
of which SRF	Jun 25, 2002	Jun 24, 2003	128.70	128.70
Stand-By	May 31, 2000	Mar 31, 2002	150.00	150.00

Overdue Obligations and Projected Payments to Fund¹

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2021	2022	2023	2024	2025
Principal					
Charges/Interest	0.01	0.05	0.05	0.05	0.05
Total		0.05	0.05	0.05	0.05

Implementation of HIPC Initiative: Not Applicable

Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

Implementation of Catastrophe Containment and Relief (CCR): Not Applicable

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

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

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

Exchange Rate Arrangement. The currency is the Uruguayan peso (UY\$). Uruguay's de jure and de facto exchange rate arrangements are classified as floating. In September 2020, the central bank switched to the interest rate as its main policy instrument. Prior to that, and since June 2013, monetary policy targeted the growth rate of M1 plus saving deposits as the intermediate instrument. On October 20, 2021, the exchange rate in the official market was UY\$43.378 per U.S. dollar. Uruguay has accepted the obligations of Article VIII and maintains an exchange rate system free of multiple currency practices and restrictions on payments and transfers for current international transactions.

Article IV Consultation. Uruguay is on the standard 12-month consultation cycle. Discussions for the 2019 Article IV consultation took place during February 20, 2020 (IMF Country Report No. 20/51). Staff discussions for the 2021 Article IV consultation were virtual during September 23–October 5, 2021.

FSAP Participation and ROSCs. A Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). An FSAP Update was conducted in 2012 and the FSSA was published on May 31, 2013 (Country Report No. 13/152). An FSAP Update is planned for 2022. A ROSC module on fiscal transparency was published on March 5, 2001. A ROSC module on data dissemination practices was published on October 18, 2001. A ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 12, 2006 (Country Report No. 06/435). A data module ROSC was published on February 11, 2014 (Country Report No. 14/42).

Technical Assistance 2009–21.

DPT	Purpose	Date of Delivery
FAD	Public Financial Management	November 2018
	Revenue Administration (Follow-up)	November 2017
	Assist with strengthening customs' reform strategy and implementation of the governance framework	November 2015
	Tax Administration, PFM (Follow-up)	October 2015
	Treasury Management	August 2014
	Tax, customs, and social security administration	August 2014, March 2014, November 2012, November 2011, September 2010

	Performance Informed Budgeting	March 2011
	Private public partnership	May 2010
LEG	Structures and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2017
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	November 2016
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2016
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2015
	Structure and tools for strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	March 2015
	Assist the authorities on strengthening the AML/CFT capacity of the Superintendency of Financial Services and the Financial Intelligence Unit	October 2014
	Follow up of the implementation of the AML/CFT National Strategy	October 2013
	Assist the authorities on the launch of the recently designed AML/CFT national strategy	June 2012
	Assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	Conduct a money laundering/terrorist financing country risk assessment consistent with the objectives of the national AML/CFT strategy	January, April, and July 2009
MCM	Central Bank Transparency Review	September 2021
	Sovereign Asset and Liability Management and Development of the Local Currency Government Bond Market	September 2016
	Bank resolution	June 2014
	FSAP update	September 2012

STA	Monetary and Financial Statistics	February 2020
	Trade Margins and Commercialization Channels	September 2016
	Balance of Payments and International Investment Position Statistics.	April and October 2015
	Data ROSC reassessment	August 2012

RELATIONS WITH OTHER INTERNATIONAL INSTITUTIONS

- World Bank: <https://www.worldbank.org/en/country/uruguay>
- Inter-American Development Bank: <https://www.iadb.org/en/countries/uruguay/overview>
- Development Bank of Latin America: <https://www.caf.com/es/paises/uruguay/>

STATISTICAL ISSUES

(As of October 5, 2021)

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provision has some shortcomings but is broadly adequate for surveillance. Most affected area is national accounts.</p>
<p>National accounts: In 2020, the Uruguayan authorities completed a revision of national accounts statistics, in which they updated the benchmark year (from 1997 to 2012), set the reference period for the volume estimates in 2016, and adopted the <i>System of National Accounts (SNA) 2008</i>. However, new national accounts statistics are not as detailed as before, and there are not historical numbers pre-2016 still have some shortcomings: expenditure GDP contains some residual components, fixed ratios are used for various activities, coverage of the enterprise survey is limited, the update of the business register is partial, source data for some components of GDP are of poor quality, and information on the informal economy is inadequate. Under the new methodology, GDP time series on the BCU website are available starting in 2016. Developing a monthly indicator of economic activity would allow more timely surveillance.</p>
<p>Prices: The base period for the consumer price index is December 2010 = 100. The CPI has national coverage, and it does not cover either the implicit rent or the net acquisitions of owner-occupied dwellings. The reselection of the sample of detailed products has not been done for an extended period (the current weights are based on the 2005-06 household income and expenditure survey). Producer price indices (March 2010 = 100) for national products are available, but do not cover utilities, construction, and services, and exported output. The CPI and PPI would benefit from a more regular and frequent schedule of weight updates.</p>
<p>Government finance statistics: Statistics are on a modified cash basis. Official data on the central administration, the state-owned enterprises and the social security system are disseminated regularly and on time. However, above-the-line data (revenue and expenditure) for local governments are not available. Monthly data for financing and quarterly data for debt for the central government and total public sector are disseminated on the BCU website from 1999 onwards, but no information is reported for publication in the <i>International Financial Statistics</i>. Annual information submitted for the <i>Government Finance Statistics Yearbook</i> covers the consolidated central government (budgetary central government plus social security funds) and consolidated general government, but COFOG is not reported, and local governments information belong to financing operations only; thereby, consolidated general government's covers only operations and stocks on financial assets and liabilities.</p>
<p>Monetary and financial statistics: Monetary and financial statistics are prepared in accordance with the IMF's Monetary and Financial Statistics Manual (2000). The authorities report monetary data for the central bank, other depository corporations, and other financial corporations (OFCs) using the standardized reporting forms (SRFs). However, data for the OFCs are limited to off-shore financial institutions. A mission to expand the institutional coverage of</p>

OFCs and compile the SRF for OFCs with full institutional coverage was proposed to the authorities and is expected to take place in 2020.

Financial sector surveillance: The authorities participate in the IMF's Coordinated Direct Investment Survey (CDIS), Coordinated Portfolio Investment Survey (CPIS), and Financial Soundness Indicators (FSIs) databases. However, only annual FSIs data for deposit-takers and other financial corporations are being reported. FSIs on nonfinancial corporations, households, market liquidity, and real estate markets are not available. The BCU disseminates FSIs for individual banks on a monthly basis and generates FSIs for the banking system weighting individual bank FSIs by their asset share. Uruguay reports data on several series indicators of the Financial Access Survey (FAS) including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

External sector statistics: Balance of payments and international investment position statistics are compiled and published on a quarterly basis. Data are compiled following the recommendations of the sixth edition of the *Balance of Payments Manual*. Uruguay disseminates the international reserves and foreign currency liquidity data template, submits quarterly external debt statistics to the World Bank's Quarterly External Debt Statistics (QEDS) database, and participates in the Coordinated Portfolio Investment Survey (CPIS) and the Coordinated Direct Investment Survey (CDIS).

II. Data Standards and Quality

Uruguay subscribed to the SDDS in February 2004 and is in observance.

Data ROSC published on October 1, 2001.

A data reassessment ROSC on CPI, PPI and NA was published in February 2014.

III. Reporting to STA

Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *International Financial Statistics (IFS)*. The authorities do not provide trade price and volume indices for publication in the *IFS*.

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

Uruguay reports to STA balance of payments and IIP data for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*.

Uruguay: Common Indicators Required For Surveillance

(As of October 5, 2021)

	Date of latest observation	Date received	Frequency of Data 7/	Frequency of Reporting 7/	Frequency of Publication 7/	Memo items:	
						Data Quality – Methodological Soundness 8/	Data Quality – Accuracy and Reliability 9/
Exchange Rates	10/04/21	10/04/21	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities 1/	10/04/21	10/05/21	D	D	D		
Reserve/Base Money	08/21	10/05/21	M	M	M		
Broad Money	08/21	10/05/21	M	M	M		
Central Bank Balance Sheet	08/21	10/05/21	M	M	M		
Consolidated Balance Sheet of the Banking System	08/21	10/05/21	M	M	M		
Interest Rates 2/	10/04/21	10/04/21	D	D	D		
Consumer Price Index	09/21	10/05/21	M	M	M	O, LO, O, O	LO, O, O, LNO,
Revenue, Expenditure, Balance and Composition of Financing 3/– Central Government 4/	08/21	09/30/21	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt 4/ 5/	Q2/21	09/30/21	Q	Q	Q		
External Current Account Balance	Q2/21	10/04/21	Q	Q	Q		
Exports and Imports of Goods and Services	07/21	09/23/21	M	M	M		
GDP/GNP	Q2/21	09/23/21	Q	Q	Q	LO, LO, LO, LO	LNO, LNO, LO,
Gross External Debt	Q2/21	09/30/21	Q	Q	Q		
International Investment Position 6/	Q2/21	10/04/21	Q	Q	Q		

1/ Includes reserve assets pledged or otherwise encumbered as well net derivative positions.

2/ Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

3/ Foreign, domestic bank, and domestic nonbank financing.

4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

5/ Including currency and maturity composition.

6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

7/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

8/ This reflects the reassessment provided in the data ROSC (published in February 2014 and based on the findings of the mission that took place during August 20–31, 2012) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) (i) concepts and definitions, (ii) scope, (iii) classification/sectorization, and (iv) basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

9/ Same as footnote 9, except referring to international standards concerning (respectively) (i) source data, (ii) assessment of source data, (iii) statistical techniques, (iv) assessment and validation of intermediate data and statistical outputs, and (v) revision studies.

**Statement by Mr. Chodos, Executive Director, and Ms. Bustillo, Advisor, on Uruguay
November 29, 2021**

On behalf of the Uruguayan authorities, we would like to thank the Mission team for the open and constructive dialogue during the Article IV Consultation. The authorities highly value staff's analytical work and relevant contributions to policy discussions.

During most of 2020, Uruguay successfully contained the virus spread without imposing a mandatory lockdown. The new government that came into office only two weeks before the COVID-19 outbreak in March of last year appealed to the citizens' "freedom with responsibility".

Yet the country faced its first wave of coronavirus cases and a surge in fatalities in the first half of 2021. The government responded by launching a massive vaccination campaign, securing enough vaccines for the whole population and deploying an efficient rollout throughout the country. As of November 16, 2021, Uruguay is one of the countries with the highest percentage of people vaccinated against COVID-19 in the world: 78 percent of the total population has received at least one dose, and more than 74 percent of the population has received two doses. In August 2021, the government started providing a third booster shot, which has been taken up by 36 percent of the total population. As a result of the steadfast vaccination program and the effectiveness of the vaccines, the spread of the virus has significantly abated, which has allowed a faster normalization of business activity and community mobility. In November, the country reopened its borders to fully immunized non-residents.

Economic policymaking requires careful judgment and a recognition of tradeoffs within budget constraints, particularly in the current uncertain environment. During the pandemic, the government secured the necessary public savings to provide well-targeted support to firms, employment, and the most vulnerable while prudently balancing fiscal sustainability objectives. At the same time and despite the COVID-19 outbreak, the government moved forward with an ambitious agenda of fiscal, monetary, and structural reforms, managing the crisis with a long-term view to place the economy on a higher growth trajectory.

Uruguay's economy is recovering from the COVID-19 shock

After contracting by 5.9 percent in 2020, Uruguay's economy is showing clear signs of recovery with real GDP projected to grow by 3.5 percent in 2021, broadly in line with staff estimates. This growth has been led by exports, private consumption, and investment. Leading indicators for the third quarter are encouraging, reflecting continued growth in economic activity across sectors. The opening of borders bodes well for tourism inflows and is expected to reinforce the recovery in the last quarter of this year.

The economic recovery has been accompanied by the strengthening of the labor market. In the last five months, total beneficiaries of the unemployment insurance have declined by 36 percent. Three out of four jobs lost in 2020 during the pandemic are expected to be recovered by year-end.

2021. Unemployment insurance and measures introduced by the authorities in support of workers during the pandemic have cushioned the loss of employment. Moreover, the partial modality of unemployment insurance has enabled workers to return to their jobs once activity picks up.

Notwithstanding the success of the vaccination campaign and the strengthening of the economic recovery, Uruguay is a small, highly open economy and is exposed to downside external risks, including weaker commodity prices and a tightening of global financial conditions. The authorities are prepared to bolster the economy with additional support as needed. They broadly concur with staff that sustaining growth in the medium term requires actions on various fronts. The previously noted reform agenda strengthens fiscal and monetary frameworks, critical to macroeconomic stability, and focuses efforts to enhance inclusive and sustainable growth.

Fiscal policy and debt management

Since the onset of the pandemic, the authorities have taken effective and timely measures to protect household income and human capital, including through social transfers, enhanced unemployment and health insurance, tax credits, and regulatory forbearance. They also took measures for credit preservation and loan guarantees for micro, small and medium-sized enterprises. These measures have been adjusted to meet the unfolding demands of the most vulnerable population and firms. The authorities are pleased that staff recognizes that country-specific circumstances are critical to the appropriateness of fiscal responses across countries. As well noted in the report, Uruguay's strong social protection and health coverage were instrumental in calibrating the appropriate level of fiscal response to the pandemic.

The authorities have a firm commitment to high standards of transparency and accountability, including managing resources and expenditures tied to the COVID-19 response. To this end, the COVID-19 Solidarity Fund (Coronavirus Fund) was created by law in April 2020 with the support of all political parties, making it possible to clearly distinguish and report between non-pandemic and pandemic-related budgetary expenditures, with strict requirements for earmarking and timely disclosure of information. Budgetary resources amounted to 1.4 percent of GDP in 2020 and 1.7 percent of GDP in 2021. In addition, credit guarantees amounted to 1.3 percent of GDP in 2020 and are estimated at 0.3 percent of GDP in 2021.

At the same time, the authorities took decisive actions to strengthen public finances that had been steadily deteriorating in the years prior to the pandemic. The 5-year Budget Law 2020-2024 approved by Congress in December 2020 laid the foundation for changes in fiscal policy decision-making and execution. The new fiscal rule is based on structural balance targets, to account for business cycle fluctuations and one-off/temporary spending and revenue items, together with a cap on real growth in primary expenditures in line with potential real economic growth. The framework also establishes a limit to the central government net indebtedness, which effectively caps the observed fiscal deficit. During 2020, the government met all three pillars of the new fiscal rule, restoring fiscal credibility amid the global pandemic.

While the response to the pandemic widened the fiscal deficit, the reduction of inefficient public spending unrelated to the COVID-19 pandemic, restrictions on public sector hiring, and spending oversight contained the fiscal deterioration, which was one of the smallest in Latin America,

helping to stabilize the debt burden over GDP in 2021, in a context of declining debt service costs. In addition, fiscal estimates in the annual budget law have started to be made over a rolling five-year period, beyond the current administration. Also, public debt sensitivity analysis is now included in the budget analysis. All in all, important first steps were taken in a cautious and deliberate way.

More generally, the government believes that the road to improving fiscal accounts is through greater efficiency in structural spending, and not by increasing taxes on the private sector. Quite to the contrary, the government has provided broad tax incentives for construction projects and other economic activities under the General Investment Promotion Regime (COMAP), underpinning investment and formal employment generation.

Going forward, the authorities remain committed to fiscal prudence grounded on the rules-based fiscal framework and have made progress in setting up the external fiscal councils. The Fiscal Advisory Council held its first meeting on September 29, 2021, and its central mandate is assessing the Ministry of Finance's structural fiscal estimates and overall implementation of the fiscal rule. The Committee of Experts, on the other hand, is in its final stage of formation and will be tasked with providing the macroeconomic assumptions to the Ministry of Finance to calculate potential GDP growth.

The authorities have pursued a proactive financing strategy that has included disbursement of credit lines from multilateral institutions, as well as bond issuance in both international and domestic markets, mostly in local currency. Despite the increasing debt burden, the country kept its investment grade status across all credit rating agencies and favorable access to international capital markets even in the worst stage of the COVID-19 crisis. More recently, in May 2021, Uruguay made another successful debt issuance equivalent to US\$1.7 billion, of which almost US\$1.2 billion correspond to a new global bond denominated in fixed-rate nominal pesos.

Monetary policy

To respond to the current Covid-19 health emergency, monetary policy pivoted into an accommodative stance. The Central Bank of Uruguay (BCU) lowered interest rates and deployed countercyclical monetary policy tools, including decreasing reserve requirements conditional on credit expansion, authorizing financial institutions to provide automatic maturity extension, and loan payments deferral, as well as other measures to inject liquidity in the financial system.

As the pandemic has started to ease and economic activity picks up, the BCU has gradually started exiting the expansionary phase of monetary policy to anchor medium term inflation expectations. The monetary policy rate has been raised by 125 basis points to 5.75 percent since August 2021. As long as there are no setbacks in the evolution of the pandemic and economic recovery, this gradual process of monetary tightening is expected to continue.

The BCU is committed to addressing Uruguay's long periods of above-target inflation and rebuilding central bank credibility. To this end, the authorities have introduced changes to the institutional design and practice of monetary policy. An enhanced monetary policy framework reaffirms price stability as the primary mandate, notwithstanding support to be provided in economic emergencies. The BCU changed its main policy instrument away from targeting

money supply growth to the short-term interest rate, allowing for fine-tuning of monetary policy at higher frequency. The inflation target range will be reduced from 3-7 percent to 3-6 percent starting in September 2022 to provide forward guidance. The authorities have also introduced new practices in communication and transparency, including doubling the frequency of monetary policy meetings, issuing the minutes of monetary policy with forward looking statements, publishing official inflation projections and surveys of firms' inflation expectations, and improving communications with forecasters and the press. The BCU concurs with staff that a well communicated strategy is essential to continue guiding expectations. In May 2021, the BCU requested the Fund to assess its monetary policy communication to complement the work already undertaken.

Moreover, the BCU has made explicit the objective of de-dollarizing the economy and rebuilding the Uruguayan peso currency markets, aiming to enhance monetary policy transmission. Monetary authorities understand that financial de-dollarization is a long-term process, which can be slow and halting, and involves changes not only in regulations, but also in borrowing, saving, and cultural practices in the private sector. For these reasons, the BCU has launched a wide dialogue with all interested parts in the financial system, public institutions, and businesses and consumer groups.

The authorities concur with staff's assessment that gains in credibility from the reforms are apparent. Inflation had been declining since it peaked in mid-2020—although it has temporarily increased to 7.89 percent year-on-year in October 2021 (above the upper ceiling of the target range), mainly driven by new underlying pressures from commodity and other tradable prices. The convergence of inflation expectations to the inflation target has thus slowed down and remains slightly out of range. As long as there are no setbacks in the health situation, the priority of monetary policy will be to drive inflation and inflation expectations to the center of the target range in the monetary policy horizon.

The BCU remains committed to preserving exchange rate flexibility while avoiding undue and non-fundamental market volatility. With Uruguay being a small, open, and dollarized economy, the central bank intervenes in the foreign exchange market to prevent disorderly market conditions. International reserves, which are well above the upper bound of the IMF reserve adequacy benchmark, remain an important backstop for external stability and a key policy anchor. At the end of September 2021, international reserves amounted to 30 percent of GDP.

Financial sector

The financial sector is resilient due to prudent supervision and regulation measures in place. As of the end of June 2021, the capital structure of financial institutions almost doubled the minimum regulatory requirement. Regarding liquidity risk of the banking system, the ratio of liquid assets to total assets remained at a healthy 60 percent. The profitability of banks represented a return on assets of 1.6 percent and a return on equity of 15.1 percent in the second quarter of 2021. The general delinquency of credit dropped to 2.4 percent from 2.7 percent in March 2021, which also represents a reduction from 3.1 percent from a year ago. Stress tests of the banking system showed that it would withstand a severe recession scenario. Going forward, the authorities are working on deepening capital markets based on international best practices.

On February 2021, the authorities requested an FSAP assessment and look forward to its policy recommendations.

Reform agenda

As noted by staff in the Selected Issues Paper Chapter on Uruguay's Potential Growth, tackling structural impediments to growth requires action on several fronts. Over the last year and a half, the authorities made progress in passing legislation and advancing measures laying the foundations of a structural reform agenda, including a new fiscal framework to strengthen fiscal discipline, reforming the pension system, introducing a new governance to increase the efficiency of state-owned enterprises (a significant part of the Uruguayan economy), developing capital markets development, and promoting trade openness and integration.

The authorities' priorities include the improvement of the business environment, the generation of jobs, and the promotion of human capital. An additional priority is to increase investments in education, health care, and housing to reduce the poverty rate of children aged three and under, which remains considerably higher than in the rest of the population and has worsened during the pandemic. Incentives and subsidies have been made available to facilitate the entry or reintegration to the labor market of young people aged 15 and 29 years of age, workers over 45 years of age, people with disabilities, and women. Efforts to increase the rates of permanence and graduation in basic and higher secondary education and improve the quality of the curricula are underway with support from multilateral institutions, as well as an early childhood action plan to improve early childhood care.

The pension reform is advancing and is critical to fiscal sustainability in the longer run. The Committee of Experts on Social Security (CESS) tasked with preparing a diagnosis and reform proposals concluded its work in November 2021, after ample consultation with stakeholders and civil society. The next reform steps are the drafting of a bill by the Executive Power and its subsequent debate and parliamentary process.

Addressing climate change and climate finance

Uruguay remains at the forefront of environmentally friendly policies and is a sustainable-focused country. Over the past decade, it has transformed its energy matrix by increasing and diversifying its renewable sources of electricity generation. Uruguay is one of the leading countries in the world in terms of clean energy and wind energy production with 94 percent of its electricity production generated using renewables sources.

As we move from pandemic response to recovery, the authorities are committed to a growth path consistent with low greenhouse gas emissions and a climate-resilience economy. For this purpose, the Helsinki Principles were explicitly incorporated in the 2020-2024 Budget Law, putting climate change mitigation and adaptation objectives at the center of the planning and design of economic policies and fiscal management.

The authorities are launching the second generation of renewable energy transformation and decarbonization of heavy transportation and industry through a national strategy for green hydrogen and promotion of electric mobility, in line with an aspirational goal of becoming net CO₂- zero by 2050. As a testament to these efforts, Uruguay ranks first among emerging market

countries in MIT's Green Future Index, which tallies countries' progress and commitment toward building a low carbon future.

In addition, the authorities are connecting the objectives of sovereign debt funding with the imperative of tackling climate change. The Ministry of Finance, in coordination with the Ministries of Environment, Industry and Energy and Agriculture and Livestock, is working on a novel Sustainability-Linked Sovereign Bond that explicitly embeds Uruguay's forward-looking environmental targets, as set out in its Nationally Determined Contributions (NDCs) under the Paris Agreement. The authorities consider that the cost of borrowing should be increasingly linked to environmental performance and linked to countries' contribution to global public goods.

Final remarks

Amid the challenges posed by the global pandemic, the authorities have advanced reforms to build a credible macroeconomic policy framework and a structural reform agenda to achieve higher and inclusive growth. Uruguay remains a bastion of democracy, solid institutions, freedom, judicial independence and political stability. Going forward, these attributes remain an important source of strength in an uncertain global landscape.