INTERNATIONAL MONETARY FUND

IMF Country Report No. 13/108

URUGUAY

2012 ARTICLE IV CONSULTATION

April 2013

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 2012 Article IV Consultation with Uruguay, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV Consultation, prepared by a staff team of the IMF, following discussions that ended on November 2, 2012, 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 20, 2012. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- **Staff Supplement** of November 20, 2012, updating information on recent developments.
- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its December 10, 2012 discussion of the staff report that concluded the Article IV Consultation.

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

Selected Issues Paper

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

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INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

November 20, 2012

Context: After a decade of strong and inclusive growth, supported by prudent policies and a positive external environment, the economy is slowing toward potential. However, inflation is well above target and rising, and external risks cloud the outlook.

Focus: Discussions focused on how best to tackle inflation while managing external head winds and tail winds and related spillover risks, and, for the medium term, how to enhance resilience to shocks and boost long-term growth.

Near-term policy mix: *Baseline:* Bringing actual and expected inflation toward target will require action on several fronts. Further monetary tightening will be needed but the pace should depend on the evolution of the economy and risks. Moderate wage growth will be essential, including in the 2013 wage negotiation round. On the fiscal side, there is scope for firmer spending restraint to support monetary policy and secure the target to reduce public debt to about 45 percent of GDP by 2015. Continued exchange rate flexibility is also important. *In a downturn:* International reserves can be used to contain overshooting. Monetary policy easing could proceed so long as inflation expectations have become reasonably anchored. Fiscal automatic stabilizers should be allowed to operate though in a lasting downturn fiscal space would be limited by the need to preserve prudent debt dynamics. The government has built substantial liquidity buffers that can be used in a "sudden stop."

Medium term: Prospects for strong and stable growth would be bolstered by further improvements to the macroeconomic policy framework, financial deepening (drawing on the accompanying FSAP Update), and other productivity-enhancing reforms.

Past advice: There is a long-shared view on broad macroeconomic policy priorities. In recent consultations the Fund has placed greater emphasis on reducing inflation to the target range to help de-dollarization and open up space for monetary policy easing during downturns. The Fund has also called for restraint on current public expenditures, in part to help monetary policy.

Approved By
Vivek Arora and Charles Kramer

A team comprising U. Erickson von Allmen (Head), O. Celasun (incoming Mission Chief), C. Tovar, and C. Perez (all WHD) visited Montevideo during October 22–November 2. S. Maziad (MCM), N. Melgar (IMF office in Uruguay), and F. Arizala and X. Jordan (both WHD) supported the mission.

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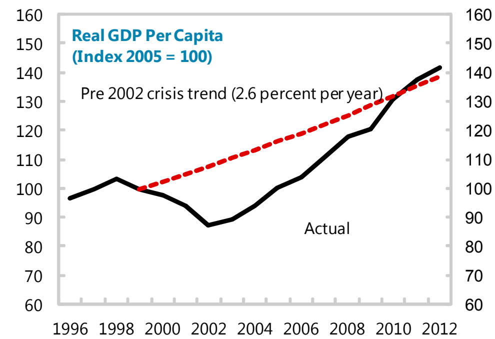
THE SETTING

1. Uruguay has put in a spectacular recovery since its financial crisis in 2002. With the strongest decade-long growth spell on record, Uruguay's per capita income has more than doubled from pre-2002 levels in purchasing power terms, employment is at historic highs, and social indicators have improved (Figure 1). In 2012, Uruguay regained investment-grade rating. This recovery, set in motion by a large exchange rate and real wage adjustment, has been supported by important policy reforms, prudent macroeconomic policies, and active social policies (Box 1). It has also been achieved in a largely supportive international environment.



Sources: World Economic Outlook and Fund staff estimates.

2. The near-term outlook is positive, but with risks and policy challenges. Uruguay has extensive trade, investment, and financial links to the region and the rest of the world (Annex I). It is now buffeted by conflicting global and regional influences: terms of trade and global financing conditions remain favorable, but demand is sagging in Europe and in the key partner, Argentina (whose restrictive trade and foreign currency policies are also taking a toll on Uruguay). Risks are two sided and relate to further spillovers from abroad and to domestic wage and cost developments. Meanwhile, monetary policy is grappling with difficult trade-offs: despite slowing growth and a closing output gap, inflation is stuck above target and rising, and inflation expectations remain stubbornly above the inflation target. Moreover, swelling capital inflows and appreciation against Brazil and Argentina have caused concern about peso strength.

3. Medium-term challenges include bolstering the economy's resilience to shocks and fostering productivity growth. In addition to continued prudent macroeconomic policies, it will be important to shore up key infrastructure (e.g., energy, roads, ports), promote a dynamic and deeper (but stable) financial system, enhance the policy framework, and ensure a competitive business environment.

4. The political cycle should be propitious for continued sound policies and progress with reforms. Presidential elections are not until late 2014. At the same time, divergences of views on economic policy within the broad Frente Amplio government coalition (consisting of 21 groups) are injecting some elements of unpredictability into policy making.

THE CURRENT STATE: SPILLOVERS IN ACTION

5. Output is slowing toward potential. Staff projects growth at 3½ percent in 2012, down from 5.7 percent in 2011 and 8.9 percent in 2010. On this basis, the output gap will close in 2012.

6. While domestic demand remains buoyant, negative spillovers and idiosyncratic factors have caused a somewhat sharper-than-expected slowdown.

- *Domestic demand*. After slowing in 2011, domestic demand showed new vim in the first half of 2012. Construction of a large pulp mill boosted investment, while strong real wage growth fueled consumption. More recently, though, consumer confidence indicators (and the increase in reserve requirements) point to moderation ahead (Figure 2).
- *Spillovers*. Exports remain firm in dollar terms thanks in part to still-rising export prices and strong demand in Asia. However, export volumes to the EU and Argentina fell by 22 percent and 12 percent, respectively, during January-August 2012 from the same period in 2011, while export volumes to Brazil were flat.
- *Idiosyncratic factors*. 2012 growth is affected by the carry-over from the shutdown of the state-oil refinery (ANCAP) in late 2011, and by the drought that forced the state electricity company, UTE, in early 2012 to rely more on petroleum power with lower value-added than hydropower. These events cut about half a percentage point from growth in 2012.

GDP Growth and Contributions, 2010–11 Q1

	2010				2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Real GDP, quarter on quarter (S.A.)	2.3	2.3	0.4	2.0	1.8	0.9	2.7	-1.8	2.2	0.8
	(Contributions to GDP growth)									
Real GDP, year-on-year	9.7	11.1	8.2	6.9	6.7	5.1	7.7	3.5	4.2	3.8
Consumption	8.4	9.9	10.4	10.2	7.8	7.4	6.2	4.5	5.4	5.0
Private consumption	8.2	9.9	10.4	10.0	7.5	7.1	5.8	4.2	4.7	4.7
Public consumption	0.2	0.0	0.0	0.1	0.2	0.3	0.3	0.3	0.6	0.3
Gross investment	3.1	0.3	-1.6	5.8	2.5	3.1	3.4	-2.9	1.0	3.4
Private investment	1.9	3.0	0.4	4.5	1.6	1.2	2.3	0.1	1.9	3.5
Public investment	-0.6	-0.4	-1.3	1.2	0.5	-0.5	-0.3	-0.4	-0.7	-0.3
Changes in inventories	1.8	-2.3	-0.7	0.2	0.5	2.4	1.3	-2.6	-0.2	0.2
Exports	0.3	5.6	2.2	-0.1	3.8	-0.7	2.2	1.8	1.4	0.0
Imports	-2.2	-4.6	-2.5	-9.2	-7.5	-4.8	-4.1	0.2	-3.6	-4.9

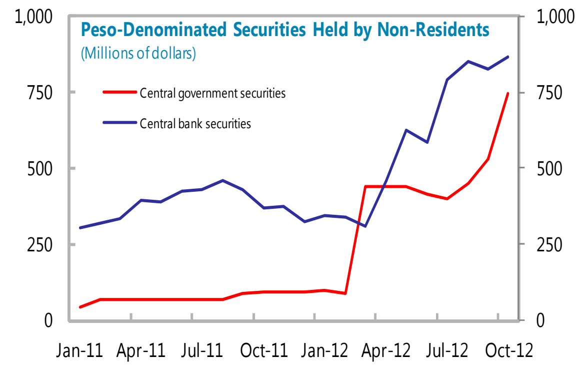
Sources: Banco Central del Uruguay, and Fund staff calculations.

7. Inflation is well above the target despite monetary tightening. From September 2010 through end-2011, the Banco Central del Uruguay (BCU) increased its policy rate by a cumulative 250 basis points, raised average reserve requirements, and introduced marginal reserve requirements.[1] The BCU left the rate on pause for most of 2012, partly on growing capital inflows

[1] In May 2011, the BCU raised average reserve requirements on local and foreign currency deposits (levels vary with maturity) and introduced marginal requirements (15 percent for local currency deposits and 27 percent for foreign currency deposits). Marginal requirements were raised, effective August 1, 2012, to 20 and 40 percent, respectively.

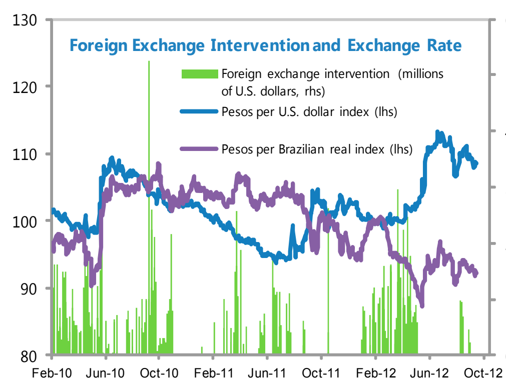
and currency appreciation concerns; in September it notched up the rate by another 25 basis points to 9 percent as inflation pressures mounted. But the monetary tightening has not succeeded in bringing actual and expected inflation toward the target (Box 2 and Figure 3). Indeed, inflation has jumped in recent months and reached 9.1 percent in October 2012 (y/y), pushing further above the 4–6 percent target range. Although the latest jump is due to food prices and energy-related price adjustments, inflation is broad based (staff's estimate of core inflation was 8.8 percent in October) and reflects brisk domestic demand, a tight labor market, extensive wage indexation, a monetary stance that is not sufficiently tight, and a target that is not anchoring expectations within the range.

8. Starting in March 2012, a spike in portfolio inflows has sharpened monetary policy trade-offs. In the context of ample global liquidity, a favorable outlook for Uruguay—epitomized by the upgrade to investment grade—and rate cuts in Brazil, Uruguay saw a sharp spike in capital flows into central bank and government papers (the only liquid capital market instruments in Uruguay). To manage surging capital inflows, appreciation pressures, and inflation the authorities have responded as follows:



Source: Banco Central del Uruguay.

- *Monetary/exchange rate policy*. The authorities have continued to allow the peso to fluctuate, albeit with episodic intervention to lean against rapid appreciation. With the sharp depreciation of the Brazilian *real* in the spring of 2012, the authorities became wary about the strength of the peso. But with inflation (and expectations) above target, the BCU was in a bind. The BCU left the policy rate on hold in its March and July 2012 monetary policy meetings—despite high inflation readings—and instead it intensified intervention. In recent months intervention has been modest and infrequent, and the peso has strengthened again against the dollar.



Sources: Banco Central del Uruguay and Fund staff calculations.
Note: Central bank foreign exchange operations with the banking system.
Exchange rate indexes equal 100 in January 2010.

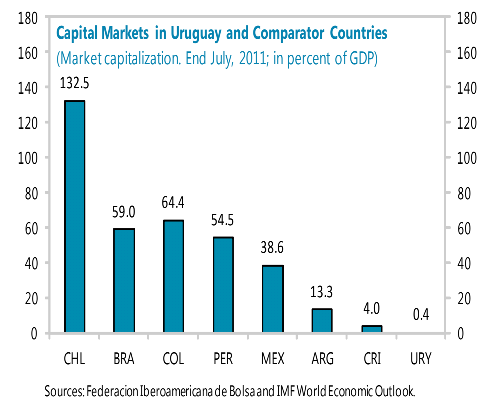
- *Debt management*. Through continued deft debt management, the government has taken advantage of rising appetite for Uruguayan paper to build substantial liquidity buffers and improve the debt structure further (Box 3).

- *Capital flow measure*. Inflows were particularly pronounced into central bank paper (*letras de regulación monetaria*). To discourage such inflows, in October, the BCU imposed a 40 percent reserve requirement on new foreign purchases of this paper.

- *Price agreement*: As food prices shot up in September, the government announced (in October) an agreement with key supermarket chains to cut prices on 200 basic consumer goods by 10 percent and to keep all other prices (with a few exceptions) frozen until end-2012. The impact on inflation is estimated at about 1 percentage point.

9. The fiscal deficit has widened significantly in 2012, mostly due to temporary factors. The overall fiscal deficit is projected to widen to 2.3 percent of GDP in 2012, from 0.9 percent in 2011. According to the authorities, about 1.2 percentage points come from the drought-induced cost overruns in UTE and a one-off payment to foreign institutions.[2] These outlays do not imply fiscal impulse, but the recurring drought-related deficits in UTE pose fiscal risks that need to be tackled. At the same time, revenues have been robust (including through further reductions in tax evasion), allowing a strong expansion in primary spending, which rose by about 10 percent in real terms in the first nine months of 2012 over the same period in 2011.

10. Though more mixed than a year ago, Uruguay's external stability risks remain contained. Although the currency has strengthened against those of Argentina and Brazil, causing competitiveness concerns in some sectors, staff does not see a generalized competitiveness problem, and balance of payments risks appear contained (Box 4 and Figure 4). That said, a further significant and sustained real appreciation is possible if strong capital inflows continue, and could tilt the balance of this assessment.



11. And macro-financial stability risks are modest. Several factors underpin this assessment (Figure 5)***:***

- *Muted real-financial links*. Potential real-financial spillovers are checked by the undersized financial system: private sector bank credit equals only 22 percent of GDP and stock market capitalization is less than ½ percent of GDP.

- *A sound but dollarized banking system.* Banks are very liquid, funded by retail deposits, and carry low non-performing loans. The FSAP Update's stress tests show adequate capital to handle a range of shocks, though capital ratios of a few private banks would fall moderately below the 8 percent regulatory floor in an adverse scenario.[3] Deposit and credit dollarization are on a long-term downward trend, but remain high at 71 and 56 percent, respectively. One vulnerability is the share (34 percent) of foreign currency loans to borrowers without a natural foreign exchange hedge (largely in the

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[2] The payment to three foreign financial institutions (recorded as a transfer) relates to the liquidation of Banco Comercial in 2002.

[3] The adverse scenario entails a 3.6 percent fall in real GDP, 20 percent currency depreciation, 9.4 percent inflation, and increments of 200 and 60 basis points in country risk and international interest rates, respectively. The stress tests capture the effects from banks' foreign exchange lending to unhedged borrowers. The capital shortfall seems manageable (capital ratios would not fall below 6.5 percent). As of January 2013, the BCU is requiring a capital surcharge for operational and systemic risks.

construction and service sectors). On the other hand, Argentinean deposits in Uruguayan banks—a key factor in the 2002 crisis—are not as important today: they have fallen from $8.5 billion (43 percent of GDP) in 2001 to $3.9 billion (8.3 percent of GDP) in mid-2012, and are more than covered by banks' foreign assets.

- *No apparent bubbles*. Capital inflows have not fueled a credit expansion. Last year's consumer credit boom has lost steam after BCU tightened policies and as the riskier outlook dented demand. As for real estate, anecdotal evidence suggests Uruguay is expensive compared with other countries in upper market segments, but available data (limited to Montevideo) do not suggest broader price bubbles (Figure 6). While it is unclear if (and by how much) prices might be misaligned in Uruguay as a whole, a sharp price correction would crimp domestic demand and hurt construction activity, but would not trigger major ripple effects in the banking system, as most real estate is cash or FDI financed.

Selected Financial Soundness Indicators

	2007	2008	2009	2010	2011	2012 1/	LA5 1/ 2/
Regulatory capital in percent of risk-weighted assets	17.8	16.7	16.8	15.2	14.3	15.0	15.7
Non-performing loans in percent of total loans	1.1	1.0	1.2	1.0	1.3	1.4	2.5
Non-performing loans in percent of total household loans	3.4	3.3	3.4	3.1	3.0	3.5	n.a
Specific loan-loss provisions in percent of non-performing loans	55.1	63.1	72.8	72.2	74.0	70.4	155.0
Operating costs in percent of gross income	n.a	80.5	97.9	87.3	79.8	66.5	n.a
Return on assets 3/	1.8	1.6	0.5	1.2	1.2	2.1	1.6
Return on equity 4/	18.0	16.3	5.5	12.1	12.6	24.4	20.8
Liquidity ratio (maturities up to 30 days) 5/	53.9	66.0	64.4	56.9	54.1	52.1	30.6
Dollar loans in percent of total loans	56.7	54.3	52.2	52.0	53.9	55.7	18.4
Dollar deposits in percent of total deposits	74.1	76.5	71.7	69.6	68.0	70.9	22.2
Private sector credit in percent of GDP	24.1	22.4	23.9	23.4	20.5	22.0	31.8
Household consumer credit in percent of GDP	3.9	4.0	4.0	5.1	5.9	5.7	n.a
Implicit exchange rate risk 6/	35.2	36.2	31.6	31.4	31.4	34.0	n.a

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

Data excludes Banco Hipotecario del Uruguay.

1/ Latest available data.

2/ Median of Brazil, Chile, Colombia, Mexico, and Peru. The official definition of soundness indicators varies by country.

3/ Annualized net income before extraordinary items and taxes from the beginning of the year until the reporting month, in percent of average value of total assets over the same period.

4/ Same as footnote 3 but in percent of average value of capital over the same period.

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

6/ Share of foreign currency credit to unhedged borrowers.

OUTLOOK AND RISKS

12. The baseline near-term outlook remains favorable with output projected at potential. In staff's baseline scenario, which is similar to that of the authorities, growth stabilizes around potential (4 percent a year). Large investments, in particular in the energy and pulp sectors, will boost growth while private consumption is projected to moderate somewhat. The negative contribution from net exports is expected to shrink as consumer imports slow and exports benefit from projected gradual recoveries in Argentina and Brazil and world growth more broadly.

13. But the baseline is clouded by risks from the twisting global and regional outlook and from domestic inflation and cost developments. Annex I looks at spillovers more closely.

- *Risks from the region.* Brazil and (especially) Argentina affect Uruguay—directly and as transmitters of global shocks—via trade, tourism, investment, and (to a lesser extent) financial links. At this time, the main regional risk stems from further spillovers from Argentina on exports, the upcoming tourism season, and on FDI into real estate.

Uruguay's External Linkages, 2011

(In percent of total)

	Exports	Tourism	FDI 1/
Argentina	7.4	56.8	25.7
Brazil 2/	20.5	20.5	4.7
China	6.6	n.a.	n.a
European Union	14.5	8.0	8.5
United States	3.1	6.6	-1.6
Other	47.8	8.1	62.7
Total (millions of U.S. dollars)	7,914	2,187	2,289
In percent of GDP	20.1	5.5	5.8

Source: Banco Central del Uruguay.

1/ Data for 2010.

2/ Tourism data includes Paraguay and Chile.

- *Strong intensification of the crisis or growth stagnation in euro zone*. A worsening growth outlook in Europe would hurt Uruguay's exports, including via indirect effects on terms of trade and regional partners, and possibly also FDI. The key financial link is the large presence of Spanish banks Santander and BBVA (the second and third largest banks in Uruguay by assets). But like other subsidiaries, they are well-capitalized, liquid, and rely on a large domestic deposit base for funding.

- *Sharp fall in main export prices*. A fall in the prices of non-oil commodities—say, triggered by a larger-than-envisaged slowdown in China—would significantly affect Uruguay's exports (roughly two-thirds of exports are commodity related) and growth directly, and via knock-on effects from Argentina and Brazil (which are exposed to similar terms-of-trade shocks).

- *Excessive wage growth*. Excessive growth in wages in the coming years would boost private consumption, fuel inflation, and cause further real appreciation. The ensuing loss of competitiveness would hurt exports and growth prospects, raising the risk of a hard landing.

Risk Assessment Matrix [1/]

	Upside/ downside	Risk	Impact
Region: Sharply weaker growth and/or negative policy spillovers.	↓	L	M
Euro zone: (i) Strong intensification of the crisis and (ii) stagnation of economic growth.	↓	M/H	M
Terms of trade: A sharp fall in non-oil commodity prices.	↓	M	H
Domestic: Excessive real wage growth in 2013-14 and strong capital inflows cause undue real appreciation.	↑↓	M	M

1/ The risk assessment matrix shows events that could materially alter the baseline path discussed in this report (which is the most likely to materialize in the view of the staff). The matrix reflects staff's subjective assessment of the sources of risks around this baseline, their relative likelihood, and overall level of concerns as of the time of the discussions with the authorities.

14. Uruguay is in a reasonably good position to cope with negative spillovers; however, policy space is limited.

- *Modest amplifiers.* The banking system's foreign exchange exposure to un-hedged borrowers could amplify shocks. But other financial risks are small, external imbalances are modest, and the exchange rate is floating and does not appear overvalued.
- *Large liquidity buffers.* BCU's international reserves stand at $12½ billion (27 percent of 2011 GDP) and include the counterpart to a $2½ billion liquidity buffer the government has built. In addition, the government has access to contingent credit lines worth $1.4 billion with international and regional organizations, while banks have a net foreign asset position of $4.8 billion.[4]
- *But limited policy space.* The high inflation limits the scope for monetary easing in a downturn. On the fiscal side, there is some more room for maneuver, though gross debt dynamics remain sensitive to growth and exchange rate shocks (see Annex II). The net debt position is less sensitive because of dollar assets.

Uruguay: Contingent Credit Lines

Institution	Amount (US$ mn)	Length (months)	Conditionality
World Bank	520	36	None
CAF	400	12	None
FLAR	470	6	None
Total	**1,390**		

Sources: Ministry of Finance and the World Bank.

15. Authorities' views. The authorities broadly agreed with staff's assessment of the outlook and risks. They consider Uruguay well-prepared to face the challenging global conditions and the eventual spillovers to the region. They—as well as most private sector analysts—believe that a sharp drop in key export prices constitutes a main risk to the outlook (by impact) although with low probability in the coming years. The authorities follow developments in Argentina very closely, particularly those that may affect tourism, FDI, and certain manufacturing export sectors. The authorities were confident that the upcoming wage round would deliver prudent wage agreements in line with productivity growth. While the authorities agreed that the currency does not appear overvalued on a trade-weighted basis, they considered it important to avoid (including via foreign exchange intervention) possible sharp currency movements that could have negative effects on competitiveness in the short run.

POLICY DISCUSSIONS

A. The Appropiate Near-Term Stance

16. The combination of inflation persistently above target and rising short-term capital inflows has sharpened monetary policy trade-offs. In the context of Uruguay's open capital account, swelling short-term capital inflows have made the monetary policy dilemma between reducing inflation and avoiding a large nominal appreciation starker.

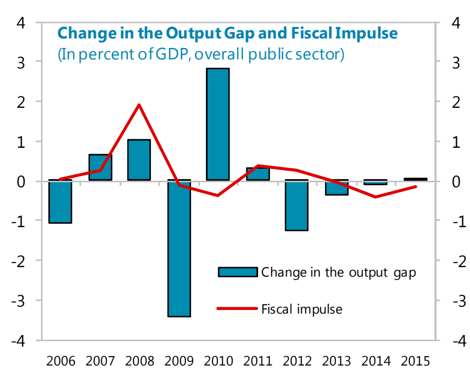
[4] Banks' large net foreign asset position is a structural characteristic associated with the high degree of deposit dollarization. It does not imply large net foreign exchange exposure, which is tightly regulated.

17. Tackling inflation is the overriding near-term policy priority. Inflation and inflation expectations anchored to the mid-point of the target range—not just closer to the upper band—would create room for monetary easing in future downturns and in response to surges in capital inflows, and help foster de-dollarization and de-indexation of the economy. The authorities stressed their commitment to bringing down inflation, and pointed to the monetary tightening undertaken so far and their broadly neutral fiscal stance. They expected a dampening impact on inflation from the economic slowdown underway, the recent peso appreciation, and from the voluntary cuts and freezes in basic consumer goods prices.

18. Staff welcomed the recent monetary tightening via increases in reserve requirements and the policy rate, and recommended maintaining a tightening bias to lower actual and expected inflation toward the target range. The pace of policy rate increases should depend on the evolution of the economy, including the output gap and the exchange rate. Reserve requirements could also be tightened, if needed. Since there would likely be some further nominal appreciation, which should help bring down inflation, competitiveness should be monitored carefully. At the same time, most *real* appreciation in recent years has come from Uruguay's persistently higher inflation than in partner countries, so the dilemma between avoiding nominal appreciation and reducing inflation should not be exaggerated from a medium-term competitiveness perspective (see Figure 4). Staff also suggested enhancements to the monetary policy framework to help guide expectations (see Section C). The authorities expect a moderation in inflation in coming months, but did not rule out further monetary tightening, if needed. They stressed that, meanwhile, they will continue to monitor developments, including with regard to the slowdown in consumer credit (and its effect on inflation) and possible competitiveness concerns.

19. Given monetary policy trade-offs, staff argued that fighting inflation and coping with capital inflows will require concerted action on several fronts. Discussions focused on: further fiscal restraint, especially on spending, to moderate domestic demand; prudent wage growth to contain costs; foreign exchange intervention to limit exchange rate overshooting amid strong capital inflows; active debt management to reduce dollar debt further; expanded foreign investment options for pension funds; and capital flow management measures.

20. On fiscal policy, staff encouraged greater spending restraint to support monetary policy. A broadly neutral stance would be appropriate given the closing output gap, but in the context of high inflation and capital inflows, staff argued that the optimal strategy would be to rein in the very rapid real primary spending growth to moderate domestic demand, alleviate appreciation pressures, and support disinflation. The authorities thought that a neutral fiscal stance was appropriate, and that fiscal policy would have a limited effect on inflation in the near term. They did not consider it necessary to alter fiscal plans in the short run.



Sources: Ministry of Finance, and Fund staff estimates.

21. Greater spending restraint would also help secure the authorities' debt reduction target. The mid-year 2012 budget targets a reduction in gross public debt to about 45 percent of

GDP by 2015.[5] However, based on the updated fiscal outlook for 2012, staff projects gross public debt at closer to 50 percent of GDP in 2015. Furthermore, until the structural reforms in the energy sector are implemented, the fiscal accounts remain exposed to drought-related volatility in UTE's revenues.[6] Staff argued that, in the meantime, the budget should rely on a greater contribution from the central government to achieve the debt target. Hence, a tight grip on spending would be important. The authorities explained that as part of the normal process of revising the fiscal projections, they continue to aim at reducing debt to 45 percent of GDP by 2015, a target that they consider fully achievable.

22. Prudent wage increases are essential to ensure competitiveness, especially if locked into multi-year agreements. This will require cooperation by wage setters in the important 2013 wage round (covering about 80 percent of country-wide wages) but also a clear government stance, given its "tie-breaking" deciding role in the tripartite negotiation framework. The authorities were confident wage agreements would be prudent and emphasized that the challenges stem mostly from the tight labor market (evidenced by the historically low unemployment) with shortages in some sectors. Staff welcomed the efforts to align real wages with sector-specific productivity growth, even if this may be difficult to implement in practice in all sectors. Staff also noted that it will be important that multi-year wage agreements preserve flexibility in case of an economic downturn.

23. Staff was skeptical about recent initiatives to cut and freeze prices of consumer goods. The authorities considered that the cut/freeze of consumer goods prices would help prevent a temporary surge in food prices from feeding into core inflation. In staff's view, this measure creates distortions without addressing the root cause of inflation. The extensive and hard-wired wage indexation is a key reason price shocks feed into wages and core inflation. Pervasive indexation also exacerbates Uruguay's high employment and output volatility. The authorities acknowledged these difficulties with wage indexation, but considered it an important part of the implicit social pact.

24. Staff welcomed the authorities' commitment to the floating exchange rate regime, a key component of the policy framework. Given the comfortable reserves position, there is no need to accumulate more reserves for prudential reasons. Staff suggested that intervention be limited to avoiding excessive swings in the exchange rate. The authorities considered that the global situation with ample liquidity and the small size of the market gave them little choice but to be active. To help cope with inflows, staff also encouraged continued pro-active public debt management, including through operations to reduce further external dollar debt. There is also a case for expanding the foreign investment mandate for pension funds.

25. The recently introduced capital flow management measure is an innovation in Uruguay's policy framework (Box 5). The BCU noted that the temporary reserve requirement applies only to foreign purchases of its monetary policy instrument; the surge in such purchases interfered with monetary policy operations. It is too early to say how effective the measure will be.

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[5] The authorities' target for gross public debt by end-2015 has been raised from 40 to 45 percent of GDP to reflect the borrowing associated with the build-up of government liquidity buffers. Net debt is unchanged.

[6] An Energy Stabilization Fund has helped smooth volatility of UTE's revenues this year, but it is now depleted.

Early indications suggest it has dampened demand for BCU paper but increased demand for government debt. Hence, the measure may not have much effect on overall short-term portfolio inflows in the end. The authorities indicated they have no plans to adopt further measures to curb capital inflows, and they saw the open capital account as a key feature of Uruguay's economic and financial landscape.

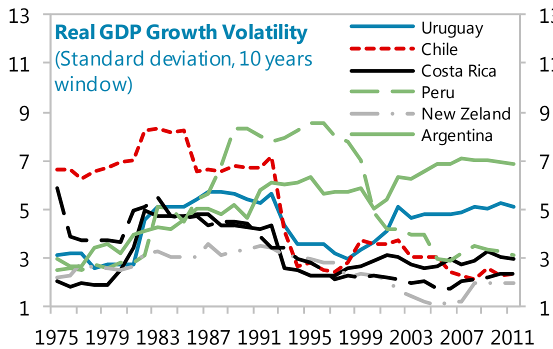
B. Coping with Spillovers

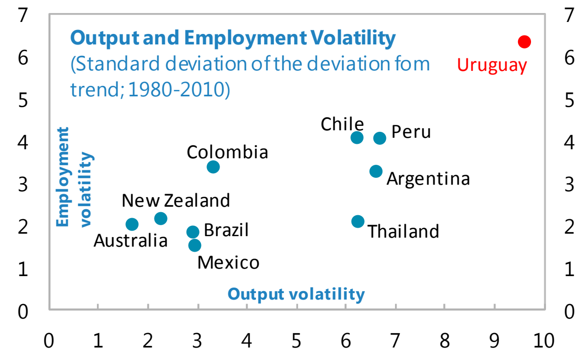
26. It was agreed that if external shocks materialize, the macroeconomic policy response should be pragmatic and prudent.

- *Exchange rate policy*. The floating exchange rate should be the first line of defense and a key absorber of most shocks, in particular if terms of trade experience a sharp and persistent decline. To guard against balance sheet and inflation risks—given high dollarization and indexation—the ample reserves could be used to contain the overshooting.
- *Liquidity*. Banks are very liquid, in particular in dollars, and do not depend on wholesale funding. Hence, the likelihood that the BCU would need to intervene to contain liquidity pressures is small, even in the event of a run on nonresident deposits.
- *Monetary policy*. High inflation limits the monetary policy room for maneuver. In a crisis, the immediate inflationary effects of a sharp depreciation would likely dominate the deflationary effect of a sharp fall in demand (as in 2002). Staff suggested that policy rate cuts proceed so long as inflation expectations have become reasonably anchored. As in the past, reserve requirements could be cut to mitigate a credit crunch.
- *Fiscal policy*. Automatic stabilizers (mainly tax revenue) should be allowed to operate though not unimpeded in a lasting downturn so as to preserve prudent debt dynamics. It would be important to protect social spending.

C. Policies to Bolster Growth Prospects and Reinforce Resilience to Shocks

27. Uruguay's medium-term outlook is also favorable but with challenges. The authorities' projection of 4 percent growth a year should be feasible. However, it will require sustained productivity growth and/or higher investment as labor will not provide much boost: working-age population is projected to grow by a meager ½ percent a year and unemployment is already low. Moreover, although Uruguay's economy has become more resilient over the past decade, it has a history of booms and busts—in large part due to external shocks—and output and employment volatility is still high (partly due to extensive wage indexation).





Sources: International Financial Statistics, World Economic Outlook, and Fund staff calculations.

28. Action in a number of areas would help bolster prospects for strong and inclusive growth prospects and lower output volatility. In addition to continued prudent macroeconomic policies, it would be important to enhance further elements of the macroeconomic policy framework, promote a dynamic and deeper (but stable) financial system, and ensure a competitive business environment.

29. Strengthening aspects of the macroeconomic policy framework further can help reinforce the economy's resilience to shocks.

- *Monetary policy*. Inflation expectations have yet to become anchored within the inflation target. Many market participants doubt the authorities' commitment to the 4–6 percent target and see them tolerant of inflation until it approaches 10 percent. This perception limits the BCU's ability to respond to shocks. In addition to a steadfast focus on bringing actual and expected inflation to target, the framework's traction on expectations could be strengthened with more comprehensive communication of how the BCU sees the inflation outlook and how its policy actions will lead inflation to the target (including through publication of the BCU's conditional inflation forecast). Predictability of monetary policy could also be enhanced with monthly rather than quarterly policy meetings, the standard frequency of most inflation targeting central banks.[7] The authorities took note of the staff's views, as they consider further changes to the framework.

- *Fiscal framework*. The top-down approach to budget planning and anchoring it in a debt target are two strengths of Uruguay's fiscal framework. To strengthen this framework further, staff encouraged the authorities to consider casting the budget on a rolling five-year horizon and to include even longer horizons for certain items (e.g., social spending). In this context, it will be important to tackle the contingent fiscal liabilities in the state-owned insurance company, *Banco de Seguros del Estado*, arising from the indexation of pensions to wages (while BSE's assets are mostly indexed to inflation). The authorities are well-aware of this issue and are reviewing the situation. They noted that the attendant liabilities will not start to become important until around 2020.

[7] See Selected Issues Paper "Why are Inflation and Inflation Expectations Above Target in Uruguay?" by C. Tovar.

30. There was agreement that a sound, resilient, and more dynamic financial system would support long-term growth. The 2012 FSAP Update noted the landmark legal, regulatory, and institutional reforms since the 2006 FSAP, as well as significant improvement in banking supervision, progress on Basel II, a shift toward risk-based supervision, and the achievement of meeting most of the Basel Core Principles (one remaining area for improvement relates to the risk assessment methodology). At the same time, the financial sector's contribution to economic growth remains limited, and the Update identified potential areas for reform (Box 6). The authorities are still reviewing the FSAP assessment and recommendations.

31. There is scope to strengthen resilience further by building on recent progress. Over the past year, the BCU has raised capital requirements relating to operational and systemic risk (effective January 2013)—and the authorities consider making further enhancements in that direction, introduced requirements for non-bank financial institutions to report their activities (in line with staff advice), and modified the method for calculating dynamic provisions to reduce pro-cyclicality. The FSAP Update also recommended strengthening crisis preparedness and contingency planning. Staff welcomed that the Financial Stability Council—established in 2011 as the coordinator of safety net and macro-prudential policies—is commissioning research on macro-prudential issues. Finally, staff stressed the importance of adequate funding and staffing for effective financial supervision, as discussed in the Update.

32. It would also be important to deepen financial markets.

- *Deeper capital markets.* The underdeveloped domestic capital market makes it difficult for Uruguay to reap the benefits of portfolio inflows by channeling them to productive use. In addition, ample and growing savings in domestic pension funds are outgrowing the capacity of the local capital market. To develop a capital market that attracts potential issuers and investors, and promotes efficient allocation of financial resources, staff suggested that the authorities press ahead on developing a strategy. On pensions, the FSAP Update recommended expanding the foreign investment mandate for pension funds and encouraging participation in domestic alternatives to government bonds (such as equities and Private-Public Partnership projects) to enhance returns and diversification and start providing members with portfolio options along their working life tailored to their needs.
- *A more dynamic banking system.* The FSAP Update highlighted a number of factors that limit banking sector efficiency and competition. One is the dominant role and preferential status of the state-owned *Banco Republica Oriental del Uruguay* (BROU), with more than half of banking system assets. Another is high labor costs and operating constraints. To promote a more dynamic, yet sound, banking system, the authorities should consider measures to level the playing field among banks.

33. Ensuring a competitive and dynamic business environment will require attention to a few key areas: [8]

[8] For a discussion of Uruguay's investment climate, see the Selected Issues Paper "FDI in Uruguay: A Note on Recent Trends and Determinants," by C. Perez and N. Melgar.

- *A competitive infrastructure*. Major projects in the energy sector—involving private and public investments— will improve the energy supply by 2015, making half of the electricity supply based on renewable sources and help reduce drought risks for UTE. There have been delays in tackling key infrastructure gaps (e.g., roads, ports) through Private-Public Partnerships but the authorities expected these projects to move ahead over the coming years.

- *A dynamic labor market*. A well-functioning labor market is essential to spur productivity growth, support the evolving competitive structure of the economy, and facilitate adjustment to shocks. However, the World Economic Forum's 2012–13 Global Competitiveness Report ranks labor market efficiency (in particular, flexibility in wage determination, cooperation in labor-employers relations, pay and productivity, and hiring and firing practices) as the most difficult aspect of doing business in Uruguay. Staff suggested that the authorities evaluate the experience with the regulations introduced in recent years and consider changes to ensure a labor market commensurate with the needs of a dynamic economy, while ensuring appropriate protection for workers. The authorities considered that efforts to link wages more closely to productivity growth in upcoming wage negotiations would enhance the labor market further.

34. The mission welcomed the progress on meeting international tax standards and in strengthening further Uruguay's AML/CFT regime. To comply with international tax standards, the government has established seven double-taxation treaties and one tax information sharing treaty (and several more of each are pending Parliamentary approvals in Uruguay and/or the partner country). Importantly, an information exchange treaty with Argentina that includes double taxation components has been submitted to Parliament. As for AML/CFT, as noted in the FSAP Update, the authorities adopted in August 2012 a new National Strategy against money laundering and amended the 2009 law to expand the scope for information sharing on terrorist financing.

STAFF APPRAISAL

35. Uruguay has experienced a decade of record-strong and inclusive growth. This record is a result of prudent macroeconomic policies, institutional reforms, and favorable external factors, and has resulted in significant welfare gains.

36. The outlook is favorable but with risks and challenges. Growth is slowing toward potential, but inflation remains well above target. Inflation reflects robust domestic demand, insufficiently tight monetary policy, extensive wage indexation, food price shocks, and an inflation targeting framework that is not anchoring expectations. Short-term capital inflows are presenting monetary policy with difficult choices between lowering inflation and avoiding a sharp appreciation. And the economy is being affected by global and regional headwinds and tailwinds. Risks to the outlook are two-sided and relate to further spillovers from abroad and domestic wage and cost developments.

37. Uruguay is in a reasonably good position to tackle these challenges but policy space is limited. The financial system is small, sound, and liquid, and there are no generalized credit or real estate bubbles in the economy. Deft debt management has reduced public debt vulnerabilities significantly. And the central bank and the government have substantial foreign exchange buffers to help cushion large shocks. While Uruguay has lost competitiveness vis-à-vis some trading partners over the last year, the peso still seems broadly in line with fundamentals, though a sharp and sustained real appreciation could alter this assessment.

38. Tackling inflation is a priority. Having inflation and inflation expectations stable at the mid-point of the target range would create room for monetary policy to respond to downturns and capital inflows, and help reduce dollarization and indexation.

39. Thus, staff supports the recent increases in the policy rate and reserve requirements. While this is not the time for aggressive monetary tightening, maintaining a tightening bias to lower actual and expected inflation toward the mid-point of target range is appropriate. However, the pace of tightening should depend on the evolution of the economy and risks. The target's influence on inflation expectations could be strengthened with more explicit communication of the BCU's likely direction of policy stance, its conditional inflation forecast, and how it would respond to shocks. More frequent policy meetings would also be useful.

40. But monetary policy cannot fight inflation alone, given capital inflow concerns; concerted efforts on other fronts are also necessary. In particular, fiscal policy could better support monetary policy. At the same time, recent initiatives to cut/freeze some consumer prices create distortions without addressing the root causes of inflation. In the view of the mission, extensive wage indexation is a key reason why price shocks feed into wages and core inflation.

41. Near-term fiscal policy could better support monetary policy. A neutral stance would in principle be appropriate given the cycle, but a stronger counter-cyclical stance should be considered to help monetary policy. While the larger deficit in 2012 is mostly on account of factors that do not imply fiscal impulse, there has also been a substantial increase in real spending. Slower spending would help moderate domestic demand, alleviate real appreciation pressures, and support disinflation. It would also help secure the authorities' target of reducing public debt to 45 percent of GDP by 2015.

42. Prudent wage growth is also essential. The upcoming wage negotiation round is key given its wide coverage and its multi-year focus. The attempts to link real wage growth with sector productivity growth are welcome, even though it will be challenging in practice. Flexibility to reconsider wage agreements in case of an economic downturn will be important.

43. Staff acknowledges the circumstances in which the recent temporary capital flow management measure was introduced. The measure can be justified given the sharp spike in foreign demand for central bank paper. Though it remains to be seen how effective the measure will be in increasing monetary policy space, it would be important to use any such space to tackle inflation.

44. The floating exchange rate is a crucial part of the policy framework and a key shock absorber. There is no clear need for further reserve accumulation for prudential reasons. However, occasional intervention may be appropriate to avoid excessive exchange rate swings. Sector-specific competitiveness problems are best handled through structural policies.

45. In the case of downside external shocks, the policy response should be prudent and pragmatic (as in the past). The floating exchange rate should be the first defense. Monetary easing could proceed so long as inflation expectations have become reasonably anchored. As in the past, reserve requirements could be cut to mitigate the risk of a credit crunch. Automatic fiscal stabilizers should be allowed to operate, though in a lasting downturn the fiscal space would be limited by the need to preserve prudent debt dynamics. The sizable liquidity buffers can be used in a sudden stop.

46. A long-term policy challenge is to bolster growth prospects and reduce output volatility. Actions on many fronts will be needed. Infrastructure plans in the energy and transportation sectors are welcome. Ensuring a dynamic labor market is also important for fostering productivity growth and facilitating adjustment to shocks, while ensuring appropriate protection for workers.

47. The prudent fiscal policy management could be enhanced further in view of medium-term challenges. The budget could usefully be cast on a rolling five-year horizon and include even longer horizons for certain items (e.g., social spending). In this context, it is appropriate that the contingent liabilities in *Banco de Seguros del Estado* are receiving attention.

48. There is scope to strengthen financial sector resilience further and bolster medium-term growth by building on recent progress, drawing on the recent FSAP Update. A strategy to develop a capital market that promotes efficient allocation of financial resources is needed. In the area of pensions, it would be opportune to review the foreign investment mandate for pension funds, and to start providing pension savers with different portfolio options tailored to their needs. It will also be important to enhance financial crisis preparedness and contingency planning, and ensure adequate funding for supervision. Finally, a dynamic, yet sound, banking system would benefit from a more level playing field among banks.

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

Box 1. Uruguay: Social Policies for Inclusive Growth

Uruguay has made progress in improving social conditions. This trend towards better social indicators has been fostered by rapid economic and employment growth, and targeted social programs.

Socio-Economic Indicators in Uruguay and Comparators

	Uruguay		LA-5 1/ 2/	OECD 2/
	2004	2011	2011	2011
GDP per capita (PPP, in U.S. dollars)	8,732	15,181	12,921	33,971
Income inequality (Gini index, lower value=less inequality) 3/	47.1	46.3	51.8	31.4
Human Development Index ranking (169 countries: lower value=better ranking)	50	48	70.4	22.6
Unemployment (average)	13.1	5.3	7.9	8.0
Population (in millions)	3.3	3.4	81.0	41.0
Poverty (percent of population below poverty line) 4/	39.9	14.3	31.3	17.7
Illiteracy (percent of population age 15 years and over) 3/	2.2	1.7	7.0	1.6
Life expectancy at birth (years, average)	75.2	76.2	75.2	79.7

Sources: UNDP Human Development Report, World Bank Development Indicators, IMF World Economic Outlook, and Instituto Nacional de Estadistica del Uruguay.
1/ Brazil, Mexico, Chile, Colombia, and Peru.
2/ Simple averages.
3/ Latest survey.
4/ For towns of more than 5,000 inhabitants.

Key social policies in recent years include:

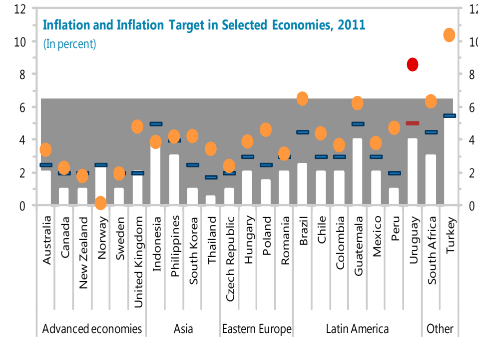
- Reform of the health system to increase gradually the coverage to over 2.2 million people by 2016.
- Expansion of the Family Allowance Program, which reaches almost 410,000 children and adolescent from low-income households (2011). The average monthly transfer is about $70.
- Establishment of the Family Food Card Program, which covers 88,000 households with a monthly allowance of about $40, (2010).
- Expansion of unemployment benefits and provision of old-age pensions to people who had not contributed to the pension system (2010).
- Increase in the progressivity of the tax system with the introduction of the personal income tax (2007).
- Refund of the 22 percent VAT on purchases made with Food and Family Allowance cards to 200,000 low-income households (2012).
- Increase in the non-taxable base of the personal income tax and introduction of a new 30 percent bracket (2012).
- Allowing mortgage deductions for houses valued up to $93,370 (benefiting about 6 percent of households) (2012).

Box 2. Uruguay: The Monetary Policy Stance [1/]

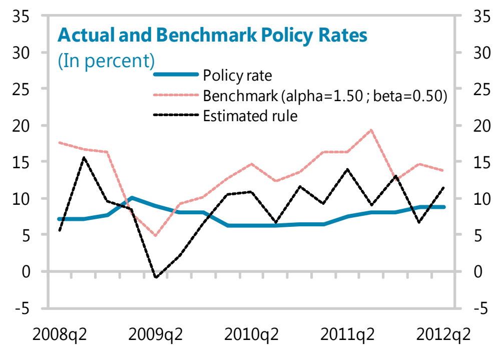
Uruguay's inflation and inflation expectations have been persistently above the official target range; what has been the monetary stance?

- Uruguay's inflation target (4-6 percent) is on the high side compared with those of other inflation targeting countries. The overshooting of this target is also higher than in most countries. The overshooting is not new. Since Uruguay adopted inflation targeting in September 2007, inflation has averaged 7.5 percent (also mostly above the previous target of 3–7 percent).

- Despite significant monetary tightening, the policy rate (9 percent) remains below the level consistent with keeping actual and expected inflation at the target range within the 18-months policy horizon. The rate is also below levels consistent with benchmarks such as the Taylor rule or the level predicted by an estimated Taylor-rule linking BCU's policy rate to the output and inflation gaps for the period 1997Q1–2012Q2[2/]. Measures of the neutral interest rate (calculated as potential output growth plus actual or expected inflation) are also some 400 basis points above the current policy rate. At the same time, the gap between the actual and the "predicted" policy interest rates likely overstates the tightening needed to bring inflation to target given the other policy actions (e.g., with respect to reserve requirements).



Source: Central Banks.
Note: Bars show the official target ranges, with the horizontal line marking the mid-point. Dots show end-year inflation for 2011.



Source: Fund staff estimates.
Note: See details in Selected Issues Paper "Why are Inflation and Inflation Expectations above Target in Uruguay?" by C. Tovar.

1/ See Selected Issues Paper "Why Are Inflation and Inflation Expectations Above Target in Uruguay?" by C. Tovar. See also: "To Cut or Not to Cut? That is the (Central Bank's) Question–In Search of the Neutral Interest Rate in Latin America,", by N. Magud and E. Tsounta, IMF Working Paper 12/243, October 2012.

2/ See Taylor, 1993, "Discretion versus Policy Rules in Practice," Carnegie-Rochester Series on Public Policy, North-Holland, 39, pp. 195–214.

Box 3. Uruguay: Recent Debt Management Operations

Pro-active debt management has improved the structure of Uruguay's public debt significantly, reducing vulnerabilities and contributing to the development of the local bond market. Importantly, in recent years, the fraction of central government debt that is foreign currency denominated has been reduced to below 50 percent.

Key debt operations in the past year include:

- A large multi-purpose liability management operation in December 2011 consisting of an offer to exchange various foreign currency-denominated bonds with new 2028 Global inflation-indexed (UI) bonds.
- In the local market, the authorities are improving transparency and predictability, and intensifying the issuance of benchmark bonds. The debt management office announced for the first time a six-month issuance program equivalent to $600 million, including a 3-year nominal peso note maturing in 2015 and two UI notes of 5 and 10-year maturities (due 2017 and 2022 respectively). The 3-year peso note will be issued every month, and each of the UI notes every two months.
- A primary dealer system is under consideration to encourage secondary-market trading and improve liquidity. Reducing the frequency of regular auctions is also expected to enhance activity in the secondary market and improve the efficiency of the yield curve.
- There is also an effort to consolidate the market for securities issued by the central bank and the Treasury and reduce sterilization costs. In March 2012, the Ministry of Finance carried out an exchange operation, issuing local-currency and UI securities in exchange for BCU papers.

Box 4. Uruguay: Assessment of External Stability Risks

Staff's assessment is that balance of payments risks remain contained.

- Uruguay's real effective exchange rate has appreciated over the last decade and is now about 15 percent above its pre-2002 crisis level. But productivity and global price gains in the tradable sector have raised the equilibrium rate and CGER and EBA estimates suggest that the peso is broadly aligned with fundamentals and the current account is close to its estimated medium-term norm.

- Although a recent widening of the current account deficit may suggest that the peso is on the strong side, at 3 percent of GDP, the deficit is not so large as to raise immediate stability concerns, especially since it is more than financed by FDI (6.7 percent of GDP in 2012). And exports (except to Argentina and Europe) remain robust. For the medium term, the deficit is projected to stabilize at around 2 percent of GDP.

International Investment Position
(In percent of GDP)

	2004-07(avg)	2011
Assets	96.2	62.5
Of which:		
Portfolio investment	12.6	9.1
Currency and deposits	54.4	27.8
Reserve assets	17.4	22.0
Liabilities	103.9	70.3
Of which:		
FDI	19.7	31.8
Portfolio investment	30.0	19.3
Loans	29.6	8.7
General government	15.2	6.3
BCU	9.3	0.0
Other	5.1	2.4
Nonresident deposits	14.5	7.3
Net position	-7.7	-7.8

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

- The growing importance of portfolio inflows, while welcome, is raising Uruguay's exposure to sudden stops. This risk is contained by the relatively small stock of short-term external liabilities and the substantial foreign exchange reserves of the BCU and banks.

- More broadly, the net international investment position has remained stable and gross assets and liabilities have declined in recent years.

Exchange Rate Assessment
Deviation from equilibrium (in percent) 1/

I. Macroeconomic Balance (MB) approach	-3.6
II. External Sustainability (ES) approach	1.1
III. Equilibrium Real Exchange Rate (ERER) approach 2/	2.3
IV. Vector Error Correction Model approach 3/	-0.6
V. EBA 4/	-3.5
Memo Item	
Big Mac Index	5.0

1/ Positive values indicate overvaluation.
2/ Considers the REER as of July 2012.
3/ Considers the average REER as of 2012Q2.
4/ Using the latest EBA CA gap to gauge the REER misalignment.

Gross International Reserves

In billions of U.S. dollars (latest)	12.5
In months of imports (2012)	11.2
In percent of:	
GDP (2011)	27
Short-term debt (end of 2011)	448
ST debt and nonresident deposits (end of 2011)	151
M2 (latest)	172
M3 (latest)	61
Memo items (in billions of U.S. dollars)	
IMF's new reserve adequacy metric range	4.4-6.6
Banks net foreign assets	4.7

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

Note: The MB approach calculates the difference between the medium-term current account (CA) balance and an estimated equilibrium CA "norm". The ES approach calculates the difference between the actual CA balance and the NFA-stabilizing CA balance. The real exchange rate gap is calculated to bring the current account balance in line with its NFA-stabilizing level or medium-term MB norm. The ERER is estimated as a function of medium-term fundamentals. The new EBA approach (see details in the IMF's Pilot External Sector Report, July 2012) suggests that Uruguay's CA balance is about 2 percentage points of GDP above the estimated norm under desirable policies, implying a modest undervaluation of the REER (about 3.5 percent).

Box 5. Uruguay: The Recent Capital Flow Management Measure

On October 1 2012, the BCU introduced a capital flow management measure. Uruguay has a long-standing record of an open capital account. Since spring 2012, Uruguay has seen a sharp increase in portfolio inflows, almost exclusively into government securities and central bank paper (*letras de regulación monetaria*). To discourage flows into *letras*—which the BCU saw as interfering with its monetary policy operations—the BCU introduced a 40 percent reserve requirement on non-resident purchases of this instrument effective October 1. The reserve requirement does not apply to foreign purchases of other instruments, including government securities. Hence, it is not intended or designed to stem all short-term capital inflows. It is too early to say how effective the measure will be.

The context for this measure is as follows:

- The Uruguayan peso is broadly in line with long-run fundamentals (see Box 4).
- Uruguay has accumulated substantial foreign exchange reserves, which at 27 percent of GDP, exceed most measures of prudential levels, including the Fund's reserve metric (see Box 4). Intervention has been limited after the measure and the peso has appreciated somewhat.
- With inflation (9.1 percent) above the official target (4–6 percent), there is no room to lower policy rates in Uruguay to discourage capital inflows. Indeed, further tightening appears necessary. While fiscal policy is broadly neutral, a somewhat tighter stance would help support monetary policy in reducing inflation. However, there is little scope to alter fiscal policy in a major way in the short run.
- The BCU has stated it is a temporary measure.
- The measure is designed to deal with the surging inflows into the BCU's monetary policy instrument that, according to the BCU, were undermining the efficiency of monetary operations. Since it is the monetary policy instrument, the measure was not applied to residents' purchases.
- The capital inflows are not financing an expansion in bank credit. Hence, changes in the macro-prudential framework were not necessary.

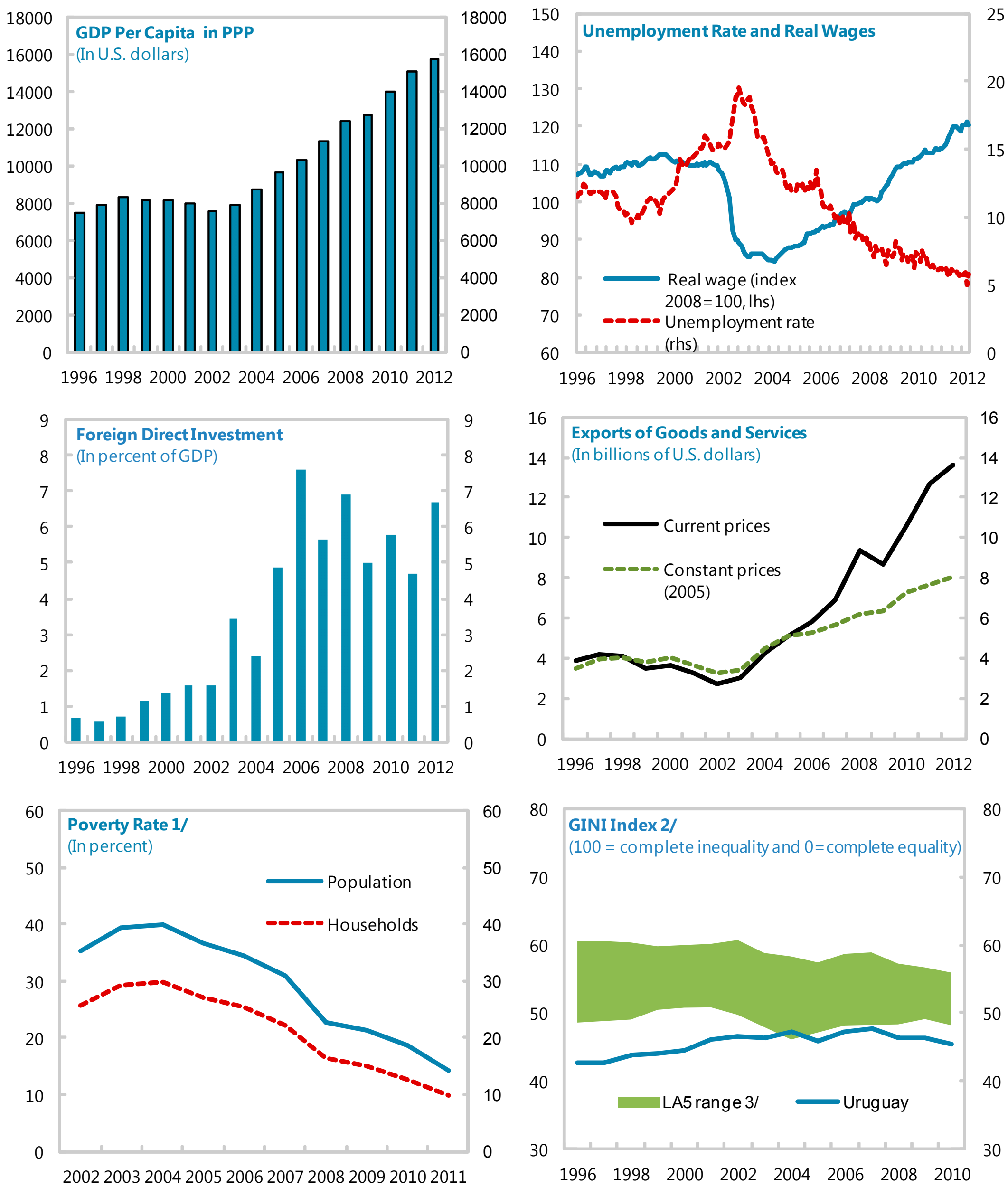
Box. 6. Uruguay: FSAP Update 2012—Key Recommendations

Recommendations	Time Frame[1/]
Institutional Shortcomings and Structural Distortions	
Increase supervisory independence, including by broadening the technical and operational independence of the *Superintendencia de Servicios Financieros* (SSF).	MT
Increase financial and human resources for SSF.	ST
Regulation and Supervision of the Banking Industry	
Better discriminate among banks of different risk profiles, including capturing low probability but high impact events.	ST
Enhance risk concentration rules to capture linkages among connected borrowers due to financial, commercial and operational exposures.	ST
Provide further guidance to the industry on expected risk measurement, stress testing, contingency planning, risk management, and AML/CFT standards.	MT
Require systemic and large banks to operate separate risk management units and integrate risk measures into limits/operations.	ST
Securities Market	
Prepare a comprehensive capital market development strategy, including bringing new issuers to the market.	ST
Insurance, Pension Funds and Annuities Market	
Contract an independent diagnostic of the *Banco de Seguros de Estado* (BSE), including a review of its strategy, solvency, efficiency, and governance.	ST
Liberalize pension fund rules for prudent investment abroad.	ST
Provide hedging mechanisms or allow for phased withdrawals, in view of the indexation to wages.	MT
Safety Net and Crisis Management	
Strengthen contingency planning, develop scenarios, and specify agencies' roles	ST
Undertake joint and separate crisis preparedness work among the safety net participants.	ST
Financial Infrastructure	
Amend the procedural legislation to accelerate the asset execution process, including effective measures to expedite the post-judgment phase.	MT
Finalize decisions with regard to the functionalities of the Central Securities Depository (efficient interfaces with trading systems, identification of beneficial owners).	ST
Develop and implement the payment system oversight function, including Securities Settlement Systems and retail payments.	MT
Finalize an agreement on the interbank pricing scheme for the Automated Clearing House (ACH) to become operational.	ST

[1/] 'ST' for short-term (up to 12 months) and 'MT' for medium-term (12 -24 months).

Figure 1. Uruguay: The Long Term Economic Revival

Over the last decade, per capita income has more than doubled and social indicators have improved. The economy has benefited from strong FDI inflows and export prices.



Sources: World Economic Outlook, World Development Indicators, Haver Analytics, and Fund staff calculations.

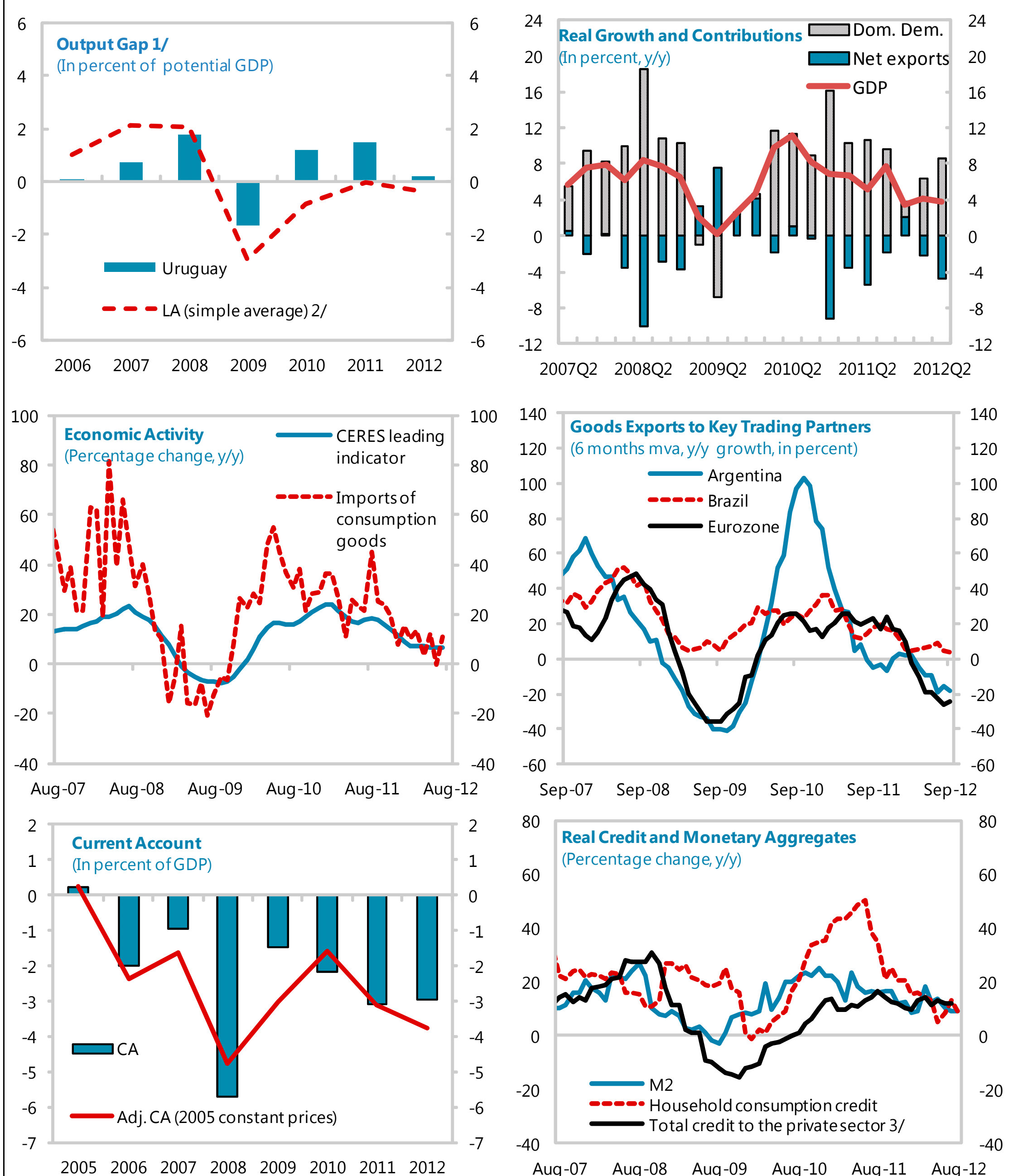
1/ Percent of population or households below poverty line.

2/ Linear interpolation used to fill in missing data.

3/ LA5 includes Brazil, Chile, Colombia, Mexico, and Peru.

Figure 2. Uruguay: Current Cycle

The output gap is closing. Net exports have been a drag in recent quarters, with exports to Argentina and the Eurozone down in volume terms.



Sources: World Economic Outlook, Haver Analytics, Centro de Estudios de la Realidad Economica y Social (CERES), and Fund staff estimates and calculations.

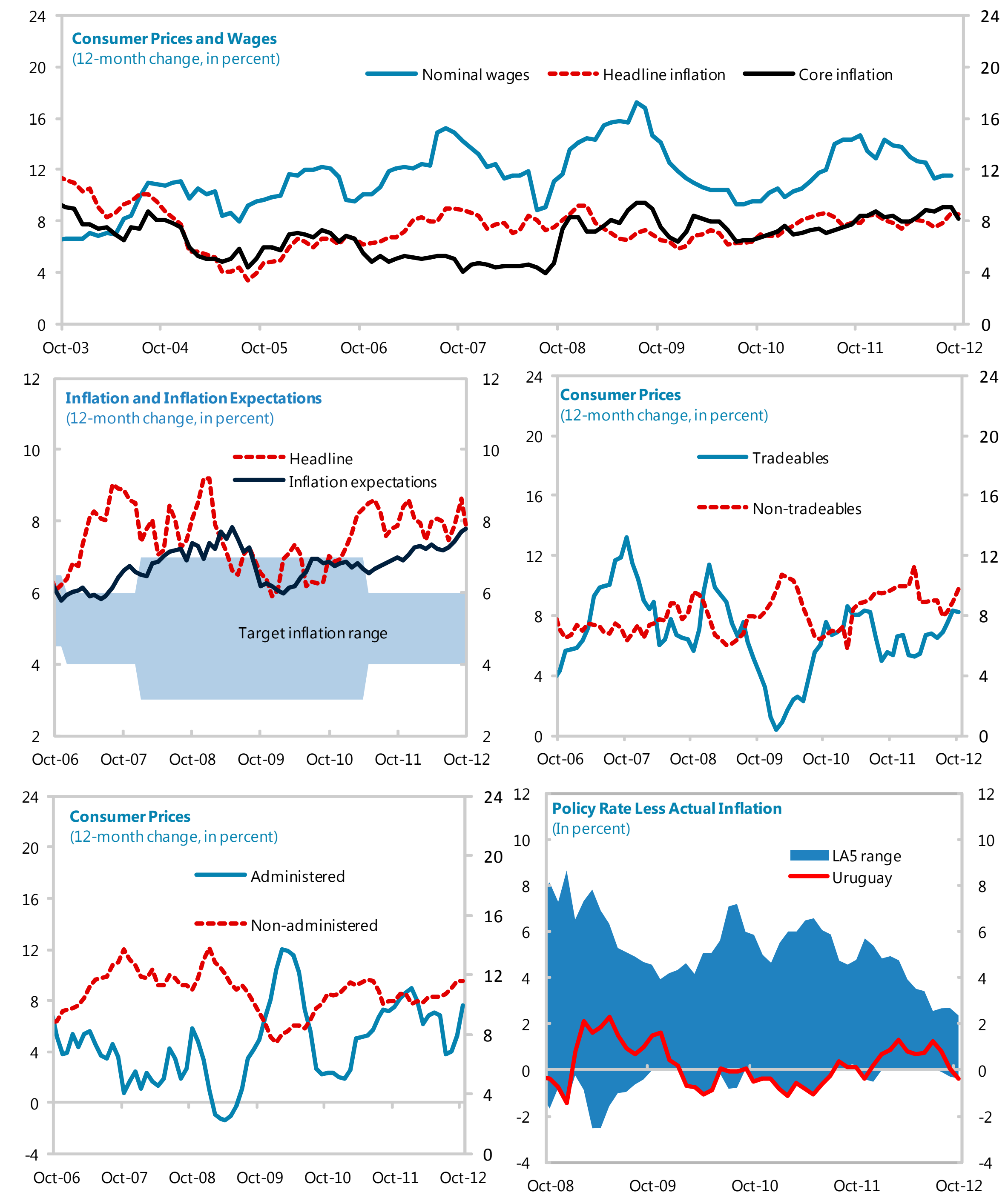
1/ Calculated with the Hodrick-Prescott filter.

2/ LA5 includes Brazil, Chile, Colombia, Mexico, and Peru.

3/ Using a constant exchange rate equal to the average in 2007.

Figure 3. Uruguay: Inflation and Monetary Policy

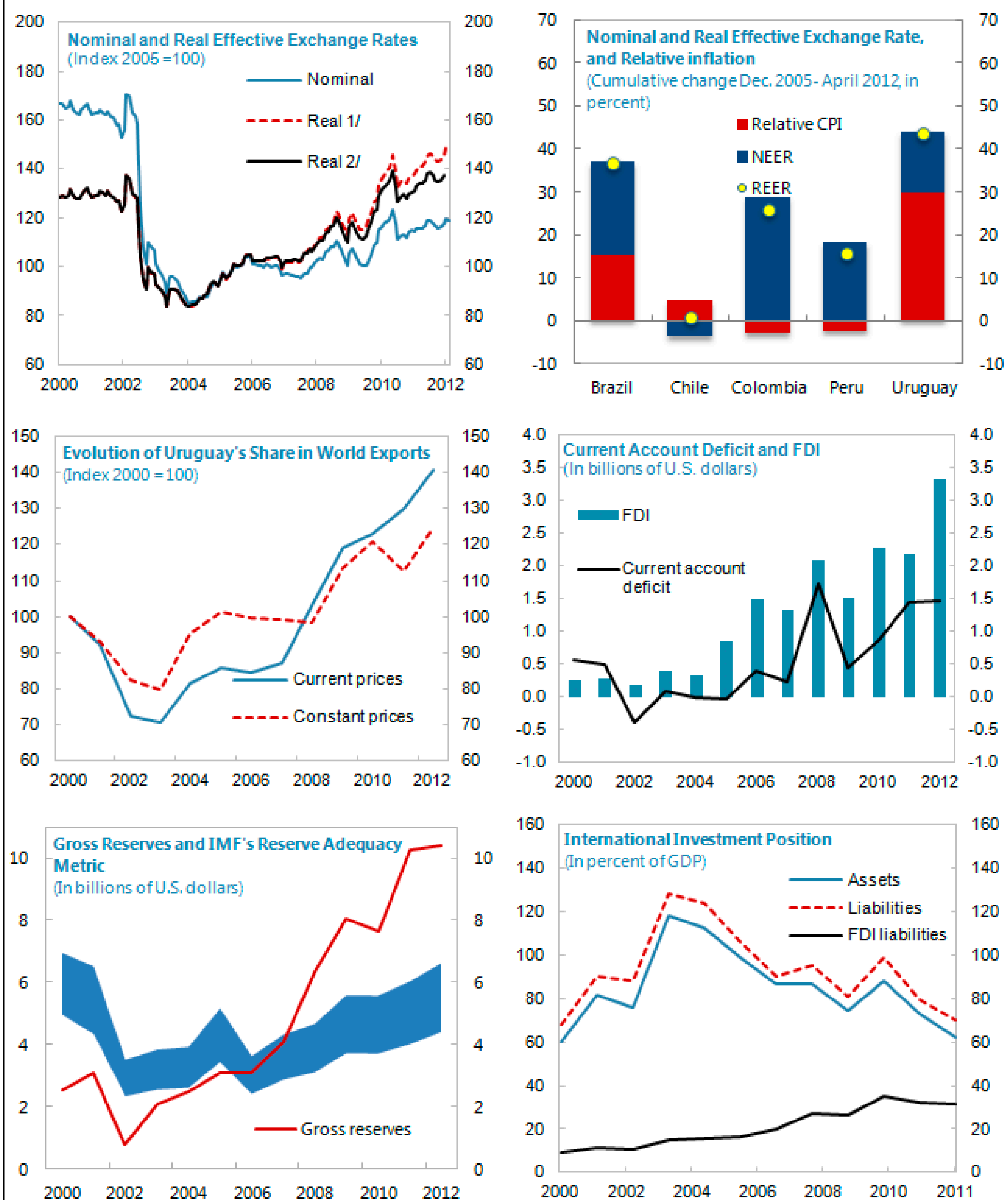
Inflation has crept up in recent months and persists above the target range.
Nominal wage growth remains strong.



Sources: Banco Central de Uruguay (BCU), and Fund staff calculations.

Figure 4. Uruguay: External Stability

The REER has continued to appreciate, mostly because of higher inflation than in partner countries. However, Uruguay's exports have risen faster than world exports.

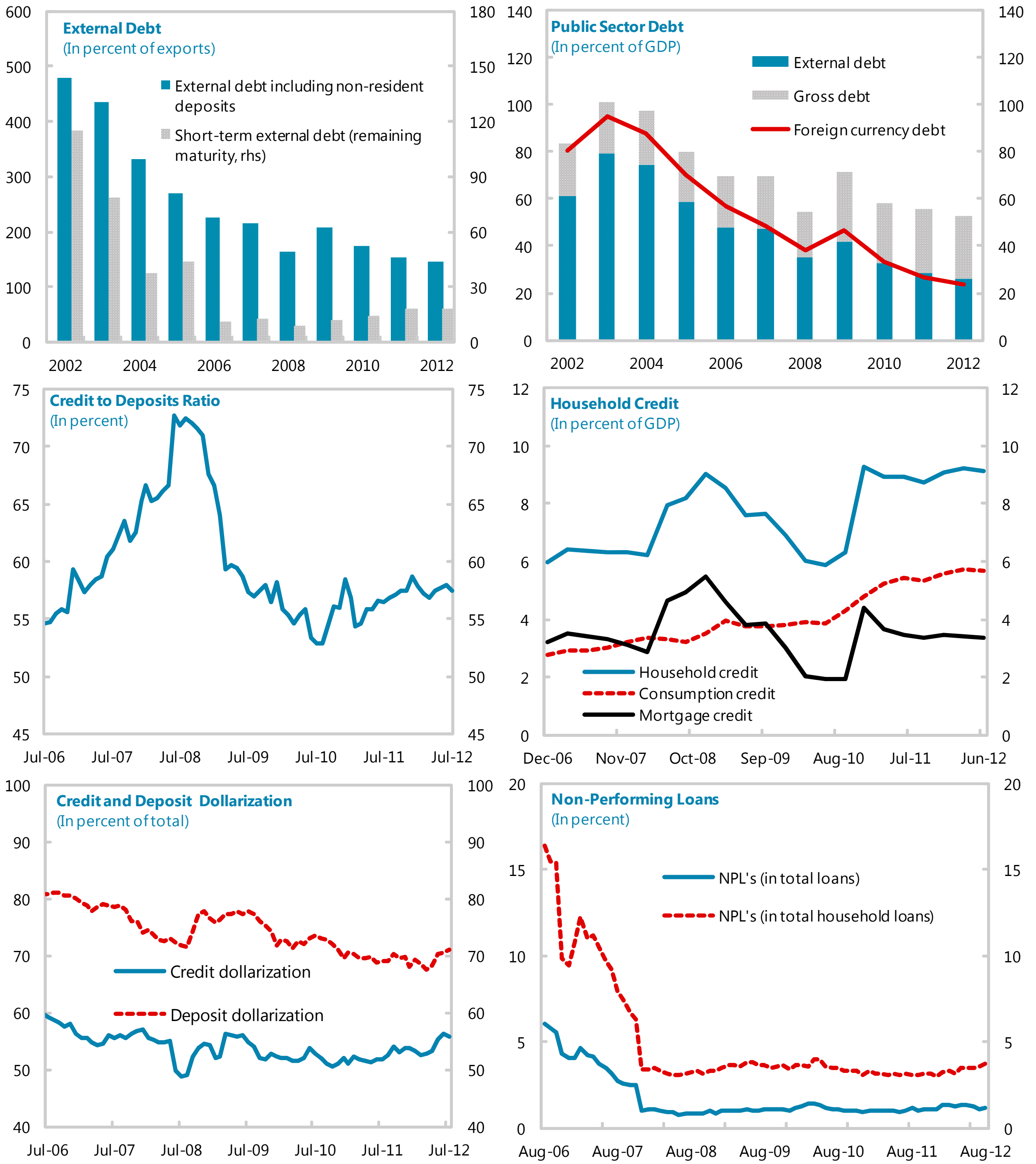


Sources: World Economic Outlook, Haver Analytics, and Fund staff calculations

1/ For Argentina, calculated using official CPI.
2/ For Argentina, calculated using Fund staff's estimate of the average inflation rate in 7 provinces, excluding Buenos Aires.

Figure 5. Uruguay: Balance Sheet Vulnerabilities

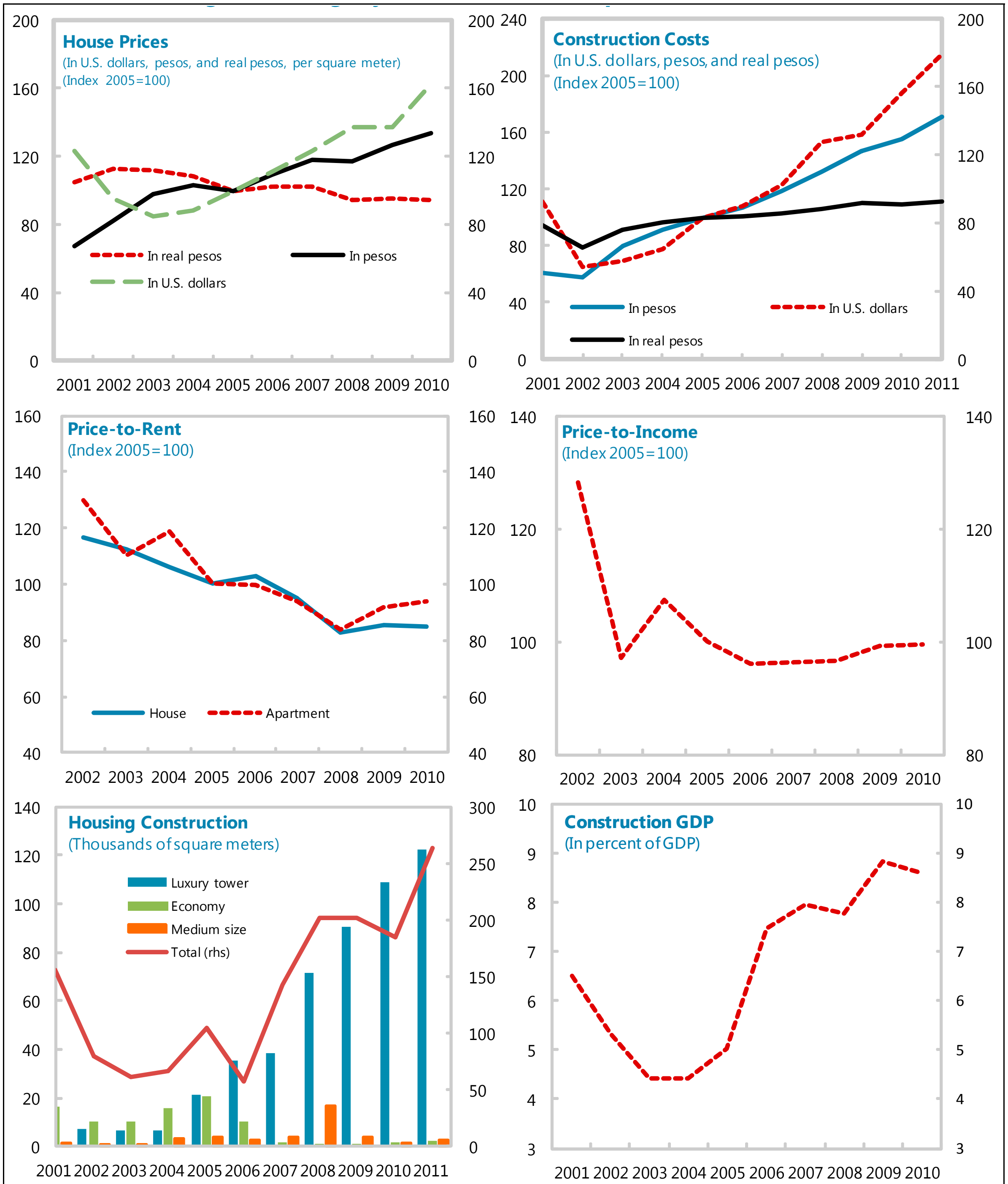
The public debt-to-GDP ratio has declined, mostly the foreign currency and external components. Dollarization has declined but remains elevated. NPLs remain very low.



Sources: World Economic Outlook, and Fund staff estimates and calculations.

Figure 6. Uruguay: Real Estate Developments

Construction and house prices have risen in recent years. At least in Montevideo, prices appear to be in line with rents and incomes.



Sources: Instituto Nacional de Estadisticas del Uruguay, and Fund staff estimates and calculations.

Table 1. Uruguay: Selected Economic and Social Indicators

					Prel.	Proj.					
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Percent change, unless otherwise specified)										
Real GDP	6.5	7.2	2.4	8.9	5.7	3.5	4.0	4.0	4.0	4.0	4.0
GDP (US$ billions)	23.4	30.4	30.5	39.4	46.7	49.2	56.3	59.6	63.1	66.3	69.7
CPI inflation (average)	8.1	7.9	7.1	6.7	8.1	8.0	8.0	7.3	6.6	6.2	6.0
Unemployment (in percent, end of period)	7.7	6.8	6.3	5.4	5.3	6.0	...	...	...	...	...
Base Money 1/	16.4	29.3	6.5	16.2	17.3	27.4	...	...	...	...	...
M-1 1/	29.4	18.6	12.2	28.9	21.3	20.4	...	...	...	...	...
M-2 1/	30.6	17.1	15.0	30.3	21.4	17.4	...	...	...	...	...
M-3 1/	3.8	28.6	-2.6	22.1	17.2	27.0	...	...	...	...	...
Credit to the private sector (constant exch. rate) 1/	22.1	28.0	-7.5	21.3	20.3	20.8	...	...	...	...	...
NPL ratio	1.1	1.0	1.2	1.0	1.3	...	...	...	...	...	...
Bank assets (in percent of GDP)	58.5	66.1	58.8	61.5	61.5	...	...	...	...	...	...
Foreign bank market share	54.5	56.8	56.4	57.6	56.7	...	...	...	...	...	...
	(Percent of GDP, unless otherwise specified)										
Revenue 2/	28.6	26.9	28.7	29.4	28.9	29.0	30.3	30.9	31.0	31.2	31.3
Non-interest expenditure 2/	25.3	25.7	27.9	27.7	27.1	28.8	29.2	29.4	29.3	29.4	29.4
Wage bill	4.6	4.6	5.2	5.0	5.0	5.1	5.1	5.2	5.2	5.2	5.2
Primary balance 3/	3.6	1.4	1.1	1.9	2.0	0.5	1.3	1.7	1.8	1.9	2.0
Interest 3/	3.6	2.9	2.9	3.0	2.9	2.8	3.0	3.1	3.0	3.0	3.1
Overall balance 3/	0.0	-1.6	-1.8	-1.1	-0.9	-2.3	-1.7	-1.4	-1.2	-1.1	-1.1
Gross public sector debt	64.4	63.3	62.7	58.0	57.8	52.3	52.1	50.6	48.3	45.7	43.0
Foreign currency debt	44.7	44.2	40.9	33.0	27.9	23.5	21.9	21.7	21.3	20.2	19.1
Net public sector debt 4/	38.1	31.6	32.0	31.2	34.4	31.2	33.3	32.9	31.5	29.8	27.9
Merchandise exports, fob (US$ millions)	5,100	7,095	6,392	8,031	9,307	9,852	10,693	11,686	12,615	13,511	14,685
Merchandise imports, fob (US$ millions)	5,645	8,810	6,896	8,558	10,690	11,195	11,801	12,671	13,761	14,682	15,791
Terms of trade (percentage change)	2.3	-1.2	5.7	-3.0	0.1	3.1	2.9	2.2	2.3	2.0	2.1
Current account balance	-0.9	-5.7	-1.5	-2.2	-3.1	-3.0	-2.4	-2.1	-2.4	-2.4	-2.4
Foreign direct investment	5.7	6.9	5.0	5.8	4.7	6.8	5.1	4.3	4.2	4.3	4.3
Overall balance of payments (US$ millions)	1,005	2,232	1,588	-361	2,564	2,385	192	188	192	190	500
External debt 5/	48.3	46.1	40.4	35.4	32.9	30.5	28.7	27.5	26.6	24.9	23.6
Of which: external public debt	43.7	41.1	36.6	32.4	29.8	25.9	23.4	22.2	21.3	19.7	18.3
External debt service (percent of exports of goods and services)	26.1	21.7	23.8	29.7	21.2	26.9	20.1	18.1	18.4	17.5	18.8
Gross official reserves (US$ millions) 6/	4,124	6,362	8,040	7,655	10,274	12,659	12,851	13,039	13,231	13,421	13,921
In months of imports of goods and services	4.8	9.3	9.5	7.2	9.2	10.7	10.0	9.3	9.3	9.3	9.3
In percent of short-term debt	471.8	797.2	772.3	517.1	447.9	512.8	445.1	430.2	403.0	395.3	351.9
In percent of short-term debt plus bank non-resident deposits	117.2	151.4	162.6	129.5	151.4	179.7	152.0	146.2	139.3	135.4	129.0

Sources: Banco Central del Uruguay, Ministerio de Economia y Finanzas, Instituto Nacional de Estadistica, and Fund staff calculations.
1/ In 2012 corresponds to the change between June 2011 and June 2012.
2/ Non-financial public sector excluding local governments.
3/ Total public sector.
4/ Public sector debt net of Banco Central del Uruguay' assets.
5/ Excludes nonresident deposits.
6/ Includes reserve buildup through reserve requirements of resident financial institutions.

Table 2. Uruguay: Main Fiscal Aggregates 2007–2015

					Projections				
	2007	2008	2009	2010	2011	2012	2013	2014	2015
	(In millions of pesos, unless otherwise indicated)								
Public sector									
Non financial public sector									
Revenues	**157,132**	**170,943**	**197,234**	**232,512**	**260,289**	**290,507**	**339,910**	**383,462**	**424,193**
Taxes	105,054	120,560	134,334	152,175	175,104	188,475	213,566	237,706	262,984
Non tax	10,234	10,190	10,541	12,449	15,448	19,945	24,531	30,745	34,199
Social security	28,473	34,778	42,922	49,742	59,930	72,344	85,110	95,391	106,604
SOE Operating balance	13,370	5,414	9,438	18,146	9,807	9,743	16,704	19,621	20,406
Primary expenditures	**138,955**	**163,784**	**192,167**	**219,323**	**244,118**	**288,228**	**327,835**	**364,267**	**400,923**
Current	122,836	142,593	168,187	190,711	219,487	260,242	290,961	327,034	360,434
Capital	16,119	21,191	23,980	28,612	24,631	27,986	36,874	37,233	40,489
Primary balance (local governments)	1,053	925	2,132	-167	929	812	877	1,213	1,337
Primary balance (NFPS)	19,230	8,084	7,200	13,022	17,100	3,091	12,952	20,408	24,606
Primary balance (BSE and BCU)	509	686	450	2,153	816	2,015	1,546	475	523
Primary balance (public sector)	**19,740**	**8,770**	**7,649**	**15,176**	**17,917**	**5,106**	**14,498**	**20,883**	**25,130**
Interest	19,681	18,630	19,850	23,804	26,186	27,678	33,594	37,874	41,711
Overall balance	**58**	**-9,860**	**-12,200**	**-8,628**	**-8,269**	**-22,572**	**-19,096**	**-16,991**	**-16,582**
Public gross debt (in millions of U.S. dollars)	**16,319**	**16,534**	**21,891**	**22,927**	**26,122**	**26,209**	**29,303**	**30,187**	**30,454**
External	11,081	10,748	12,775	12,825	13,452	12,956	13,176	13,260	13,447
Domestic	5,238	5,786	9,116	10,101	12,670	13,253	16,127	16,927	17,007
Foreign-currency debt (in millions of U.S. dollars)	**11,323**	**11,543**	**14,304**	**13,060**	**12,583**	**11,789**	**12,341**	**12,917**	**13,453**
Short term debt (remaining maturity), (in millions of U.S. dollars)	**1,135**	**992**	**2,445**	**3,575**	**3,706**	**2,094**	**2,408**	**2,439**	**2,412**
	(In percent of GDP, unless otherwise indicated)								
Public sector									
Non financial public sector									
Revenues	**28.6**	**26.9**	**28.7**	**29.4**	**28.9**	**29.0**	**30.3**	**30.9**	**31.0**
Taxes	19.1	19.0	19.5	19.2	19.4	18.8	19.0	19.2	19.2
Non tax	1.9	1.6	1.5	1.6	1.7	2.0	2.2	2.5	2.5
Social security	5.2	5.5	6.2	6.3	6.6	7.2	7.6	7.7	7.8
SOE operating balance	2.4	0.9	1.4	2.3	1.1	1.0	1.5	1.6	1.5
Primary expenditures	**25.3**	**25.7**	**27.9**	**27.7**	**27.1**	**28.8**	**29.2**	**29.4**	**29.3**
Current	22.4	22.4	24.4	24.1	24.3	26.0	25.9	26.4	26.4
Capital	2.9	3.3	3.5	3.6	2.7	2.8	3.3	3.0	3.0
Primary balance (Local governments)	0.2	0.1	0.3	0.0	0.1	0.1	0.1	0.1	0.1
Primary balance (NFPS)	3.5	1.3	1.0	1.6	1.9	0.3	1.2	1.6	1.8
Primary balance (BSE and BCU)	0.1	0.1	0.1	0.3	0.1	0.2	0.1	0.0	0.0
Primary balance (public sector)	**3.6**	**1.4**	**1.1**	**1.9**	**2.0**	**0.5**	**1.3**	**1.7**	**1.8**
Interest	3.6	2.9	2.9	3.0	2.9	2.8	3.0	3.1	3.0
Overall balance	**0.0**	**-1.6**	**-1.8**	**-1.1**	**-0.9**	**-2.3**	**-1.7**	**-1.4**	**-1.2**
Public gross debt	**64.4**	**63.3**	**62.7**	**58.0**	**57.8**	**52.3**	**52.1**	**50.6**	**48.3**
External	43.7	41.1	36.6	32.4	29.8	25.9	23.4	22.2	21.3
Domestic	20.7	22.2	26.1	25.5	28.0	26.5	28.7	28.4	26.9
Foreign-currency denominated debt	**44.7**	**44.2**	**40.9**	**33.0**	**27.9**	**23.5**	**21.9**	**21.7**	**21.3**
Short-term debt (remaining maturity)	**4.5**	**3.8**	**7.0**	**9.0**	**8.2**	**4.2**	**4.3**	**4.1**	**3.8**
Memorandum items									
GDP (in billions of pesos)	549,470	636,151	688,257	790,576	902,163	1,001,765	1,122,624	1,241,114	1,367,871

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

Table 3. Uruguay: Statement of Operations of the Central Government [1/2/]

(Percentages of GDP, based on the 2001 GFS Manual)

	2007	2008	2009	2010	2011
Revenue	**26.5**	**26.5**	**30.3**	**30.6**	**30.8**
Taxes	18.4	18.2	19.4	19.3	19.6
Social contributions	5.5	5.8	9.0	9.1	9.4
Grants	0.0	0.0	0.0	0.0	0.0
Other revenue	2.6	2.4	1.9	2.2	1.9
Expense	**26.5**	**25.6**	**30.2**	**30.1**	**29.9**
Compensation of employees	6.0	6.1	7.4	6.9	7.1
Use of goods and services	4.1	3.8	3.8	3.8	3.5
Consumption of fixed capital 3/	....	....	....	....	....
Interest	3.8	2.9	2.8	2.4	2.5
Subsidies	2.7	2.6	0.4	0.2	0.2
Grants	0.0	0.0	0.7	0.0	0.0
Social benefits	9.9	10.3	13.2	13.7	13.8
Other expenses	0.0	0.0	2.0	3.0	2.8
Net acquisition of nonfinancial assets	**1.6**	**1.8**	**1.6**	**1.4**	**0.9**
Acquisitions of nonfinancial assets 3/	....	....	....	....	....
Disposals of nonfinancial assets 3/	....	....	....	....	....
Consumption of fixed capital 3/	....	....	....	....	....
Gross operating balance	0.0	0.9	0.1	0.5	0.9
Net operating balance 4/	....	....	....	....	....
Net lending (+) borrowing (-)	**-1.5**	**-0.9**	**-1.5**	**-0.9**	**-0.6**
Net acquisition of financial assets	**2.4**	**-0.9**	**4.7**	**-2.4**	**3.6**
By instrument					
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0
Currency and deposits	2.7	-1.2	1.9	-2.1	3.3
Debt securities	0.0	0.0	2.0	0.1	0.4
Loans	-0.3	0.3	0.1	-0.4	-0.1
Equity and shares	0.0	0.0	0.7	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0
By residency					
Domestic	2.4	-0.9	4.7	-2.4	3.3
External	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	3.9	0.2	6.4	-1.2	4.2
By instrument					
SDRs	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0
Debt securities	4.0	-0.9	1.5	-0.1	4.7
Loans	0.0	1.1	4.9	-1.2	-0.6
Equity and shares	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0
Other accounts payable	0.0	0.0	0.0	0.0	0.0
By residency					
Domestic	-0.4	1.5	3.9	-0.8	4.4
External	4.4	-1.3	2.5	-0.4	-0.2
Memorandum items					
Public sector net lending (+) borrowing (-)	0.0	-1.6	-1.8	-1.1	-0.9
Public sector primary balance	3.6	1.4	1.1	1.9	2.0

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

1/ Central government and Social Security Bank. Collection of above the line data for feasible at this moment.

2/ Preliminary data. Authorities are in the process of revising historical data in the context of their work to improve reporting under the 2001 GFS framework.

3/ Not compiled by the authorities.

4/ Not available.

Table 4. Uruguay: Central Government Stock Positions

(Percentages of GDP, based on the 2001 GFS Manual)

	2007	2008	2009	2010	2011
Stock positions					
Net worth	....	....	....	....	....
Nonfinancial assets	....	....	....	....	....
Net financial worth	**-47.2**	**-47.9**	**-39.8**	**-36.4**	**-35.9**
Financial assets	**11.3**	**9.3**	**11.4**	**8.8**	**10.6**
By instrument					
Monetary gold and SDRs	0.0	0.0	0.0	0.0	0.0
Currency and deposits	8.3	6.8	7.2	4.5	7.0
Debt securities	0.0	0.0	1.6	2.1	2.5
Loans	3.0	2.5	1.9	1.7	0.6
Equity and shares	0.0	0.0	0.7	0.6	0.5
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0
Other accounts receivable	0.0	0.0	0.0	0.0	0.0
By residency					
Domestic	11.3	9.3	11.4	8.8	10.6
External	0.0	0.0	0.0	0.0	0.0
Liabilities	**58.5**	**57.3**	**51.2**	**45.2**	**46.6**
By instrument					
SDRs	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0
Debt securities	45.0	42.8	36.6	33.2	35.5
Loans	13.5	14.4	14.5	12.0	11.0
Equity and shares	0.0	0.0	0.0	0.0	0.0
Insurance technical reserves	0.0	0.0	0.0	0.0	0.0
Derivatives	0.0	0.0	0.0	0.0	0.0
Other accounts payable	0.0	0.0	0.0	0.0	0.0
By residency					
Domestic	19.6	20.7	20.8	18.3	21.6
External	38.9	36.5	30.3	26.9	25.0
Memorandum items					
Central government gross debt	58.5	57.3	51.2	45.2	46.6
General government gross debt	59.3	58.0	51.7	45.6	47.0
Public sector gross debt	64.4	63.3	62.7	58.0	57.8
Public sector external debt	43.7	41.1	36.6	32.4	29.8

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

Table 5. Uruguay: Summary Accounts of the Banking System

(In millions of U.S. dollars)

	2007	2008	2009	2010	2011	2012 1/
	Banco Central del Uruguay					
Net foreign assets	5,208	7,034	8,255	7,659	10,324	12,094
Net international reserves 2/	4,124	6,362	8,040	7,655	10,302	12,546
Gross international reserves	4,124	6,362	8,040	7,655	10,302	12,546
Reserve liabilities 2/	0	0	0	0	0	0
Other net foreign assets	1,086	674	217	4	22	-451
Net domestic assets	-3,263	-4,858	-5,473	-4,307	-6,217	-8,114
Net credit to the public sector	-55	1,512	991	2,540	1,115	1,266
Net credit to the financial system	-1,799	-3,314	-2,695	-1,776	-2,602	-3,797
Credit to the private sector	15	14	15	14	15	14
Securities issued by the BCU	-2,564	-2,545	-4,431	-6,134	-6,054	-6,658
Other	1,140	-526	647	1,049	1,310	1,061
Peso monetary liabilities	1,945	2,176	2,782	3,353	4,107	3,981
	Public and Private Banks 3/					
Net foreign assets	2,345	1,722	2,790	4,906	5,225	4,664
Net domestic assets	7,706	9,856	10,922	11,161	13,699	15,467
Net credit to the public sector	142	-1	1,222	551	1,054	1,309
Net credit to the financial system	3,352	4,858	5,129	4,678	5,569	6,411
Credit to the private sector	5,968	7,260	7,456	8,949	10,253	11,023
Other	-1,756	-2,261	-2,885	-3,018	-3,177	-3,276
Liabilities to the private sector (residents)	10,051	11,578	13,712	16,067	18,924	20,131
Public banks	5,367	5,978	6,981	8,004	9,433	10,139
Local currency	1,618	1,751	2,352	2,804	3,469	3,592
Foreign currency	3,749	4,227	4,629	5,200	5,964	6,547
Private banks	4,684	5,599	6,731	8,063	9,491	9,992
Local currency	1,122	1,226	1,808	2,335	2,641	2,597
Foreign currency	3,562	4,373	4,923	5,729	6,850	7,395
	Banking System					
Net foreign assets	7,552	8,756	11,044	12,566	15,550	16,758
Net domestic assets	2,822	2,501	3,179	4,405	4,671	4,064
Credit to the public sector	87	1,511	2,213	3,091	2,169	2,575
Credit to the rest of financial system	-67	-953	164	453	156	-675
Credit to the private sector	5,983	7,274	7,471	8,964	10,268	11,037
Other	-3,180	-5,331	-6,669	-8,103	-7,922	-8,873
Broad money (M3)	10,375	11,257	14,224	16,971	20,221	20,822
	(Percentage change, unless otherwise indicated)					
Memorandum items:						
Base money (end-of-period)	16.4	29.3	6.5	16.2	17.3	27.4
Currency issued	11.6	14.8	13.2	19.3	18.4	19.2
M-1	29.4	18.6	12.2	28.9	21.3	20.4
M-2	30.6	17.1	15.0	30.3	21.4	17.4
M-3	3.8	28.6	-2.6	22.1	17.2	27.0
Credit to private sector (constant exchange rate)	22.1	28.0	-7.5	21.3	20.3	20.8
"Free" international reserves (in millions of US$) 4/	1,847	2,615	4,882	5,808	7,466	8,598

Source: Banco Central del Uruguay.
1/ Data as of June 2012.
2/ Includes all outstanding liabilities to the IMF, but excludes liabilities to resident financial institutions.
3/ The Banco de la Republica Oriental de Uruguay (BROU), Banco Hipotecario de Uruguay (BHU; mortgage institution), private banks, casas financieras and cooperatives.
4/ Net of liabilities to resident financial institutions.

Table 6. Uruguay: Balance of Payments and External Sector Indicators

(In millions of U.S. dollars, unless otherwise stated)

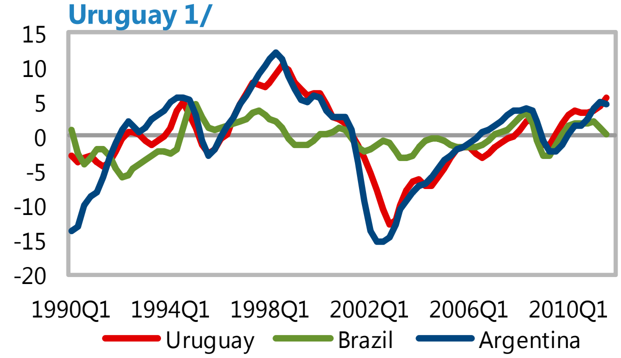
					Prel.			Projections			
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					Balance of Payments						
Current account	**-220**	**-1,729**	**-449**	**-863**	**-1,442**	**-1,468**	**-1,369**	**-1,267**	**-1,506**	**-1,619**	**-1,678**
Trade balance	-545	-1,714	-504	-526	-1,384	-1,342	-1,108	-985	-1,146	-1,170	-1,105
Exports, f.o.b.	5,100	7,095	6,392	8,031	9,307	9,852	10,693	11,686	12,615	13,511	14,685
Imports, f.o.b.	5,645	8,810	6,896	8,558	10,690	11,195	11,801	12,671	13,761	14,682	15,791
Of which: Fuel products	1,148	2,504	1,354	1,593	2,008	1,672	1,699	1,825	1,970	2,079	2,200
Services	703	753	930	1,024	1,381	1,569	1,418	1,478	1,546	1,527	1,485
Exports, f.o.b.	1,833	2,277	2,245	2,576	3,395	3,773	3,873	4,219	4,545	4,867	5,215
Imports, f.o.b.	1,130	1,523	1,315	1,553	2,014	2,204	2,455	2,741	2,999	3,340	3,730
Income (net)	-516	-917	-1,013	-1,479	-1,565	-1,824	-1,812	-1,897	-2,046	-2,120	-2,207
Transfers (net)	137	148	138	118	126	130	133	137	141	145	149
Financial and capital account	**1,505**	**3,098**	**1,184**	**1,067**	**3,410**	**3,853**	**1,561**	**1,455**	**1,698**	**1,809**	**2,178**
Foreign direct investment	1,329	2,106	1,529	2,289	2,191	3,328	2,877	2,536	2,668	2,826	2,993
Other capital flows (net)	176	992	-345	-1,222	1,218	525	-1,316	-1,080	-971	-1,017	-815
Portfolio investment (net)	1,151	-558	-821	-654	...	...	...	...	...	...	...
Loans (net)	422	667	928	-986	...	...	...	...	...	...	...
Deposits (net)	-1,595	1,316	-955	438	...	...	...	...	...	...	...
Other flows, net	281	-445	520	-80	...	...	...	...	...	...	...
Unidentified financing	-86	11	-16	60	...	...	...	...	...	...	...
Errors and omissions	-279	864	853	-565	597	0	0	0	0	0	0
Reserve assets (- increase)	**-1,005**	**-2,232**	**-1,588**	**361**	**-2,564**	**-2,385**	**-192**	**-188**	**-192**	**-190**	**-500**
					Reserve Adequacy and External Indicators						
Gross official reserves (stock)	**4,124**	**6,362**	**8,040**	**7,655**	**10,274**	**12,659**	**12,851**	**13,039**	**13,231**	**13,421**	**13,921**
In months of next year's imports of goods and services	4.8	9.3	9.5	7.2	9.2	10.7	10.0	9.3	9.3	9.3	9.3
In percent of short-term debt	471.8	797.2	772.3	517.1	447.9	512.8	445.1	430.2	403.0	395.3	351.9
					(As percent of GDP)						
Exports of goods	21.8	23.4	21.0	20.4	19.9	20.0	19.0	19.6	20.0	20.4	21.1
Imports of goods	24.1	29.0	22.6	21.7	22.9	22.8	21.0	21.2	21.8	22.1	22.7
Current account	-0.9	-5.7	-1.5	-2.2	-3.1	-3.0	-2.4	-2.1	-2.4	-2.4	-2.4
Financial and capital account	6.4	10.2	3.9	2.7	7.3	7.8	2.8	2.4	2.7	2.7	3.1
Of which: Foreign direct investment (net)	5.7	6.9	5.0	5.8	4.7	6.8	5.1	4.3	4.2	4.3	4.3
Other capital flows (net)	0.8	3.3	-1.1	-3.1	2.6	1.1	-2.3	-1.8	-1.5	-1.5	-1.2
Changes in GIR	-4.3	-7.4	-5.2	0.9	-5.5	-4.9	-0.3	-0.3	-0.3	-0.3	-0.7
Total external debt	48.3	46.1	40.4	35.4	32.9	30.5	28.7	27.5	26.6	24.9	23.6
Short-term debt (residual maturity)	3.7	2.6	3.4	3.8	4.9	5.0	5.1	5.1	5.2	5.1	5.7
External public debt	43.7	41.1	36.6	32.4	29.8	25.9	23.4	22.2	21.3	19.7	18.3
Total external debt + NR deposits	58.7	59.1	51.5	46.6	42.8	39.7	38.6	37.4	36.4	34.8	33.4
					(As percent of annual exports of goods and services)						
Total external debt	176.5	128.4	163.2	131.9	116.9	112.2	110.9	103.2	97.8	90.1	82.6
Total external debt (including nonresidential deposits	214.6	164.7	208.4	173.7	152.3	145.8	149.1	140.2	134.0	125.5	117.0
Debt service	26.1	21.7	23.8	29.7	21.2	26.9	20.1	18.1	18.4	17.5	18.8
Of which: Interest payments	12.5	8.9	9.3	7.8	6.8	7.8	6.7	6.2	6.2	5.7	5.3
					(Annual percent changes)						
Exports of goods (merchandise)	15.9	39.1	-9.9	25.7	15.9	5.9	8.5	9.3	8.0	7.1	8.7
Imports of goods (merchandise)	15.2	56.1	-21.7	24.1	24.9	4.7	5.4	7.4	8.6	6.7	7.6
Export prices in US$ (year-on-year percent change)	11.6	22.8	-10.1	7.7	12.6	2.5	2.6	2.7	2.8	2.6	3.3
Import prices in US$ (year-on-year percent change)	9.0	24.3	-14.9	11.1	12.5	-0.5	-0.2	0.5	0.5	0.6	1.1
Terms of trade	2.3	-1.2	5.7	-3.0	0.1	3.1	2.9	2.2	2.3	2.0	2.1
Export volume	7.4	10.1	2.5	14.0	6.3	4.7	4.2	6.3	4.9	4.3	4.9
Import volume	5.7	22.7	-6.6	10.9	11.7	6.0	6.6	7.6	8.2	6.9	7.1

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

ANNEX I. SPILLOVERS FROM ABROAD-HOW IMPORTANT ARE THEY FOR URUGUAY'S GDP?

Uruguay is a small, very open economy affected by developments in the global economy through trade, tourism, and investment flows, as well as commodity price fluctuations. Its two key partners, Argentina and Brazil, account for about a third of merchandise exports. During the last decade, Argentina's share has fallen from 18 to 7 percent, while that of Brazil has stayed around 20 percent. The last decade also saw a growing share of emerging Asia and other Latin American countries in Uruguay's exports. In addition to being a key trade partner, Argentina is also an important source of tourism and FDI flows into Uruguay, accounting for about half of tourism revenues and a quarter of FDI, respectively (Figure A1.1). This annex analyzes and quantifies the importance of various external shocks for Uruguay's output fluctuations, and the extent to which global shocks are transmitted to Uruguay via Argentina and Brazil.

Business Cycles in Argentina, Brazil, and Uruguay 1/



Source: Fund staff estimates.
1/ Deviation of real GDP from a Hodrick-Prescott trend (percent of trend).

To estimate the responses of the Uruguayan economy to external shocks, we follow the methodology used in Chapter 4 of the April 2012 Western Hemisphere Regional Economic Outlook (REO). We estimate a vector autoregressive (VAR) model that includes Uruguay's real GDP growth and a set of external variables: global GDP growth, GDP growth in Argentina, GDP growth in Brazil, commodity prices, and global financial conditions (as measured by the VIX).[1] The model is estimated using quarterly data for the period 1990Q1–2011Q4.[2]

The VAR is run in three specifications. In the first specification, all variables are considered endogenous. In the second specification, Brazil's GDP enters as exogenous. In the third specification, Argentina's GDP enters as exogenous. In the second and third specifications, the estimated responses to global shocks exclude the impact that is transmitted through Brazil and Argentina, respectively. Thus, comparing the estimated response to global shocks in the first and second (third) models gives the share of the global shock transmitted through Brazil (Argentina). These shares reflect both the sensitivity of Brazil's (Argentina's) output to global shocks, and the effect of that response on Uruguay.

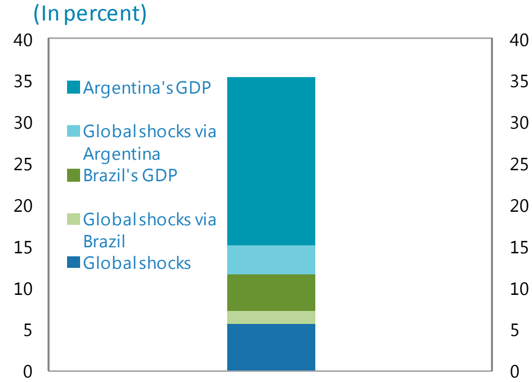
[1] Commodity prices are measured by a broad price index, in real terms and stripped of exchange rate effects (as in "Intra-regional spillovers in South America; Is Brazil systemic after all?" by G. Adler and S. Sosa, IMF Working Paper 12/145, June 2012).

[2] The model is estimated in first differences of log levels (except the VIX, which is in levels), using two lags. Structural parameters are identified by Choleski decomposition. The ordering, from more exogenous to more endogenous variables, is as follows: first the global variables, second, growth in Brazil and Argentina, and finally, Uruguayan output.

The impulse responses in Figure A1.2 confirm that Uruguay is subject to spillovers from Brazil. Shocks are transmitted quickly, and most of the response takes place within the first four quarters, and then it fades. Positive shocks to global GDP and commodity prices also have expansionary effects on Uruguay's GDP, while a rise in the VIX has contractionary effects. Finally, spillovers from Argentina stand out as particularly important. The impact on Uruguay from a shock to Argentina's GDP is bigger and more persistent than the impact from a shock to Brazil's GDP.

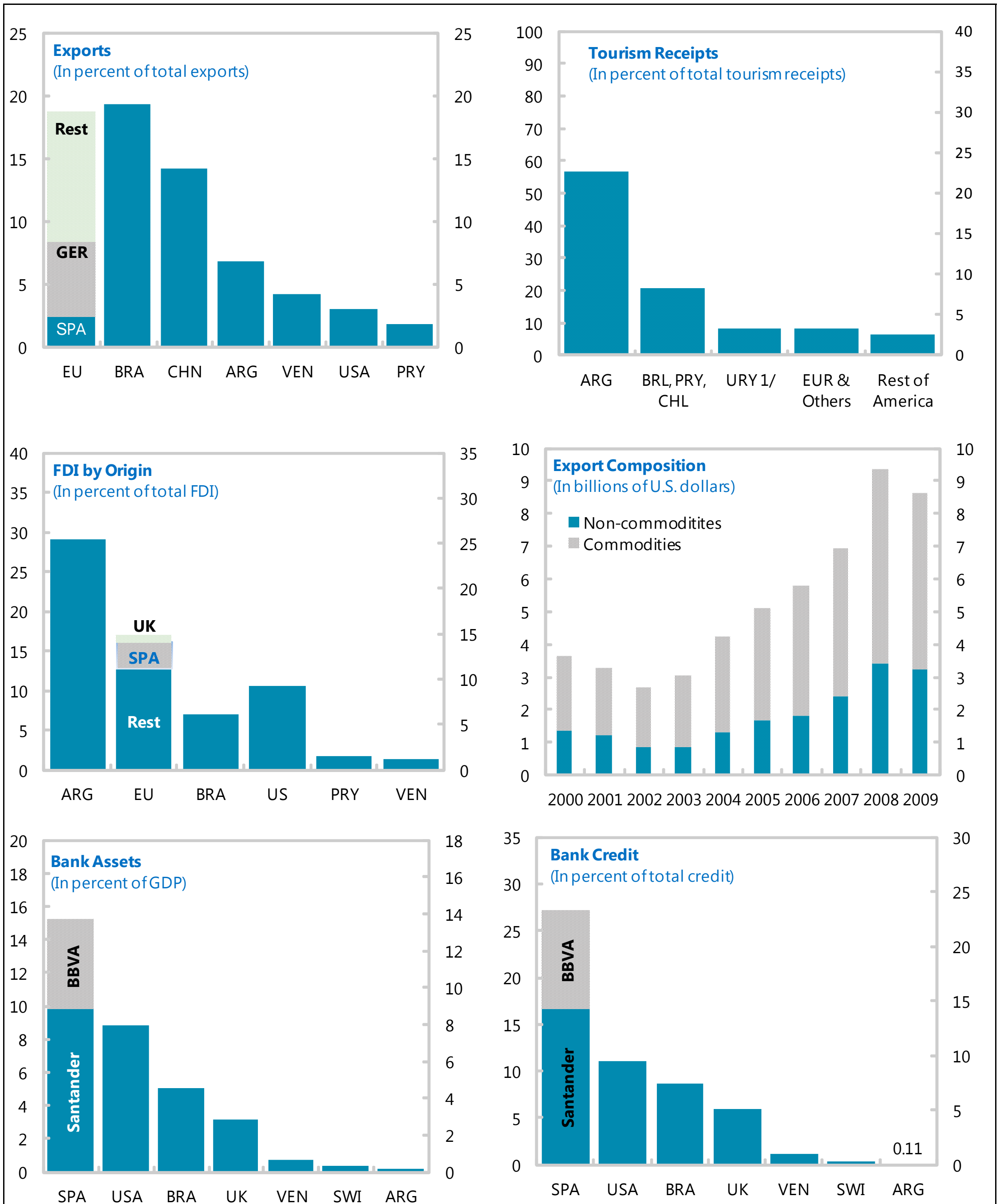
The peak cumulative impact of a 1 percentage point increase in Brazil's growth is about 0.2 percentage points for Uruguay, and it peaks within 1–2 quarters. The effect from a shock of the same magnitude in Argentina and the rest of the world are 1.1 and 1.3 percentage points, respectively. However, the sensitivity to growth in Argentina has diminished over time. Estimated VARs for two sub-periods, we find that the elasticity of Uruguay's growth to growth in Argentina declined from 1.4 in 1990–2002 to 0.7 in 2003–2011.

Fraction of GDP Variance Explained by External Factors
(In percent)



Variance decomposition suggests that about 35 percent of output fluctuations in Uruguay are attributable to external shocks. Spillovers from Argentina are the main external source of output fluctuations (20 percent of the total). Spillovers from Brazil are also important, but much smaller (4 percent of the total). Global shocks intermediated through Brazil and Argentina account for 5 percent of the fluctuations in Uruguay's GDP, while the direct effect of global factors account for another 6 percent.

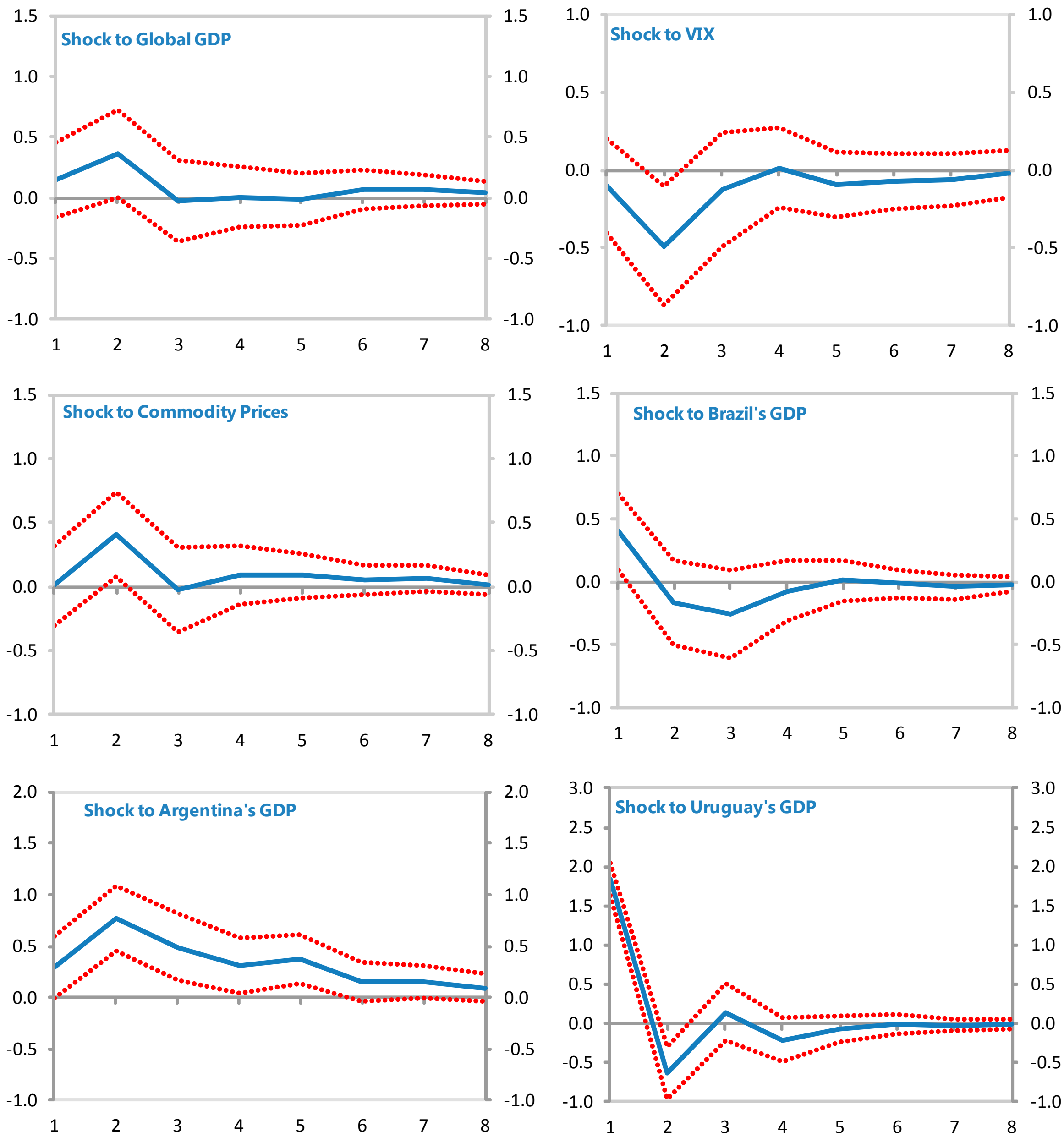
Figure A1.1. Uruguay: External Linkages



Sources: Banco Central del Uruguay and Fund staff calculations.
1/ URY corresponds to Uruguayans living abroad.

Figure A1.2. Dynamic Responses of Uruguay's GDP Growth to Shocks

Response to one standard deviation shocks +/-2 standard errors 1/



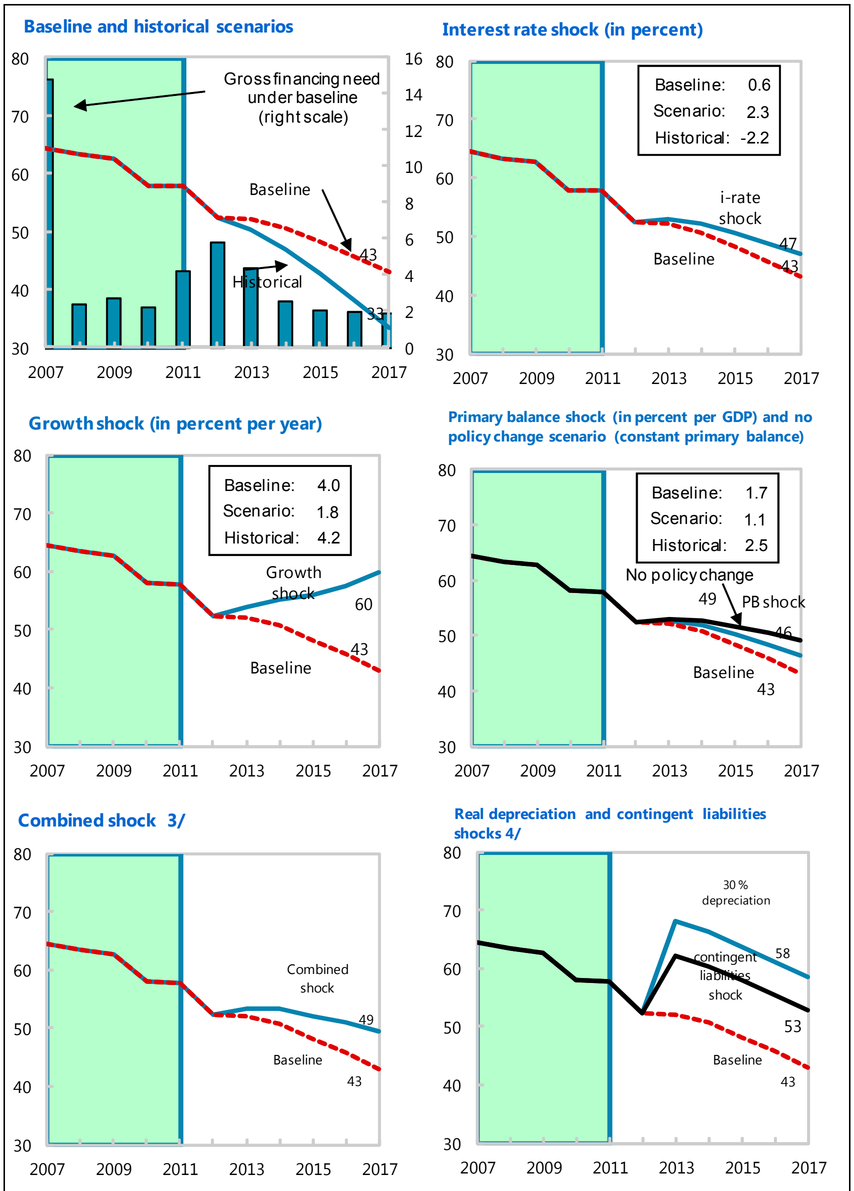
Sources: Fund staff estimates.

1/ The size of one standard deviation shocks are as follows: World GDP: 0.5 percentage point (pp); VIX: 8 points; commodity prices: 7.2 pp; Brazil's GDP: 2 pp; Argentina's GDP: 2.5 pp; Uruguay's GDP: 2.6 pp.

ANNEX II. PUBLIC AND EXTERNAL DEBT SUSTAINABILITY ANALYSES

Figure A2.1. Uruguay: Public Debt Sustainability: Bound Tests 1/2/

(Public debt in percent of GDP)



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

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

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

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

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

A2.1. Uruguay : Public Sector Debt Sustainability Framework, 2007–2017

(In percent of GDP, unless otherwise indicated)

		Actual					Projections						
		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
1	**Baseline: public sector debt 1/**	**64.4**	**63.3**	**62.7**	**58.0**	**57.8**	**52.3**	**52.1**	**50.6**	**48.3**	**45.7**	**43.0**	**0.1**
	o/w foreign-currency denominated	47.8	37.3	37.8	36.3	28.0	25.6	22.2	23.3	23.3	23.0	21.8	
2	Change in public sector debt	-6.7	-1.1	-0.6	-4.7	-0.1	-5.5	-0.3	-1.5	-2.4	-2.5	-2.7	
3	Identified debt-creating flows (4+7+12)	-11.5	-11.9	-0.2	-10.9	-7.5	-3.5	-3.9	-3.6	-3.5	-3.1	-2.9	
4	Primary deficit	-3.6	-1.4	-1.1	-1.9	-2.0	-0.5	-1.3	-1.7	-1.8	-1.9	-2.0	
5	Revenue and grants	31.5	29.7	31.4	32.2	31.7	31.9	33.2	33.8	33.9	34.1	34.2	
6	Primary (noninterest) expenditure	27.9	28.3	30.3	30.3	29.7	31.4	31.9	32.1	32.1	32.2	32.2	
7	Automatic debt dynamics 2/	-7.9	-10.5	0.9	-9.0	-5.5	-3.0	-2.6	-1.9	-1.6	-1.2	-0.8	
8	Contribution from interest rate/growth differential 3/	-6.5	-5.9	-1.9	-5.1	-4.3	-3.0	-2.6	-1.9	-1.6	-1.2	-0.8	
9	Of which contribution from real interest rate	-2.5	-1.9	-0.5	-0.2	-1.4	-1.2	-0.8	0.0	0.2	0.6	0.8	
10	Of which contribution from real GDP growth	-4.0	-4.0	-1.4	-4.9	-2.9	-1.8	-1.9	-1.9	-1.8	-1.8	-1.7	
11	Contribution from exchange rate depreciation 4/	-1.4	-4.7	2.8	-3.9	-1.2	...	...	...	...	...	...	
12	Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
13	Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
14	Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15	Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16	Residual, including asset changes (2-3) 5/	4.8	10.8	-0.4	6.2	7.3	-2.0	3.7	2.1	1.1	0.6	0.2	
	Public sector debt-to-revenue ratio 1/	204.8	213.1	199.7	180.0	182.3	164.1	157.0	149.7	142.2	134.0	125.7	
	Gross financing need 6/	14.8	2.4	2.7	2.2	4.2	5.8	4.4	2.5	2.0	1.9	1.8	
	in billions of U.S. dollars	3.5	0.7	0.8	0.9	2.0	2.8	2.5	1.5	1.3	1.3	1.3	
	Scenario with key variables at their historical averages 7/						**52.3**	**50.4**	**47.0**	**42.7**	**38.1**	**33.3**	**-1.4**
	Scenario with no policy change (constant primary balance) in 2012-2017						**52.3**	**52.9**	**52.5**	**51.5**	**50.4**	**49.2**	**0.1**
	Key macroeconomic and fiscal assumptions underlying baseline												
	Real GDP growth (in percent)	6.5	7.2	2.4	8.9	5.7	3.5	4.0	4.0	4.0	4.0	4.0	
	Average nominal interest rate on public debt (in percent) 8/	5.9	5.3	4.9	5.5	5.7	5.3	6.4	6.5	6.6	6.8	7.3	
	Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-3.5	-2.8	-0.7	0.0	-2.2	-2.0	-1.3	0.2	0.7	1.5	2.2	
	Nominal appreciation (increase in U.S. dollar value of local currency, in percent)	2.6	12.0	-7.2	12.5	3.9	...	...	...	...	...	...	
	Inflation rate (GDP deflator, in percent)	9.4	8.0	5.6	5.5	8.0	7.3	7.8	6.3	6.0	5.3	5.2	
	Growth of real primary spending (deflated by GDP deflator, in percent)	7.2	9.0	9.4	8.9	3.8	9.2	5.7	4.8	3.9	4.4	4.1	
	Primary deficit	-3.6	-1.4	-1.1	-1.9	-2.0	-0.5	-1.3	-1.7	-1.8	-1.9	-2.0	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = 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).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

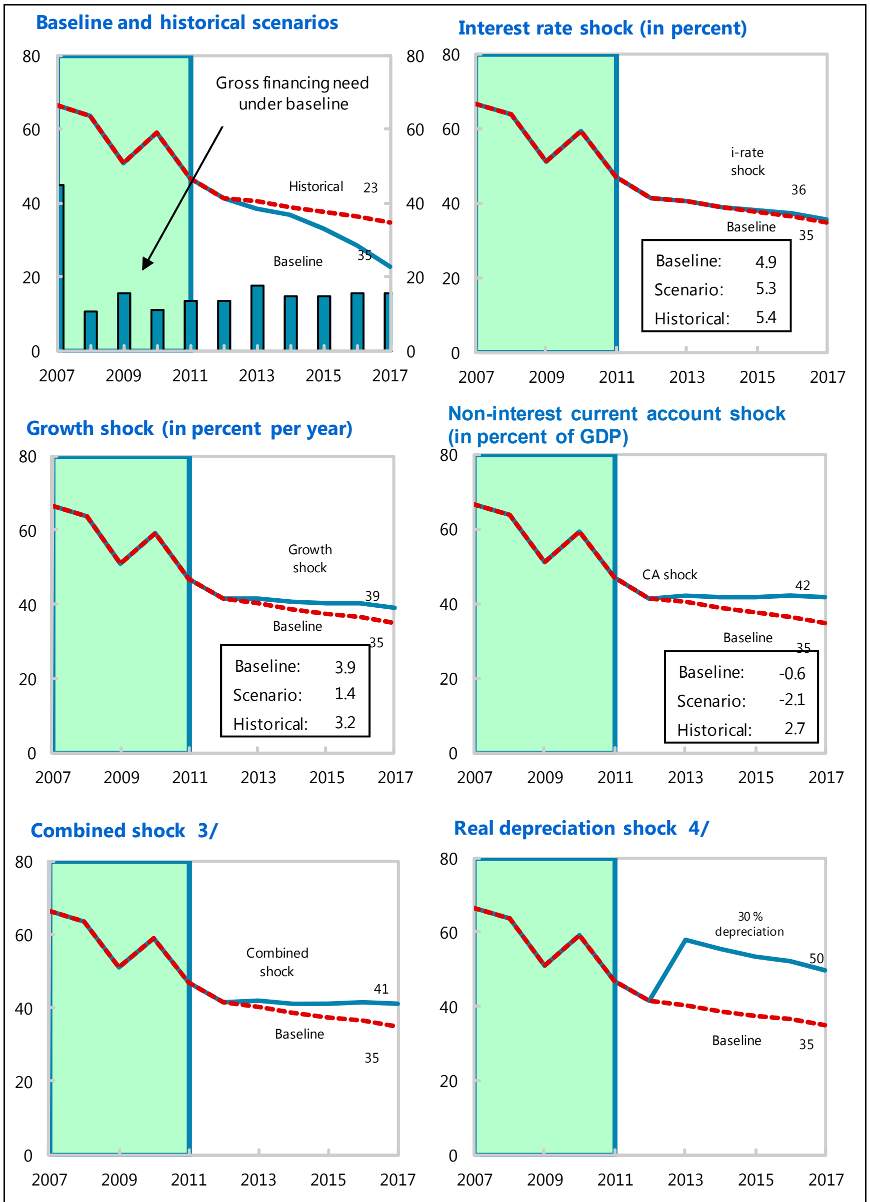
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

A2.2. Uruguay : External Debt Sustainability:Bound Tests [1/2/]

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2013.

A2.2. Uruguay : External Debt Sustainability Framework, 2007–2017

(In percent of GDP, unless otherwise indicated)

	Actual							Projections							
	2007	2008	2009	2010	2011			2012	2013	2014	2015	2016	2017		
								I. Baseline Projections							Debt-stabilizing non-interest current account 6/
1 External debt	66.4	63.6	50.8	59.0	46.7			41.4	40.4	38.6	37.4	36.4	34.8		-4.7
2 Change in external debt	-12.7	-2.8	-12.7	8.2	-12.3			-5.3	-1.0	-1.8	-1.2	-0.9	-1.7	0.0	
3 Identified external debt-creating flows (4+8+9)	-14.0	-15.5	-15.0	-4.1	-16.6			-8.8	-6.2	-7.6	-5.1	-4.2	-3.9	0.0	
4 Current account deficit, excluding interest payments	-2.6	-2.8	3.0	-1.2	0.1			1.2	0.8	0.7	0.0	0.7	0.9	4.7	
5 Deficit in balance of goods and services	0.5	-0.7	3.2	-1.4	-1.3			0.0	-0.5	-0.6	-0.8	-0.6	-0.5		
6 Exports	29.6	29.6	30.9	28.3	26.9			27.2	27.7	25.9	26.7	27.2	27.7		
7 Imports	30.0	28.9	34.0	26.9	25.7			27.2	27.3	25.3	25.8	26.6	27.2		
8 Net non-debt creating capital inflows (negative)	-7.5	-5.7	-6.9	-5.0	-5.8			-4.7	-6.8	-5.1	-4.2	-4.2	-4.3	-4.3	
9 Automatic debt dynamics 1/	-3.8	-7.1	-11.1	2.0	-10.8			-5.3	-0.3	-3.2	-0.9	-0.7	-0.5	-0.5	
10 Contribution from nominal interest rate	4.7	3.7	2.7	2.6	2.1			1.8	2.2	1.7	1.7	1.7	1.6	1.5	
11 Contribution from real GDP growth	-2.9	-3.6	-3.5	-1.2	-4.1			-2.2	-1.4	-1.4	-1.5	-1.4	-1.4	-1.3	
12 Contribution from price and exchange rate changes 2/	-5.6	-7.1	-10.3	0.6	-8.9			-4.9	-1.0	-3.5	-1.1	-0.9	-0.7	-0.7	
13 Residual, incl. change in gross foreign assets (2-3)	1.2	12.7	2.3	12.3	4.3			3.4	5.2	5.8	3.9	3.3	2.2	0.0	
External debt-to-exports ratio (in percent)	224.6	214.6	164.7	208.4	173.7			152.3	145.8	149.1	140.2	134.0	125.5		
Gross external financing need (in billions of US dollars) 3/	8.8	2.4	4.7	3.3	5.3			6.2	8.7	8.3	8.6	9.7	10.4		
in percent of GDP	44.9	10.3	15.4	10.8	13.4			13.3	17.6	14.7	14.5	15.3	15.6		
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							For debt stabilization	Projected Average
Real GDP growth (in percent)	4.1	6.5	7.2	2.4	8.9	3.2	5.0	5.7	3.5	4.0	4.0	4.0	4.0	4.0	3.9
Exchange rate appreciation (US dollar value of local currency, change in p	1.1	2.5	12.0	-7.2	12.5	-3.4	17.2	3.9	-5.2	2.1	-4.1	-4.0	-4.0	-4.0	-3.0
GDP deflator in US dollars (change in percent)	7.7	12.2	21.0	-1.9	18.7	3.7	16.5	12.1	1.7	10.1	1.9	1.7	1.1	1.1	3.3
Nominal external interest rate (in percent)	6.6	6.7	5.6	5.2	4.6	5.4	0.9	4.7	5.5	4.9	4.6	4.8	4.6	4.6	4.9
Growth of exports (US dollar terms, in percent)	13.8	19.8	35.2	-7.8	22.8	12.8	19.2	19.7	7.3	6.9	9.2	7.9	7.1		7.7
Growth of imports (US dollar terms, in percent)	25.2	15.3	52.5	-20.5	23.1	12.3	26.7	25.7	5.5	6.4	8.1	8.8	7.5		7.2
Current account balance, excluding interest payments	2.6	2.8	-3.0	1.2	-0.1	2.7	3.0	-1.2	-0.8	-0.7	0.0	-0.7	-0.9		-0.6
Net non-debt creating capital inflows	7.5	5.7	6.9	5.0	5.8	4.5	2.1	4.7	6.8	5.1	4.2	4.2	4.3		4.9
								II. Stress Tests for External Debt Ratio							non-interest current account 6/
A. Alternative Scenarios															
A1. Key variables are at their historical averages in 2012-2017 4/								41.4	38.4	36.9	32.9	28.3	22.8		-5.0
B. Bound Tests															
B1. Nominal interest rate is at baseline plus one-half standard deviation								41.4	40.6	38.9	37.9	37.1	35.6		-4.6
B2. Real GDP growth is at baseline minus one-half standard deviations								41.4	41.4	40.5	40.2	40.0	39.0		-4.4
B3. Non-interest current account is at baseline minus one-half standard deviations								41.4	41.9	41.4	41.6	42.1	41.8		-4.8
B4. Combination of B1-B3 using 1/4 standard deviation shocks								41.4	41.7	41.1	41.1	41.4	40.9		-4.5
B5. One time 30 percent real depreciation in 2013								41.4	57.8	55.3	53.5	52.2	49.7		-7.1

1/ 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.
2/ 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).
3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
4/ 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.
5/ The implied change in other key variables under this scenario is discussed in the text.
6/ 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.

INTERNATIONAL MONETARY FUND

URUGUAY

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

November 20, 2012

Prepared By: Western Hemisphere Department

CONTENTS

ANNEX I. FUND RELATIONS

(As of October 31, 2012)

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

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	306.50	100.00
Fund holdings of currency	217.89	71.09
Reserve Tranche Position	88.62	28.91

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	293.26	100.00
Holdings	245.61	83.75

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

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

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

	Forthcoming				
	2011	2012	2013	2014	2015
Principal					
Charges/Interest	0.04	0.15	0.15	0.15	0.15
Total	0.04	0.15	0.15	0.15	0.15

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.

VII. 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).

VIII. Exchange Rate Arrangement. The currency is the Uruguayan peso (Ur$). Uruguay has followed an independently floating exchange rate regime since July 29, 2002. Since September 2007, monetary policy uses the policy rate, and no longer monetary targets, as intermediate instrument. In 2008, Uruguay's de facto exchange rate regime was reclassified from a managed float with no predetermined path for the exchange rate to a floating exchange rate regime. On October 31, 2012, the exchange rate in the official market was Ur$19.906 per U.S. dollar. Uruguay has accepted the obligations of Article VIII and maintains an exchange rate system free of restrictions on payments and transfers for current international transactions.

IX. FSAP Participation and ROSCs. The Financial Sector Stability Assessment (FSSA) was considered by the Executive Board on June 28, 2006 (Country Report No. 06/187). An FSAP Update mission took place in September, 2012. The ROSC-module on fiscal transparency was published on March 5, 2001. A ROSC-module on data dissemination practices was published on October 18, 2001. The ROSC on Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) was published on December 2006 (Country Report No. 06/435). A data ROSC reassessment mission was undertaken during August 2012.

X. Technical Assistance 2008–12

DPT	Purpose	Date of Delivery
FAD	Private public partnership.	May 2010
	Tax, customs, and social security administration.	November 2012, March 2011, September 2010.
LEG	TA to assist the authorities on the launch of the recently designed AML/CFT national strategy.	June 2012
	TA to assist the authorities on the elaboration of a risk-based national strategy enhancing the AML/CFT regime	December 2010
	TA to 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	FSAP update.	September 2012
STA	ROSC reassessment mission.	August 2012
	Government Finance Statistics, to assist in improving the quality of public debt data.	February 2008

XI. Article IV Consultation. The 2011 Article IV consultation was concluded by the Executive Board on December 5, 2011 (Country Report No. 11/375). Uruguay is on the standard consultation cycle governed by the provisions approved by the Executive Board on July 15, 2002.

ANNEX II. RELATIONS WITH THE WORLD BANK UNDER JMAP

Title	Products	Provisional Timing of Missions	Expected Delivery Date*
	A. Mutual Information on Relevant Work Programs		
Bank work program for next 12 months	**A. Lending** 1. UY public sector management and social inclusion DPL 2. UY PforR road infrastructure program		November 2012 November 2012
	B. ESW 1. Productivity linked wage setting in Uruguay 2. Public sector expenditure review		December 2012-April 2013 Final delivery: February 2013
	C. Technical Assistance 1. UY capacity building to the Ministry of Economy and Finance on private public partnerships		December 2012

*Delivery date refers to the Board date in lending projects, and to delivery to client in case of AAA.

ANNEX III. RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of September 31, 2012)

The Inter-American Development Bank's Board of Executive Directors approved in August 2011 the new Country Strategy with Uruguay (2010–2015). Sovereign-guaranteed lending under the new program is expected to reach approximately US$1.8 billion, which is considered to be consistent with Uruguay's five year budget. The program includes additional non reimbursable financing for technical assistance and analytical work. Lending under the previous Country Strategy (2005–2009) reached approximately US$1.3 billion.

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

As of September 30th 2012, the Bank's portfolio in Uruguay includes loans for the financing of 45 projects; five of which are without sovereign guarantee. The lending portfolio amounts to US$1,693.0MM, of which US$866.9MM are pending disbursement. Disbursements in 2012 are expected to total US$137MM. The current portfolio includes lending to support the Government in the following sectors: infrastructure and environment (18 loans adding US$726.2MM and representing 43% of the approved amounts); social sector (4 loans adding US$97.2MM, representing 6% of the approved amounts); institutional capacity and finance (15 loans adding US$295.8MM and representing 17% of the approved amounts) and integration and trade (3 loans, adding

US$27.0 MM; 2% of the approved amounts). The portfolio also includes 5 loans to the private sector for US$547MM (32% of the approved amounts).

In 2012, the Bank approved loans to the public sector in the areas of transportation (US$80MM), local development and municipal management (US$70MM), water and sanitation (US$36.25MM), entrepreneurship (US$8MM), public safety (US$5MM), institutional capacity (US$3 MM) as well as a non-sovereign guaranteed loan of US$65MM loan to an agribusiness company.

Financial Relations with the Inter-American Development Bank

(In millions of U.S. dollars)

Total Outstanding Loans: US$2,244.6 1/

Loan Transactions:

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012p 2/
Disbursements	363.2	57.6	242.3	114.8	112.9	337.2	477.3	54.3	177.2	137.0
Amoritization	103.2	113.0	222.3	520.8	142.1	138.7	160.8	463.9	114.2	100.9
Net Loan Flows	270.1	-55.5	20.0	-406.0	-29.2	198.5	316.5	-409.6	-63.0	36.1

Source: Inter-American Development Bank.

1/ As of September 30, 2012.

2/ IDB staff projection.

ANNEX IV. STATISTICAL ISSUES

(As of November 12, 2012)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but broadly adequate for surveillance. Most affected area is national accounts.
National Accounts: In 2009, the Uruguayan authorities completed a revision of national accounts statistics, in which they updated the benchmark year (from 1983 to 1997 and 2005) and adopted the *System of National Accounts 1993 (SNA93)*. However, national accounts statistics still have a number of shortcomings, limited coverage of the enterprise survey, long publication lags, inadequate information on the informal economy, extensive use of fixed input-output ratios from 1997, and incomplete quarterly accounts. Household consumption is not independently derived and changes in inventories are obtained as residuals. The central bank (BCU) compiles and disseminates annual GDP estimates in current and at previous year prices by the production and expenditure approaches, as well as quarterly constant price GDP estimates by the production and expenditure approaches. Gross national income, gross disposable income and gross savings are also available annually.
Consumer Prices: Both the consumer and wholesale price indices are reported on a regular and timely basis for publication in the *IFS*. The new base period for the consumer price index is December 2010 = 100. The CPI has national coverage and includes nearly fifty thousand price quotations. It does not cover either the implicit rent or the net acquisitions of owner-occupied dwellings. The base of the wholesale price index has been updated to 2001. Producer price indices (March 2010 =100) for national products have been recently disseminated. The PPI does not cover services and exported output. The authorities do not provide trade price and volume indices for publication in the *International Financial Statistics (IFS)*.
Government Finance Statistics: Official data on the central administration, the state enterprises and the social security system are complete and current, but there are problems with the timeliness of the data on local governments. There are also problems with the timeliness of financing and debt data reported for inclusion in the Fund's statistical publications. Information on a monthly and quarterly basis for financing and debt data respectively, are disseminated on the BCU website from 1999 onwards for the central government and total public sector, but no information is reported for publication in the *International Financial Statistics*. The information reported for publication in the *Government Finance Statistics Yearbook* covers transactions on revenue and expense for the consolidated central government (data on revenue and expense for local governments have not been reported since 1994), and the general government's operations on financial assets and liabilities, both in terms of flows (financing) and stocks (debt).

I. Assessment of Data Adequacy for Surveillance	
Monetary and Financial Statistics: Monetary and financial statistics are prepared in accordance with the IMF's *Monetary and Financial Statistics Manual (2000).* Authorities report monetary data for the central bank, other depository corporations, and other financial corporations (OFCs) using the standardized reporting forms (SRFs). However, data for the OFCs are limited to off-shore financial institutions. A mission could be fielded in FY 2014 to expand the institutional coverage of the OFCs and compile the SRF for OFCs with full institutional coverage. Authorities reported annual financial soundness indicators (FSIs) for 2008, 2009, and 2010, but only 2008 data have been disseminated due to unresolved problems in the 2009 and 2010 data. Historical series, revisions to 2009 and 2010 data, and updates have not been submitted.	
External Sector Statistics: Balance of payments statements are compiled and published on a quarterly basis. Data are compiled following the recommendations of the fifth edition of the *Balance of Payments Manual*. Uruguay compiles and reports to STA quarterly data on balance of payments and annual data on the international investment position (IIP) for publication in the *IFS* and the *Balance of Payments Statistics Yearbook*. New surveys are allowing for improved coverage of the private sector in the IIP. Uruguay started disseminating the international reserves and foreign currency liquidity data template on the Fund's external website in 2005. The BCU also disseminates quarterly external debt statistics on its website, although not in the format envisaged by the SDDS.	
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 ROSC mission on CPI and NA was conducted in August 2012.
III. Reporting to STA (Optional)	
Annual GFS are regularly reported to STA for publication in the *Government Finance Statistics Yearbook.* No high frequency GFS are reported for publication in the *International Financial Statistics*.	

URUGUAY: COMMON INDICATORS REQUIRED FOR SURVEILLANCE

(As of October 31, 2012)

	Date of Latest Observation	Date Received	Frequency of Data [5]/	Frequency of Reporting [5]/	Frequency of Publication [5]/
Exchange Rates	Oct. 31, 2012	11/01/12	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities [1]/	Oct. 2012	11/01/12	M	M	M
Reserve/Base Money	Sept. 2012	10/17/12	M	M	M
Broad Money	Sept. 2012	10/17/12	M	M	M
Central Bank Balance Sheet	Sept. 2012	10/17/12	M	M	M
Consolidated Balance Sheet of the Banking System	Aug. 2012	10/17/12	M	M	M
Interest Rates [2/]	Oct. 31, 2012	11/01/12	D	D	D
Consumer Price Index	Oct. 2012	11/01/12	M	M	M
Revenue, Expenditure, Balance and Composition of Financing [3/]– Central Government	Sep. 2012	10/31/12	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt [4/]	Q2/12	10/25/12	Q	Q	Q
External Current Account Balance	Q2/12	9/30/12	Q	Q	Q
Exports and Imports of Goods and Services	Q2/12	9/30/12	Q	Q	Q
GDP/GNP	Q2/12	9/14/12	Q	Q	Q
Gross External Debt	Q2/12	9/30/12	Q	Q	Q

1/ Includes reserve assets pledged or otherwise encumbered as well as 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/ Including currency and maturity composition.
5/ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 12/141
FOR IMMEDIATE RELEASE
December 14, 2012

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

IMF Executive Board Concludes 2012 Article IV Consultation with Uruguay

On December 10, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the 2012 Article IV consultation with Uruguay, and considered and endorsed the staff appraisal without a meeting.[1]

Background

Uruguay has experienced a decade of record-strong growth since its 2002 crisis. This record is a result of prudent macroeconomic policies, institutional reforms, and favorable external factors, and it has resulted in significant welfare gains.

The economy is now slowing toward potential. Real gross domestic product (GDP) growth is projected at 3½ percent in 2012 and 4 percent in 2013. Annual inflation (9.1 percent in October) remains well above the target range (4-6 percent). Recently, the central bank

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

tightened reserve requirements and notched up the policy interest rate, after a pause following significant monetary tightening in December 2011. At the same time, burgeoning portfolio inflows have created currency appreciation pressures. Effective October 2012, the central bank introduced a reserve requirement on foreign purchases of central bank securities. The fiscal deficit has widened in 2012 mostly due to one-off factors.

The baseline outlook is positive but with risks and challenges. Uruguay's economic and financial vulnerabilities are relatively small, and the government has reduced debt vulnerabilities significantly and built important financial buffers. Still, policy space is limited by inflation and debt considerations, and the economy is exposed to the risk of a deteriorating global outlook and risks from domestic wage and cost pressures. The longer-term policy challenge is to bolster growth prospects and reduce output volatility.

Executive Board Assessment

In concluding the Article IV consultation with Uruguay, Executive Directors endorsed staff's appraisal as follows:

Uruguay has experienced a decade of record-strong and inclusive growth. This record is a result of prudent macroeconomic policies, institutional reforms, and favorable external factors, and has resulted in significant welfare gains.

The outlook is favorable but with risks and challenges. Growth is slowing toward potential, but inflation remains well above target. Inflation reflects robust domestic demand, insufficiently tight monetary policy, extensive wage indexation, food price shocks, and an inflation targeting framework that is not anchoring expectations. Short-term capital inflows are presenting monetary policy with difficult choices between lowering inflation and avoiding a sharp appreciation. And the economy is being affected by global and regional headwinds and tailwinds. Risks to the outlook are two-sided and relate to further spillovers from abroad and domestic wage and cost developments.

Uruguay is in a reasonably good position to tackle these challenges but policy space is limited. The financial system is small, sound, and liquid, and there are no generalized credit or real estate bubbles in the economy. Deft debt management has reduced public debt vulnerabilities significantly. And the central bank and the government have substantial foreign exchange buffers to help cushion large shocks. While Uruguay has lost competitiveness vis-à-vis some trading partners over the last year, the peso still seems broadly in line with fundamentals, though a sharp and sustained real appreciation could alter this assessment.

Tackling inflation is a priority. Having inflation and inflation expectations stable at the mid-point of the target range would create room for monetary policy to respond to downturns and capital inflows, and help reduce dollarization and indexation.

Thus, staff supports the recent increases in the policy rate and reserve requirements. While this is not the time for aggressive monetary tightening, maintaining a tightening bias to lower actual and expected inflation toward the mid-point of target range is appropriate. However, the pace of tightening should depend on the evolution of the economy and risks. The target's influence on inflation expectations could be strengthened with more explicit communication of the BCU's likely direction of policy stance, its conditional inflation forecast, and how it would respond to shocks. More frequent policy meetings would also be useful.

But monetary policy cannot fight inflation alone, given capital inflow concerns; concerted efforts on other fronts are also necessary. In particular, fiscal policy could better support monetary policy. At the same time, recent initiatives to cut/freeze some consumer prices create distortions without addressing the root causes of inflation. In the view of the mission, extensive wage indexation is a key reason why price shocks feed into wages and core inflation.

Near-term fiscal policy could better support monetary policy. A neutral stance would in principle be appropriate given the cycle, but a stronger counter-cyclical stance should be considered to help monetary policy. While the larger deficit in 2012 is mostly on account of factors that do not imply fiscal impulse, there has also been a substantial increase in real spending. Slower spending would help moderate domestic demand, alleviate real appreciation pressures, and support disinflation. It would also help secure the authorities' target of reducing public debt to 45 percent of GDP by 2015.

Prudent wage growth is also essential. The upcoming wage negotiation round is key given its wide coverage and its multi-year focus. The attempts to link real wage growth with sector productivity growth are welcome, even though it will be challenging in practice. Flexibility to reconsider wage agreements in case of an economic downturn will be important.

Staff acknowledges the circumstances in which the recent temporary capital flow management measure was introduced. The measure can be justified given the sharp spike in foreign demand for central bank paper. Though it remains to be seen how effective the measure will be in increasing monetary policy space, it would be important to use any additional space to tackle inflation.

The floating exchange rate is a crucial part of the policy framework and a key shock absorber. There is no clear need for further reserve accumulation for prudential reasons. However, occasional intervention may be appropriate to avoid excessive exchange rate swings. Sector-specific competitiveness problems are best handled through structural policies.

In the case of downside external shocks, the policy response should be prudent and pragmatic (as in the past). The floating exchange rate should be the first defense. Monetary easing could proceed so long as inflation expectations have become reasonably anchored. As in the past, reserve requirements could be cut to mitigate the risk of a credit crunch. Automatic fiscal stabilizers should be allowed to operate, though in a lasting downturn the fiscal space would be limited by the need to preserve prudent debt dynamics. The sizable liquidity buffers can be used in a sudden stop.

A long-term policy challenge is to bolster growth prospects and reduce output volatility. Actions on many fronts will be needed. Infrastructure plans in the energy and transportation sectors are welcome. Ensuring a dynamic labor market is also important for fostering productivity growth and facilitating adjustment to shocks, while ensuring appropriate protection for workers.

The prudent fiscal policy management could be enhanced further in view of medium-term challenges. The budget could usefully be cast on a rolling five-year horizon and include even longer horizons for certain items (e.g., social spending). In this context, it is appropriate that the contingent liabilities in Banco de Seguros del Estado are receiving attention.

There is scope to strengthen financial sector resilience further and bolster medium-term growth by building on recent progress, drawing on the recent FSAP Update. A strategy to develop a capital market that promotes efficient allocation of financial resources is needed. In the area of pensions, it would be opportune to review the foreign investment mandate for pension funds, and to start providing pension savers with different portfolio options tailored to their needs. It will also be important to enhance financial crisis preparedness and contingency planning, and ensure adequate funding for supervision. Finally, a dynamic, yet sound, banking system would benefit from a more level playing field among banks.

Uruguay: Basic Data

	2007	2008	2009	2010	2011	2012	2013
						Projections	
(Annual percent change, unless otherwise specified)							
Real GDP	6.5	7.2	2.4	8.9	5.7	3.5	4.0
Real consumption	6.8	9.1	0.1	12.0	7.6	6.1	3.4
Real investment	7.4	25.0	-8.5	10.1	7.0	6.5	11.3
Prices							
CPI inflation (average)	8.1	7.9	7.1	6.7	8.1	8.0	8.0
CPI inflation (eop)	8.5	9.2	5.9	6.9	8.6	8.0	7.9
Terms of trade	2.3	-1.2	5.7	-3.0	0.1	3.1	2.9
(In percent of GDP)							
Public sector finances							
Total revenues	28.6	26.9	28.7	29.4	28.9	29.0	30.3
Non-interest expenditure	25.3	25.7	27.9	27.7	27.1	28.8	29.2
Primary balance	3.6	1.4	1.1	1.9	2.0	0.5	1.3
Overall balance	0.0	-1.6	-1.8	-1.1	-0.9	-2.3	-1.7
Gross public sector debt	64.4	63.3	62.7	58.0	57.8	52.3	52.1
Outstanding external debt	48.3	46.1	40.4	35.4	32.9	30.5	28.7
Of which: Public external debt	43.7	41.1	36.6	32.4	29.8	25.9	23.4
(Annual percent change, unless otherwise specified)							
Money and credit							
Base money (eop) 1/	16.4	29.3	6.5	16.2	17.3	27.4	...
M-1 1/	29.4	18.6	12.2	28.9	21.3	20.4	...
M-2 1/	30.6	17.1	15.0	30.3	21.4	17.4	...
M-3 1/	3.8	28.6	-2.6	22.1	17.2	27.0	...
Credit to the private sector (constant exch. rate) 1/	22.1	28.0	-7.5	21.3	20.3	20.8	...
(In percent of GDP, unless otherwise indicated)							
Balance of payments							
Current account balance	-0.9	-5.7	-1.5	-2.2	-3.1	-3.0	-2.4
Merchandise exports, fob	21.8	23.4	21.0	20.4	19.9	20.0	19.0
Merchandise imports, fob	24.1	29.0	22.6	21.7	22.9	22.8	21.0
Services, income, and transfers (net)	1.4	0.0	0.2	-0.9	-0.1	-0.3	-0.5
Capital and financial account	6.4	10.2	3.9	2.7	7.3	7.8	2.8
Foreign direct investment	5.7	6.9	5.0	5.8	4.7	6.8	5.1
Overall balance of payments (In millions of U.S. dollars)	1,005.4	2,232.4	1,588.3	-360.8	2,564.4	2,385.0	192.0
Gross official reserves (In millions of U.S. dollars) 2/	4,124	6,362	8,040	7,655	10,274	12,659	12,851
In percent of short-term debt	471.8	797.2	772.3	517.1	447.9	512.8	445.1
In percent of short-term debt and FX deposits	117.2	151.4	162.6	129.5	151.4	179.7	152.0
External debt service (percent of exports of goods and services)	26.1	21.7	23.8	29.7	21.2	26.9	20.1

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

1/ In 2012 corresponds to the change between June 2011 and June 2012.

2/ Includes reserves buildup through reserve requirements of resident financial institutions.