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IMF Executive Board Approves US$ 1.13 billion Stand-By Arrangement for Uruguay

The Executive Board of the International Monetary Fund (IMF) today approved a 36-month, SDR 766.3 million (about US$ 1.13 billion) Stand-By Arrangement for Uruguay, aimed at supporting the country's economic stabilization through mid-2008 and helping to foster sustainable growth while reducing vulnerabilities related to high public debt. The approval enables the immediate release of SDR 30.7 million (about US$ 45.3 million) under the arrangement.

Following the Executive Board discussion on Uruguay, Mr. Agustín Carstens, Deputy Managing Director and Acting Chair, made the following statement:

"Uruguay's economic performance over the past three years has been very favorable. After stabilizing the economy from the severe financial crisis in 2002, the authorities' Fund-supported program achieved an impressive recovery of growth, in an environment of rising exports and international reserves, falling inflation, and sharply improving fiscal accounts. These favorable results reflect the steadfast pursuit of prudent fiscal and monetary policies, important structural reforms especially in the banking sector, and a generally supportive external environment. The smooth political transition to a new government following the 2004 elections also helped solidify market confidence in sustained domestic consensus on a core framework of stability and growth-oriented policies.

"While much has been achieved over the past three years, the task is now to sustain the recent recovery and build a lasting trend of rapid growth and improving social conditions. Although fiscal adjustment, prudent monetary policy, and banking reforms have reduced economic vulnerabilities, important weaknesses and risks remain—including a still large public debt, weaknesses in the financial sector, and obstacles to investment that hamper Uruguay's growth potential and its ability to compete in the global market place. There have also been delays with planned tax and pension system reforms, which—unless addressed—leave the fiscal accounts vulnerable to shocks and contingent costs.

"The authorities' economic strategy aims to address these challenges and create a sustained dynamic of rapid growth, declining public debt, and improving social conditions. Key to their strategy is the creation of a favorable environment for private investment, through the pursuit of

prudent fiscal and monetary policies and a comprehensive growth-oriented structural reform agenda. Decisive implementation of these envisaged measures will be crucial. At the same time, the strategy places increased emphasis on ensuring that the benefits of growth are more equally shared and on addressing the lingering social dislocations from the recent crisis.

"A key plank of the authorities' strategy is continued fiscal consolidation, supported by structural fiscal reforms, while making room for a temporary social emergency program to address urgent social needs. Monetary policy will be geared to achieving a steady reduction in inflation to the low single digits, while strengthening international reserves in the context of a flexible exchange rate system. As in the fiscal area, the agenda includes important institutional reforms to strengthen the framework and instruments of monetary policy. A broad range of growth-enhancing structural reforms, supported by the World Bank and the Inter-American Development Bank, aim to strengthen the environment for private investment and productive enterprise, with emphasis on improving access to financing, competition, infrastructure, and the regulatory framework," Mr. Carstens said.

Annex

Program Summary

The authorities' program for 2005–08 envisages real GDP growth to average around 4 percent a year, benefiting from the momentum of the recent recovery and two large foreign investment projects. Inflation is targeted to decline gradually, by 1 percentage point a year, to around 3½ percent by 2008, while exports are projected to increase by about 9 percent a year and net international reserves to increase by US$1.5 billion over the program period. A key program goal is to gradually re-establish Uruguay's access to international capital markets, instrumental to the country's longer-term growth prospects as well as the envisaged exit from IMF financial support.

The fiscal program is anchored on a medium-term primary surplus target of 4 percent of GDP, to bring down the public debt-to-GDP ratio to about 60 percent by 2008 and to about 50 percent by 2012. Key measures to achieve these goals include a comprehensive tax reform, an improved budgetary framework and firm spending control, timely adjustment of public tariffs, and reform of the specialized pension funds. The primary surplus in 2005–06 would be somewhat lower to accommodate a temporary social emergency program.

Monetary policy will continue to be based on base money targeting in the context of a flexible exchange rate regime, until conditions are in place to move to an inflation targeting framework. To prepare for this move, the program envisages a strengthening of the autonomy and financial position of the central bank.

Financial system reforms are to continue, building on the crisis resolution efforts of recent years with a view to creating the necessary infrastructure of financial intermediation in support of sustained private-sector led growth. Priorities include the continued reform of public banks (BROU and BHU); strengthening NBC, including by divesting the government's stake; further improving the supervisory framework; and overhauling the bank resolution framework to ensure rapid and efficient resolution of banking problems should they occur.

A wide range of growth-enhancing reforms constitute another core pillar of the program and are designed to stand beside prudent macroeconomic policies and supporting institutional reforms. Many of these reforms are being supported under World Bank and the Inter-American Development Bank lending programs, and aim at creating an environment conducive to private investment and productive enterprises. The reforms include developing capital markets, opening up sectors currently reserved for the state to private sector participation and competition, bolstering property and creditor rights, improving infrastructure, and strengthening Uruguay's investment climate.

Table 1. Uruguay: Selected Economic Indicators, 2002–08

				Projection			
	2002	2003	2004	2005	2006	2007	2008
			(percentage changes)				
Output and prices							
Real GDP	-11.0	2.5	12.3	6.0	4.0	3.5	3.0
Consumer prices (eop)	25.9	10.2	7.6	6.5	5.5	4.5	3.5
Exchange rate (Ur$/U.S.$, eop)	84.2	7.3	-2.8	...	...	...	...
GDP (in U.S. dollar billion)	12.1	11.2	13.3	16.4	18.0	19.4	20.5
Monetary indicators							
Currency issued	5.8	22.4	15.7	11.6	12.0	9.4	11.5
Credit to the private sector (constant exchange rate)	-13.7	-25.5	-20.1	8.6	14.1	12.5	15.3
			(percent of GDP)				
Public sector operations							
Revenue	31.1	31.1	30.0	30.2	29.4	29.3	29.1
Non-interest expenditure	31.1	28.4	26.3	26.7	25.6	25.3	25.1
Primary balance	0.0	2.7	3.8	3.5	3.7	4.0	4.0
Interest	4.7	6.0	6.0	5.2	5.0	4.8	4.8
Overall balance	-4.6	-3.2	-2.2	-1.7	-1.3	-0.8	-0.8
Public sector debt 1/	95.5	104.4	92.5	75.8	70.1	65.5	62.5
			(U.S. dollar million)				
External indicators							
Merchandise exports, f.o.b.	1,922	2,273	3,025	3,276	3,463	3,862	4,248
Merchandise imports, f.o.b.	1,874	2,092	2,990	3,713	4,429	4,144	4,430
Current account balance (in percent of GDP) 2/	3.1	-0.3	-0.8	-2.8	-5.3	-1.2	-0.7
External debt (in percent of GDP)	87.2	98.3	87.4	70.2	63.4	58.1	54.5
Gross official reserves	776	2,087	2,512	2,656	2,866	3,067	3,230
in percent of short-term debt and FX deposits	7.0	20.0	27.7	26.2	25.7	26.5	27.4
Net international reserves (program definition) 3/	-2,391	-2,508	-2,218	-1,938	-1,692	-1,106	-738
REER (percentage depreciation -, e.o.p.)	-20.3	-13.2	9.3	...	...	...	...

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

1/ Includes nonfinancial public sector debt plus liabilities to the IMF.

2/ Includes imports of the forestry project Botnia, which are fully financed by FDI.

3/ Includes all liabilities to the Fund and to resident financial institutions.