

URUGUAY

1. General trends

Uruguay, like the region as a whole, is undergoing a period of significant economic uncertainty. The country has posted a negative economic performance on several fronts over the past year and a half. After 13 years of uninterrupted growth at historically high levels, gross domestic product is set to remain virtually unchanged in 2016, with an increase of just 0.5% expected.

In 2015, GDP grew by just 1.0% after rising by 3.5% in 2014, and contracted by 0.5% in the first quarter of 2016 compared with the year-earlier period. Inflation stood at 9.4%, up roughly one percentage point compared with the last few years. In the first few months of 2016, inflation continued to rise, and exceeded the 10% threshold.

The fiscal deficit came to 3.6% of GDP in 2015, the worst performance in 13 years, and public accounts have continued to deteriorate in the past few months. In the accountability report to be approved around mid-2016, the Government of Uruguay will have to outline measures to reduce this deficit. In 2015, the moderate increase in spending was funded by a higher level of net debt, but this debt level does not indicate any underlying risk. The country continues to maintain reasonable debt-to-GDP levels, limited mismatch risk, significant contingent credit lines with international organizations and a solid long-term debt maturity profile.

The government faces several economic challenges, and the main one seems to be reducing the deficit. However, inflation continues to rise and the government's manoeuvring room for controlling it has narrowed. Under some recently-approved wage clauses, fresh wage negotiations would only begin once the 12% threshold has been reached. Another challenge for the government is the constant fluctuation in external competitiveness resulting from fluctuating exchange rates.

The value of exported goods declined by 12% in 2015 as prices for the country's main commodities fell and some key markets closed. This decline continued in the first few months of 2016. Nonetheless, the current account balance improved in 2015 as imports dropped even more sharply.

In light of a decrease in foreign direct investment, the government is trying to boost demand through private investment via public-private partnerships, and for this reason it is pushing an infrastructure development programme in areas such as energy, highways, schools, and prisons.

2. Economic policy

(a) Fiscal policy

Fiscal policy was moderately expansionary in 2015. Although the primary balance for the public sector was stable (0.0% of GDP), interest payments led to a historically high fiscal deficit in 2015. The 2016-2017 budget was based on growth projections that are unlikely to materialize, so the accountability report to be approved in mid-2016 will have to include revised spending and revenue figures. On one hand, the government has announced that it will postpone some of the budget increases scheduled for

2017 by one year, and that it will not adjust some of its planned spending and investment for inflation. On the other hand, it has announced increases in the top income tax rates and a decrease in deductions. The government finds itself in a tight spot as it is bound by electoral promises, such as the development of a national care system and improvements in infrastructure and education. At the same time, 70% of spending is indexed or fixed (wages, pensions and transfers), which will make any adjustments difficult to implement. In 2015 and 2016, the government focused on improving the earnings of State-owned companies, cutting back on investment and raising prices above production cost levels. At the end of 2015, the government had to increase its expenditure to cover the growing deficit of ANCAP, the highest-earning State-owned company, which accumulated losses equivalent to 0.4% of GDP between 2013 and 2015 despite its monopoly in the fuel refining and distribution industry.

As a result of the measures taken to alter the debt profile discussed in the section on monetary policy, the central bank's deficit widened from 0.6% of GDP in 2014 to 1.4% in 2015.

In light of dwindling income, the prospects of reducing the deficit appear slim, even with certain fiscal adjustments. Gross public debt came to 64% of GDP at the end of 2015, while net debt remained low in relative terms, at 26% of GDP. Nevertheless, Uruguay maintains contingent credit lines with international organizations, and has a solid long-term debt maturity profile, with most repayments due after 2023.

(b) Monetary policy

Monetary policy was contractionary in 2015, as the government began scaling back some of the measures imposed during periods when significant capital inflows were flowing into government bonds. These measures had included marginal reserve requirements applicable to foreign investors. The government bonds issued in the last few months continued to be well received by the markets.

Monetary policy is heavily influenced by the volatility of the United States dollar. In order to smooth out this impact, the Central Bank of Uruguay bought back monetary regulation notes and agreed on a debt swap with the Ministry of Economy and Finance. This operation consisted of the Ministry issuing 3-, 5- and 10-year local-currency bonds, which were mostly integrated with monetary regulation bills and treasury notes in local currency. The central bank then bought back monetary regulation bills redeemed by the Ministry, paying for half of the amount in pesos and the rest in dollars. The buyback helped to ease pressure on the foreign-exchange market by allowing payments to bondholders to be made in dollars, while the debt swap generated pesos for the government, and helped reduce both dollar-denominated debt and the central bank's liabilities. The repurchase of monetary regulation bills reduced available international reserves, reverting the growth trend seen in the past few years. Both operations helped to lower the central bank's interest on a cash basis for 2016 and 2017.

A new reserve requirement policy came into effect in 2016, eliminating marginal reserve requirements and increasing average reserve requirements for local-currency bonds. Monetary policy aims to reduce the money supply amid more limited demand conditions given the economic slowdown and a preference for foreign currencies. There is still excess liquidity in the market, however, which is being managed via the placement of monetary regulation notes (at lower interest rates) and foreign-exchange sales, payment in dollars of domestic bonds upon maturity, cancellation of forward contracts, and spot market sales. Average growth in expanded M1 declined from 6% in the fourth quarter of 2015 to 2.6% in the first quarter of 2016, owing to a deceleration in growth in the money supply. During its last meeting, the central bank's Monetary Policy Committee decided to lower the target range for expanded

M1 growth from 7%-9% year-on-year in 2015 to 4%-6% in 2016, in view of the limited increase in money supply.

(c) Exchange-rate policy

The interbank dollar rate on the domestic market rose 23% in 2015, the highest annual increase since the acute economic crisis of 2002. During the first four months of 2016, the dollar appreciated by 5.3%. After increasing sharply in the first two months of the year, the dollar then weakened in the following months. As mentioned above, the government intervened sporadically in foreign-exchange markets in order to control the strongest fluctuations.

Thus far in 2016, the real effective exchange rate with Argentina rose as a result of exchange-rate harmonization in that country, while the corresponding exchange rate with Brazil fell due to the appreciation of the Brazilian real in March. The exchange rate with the rest of the world also rose, given the trend in the dollar in Uruguay.

(d) Other policies

The government has announced an ambitious infrastructure development policy, mainly concerning roads. The sharp increase in primary production in the last decade has not been matched by investment in roads, which has led to a deterioration in infrastructure. In order to avoid worsening the significant fiscal deficit, the government will seek direct funding from international agencies. Some of the work will also be carried out through public-private partnerships. For 2016-2019 the overall budget for public (or public-private) works stands at US\$ 12.37 billion, equivalent to 23% of 2015 GDP. Projects are planned in energy (one third of the total, stemming mainly from the construction of a regasification plant), roads (one fifth of the total), social infrastructure (early childhood development centres, educational centres, hospitals and prisons), and social housing, among others.

With a view to improving the performance of its exports, the government is pursuing a more active trade agreement policy. Although this change in stance has still to pay off, in May 2016, 12 years after the last agreement was signed, MERCOSUR and the European Union exchanged offers on market access. Despite this step forward, the two blocs have not finalized an agreement yet.

3. The main variables

(a) The external sector

In 2015, the trade deficit contracted by about one percentage point of GDP, from 4.6% to 3.5%. This was due to the sharper decline in imports (17%) than in exports (12%). The declines in goods and services were basically the same, so the relative percentage breakdown remained unchanged. The fall in exports was due solely to prices, while that seen in imports was due to both prices and volumes.

Agricultural and dairy products posted the largest declines. With the drop in agricultural products and the full-year operation of the Montes del Plata plant, paper pulp became the second-largest export category for Uruguay, behind beef. China was the main destination of the three major export products in 2015 — beef, paper pulp and oilseed crops.

In terms of imports, the largest drop was in crude oil, which fell 42% in price terms, although it increased 11% by volume. Excluding this category, the decrease in imports would have been equivalent to that of exports (12%). Among the remaining imported goods, purchases of durable consumer goods and capital goods were notably down. In terms of services, the travel surplus improved as a result of more limited tourist purchases abroad, an unusual trend in 2015. The trade balance for other services also showed a sharper decline in imports than in exports, which included a contraction in financial services.

The trends of 2015 carried over into the first few months of 2016. Exports in all categories declined, particularly for the products that had posted the sharpest decreases in 2015. Disastrous weather conditions in April led to a significant loss in the soybean crop, and hurt milk production. Paper pulp and rice were the least affected by the drop in 2016. Imports were also heavily down owing to the lower oil prices.

Although exports to China have decreased in the past few months owing to falling commodity prices, the most worrying market is Brazil. It imports nearly 100% of Uruguay's output of certain products, such as barley and barley malt, automobiles, plastics and, to a lesser extent, chemicals. In these sectors, Brazil's fragile economic situation has led to a decrease in industrial production.

The improvement in the current account deficit can be explained by the performance of the trade balance account, given that the investment income deficit was slightly higher than in 2014 owing to a higher level of repatriated earnings. The trade balance posted a small surplus of US\$ 54 million.

Foreign direct investment (FDI) fell 25%, mainly reflecting to fewer purchases of property and company stocks. Moreover, part of the investment in the Montes del Plata paper pulp mill was factored into the first half of 2014. FDI was equivalent to 2.8% of GDP in 2015, which is lower than the average seen in the past few years, but higher than the long-term historical average for the country.

(b) Economic activity

Preliminary figures indicate that gross domestic product grew 1.0% in 2015. This growth was concentrated in the first quarter of the year, and virtually stagnant in the other three. It stemmed from paper pulp manufacturing, as momentum in the other industrial sectors was weak. Other sectors that posted noticeable growth were transport, storage and communications, thanks to the continued increase in productivity in the last category, and to a lesser extent 'other activities'. Conversely, electricity, gas and water supply contracted heavily, as did construction, as property investment cooled and several major projects were completed. There was also a sharp decline in commerce, restaurants, and hotels as a result of slacker aggregate demand.

Government spending rose by 2.6% of GDP, while spending by the private sector was similar to the level seen the previous year. The decline in gross fixed capital formation was more than offset by an increase in net exports, which in turn stemmed from a sharp drop in imports. As noted earlier, while the drop in exports was attributable to prices, the fall in imports stemmed from both prices and volumes.

Growth in national disposable income fell short of output growth, owing to higher net factor payments abroad.

The data available for the first few months of 2016 indicate a risk of contraction in activity. The tourism industry performed better than expected, as large inflows of Argentine tourists more than offset

the decline in Brazilian tourist arrivals. Nonetheless, the increase in tourist spending was not enough to offset the decline in sales, and the commerce, restaurants and hotels category weighed the most on performance. As regards production, the trade difficulties seen in 2015 must be considered along with the costs and production losses arising from the tornado that hit the city of Dolores as well as floods in the west, south and east of the country, which forced the government to declare a state of emergency in some departments.

(c) Prices, wages and employment

Inflation has continued to rise since mid-2015. In previous years, consumer inflation stood at about 8.5%, but from July onwards it rose to 9% and then hit double digits in February 2016 (10.47% in the 12 months to April). Analysts expect inflation to remain in double digits for most of 2016, for a number of reasons. The strengthening of the dollar pushed up the value of various goods in the market basket. Moreover, production problems in the second quarter affected the supply of many foodstuffs over an extended period. One of the key drivers of inflation was the adjustment of State-owned companies' tariffs in January. In order to combat spiralling prices and signal its concern, in 2015 the government maintained some price agreements with retailers to freeze the price of a fixed basket of goods. It also announced that it would help strengthen antitrust rules to prevent the abuse of dominant market positions from leading to higher prices. Wage agreements include renegotiation clauses that will take effect if annual inflation exceeds 12%, but this does not appear to be a likely scenario. Among other things, aggregate demand is too weak to exert upward pressure on prices.

Real wages grew 1.6% in 2015, the lowest rate since 2004. In the first few months of 2016, this trend intensified and the real wage index indicated a rise of 0.93% in the 12 months to March, about 2.5 percentage points less than a year earlier. For several years now, wages have grown more slowly in the public than the private sector. The current round of wage negotiations that began in 2015 and will be completed in mid-2016 incorporates much smaller real wage gains than previous rounds. Moreover, the government has voted more measures supporting businesses than those for employees, in a clear sign that it wants to implement austerity, control inflation, and basically protect the employment rate.

In the first few months of 2016, the participation rate was in line with the average level seen over the past few years, at 63.9%, and was higher for Montevideo than the interior. However, the employment rate was slightly lower than in recent years, although still higher than longer-term averages. Following several months of fluctuation, the unemployment rate stood at 8.0% in the first quarter of the year, 0.7 percentage points up on the year-earlier period.

Table 1
URUGUAY: MAIN ECONOMIC INDICATORS

	2007	2008	2009	2010	2011	2012	2013	2014	2015 a/
	Annual growth rates b/								
Gross domestic product	6.5	7.2	4.2	7.8	5.2	3.5	4.6	3.2	1.0
Per capita gross domestic product	6.3	6.8	3.9	7.5	4.8	3.2	4.3	2.9	0.6
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	-10.2	2.1	3.3	-1.5	13.2	-0.8	2.0	0.3	0.9
Mining and quarrying	6.3	1.7	31.1	35.5	-21.1	-2.3	2.5	-10.8	-10.3
Manufacturing	8.3	8.1	5.2	2.6	2.0	-3.9	1.2	4.2	5.7
Electricity, gas and water	50.2	-51.1	11.6	89.3	-24.2	-21.9	54.7	15.7	-8.1
Construction	9.3	2.6	2.7	2.4	2.4	16.3	0.9	0.7	-5.4
Wholesale and retail commerce, restaurants and hotels	8.7	11.9	0.9	11.6	7.0	5.6	8.0	-0.6	-2.5
Transport, storage and communications	16.1	30.7	14.9	15.0	10.7	10.0	6.9	7.4	3.1
Financial institutions, insurance, real estate and business services	2.6	4.5	1.7	4.3	6.5	5.3	4.0	3.7	2.5
Community, social and personal services	3.6	4.6	3.9	1.4	2.4	1.5	2.7	2.9	0.7
Gross domestic product, by type of expenditure									
Final consumption expenditure	6.8	9.1	2.7	8.6	6.7	5.1	5.5	2.9	0.3
Government consumption	4.7	9.3	5.2	3.1	3.7	6.0	4.9	2.5	2.6
Private consumption	7.1	9.1	2.3	9.4	7.2	4.9	5.5	3.0	0.0
Gross capital formation	7.4	25.0	-11.2	15.2	9.9	14.5	4.8	0.0	-7.7
Exports (goods and services)	4.8	8.5	4.5	7.2	5.8	3.6	-0.1	3.5	-1.2
Imports (goods and services)	5.9	24.4	-8.7	13.6	12.4	13.6	2.8	0.8	-7.4
Investment and saving c/	Percentajes of GDP								
Gross capital formation	19.5	23.2	19.6	19.4	20.9	22.9	22.5	21.2	19.8
National saving	18.6	17.5	18.4	17.6	18.1	17.9	17.5	16.6	16.2
External saving	0.9	5.7	1.2	1.8	2.7	5.1	5.0	4.6	3.6
Balance of payments	Millions of dollars								
Current account balance	-220	-1,730	-384	-733	-1,315	-2,593	-2,861	-2,655	-1,947
Goods balance	-545	-1,714	-504	-527	-1,431	-2,361	-1,352	-908	-279
Exports, f.o.b.	5,100	7,095	6,392	8,031	9,274	9,916	10,257	10,344	9,067
Imports, f.o.b.	5,645	8,810	6,896	8,558	10,704	12,277	11,609	11,252	9,345
Services trade balance	703	753	1,025	1,157	1,592	1,189	241	143	333
Income balance	-516	-918	-1,043	-1,503	-1,631	-1,536	-1,881	-2,022	-2,124
Net current transfers	137	148	138	140	156	115	130	131	124
Capital and financial balance d/	1,231	3,963	1,972	372	3,879	5,880	5,784	4,015	159
Net foreign direct investment	1,240	2,117	1,512	2,349	2,511	2,539	3,027	2,148	1,614
Other capital movements	-9	1,846	460	-1,977	1,368	3,341	2,757	1,867	-1,455
Overall balance	1,010	2,233	1,588	-361	2,564	3,287	2,923	1,360	-1,788
Variation in reserve assets e/	-1,005	-2,232	-1,588	361	-2,564	-3,287	-2,923	-1,360	1,788
Other financing	-5	0	0	0	0	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	99.3	93.3	91.3	79.9	77.9	76.3	70.8	74.9	78.0
Terms of trade for goods (index: 2010=100)	87.1	94.1	100.5	100.0	102.4	106.3	108.1	112.3	114.5
Net resource transfer (millions of dollars)	710	3,045	929	-1,131	2,248	4,343	3,903	1,993	-1,966
Total gross external debt (millions of dollars)	14,864	15,425	17,969	18,425	18,345	24,030	26,518	28,100	28,678
Employment	Average annual rates								
Labour force participation rate g/	62.5	62.7	63.4	62.9	64.8	64.0	63.6	64.7	63.8
Open unemployment rate h/	9.8	8.3	8.2	7.5	6.6	6.7	6.7	6.9	7.8
Visible underemployment rate h/	12.9	10.8	9.2	8.9	7.6	7.4	6.9	6.9	7.3

Table 1 (concluded)

	2007	2008	2009	2010	2011	2012	2013	2014	2015 a/
Prices	Annual percentages								
Variation in consumer prices (December-December)	8.5	9.2	5.9	6.9	8.6	7.5	8.5	8.3	9.4
Variation in producer prices (December-December)	16.1	6.4	10.5	8.4	11.1	5.9	6.3	10.6	6.6
Variation in nominal exchange rate (annual average)	-2.4	-10.8	7.8	-11.2	-3.8	5.1	0.9	13.6	17.5
Variation in average real wage	4.7	3.5	7.4	3.3	4.0	4.2	3.0	3.4	1.6
Nominal deposit rate i/	2.3	3.2	4.0	3.7	4.4	4.2	4.3	4.4	5.3
Nominal lending rate j/	10.0	13.1	16.6	12.0	11.0	12.0	13.3	17.2	17.0
Central government	Percentajes of GDP								
Total revenue	21.0	20.6	20.3	20.7	20.6	19.9	20.7	20.0	19.8
Tax revenue	18.4	18.2	17.9	18.1	18.3	18.0	18.2	17.7	17.7
Total expenditure	22.6	21.7	21.7	21.9	21.1	21.9	22.2	22.3	22.6
Current expenditure	21.1	19.8	20.2	20.2	19.7	20.4	20.8	20.9	21.3
Interest	3.8	2.9	2.7	2.4	2.4	2.3	2.4	2.3	2.3
Capital expenditure	1.5	1.8	1.6	1.7	1.5	1.4	1.4	1.4	1.3
Primary balance	2.1	1.8	1.3	1.2	1.8	0.4	0.9	-0.1	-0.5
Overall balance	-1.6	-1.1	-1.5	-1.1	-0.6	-1.9	-1.5	-2.3	-2.8
Non-financial public sector debt	57.2	44.5	53.3	39.9	38.4	40.2	36.9	39.2	46.6
Domestic	14.9	13.2	18.6	13.6	14.9	15.1	12.2	11.8	13.2
External	42.3	31.4	34.7	26.3	23.6	25.1	24.8	27.4	33.3
Money and credit	Percentages of GDP, end-of-year stocks								
Domestic credit	...	...	15.1	18.4	18.3	17.5	18.6	19.3	21.4
To the public sector	...	...	-2.3	-2.8	-3.9	-4.9	-4.8	-3.8	-3.5
To the private sector	...	...	19.2	20.4	20.2	20.5	20.4	20.4	20.8
Others	...	...	-6.0	-5.9	-5.2	-4.6	-5.4	-5.8	-6.4
Monetary base	5.7	5.6	5.4	5.4	5.7	6.0	6.4	6.3	6.3
Money (M1)	8.6	8.7	8.7	9.8	10.2	9.9	9.9	8.9	8.5
M2	13.2	13.4	13.7	15.8	16.8	16.5	16.6	15.7	15.6
Foreign-currency deposits	27.4	31.8	25.4	26.5	26.7	25.8	28.3	31.7	37.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

a/ Preliminary figures.

b/ Based on figures in local currency at constant 2005 prices.

c/ Based on values calculated in national currency and expressed in current dollars.

d/ Includes errors and omissions.

e/ A minus sign (-) indicates an increase in reserve assets.

f/ Annual average, weighted by the value of goods exports and imports.

g/ Nationwide total. Up to 2005, urban total.

h/ Urban total.

i/ Local-currency fixed-term deposits, 30-61 days

j/ Business credit, 30-367 days.

Table 2
URUGUAY: MAIN QUARTERLY INDICATORS

	2014				2015				2016	
	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2	Q.3	Q.4	Q.1	Q.2 a/
Gross domestic product (variation from same quarter of preceding year) b/	3.3	3.7	3.7	2.4	4.2	-0.5	0.5	-0.1	-0.5	...
Gross international reserves (millions of dollars)	16,376	17,637	18,028	17,570	18,136	18,539	17,222	16,385	14,435	14,114 c/
Real effective exchange rate (index: 2005=100) d/	71.9	75.5	76.8	75.4	73.0	77.8	79.7	81.4	81.6	82.9 c/
Open unemployment rate e/	7.0	7.1	6.6	6.9	7.3	7.9	7.9	8.3	8.2	...
Employment rate f/	60.6	60.1	60.2	60.8	59.3	59.0	58.4	59.2	58.9	...
Consumer prices (12-month percentage variation)	9.7	9.1	8.4	8.3	7.6	8.5	9.1	9.4	10.6	11.0 c/
Wholesale prices (12-month percentage variation)	10.2	10.7	10.6	10.6	4.9	6.5	6.6	6.6	10.3	6.9
Average nominal exchange rate (pesos per dollar)	22.18	22.93	23.65	24.12	24.75	26.56	28.31	29.51	31.49	31.24
Nominal interest rates (average annualized percentages)										
Deposit rate g/	4.3	4.4	4.0	4.8	4.6	4.1	5.5	7.1	4.9	6.2 c/
Lending rate h/	17.5	18.2	16.3	16.7	17.3	16.6	16.6	17.3	18.0	18.8 c/
Sovereign bond spread, Embi Global (basis points to end of period) i/	192	169	196	208	214	213	305	280	279	270
International bond issues (millions of dollars)	-	2,000	-	-	1,200	200	-	1,205	-	-
Domestic credit (variation from same quarter of preceding year)	19.8	22.1	14.4	18.1	4.3	4.4	20.7	22.0	41.4	51.9 c/
Non-performing loans as a percentage of total credit	1.7	1.8	1.9	1.8	2.0	2.1	2.2	2.2	2.4	2.9 c/

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

a/ Preliminary figures.

b/ Based on figures in local currency at constant 2005 prices.

c/ Figures as of May.

d/ Quarterly average, weighted by the value of goods exports and imports.

e/ Urban total.

f/ Nationwide total.

g/ Local-currency fixed-term deposits, 30-61 days

h/ Business credit, 30-367 days.

i/ Measured by J.P.Morgan.