

## URUGUAY

### 1. General trends

Uruguay recorded a moderate level of economic growth in 2016, which nonetheless exceeded mid-year estimates. Gross domestic product (GDP) grew 1.5%, giving a fourteenth consecutive year of economic growth. The economy is expected to expand at a rate of 3% in 2017, boosted by investment and private consumption, as well as by external demand.

After slowing since mid-2015, Uruguay's economy registered an uptick during the final months of 2016; specifically, fourth quarter data showed a 3.4% expansion, compared to the year-earlier period. Meanwhile, inflation has trended steadily downwards since May 2016 (when it exceeded the 10% threshold) to reach 6.5% in the 12-month period ending in April 2017.

The fiscal deficit remains very high and, despite measures adopted by the government, shows little sign of narrowing yet. In 2016, the consolidated deficit of the public sector rose to 4% of GDP, the largest imbalance since 1989. However, Uruguay maintains reasonable debt-to-GDP levels, significant contingent credit lines with international organizations and a very long-term debt maturity profile, apart from continuing with the gradual de-dollarization of its debt.

Reducing the fiscal deficit remains one of the government's greatest economic challenges. Accordingly, at the start of the year Uruguay implemented the personal income tax hike it had approved in mid-2016. The tax hike does not seem to have significantly affected household consumption expectations, but little political room likely remains to raise taxes again. At the same time, rising pensions and expenditures resulting from the expansion of coverage afforded by the health system in 2016 will make it difficult to greatly reduce public spending in 2017.

The improvements in the terms of trade in recent quarters have contributed to a healthier trade balance. In 2016, average export prices in dollars fell 6%, while import prices fell 11%. In this scenario, the larger drop in imports than exports in value terms steadily pushed up Uruguay's trade surplus; more specifically, exports of goods fell by 8% in 2016, while imports dropped by 14%.

In this context, the government continues looking for ways to boost demand, although the process is taking longer than expected. It is attempting in particular to finalize investment projects under public-private partnerships, and to sign trade agreements with key markets. Also, negotiations are under way for the construction of a third paper pulp mill in the country, which in the medium term could result in a US\$ 4.0 billion investment (equivalent to 7% of annual GDP). However, the project has yet to be approved, pending decisions on the applicable tax regime and its infrastructure requirements.

### 2. Economic policy

#### (a) Fiscal policy

Fiscal policy was expansionary in 2016. The public sector's primary balance deteriorated from equilibrium (0.0% of GDP) in 2015 to a deficit of 0.7% in 2016, owing mainly to the differentiated increase in expenditures and revenues in the consolidated account of the central government and the

social security fund, Banco de Previsión Social (BPS). There was a notable increase in transfers (equivalent to 0.5% of GDP), which included expenditures linked to the national health fund, FONASA, which have grown substantially since the completion in 2016 of plans to provide universal coverage for pensioners. Interest payments fell by 0.3 GDP points to 3.3% of GDP, thus raising the consolidated public sector deficit to 4% of GDP, which despite being lower than forecast in the last accountability report (4.3%), still represents the highest level for 27 years.

The government now finds itself in a difficult situation. At the beginning of 2017, personal income tax increases for the higher-income brackets came into effect, as did the reduction in corresponding deductions, with which the government aims to increase revenues by 1% of GDP. Nonetheless, Uruguay has little room to increase spending, which represents a challenge in view of the budgetary allocations needed to fulfil its education and care system plans, among others.

The succession of government deficits has taken a toll on public debt; gross public debt stood at 62% of GDP at the end of 2016, similar to 2015 levels. Net debt grew by 4 GDP points to 30% of GDP in 2016. However, Uruguay is under no immediate pressure in terms of its debt maturity profile, as half of its servicing commitments will not be due until after 2023 and its contingent credit lines represent close to 4.5% of GDP.

#### **(b) Monetary policy**

Monetary policy remained tight in 2016, continuing in the same vein as in 2015. The central bank announced successive downward adjustments to its planned year-on-year growth target for the expanded monetary aggregate M1, the benchmark for its policy decisions. Monetary restriction was accompanied by a clear slowdown in money demand, whose year-on-year variation was nil at mid-year. However, money demand increased substantially as from the fourth quarter of 2016, and especially during the first quarter of 2017, on the back of the country's economic recovery.

During the first half of 2016, the central bank sought to reduce excess liquidity by shifting its monetary reserve policy towards higher average requirements, and by issuing monetary regulation bills. Furthermore, given the rise in relative demand for domestic currency compared to foreign currency since mid-2016, the central bank went from being a seller to a net buyer in the foreign-exchange market. It also eliminated investors' option to receive dollar payments on peso-denominated instruments, and instead allowed these instruments to be purchased directly in dollars. In September, the government also began to channel the dollar requirements of State-owned companies through the foreign-exchange market instead of through the Ministry of Economy, as had been the case until recently.

The average annual growth rate of expanded M1 reached 10.5% in the first quarter of 2017, a substantial increase compared to the 6.9% recorded in the previous quarter. The Monetary Policy Committee accordingly adjusted the target range for expanded M1 growth to 9%-11%, arguing nevertheless that this measure represents a continuation of the central bank's contractionary policy of recent years, insofar as both the country's economic recovery and the shift in investor portfolios were responsible for the greater demand for domestic currency.

#### **(c) Exchange-rate policy**

The dollar followed two distinct paths in 2016. In the first half of the year it appreciated sharply, recording an average parity of 32.2 Uruguayan pesos per dollar in March. It then stalled and began to decline in value, to close at an average rate of 29.3 Uruguayan pesos in December 2016, resulting in a net

dollar depreciation of 2% in 2016. This moderate downward trend of the dollar continued in the early months of 2017, at the same time as the central bank began consolidating its position as a net buyer of foreign exchange.

The dollar's exchange rate evolved hand in hand with international reserves. In fact, the central bank had been steadily drawing down reserves since mid-2015, as part of its policy to buffer the upward pressure on the exchange rate. Towards the second half of 2016, it started reversing this policy as peso depreciation began to ease. The central bank started buying dollars in the foreign-exchange market once again and increased its international reserves, which despite being high still fall short of the record levels seen early in 2015.

In recent months, the real effective bilateral exchange rate has followed two different paths, depending on whether domestic prices are compared to prices in Uruguay's regional counterparts or in the rest of the world. Thus, the real effective exchange has fallen slightly with respect to the Argentine and Brazilian currencies, compared to one year ago, but risen sharply since mid-2016 with regard to the currencies of the United States, Europe and China. This can be attributed to the fact that the peso is no longer depreciating, and to the much higher level of inflation in Uruguay than in its aforementioned trading partners.

#### **(d) Other policies**

On 1 January 2017, a permanent reduction of 2% on VAT —charged on all sales up to 14,000 Uruguayan pesos and paid in full, in one instalment, by debit card or other forms of electronic cash— came into effect. This came on top of a previous 2% reduction. The forgone revenues associated with this VAT cut are estimated at US\$ 50 million. Also, as from May 2017, it will be mandatory for all wages to be paid through a bank account or other electronic cash system, with the exception of those paid to rural workers. This has resulted in a structural transformation of expanded M1 whereby on-demand and saving deposits are consistently outgrowing circulating cash.

The final competitive tenders for wind farms were completed in 2016. However, there will be no further plans to increase installed capacity until an interconnection agreement allowing energy sales to Brazil is finalized. Wind energy represented 22% of power generation in 2016, almost entirely replacing the much more expensive and polluting fossil fuel generation, which is also detrimental to the current account.

One of the most important announcements made by the incoming government in 2015 was the development of a national care system to provide services for three segments of the population: children aged 0-3 years, persons with disabilities and non-autonomous persons over 65. Despite budgetary constraints weighing on the system's ability to reach the level of coverage it had initially planned, the intention in 2017 and 2018 is to significantly increase coverage for early childhood through the construction and expansion of early childhood and family care centres (CAIF). Financing for carers of older persons and those with disabilities has started to materialize; initially, US\$ 57 million had been earmarked for operational expenditures in 2017, but the accountability law of 2016 reduced available funding by US\$ 14 million. It is expected that, as coverage expands through this policy, it will increase not only the demand for caregivers but also the labour supply in general, especially from women, as the time they previously devoted to family care is freed.

### **3. The main variables**

**(a) The external sector**

In 2016, the trade balance confirmed the change of direction begun at the end of 2015 and remained positive throughout the year. At the end of 2016, the trade account registered a surplus of more than US\$ 1.0 billion, which represented 2% of GDP compared with 0.4% of GDP at the end of 2015. The improvement in the trade balance was due to a sharper decline in values of imports than exports, principally in the tradables category.

Exports declined by 7.7% in 2016, with agricultural and dairy products and chemicals posting the sharpest falls. Soybean sales were heavily down on the 2015 figure, owing to a poorer harvest, but production has rebounded strongly in 2017. The downturns in dairy product and chemical exports were attributable to lower prices, as physical volumes of both actually increased.

Imports fell across the board in 2016, with a 13.9% decrease for the year overall. The largest drop was in crude oil (28.6%), as a result of a drop in both prices and volumes. In other sectors, the lower import values may be explained mainly by the fall in prices, most notably the 18.3% drop in those of capital goods imports. With regard to services, transport and travel continued the downward trend that has been evident since 2014 and which has steadily improved the services balance. By end-2016, the current account surplus stood at 2% of GDP, which was countered by a deficit on the income balance.

At the end of the first four months of 2017, exports of goods had grown 9.3%, while imports had declined 10% compared with the year-earlier period. The largest drivers of export expansion were beef, dairy products and, especially, soybean. Tourism enjoyed a very successful high season, generating over US\$ 1.0 billion in foreign-exchange revenues, which was 38% more than the previous period.

**(b) Economic activity**

GDP grew 1.5%, yielding a fourteenth consecutive year of economic growth. Although below the average rate of recent years, growth in 2016 was nonetheless an improvement on the 0.4% recorded in 2015, and came in above expectations during the year. After an uncertain start, economic activity picked up over the rest of the year and recorded a 3.4% year-on-year expansion in the fourth quarter of 2016. Growth was positive for most sectors, although some downturns were recorded. Such was the case of construction which, after falling by more than 6% in 2015, registered a 4% year-on-year decline in 2016 as a result of the slowdown in real estate investment. In other spheres, despite recovering in the last two quarters, for the year overall the commerce, restaurant and hotel sectors declined after weak consumption levels hindered growth in the first half. Transport and communications was one of the fastest-growing sectors in 2016, with 6.5%, and continues to exhibit the healthy activity levels seen in recent years thanks to the continued expansion of the telecommunications segment.

On the demand side, GDP was boosted by a moderate rise in domestic demand and by the positive contribution from net external demand. Final consumption expenditure grew 0.8% amid subdued private consumption for most of the year and a mild upward trend in public consumption. Gross fixed capital formation grew by a timid 0.9% for the year, despite a slight retrenchment of private investment. External demand made a positive net contribution owing to the volume of exports falling less than the volume of imports for the year.

Preliminary data for the early months of 2017 signal a continuation of the economic recovery seen towards the end of 2016. The high season was hugely successful for the tourism sector, which is expected to confirm fresh annual records for tourist arrivals and foreign-exchange earnings from inbound

tourism. Furthermore, the recovery in the commerce, restaurant and services sector appears to have gained a sound footing, with a notable contribution from resurgent sales of new cars and trucks. GDP figures for the first half-year will be affected by the temporary maintenance closure of the State-owned National Fuel, Alcohol and Portland Cement Administration (ANCAP) refinery (which has a monopoly over Uruguay's refining), which is expected to detract 0.5% from annual growth.

### **(c) Prices, wages and employment**

Inflation trended downwards at the end of 2016 and has continued to do so in the first half of 2017. After increasing sharply in the first half of 2016 and exceeding the 10% threshold owing to steep price increases in fruits and vegetables and in tradable goods, inflation reversed later in the year as a result of falls in the prices of these same categories. In fact, fruit and vegetable prices went from rising 34% year-on-year in June 2016 to contracting 2% in April 2017. Similarly, the reversal in the appreciation of the dollar and its subsequent stagnation at under 30 pesos translated into a substantial drop in tradable goods inflation. Thus, in April 2017 the consumer price index recorded a 6.5% year-on-year rise, meaning that for the second month running inflation was within the government's target range (3%-7%) after six years of existence breaching it.

Real wages were up by 3.3% year-on-year in December 2016; this was a stronger increase than in 2015 and thus continued the upward trend of recent years. The real wage gain was slightly larger in the private than the public sector, at 3.6% and 3.1%, respectively. These increases took place in the context of the 2016 round of wage negotiations aimed at establishing a fixed nominal adjustment scheme with six-monthly revisions, aligned with official guidelines. The process generated increasing opposition between the stakeholders and resulted in fewer tripartite agreements being reached, compared to previous processes that yielded broader support.

The labour market deteriorated slightly in 2016 and early 2017. The participation rate remained unchanged in Montevideo but fell in the rest of the country, which brought down the overall average. The employment rate fell both in the capital city and in the rest of the country, resulting in an aggregate level of 58.4% which, although high in historical terms, is the lowest annual reading since 2010. At the national level, unemployment rose to 7.8% in 2016, 0.3% higher than in 2015. In February 2017, the unemployment rate rose to 8.2%, 0.2% above the rate recorded 12 months before.

Table 1  
URUGUAY: MAIN ECONOMIC INDICATORS

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
	<b>Annual growth rates b/</b>								
Gross domestic product	7.2	4.2	7.8	5.2	3.5	4.6	3.2	0.4	1.5
Per capita gross domestic product	6.8	3.9	7.5	4.8	3.2	4.3	2.9	0.0	1.1
Gross domestic product, by sector									
Agriculture, livestock, hunting, forestry and fishing	2.1	3.3	-1.5	13.2	-0.8	2.0	0.3	-1.2	0.7
Mining and quarrying	1.7	31.1	35.5	-21.1	-2.3	2.5	-10.8	-15.5	7.8
Manufacturing	8.1	5.2	2.6	2.0	-3.9	1.2	4.2	4.9	0.4
Electricity, gas and water	-51.1	11.6	89.3	-24.2	-21.9	54.7	15.7	-6.7	15.6
Construction	2.6	2.7	2.4	2.4	16.3	0.9	0.7	-6.1	-3.9
Wholesale and retail commerce, restaurants and hotels	11.9	0.9	11.6	7.0	5.6	8.0	-0.6	-4.0	-1.6
Transport, storage and communications	30.7	14.9	15.0	10.7	10.0	6.9	7.4	4.8	6.5
Financial institutions, insurance, real estate and business services	4.5	1.7	4.3	6.5	5.3	4.0	3.7	2.7	0.5
Community, social and personal services	4.6	3.9	1.4	2.4	1.5	2.7	2.9	0.1	-0.6
Gross domestic product, by type of expenditure									
Final consumption expenditure	9.1	2.7	8.6	6.7	5.1	5.5	2.9	-0.2	0.8
Government consumption	9.3	5.2	3.1	3.7	6.0	4.9	2.5	2.2	1.6
Private consumption	9.1	2.3	9.4	7.2	4.9	5.5	3.0	-0.5	0.7
Gross capital formation	25.0	-11.2	15.2	9.9	14.5	4.8	0.0	-9.0	0.7
Exports (goods and services)	8.5	4.5	7.2	5.8	3.6	-0.1	3.5	-0.6	-1.4
Imports (goods and services)	24.4	-8.7	13.6	12.4	13.6	2.8	0.8	-7.3	-2.9
Investment and saving c/	<b>Percentajes of GDP</b>								
Gross capital formation	23.2	19.6	19.4	20.9	22.9	22.5	21.2	19.7	18.7
National saving	17.5	18.4	17.6	18.1	17.9	17.5	16.7	17.6	18.6
External saving	5.7	1.2	1.8	2.7	5.1	5.0	4.5	2.1	0.1
Balance of payments	<b>Millions of dollars</b>								
Current account balance	-1 730	-381	-731	-1 315	-2 593	-2 861	-2 580	-1 140	-36
Goods balance	-1 714	-504	-527	-1 431	-2 361	-1 352	-909	-243	351
Exports, f.o.b.	7 095	6 392	8 031	9 274	9 916	10 257	10 343	9 091	8 387
Imports, f.o.b.	8 810	6 896	8 558	10 704	12 277	11 609	11 252	9 334	8 037
Services trade balance	753	1 025	1 157	1 592	1 189	241	133	465	767
Income balance	-918	-1 040	-1 501	-1 631	-1 536	-1 881	-1 935	-1 483	-1 275
Net current transfers	148	138	140	156	115	130	131	121	122
Capital and financial balance d/	3 963	1 970	370	3 879	5 880	5 784	3 940	-648	-2 130
Net foreign direct investment	2 117	1 512	2 349	2 511	2 539	3 027	2 148	1 293	919
Other capital movements	1 846	458	-1 979	1 368	3 341	2 757	1 791	-1 941	-3 049
Overall balance	2 233	1 588	-361	2 564	3 287	2 923	1 360	-1 788	-2 166
Variation in reserve assets e/	-2 232	-1 588	361	-2 564	-3 287	-2 923	-1 360	1 788	2 166
Other financing	0	0	0	0	0	0	0	0	0
Other external-sector indicators									
Real effective exchange rate (index: 2005=100) f/	93.2	91.3	79.9	77.9	76.3	70.7	74.3	74.1	74.4
Terms of trade for goods (index: 2010=100)	94.1	100.5	100.0	102.4	106.3	108.1	112.3	114.5	120.8
Net resource transfer (millions of dollars)	3 045	929	-1 131	2 248	4 344	3 903	2 005	-2 131	-3 406
Total gross external debt (millions of dollars)	15 425	17 969	18 425	18 345	24 030	26 518	28 100	28 450	26 149
Employment	<b>Average annual rates</b>								
Labour force participation rate g/	62.7	63.4	62.9	64.8	64.0	63.6	64.7	63.8	63.4
Open unemployment rate h/	8.3	8.2	7.5	6.6	6.7	6.7	6.9	7.8	8.2
Visible underemployment rate h/	10.8	9.2	8.9	7.6	7.4	6.9	6.9	7.3	8.3

Table 1 (concluded)

	2008	2009	2010	2011	2012	2013	2014	2015	2016 a/
<b>Prices</b>	<b>Annual percentages</b>								
Variation in consumer prices (December-December)	9.2	5.9	6.9	8.6	7.5	8.5	8.3	9.4	8.1
Variation in producer prices (December-December)	6.4	10.5	8.4	11.1	5.9	6.3	10.6	6.6	-1.9
Variation in nominal exchange rate (annual average)	-10.8	7.8	-11.2	-3.8	5.1	0.9	13.6	17.5	10.3
Variation in average real wage	3.5	7.4	3.3	4.0	4.2	3.0	3.4	1.6	1.6
Nominal deposit rate i/	3.2	4.0	3.7	4.4	4.2	4.3	4.4	5.3	5.1
Nominal lending rate j/	13.1	16.6	12.0	11.0	12.0	13.3	17.2	17.0	17.6
<b>Central government</b>	<b>Percentajes of GDP</b>								
Total revenue	26.0	26.3	26.9	27.0	26.9	28.0	27.6	27.2	27.9
Tax revenue	23.7	23.9	24.2	24.7	25.0	25.5	25.3	25.2	25.6
Total expenditure	27.1	27.8	28.0	27.6	28.9	29.5	29.9	30.0	31.6
Current expenditure	25.3	26.3	26.3	26.1	27.5	28.1	28.5	28.8	30.3
Interest	2.9	2.7	2.4	2.4	2.3	2.4	2.3	2.3	2.7
Capital expenditure	1.8	1.6	1.7	1.5	1.4	1.4	1.4	1.2	1.4
Primary balance	1.8	1.2	1.3	1.9	0.3	0.9	0.0	-0.5	-1.0
Overall balance	-1.1	-1.5	-1.1	-0.6	-2.0	-1.5	-2.3	-2.8	-3.7
<b>Non-financial public sector debt</b>	44.5	53.3	39.9	38.4	40.2	36.9	39.2	47.4	47.1
Domestic	13.2	18.6	13.6	14.9	15.1	12.8	11.9	15.6	19.0
External	31.4	34.7	26.3	23.6	23.9	26.0	27.5	31.8	28.1
<b>Money and credit</b>	<b>Percentages of GDP, end-of-year stocks</b>								
Domestic credit	...	15.1	18.4	18.3	17.5	18.6	19.3	21.5	23.7
To the public sector	...	7.2	9.1	6.9	7.4	9.2	8.2	4.6	6.2
To the private sector	...	20.4	22.0	22.9	23.3	25.7	26.9	30.0	28.2
Others	...	-12.5	-12.7	-11.5	-13.2	-16.2	-15.8	-13.1	-10.8
Monetary base	5.6	5.4	5.4	5.7	6.0	6.4	6.3	6.3	6.4
Money (M1)	8.7	8.7	9.8	10.2	9.9	9.9	8.9	8.5	8.4
M2	13.4	13.7	15.8	16.8	16.5	16.6	15.7	15.7	16.5
Foreign-currency deposits	31.8	25.4	26.5	26.7	25.8	28.3	31.7	37.9	34.8

**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.

h/ Urban total.

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

j/ Business credit, 30-367 days.

Table 2  
URUGUAY: MAIN QUARTERLY INDICATORS

	2015				2016				2017	
	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/	3.9	-1.1	0.3	-1.3	0.0	1.3	1.1	3.4	4.3	...
Gross international reserves (millions of dollars)	18 136	18 539	17 222	16 385	14 435	13 995	14 685	13 737	12 919	12 882 c/
Real effective exchange rate (index: 2005=100) d/	70.1	74.2	75.5	76.5	76.6	77.6	72.8	70.6	69.8	70.0 c/
Open unemployment rate e/	7.3	7.9	7.9	8.3	8.2	8.2	8.4	7.8	8.9	...
Employment rate f/	59.3	59.0	58.4	59.2	58.9	58.2	58.0	58.7	57.8	...
Consumer prices (12-month percentage variation)	7.6	8.5	9.1	9.4	10.6	10.9	8.9	8.1	6.7	5.6 c/
Wholesale prices (12-month percentage variation)	4.9	6.5	6.6	6.6	10.3	6.9	-1.0	-1.9	-1.9	0.1
Average nominal exchange rate (pesos per dollar)	24.7	26.6	28.3	29.5	31.5	31.2	29.2	28.4	28.5	28.3
Nominal interest rates (average annualized percentages)										
Deposit rate g/	4.6	4.1	5.5	7.1	4.9	5.5	5.0	5.1	4.8	5.2 h/
Lending rate i/	17.3	16.6	16.6	17.3	18.0	18.5	17.1	16.8	17.1	16.5 h/
Sovereign bond spread, Embi Global (basis points to end of period)j/	214	213	305	280	279	270	232	244	209	205 c/
International bond issues (millions of dollars)	1 200	200	-	1 205	-	-	1 147	-	-	- c/
Domestic credit (variation from same quarter of preceding year)	4.3	4.4	20.7	22.0	41.4	50.4	24.0	21.3	12.9	8.0 h/
Non-performing loans as a percentage of total credit	2.0	2.1	2.2	2.2	2.4	2.8	3.0	3.3	3.6	3.9 h/

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/ Figures as of April.

i/ Business credit, 30-367 days.

j/ Measured by J.P.Morgan.