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November 23, 2021

**Statement by Mr. Stephan and Ms. Khademi on Uruguay  
(Preliminary)  
Executive Board Meeting  
November 29, 2021**

**We thank staff for an insightful and well-written report and Mr. Chodos and Ms. Bustillo for their helpful Buff statement. We concur with the thrust of the assessment.** Uruguay's economy is on a recovery path, supported by a successful vaccination campaign, an effective economic policy response and rising world prices for its agricultural commodity exports. Downside risks to the economy should be monitored closely. The report rightly highlights that while short-term risks mainly relate to a possible resurgence of Covid-19 infections and weaker commodity prices, medium-term risks stem primarily from a lack of progress with structural reforms or insufficient fiscal discipline. Against this background, and in line with staff's recommendations, additional fiscal support should be well-targeted and phased out gradually. The current gradual tightening of the monetary policy stance appears appropriate given inflationary pressures. Medium-term policy priorities should include determined fiscal consolidation to put public debt on a firm downward path and measures to reduce pre-pandemic structural impediments to stronger growth.

**We concur with staff that a credible strategy to restore fiscal space while maintaining targeted support in the short term are appropriate priorities as the economy is recovering.** Uruguay was able to mitigate the crisis through effective policy measures, taking advantage of the social protection and health care systems already in place. During the economic recovery, policy support should be targeted exclusively at those in need and phased out gradually. Given the further deterioration of public finances, the authorities' commitment to fiscal consolidation to restore fiscal space is welcome. At the same time, considering the high uncertainty surrounding the evolution of the pandemic, the authorities should continue to be mindful of downside risks and avoid pro-cyclicality in fiscal policy. In the medium term, additional fiscal measures are necessary to put debt on a firm downward path. In this context, staff rightly highlights the importance of a pension reform, even though associated fiscal savings may take time to materialize, as well as the benefits of a credible, rules-based fiscal framework. Concerning the latter, we welcome staff's detailed considerations for strengthening Uruguay's fiscal framework, which should provide valuable advice for the authorities.

**The authorities' reform efforts to address low potential growth and support competitiveness through structural reforms are laudable.** Consistent with staff's assessment, measures to reduce pre-pandemic structural impediments to stronger growth, including in the SOEs sector and the labor market, would also help improve competitiveness and resilience, especially in non-commodity

sectors. In this regard, we see merit in the reforms passed in 2020 (including the ‘Ley de Urgente Consideracion’). *Could staff elaborate on the prospect of a referendum to reverse some elements of the law and the potential influence on fiscal consolidation and tackling structural imbalances?*

**In line with staff’s assessment, the current gradual tightening of the monetary policy stance seems appropriate.** In view of inflationary pressures and inflation expectations still being above the target range, monetary policy should maintain a tightening bias. Together with a very accommodative monetary policy stance during the crisis, we note that the exchange rate effectively acted as a shock absorber in 2020. We encourage the BCU to maintain a high degree of exchange rate flexibility.

**We welcome the improvements in the monetary policy framework to enhance credibility and facilitate achieving low and stable inflation.** The authorities’ commitment to price stability as well as the BCU’s progress in line with staff’s previous recommendation to, among other things, improve central bank communication and shift to the interest rate as a policy tool, has helped lowering inflation expectations closer towards the target range as well as leading to lower dispersion of expectations across different actors. Further solidifying these apparent gains in credibility should also support the BCU’s efforts to reduce dollarization and strengthen the local debt market, thereby improving monetary policy transmission.

**The financial system appears broadly robust but potential downside risks should continue to be monitored vigilantly.** Consistent with staff’s assessment, we favor a gradual phasing out of forbearance and credit support measures taken during the pandemic as the economy recovers. Banks appear to be well-capitalized and nonperforming loans remain low but should be monitored as the support measures are phased out.

**Given the high level of dollarization and the fact that agricultural commodities account for the bulk of Uruguay’s exports, potential external pressures stemming from exchange rate risks and global commodity prices should be considered.** In this context, we note the appropriate foreign exchange reserves and appreciate the authorities’ intention to retain the SDR allocation as a buffer.