FOR AGENDA

EBS/84/160

CONFIDENTIAL

July 30, 1984

To: Members of the Executive Board

From: The Acting Secretary

Subject: Uruguay - Stand-By Arrangement - Program for the Second Year

Attached for consideration by the Executive Directors is a paper on the program for the second year of the stand-by arrangement for Uruguay. A draft decision appears on pages 41-44.

It is proposed to bring this subject to the agenda for discussion on Monday, August 27, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Di Tata (ext. (5)8606) or Mr. Baliño (ext. (5)8551).

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

URUGUAY

Stand-By Arrangement: Program for the Second Year

Prepared by the Western Hemisphere, Exchange and Trade Relations, and Central Banking Departments

(In consultation with Legal and Treasurer's Departments)

Approved by Eduardo Wiesner, Linda M. Koenig, and Manuel Guitian

July 30, 1984

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I. Introduction

On April 22, 1983 (EBM/83/66) the Executive Board approved Uruguay's request for access to Fund resources for the equivalent of SDR 378 million (300 percent of Uruguay's quota of SDR 126 million in effect at that time and 231 percent of Uruguay's present quota of SDR 163.8 million) in the framework of a two-year stand-by arrangement. The arrangement established macroeconomic targets for the period 1983-84 and performance clauses for the period through March 1984. It also stipulated that Uruguay would have to reach understandings with the Fund prior to the end of March 1984 on the performance clauses of the program for the period through the end of the arrangement.

Uruguay was in compliance with the targets of the program through September 1983, but there were deviations from the program path in the last quarter of the year and in the first quarter of 1984. Several rounds of discussions were held in Montevideo from mid-November 1983 to review ways of correcting for these deviations and to develop a program for the remainder of the arrangement. A set of measures aimed at ensuring return to the path of adjustment that had been sought originally was adopted in May-June 1984, and the discussions on the program for the period ahead were concluded in Montevideo during May 30-June 21, 1984.1/

In the letter dated July 23, 1984 and the accompanying Memorandum of Economic Policy and Memorandum of Understanding (attached), the Minister of Economy and Finance and the President of the Central Bank of Uruguay review the performance since the beginning of the arrangement and describe the economic and financial policies of the Government of Uruguay for the period ahead. In that same letter, the authorities indicate that they have cast their policies within a time frame that extends somewhat beyond the period of the arrangement and they request that the date of expiration of the arrangement be extended from April 21, 1985 to June 3, 1985.2/

1/ The staff team that participated in these discussions comprised Christian Brachet (Head-WHD), Tomas Baliño (CBD), Juan Carlos Di Tata, Olav Grønlie, Roberto Ramaciotti (all WHD), and Alice McGann (Secretary-ADM). The team was assisted by Humberto Arbulú-Neira, the Fund resident representative in Uruguay.

2/ The 1983-84 program had been discussed in Montevideo in late 1982-early 1983 and the staff documents had been issued to Executive Directors in February 1983. At that time, the proposed phasing provided for the last purchase to take place in February 1985 on the basis of performance at end-December 1984. Discussion by the Executive Board of Uruguay's request for a stand-by arrangement in support of this program had had to be postponed to late April 1983, however, because of delays in Uruguay's securing the external financing that had been built into the program for the first year of the arrangement. Because of this delay, March 31, 1984 was made a testing date in the first year of the program, and March 31, 1985 was to be made the final testing date; postponement of the expiration date of the arrangement to early June 1985 would give sufficient time to monitor the observance of quantitative performance criteria as of the end of March 1985, on which the last purchase under the arrangement is predicated.

Uruguay made three purchases under the stand-by arrangement in 1983 totaling SDR 151.2 million, but was prevented from making the February 1984 and May 1984 purchases because of its inability to meet certain targets of the program at end-December 1983 and end-March 1984 and to reach agreement with the Fund by March 31, 1984 on the performance clauses of the program for the second year of the arrangement.1/ At the end of June 1984, total Fund credit outstanding to Uruguay (including a first credit tranche purchase made in July 1982) stood at 138.5 percent of Uruguay's quota (111.5 percent of quota excluding purchases under the compensatory financing facility), of which 60 percent was financed from ordinary resources and the remainder from borrowed resources under the policy of enlarged access (Table 1).

The stand-by arrangement for Uruguay would provide for possible purchases of SDR 226.8 million during the remainder of the arrangement. In the attached communication, however, the authorities note the deviations from the program path since the last quarter of 1983; they also refer to the possible need for the Government which is to reach office in March 1985 to approach the Fund with requests for further assistance and, therefore, to the need for maintaining Uruguay's potential access to Fund resources at a high level. Accordingly, they request that the amount of the arrangement be scaled down from SDR 378 million to SDR 271.2 million, which would leave SDR 120 million, equivalent to 73 percent of quota, available in the ten months through the proposed revised date of expiration of the arrangement.2/ Purchases would be phased evenly in four installments to take place in August and November 1984 and in February and May 1985. Such utilization of the adjusted amount would raise Fund credit to Uruguay to the equivalent of 212 percent of quota by the end of May 1985. Further information on Uruguay's relations with the Fund is presented in Appendix II.

The last Article IV consultation discussions with Uruguay were conducted in Montevideo in several rounds from mid-November 1983 to end-January 1984. The attendant documentation (SM/84/70 and SM/84/78) was considered by the Executive Board at EBM/84/71 on May 2, 1984.

1/ The end-June 1983 balance of payments and net domestic assets tests were exceeded slightly but these departures were more than fully explained by delayed disbursement of the first tranche of the medium-term loan negotiated with foreign banks in parallel with the program. The Fund thus agreed to waive these performance criteria (EBS/83/177, August 18, 1983).

2/ At an annual rate, Uruguay's access to Fund resources during the remainder of the arrangement thus would be equivalent to SDR 144 million, or 88 percent of Uruguay's new quota.

Table 1. Uruguay: IMF Position 1/

	Outstanding Feb. 28, 1983	Operations in the First Year of Program: Apr.-July 1983	Aug.-Oct. 1983	Nov.1983-Jan.-1984	Feb.-Mar. 1984	Total	Outstanding June 30, 1984	Operations in the Second Year of the Program: Aug.-Oct. 1984	Nov. 1984-Jan. 1985	Feb.-Apr. 1985	May 1985	Total	Outstanding June 3, 1985
					(In millions of SDRs)								
Transactions under tranche policies (net) 2/													
Purchases	31.5	47.2	47.3	56.7	--	151.2	182.7	30.0	30.0	30.0	30.0	120.0	302.7
Ordinary resources	(31.5)	(14.3)	(21.5)	(25.8)	(--)	(61.6)	(93.1)	(15.0)	(15.0)	(2.9)	(--)	(32.9)	(126.0)
First credit tranche	/31.5/	/--/	/--/	/--/	/--/	/--/	/31.5/	/--/	/--/	/--/	/--/	/--/	/31.5/
Stand-by arrangement	/--/	/14.3/	/21.5/	/25.8/	/--/	/61.6/	/61.6/	/15.0/	/15.0/	/2.9/	/--/	/32.9/	/94.5/
Enlarged access resources	(--)	(32.9)	(25.8)	(30.9)	(--)	(89.6)	(89.6)	(15.0)	(15.0)	(27.1)	(30.0)	(87.1)	(176.7)
Repurchases	--	--	--	--	--	--	--	--	--	--	--	--	--
Transactions with special facilities (net) 3/	44.1	--	--	--	--	--	44.1	--	--	--	--	--	44.1
Purchases	44.1	--	--	--	--	--	44.1	--	--	--	--	--	44.1
Repurchases	--	--	--	--	--	--	--	--	--	--	--	--	--
Total Fund credit outstanding (end of period)	75.6	122.8	170.1	226.8	226.8	226.8	226.8	256.8	286.8	316.8	346.8	346.8	346.8
Under tranche policies	31.5	78.7	126.0	182.7	182.7	182.7	182.7	212.7	242.7	272.7	302.7	302.7	302.7
Special facilities	44.1	44.1	44.1	44.1	44.1	44.1	44.1	44.1	44.1	44.1	44.1	44.1	44.1
					(As percent of new quota)								
Total Fund credit outstanding (end of perod)	46.2	75.0	103.8	138.5	138.5	138.5	138.5	156.8	175.1	193.4	211.7	211.7	211.7
Under tranche policies	19.2	48.0	76.9	111.5	111.5	111.5	111.5	129.9	148.2	166.5	184.8	184.8	184.8
Special facilities	26.9	26.9	26.9	26.9	26.9	26.9	26.9	26.9	26.9	26.9	26.9	26.9	26.9

Source: International Monetary Fund.

1/ Partials may not add up to totals because of rounding.
2/ Ordinary and enlarged access resources.
3/ Compensatory financing facility.

II. Background and Recent Developments

Following a six-year period of strong economic growth, balance of payments surpluses, and generally declining inflation, Uruguay's economic and financial position took a sharp turn for the worse from mid-1981. Output stagnated in the second half of 1981 and dropped by almost 10 percent in 1982 (Table 2). Unemployment, which had been less than 6 percent of the labor force in the second quarter of 1981 reached 14 percent in the fourth quarter of 1982 (Statistical Appendix Table 17).

This abrupt downturn can be traced to a number of factors. The slowdown in the world economy that started in 1980, and rapid changes in economic conditions in neighboring countries beginning in 1981 had adverse effects on Uruguay. In the main, however, the cost/price distortions arising from the inconsistency between incomes and exchange rate policy, and the eventual weakening of domestic demand policies, appear to have been the determining factor. Beginning in late 1978, the rate of depreciation of the peso vis-à-vis the U.S. dollar was slowed steadily, in accordance with a schedule for the exchange rate that was published several months in advance. The rate of increase in domestic costs and prices also was brought down--during the 12-month period to November 1982 consumer prices rose by 11 percent, compared with an increase of more than 80 percent during 1979--but for the four-year period as a whole it exceeded by far the pace of currency depreciation; consequently there was a large real appreciation of the peso (Chart 1).

In the public sector, tax collections declined in real terms in 1982 as a result of the contraction in real GDP, but wages and social security benefits continued to rise as they were about indexed to past price or wage inflation; the nonfinancial public sector thus moved to a deficit in excess of 10 percent of GDP in 1982, from a small surplus in 1980 and a small deficit in 1981 (Table 3). In addition, in 1982 the Mortgage Bank received assistance from the Central Bank equivalent to 7 1/2 percent of GDP as it stepped up its lending for social housing to mitigate the effects on employment of the fall in Argentine real estate investment in Uruguay.1/ Moreover, these demands on the Central Bank emerged at a time when the Central Bank came under pressure to take measures to maintain the solvency of the commercial banking system. As corporate bankruptcies multiplied and banks experienced growing financial difficulties, the Central Bank first extended emergency assistance to the banking system and eventually, in October 1982, announced that it

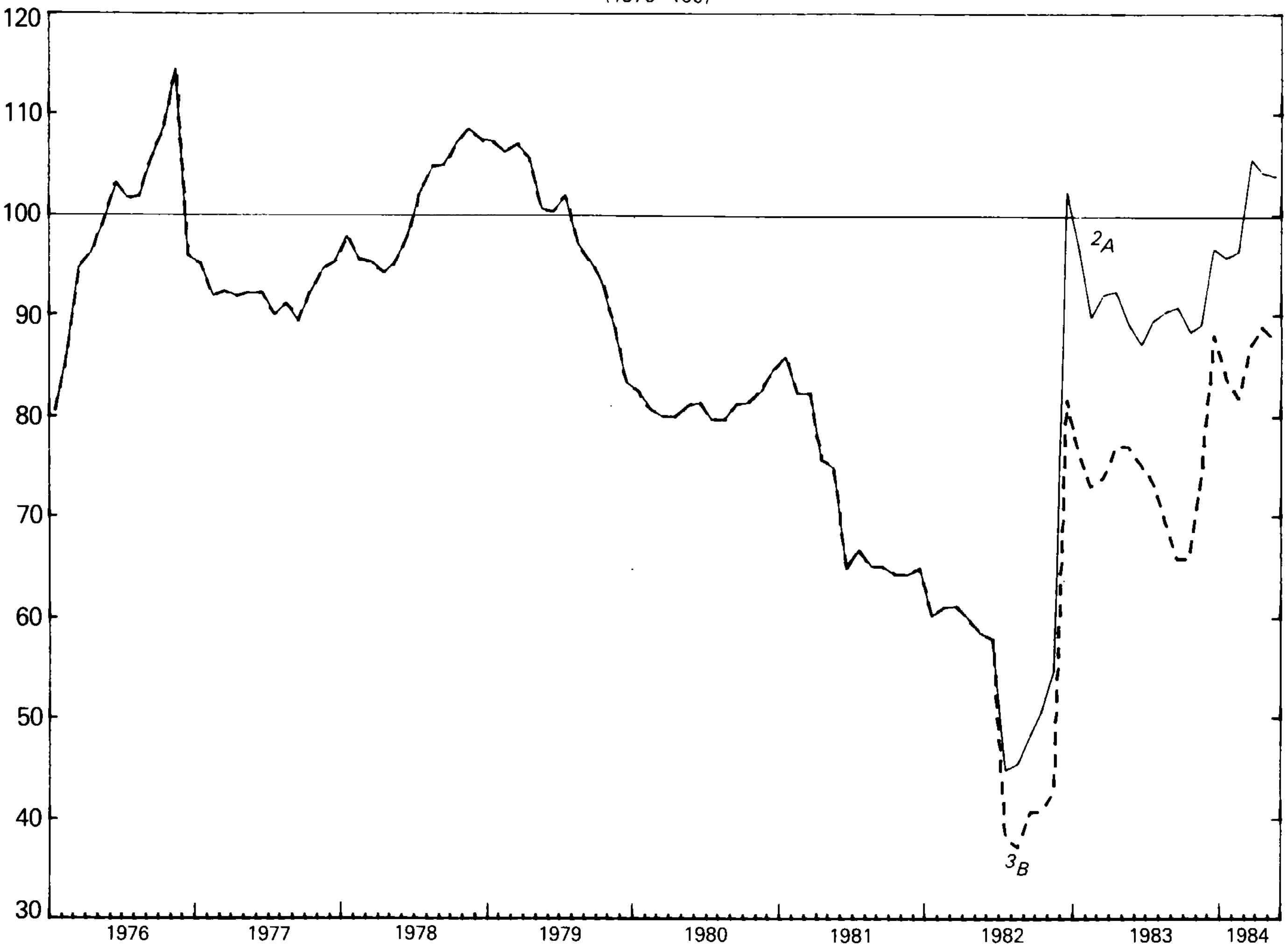
1/ This increased lending activity coincided with the discontinuation of central administration transfers to the Mortgage Bank of the proceeds of a 2 percent tax on wages and with a virtual stagnation in the Bank's own loanable resources.

CHART 1

URUGUAY

REAL EFFECTIVE EXCHANGE RATE, 1976-84[1]

(1976=100)



Sources: Central Bank of Uruguay, and IMF, *International Financial Statistics* and *Direction of Trade*

[1] A decline in the value of the index represents a real appreciation of the peso.

[2] A = is the real effective exchange rate computed using consumer prices in Uruguay and partner countries and official exchange rates of partner countries

[3] B = is the same as A except that beginning in July 1982 the parallel exchange rates for the Argentine peso and the Brazilian cruzeiro were used

Table 2. Uruguay: Selected Economic Indicators

(Percentage changes unless otherwise indicated)

	1980	1981	1982	1983 Proj.	1983 Est.	1984 Proj.	1984 Rev.	July 1984–June 1985 Proj.
Gross domestic product 1/								
In current market prices	60.0	32.8	5.0	39.9	44.9	21.1	50.8	42.7
In constant 1978 prices	6.0	1.9	-9.7	1.0	-4.7	4.0	2.9	4.0
GDP deflator	51.0	30.2	16.2	38.5	52.1	16.5	46.6	37.2
Prices, wages, and exchange rate 2/								
Consumer prices	42.8	29.4	20.5	29.1	51.5	...	45.5	21.9
Wholesale prices	28.6	14.9	33.5	...	73.8	...	...	...
Wholesale prices of domestic manufactures	32.9	18.1	37.9	...	62.9	...	...	...
Wages - Public sector	66.5	26.8	7.9	...	28.3	...	30.8	16.6
- Private sector	67.1	35.2	6.6	...	35.6	...	41.8	22.8
Exchange rate (selling) 3/	18.0	15.9	147.3	32.1	49.8	...	48.5	21.9
Labor Market 4/								
Labor participation rate 5/	56.6	58.0	54.4	...	58.6	...	...	...
Unemployment rate 6/	6.0	9.0	13.3	...	15.1	...	...	...

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Historical series differ from those in SM/84/70 because of a recent revision of national accounts data.
2/ End of period.
3/ In terms of pesos per U.S. dollar.
4/ Data for December.
5/ In percent of population 14 years and older.
6/ In percent of labor force.

Table 3. Uruguay: Summary of the Nonfinancial Public Sector Operations

(In percent of GDP)

	1981	1982	Est. 1983	1984 I	1984 II	1984 III	1984 IV	1984 Year	1985 I	1985 II	Program July 1984–June 1985
General Government											
Revenue	22.4	21.1	20.9	20.2	18.6	18.9	20.6	19.6	21.8	21.0	20.6
Expenditure	21.0	26.6	22.1	20.8	20.6	19.3	19.3	19.9	19.8	20.0	19.6
Current account surplus or deficit (-)	1.4	-5.5	-1.2	-0.6	-2.0	-0.4	1.3	-0.3	2.0	-1.0	1.0
Public enterprises											
Current account surplus or deficit (-)1/	2.2	0.8	0.7	2.6	1.4	2.9	3.2	2.5	3.1	2.1	2.8
Public sector savings	3.6	-4.7	-0.4	2.0	-0.6	2.5	4.5	2.2	5.1	3.1	3.8
Capital expenditure	5.9	5.4	4.0	4.7	5.2	5.1	5.6	5.2	4.5	4.6	4.9
Overall surplus or deficit (-) of the nonfinancial public sector	-2.3	-10.1	-4.4	-2.7	-5.8	-2.6	-1.1	-3.0	0.6	-1.5	-1.1
Bonds and bills in dollars	--	0.8	0.8	2.5	-1.2	--	-1.3	-0.1	-0.5	-1.1	-0.8
Other foreign financing (net)	1.8	3.1	-4.1	-2.0	1.9	1.4	1.8	0.9	-0.1	-0.3	0.8
Domestic financing (net)2/	0.5	6.2	7.7	2.2	5.1	1.2	0.6	2.2	--	2.9	1.1
Memorandum item:											
Total expenditure	26.9	32.0	26.1	25.5	25.8	24.4	24.9	25.1	24.3	24.6	24.5

Sources: Ministry of Economy and Finance; SEPLACODI; Central Bank of Uruguay; and Statistical Appendix Tables 16 and 18.

1/ Net of transfers.
2/ New medium-term financing and refinancing loans negotiated in 1983 with foreign commercial banks are shown as channeled through the Central Bank.

would be prepared to purchase some of the banks' loan portfolios.1/ Also, in September 1982 an export prefinancing scheme was introduced, which involved an exchange rate guarantee (amounting to a subsidy) from the Central Bank. As a result, the quasi-fiscal spending of the Central Bank amounted to 8 1/3 percent of GDP in 1982, which, added to the deficit of the nonfinancial public sector, made for an overall fiscal deficit of about 18 1/2 percent of GDP (Table 4).

Notwithstanding a marked decline in private investment, the external current account deficit remained at around 7 percent of GDP in 1982. At the same time, private capital outflow increased markedly as a result of the widening public sector deficit and sharp expansion in central bank credit, and of the attendant weakening of domestic confidence. Despite massive reliance on official external borrowing, the balance of payments in 1982 moved into a deficit of US$800 million, or close to 14 percent of GDP (Chart 2).

As a series of attempts at corrective action in the course of 1982 had failed to redress the situation, in late 1982 the authorities adopted a comprehensive adjustment program that was supported by the current stand-by arrangement. The market-oriented, outward looking thrust of the economic strategy pursued since 1974 was reaffirmed, and measures were adopted to improve domestic demand management and to adjust the external position. The objectives of the program were a marked improvement in the balance of payments and a return to relative price stability once corrective price adjustments had worked their way through the economy. It also was expected that the program would lay the basis for a progressive recovery of economic activity.

The main features of the program were: (a) an intensification of the efforts that had been under way since 1974 to achieve a better allocation of resources; (b) a virtual withdrawal of the Government from the process of wage determination in the private sector; (c) a sharp reduction in the borrowing requirements of the nonfinancial public sector;

1/ Under the terms of the "portfolio purchase scheme," the Central Bank in 1982 and early 1983 acquired some US$215 million in private sector debt owed to foreign-owned local commercial banks, out of the proceeds of about US$540 million in new medium-term loans from these banks' head offices. (The remaining US$325 million was passed on to the Central Administration and to the Mortgage Bank.) Under the same scheme, the Central Bank also acquired the equivalent of some US$415 million in poor quality assets held by insolvent locally owned commercial banks (a quid pro quo for the acquisition of these banks by foreign financial institutions), against cancellation of previous assistance or in exchange for interest-bearing bonds or promissory notes denominated in the currency of the original loans--mostly U.S. dollars. As a result of these operations, the Central Bank has on its books some US$630 million in claims on the Uruguayan private sector on which it receives virtually no income, and it has taken on about US$820 million in liabilities on which it pays market-related rates.

Table 4. Uruguay: Public Sector Deficit Adjusted for Central Bank Fiscal Expenditures 1/

(As percent of GDP)

	1982	1983	Proj. 1984	Est. July 1983-June 1984: Prel. July-Dec. 1983	Est. July 1983-June 1984: Est. Jan.-June 1984	Est. July 1983-June 1984: Year	Proj. July 1984-June 1985: Proj. July-Dec. 1984	Proj. July 1984-June 1985: Proj. Jan-June 1985	Proj. July 1984-June 1985: Year
Nonfinancial public sector's financing needs	10.1	4.4	3.0	6.7	4.4	5.4	1.8	0.5	1.1
Central Bank	8.3	11.4	3.7	11.5	4.3	7.5	3.2	3.4	3.3
Assistance to Mortgage Bank	7.5 2/	6.8 2/	0.5	8.8	0.8	4.4	0.3	0.3	0.3
Subsidies arising from 1982 export pre-financing scheme	--	1.3	--	--	--	--	--	--	--
Net operating losses	0.8	3.3	3.2	2.7	3.5	3.1	2.9	3.1	3.0
Foreign exchange costs (net)	0.3	1.5	2.9	1.0	2.8	2.0	3.0	3.0	3.0
Expenditures	0.7	1.8	3.6	1.2	3.5	2.5	3.6	3.7	3.7
Interest of foreign debt	(		2.4	0.8	2.3	1.7	2.4	2.5	2.5
Interest on liabilities issued in connection with the "portfolio purchase scheme"	(0.7 3/	1.8 3/	1.0	0.3	1.0	0.7	0.9	0.9	0.9
Interest on private banks and BROU foreign-currency deposits	(		0.2	0.1	0.2	0.1	0.2	0.2	0.2
Receipts	0.4	0.3	0.7	0.2	0.7	0.5	0.6	0.6	0.7
Interest income on purchased portfolio	...	...	0.1	...	0.1	0.1	0.1	0.1	0.1
Interest on foreign reserves and other interest income	0.4	0.3	0.6	0.2	0.6	0.4	0.5	0.5	0.5
Local currency costs (net)	0.6	1.8	0.3	1.8	0.7	1.2	-0.1	0.1	--
Expenditures	0.6	1.8	0.8	2.3	1.3	1.7	0.4	0.5	0.5
Wages and other operating costs	0.5	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Interest on bills issued in connection with the "portfolio purchase scheme"	0.1	0.2	0.2	0.4	0.2	0.3	0.2	0.3	0.3
Interest on banks' local currency deposits	--	1.1	0.4	1.6	0.8	1.2	--	--	--
Interest on treasury bills for open market operations and other interest expenditure	...	...	--	0.1	0.1	0.1	--	--	--
Receipts	...	...	0.5	0.5	0.6	0.6	0.5	0.4	0.5
Interest income on purchased portfolio	...	...	0.2	...	0.2	0.1	0.2	0.1	0.2
Other interest income	...	...	0.4	0.5	0.4	0.5	0.3	0.3	0.3
Total public sector financing needs	18.4	15.8	6.7	18.2	8.7	12.9	5.0	3.9	4.4

Sources: Ministry of Economy and Finance; Planning Secretariat; Central Bank of Uruguay; and Fund staff estimates.

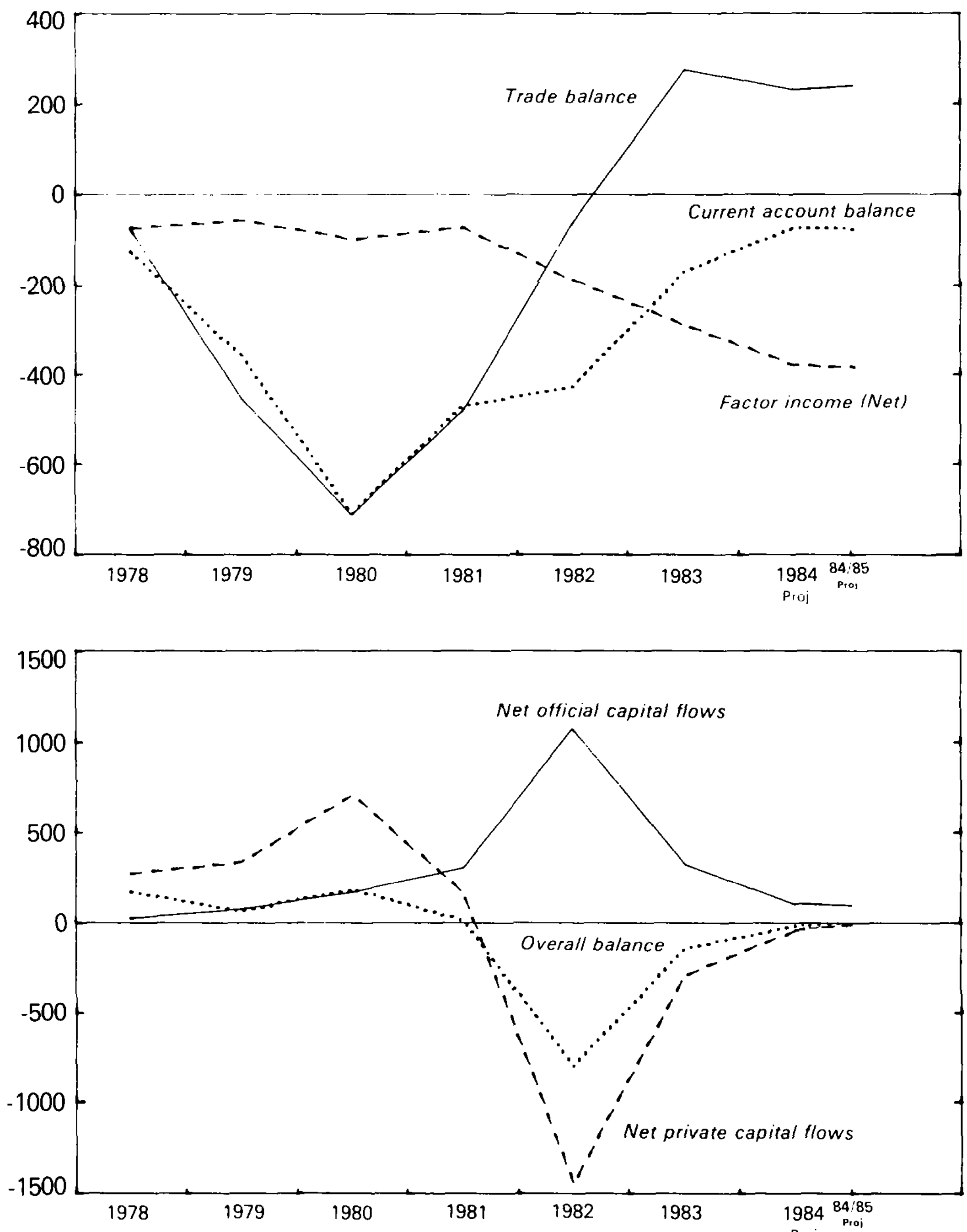
1/ Partials may not add up to totals because of rounding.
2/ Before write-off of interest charges on Mortage Bank's debt to the Central Bank (which eventually appeared as a loss in the Central Bank's profit and loss statement).
3/ Includes assistance to private banks in local currency.

CHART 2

URUGUAY

SELECTED BALANCE OF PAYMENTS FLOWS

(In millions of U.S. dollars)



Sources: Central Bank of Uruguay, and Fund staff estimates and projections.

(d) a scaling down of official external borrowing; and (e) a deceleration of central bank credit growth to a rate consistent with the balance of payments and inflation objectives.

The improvement in resource allocation was predicated on: (a) the freeing of the exchange rate in late November 1982 and the substantial depreciation of the peso that was expected to ensue;1/ (b) a further liberalization of the trade system; and (c) the maintenance of realistic prices for goods and services produced or marketed by the public sector.

The deficit of the nonfinancial public sector was to be reduced from over 10 percent of GDP in 1982 to 3 percent of GDP in 1983 and about 1 percent of GDP in 1984. To achieve this objective, various revenue measures were announced in late November 1982, including increases in tax rates, the extension of the value added tax to many services, and the introduction of emergency taxes on traditional exports.2/ At the same time, expenditure was to be cut substantially relative to GDP, in part by holding increases in wages and social security benefits below projected inflation. The compression of the borrowing requirement of the public sector, in turn, was to make possible a marked slowdown in the rate of central bank credit expansion. This slowdown was to be aided by a drastic curtailment of central bank assistance to the Mortgage Bank, and by the reintroduction of legal reserve requirements (discontinued in 1979) and of open market operations.

With these changes in exchange rate and financial policies, it was expected that the current account deficit of the balance of payments would decline somewhat in 1983 and 1984, and that private capital outflow would abate rapidly. The need for net official external borrowing therefore was projected to decline, from more than US$1 billion in 1982 to around US$450 million in 1983 and about US$100 million in 1984. The balance of payments deficit was to be limited to no more than US$100 million in 1983, and approximate balance was to be achieved in 1984.3/

1/ Central bank intervention was to be limited to preventing erratic market fluctuations and to meeting the foreign exchange cost of the export prefinancing scheme. (The balance of payments deficit programmed for 1983 was mostly in reflection of the unwinding of this scheme.)

2/ These taxes were temporary and in lieu of the existing farm income tax (IMAGRO). IMAGRO is collected with a one-year lag and therefore was unlikely to yield much in 1983 because of the delayed impact of the exchange rate change on farm income.

3/ The balance of payments target for 1983 was made adjustable, however, to up to a deficit of US$180 million (US$200 million through March 1984) in case of a shortfall in actual compared with programmed net recourse by the public sector to external financing.

III. Performance in the First Year of the Stand-By Arrangement

Even though the end-1983 and end-March 1984 program limits for the public sector deficit were exceeded, and inflation has been significantly higher than projected, Uruguay's economy has undergone a large measure of adjustment in the last 18 months (Table 5 and Chart 3). There has been a substantial reduction in the borrowing needs of the nonfinancial public sector; the peso has depreciated sharply in real terms, to a level close to the average of 1975-79 (when exports grew rapidly and there were rising external surpluses), and the balance of payments has strengthened markedly (Table 6).1/ Also, after five consecutive quarters of decline in output, real GDP began to rise again from mid-1983.

In the first half of 1983, imports fell off sharply, and the current account moved close to balance. For 1983 as a whole, the current account deficit is estimated to have declined to around 3 percent of GDP, from 7 percent of GDP in 1982, and it moved into a surplus equivalent to 6 1/3 percent of GDP in the first quarter of 1984 (Table 7). The trade account shifted from a small deficit in 1982 to a large surplus in 1983 and early 1984, more than offsetting the increase in interest payments on the external debt. Contrary to expectations, there continued to be a deficit on travel account in 1983, because of a pronounced decline in Argentine and Brazilian tourism and increased travel abroad by Uruguayans who took advantage of the parallel exchange rates for the currencies of Uruguay's neighbors. This deficit, however, was reversed in early 1984 owing to a strong rebound in tourist arrivals from Argentina.

The stronger than anticipated performance on current account compensated for, but also to an extent reflected the weakness of the capital account. For one, net official capital inflows fell short of the amounts envisaged in the program, owing in part to Uruguay's foreign bank creditors having rescheduled only 90 percent of principal falling due in 1983,2/ but also to a shortfall from original estimates in the external financing operations related to the "portfolio purchase scheme." At the same time, despite domestic interest rates that, during most of the year, were both high in real terms and at or above the arbitrage rate vis-a-vis assets denominated in foreign currency, the private capital account remained significantly more negative than had been expected.

To an extent, the continued high inflationary expectations and low level of confidence stemmed from the difficult economic conditions prevailing in the region and from uncertainties attaching to Uruguay's transition toward its first elections in 13 years (scheduled for November

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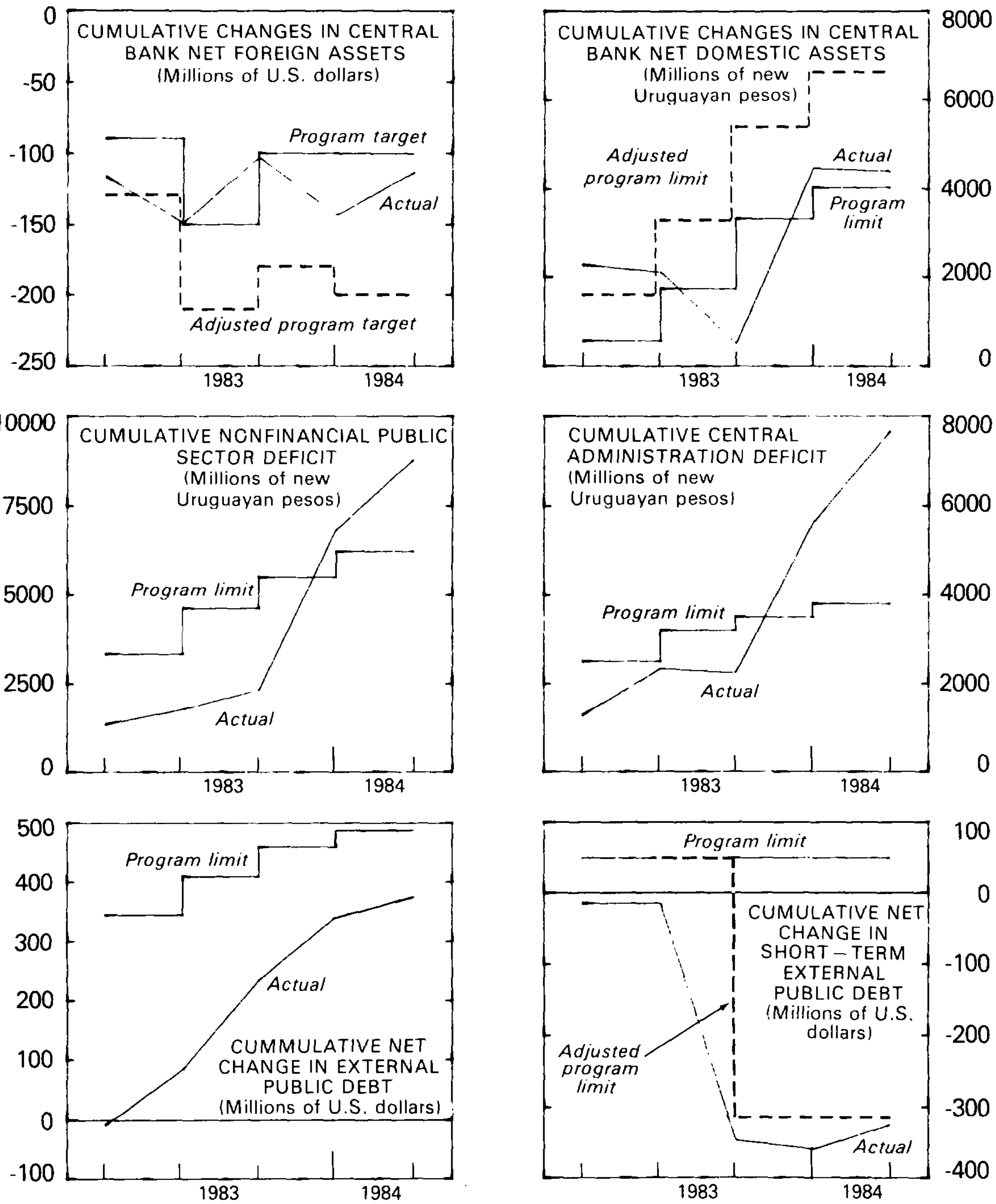
1/ The balance of payments targets were met by ample margins through March 1984.

2/ For a review of Uruguay's external debt position and of the rescheduling and new financing operations of 1983, see Appendix I in SM/84/70.

CHART 3

URUGUAY

PERFORMANCE UNDER PROGRAM



Source: Ministry of Economy and Finance, Planning Secretariat and Central Bank of Uruguay.

Table 5. Uruguay: 1983-85 Program 1/2/

	1981	1982	1983 Or. Proj.	1983 Est.	1984 Or. Proj.	1984 Rev. Proj.	July 84-June 85 Proj.
			(Percentage changes)				
Real GDP	1.9	-9.7	1.0	-4.7	4.0	2.9	4.0
Money GDP	32.8	5.0	39.9	44.9	21.2	50.8	42.7
Deflator	30.2	16.2	38.5	52.1	16.5	46.6	37.2
			(In percent of GDP)				
External sector							
Exports GNFS	14.7	14.1	15.8	18.5	23.7	21.7	20.6
Imports GNFS	18.6	17.4	15.5	15.7	22.4	15.7	14.9
Factor payments and transfers	-0.6	-2.1	-4.9	-5.8	-5.2	-7.5	-7.2
Current account deficit (-)	-4.5	-5.4	-4.6	-3.0	-3.9	-1.5	-1.5
Official capital	2.7	10.9	6.1	9.3	1.4	2.0	1.5
NFPS	(1.8)	(4.6)	(1.3)	(0.5)	(1.0)	(0.8)	(--)
Official banks	(0.9)	(6.3)	(4.8)	(8.8)	(0.4)	(1.2)	(1.5)
Nonbank private sector 3/	1.1	-12.0	-2.8	-3.0	)	)	)
Private financial system	0.9	0.2	--	-1.6	) 2.5	) -0.9	) --
Net reserve change (increase -)	-0.2	6.3	1.3	-1.7 4/	--	0.4	--
Nonfinancial public sector							
Saving 5/	3.6	-4.7	2.1	-0.4	4.1	2.2	3.8
General government 5/	(-1.4)	(-8.0)	(-1.5)	(-3.2)	(-0.5)	(-3.0)	(-1.7)
Public enterprises 5/	(5.0)	(3.3)	(3.6)	(2.8)	(4.6)	(5.2)	(5.5)
Investment	5.9	5.4	4.9	4.0	5.2	5.2	4.9
Overall deficit (-)	-2.3	-10.1	-2.8	-4.4	-1.1	-3.0	-1.1
External financing	1.8	4.6	1.3	0.5	1.1	0.8	--
Internal financing	0.5	5.5	1.5	3.9	--	2.2	1.1
Saving and investment							
Public investment	5.9	5.4	4.9	4.0	5.2	5.2	4.9
Private investment	9.4	6.6	6.9	6.5	8.6	6.5	7.4
Investment = saving	15.3	12.0	11.8	10.5	13.8	11.7	12.3
External saving	4.5	5.4	4.6	3.0	4.0	1.5	1.5
Nonfinancial public sector	(1.8)	(4.6)	(1.3)	(0.5)	(1.1)	(0.8)	(--)
Financial system and other	(2.9)	(-5.5)	(2.0)	(4.2)	(2.9)	(0.3)	(1.5)
Net reserve change (increase -)	(-0.2)	(6.3)	(1.3)	(-1.7)	(--)	(0.4)	(--)
Domestic saving	10.8	6.6	7.2	7.5	9.8	10.1	10.8
Nonfinancial public sector	(3.6)	(-4.7)	(2.1)	(-0.4)	(4.1)	(2.2)	(3.8)
Private sector	(7.2)	(11.3)	(5.1)	(7.9)	(5.7)	(7.9)	(7.0)

Sources: Ministry of Economy and Finance; SEPLACODI; Social Security Directorate; public enterprises; Central Bank of Uruguay; and Fund staff estimates.

1/ Cash basis.
2/ External accounts converted to new Uruguayan pesos at average annual exchange rate. Ratios to GDP therefore differ from those in Tables 6, 7, 11, and 12 where GDP in U.S. dollar terms has been estimated on the basis of a shadow exchange rate.
3/ Includes SDR allocation, gold valuation adjustments, and errors and omissions.
4/ After refinancing at medium term of US$117.1 million in central bank reserve liabilities.
5/ Before receipts and transfer payments; also includes capital receipts.

Table 6. Uruguay: Summary Balance of Payments

(In millions of U.S. dollars)

	1981	1982	1983 Prog.	1983 Actual Prog. Basis 1/	1983 Actual Adj.2/	Proj. 1984 Orig.	Proj. 1984 Rev.	Prog. July 1984–June 1985
Current account	-470	-426	-343	-171	-171	-116	-75	-81
Trade balance	-480	-64	-1	275	275	363	231	254
Exports, f.o.b.	1,215	1,023	1,159	1,045	1,045	1,104	1,028	1,058
Imports, c.i.f.	-1,695	-1,087	-1,160	-770	-770	-741	-797	-804
Factor services	-74	-188	-368	-288	-288	-353	-378	-387
Other	84	-174	26	-158	-158	-126	72	52
Capital account	471	-374	243	26	143	...	55	81
Public sector	303	1,072	455	322	439	145	98	81
Medium- and long-term	222	472	885	687	804 2/	125	58	81
Short-term	81	600	-430	-365	-365	20	40	--
Private sector	168	-1,446	-212	-296	-296	...	-43	--
Financial	101	14	...	25	25	...	--	--
Nonfinancial 3/	67	-1,460	...	-321	-321	...	-43	--
SDR allocations	11	--	--	--	--	--	--	--
Overall balance	12	-800	-100	-145	-28	...	-20	--
Valuation adjustment	13	215	--	101	113	--	--	--
Official reserve movement (increase -)	-25	585	100	44	-85	...	20	--
Memorandum items 4/								
Current account/GDP	-6.6	-7.1	-5.8	-3.1	-3.1	-1.9	-1.3	-1.3
Overall balance/GDP	0.2	-13.3	-1.7	-2.6	-0.5	...	-0.3	--

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ As per program, shows US$117.1 million as reserve liabilities of the Central Bank even though these liabilities were refinanced at medium term; excludes exchange gain on gold sales. Gold valued at US$42 per troy ounce; accounting rate for the SDR: SDR 1 = US$1.10.

2/ Treats as medium-term financing US$117.1 million in refinanced reserve liabilities; reflects adjustment in reserves for actual average SDR/U.S. dollar relationship in 1983 (SDR 1 = US$1.05).

3/ Includes errors and omissions.

4/ For the purpose of these ratios, the GDP in U.S. dollar terms has been estimated using an Uruguayan peso/U.S. dollar exchange rate that is constant in real terms at its average 1976 level (these ratios therefore differ from those that emerge from the national accounts).

Table 7. Uruguay: Balance of Payments Indicators

(In percent of GDP)

	1981 1/	1982 1/	Prel. 1983 I 2/	II 2/	III 2/	IV 2/	Year	Est. 1984 I 2/	II 2/	III 2/	IV 2/	Year	Proj. 1985 I 2/	II 2/	Est. July 1983-June 1984	Proj. July 1984-June 1985
Trade balance	-6.8	-1.1	5.2	7.2	1.2	6.6	5.0	5.4	3.7	3.3	5.9	3.9	5.2	5.3	4.2	4.1
Net travel receipts	1.1	-3.3	-1.3	-3.8	-3.8	-3.6	-3.1	6.5	-1.1	-0.6	-0.3	0.9	4.3	-0.5	-0.6	0.6
Net factor income payments	-1.0	-3.1	-3.8	-6.3	-4.6	-6.6	-5.2	-6.2	-8.5	-6.6	-8.7	-6.3	-6.9	-8.1	-6.4	-6.3
Current account balance (deficit -)	-6.6	-7.1	0.5	-2.7	-7.2	-3.1	-3.1	6.3	-5.7	-4.0	-2.5	-1.3	3.1	-3.0	-2.6	-1.3
Net capital inflows	6.6	-6.2	-9.1	0.3	10.6	--	0.5	-3.6	3.0	2.0	2.9	1.0	--	1.5	2.7	1.3
Public	(4.3)	(17.8)	(-6.0)	(6.3)	(14.7)	(8.6)	(5.8)	(-0.5)	(3.5)	(2.5)	(2.3)	(1.6)	(0.4)	(1.1)	(6.9)	(1.3)
Private	(2.3)	(-24.0)	(-3.1)	(-6.0)	(-4.1)	(-8.6)	(-5.3)	(-3.1)	(-0.5)	(-0.5)	(0.6)	(-0.6)	(-0.4)	(0.4)	(-4.2)	(--)
Overall balance (deficit -)	0.2	-13.3	-8.6	-2.4	3.4	-3.1	-2.6	2.6	-2.6	-2.0	0.4	0.3	3.1	-1.5	0.1	--

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ To correct for the distortions in these measurements arising from the different movements of the exchange rate and of the GDP deflator, especially in 1981 and 1982 when the peso became increasingly overvalued, GDP in U.S. dollar terms has been estimated for each year using an Uruguayan peso/U.S. dollar exchange rate that is constant in real terms at its average 1976 level.

2/ Annual rates.

1984) and the transfer of power to a civilian government in March 1985. However, delays in the introduction of certain fiscal measures and monetary control procedures that were crucial to the successful implementation of the program also played a role.1/ In addition, in the four months after the peg was severed, there was a severe lack of coordination between the exchange market operations of the official financial institutions--in the period December 1983 to March 1984, the Bank of the Republic (BROU), the state-owned commercial bank, increased its foreign exchange position by some US$70 million--and this caused confusion among market participants about the authorities' actual policy stance. Finally, as the year advanced, evidence of growing difficulties in adhering to the fiscal component of the program cast doubt on the ability of the Government to carry out the adjustment effort.

In the first three quarters of 1983 the deficit of the nonfinancial public sector was kept below the limit under the program, dropping to 2 percent of GDP at an annual rate (Table 8). Yet, for the year as a whole the deficit was about 4 1/2 percent of GDP. Although a major improvement from 1982, the deficit hence was substantially more than had been sought originally. Spending was reduced by almost 6 percentage points of GDP, significantly more than planned, but the lower than expected level of economic activity and imports caused government revenue to fall short of projections.

As early as the middle of the second quarter of 1983, it was apparent that additional action would have to be taken if the quarterly fiscal targets of the program were to be met. Some substantive measures were adopted, including additional cuts in spending. However, there also was reliance on special one-time payments from the rest of the public sector, while the collection of some taxes was advanced and certain payments were delayed. These various actions were sufficient to ensure compliance with the limits on the borrowing needs of the Central Administration and of the entire nonfinancial public sector at the end of September. However, since some were of a one-time nature and others had to be reversed in the fourth quarter--and since there also was an unplanned wage increase of about 15 percent for public sector employees in September--the end-year limits were exceeded by wide margins. These excesses continued in the first two quarters of 1984, despite sharp adjustments in state enterprise prices in January and May and some recovery of tax collections in response to the mild revival of economic activity.

There was no progress in 1983 in reducing pressures on the Central Bank from sources other than the nonfinancial public sector. In fact, these pressures intensified and the combined imbalances of the nonfinancial public sector and the Central Bank (as defined in Table 4) still amounted to 15 2/3 percent of GDP. Assistance to the Mortgage Bank declined only marginally while central bank losses rose abruptly

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1/ For a more detailed discussion of policy developments in the immediate aftermath of the float, see Section II in SM/84/70.

Table 8. Uruguay: Indicators of Fiscal Performance 1/

(In percent of GDP)

	Central Administration Deficit (-) (1)	Nonfinancial Public Sector (NFPS) Deficit (2)	Memorandum Items: Central Bank Credit to Public Sector Other than to NFPS 2/ (3)	Memorandum Items: Central Bank Profits and losses (-) (4)	Memorandum Items: Adjusted Public Sector Deficit (5=2+3+4)
1981	-0.9	-2.4	-0.1	0.4	-2.1
1982	-9.1	-10.1	-7.5	-0.8	-18.4
1983	-4.0	-4.4	-8.1	-3.3	-15.8
I	-3.7	-3.8	...	-2.6	...
II	--	0.2	...	-5.3	...
III	-1.2	-3.1	...	-2.0	...
IV	-10.9	-9.9	...	-3.4	...
1984	-2.6	-3.0	-0.5	-3.2	-6.7
I	-3.1	-2.7	-1.4	-4.3	-8.4
Est. II	-4.0	-5.8	-0.3	-2.8	-8.9
Proj. III	-3.1	-2.5	-0.3	-2.9	-5.7
Proj. IV	-0.6	-1.1	-0.3	-3.0	-4.4
1985					
Proj. I	--	0.6	-0.3	-2.6	-2.3
Proj. II	-1.0	-1.5	-0.4	-3.6	-5.5
Est. July 1983-June 1984	-4.8	-5.4	-4.4	-3.1	-12.9
Proj. July 1984-June 1985	-1.1	-1.1	-0.3	-3.0	-4.4

Sources: Ministry of Economy and Finance; Planning Secretariat; Central Bank of Uruguay; and Fund staff estimates.

1/ Quarterly data are not adjusted for seasonal variations.
2/ Principally assistance to Mortgage Bank; in 1983 also includes cost of the unwinding of the 1982 export prefinancing scheme.

on account of: (a) the unwinding of the export prefinancing scheme; (b) the cost of the "portfolio purchase scheme;" (c) the cost of servicing external loans at the same time that lending to the public sector was virtually interest free; and (d) interest payments on commercial banks' reserve deposits (Table 9).

As inflationary expectations continued to be strong and confidence remained weak, high domestic interest rates relative to actual inflation (Chart 4)1/ failed to stem the decline in real money and quasi-money and pressures on the exchange rate remained high during the greater part of the year. At first, the exchange rate was highly volatile, reaching NUr$40 per U.S. dollar in early January 1983--for a depreciation of almost 200 percent (in terms of pesos per U.S. dollar) relative to the value of the peso on the eve of the float. The market remained unstable for a time, but as policies began to take hold and the outlook for foreign financing improved,2/ the peso appreciated substantially, with the exchange rate stabilizing within a narrow band of NUr$31-34 per U.S. dollar in the period March to July (Statistical Appendix Table 24).

In July, political developments and growing public awareness of problems in the public finances brought renewed pressures on the exchange rate. From mid-July to early December, the BROU was instructed to intervene in the exchange market, at first on an ad hoc basis and then under a crawling peg system; during this period the peso depreciated from NUr$34 per U.S. dollar to NUr$39 per U.S. dollar. The intervention, however, served but to revive doubts about the appropriateness of the exchange rate and turned out to be very costly in terms of foreign exchange reserves. The nominal depreciation of the peso between November 1982 and end-1983 eventually far exceeded that expected at the start of the program on the basis of the projected increase in costs.

Inflation also has been much higher than had been anticipated. It originally had been envisaged that, following a spurt of corrective inflation, the rate of price increases would come down gradually during the course of the year, and for the year as a whole inflation was projected at 30 percent. In fact, inflation has remained quite volatile since November 1982; during 1983 consumer prices rose by 50 percent, and they have risen by a further 25 percent in the first five months of 1984 (Chart 5).

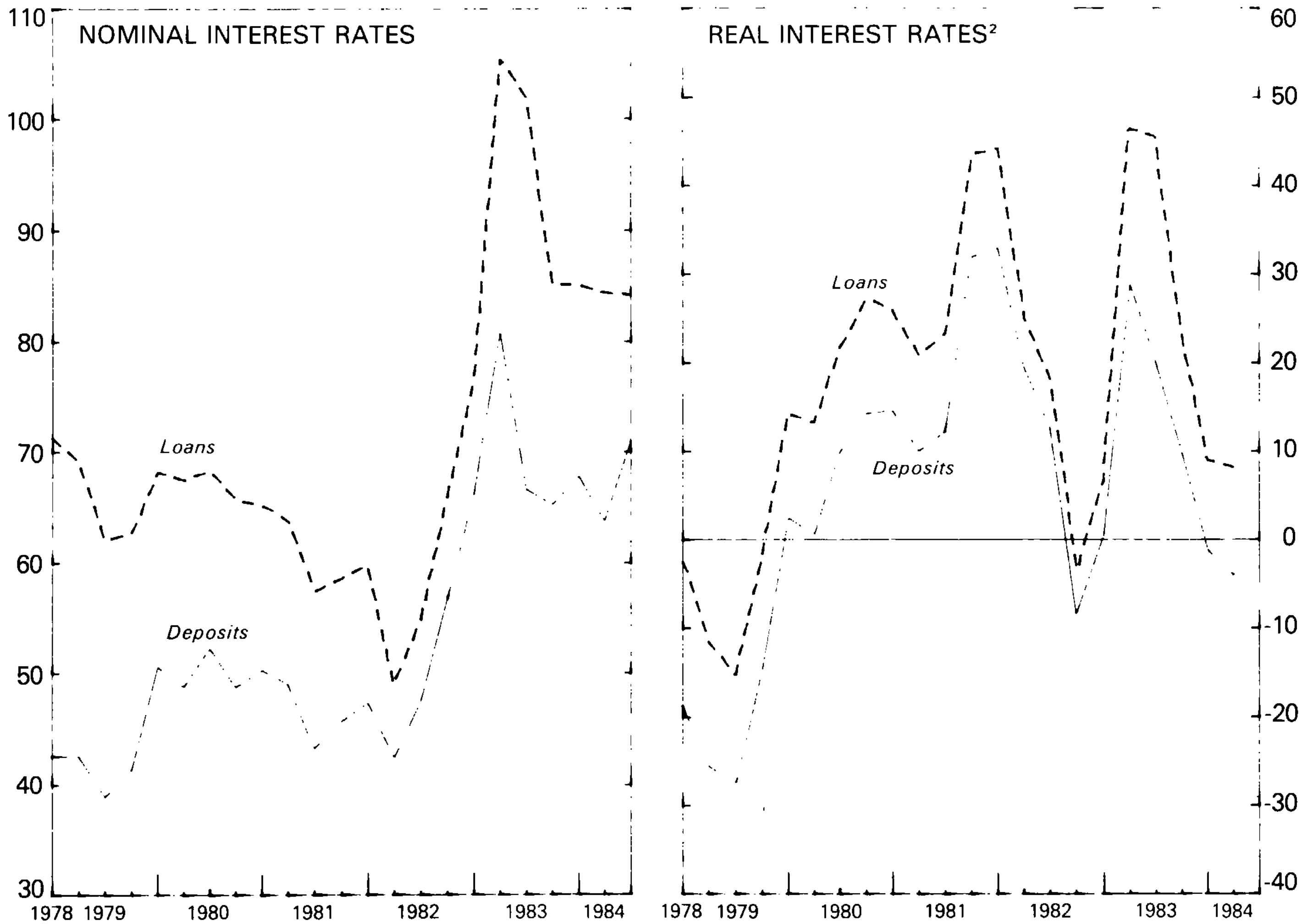
1/ For a discussion of interest rate movements in 1983, see Section III, subsection 3(d) in SM/84/78, April 13, 1984.

2/ Discussions between Uruguay and its foreign commercial bank creditors on the refinancing of maturities falling due in 1983-84 and on a new medium-term loan did not make significant progress until late March 1983, when the Managing Director of the Fund informed the Bank's working committee on Uruguay that he would not submit Uruguay's request for stand-by arrangement to the Executive Board until he had received assurances that a "critical mass" of new financing had been committed.

CHART 4

URUGUAY

NOMINAL AND REAL INTEREST RATES[1]



Source: Central Bank of Uruguay, and Fund staff estimates

1 Average annual interest rates. Ex post facto

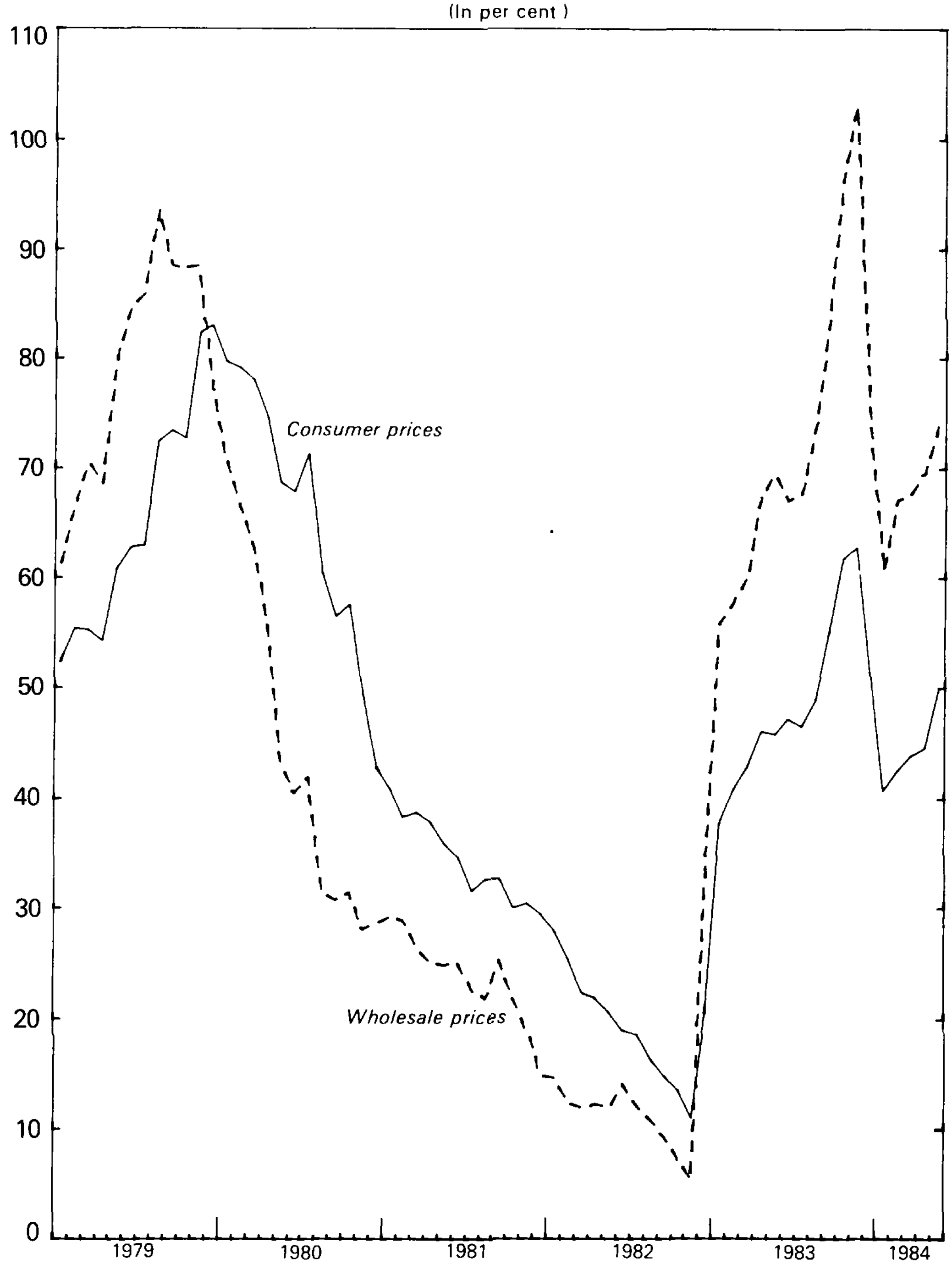
2 Up to 6 months. Deflated by the actual change in the consumer price index in the following six months

CHART 5

URUGUAY

12-MONTH INFLATION RATE

(In per cent)



Source: Central Bank of Uruguay.

Table 9. Uruguay: Changes in Central Bank Credit

(In millions of new Uruguayan pesos)

	1981 1/	1982 2/	1983 3/ Proj.	1983 3/ Est.	1984 4/ Proj.	July 1984-June 1985 4/
Net international reserves 5/	279	-7,395	-2,600	-3,767 6/	-1,204	--
Net domestic assets	877	9,660	9,148	12,232	4,433	3,460
Net credit to public sector 7/	396	8,235	3,412	14,984 8/	425	575
Credit to commercial banking system	241	2,759	--	1,270	1,824	2,743
Credit to Mortgage Bank	119	4,364	2,220	5,083	1,658	945
Credit to private sector	-7	2,274	6,066	11,643	4,759	-78
Net unclassified assets 9/	390	-3,915	3,950	5,752	10,389	7,882
Medium- and long-term foreign liabilities	-4	-3,446	-6,500	-25,016 6/8/	-4,932 10/	-4,944 10/
Counterpart SDR allocations	-58	37	--	--	--	--
Liabilities to financial system 11/	-200	-648	--	-1,484	-9,690	-3,663
Base money	1,156	2,265	6,548	8,465	3,229	3,460
Currency issue	1,130	2,009	2,740	729	4,004	3,218
Banks' local currency deposits	26	256	3,808	7,736	-775	242

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Foreign currency converted at NUr$10.9 per US$1.
2/ Foreign currency converted at NUr$12.7 per US$1.
3/ Foreign currency converted at NUr$26.0 per US$1.
4/ Foreign currency converted at NUr$60.0 per US$1.
5/ With gold valued at US$42 per troy ounce.
6/ Before rescheduling of US$117.1 million in short-term foreign liabilities of the Central Bank.
7/ Includes net credit to the Salto Grande Commission.
8/ Includes the refinancing by foreign bank creditors of short-term and medium-term external obligations of the nonfinancial public sector, which have been assumed by the Central Bank.
9/ Includes nonmonetary international organizations and treasury bills for open market operations.
10/ Excludes foreign currency-denominated bonds issued to local private banks as counterpart of purchased portfolio.
11/ Excludes vault cash and banks' local currency deposits.

In the first half of 1983, economic activity remained more sluggish than had been hoped and, for the year as a whole, real GDP declined by 4 1/2 percent. However, signs of an economic upturn, particularly in export-oriented industries, began to emerge in the third quarter of the year. Real GDP rose at a seasonally adjusted annual rate of 2 1/2 percent in that quarter and continued to advance in the following two quarters, owing in part to the strengthening of tourist demand. The employment situation also has improved somewhat; notwithstanding a marked increase in the labor participation rate, unemployment has declined from a peak of 16 1/2 percent of the labor force in the second quarter of 1983 to 14 percent in March 1984.

IV. The Program for July 1984-June 1985

Despite the deviations from the program path that became manifest in the last quarter of 1983 and in the first half of 1984, the authorities have stressed their intention to hand over power to the elected Government with internal and external equilibrium approximately restored and with the recovery of output solidly established.

A number of measures have been taken since the beginning of the year to facilitate the resumption of adjustment in the public finances and lessen other pressures on the Central Bank. With these measures, and a prudent incomes policy, the authorities aim at keeping the growth of domestic expenditure in the next 12 months to a rate compatible with a marked deceleration of inflation and a further reduction in the balance of payments current account deficit. At the same time, their hope is that continued adherence to an outward-looking economic strategy that reduces, or altogether foregoes, reliance on trade and payments restrictions and aims at achieving a structure of relative prices free from distortions will be instrumental in supporting the mild recovery of economic activity that has been underway since mid-1983.

1. Domestic demand management

a. Fiscal policy

Central to bringing domestic spending into a closer balance with available resources will be a renewed effort to restore equilibrium in the public finances. The current account of the nonfinancial public sector is projected to shift from a deficit equivalent to one half of 1 percent of GDP in calendar year 1983 to a surplus in excess of 2 percent of GDP in calendar year 1984 and to one of 3 2/3 percent of GDP in the 12 months ending in June 1985. Despite the mild recovery of investment outlays (from a very depressed level in 1983) that is being programmed for the next 12 months, this continued improvement in savings should help lower the borrowing requirements of the nonfinancial public sector from 5 1/2 percent of GDP in the 12 months from July 1983 to 3 percent in calendar year 1984 and to just a little over 1 percent of GDP in the 12-month period from July 1984.

General government revenue relative to GDP is projected to decline somewhat from 1983 to 1984, but to recover, to about 20 1/2 percent of GDP, during the 12-month period from July 1984. The decline expected in calendar year 1984 is in keeping with trends in the second half of 1983 when tax collections remained below forecasts because of the much greater than projected drop in domestic expenditure.1/ Also, consistent with the objective of reducing distortions in resource allocation, the emergency tax on traditional exports introduced in late 1982 has been reduced in steps from 15 percent to 8 percent for wool and beef, and eliminated for other products, without being replaced yet by another form of farm taxation.2/ These reductions have had an adverse effect on government revenue in the last several months.

To assure a recovery of tax collections from the second half of this year, the authorities recently adopted a series of revenue measures that, together, are expected to yield some 2 1/2 percent of GDP in the next 12 months. These measures include: an increase in the fuel tax; an adjustment in the basic rate of the value-added tax (VAT) from 18 percent to 20 percent; and the extension of the corporate income tax (IRIC) to state enterprises and official financial institutions (only in the latter case will the extension have an impact on the financial position of the overall nonfinancial public sector, although central administration finances will gain from the extension of IRIC to the state enterprises). Also, the refund to exporters of indirect taxes (other than VAT) paid during the production process has been discontinued. (This last measure is expected to about offset the effect of the extension of VAT reimbursement to farm exports.)

The authorities also have introduced a 1 percent tax on sales of foreign exchange. They are concerned that this levy increases import costs at a time when, not to penalize exports, efforts are being geared to reducing protection; but, given that over 70 percent of domestic financial intermediation now is in foreign currency,3/ they believe that it can be justified because the attendant increase in transaction costs may help to restore intermediation in local currency.

1/ Uruguay's tax system is largely expenditure based.

2/ When the program was framed in late 1982, the intention of the authorities was to switch back as soon as conditions would permit to a modernized form of the farm income tax (IMAGRO). Discussions now under way with the World Bank on an agricultural sector loan are bearing, among other matters, on ways to gear agricultural taxation toward increased efficiency in land use. There has been much progress in these discussions in recent months, and a modification of the tax regime applicable to agriculture may well be enacted in the next few months, allowing for a further reduction, and eventual elimination, of the export tax.

3/ With the result that balance of payments transactions per se on the average represent no more than one third of total exchange market transactions.

On the expenditure side, the authorities believe that there is little additional room for economies after the drastic reduction in spending that was carried out in 1983, particularly since real wages in public employment have declined by a cumulative 24 percent since the end of 1981 (Chart 6). Nevertheless, the impossibility in Uruguay's current circumstances of tackling the problem of a high public sector wage bill (relative to other expenditures) through reductions in public employment dictates the need for restraint in nominal adjustments. Salary raises for government employees therefore will continue to be kept below the projected rate of inflation. This moderation in salary awards, and continued austerity in other current outlays, should offset the increased cost of servicing the internal and external debt and still allow for a further decline, relative to GDP, in current general government expenditure in 1984 and during the program period. Dissaving by the General Government therefore should about disappear in 1984, and a current account surplus is projected in the 12-month period from July 1984.1/

A major improvement also is being sought in the financial position of the public enterprises, whose operating surplus during the next 12 months is targeted to rise by more than 2 percentage points of GDP in relation to its level in 1983. This improvement is predicated in part on the wage restraint that is being planned in the public sector and on continued efforts to streamline operating costs. The authorities, however, also intend to raise operating income in real terms. Enterprise prices already have been increased by a cumulative 45 percent, or well ahead of inflation, during the first five months of the year; and the intention is that enterprises' current revenue not only cover costs but also help to cover a growing portion of investment outlays.

Because of the completion in 1982 of a number of large projects, the program for 1983 contemplated some reduction in real public sector capital spending. Public investment in practice declined even more than planned, partly as a response to the shortfall in government revenue and partly because the social housing program of the Mortgage Bank (which was operated outside the budget) continued to place heavy claims on resources. The plans for the next 12 months contemplate some acceleration in the execution of priority investments (especially those in telecommunications, power distribution, and transport infrastructure) and a replenishment of oil inventories, which have been severely drawn-down in the last 18 months. Investment outlays, therefore, are projected to recover from 4 percent of GDP in 1983 to close to 5 percent of GDP during the next 12 months, or about the average ratio of the period 1976-80.

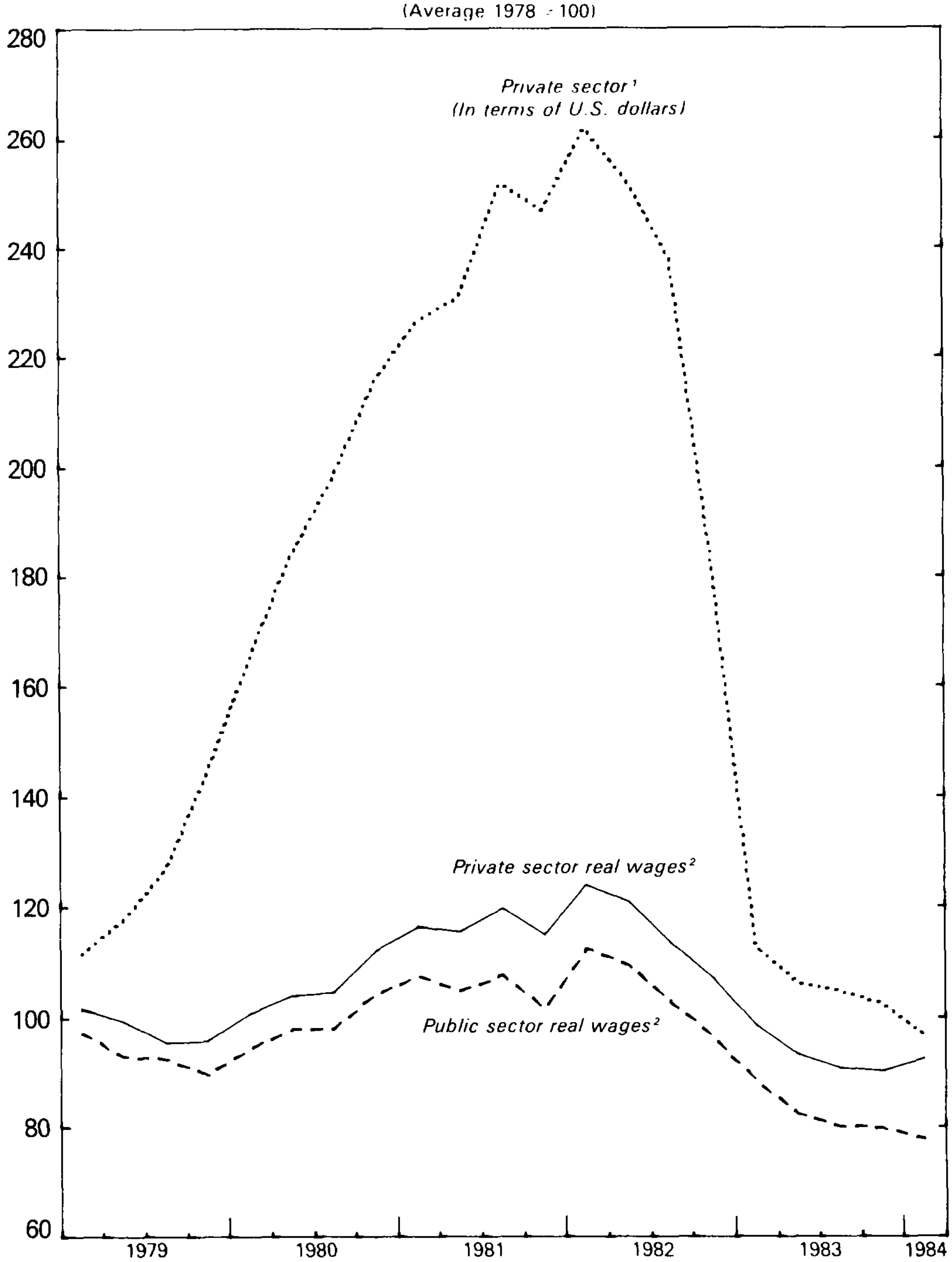
1/ Even after transfers to the Mortgage Bank, whose needs for assistance have been incorporated into the budget since May 1984.

CHART 6

URUGUAY

PRIVATE AND PUBLIC SECTOR WAGES

(Average 1978 = 100)



Sources: Directorate of Statistics and Census; Central Bank of Uruguay; and Fund staff estimates.

[1] Nominal wages converted to U. S. dollars

[2] Nominal wages deflated by the consumer price index

The performance criterion for fiscal policy is a set of cumulative limits, to be verified at the end of each quarter, on the overall borrowing needs of the nonfinancial public sector, supported by a set of sub-limits on the overall borrowing of the Central Administration.1/ These limits are described in Table 13, and in paragraph 3 of the Memorandum of Understanding.

b. Monetary policy

The strong fiscal adjustment called for by the program is being made necessary by the substantial claims on central bank resources from other sources foreseen for the months ahead, and by the increasing difficulty of collecting the inflation tax in a situation where a very high proportion of financial intermediation is in foreign currency. It also stems from the need for prudence in a period during which inflationary expectations may remain high and uncertainties about the course of policies once the new Government is installed may induce a fall in money demand, irrespective of the current stance of policies.

To be consistent with the objective of lowering inflation from around 50 percent in the period July 1983-June 1984 to 20-25 percent in the 12 months of the program, M_1 is projected to increase by 27 percent in the period July 1984-June 1985, down from 46 percent in the 12-month period ended in June 1984 (Table 10). Over the same period, the rate of growth of M_2 is projected to decelerate from 35 percent to 29 percent. These projections, however, call for a much smaller increase in base money (18 percent during July 1984-June 1985, down from 40 percent a year earlier) because of: (a) the large initial stock of base money relative to other monetary aggregates, a reflection of the substantial excess reserves currently held by the BROU; and (b) changes in the structure of legal reserve requirements in April 1984 that have raised significantly the money multiplier.2/

These projections assume a slackening in the rate of increase of velocity for M_1, which would go up by a further 2 percent in the last seven months of 1984 and remain constant thereafter--M_1 velocity increased by 2 1/2 percent between the last five months of 1983 and the first five months of 1984; for M_2 it is assumed that velocity will

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1/ Borrowing needs are to be measured in both cases as the sum of net external borrowing, net borrowing from the domestic financial system, and the net increase in holdings of treasury bills and bonds by the nonbank private sector, but excluding those treasury bills issued by the Central Bank for purposes of open market operations.

2/ These changes included a 1 percent increase in reserve requirements on sight deposits and time deposits of less than 30 days, but also a reduction from 14 percent to 5 percent of the reserves on time deposits of more than 30 but less than 180 days and the elimination of the 14 percent reserve requirement previously in effect for deposits of more than six-month maturity--for a marked reduction in average required reserves. At the same time, legal reserve requirements have been extended to resident-held foreign currency deposits.

Table 10. Uruguay: Monetary Aggregates

I. Stocks at End of Period

(In millions of new Uruguayan pesos)

	Dec. 1981	Dec. 1982	Jun. 1983	Dec. 1983	Jun. 1984	Dec. 1984	Jun. 1985
Unadjusted							
Currency in circulation	6,145	7,880	6,144	8,367	8,585	10,997	10,890
M_1	9,836	11,790	9,232	12,692	13,442	16,723	17,051
M_2	27,567	30,354	32,005	35,805	43,183	50,665	55,700
Seasonally adjusted							
Currency in circulation	5,385	6,906	6,063	7,332	8,472	9,637	10,747
M_1	8,912	10,682	9,149	11,499	13,321	15,152	16,897
M_2	26,871	29,558	31,644	34,901	42,696	49,386	55,072

II. Percentage Changes

	Dec.82/ Dec.81	Jun.83/ Dec.82	Dec.83/ Dec.82	Dec.83/ Jun.83	Jun.84/ Jun.83	Jun.84/ Dec.83	Dec.84/ Dec.83	Dec.84/ Jun.84	Jun.85/ Jun.84	Jun.85/ Dec.84
Unadjusted										
Currency in circulation	28.2	-39.3	6.2	85.5	39.7	5.3	31.4	64.0	26.8	-1.9
M_1	19.9	-38.7	7.7	89.0	45.6	12.2	31.8	54.8	26.8	4.0
M_2	10.1	11.2	18.0	25.2	34.9	45.5	41.5	37.6	29.0	20.8
Seasonally adjusted										
Currency in circulation	28.2	-22.9	6.2	46.2	39.7	33.5	31.4	29.3	26.8	24.3
M_1	19.9	-26.7	7.7	58.0	45.6	33.8	31.8	29.2	26.8	24.3
M_2	10.1	14.3	18.0	21.6	34.9	49.6	41.5	33.7	29.0	24.3

Sources: Central Bank of Uruguay; and Fund staff estimates.

remain at its level at the end of May 1984.1/ Underlying these assumptions is the fact that part of the rise in prices observed in the first half of 1984 was due to corrective price adjustments in the public sector, which resulted in real money balances possibly falling below their equilibrium level. In the case of M_2, stability in velocity from May 1984 on is predicated on both the expected slowdown of inflation and on interest rate flexibility. The authorities, in particular, are giving consideration to removing the de facto capping of interest rates for loans that has been in effect since mid-1983 through informal understandings with local commercial banks and that has acted as a break on the free movement of deposit rates.2/

Of course, in order for financial assets denominated in pesos to be attractive, their yield must be kept competitive with that of foreign currency-denominated assets. For that purpose, the authorities deem maintenance of an exchange rate that reflects market perceptions--as seems to be presently the case--to be crucial. They also are giving thought to fostering the development of a forward exchange market to facilitate arbitrage between domestic and foreign currency. In any event, the authorities were in agreement that uncertainties surrounding the demand for money and the private capital account of the balance of payments justified holding with the Fund a formal review of developments under the program about midway during the program period. This review would have to be completed before the third purchase under the arrangement, which is scheduled for February 1985.

For the monetary targets to be met, efforts have to be geared to achieving greater control over bank credit expansion. The financing requirements of the Mortgage Bank, which still amounted to the equivalent of 6 3/4 percent of GDP in 1983, have been cut drastically since early 1984 and are projected to fall to about 1 percent of GDP in the 12-month period through June 1985. Moreover, since May 1984 most of these requirements have been incorporated into the budget, and direct assistance from the Central Bank during the program period is projected to be equivalent to no more than 0.3 percent of GDP (mostly interest payments on foreign loans that the Mortgage Bank contracted in 1981). As regards other claims on central bank resources, the cost of the 1982 export prefinancing scheme has been paid in full while, from late February 1984, the Central Bank has ceased paying interest on commercial banks' reserve deposits.

In contrast, the "portfolio purchase scheme" continues to be a source of very large credit expansion, since collection of interest on the acquired loans remains a very small fraction of the interest the

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1/ Because of the heavy seasonality in demand for money, especially for currency and M_1, the discussion in this paragraph is in terms of seasonally adjusted rates of change.

2/ Measures like the recent reduction of reserve requirements for deposits with maturities extending beyond 180 days, by reducing banks' financial costs, also have had a favorable effect on the growth of M_2.

Bank has to pay on the liabilities issued to finance such acquisitions. To improve collections, the authorities recently adopted measures that would involve a substantial stretching out of repayment terms, as well as forgive part of the interest cost, provided debtors brought interest in arrears up to date by late June 1984.

Even with this scheme--which has elicited little debtor interest--it is unlikely that the Central Bank will reduce its losses in the short run. In many instances, the value of the collateral originally posted by the debtors has been reduced drastically by the depreciation of the peso; expectations that the incoming Government will de facto or de jure cancel outstanding obligations have become widespread; and many debtors simply are in no position to pay. Therefore, the program conservatively assumes that monthly collections on the "purchased portfolios" will remain at about their present level of US$1.5 million which, together with other financial and operating costs, would keep central bank losses to almost 3 percent of GDP during the program period.

The financing needs of the nonfinancial public sector are to be met through external financing (likely to be channeled, though, through the Central Bank), compulsory acquisition by banks of U.S. dollar-denominated treasury bills, and some central bank credit. The reduction in the credit demands of the public sector nevertheless should allow the banking system as a whole to keep credit to the private sector about constant in real peso terms. The authorities noted in this connection that, in a system with freedom of exchange transactions, a prudent credit policy vis-a-vis the private sector needed not be very damaging to private sector activity if the program in its totality led to an improvement in confidence and capital outflows were brought to a halt, and perhaps even reversed.

The performance criterion for monetary policy is a set of quarterly cumulative limits on the changes in the net domestic assets of the Central Bank, defined as the difference between base money and the Bank's net international reserve holdings. The growth of the Bank's net domestic assets has been constrained to the increase in base money, up to a maximum consistent with the inflation target, plus (minus) the balance of payments deficit (surplus) targeted for each quarter. As explained in subsection 3 below, the balance of payments targets have been made adjustable by up to US$30 million for possible delays in World Bank disbursements of the US$60 million loan now being negotiated or for delays in collecting arrears from the Salto Grande Commission, and the net domestic asset targets are to be made adjustable in the opposite direction by an equivalent amount.

The authorities view their monetary program as tight--as evidenced by the modest increase in base money contemplated for the next 12 months--but as realistic in the light of the circumstances of Uruguay in the period immediately ahead. They also have indicated that they are prepared to adjust legal reserve requirements and make use of open market operations as needed to meet the program's targets. They recognize, however, that the only route to greater flexibility in overall monetary management--as well as to a more efficient allocation of credit--is to achieve a cash return on the "purchased portfolio" higher than that conservatively built into the program; hence their intention for the months ahead is to mount a concerted effort to improve central bank management of its private loan portfolio.

2. Incomes policy

The authorities view the de facto indexing of wages and social security benefits on past inflation in the period 1978-82--at a time when the announced daily exchange rate was set on a slope that sought rapid convergence of domestic and foreign inflation--as a central cause of the cost-price distortions that led to the economic crisis of 1982. Their position is that any lasting improvement in labor market conditions can only result from productivity increases and the continued revival of the economy.

Accordingly, their intention for the rest of their term in office is to maintain the policy inaugurated after the float of the peso in late 1982 of not intervening in private sector wage determination. The minimum wage will continue to be adjusted from time to time, however, though not to an extent that might cause actual average remunerations to move on a path inconsistent with the intended deceleration of inflation and improvement in the employment situation.1/

In the public sector, where it is recognized that wage movements tend to influence trends in private sector remunerations, the authorities intend to continue exercising prudence. As noted above, some partial adjustment of wages for past inflation will be unavoidable, but the authorities have indicated that the periodicity and magnitude of these adjustments will be decided in the light of revenue growth and of spending priorities in general, and that they will have to remain consistent with the objective of further reducing the deficit of the public sector.

3. External policies

a. Balance of payments policies and prospects

After the short-lived experiment with a crawling peg system in the second half of last year, the authorities have come to the view that, for the general public to be convinced that the external value of the peso is not being maintained artificially, determination of the exchange rate must be left to market forces. Also, while official gold holdings remain substantial, freely disposable foreign exchange holdings are not sufficient to permit large-scale intervention in the market for any length of time.

1/ In accordance with ILO conventions, the minimum wage is set by law.

Accordingly, as from December 1983 the BROU has ceased to intervene in the exchange market (except for the account of its own clients like any other commercial bank). At the same time, all exchange needs and debt operations of the public sector have been centralized in the Central Bank, which thus has become a net purchaser in the market to the extent of these requirements. Market intervention per se now is limited to mitigating the effect of the strong seasonality of exchange receipts and outlays, within the limits set by the objectives for the balance of payments.1/ Following these changes in exchange arrangements, the peso depreciated by some 10 percent in December 1983 and, since then, has moved about in line with domestic inflation. During this period, the balance of payments has been in approximate equilibrium, with a US$33 million surplus in the first quarter of 1984 about offset by a deficit of the same magnitude in the second quarter.

In the area of trade policy, as already indicated, the emergency export taxes introduced in late 1982 have been halved for beef and wool and eliminated for other products. The authorities intend to continue with this process, until complete elimination of the export taxes once agreement has been reached on a new tax regime for agriculture. The refunding to exporters of indirect taxes (other than VAT) paid in the production process also has been discontinued, while the reimbursement of VAT has been extended to farm exports (which therefore have now been brought under the same general regime as other exports). On the import side, the authorities initially hoped to be able to proceed in 1984-85 with the program adopted in December 1978, and accelerated in late 1982, to reduce gradually the level of import duty rates.2/ Budget constraints, however, have stood in the way of further progress in this area, even though the situation is to be kept under review and further reductions in duty rates may be decided upon if price developments warrant and/or the fiscal situation permits.

On the basis of these policies, the program calls for the overall balance of payments to move from a deficit of US$145 million in 1983 to equilibrium in the 12 months from July 1984, with, as intermediate targets, a deficit of no more than US$20 million in calendar year 1984, and a surplus of no less than US$20 million in the nine months through March 1985. These targets are to be adjusted downward by up to US$20 million through the end of calendar year 1984 and up to US$30 million through March 1985 (about one fourth of available Fund financing during the program period) for any shortfall or delay in disbursements on a

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1/ Within the context of a free float aimed at balance of payments equilibrium for the year as a whole, the Central Bank should accumulate reserves in the first and last quarters of the year and incur losses in the second and third quarters.

2/ For a review of the trade liberalization measures adopted in the wake of the November 1982 exchange rate action, see Section III in EBS/83/43, February 25, 1983.

the World Bank, or for Argentina's inability to clear some US$40 million in payments arrears to Uruguay on account of an advance Uruguay made to Salto Grande in 1982 to settle external debt obligations that were Argentina's responsibility.1/2/ Any shortfall in external resources in excess of US$20 million in 1984 and of US$30 million in the period of the program would have to be made up for by a greater adjustment effort. After a cumulative deficit of well over US$900 million in 1982-83, the objectives for the balance of payments reflect the need to strengthen domestic and foreign confidence in Uruguay so that the country can maintain freedom of exchange transactions and improve further its creditworthiness.

With only limited net capital inflows, the bulk of the improvement in the balance of payments is predicated on a further reduction in the current account deficit in 1984 and on maintaining this deficit at its 1984 level in the year ending June 1985. The current account deficit thus is projected to decline from slightly over 3 percent of GDP in 1983 to around 1 1/3 percent of GDP both in 1984 and in the 12-month period through June 1985.

Following the sharp contraction of 1983, merchandise imports, mostly intermediate goods and petroleum, are expected to rise moderately as economic recovery takes hold and there is some rebuilding of inventories. Capital goods imports are projected to remain about unchanged at their 1983 level; given the large unused capacity that exists in most industries and the uncertainties about the course of policies from March of next year, the authorities do not foresee any significant revival of private investment during the next 12 months--except perhaps in agriculture, but this sector makes limited use of imported inputs. Meanwhile, the value of exports is expected to decline slightly in 1984. Nontraditional exports and exports of wool are projected to post modest gains despite continued difficulties with regional markets; but these gains are likely to be more than offset by a fall in the volume of beef exports as the cattle industry, after heavy slaughtering in 1983, continues to rebuild its stocks.3/ Expectations therefore are for some reduction in the trade surplus in calendar year 1984. The surplus, however, should widen somewhat in the first half of 1985 as a marked increase in acreage in the recent planting season is expected to result in a strong growth of nontraditional farm exports (mostly rice, barley, and sorghum).

1/ Uruguay and Argentina are co-guarantors of the external debt of the Salto Grande Commission, a binational entity that operates the Salto Grande power plant on the Uruguay River.

2/ However, should Uruguay make up for a shortfall on one account or the other through other types of foreign borrowing, the adjustment would not apply.

3/ Projections of both exports and imports are in accordance with developments in the first five months of this year as well as with export and import registrations for the next three to six months.

With a decline in the trade surplus and a continued rise in interest payments on the external debt, the current account improvement in 1984 is predicated entirely on a turnaround in net travel receipts. More than one half of this turnaround already took place in the first six months of this year, and hopes are that, with the improvement that has taken place in Uruguay's competitive position vis-à-vis Argentina, net travel expenditures will remain only marginally negative in the second half of this year (compared with a deficit of US$100 million in the same period of 1983). For the first half of 1985, however, the program contemplates some weakening of the travel account (compared with the same period in 1984) on the assumption that spending in Uruguay by Argentine travelers will slacken.

Private capital outflows significantly exceeded program projections in 1983, and one objective of the return to greater exchange rate flexibility and of the tightening of monetary policy is to bring these outflows to a halt.1/2/ However, even with balance in the private capital account, keeping the balance of payments in surplus through March 1985, and in equilibrium for the 12 months of the program period, will require net official capital inflows of US$120 million in the 18 months through the end of the second quarter of 1985. This external financing need is likely to be covered from identified sources in calendar year 1984, including the agricultural sector loan now under discussion with the World Bank, but new financing from the market will be required in 1985.

b. External debt policies

Relative to national income, Uruguay's public external debt was one of the lowest in the Western Hemisphere through 1981, reflecting the strong fiscal performance of earlier years. The debt, however, virtually doubled in the following 18 months as the authorities tried to protect the official foreign reserve position from the effects of the mounting deficit in the public finances and of the growing overvaluation of the peso (Table 11). The significant external adjustment that took place in 1983 allowed for a sharp curtailment in public sector recourse to foreign borrowing in that year. At the same time, 90 percent of principal obligations to foreign commercial banks falling due in 1983 and 1984 were rescheduled.

1/ The projections of capital outflow in the program for 1983 reflected the expected unwinding of certain special assistance schemes to the private sector introduced in September 1982 and which constituted foreign exchange obligations of the Central Bank.

2/ It is recognized, however, that in a situation where financial intermediation is in several currencies and where, as the change of government nears, demand for financial assets may be determined by considerations unrelated to current economic policies, it may prove difficult to prevent private capital from being exported. The midyear review will offer an opportunity to discuss what policy action may be necessary should demand for peso-denominated financial assets and the private capital account of the balance of payments behave differently from what is being assumed in the program.

Table 11. Uruguay: External Debt and Foreign Currency Lending to the Economy, 1980-83

	1980	1981	1982	Est. 1983
(In millions of U.S. dollars)				
I. External Debt				
Medium- and long-term debt	1,268.0	1,692.1	2,095.9	2,891.6
Public sector 1/	1,046.7	1,264.7	1,733.6	2,327.4
Private sector 2/	221.3	427.4	362.3	364.2
Short-term	253.0	362.6	1,001.0	530.6
Public sector	15.3	81.4	562.2	197.1
Treasury notes	--	--	84.4	128.3
BROU	15.3	1.4	108.5	68.8
Mortgage Bank	--	80.0	165.0	--
COMIPAL	--	--	135.0	--
Salto grande	--	--	69.2	--
Private sector	237.7	281.2	438.8	333.5
Commercial banks	237.7	281.2	438.8	333.5
Total external debt	1,521.0	2,054.7	3,096.9	3,422.2
Public	1,062.0	1,346.1	2,295.8	2,724.5
Private	459.0	708.6	801.1	697.7
II. Net Foreign Currency Lending to the Economy				
Total external debt	1,521.0	2,054.7	3,096.9	3,422.2
Plus:				
Foreign currency deposits	1,223.7	2,134.2	1,988.8 3/	1,644.4
Held by nonresidents	514.6	956.1	868.4	783.5
Held by residents	709.1	1,178.1	1,120.4	860.9
Minus:				
Net foreign assets of the monetary authorities	428.2	453.2	-131.5	-49.3
Assets 4/	545.3	571.7	227.7	304.5
Liabilities	117.1	118.5	359.2	353.8
Minus:				
Gross foreign assets of the financial system (excluding monetary authorities)	363.6	662.1	567.2	501.5
BROU	171.0	152.4	122.9	146.9
Private commercial banks	192.6	509.7	444.3	354.6
Equal to:				
Foreign currency lending to the economy	1,952.9	3,073.6	4,650.0	4,614.4
(As percent of GDP) 5/				
Medium- and long-term debt	18.3	23.8	34.8	52.4
Public sector	15.1	17.8	28.8	45.8
Private sector	3.2	6.0	6.0	6.6
Short-term debt	3.6	5.1	16.6	9.6
Public sector	0.2	1.1	9.3	3.6
Private sector	3.4	4.0	7.3	6.0
Total external debt	21.9	28.9	51.3	62.0
Public sector	15.3	18.9	38.1	49.4
Private sector	6.6	10.0	13.0	12.6
Foreign currency deposits	17.7	30.0	33.0	29.8
Nonresidents	7.4	13.4	14.4	14.2
Residents	10.3	16.6	18.6	15.6
Foreign currency lending to the economy	28.2	43.3	79.4	83.7

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Includes long-term debt of the Central Bank.
2/ Suppliers' credits (including short-term).
3/ Includes foreign currency deposits in the Mortgage Bank.
4/ Gold is valued at SDR 35 per fine troy ounce.
5/ For the purpose of these ratios, U.S. dollar GDP has been estimated using an Uruguayan peso/U.S. dollar exchange rate constant in real terms at its average 1976 level (these ratios therefore differ from those that emerge from the national accounts).

Yet, at the end of 1983 the official external debt was equivalent to almost one half of GDP, with interest payments in that year of about 18 percent of exports of goods and services and a debt service ratio (after rescheduling) that approached 25 percent (Table 12). The authorities believe that they should maintain prudence in resorting to external financing. At US$100 million, their net borrowing plans for 1984 are similar to those formulated when the original program was framed. The authorities have noted, however, that on present prospects they will not have to approach the international financial market in 1984. The refinancing of the 1983-84 obligations that was arranged last year will cover the bulk of amortization payments falling due in 1984, and new financing needs are to be met through the issues of dollar-denominated treasury bills (these already have taken place),1/ disbursement of one half of the World Bank loan now under discussion, and project loans already in the pipeline.

The authorities expect that Uruguay's absence from the international financial market in 1984 will enhance its creditworthiness and facilitate access to market financing next year. (The administration to be installed next March will face large amortization payments in 1985 on the foreign loans obtained in connection with "portfolio purchases" from the local branches of foreign banks and, as grace periods expire, on the rescheduling loans and new financing obtained in 1983.) They also hope that a systematic refinancing exercise of the type carried out in 1983 can be avoided and that Uruguay will be able to resort again to regular-type syndicated credits to meet its principal payment obligations. To this end, they intend to impress on creditors the quality of the policies that have been pursued, the magnitude of the adjustment carried out in 1983-85, and Uruguay's likely limited need for fresh financing as the public finances are being brought into approximate balance.

The performance criterion for external debt policy is a set of cumulative limits on the net external borrowing of the entire public sector, to the exclusion of the short-term foreign liabilities of the Central Bank.2/ The program also includes a sublimit on the net increase in the stock of official short-term debt. This sublimit is to be adjusted downward, including to negative values, for any short-term debt outstanding at the end of 1983 that is refinanced at terms of more than one year.

1/ Placement of dollar-denominated treasury bills in the nonbank private sector is treated as external borrowing as the evidence suggests that most such treasury bills eventually are sold to nonresidents in the secondary market.

2/ Changes in the Central Bank's short-term foreign liabilities are captured by the performance criterion for the balance of payments (whose movements are measured on changes in the net foreign reserves of the Central Bank).

Table 12. Uruguay: Public Sector Debt Profile, 1981-89

(In millions of U.S. dollars)

	1981	1982	1983	1984	1985	Projections 1986	1987	1988	1989
Public sector debt outstanding 1/	1,346.1	2,295.8	2,724.5	2,822.9	2,922.8	3,022.8	3,142.8	3,262.8	3,362.8
Long and medium term	1,264.7	1,733.6	2,527.4	2,586.2	2,686.2	2,786.2	2,906.2	3,026.2	3,126.2
Short term	81.4	562.2	197.1	236.6	236.6	236.6	236.6	236.6	236.6
Public sector debt service									
On long-term debt (with no additional financing after 1984)	146.4	199.5	293.7	362.7	560.8	592.4	622.5	580.5	422.2
Interest	103.0	133.6	194.5	249.9	242.7	207.6	165.4	120.1	79.4
Principal 2/	43.4	65.9	99.2	112.8	318.1	384.8	457.1	460.4	342.8
On long-term debt (with additional financing after 1984)1/3/	146.4	199.5	293.7	362.7	589.0	681.5	783.3	820.0	748.9
Interest	103.0	133.6	194.5	249.9	270.9	296.7	326.2	359.6	388.7
Principal	43.4	65.9	99.2	112.8	318.1	384.8	457.1	460.4	360.2
On short-term debt									
Interest	0.7	23.8	49.3	25.5	29.0	29.0	29.0	29.0	29.0
Total 1/	147.1	223.3	343.0	388.2	618.0	710.5	812.3	849.0	777.9
Interest	103.7	157.4	243.8	275.4	299.9	325.7	355.2	388.6	417.7
Principal on long and medium term	43.4	65.9	99.2	112.8	318.1	384.8	457.1	460.4	360.2
On IMF debt	--	1.7	22.2	15.4	39.2	79.8	111.2	98.7	72.2
Charges	--	1.7	10.2	15.4	29.3	29.6	24.4	17.8	11.0
Repurchases	--	--	12.0	--	9.9	50.2	86.8	80.9	61.2
Exports 4/	1,824.8	1,483.0	1,376.7	1,430.3	1,567.0	1,655.0	1,760.0	1,853.0	1,950.0
Debt service ratio									
Excluding IMF debt service	8.0	15.1	24.9	27.2	39.5	43.0	46.1	45.9	39.9
Long term	8.0	13.5	21.3	25.4	37.6	41.2	44.5	44.3	38.4
Short term	--	1.6	3.6	1.8	1.9	1.8	1.6	1.6	1.5
Including IMF debt service	8.0	15.2	26.5	28.2	42.0	47.8	52.4	51.2	43.6
Long term	8.0	13.6	22.9	26.4	40.1	46.0	50.8	49.6	42.1
Short term	--	1.6	3.6	1.8	1.9	1.8	1.6	1.6	1.5
Interest/exports 4/									
Excluding IMF debt	5.7	10.6	17.7	19.3	19.1	19.7	20.2	21.0	21.4
Including IMF debt	5.7	10.7	18.4	20.3	21.0	21.5	21.6	21.9	22.0
Interest/GDP 5/									
Excluding IMF debt	1.5	2.6	4.4	4.6	4.7	4.7	4.8	4.9	4.9
Including IMF debt	1.5	2.6	4.6	4.9	5.1	5.2	5.1	5.1	5.1

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ After rescheduling of principal obligations to commercial banks and other financial institutions in 1983-84, but excluding debt to IMF. After 1984 includes additional financing consistent with the medium-term balance of payments scenario (see Table 14).
2/ Includes actual repayments until 1985 and scheduled repayments thereafter.
3/ Projections assume additional financing with four years of grace, ten years of maturity, and an interest rate of 1 1/2 percent over LIBOR.
4/ Exports of goods and services and private transfers.
5/ U.S. dollar GDP based on a shadow rate of exchange necessary to maintain the real effective rate of the peso at the 1976 level.

4. Prospects for output and prices

The authorities are encouraged by the mild recovery of economic activity that has been in evidence since the third quarter of last year. As had been expected, the pickup has been most noticeable in the tradable goods sectors, especially agriculture and the textile and leather industries. More recently, commerce also has shown signs of recovery in response to the strengthening of tourist demand. The view of the authorities is that the present policy framework, including the level of the exchange rate and the prevailing set of relative prices, is appropriate to support a self-sustaining recovery of economic activity; and the program assumes that real GDP will advance in 1984 by between 2 1/2 percent and 3 percent, and by 4 percent from the 12-month period ended June 1984 to the 12-month period ending in June 1985.

At the same time, however, the authorities are aware that the sustainability of output growth will depend on whether domestic confidence can be strengthened and demand for peso-denominated money balances recover after a long period of increase in velocity. Since their stated priority is to hand over the administration with fiscal balance and domestic and external equilibrium restored, they have stressed their determination to resist calls for measures to expand demand, which, given the resource constraint, would in all likelihood result in a resurgence of inflationary pressures. In fact, they have indicated that, to attain their price and balance of payments objectives, they will not hesitate to tighten financial policy beyond what the program calls for--even if this should result initially in a slower recovery of economic activity.

With the real depreciation of the currency and various rounds of adjustments in public enterprise prices since last December, there has been substantial corrective inflation in the past seven months. The need for corrective price action is projected to be less in the period ahead and, with the intended tightening of fiscal and monetary policies, the program seeks to achieve a substantial deceleration in the rate of price increase. The objective is for the annual rate of inflation to be about halved between the first and second half of this year, and hopes are that it will fall to close to international levels by early 1985.

5. Performance criteria 1/

The program contains as performance criteria: (a) a quarterly balance of payments test aiming at equilibrium over the period of the program (while allowing for seasonal variations), adjustable by up to US$30 million in the event of a shortfall or delay in disbursements on a World Bank loan, or of a continued inability on the part of Argentina to settle US$40 million in payments arrears to Uruguay (paragraph 2 of the Memorandum of Understanding); (b) quarterly cumulative limits on

1/ Quantitative performance criteria are presented in Table 13.

Table 13. Uruguay: Stand-By Arrangement, Quantitative Performance Criteria for the Period Through May 1985

	1984		1985	
	Jan.-Sept.	Oct.-Dec.	Jan.-March	April-May
(In billions of new Uruguayan pesos)				
Cumulative global deficit of the nonfinancial public sector	7.5	8.4	7.9	9.1
Cumulative global deficit of the Treasury	6.9	7.4	7.4	8.3
Cumulative net domestic assets of the Central Bank: change in base money since December 31, 1983 plus indicated peso amounts 1/	1.5	1.2	-1.2	--
with an upper limit of 1/	1.9	4.4	2.2	3.8
(In millions of U.S. dollars)				
Cumulative change in the net international reserves of the Central Bank of Uruguay 2/	-25	-20	20	--
Cumulative change since December 31, 1983 in disbursed external debt of the public sector	70	100	105	120
Maximum increment since December 31, 1983 of outstanding stock of public sector debts with maturities of less than one year 3/	...	...	60	40

Sources: Ministry of Economy and Finance; Secretariat of Planning and Coordination; Central Bank of Uruguay; and Fund staff estimates.

1/ In case of delays in disbursements on the US$60 million loan now being negotiated with the World Bank or in case of failure to collect arrears of US$40 million in respect of payments Uruguay made on behalf of the co-guarantor in 1982 on Salto Grande's external debt, this set of ceilings will be adjusted in each quarter for the shortfall with a limit of NUr$600 million through the end of the third quarter of 1984; of NUr$1,200 million through the end of the fourth quarter of 1984; and of NUr$1,800 million through the end of the first quarter of 1985 as well as through the end of May 1985.

2/ In case of delays in disbursements on the US$60 million loan now being negotiated with the World Bank or in case of failure to collect arrears of US$40 million in respect of payments Uruguay made on behalf of the co-guarantor in 1982 on Salto Grande's external debt, these quarterly cumulative limits will be adjusted for the attendant shortfalls, with a limit to the adjustment of US$10 million in the period from December 31, 1983 until September 30, 1984; of US$20 million until December 31, 1984; and of US$30 million until both March 31, 1985 and May 31, 1985.

3/ Excludes central bank short-term foreign liabilities but includes U.S. dollar-denominated Treasury bills. These limits will be adjusted downward--including to negative values--for any substitution of medium-term external debts for existing short-term debts over the course of the program.

the global borrowing requirements of the nonfinancial public sector and of the Central Administration covering net borrowing from the domestic financial system, net placement of government paper outside this system to the exclusion of treasury bills issued for the purpose of conducting open market operations, and net external borrowing (paragraph 3 of the Memorandum of Understanding); (c) a ceiling on the increase in the total outstanding external debt of the public sector, as well as a sublimit on the growth of official external debt with maturity of less than one year (paragraph 4 of the Memorandum of Understanding); (d) quarterly limits on the expansion of the net domestic assets of the Central Bank related to the growth of base money, constrained to absolute amounts consistent with the inflation target, and adjustable by up to NUr$1.8 billion for any shortfall or delay in disbursements on a World Bank loan, or for a continued inability on the part of Argentina to clear US$40 million in payments arrears to Uruguay (paragraph 5 of the Memorandum of Understanding); (e) the usual provisions regarding the exchange and import system (paragraph 25 of the Memorandum of Policy); and (f) a review with the Fund prior to the third scheduled purchase (paragraph 6 of the Letter of Intent).

V. Medium-Term Projections

The changed economic conditions in Uruguay's neighbors make it unlikely that Uruguay will return soon to the rates of output growth of the second half of the 1970s. However, if industrial country markets remain open to Uruguay's exports, and Uruguay's newly elected authorities maintain the present thrust of policies, it would not seem unreasonable to expect Uruguay to achieve a rate of economic growth of the order of 3-3 1/2 percent a year on average through the end of the decade, about twice the projected rate of increase in population.

Based on historical relationships, such a growth of output would entail a ratio of investment to GDP of around 14-15 percent, compared with a ratio of about 10 1/2 percent in 1983. This in turn would point to the need for approximate balance or small surpluses in the nonfinancial public sector as there probably would not be sufficient private sector saving to finance the public sector and the suggested increase in private investment. In the view of the authorities, public sector investment probably should not exceed 5 percent of GDP, so that private sector investment would have to rise to about 10 percent of GDP. Private sector saving has exceeded 10 percent of GDP on only a few occasions in the past several years.

If demand management and wage policy remain prudent, it should be possible to maintain low inflation over the medium term. Most of the corrective price action in principle should have been undertaken in 1983 and 1984. Continued liberalization of commercial policies also should prove of assistance in increasing the overall efficiency of the economy and in keeping price pressures in check.

Two balance of payments projections have been prepared for the period through 1989, with different assumptions about private capital flows during the period 1985-89 (Table 14). In both scenarios it is assumed that the balance of payments would yield a cumulative increase in net reserves of slightly less than US$300 million in the period 1985-89, equivalent to Uruguay's repurchase obligations to the Fund. National saving relative to GDP is assumed to be the same in the two scenarios, and in both cases the outstanding stock of external debt of the public sector including the Central Bank is assumed to rise by slightly more than US$100 million a year during the period 1985-89--which would mean that the outstanding public external debt would fall gradually from the equivalent of almost 50 percent of GDP at the end of last year to less than 40 percent of GDP in 1989. Thus, the current account outcome depends on private capital flows; larger inflows would be associated with larger current account deficits and higher rates of private investment and economic growth.1/

For the economy to grow at an annual average rate of about 3 percent, it is believed (given the projected rise in import unit values) that the U.S. dollar value of imports should rise on average by 7 percent a year through 1989--implying an elasticity of non-oil imports to real GDP growth of the order of 1 1/2 and an increase in the value of oil imports of about 6 percent a year (one half of which on account of rising unit import values in U.S. dollar terms).2/ The value of exports is expected to rise at an annual average rate of 6 percent, while factor payments abroad are projected to remain around US$370 million on the average during the period. Assuming that the travel account remains approximately in balance, the current account would yield small and declining deficits during 1985-89 (Scenario A). This outcome would be consistent with small positive cumulative private capital flows in the five-year period, with some variability from year to year.

Under Scenario B, private capital inflows would average about US$90 million a year in the period 1985-89, making for current account deficits that on average would be 1 percentage point of GDP a year larger than in Scenario A. The higher level of investment associated with the greater capital inflows would allow for a somewhat higher rate of growth of output than in Scenario A--of the order of 1/2 percentage point a year.

1/ For the sake of simplicity, it is assumed that the different private capital flows in the two scenarios do not generate different factor payment streams--a working assumption that would hold if the capital movements involve the repatriation of Uruguayan capital held abroad or, in case of higher direct investment, if earnings subsequently are reinvested.

2/ With the coming on stream of a new hydropower plant in December 1982, all of Uruguay's power generation is now being provided by hydroelectric sources, which has led to a one-time reduction in oil import needs. Therefore, oil import growth in 1985 and beyond is predicated principally on the growth of the transport and farm sectors.

Table 14. Uruguay: Medium-Term Balance of Payments Projections

(In millions of U.S. dollars)

	1983	1984	1985	1986	1987	1988	1989
Scenario A							
Current account	-171	-75	-87	-80	-72	-62	-53
Trade balance	275	231	265	275	280	285	295
Travel	-169	56	19	--	--	--	--
Investment income	-288	-378	-386	-370	-367	-362	-363
Other services and transfers	11	16	15	15	15	15	15
Capital account	143	55	-97	131	160	141	110
Public sector	439	98	100	100	120	120	100
Private sector	-296	-43	-3	31	40	21	10
Overall balance 1/	-28	-20	10	51	88	79	57
Memorandum items:							
Current account/GDP	-3.1	-1.2	-1.3	-1.2	-1.0	-0.8	-0.6
Overall balance/GDP	-0.5	-0.3	0.2	0.7	1.2	1.0	0.7
IMF repurchases (in millions of U.S. dollars)	12	--	10	51	88	79	57
Imports (in millions of U.S. dollars)	770	797	820	875	940	1,005	1,075
Exports (in millions of U.S. dollars)	1,045	1,028	1,085	1,150	1,220	1,290	1,370
Scenario B							
Current account	-171	-75	-127	-135	-137	-142	-148
Trade balance	275	231	225	220	215	205	200
Travel	-169	56	19	--	--	--	--
Investment income	-288	-378	-386	-370	-367	-362	-363
Other services and transfers	11	16	15	15	15	15	15
Capital account	143	55	137	186	225	221	205
Public sector	439	98	100	100	120	120	100
Private sector	-296	-43	37	86	125	101	105
Overall balance 1/	-28	-20	10	51	88	79	57
Memorandum items							
Current account/GDP	-3.1	-1.2	-2.0	-2.0	-1.9	-1.8	-1.7
Overall balance/GDP	-0.5	-0.3	0.2	0.7	1.2	1.0	0.7
IMF repurchases (in millions of U.S. dollars)	12	--	10	51	88	79	57
Imports (in millions of U.S. dollars)	770	797	860	930	1,005	1,085	1,170
Exports (in millions of U.S. dollars)	1,045	1,028	1,085	1,150	1,220	1,290	1,370
Memorandum Items							
Outstanding public external debt							
In billions of U.S. dollars	2.72	2.82	2.92	3.02	3.14	3.26	3.36
In relation to GDP	49.40	47.10	45.40	43.90	42.60	41.30	39.70
Interest payments in relation to GDP	4.40	4.60	4.70	4.70	4.80	4.90	4.90

Sources: Central Bank of Uruguay; and Fund staff projections.

1/ From 1985, the overall balance of payments surplus is projected to be equivalent to Fund repurchases in respect of purchases outstanding as of June 3, 1985.

It is assumed in Scenario B that the greater capital inflows would translate into a higher level of imports, while the level of exports is the same as in Scenario A. There would be some acceleration of the increase in imports in 1985, when private capital flows are assumed to turn positive again, followed by an average increase of 8 percent a year in the next four years. If, however, some of the additional growth would be export related, which would seem to be a more realistic assumption, higher levels of exports and imports would result, for a given level of the current account deficit and domestic growth.

It must be stressed that, in Uruguay's present circumstances, projections of the private capital account for the years ahead are subject to a large margin of uncertaintity. Developments in Argentina and Brazil have an important bearing on Uruguay's external position and both countries are faced with large adjustment needs of their own. Moreover, the forthcoming political changes in Uruguay heighten the speculative character of any medium-term economic scenario.

VI. Staff Appraisal

The economic program adopted by Uruguay in late 1982, and supported by a stand-by arrangement from the Fund, has paved the way for an improvement in economic conditions, which has allowed Uruguay to begin recovering from the severe economic crisis of 1982.

At the core of the program were the adoption of a flexible exchange rate policy and an intensification of efforts to liberalize the trade system that were aimed at restoring competitiveness and efficiency to the economy. At the same time, the program sought a sharp reduction in the deficit of the nonfinancial public sector and in other claims, of a generally fiscal nature, on central bank resources.

There was a substantial reduction in fiscal imbalances in 1983 and all performance criteria were observed through September. However, as the year advanced, it became increasingly difficult to keep the momentum of the adjustment, and the end-December fiscal targets were exceeded. In addition, other quasi-fiscal pressures on the Central Bank continued to increase. The current account and overall balance of payments improved markedly but, despite high real interest rates, private capital outflows remained substantial. Inflation also was higher than had been targeted. The high degree of uncertainty that prevailed in 1983, and the magnitude of the imbalances that had to be dealt with, resulted in a contraction of real GDP for 1983 as a whole. The recession that had began in mid-1981, however, bottomed out in the second quarter of 1983, and output and employment have been rising again since the middle of the year.

There were delays in the formulation of measures to correct for the deviations from the program path in late 1983-early 1984 and in developing a program for the remainder of the arrangement. Corrective action eventually was taken in May-June 1984, setting the stage for a resumption of the adjustment effort.

During the next 12 months, the authorities will seek to achieve a substantial deceleration of inflation and to maintain balance of payments equilibrium, while keeping to policies conducive to a continued recovery of economic activity. These policies are consistent with the program adopted in late 1982 and they conform to the aims of the stand-by arrangement. The staff therefore believes that Uruguay's proposed revised access to Fund resources during the remainder of the arrangement--73 percent of quota, or about 88 percent of quota at an annual rate--is appropriate.

The further cutback in the borrowing requirements of the nonfinancial public sector that is planned is essential from the standpoint of both economic stabilization and growth, and it should assist in bringing down inflation and reducing Uruguay's dependence on foreign borrowing. Public sector policies emphasize continued restraint in current outlays, a recovery of tax revenue, and adjustments in real terms in the prices of goods produced or marketed by the public sector. These measures should produce a turnaround in public sector saving and thus make room for some recovery of public sector investment even as the deficit is being reduced substantially.

Monetary and credit policies would appear to be sufficiently restrained to ensure that the rate of price increase will decline over time and that private capital ouflows will be arrested. Because of Uruguay's present circumstances and the uncertainties about the course of policies beyond February 1985, however, the authorities will have to monitor closely the public's demand for peso-denominated assets; and in the event that money demand remains weaker than is contemplated in the program, they should not hesitate to tighten credit through increases in legal reserve requirements and open market operations. It also will be crucial that the Central Bank refrain from tampering with interest rates, as has sometimes happened in the past through informal understandings with the banks on a maximum lending rate. Otherwise, velocity is likely to continue to increase, and savers will be discouraged from maintaining local currency assets. The review with the Fund that is scheduled about midway through the program period will afford an opportunity to take stock of developments in demand for peso-denominated assets and determine whether additional action is necessary to achieve the price and balance of payments objectives of the program.

The bulk of central bank credit expansion in the next 12 months is linked to the prospective losses of the Central Bank, mostly in respect of the assets it acquired in 1982-83 from local commercial banks in difficulty. The authorities are aware that the subsidization of debtors implicit in these losses results in an allocation of credit that is both inequitable and inefficient. Although they have been prudent in projecting a very low rate of collection on these assets, the staff is of the view that, to reduce Central Bank's losses significantly, an all-out effort must be mounted to impress on debtors that their financial obligations will not be forgiven.

The authorities have taken the view that restrained fiscal and monetary policies need to be accompanied by the limitation of pressures from the side of wages if they are to achieve the deceleration of inflation that their program seeks. The decision to continue leaving the determination of private sector wages to the market is welcome as it is likely to be the best way to assure that wages are set in a manner consistent with the reduction of unemployment. The authorities, however, will have to exercise caution in deciding on the periodicity and magnitude of the adjustments in the minimum wage (which must be set by law) lest the latter move on a slope that will be inconsistent with the intended deceleration of inflation and with the desired growth of employment. Prudence also will be needed in setting public sector wages because of their influence on labor settlements throughout the economy, and also because of the need to continue reducing the public sector deficit.

In December 1983, the authorities moved to an exchange rate system in which intervention is geared solely to smoothing seasonal fluctuations in foreign exchange receipts and expenditures. Greater exchange rate flexibility is likely to assist in dispelling potential market perceptions that the external value of the peso is being maintained artificially. It also should help to improve the process of domestic financial intermediation, especially if steps are being taken to encourage the development of a forward exchange market that would signal the domestic interest rate needed to encourage arbitrage in favor of the peso. The existence of a forward rate probably would also impart greater stability to the spot rate and make it possible for importers and exporters to cover the exchange rate risk.

Much headway has been made in recent years in increasing efficiency in domestic industries and maintaining an outward looking economic strategy, with much benefit for the economy. While understanding the reasons for the lack of new initiatives in the area of trade liberalization in the next 12 months, the staff strongly believes that Uruguay's best chances of sustained economic growth in the years ahead lie in the consolidation of the process of reduction in protection initiated a few years ago. Accordingly, should fiscal developments permit, the staff would want to encourage the authorities to resume their efforts to lower import taxes. Despite the difficult domestic and regional economic situation, Uruguay maintains no multiple currency practices and has managed to avoid resorting to restrictions on payments and transfers. The authorities are to be commended for these policies and for their intention to keep them unaltered.

With the policies that have been established, it would seem reasonable to expect a further significant reduction in the balance of payments current account deficit. These policies also should help improve the private capital account, although, as already noted, eliminating private capital outflows may require an even more restrictive credit policy than is now contemplated. The need for official external borrowing therefore would seem to be very limited on the basis of the targets for the overall balance of payments. Moreover, with the financial assistance from the World Bank that is being negotiated, the issues of U.S. dollar-denominated treasury bills that already have taken place and the disbursements of project loans that already are in the pipeline, Uruguay would seem to be in a position to forego access to the international capital markets in 1984, and to require only limited net financing from this source in the first half of 1985.

Significant advances were made in 1983 in restructuring Uruguay's external public debt. Refinancing terms, however, were comparatively short and Uruguay will face large debt servicing requirements starting in 1985. Uruguay thus will need to count on the continued cooperation of the international financial community in handling its debt repayment schedule and covering its residual financing needs. However, with continued prudent demand and exchange rate policies, the need for net new foreign borrowing should remain small, and the level of the debt (relative to GDP) should decline over time.

In summary, as the Uruguayan authorities enter a new phase of their adjustment program, positive results already are evident with regard to the balance of payments and economic activity. The policies that the authorities intend to pursue in the next ten months under the program are likely to go a long way toward adjusting the economy by the time the current stand-by arrangement expires and Uruguay's newly elected administration takes office. In the coming period of political transition, however, the authorities will need to monitor developments very closely to ensure that policies remain appropriate to attain the objectives that they have set for the remainder of their term in office.

VII. Proposed Decision

Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. Uruguay has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Uruguay (EBS/83/43, Supplement 1, April 26, 1983) and paragraph 25 of the letter dated February 1, 1983 from the Minister of Economy and Finance and the President of the Central Bank of Uruguay attached thereto, in order to review progress made by Uruguay in realizing the objectives of the program, and to reach understandings with the Fund regarding the circumstances in which Uruguay can resume purchases under the arrangement and regarding policies, measures and performance clauses for the remaining period of the arrangement.

2. The letter dated July 23, 1984 from the Minister of Economy and Finance and the President of the Central Bank of Uruguay, together with the Memorandum of Economic Policy and the Memorandum of Understanding annexed thereto, shall be attached to the stand-by arrangement for Uruguay. The letter dated February 1, 1983 from the Minister of Economy and Finance and the President of the Central Bank, together with the Memorandum of Understanding annexed thereto, and the communication dated August 17, 1983 from the Minister of Economy and Finance and the President of the Central Bank, shall be read as modified and supplemented by the letter dated July 23, 1984 and the memoranda annexed thereto.

3. The Fund notes that in their letter dated July 23, 1984, the Minister of Economy and Finance and the President of the Central Bank of Uruguay request that the period of the stand-by arrangement for Uruguay be extended from April 21, 1985 to June 3, 1985 and that the amount of the stand-by arrangement be reduced from SDR 378 million to SDR 271.2 million.

4. Paragraph 1 of the stand-by arrangement for Uruguay shall be amended to read as follows:

> "For the period from April 22, 1983 to June 3, 1985, Uruguay will have the right to make purchases from the Fund in an amount equivalent to SDR 271.2 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund."

5. Paragraph 2(a) of the stand-by arrangement for Uruguay shall be amended to read as follows:

> "[... until February 20, 1984,] the equivalent of SDR 181.2 million until November 20, 1984, the equivalent of SDR 211.2 million until February 20, 1985, and the equivalent of SDR 241.2 million until May 20, 1985."

6. Uruguay will not make purchases under the stand-by arrangement for Uruguay that would increase the Fund's holdings of Uruguay's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period in which the data at the end of the preceeding calendar quarter indicate that:

(i) the cumulative overall balance of payments targets described in paragraph 2 of the Memorandum of Understanding annexed to the letter dated July 23, 1984, have not been met, or

(ii) the limit on the cumulative global deficit of the nonfinancial public sector described in paragraph 3 of the Memorandum of Understanding annexed to the letter dated July 23, 1984, has been exceeded, or

(iii) the limit on the cumulative global deficit of the Central Administration described in paragraph 3 of the Memorandum of Understanding annexed to the letter dated July 23, 1984 has been exceeded, or

(iv) the limit on the cumulative increase in the outstanding disbursed external debt of the public sector described in paragraph 4 of the Memorandum of Understanding annexed to the letter dated July 23, 1984 has been exceeded, or

(v) the limit on the cumulative increase in the outstanding short-term external debt of the public sector described in paragraph 4 of the Memorandum of Understanding annexed to the letter dated July 23, 1984, has been exceeded, or

(vi) the limit on the cumulative changes in the net domestic assets of the Central Bank described in paragraph 5 of the Memorandum of Understanding annexed to the letter dated July 23, 1984 has been exceeded, or

(b) if before February 20, 1985 the review with the Fund contemplated in paragraph 6 of the letter dated July 23, 1984 has not been completed and, as the case may be, suitable performance clauses have not been established in consultation with the Fund for the remaining period of the stand-by arrangement, or if such clauses, after having been established, are not observed.

7. Paragraph 4(d) of the stand-by arrangement for Uruguay shall be amended to read as follows:

> "(d) during any period of this stand-by arrangement, while Uruguay has any overdue financial obligation to the Fund, or [if Uruguay...]"

8. The Fund finds that in light of the letter dated July 23, 1984 and the memoranda annexed thereto, no other understandings are necessary regarding the circumstances in which purchases can be resumed by Uruguay under the stand-by arrangement and decides, pursuant to paragraph 4(c) of the arrangement, that the review of Uruguay's policies and measures, including the reaching of understandings on the quantitative targets of the program as contemplated in paragraph 25 of the letter dated February 1, 1983 is completed. Accordingly, Uruguay may proceed to request purchases under the arrangement.

Uruguay: Main Indicators

	1983 Proj.	1983 Est.	1984 Proj.	1984 Rev.	July 1984-June 1985 Proj.
(Annual percentage changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	1.0	-4.7	4.0	2.9	4.0
GDP deflator	38.5	52.0	16.5	46.6	37.2
Consumer prices 1/	38.5	49.2	16.5	46.4	37.4
External sector (in millions of U.S. dollars)					
Exports, f.o.b.	20.6	2.2	14.7	-1.6	4.7
Imports, c.i.f.	3.2	-29.1	10.3	3.5	1.7
Non-oil imports	9.5	-23.8	10.4	2.1	5.9
Export volume	10.0	1.9	8.4	-1.6	4.7
Import volume	-10.5	-22.1	4.6	3.5	1.7
Terms of trade (deterioration -)	-4.2	10.2	--	--	--
Nominal effective exchange rate (depreciation -)	...	-22.6	...	...	...
Real effective exchange rate (depreciation -)	...	-31.7	...	...	...
General Government					
Revenue and grants	58.4	43.8	17.2	41.2	48.7
Total expenditure	20.3	20.5	12.0	35.5	43.9
Money and credit					
Domestic credit 2/	27.9	27.0 3/	...	18.2 4/	7.8 4/
Public sector 2/	4.0	17.8 3/	...	4.1 4/	1.0 4/
Private sector 2/	14.0	3.4 3/	...	2.6 4/	3.9 4/
M2 5/	32.1	18.0	...	41.5	29.0
Velocity relative to M2	3.7	5.7	...	6.3	6.3
M3 6/	17.5	-2.0 3/	...	13.5 4/	8.8 4/
Velocity relative to M3	1.8	1.9	...	2.0	2.1
Interest rate (average annual rate, six-month savings deposits)	...	66.1	...	...	...

Uruguay: Main Indicators (Concluded)

	1983		1984		July 1984–June 1985
	Proj.	Est.	Proj.	Rev.	Proj.
	(In percent of GDP)				
Public sector savings	2.2	-0.4	4.1	2.2	3.8
Public sector deficit	-3.0	-4.4	-1.1	-3.0	-1.1
Central administration deficit	-1.9	-4.0	-0.7	-2.6	-1.1
Domestic bank financing	1.0	3.9	...	2.2	...
Foreign financing 7/	0.9	0.1	...	0.4	...
Gross domestic investment	12.6	10.5	13.8	11.7	12.3
Gross national savings	7.7	7.5	9.9	10.2	10.8
Current account deficit (balance of payments -)	-4.9	-3.0	-3.9	-1.5	-1.5
External public debt (medium- and long-term) inclusive of use of Fund credit 8/	40.3	50.2 9/	37.3	48.2 9/	...
Debt service ratio (in percent of exports of goods and services) 10/	30.9	26.5	36.0	28.2	...
Interest payments (in percent of exports of goods and services)	16.0	18.4	17.1	20.3	...
	(In millions of U.S. dollars)				
Overall balance of payments deficit (-)	-100.0	-144.9	--	-20.9	--
Gross official reserves (months of imports)	3.5	5.0	5.0	5.5	6.7
External payments arrears	--	--	--	--	--

Sources: Ministry of Economy and Finance; Central Bank of Uruguay; Planning Secretariat; and Fund staff estimates.

1/ Annual average.
2/ In relation to the stock of liabilities to the private sector at the beginning of the period. Public sector credit includes net credit to the Salto Grande Commission.
3/ Foreign currency accounts converted at the rate of NUr$33.9 per US$1.
4/ Foreign currency accounts converted at the rate of NUr$60.0 per US$1.
5/ Includes only deposits and liabilities to the private sector in local currency.
6/ Includes foreign currency deposits.
7/ Includes dollar-denominated bills sold to residents and nonresidents.
8/ For the purpose of these ratios, U.S. dollar GDP has been estimated using an exchange rate fot the Uruguayan peso that would keep the Uruguayan peso/U.S. dollar exchange rate constant in real terms at its average 1976 level.
9/ Includes central bank short-term foreign liabilities that were refinanced at medium term in 1983.
10/ External public debt only.

Uruguay - Fund Relations
(As of June 30, 1984)

I. Membership Status

(a) Date of membership: March 1946
(b) Status: Article VIII

(A) Financial Relations

II. General Department

(a) Quota: SDR 163.8 million
(b) Total Fund holdings of New Uruguayan pesos: 381.2 million SDRs, equivalent to 232.7 percent of quota.
(c) Fund credit, of which:

Under:	Millions of SDRs	Percent of Quota
CFF	44.1	26.9
Credit tranches	93.1	56.9
Enlarged access	89.6	54.7
	226.8	138.5

III. Current Stand-by Arrangement

(a) (i) Duration: From April 22, 1983 to April 21, 1985
(ii) Amount: SDRs 378.0 million
(iii) Utilization: SDRs 151.2 million
(iv) Unutilized balance: SDRs 226.8 million.

(b) Previous stand-by arrangements since 1974.

Uruguay has had 6 stand-by arrangements since 1974. The first one, for SDR 17.25 million, was fully utilized; no purchase was made under the next four arrangements. The last one, in the first credit tranche for SDR 31.5 million, expired on July 14, 1982 and was fully utilized.

(c) Special facilities.

A purchase of SDR 55.3 million under the compensatory financing facility was made in August 1982. A repurchase of SDR 11.2 million was made in February 1983 because of overcompensation under the August 1982 CFF purchase.

IV. SDR Department

(a) Net cumulative allocation: 49.98 million.

(b) Holdings: SDR 5,639,761, equivalent to 11.28 percent of net cumulative allocation.

(B) Nonfinancial Relations

V. Exchange Rate Arrangement: The currency of Uruguay is the New Peso. From December 26, 1978 to November 26, 1982, the peso was depreciated daily in accordance with a peso-U.S. dollar exchange rate schedule announced several months in advance. This exchange rate system was then replaced by a floating exchange rate system. On June 29, 1984, buying and selling interbank rates for the U.S. dollar, the intervention currency, were NUr$53.75 and NUr$54.00.

VI. Last Consultation: The 1983 Article IV consultation was completed by the Executive Board on May 2, 1984 (EBM/84/71) The consultation is on the standard 12-month cycle.

VII. Technical Assistance: In 1981-83 the Fiscal Affairs Department provided assistance to the Accounting General's Office in the introduction of a new accounting system for government operations and of new expenditure and debt operations recording procedures. A panel expert was stationed in Montevideo between June 1981 and July 1983.

VIII. Resident Representative: Mr. Luis Duran-Downing was stationed as Resident Representative in Uruguay during the period August 1981-December 1983. His replacement, Mr. Humberto Arbulu-Neira, was appointed in November 1983 and took up his duties in February 1984.

IX. Currentness of Data: Generally adequate. Conceptual and methodological problems with financial statistics were discussed with the Central Bank of Uruguay during a Bureau of Satistics' expert's visit to Montevideo in March 1984.

Uruguay--Basic Data

Area and population	
Area	187,000 sq. kilometers
Population (mid-1983)	3.0 million
Annual rate of population increase (1975-83)	0.6 percent
GDP (1983)	SDR 5,067.4 million
	US$5,419.0 million
	NUr$186,289 million
GDP per capita (1983)	SDR 1,689

	1981	1982	Prel. 1983	Proj. 1984
		(percent)		
Origin of GDP				
Agriculture	11.9	11.7	12.6	...
Manufacturing	23.3	21.3	20.6	...
Construction	5.3	5.1	3.9	...
Transportation and communications	6.7	6.6	6.7	...
Commerce	17.7	15.4	14.2	...
Other	35.1	39.9	42.0	...
Ratios to GDP				
Exports of goods and nonfactor services	14.7	14.1	18.5	21.7
Imports of goods and nonfactor services	18.6	17.4	15.7	15.7
Current account of the balance of payments	-4.5	-5.4	-3.0	-1.5
Central administration revenue	17.4	15.2	15.8	14.4
Central administration expenditure	18.2	24.3	19.8	16.9
Public sector savings	3.6	-4.7	-0.4	2.2
Public sector overall surplus or deficit (-)	-2.3	-10.1	-4.3	-3.0
External public debt (end of year)	11.8	24.8	50.3	55.8
Savings	10.8	6.6	7.5	10.2
Investment	15.3	12.0	10.5	11.7
Money and quasi-money (end of year)	46.2	46.9	53.3	50.3
Annual changes in selected economic indicators				
Real GDP per capita	1.3	-10.3	-5.3	2.3
Real GDP	1.9	-9.7	-4.7	2.9
GDP at current prices	32.8	5.0	44.9	50.8
Domestic expenditures (at current prices)	30.7	4.4	37.0	...
Investment	17.6	-9.8	15.8	69.2
Consumption	30.4	6.9	40.1	...
GDP deflator	30.3	16.3	52.0	46.6
Wholesale prices (annual averages)	23.4	12.9	73.5	...
Consumer prices (annual averages)	34.0	19.0	49.2	46.4
Central administration revenues	42.2	-8.0	50.8	41.1
Central administration expenditures	45.6	39.9	18.5	34.9
Money and quasi-money	41.9	-1.8	-2.0	13.5
Money	12.5	19.6	8.1	31.8
Quasi-money	50.2 1/	-6.7 2/	-2.9 3/	11.5 4/
Net domestic bank assets 5/	36.2 1/	24.6 2/	27.0 3/	18.2 4/
Credit to public sector (net)	3.8 1/	16.4 2/	17.8 3/	4.1 4/
Credit to private sector	33.0 1/	9.0 2/	3.4 3/	2.6 4/
Merchandise exports (f.o.b., in U.S. dollars)	14.8	-15.8	2.2	-1.6
Merchandise imports (c.i.f., in U.S. dollars)	-4.2	-35.9	-29.1	3.5

Central administration finances	1981	1982	Prel. 1983	Proj. 1984
	(millions of new Uruguayan pesos)			
Revenue	21,260	19,552	29,486	41,615
Current expenditure	19,819	27,720	32,603	43,994
Current account deficit (-)	1,441	-8,168	-3,117	-2,379
Capital expenditure	2,492	3,490	4,366	4,948
Overall deficit (-)	-1,051	-11,658	-7,483	-7,327
Internal financing (net)	127	10,239	5,738	6,129
External financing (net)	892	338	186	1,553
Dollar-denominated bills and bonds	32	1,081	1,559	-355
Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	1,215.4	1,022.9	1,045.1	1,028.5
Merchandise imports (c.i.f.)	1,695.7	1,086.8	770.3	797.2
Investment income (net)	-73.8	-187.6	-287.8	-378.2
Other services and transfers (net)	84.0	-174.6	-158.1	72.2
Balance on current and transfer accounts	-470.1	-426.1	-171.1	-74.7
Long-term capital (net)	371.4	499.9	804.1 6/	58.8
Short-term capital (net), including errors and omissions	99.7	-873.3	-660.8	-4.1
Allocation of SDRs	10.9	--	--	--
Overall balance	11.9	-799.5	-27.8	-20.0
Valuation adjustment 7/	13.1	214.9	112.6	--
Change in official net reserves (increase -)	-25.0	584.6	84.8	20.0

International reserve position	Dec. 31 1981	Dec. 31 1982	Dec. 31 1983	Dec. 31 1984 Est.
		(millions of SDRs)		
Central Bank (gross) 8/	490.6	207.6	291.6	333.8
Central Bank (net) 8/	388.8	-118.0	-46.3	-66.2

1/ Foreign currency accounts converted at the exchange rate of NUr$10.9 per US$1.

2/ Foreign currency accounts converted at the exchange rate of NUr$12.7 per US$1.

3/ Foreign currency accounts converted at the exchange rate of NUr$33.9 per US$1.

4/ Foreign currency accounts converted at the exchange rate of NUr$60.00 per US$1.

5/ In relation to the stock of money and quasi-money at the beginning of the period. Excludes contra-entry of SDR allocation.

6/ Includes as medium-term financing US$117.1 million of refinanced reserve liabilities.

7/ Includes an adjustment to allow for the difference between the price at which gold was bought or sold and the price at which it is valued for reserve purposes (SDR 35 per ounce).

8/ Gold valued at SDR 35 per fine troy ounce.

Main Targets, Assumptions, and Elements of the Financial Program

1. Targets

a. A reduction in the overall deficit of the nonfinancial public sector, relative to GDP, to slightly over 1 percent for the program period (July 1984-June 1985), compared with deficits of about 10 percent in 1982 and 5 1/2 percent in the 12-month period July 1983-June 1984.

b. A central administration deficit equivalent to slightly more than 1 percent of GDP for the program period (July 1984-June 1985), compared with deficits of 4 percent in 1983 and slightly less than 5 percent in the 12-month period July 1983-June 1984.

c. A deceleration of inflation from an annual rate of almost 65 percent during the first five months of 1984 to one of 30 percent during the second half of the year and one of 15 percent during the first half of 1985. This would imply an increase in prices of about 22 percent during the year ending June 1985.

d. A reduction in the overall balance of payments deficit from US$145 million in 1983 to US$20 million in 1984, and equilibrium in the 12-month period through June 1985. The program provides for an adjustment of up to US$30 million to this target in case of a shortfall or delay in disbursements on a US$60 million loan now being negotiated with the World Bank, or in case Uruguay fails to collect arrears in respect of payments made on behalf of Argentina in 1982 on Salto Grande's external debt.

2. Assumptions

a. Real GDP is projected to grow by 2 1/2 to 3 percent in 1984 and by 4 percent in the year ending June 1985, in line with the recovery of output in evidence since the third quarter of 1983.

b. Export earnings (in U.S. dollars) in 1984 are projected to decline slightly compared with 1983, reflecting a drop in shipments of beef as the industry enters the rebuilding phase of the cattle cycle. For the program period (July 1984-June 1985), however, total exports are projected to increase by almost 5 percent with respect to the year ended in June 1984. Import growth for the program period is estimated at only about 2 percent (3 1/2 percent in 1984 compared with 1983) and the trade surplus is projected to widen. With a marked increase in travel receipts, the current account deficit is expected to be roughly halved from 1983 to 1984, as well as from the 12 month-period through June 1984 to the program period.

c. The financial program has been made consistent with net public sector recourse to external savings of no more than US$65 million in the second half of 1984 (consistent with a total of US$100 million for calendar year 1984 as a whole) and US$80 million in the 12-month period through June 1985. These figures assume disbursements of the loan now being negotiated with the World Bank in amounts of US$30 million in the second half of 1984 and US$30 million in the first half of 1985.

3. Main elements of the program

a. Public sector policies

(1) The main feature of the program is a renewed effort at reducing imbalances in the public finances. On the revenue side, tax measures have been adopted to counter the adverse trend in collections observed in the second half of 1983 and raise the tax effort to over 20 1/2 percent of GDP in the program year: refunds to exporters of indirect taxes paid in the production process have been discontinued; the basic value added tax rate has been raised from 18 percent to 20 percent; the corporate income tax has been extended to the state enterprises and official financial institutions; a 1 percent tax has been established on sales of foreign exchange, and there has been an increase in the fuel tax. At the same time, state enterprise tariffs and prices, which were raised by 17 percent in real terms in the first five months of 1984, will continue to be adjusted gradually to cover costs and help the enterprises finance a growing portion of their investment program.

(2) On the expenditure side, the increase in the public sector wage bill will continue to lag behind the projected increase in prices. Also, some further cuts have been programmed in other government expenditure, so that total public sector final outlays (i.e., excluding the intermediate consumption of state enterprises) should fall to around 24 1/2 percent of GDP in the 12-month period ending in June 1985--from 32 percent of GDP in 1982 and more than 26 percent of GDP in 1983. Altogether, public sector savings should rise to 3 3/4 percent of GDP in the program period, compared with a negative 4 2/3 in 1982, a negative 1/2 of 1 percent in 1983, and a small surplus in the 12-month period ended in June 1984.

(3) Cumulative quarterly limits have been placed on the global deficit of both the nonfinancial public sector and the Central Administration. In both cases, the deficit is to be defined as the sum of the net increase above their respective stocks on December 31, 1983 in the net external public debt (including foreign currency-denominated treasury bills and bonds other than those in the hands of the domestic financial system), the net debt to the domestic financial system, and the net placement of peso-denominated treasury bills and bonds with the nonbank private sector (to the exclusion of those issued for purposes of open market operations).

b. Money and credit

(1) Consistent with the price objectives of the program, the monetary program is based on M_2 increasing by 29 percent, which would be made up of a rate of growth of 42 percent in calendar year 1984 and of an annual rate of increase of 21 percent in the first half of 1985. The program also envisages a reduction in the rate of growth of M_1 to 27 percent in the program period, down from 46 percent in the 12-month period ended in June 1984. These projections assume stability in velocity for M_2 from May 1984 onward and a slackening in the rate of increase of velocity for M_1. The authorities have made it clear that they are prepared to make flexible use of open market operations and that they will not hesitate to adjust legal reserve requirements as needed to meet the program targets.

(2) The increase in the net domestic assets of the Central Bank of Uruguay is to be limited on a quarterly basis to the growth in base money, with a quarterly upper limit, that is to be adjusted by specified peso amounts each quarter in line with the overall balance of payments target. These limits are adjustable in each quarter, up to a limit, in case of a shortfall in disbursements on the World Bank loan now being negotiated or delays in collecting arrears from Argentina on account of the advance made to Salto Grande in 1982.

(3) The losses incurred by the Central Bank in connection with the "portfolio purchase scheme" are expected to remain the major source of central bank credit expansion during the program period. The program, assumes that, together with the Central Bank's other financial and operating costs, these losses will continue to hover around 3 percent of GDP during the period through June 1985. Central bank assistance to the Mortgage Bank, however, is expected to fall to the equivalent of 0.3 percent of GDP during the program period; most of the Mortgage Bank's financing needs now have been incorporated into the budget, and the total of these needs has been reduced from 7 1/2 percent of GDP in 1982 to about 1 percent of GDP in the 12-month period through June 1985.

c. Wages

(1) The success of the fiscal adjustment will depend to an important extent on the degree of control maintained over the nominal growth of the public sector wage bill. Wage raises in the public sector (which were equivalent to a cumulative 19 percent in the first six months of 1984) are to be kept to a rate consistent with the targeted deceleration of inflation and the expenditure constraints of the fiscal program. Moreover, the authorities are determined not to add to public sector employment and to let attrition assist in streamlining the government work force.

(2) As regards the private sector, the authorities will maintain the policy introduced last year of not intervening in the process of wage determination. They will continue to adjust the minimum wage from time to time, but will avoid increases of a size that would cause average remunerations to move on a path inconsistent with the price objectives of the program and undermine the recovery of employment.

d. External sector

(1) The determination of the exchange rate is to be left to the free play of market forces. The Central Bank will be present in the market only to the extent necessary to meet the foreign exchange needs of the public sector and to compensate for the strong seasonality of foreign exchange receipts and outlays.

(2) Uruguay's public external debt nearly doubled in the 18-month period ended in December 1982, so that interest costs alone are estimated at 20 percent of exports of goods and services (i.e., almost 5 percent of GDP) in 1984. To prevent a further deterioration in these ratios, the program limits the net increase in the external debt of the public sector to US$100 million in calendar year 1984 and to US$80 million in the 12-month period ending in June 1985. These limits apply to the net increase in the external indebtedness of the official banks, to the exclusion of the borrowing of the Central Bank of Uruguay at maturities of less than one year. Moreover, the program sets limits on the increase in outstanding public sector external debts with maturities of less than one year (excluding those of the Central Bank of Uruguay, but including U.S. dollar-denominated treasury bills held by nonresidents). These limits are to be adjusted downward, including to negative values, for any substitution of medium-term debts for existing short-term debts.

(3) While the program aims at balance of payments equilibrium for the 12-month period ending in June 1985, account is taken of the uneven distribution over time of foreign exchange receipts and outlays. Therefore, the quarterly cumulative targets for the overall balance of payments provide for deficits in the third quarter of 1984 and second quarter of 1985 and for surpluses in the intermediate quarters of the program. For the purpose of these targets, the balance of payments performance is to be measured on changes in the net international reserves of the Central Bank, defined as the difference between the value of: (a) its gold and SDR holdings, Fund reserve position, and all other claims on nonresidents; and (b) its liabilities to nonresidents at less than one year maturity and liabilities to the Fund. This change in net international reserves is to be taken to exclude the exchange gains or losses resulting from gold transactions, in the event such transactions should continue to be made.

Uruguay. Financial Relations with the World Bank Group

(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disbursements	Undisbursed Amount
I. IBRD Operations (as of May 31, 1984)			
Sectors			
Agricultural and rural development	95.7	78.4	17.3
Industry and industrial credit	50.6	26.3	24.3
Power	105.9	95.1	10.8
Transport and telecommunications	150.0	46.6	133.4
Education	9.7	0.3	9.4
Total		246.7	
Repayments		(152.9)	
Total outstanding		93.8	
Total (after exchange adjustment)		84.6	

II. IFC Operations (as of March 31, 1984)

	Loans	Equity	Total
Commitments	20.70	2.84	23.51
Total held by IFC	18.50	2.84	21.34
Total undisbursed (including other participants)	2.00	--	2.00

III. IBRD Loan Transactions (fiscal year)

	1982	1983	1984
Disbursements	11.9	23.0	20.6
Repayments	9.0	8.5	16.4
Net lending	2.9	14.5	4.2

Source: World Bank.

Table 15. Uruguay: National Accounts

(In millions of new Uruguayan pesos at 1978 prices)

	1979	1980	1981	Prel. 1982	Est. 1983
Domestic expenditure	34,597	36,937	37,304	33,503	29,408
Consumption	28,465	30,476	31,416	28,975	26,212
General government	4,302	4,244	4,562	4,486	4,253
Private	24,163	26,232	26,854	24,489	21,959
Gross domestic investment	6,132	6,461	5,888	4,528	3,196
Fixed capital formation	5,882	6,255	6,067	4,878	3,551
Public sector 1/	2,328	1,943	1,780	2,211	1,535
Construction	1,733	1,361	1,514	1,416	981
Machinery and equipment	595	582	266	795	554
Private sector	3,554	4,312	4,287	2,667	2,016
Construction	1,804	2,396	2,326	1,846	1,461
Land improvements	122	91	54	54	37
Machinery and equipment	1,628	1,825	1,907	767	518
Changes in inventories	250	206	-179	-350	-355
Balance of trade and nonfactor services	-1,759	-2,129	-1,835	-1,475	1,124
Exports of goods and non-factor services	5,893	6,106	6,483	5,801	6,519
Imports of goods and non-factor services	7,652	8,235	8,318	7,276	5,395
Gross domestic product at market prices	32,838	34,808	35,469	32,028	30,532
Net factor payments abroad	-285	-389	-288	-775	-1,296
Gross national product at market prices	32,553	34,419	35,181	31,253	29,236
Indirect taxes net of subsidies	-4,924	-5,208	-5,296	-4,803	-4,578
Gross national product at factor cost	27,629	29,211	29,885	26,450	24,658
Provision for consumption of fixed capital	-1,853	-1,970	-1,912	-1,536	-1,118
Terms of trade effect	100	-116	78	81	-541
Net national product at factor cost = national income	25,876	27,125	28,051	24,995	22,999
Memorandum item:					
Gross domestic product at factor cost	27,914	29,600	30,173	27,225	25,954

Source: Central Bank of Uruguay.

1/ Includes spending on the Salto Grande Hydroelectric project, which is not included in the fiscal accounts.

Table 16. Uruguay: National Accounts

(In millions of new Uruguayan pesos at current prices)

	1979	1980	1981	Prel. 1982	Est. 1983
Domestic expenditure	60,205	97,366	127,285	132,877	182,055
Consumption	50,230	81,372	108,483	115,916	162,407
General government	6,789	11,482	17,336	20,261	23,672
Private	43,441	69,890	91,147	95,655	138,735
Gross domestic investment	9,975	15,994	18,802	16,961	19,648
Fixed capital formation	9,312	15,422	19,205	17,795	21,411
Public sector 1/	3,736	4,902	6,159	7,986	9,310
Construction	2,905	3,767	5,515	5,849	5,929
Machinery and equipment	831	1,135	644	2,137	3,381
Private sector	5,576	10,520	13,046	9,809	12,101
Construction	3,030	6,557	8,365	7,525	8,709
Land improvements	208	227	157	178	218
Machinery and equipment	2,338	3,736	4,524	2,106	3,174
Changes in inventories	663	572	-403	-834	-1,763
Balance of trade and nonfactor services	-2,580	-5,162	-4,832	-4,340	4,234
Exports of goods and nonfactor services	9,400	13,861	17,987	18,072	44,308
Imports of goods and nonfactor services	11,980	19,023	22,819	22,421	40,074
Gross domestic product at market prices	57,625	92,204	122,453	128,537	186,289
Net factor payments abroad	-454	-912	-797	-2,729	-10,926
Gross national product at market prices	57,171	91,292	121,656	125,808	175,363
Indirect taxes net of subsidies	-7,867	-12,665	-16,550	-15,355	-22,063
Gross national product at factor cost	49,304	78,627	105,106	110,453	153,300
Provision for consumption of fixed capital	-2,933	-4,858	-6,050	-5,605	-6,744
Net national product at factor cost = national income	46,371	73,769	99,056	104,848	146,556
Memorandum item:					
Gross domestic product at factor cost	49,758	79,539	105,903	113,182	164,226

Source: Central Bank of Uruguay.

1/ Includes spending on the Salto Grande hydroelectric project, which is not included in the fiscal accounts.

Table 17. Uruguay: Employment and Unemployment (Montevideo)

	Employment 1/	Unemployment 2/
1978		
First half	47.0	10.6
Second half	47.3	9.6
1979		
First half	47.2	8.6
Second half	48.5	8.1
1980		
First half	49.3	7.7
Second half	51.6	7.0
1981		
First half	51.5	5.8
Second half	49.4	12.7
1982		
First half	50.2	11.0
Second half	49.4	12.7
1983		
January	47.3	15.3
February	47.6	14.6
March	46.5	17.8
April	47.3	15.9
May	48.9	15.9
June	47.4	16.4
July	48.0	15.1
August	48.2	14.4
September	47.8	16.4
October	47.6	15.3
November	50.1	13.6
December	49.7	15.1
1984		
January	49.3	15.8
February	49.7	13.8
March	47.6	14.0

Source: General Directorate of Statistics and Census.

1/ As a percentage of population 14 years and older.
2/ As a percentage of the labor force.

Table 18. Uruguay: Public Sector Operations

(In millions of new Uruguayan pesos)

	1981	1982	Prel. 1983	Proj. 1984	Proj. July 84- June 85
I. Central Administration 1/					
Current revenue	21,260.0	19,551.8	29,486.4	41,615.0	51,552.0
Of which: taxes from autonomous agencies	--	--	--	6.0	6.0
taxes from state enterprises	3,120.5	2,953.8	4,020.0	7,832.0	9,491.0
Current expenditure	19,819.2	27,720.1	32,603.1	43,994.0	49,554.0
Of which transfers to: autonomous agencies	0.2	--	0.5	--	--
social security	6,622.9	12,105.0	13,455.0	16,475.0	17,700.0
state enterprises	376.4	458.6	875.0	1,456.0	1,784.0
municipalities	--	--	--	--	143.0
Current account surplus or deficit (-)	1,440.8	-8,168.3	-3,116.7	-2,379.0	1,998.0
Capital expenditure	2,491.8	3,489.8	4,366.5	4,948.0	5,699.0
Of which transfer to: autonomous agencies	--	9.0	--	--	--
municipalities	--	-108.0	--	--	--
state enterprises	--	89.2	--	--	--
Overall surplus or deficit (-)	-1,051.0	-11,658.1	-7,483.2	-7,327.0	-3,701.0
Financing	1,051.0	11,658.1	7,483.2	7,327.0	3,701.0
Dollar-denominated bonds and bills 2/	32.4	1,081.4	1,559.0	-355.0	...
Foreign loans (net)	892.0	338.3	185.5	1,553.0	...
Other	126.6	10,238.4	5,738.7	6,129.0	...
II. Autonomous Agencies 3/					
Current revenue	41.2	30.5	76.3	119.0	124.0
Current expenditure	28.2	30.8	40.5	76.0	89.0
Net intertransfers	-3.7	-0.2	-5.5	-9.0	-8.0
Transfers from central administration	-0.2	--	-0.5	-6.0	-6.0
Tax payments (-)	--	--	--	--	--
Contributions to social security (-)	-3.5	-0.2	-5.0	-3.0	-2.0
Current account surplus or deficit (-)	9.3	-0.5	30.3	34.0	27.0
Capital transfers from central administration	--	9.0	--	--	--
Capital expenditure	9.0	15.0	7.9	70.0	82.0
Overall surplus or deficit (-)	0.3	-6.5	22.4	-36.0	-55.0
Internal financing (net)	-0.3	6.5	-22.4	36.0	55.0
III. Social Security System					
Current revenue	4,296.1	5,236.2	6,679.1	9,649.0	11,197.0
Current expenditure	11,644.9	17,579.6	20,747.9	26,694.0	29,670.0
Net intertransfers	7,354.6	12,846.4	14,515.1	17,460.0	18,732.0
Contributions from central administration	6,622.9	12,105.0	13,455.0	16,475.0	17,700.0
Contributions from autonomous agencies	3.5	0.2	5.0	3.0	2.0
Contributions from municipalities	175.1	115.1	406.1	4.0	--
Contributions from state enterprises	553.1	626.1	649.0	978.0	1,030.0
Current account surplus or deficit (-)	5.8	503.0	446.3	460.0	259.0
Capital expenditure	617.6	--	85.5	103.0	102.0
Overall surplus or deficit (-)	-611.8	503.0	360.8	357.0	157.0
Internal financing (net)	611.8	-503.0	-360.8	-357.0	-157.0

Table 18. Uruguay: Public Sector Operations (Continued)

(In millions of new Uruguayan pesos)

	1981	1982	Prel. 1983	Proj. 1984	Proj. July 84-June 85
IV. Central Government (IV=I+II+III)					
Current revenue	26,325.5	25,559.7	37,296.9	52,410.0	63,902.0
Of which: transfers from municipalities	175.1	115.1	406.1	4.0	--
taxes from state enterprises	3,120.5	2,953.8	4,020.0	7,832.0	9,491.0
social security contributions from state enterprises	553.1	626.1	649.0	978.0	1,030.0
Current expenditure	24,869.6	33,225.5	39,937.0	54,286.0	61,612.0
Of which: transfers to state enterprises	376.4	458.6	875.0	1,456.0	1,784.0
Current account surplus or deficit (-)	1,455.9	-7,665.8	-2,640.1	-1,876.0	2,290.0
Capital expenditure	3,118.4	3,495.8	4,459.9	5,128.0	5,890.0
Of which transfers to: municipalities	--	-108.0	--	--	--
transfers to state enterprises	--	89.2	--	--	--
Overall surplus or deficit (-)	-1,662.5	-11,161.6	-7,100.0	-7,004.0	-3,600.0
Financing	1,662.5	11,161.6	7,100.0	7,004.0	3,600.0
Foreign loans (net)	892.0	338.3	185.5	1,198.0	...
Other (net)	770.5	10,823.3	6,914.5	5,806.0	...
V. Municipalities 4/					
Current revenue	1,248.1	1,653.4	2,086.0	2,629.0	3,017.0
Current expenditure	901.2	996.6	1,201.2	1,732.0	2,068.0
Intertransfers	-175.1	-115.1	-406.1	-4.0	--
Contributions to social security (-)	-175.1	-115.1	-406.1	-4.0	--
Current account surplus or deficit	171.8	541.7	478.7	893.0	949.0
Capital transfers from central government	--	-108.0	--	--	--
Capital expenditure	203.2	272.0	313.9	1,083.0	1,326.0
Overall surplus or deficit (-)	-31.4	161.7	164.8	-190.0	-377.0
Financing	31.4	-161.7	-164.8	190.0	377.0
Foreign loans (net)	-1.1	-1.3	172.9	443.0	...
Other (net)	32.5	-160.4	-337.7	-253.0	...
VI. General Government (VI=IV+V)					
Current revenue	27,398.5	27,098.0	38,976.8	55,035.0	66,919.0
Of which: taxes from state enterprises	3,120.5	2,953.8	4,020.0	7,832.0	9,491.0
social security contributions from state enterprises	553.1	626.1	649.0	978.0	1,030.0
Current expenditure	25,770.8	34,222.1	41,138.2	56,018.0	63,680.0
Of which: transfers to state enterprises	376.4	458.6	875.0	1,456.0	1,784.0
Current account surplus or deficit (-)	1,627.7	-7,124.1	-2,161.4	983.0	3,239.0
Capital expenditure	3,321.6	3,875.8	4,773.8	6,211.0	7,216.0
Of which: transfers to state enterprises	--	89.2	--	--	--
Overall surplus or deficit (-)	-1,693.9	-10,999.9	-6,935.2	-7,194.0	-3,977.0
Financing	1,693.9	10,999.9	6,935.2	7,194.0	3,977.0
Foreign loans (net)	890.9	337.0	358.4	1,641.0	...
Other (net)	803.0	10,662.9	6,576.8	5,553.0	...

Table 18. Uruguay: Public Sector Operations (Concluded)

(In millions of new Uruguayan pesos)

	1981	1982	Prel 1983	Proj. 1984	Proj. July 84-June 85
VII. State Enterprises 5/					
Current account surplus or deficit (-)6/	6,061.6	4,261.1	5,185.0	14,562.0	17,916.0
Net current transfers	-3,297.2	-3,121.3	-3,794.0	-7,352.0	-8,734.0
Capital receipts	108.7	89.2	--	--	--
Of which: capital transfers from central government	--	89.2	--	--	--
Capital expenditure	4,028.4	3.149.9	2,707.0	8,357.0	8,828.0
Overall surplus or deficit (-)	-1,155.3	-1,920.9	-1,316.0	-1,147.0	354.0
Financing	1,155.3	1,920.9	1,316.0	1,147.0	-354.0
Foreign loans (net)	1,569.4	2,947.5	-7,088.6	569.0	...
Dollar-denominated bonds	-33.4	-5.5	--	--	...
Other (net)	-380.7	-1,021.1	8,404.6	578.0	...
VIII. Consolidated Public Sector (VIII=VI+VII)					
Current account surplus or deficit (-)	4,392.1	-5,984.3	-770.4	6,225.0	12,422.0
Capital receipts	108.7	--	--	--	--
Capital expenditure	7,350.0	6,936.5	7,480.8	14,568.0	16,044.0
Overall surplus or deficit (-)	-2,849.2	-12,920.8	8,251.2	-8,343.0	-3,622.0
Financing	2,849.2	12,920.8	8,251.2	8,343.0	3,622.0
Dollar-denominated bonds and bills 2/	-1.0	1,075.9	1,559.0	-355.0	...
Foreign loans (net) 7/	2,460.3	3,284.5	-6,730.2	2,399.0	...
Foreign suppliers' credit (net)	-217.9	621.1	-847.5	166.0	...
Other internal financing (net) 7/	607.8	7,939.3	14,269.9	6,133.0	...

Sources: National Accounting Office; Secretariat of Planning and Coordination; Central Bank of Uruguay; and Fund staff estimates.

1/ Includes budgetary and extrabudgetary operations.
2/ Held by nonbank private sector; breakdown between resident and nonresident holders not available.
3/ National Colonization Institute.
4/ Municipality of Montevideo.
5/ Excludes operations of Salto Grande.
6/ Before transfers.
7/ New medium-term financing and refinancing loans negotiated in 1983 with foreign commercial banks are shown as channeled through the Central Bank.

Table 19. Uruguay: Central Administration Operations

(In millions of new Uruguayan pesos)

	1984					1985		Prog.
	I	II	III	IV	Year	I	II	July 84–June 85
Total revenues	8,711	9,092	10,586	13,226	41,615	13,950	13,790	51,552
Taxes on foreign trade	1,448	1,539	1,746	1,982	6,715	2,082	2,180	7,990
Imports	1,009	1,205	1,512	1,587	5,313	1,579	1,791	6,469
Exports	439	334	234	395	1,402	503	389	1,521
Internal taxes	6,858	7,149	8,394	9,287	31,688	11,339	11,104	40,124
Treasury (net)	5,789	6,544	7,764	8,524	28,621	10,114	10,357	36,759
Other	1,069	605	630	763	3,067	1,225	747	3,365
Road taxes and tolls	107	80	84	93	364	117	107	401
Taxes on wages	223	209	309	311	1,052	359	346	1,325
Transfers from the rest of the public sector and others	75	115	53	1,553	1,796	53	53	1,712
Current expenditures	9,616	10,774	11,409	12,195	43,994	12,551	13,400	49,554
Wages and salaries	3,024	3,667	3,391	3,916	13,998	3,732	4,296	15,335
Contributions to Social Security	3,600	3,883	4,546	4,446	16,475	4,230	4,478	17,700
DGSS	2,710	2,840	3,562	3,364	12,476	3,107	3,351	13,424
Other	890	1,043	984	1,082	3,999	1,083	1,127	4,276
Goods and services	1,441	1,305	1,479	1,573	5,798	1,727	1,779	6,558
Transfers	676	645	795	614	2,730	1,096	820	3,325
Interest payments	875	1,274	1,198	1,646	4,993	1,766	2,027	6,637
Current account surplus or deficit (-)	-905	-1,682	-823	1,031	-2,379	1,399	390	1,998
Capital expenditures	941	1,025	1,472	1,510	4,948	1,426	1,291	5,699
Overall surplus or deficit (-)	-1,846	-2,707	-2,295	-479	-7,327	-27	-901	-3,701

Sources: Ministry of Economy and Finance; Secretariat of Planning and Coordination; Central Bank of Uruguay; and Fund staff estimates.

Table 20. Uruguay: Projected Central Bank Operations 1/

(In millions of new Uruguayan pesos)

	Dec. 1983	March 1984	June 1984	Sept. 1984	Dec. 1984	March 1985	June 1985
Net foreign assets	-2,135	-159	-2,139	-3,639	-3,339	-939	-2,139
Net domestic assets	20,930	20,447	21,242	22,879	25,363	23,121	24,702
Net nonfinancial public sector	33,080	34,910	34,910	35,183	35,523	35,428	37,893
Salto Grande (net)	2,408	2,408	2,408	1,399	390	--	--
Commercial banking system 2/	-18,740	-25,098	-29,070	-28,005	-26,606	-28,825	-29,990
Mortgage Bank (net)	27,746	28,752	28,970	29,187	29,404	29,637	29,915
Private sector	23,726	26,725	28,519	28,485	28,485	28,441	28,441
Medium- and long-term foreign liabilities	-75,410	-78,272	-78,110	-78,962	-80,342	-81,122	-83,054
Net unclassified assets	28,120	31,022	33,615	35,592	38,509	39,562	41,497
Base money	18,795	20,288	19,103	19,240	22,024	22,182	22,563
Memorandum items:							
Currency issue 3/	10,539	11,243	11,678	11,813	14,543	14,616	14,896
M_1 3/	12,692	12,830	13,442	13,477	16,723	16,895	17,051
M_2 3/	35,805	40,864	43,183	45,022	50,665	54,321	55,700
Total bank credit to private sector, including net central bank losses	54,545	61,471	65,032	67,194	69,460	71,438	74,223

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Foreign exchange accounts converted at NUr$60 per U.S. dollar.
2/ Net of foreign currency deposits and of bond and promissory notes corresponding to portfolio purchase operations with local banks.
3/ Unadjusted.

Table 21. Uruguay: Net International Reserves of the Central Bank

(In millions of U.S. dollars)

	1983 Program Basis					1984 Program Basis						
	1982	1983				1983	1984				1985	
	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30
Net international reserves	-120.5	-237.5	-269.6	-223.0	-265.4	-35.6	-2.6	-35.6	-60.6	-55.6	-15.6	-35.6
Assets	238.7	131.7	134.1	201.7	219.0	318.2	353.2	320.2	326.7	363.2	434.7	446.2
Gold (millions of fine troy ounces)	(2.858)	(2.767)	(2.602)	(2.602)	(2.602)	(2.602)	(2.602)	(2.602)	(2.602)	(2.602)	(2.602)	(2.602)
Gold 1/	120.0	116.2	109.3	109.3	109.3	109.3	109.3	109.3	109.3	109.3	109.3	109.3
Other assets	118.7	52.4	125.7	193.3	210.6	208.9	243.9	210.9	217.4	253.9	325.4	336.9
Of which: SDRs	(1.9)	(--)	(--)	(--)	(4.0)	(3.8)	(--)	(5.3)	(5.3)	(5.3)	(5.3)	(5.3)
Liabilities	359.2	369.2	403.7	424.7	484.4	353.8	355.8	355.8	387.3	418.8	450.3	481.8
IMF	96.0	83.6	135.9	188.2	250.9	237.4 2/	237.4	237.4	268.9	300.4	331.9	363.4
Other liabilities	263.2	285.6	267.8	236.5	233.5	116.4 3/	118.4	118.4	118.4	118.4	118.4	118.4

Sources: Central Bank of Uruguay; IMF International Financial Statistics; and Fund staff estimates.

1/ Valued at US$42.00 per fine troy ounce.
2/ After adjustment for actual average SDR/U.S. dollar exchange.
3/ After adjustment for refinancing at medium-term of US$117.1 million in reserve liabilities.

Table 22. Uruguay: Balance of Payments

(In millions of U.S. dollars)

	1980			1981		
	Credit	Debit	Net	Credit	Debit	Net
Current account	1,604.9	2,314.3	-709.4	1,824.8	2,294.9	-470.1
Goods and services	1,593.7	2,311.8	-718.1	1,812.3	2,292.1	-479.8
Merchandise 1/	(1,058.5)	(1,769.8)	(-711.3)	(1,215.4)	(1,695.7)	(-480.3)
Freight and insurance	(17.0)	(--)	(17.0)	(11.2)	(--)	(11.2)
Travel	(298.0)	(202.7)	(95.3)	(283.0)	(203.0)	(80.0)
Investment income	(67.7)	(168.1)	(-100.4)	(145.8)	(219.6)	(-73.8)
Other services	(152.5)	(171.2)	(-18.7)	(156.9)	(173.8)	(-16.9)
Transfers	11.2	2.5	8.7	12.5	2.8	9.7
Capital account	998.2	118.5	879.8	1,106.7	635.6	471.1
Public sector total	244.2	74.4	169.8	367.0	63.6	303.4
Public sector long term	229.7	69.4	160.3	285.6	63.6	222.0
Nonfinancial	209.7	43.6	166.1	269.3	61.5	207.8
Central Government 2/	(61.0)	(21.8)	(39.2)	(98.4)	(15.7)	(82.7)
Local government	(--)	(0.1)	(-0.1)	(--)	(0.1)	(-0.1)
Public enterprises	(99.3)	(19.9)	(79.4)	(158.6)	(16.2)	(142.4)
Suppliers' credits (net)	(41.5)	(--)	(41.5)	(--)	(20.2)	(-20.2)
Treasury bonds 3/	(7.9)	(1.8)	(6.1)	(12.3)	(9.3)	(3.0)
Financial (long term)	20.0	25.8	-5.8	16.3	2.1	14.2
Central Bank	(15.0)	(--)	(15.0)	(16.3)	(--)	(16.3)
Banco de la Republica 3/	(5.0)	(25.5)	(-20.5)	(--)	(1.7)	(-1.7)
Banco Hipotecario	(--)	(0.3)	(-0.3)	(--)	(0.4)	(-0.4)
Public sector short-term	14.5	5.0	9.5	81.4	--	81.4
Treasury notes	(--)	(5.0)	(-5.0)	(--)	(--)	(--)
Banco de la Republica	(14.5)	(--)	(14.5)	(1.4)	(--)	(1.4)
Banco Hipotecario	(--)	(--)	(--)	(80.0)	(--)	(80.0)
COMIPAL	(--)	(--)	(--)	(--)	(--)	(--)
Salto Grande	(--)	(--)	(--)	(--)	(--)	(--)
Private sector total	754.0	44.0	710.0	739.7	572.0	167.7
Commercial banks	322.6	29.6	293.0	485.0	384.2	100.8
Reserves (net)	(96.3)	(--)	(96.3)	(43.5)	(319.9)	(-276.4)
Other assets (net) 4/	(226.3)	(29.6)	(196.7)	(441.5)	(64.3)	(377.2)
Nonfinancial	431.4	14.4	417.0	254.7	187.8	66.9
Suppliers' credits (net)	(--)	(9.1)	(-9.1)	(206.1)	(--)	(206.1)
Direct investment	(294.6)	(5.3)	(289.3)	(48.6)	(--)	(48.6)
Others including errors and omissions	(136.8)	(--)	(136.8)	(--)	(187.8)	(-187.8)
SDR allocation	11.0	--	11.0	10.9	--	10.9
Overall balance			181.4			11.9
Valuation adjustment of gold 5/		59.7	-59.7	13.1		13.1
Net foreign assets			-121.7	--	--	-25.0
Assets			-67.6			-26.4
Liabilities			-54.1			1.4

Table 22. Uruguay: Balance of Payments (Concluded)

(In millions of U.S. dollars)

	1982			1983 Est.		
	Credit	Debit	Net	Credit	Debit	Net
Current account	1,483.0	1,909.1	-426.1	1,376.7	1,547.8	-171.1
Goods and services	1,469.6	1,906.1	-436.5	1,362.6	1,544.7	-182.1
Merchandise 1/	(1,022.9)	(1,086.8)	(-63.9)	(1,045.1)	(770.3)	(274.8)
Freight and insurance	(16.9)	(--)	(16.9)	(11.3)	(--)	(11.3)
Travel	(106.0)	(304.0)	(-198.0)	(89.7)	(259.1)	(-169.4)
Investment income	(147.2)	(334.8)	(-187.6)	(62.5)	(350.3)	(-287.8)
Other services	(176.6)	(180.5)	(-3.9)	(154.0)	(165.0)	(-11.0)
Transfers	13.4	3.0	10.4	14.1	3.1	11.0
Capital account	1,849.6	2,223.0	-373.4	...	...	26.2
Public sector total	1,610.1	537.5	1,072.6	1,417.3	980.3	437.0
Public sector long term	538.4	65.9	472.5	939.4	137.3	802.1
Nonfinancial	267.9	63.5	204.4	238.8	118.5	120.3
Central Government 2/	(41.6)	(17.2)	(24.4)	(17.7)	(18.5)	(-8.0)
Local government	(--)	(0.1)	(-0.1)	(3.0)	(0.1)	(0.2)
Public enterprises	(171.3)	(29.6)	(141.7)	(192.2)	(43.4)	(151.5)
Suppliers' credits (net)	(44.8)	(--)	(44.8)	(24.1)	(39.4)	(-15.3)
Treasury bonds 3/	(10.2)	(16.6)	(-6.4)	(1.8)	(17.1)	(-15.3)
Financial (long term)	270.5	2.4	268.1	700.6	18.8	681.8
Central Bank	(270.0)	(0.4)	(269.6)	(510.5)	(1.2)	(509.3)4/
Banco de la Republica 3/	(0.5)	(1.6)	(-1.1)	(48.9)	(17.2)	(31.7)
Banco Hipotecario	(--)	(0.4)	(-0.4)	(141.2)	(0.4)	(140.8)
Public sector short term	1,071.7	471.6	600.1	477.9	843.0	-365.1
Treasury notes	(186.0)	(101.6)	(84.4)	(312.7)	(268.8)	(43.9)
Banco de la Republica	(286.5)	(60.0)	(226.5)	(96.0)	(135.8)	(-39.8)
Banco Hipotecario	(365.0)	(280.0)	(85.0)	(--)	(165.0)	(-165.0)
COMIPAL	(165.0)	(30.0)	(135.0)	(--)	(135.0)	(-135.0)
Salto Grande	(69.2)	(--)	(69.2)	(69.2)	(138.4)	(-69.2)
Private sector total	239.6	1,685.6	-1,446.0	...	...	-293.7
Commercial banks	225.9	212.2	13.7	...	...	...
Reserves (net)	(225.9)	(--)	(225.9)	(...)	(...)	(...)
Other assets (net)5/	(--)	(212.2)	(-212.2)	(...)	(...)	(...)
Nonfinancial	13.7	1,473.4	-1,459.7	(...)	(...)	(...)
Suppliers' credits (net)	(--)	(65.1)	(-65.1)	(...)	(...)	(...)
Direct investment	(13.7)	(--)	(13.7)	(...)	(...)	(...)
Others including errors and omissions	(--)	(1,408.3)	(-1,408.3)	(...)	(...)	(...)
SDR allocation	--	--	--			
Overall balance			-799.5			-27.8 4/
Valuation adjustment	214.9	--	214.9			112.6
Net foreign assets			584.6			-84.8
Assets			343.9			...
Liabilities			240.7			...

Sources: Central Bank of Uruguay; and Fund staff estimates.

1/ Exports f.o.b. and imports c.i.f.
2/ Excludes treasury bonds, notes, and debt certificates.
3/ Excludes bonds issued on behalf of COMIPAL and treasury notes.
4/ After refinancing at medium term of US$117.1 million in central bank reserve liabilities.
5/ Mostly changes in foreign currency-denominated deposits in the domestic banking system.

Table 23. Uruguay: Quarterly Balance of Payments Flows

(In millions of U.S. dollars)

		1983 Program Basis							1984 Program Basis						
		1983					1983		1984					1985	
	1982	I	II	III	IV	Year 1/	Year 2/	Year 3/	I	II	III	IV	Year	I	II
Current account (net)	-426.1	6.6	-36.1	-99.5	-42.1	-171.1	-171.1	-171.1	78.5	-71.3	-50.1	-31.8	-74.7	40.2	-38.8
Merchandise (net)	-63.9	70.6	98.0	16.8	89.4	274.8	274.8	274.8	67.6	46.0	41.9	75.8	231.3	66.6	69.2
Exports, f.o.b.	(1,022.9)	(239.5)	(274.0)	(244.0)	(287.2)	(1,045.1)	(1,045.1)	(1,045.1)	(224.0)	(255.5)	(258.2)	(290.8)	(1,028.5)	(251.1)	(258.3)
Imports, c.i.f.	(-1,086.8)	(-168.9)	(-176.0)	(-227.6)	(-197.8)	(-770.3)	(-770.3)	(-770.3)	(-156.4)	(-209.5)	(-216.3)	(-215.0)	(-797.2)	(-184.5)	(-189.1)
Travel	-198.0	-18.2	-50.9	-51.6	-48.7	-169.4	-169.4	-169.4	81.6	-13.4	-8.2	-4.3	55.7	55.0	-6.0
Credit	(106.0)	(51.1)	(8.5)	(12.4)	(17.7)	(89.7)	(89.7)	(89.7)	(109.4)	(22.7)	(18.9)	(24.3)	(175.3)	(90.0)	(30.0)
Debit	(-304.0)	(-69.3)	(-59.4)	(-64.0)	(-66.4)	(-259.1)	(-259.1)	(-259.1)	(-27.8)	(-36.1)	(-27.1)	(-28.6)	(-119.6)	(-35.0)	(-36.0)
Investment income	-187.6	-51.6	-84.4	-62.6	-89.2	-287.8	-287.8	-287.8	-77.3	-106.6	-83.3	-111.0	-378.2	-88.5	-104.6
Credit	(147.2)	(17.2)	(15.9)	(15.0)	(14.4)	(62.5)	(62.5)	(62.5)	(13.4)	(14.5)	(14.5)	(14.5)	(56.9)	(14.2)	(28.4)
Debit	(-334.8)	(-68.8)	(-100.3)	(-77.6)	(-103.6)	(-350.3)	(-350.3)	(-350.3)	(-90.7)	(-121.1)	(-97.8)	(-125.5)	(-435.1)	(-102.7)	(-118.8)
Other services (net)	13.0	2.9	-1.5	-4.8	3.7	0.3	0.3	0.3	4.0	0.2	-2.9	5.2	6.5	4.5	--
Transfers (net)	10.4	2.9	2.7	2.7	2.7	11.0	11.0	11.0	2.6	2.5	2.4	2.5	10.0	2.6	2.6
Capital account (net)	-373.4	-123.6	4.0	146.1	-0.3	26.2	143.3	143.3	-45.5	38.3	25.1	36.8	54.7	-0.2	18.8
Public sector (net)	1,072.6	-81.8	85.6	202.4	115.7	321.9	439.0	439.0	-6.3	44.3	31.2	29.1	98.3	5.0	14.5
Nonfinancial public sector	493.0	-78.9	18.9	6.5	13.5	-40.0	-40.0	-40.0	6.9	8.4	17.5	6.5	39.3	-7.5	-18.1
Medium and long term	204.4	-55.5	11.7	169.1	-5.0	120.3	120.3	120.3	-32.6	8.4	17.5	6.5	-0.2	-7.5	-18.1
Short term	288.6	-23.4	7.2	-162.6	18.5	-160.3	-160.3	-160.3	39.5	--	--	--	39.5	--	--
Financial public sector	579.6	-2.9	66.7	195.9	102.2	361.9	479.0	479.0	-13.2	35.9	13.7	22.6	59.0	12.5	32.6
Medium and long term	268.1	27.7	109.5	311.2	118.3	566.7	683.8	683.8	25.8	-3.1	13.7	22.6	59.0	12.5	32.6
Of which: new borrowing	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(74.0)
Short term	311.5 4/	-30.6	-42.8	-115.3	-16.1	-204.8	-204.8	-204.8	-39.0	39.0	--	--	--	--	--
Private sector (net) including errors and omissions	-1,446.0	-41.8	-81.6	-56.3	-116.0	-295.7	-295.7	-295.7	-39.2	-6.0	-6.1	7.7	-43.6	-5.2	4.3
Overall balance	-799.5	-117.0	-32.1	46.6	-42.4	-144.9 1/	-27.8	-27.8	33.0	-33.0	-25.0	5.0	-20.0	40.0	-20.0
Valuation adjustment	214.9	36.9	64.0	--	--	100.9	100.9	112.6	--	--	--	--	--	--	--
Net international reserves (increase -)	-584.6	80.1	-31.9	-46.6	42.4	44.0	-73.1	-84.8	-33.0	33.0	25.0	-5.0	20.0	-40.0	20.0

Sources: Central Bank of Uruguay; and Fund staff estimates and projections.

1/ Basis for 1983 program: includes as reserve liabilities of the Central Bank US$117.1 million that were refinanced at medium term. Excludes valuation gain in reserves due to gold sales; gold valued at US$42 per troy ounce, and SDRs are valued at the accounting exchange rate of SDR 1 = US$1.10.
2/ As in footnote 1/, but includes as medium-term financing US$117.1 million in refinanced reserve liabilities.
3/ Basis for 1984 program: as in footnote 2/, but also reflects increase in reserves due to valuation of SDRs at actual average rate of SDR 1 = US$1.05.
4/ Includes nonresidents deposits in BROU.

Table 24. Uruguay: Average Exchange Rate 1/

	Buying Rate (In NUr$ per US$)	Percentage Change in Terms of US$ per NUr$ 2/	Percentage Change in Terms of NUr$ per US$ 2/
1976 Average	3.30	32.6	48.4
December	3.94	33.2	49.8
1977 Average	4.65	28.8	40.5
December	5.38	26.8	36.6
1978 Average	6.05	23.1	30.1
December	6.97	22.8	29.6
1979 Average	7.84	22.8	29.6
December	8.41	17.1	20.7
1980 Average	9.08	13.7	15.8
December	9.92	15.2	18.0
1981 Average	10.79	15.8	18.8
December	11.50	11.2	15.9
1982 Average	13.85	22.2	28.5
January	11.63	1.2	1.2
February	11.77	1.2	1.2
March	11.91	1.2	1.2
April	12.06	1.3	1.3
May	12.22	1.3	1.3
June	12.39	1.3	1.4
July	12.59	1.6	1.6
August	12.83	1.9	1.9
September	13.09	2.0	2.0
October	13.38	2.2	2.2
November	14.25	6.1	6.5
December	28.21	49.5	98.0
1983 Average	34.38	59.7	148.2
January	30.09	6.2	6.7
February	29.56	-1.8	-1.8
March	31.89	7.3	7.9
April	33.53	4.9	5.1
May	32.62	-2.8	-2.7
June	32.16	-1.4	-1.4
July	33.62	4.4	4.5
August	35.13	4.3	4.5
September	36.05	2.6	2.6
October	37.11	2.9	2.9
November	38.25	3.0	3.1
December	42.50	10.0	11.1
1984 January	45.66	6.9	7.4
February	46.76	2.3	2.4
March	50.54	7.5	8.1
April	51.48	1.8	1.9
May	53.78	4.3	4.5
June	53.78	--	--

Source: Central Bank of Uruguay.

1/ Period average of buying rate. Until October 17, 1978, the exchange rates listed are those prevailing in the commercial foreign exchange market. On October 17, 1978, the Central Bank unified the commercial and financial foreign exchange markets and on December 26, 1978 the Government announced that the new peso would be depreciated each month according to a preannounced rate. On November 26, 1982, a freely floating system was implemented. It was replaced by a crawling peg system after mid-August 1983 but there was a return to a more flexible floating system on December 2, 1983.

2/ For 1975 to 1981, percentage changes are from the same period a year earlier; for each month in 1982 and 1983, the percentage changes are from month to month.

Montevideo, Uruguay

July 23, 1984

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. In its letter of February 1, 1983 the Government of Uruguay requested a two-year, SDR 378 million stand-by arrangement with ordinary and enlarged access resources in support of the program of adjustment and economic recovery that was launched in late 1982.

2. International and regional economic conditions in 1983 did not make for a favorable environment for Uruguay's adjustment effort. There was a substantial correction of the imbalances inherited from the past, and Uruguay was in compliance with the targets of the program throughout the first three quarters of the year. The response of the productive sectors and of exports, however, was slower than anticipated, with adverse consequences for government revenue. As a result, the fiscal targets of the program for end-December 1983 and end-March 1984 were exceeded.

3. It is the intention of the authorities to correct these excesses and ensure that Uruguay will return to the original path of the program by the end of the arrangement. Given the current and prospective international economic situation, however, the restoration of domestic and external equilibrium and the revival of economic activity that we are seeking clearly will require more of an effort than had been anticipated initially. The program for the period July 1984-June 1985 that we have recently developed provides for a correction of the deviations from the original program path that occurred during late 1983-early 1984 and for a return to the original targets of the program by the first quarter of 1985. The main features of this program are described in the enclosed Memorandum of Economic Policy. The accompanying Memorandum of Understanding sets out the targets that are to serve as operational guidelines for the conduct of these policies.

4. Given this proposed lengthening of the program period and the time that has been needed to develop corrective measures, we would like to request that the expiration date of the current arrangement be extended from April 21, 1985 to June 3, 1985. However, since this administration is to relinquish office on March 1, 1985, continuation of the arrangement in the three-month period after that date will be contingent on the incoming government ratifying the program described in the attached documents.

5. The Government to be inaugurated next March will be faced from mid-1985 with large service payments on the public external debt as the grace periods on the rescheduling of the 1983-84 maturities and on the medium-term loan negotiated last year with our foreign bank creditors expire. It may be, therefore, that the next administration will find it useful to continue in an operational relationship with the Fund. To maintain Uruguay's potential access to Fund resources under any future arrangement at an adequate level, and given the delay in developing corrective measures in support of the program for the next 12 months we propose that the amount of the current arrangement be scaled down from SDR 378 million to SDR 271.2 million.

6. The Government of Uruguay believes that the policies set out in the annexed Memorandum of Economic Policy, and further elaborated in the annexed Memorandum of Understanding, are adequate to achieve the objectives of its program, but it is prepared to take any further measures that may be required for this purpose. Uruguay will consult with the Fund, in accordance with the policies of the Fund on such consultations, about the progress made in the implementation of its program and any policy adaptations that may be appropriate for the attainment of its objectives. Uruguay will not make purchases from the Fund in the period after December 31, 1984 until after having completed a review with the Fund of the appropriateness of policies and performance clauses in the light of the objectives of the program and of developments during the second half of 1984.

Sincerely yours,

/s/
Alejandro Vegh Villegas
Minister of Economy and Finance

/s/
Juan Carlos Protasi
President, Central Bank of Uruguay

Enclosures (2): Memorandum of Economic Policy
Memorandum of Understanding

MEMORANDUM OF ECONOMIC POLICY

1. Some 18 months ago, Uruguay was in the midst of a severe economic and financial crisis. Output, which had advanced steadily from the mid-1970s, expanded little in 1981 and dropped by almost 10 percent in 1982; unemployment was rising rapidly; and, despite a 70 percent increase in the official external debt, the balance of payments recorded its largest deficit ever. Adverse international economic conditions, particulary in neighboring countries, contributed importantly to this abrupt reversal in Uruguay's fortunes. Their effect, however, was aggravated by the steady real appreciation of the peso and a pronounced weakening of domestic financial policies.

2. To reverse the deterioration in the domestic economy and restore the external balance, the practice of announcing the exchange rate several months in advance was abandoned in November 1982 in favor of a float of the peso. The freeing of the exchange rate, which was followed by a substantial depreciation of the currency, was supported by corrective action in the areas of incomes, fiscal, monetary, and trade policies as part of a comprehensive program of adjustment. With these measures, it was expected that the balance of payments would strengthen rapidly and that, after repressed inflation had been allowed to work its way through the economy, the rate of price increases would decline gradually. The objective also was to bring the economic downturn to a halt and to lay the basis for a gradual revival of activity.

3. Overall, the Government is satisfied that the policies underlying this program have been adhered to. If anything, during the first three quarters of 1983, adjustment was far more pronounced than had been envisaged as net official external financing did not come anywhere near the amounts originally contemplated, and the constraint on central bank credit expansion was correspondingly greater. During that period the deficit of the nonfinancial public sector was kept well below the cumulative limits of the program and, in terms of GDP, dropped to almost 2 percent, from over 10 percent in 1982. All other objectives of the program also were met through the end of September.

4. Because of the greater than anticipated external financial constraint, the adjustment in the balance of payments current account was larger than called for by the program. Imports declined markedly and for the year the current account deficit narrowed to the equivalent of 3 percent of GDP, compared with a program target of 4 2/3 percent of GDP and a deficit of more than 7 percent of GDP in 1982. The trade account moved from a small deficit in 1982 to a large surplus in 1983, which more than compensated for the increase in interest payments on the external debt and for the unexpected weakness of the travel account. Private capital outflows declined substantially and, together with debt relief and new financing from Uruguay's foreign bank creditors, permitted the overall balance of payments objective of the program for 1983 and the first quarter of 1984 to be met with ease.

5. In part because the current account adjustment that was required was greater than foreseen but also because agriculture and export industries were slow in responding to the new set of relative prices, economic activity remained more sluggish than had been anticipated. Output continued to decline in the first half of 1983, and the positive growth rates recorded from the third quarter remained modest. Although employment has been rising since mid-1983 and the rate of unemployment has declined from a peak of almost 18 percent in the first half of that year, unemployment remains at 14 percent of the labor force.

6. The public finances improved substantially in 1983 as a drastic reduction in spending brought the deficit of the nonfinancial public sector to less than 4 1/2 percent of GDP. Yet, the lower than anticipated level of economic activity and imports resulted in revenue to fall short of projections and, despite the major adjustment during the first half of the year, both the deficit of the Central Administration and that of the entire nonfinancial public sector exceeded the limits established for the quarters ending in December 1983 and March 1984.

7. The tight monetary policies and high real interest rates of the last 18 months have failed to bring private capital outflows completely to a halt, and peso-denominated financial assets have continued to decline in real terms. Even with monetary restraint and moderate increases in labor costs, consumer prices since January 1983 have risen by more than can be attributed to the readjustment of relative prices.

8. To a good extent these developments can be related to the difficult conditions prevailing in the region. In particular, the restrictive trade and payments practices adopted at one time or another by Uruguay's neighbors have tended to undermine confidence in the country's ability to maintain an open economic and financial system and have acted as an incentive to capital flight. The domestic situation, however, also has played a role. The period 1983-85 is one of political transition in Uruguay, with elections scheduled for November of this year and a return to civilian rule for March 1, 1985. The uncertainty about the future course of policies attendant on this political process has contributed to deterring the private sector from responding more actively to the adjustment of economic policies.

9. This Government is committed to hand over the administration to the elected authorities with both internal and external equilibrium restored, which is a precondition for the consolidation of the economic recovery under way since the third quarter of last year. Accordingly, a number of measures have been taken to consolidate the gains of 1983 and correct for the deviations from the path of adjustment observed in late 1983-early 1984 with a view to achieving the objectives of the program by the first half of 1985.

10. After the severance of the peg to the U.S. dollar in November 1982, exchange rate policy was kept flexible. As anticipated, there was a substantial initial decline in the exchange value of the peso

but, from March to July 1983, the rate stabilized within a narrow band of NUr$31-34 per U.S. dollar--for a 125-145 percent depreciation in terms of pesos per U.S. dollar from the quotation on the eve of the float. Official intervention was limited to preventing disorderly movements in the market and to meeting the cost of the exchange guarantee entailed in an export prefinancing scheme in effect during September-November 1982. In July 1983, however, the peso came under heavy pressure. To calm the market, the state-owned Bank of the Republic was instructed to intervene--initially on an ad hoc basis and from mid-August, under a more orderly crawling peg system where the exchange rate was adjusted daily at an annual rate of about 40-45 percent. This crawling peg regime, however, revived doubts about the appropriateness of the exchange rate, fueling capital flight and costing the Bank of the Republic, and eventually the Central Bank, a larger share of their foreign exchange positions than was thought to be prudent.

11. To better assure that the value of the peso was not being maintained at an artificially high level, on December 2, 1983 the Bank of the Republic ceased to intervene in the exchange market and began to operate on the sole account of its clients as any other commercial bank. From the same date, all exchange needs of the public sector have been centralized in the Central Bank, which thus has become a net purchaser in the market to the extent of these requirements. The peso depreciated by about 9 percent in real terms in the month that followed this modification of exchange arrangements and, since then, has been moving about in line with domestic inflation. It is the intention of the authorities to be guided strictly in their exchange rate policy by the balance of payments targets of the program as set out in paragraph 22 below.

12. Considerable progress has been made since 1973-74 in correcting relative price distortions, opening up the external sector, and removing other structural impediments to growth. An increase in real GDP of almost 5 percent a year on the average during 1974-80, after a lengthy period of economic stagnation, bears witness to the success of these efforts. The intention of the Government is to continue promoting an efficient allocation of resources. Public sector tariffs and prices will continue to be adjusted to reflect increases in costs and strengthen the enterprises' ability to contribute to the financing of their investment outlays. The temporary tax on traditional exports introduced in the wake of the float of the peso in 1982 already has been reduced substantially and, although the final decision will be left to the incoming Government, work has been initiated on a modernization of agricultural taxation to replace this export tax and encourage improvements in land use.

13. On the import side, implementation of the December 1978 plan of gradually relaxing import restraints was advanced by one year in early 1983, so that duty rates now range from 10-55 percent. The authorities are of the opinion that the effort to reduce effective protection should continue with a view to fostering efficiency in domestic industries, facilitating growth along the lines of Uruguay's comparative advantages

and combating domestic inflationary pressures. Because of current budget constraints, however, no further modification of the duty rate structure is envisaged in principle for the next 12 months. Policies nonetheless may be adapted in the light of fiscal and price developments.

14. Central to the completion of adjustment will be an effort to make overall demands on available resources consistent with the balance of payments and price targets of the program. In this respect, it is recognized that Uruguay cannot count on much external savings in the next 12 months. For one, after the sharp increase in the official external debt registered in 1982, public sector recourse to external financing must continue to be scaled down if the country's repayment capacity is to be preserved. Also, after the US$1 billion cumulative balance of payments deficit of the period 1982-83 a foreign reserve loss must be ruled out for the period of the program--even if seasonal fluctuations in earnings may justify temporary deficits. Furthermore, the Government is determined to hold domestic nominal expenditure to a level consistent with a deceleration of inflation to around 45 percent in 1984 and to an annual rate of about 15 percent in the period January-June 1985. Attainment of this objective will call for a rate of nominal money growth consistent with a demand for real balances that, as the year advances, will be influenced increasingly by considerations unrelated to economic management.

15. Although velocity of circulation for broad money has increased significantly since mid-1981, the improvement in economic conditions--together with the greater flexibility of exchange rate and monetary policy--should cause the decline in demand for peso-denominated financial assets to slacken. Accordingly, the program for the period July 1984-June 1985 aims at keeping the increase in M_2 to 29 percent, which would be consistent with a rate of growth of 42 percent in calender year 1984 and an annual rate of 21 percent in the first half of 1985. M_1 growth will be held to 27 percent (32 percent in calendar year 1984), and the increase in base money will be kept consistent with the targets for the broad monetary aggregates. To ensure that the link is being maintained between the balance of payments and price objectives of the program, the growth of the Central Bank's net domestic assets will be constrained to the increase in base money up to a maximum consistent with the inflation target.

16. In the implementation of this monetary program, the Central Bank will continue to make flexible use of open market operations and will not hesitate to adjust legal reserve requirements as circumstances require. Measures also have been taken to help the Bank regain control over the growth of its domestic assets--after two years during which central bank credit increased rapidly on account of emergency assistance to the Mortgage Bank and to private commercial banks facing insolvency as well as of heavy losses related to these operations and to the payment of interest on banks' required reserves. To reduce these pressures assistance to the Mortgage Bank has been incorporated into the central administration budget and curtailed significantly; renumeration

of bank reserves has been discontinued from February 1984; and dispositions have been adopted to ensure that the Central Bank would begin to collect on the portfolio of private sector loans it has acquired since the end of 1982 from banks in difficulties.

17. The slowdown in central bank credit growth also is predicated on a major compression of the borrowing requirements of the nonfinancial public sector. The objective of the Government is to reduce these requirements from the equivalent of 6 2/3 percent and 4 1/2 percent of GDP (at an annual rate) in the second half of 1983 and first half of 1984, respectively, to 1 3/4 percent of GDP in the second half of 1984 and 1/2 of 1 percent of GDP in the first half of 1985. For the Central Administration, the goal also is for a deficit equivalent to no more than 1 3/4 percent of GDP in the second half of 1984 and 1/2 of 1 percent of GDP in the first half of 1985, down from 6 1/3 percent and 3 1/2 percent of GDP, respectively, in the second half of 1983 and first half of 1984. Quarterly cumulative limits consistent with these objectives have been established on both the deficits of the nonfinancial public sector and of the Central Administration.

18. The Government firmly believes that Uruguay's growth prospects depend on the public sector keeping its claims on resources to a level consistent with the maintenance of room for the development of a healthy private sector. This concern was manifest in the sharp reduction in government spending achieved in 1983. A few additional cuts have been programmed for the second half of 1984 and the first half of 1985. Real wages in government employment, however, have declined significantly in the last two years, and the wage bill, social security benefits, and interest payments now account for 82 percent of total government outlays. Thus there is little room on the expenditure side for additional economies, and most of the fiscal adjustment measures approved in recent months aim at raising revenues, which in the last 18 months have fallen well short of projections.

19. Refund to exporters of indirect taxes paid in the production process has been discontinued, at a saving of about 1 percent of GDP to the Treasury in the 12-month period beginning in July 1984; the basic value-added tax rate has been raised from 18 percent to 20 percent; the corporate income tax has been extended to the state enterprises and official financial institutions; a 1 percent levy has been established on sales of foreign exchange and there has been an increase in the fuel tax. In addition, tax collections are expected to improve through the continued strengthening of tax administration and higher penalties for tax evasion. These measures, together with the gradual resumption of economic growth, are expected to yield 1 1/2 percent of GDP in calendar year 1984, or over 3 percent of GDP at an annual rate. In the rest of the public sector, state enterprise prices and tariffs have been raised by a cumulative 45 percent on the average since the beginning of the year, well ahead of the increase in the general price level. As already indicated, the Government will see to it that prices for goods and services produced or marketed by the public sector adequately cover costs, while continuing its efforts to streamline the enterprises' operating costs.

20. The success of the fiscal adjustment will depend to an important extent on control over the nominal growth of the public sector wage bill and of social security benefits--the latter tied by law to the behavior of wages a year earlier. This link points to a prospective increase in benefits of the order of 35-40 percent in the 12-month period from July 1984, which is expected to be financed by the growth of contribution as the labor market situation keeps improving. If necessary, however, the Government will not hesitate to take action to offset any additional pressure that the system might place on central administration finances. Public sector wage raises have been kept to a cumulative 19 percent since January, and it is the intention of the Government to maintain future adjustments at a rate consistent with the fiscal parameters of the program and with the targeted deceleration of inflation. Moreover, the Government is determined not to add to public sector employment and to let attrition assist in streamlining the government work force.

21. Wage policy in the private sector will be governed by the dual objectives of strengthening current trends toward a reduction of unemployment--one of the Government's leading priorities--and of preventing cost pressures from rekindling inflation following the corrective price actions of the turn of the year and of May-June 1984. Accordingly, believing as it does that wage movements must depend on changes in the productivity of each firm and on the labor market situation in general, the Government will continue with the policy inaugurated last year of not intervening in the process of wage determination. The minimum wage, however, which must be set by law--and which has been increased by a cumulative 22 percent since the beginning of the year--will be adjusted from time to time in the light of circumstances.

22. With the policy mix that has been developed, and an exchange rate regime that limits official participation in the market to the handling of public debt and import operations by the Central Bank, the program aims at balance of payments equilibrium in the 12-month period through June 1985, and at a current account deficit equivalent to about 1 1/2 percent of GDP in this 12-month period--the latter considerably less than was projected for 1984 when the original program was framed. The current account deficit is to be financed by prudent reliance on foreign borrowing by the public sector, while the tightening of domesitc financial policy is expected to reduce private capital outflows and possibly to secure approximate balance on this account. The quarterly targets for the balance of payments allow for seasonal movements in current receipts and for the uneven distribution during the program period of some large public sector transactions, consistent with the targets for the period as a whole.

23. The refinancing of obligations coming due in the period July 1983-June 1985 that was agreed with commercial banks last year will provide substantial debt relief through the end of the program period. The terms of this refinancing, however, were comparatively short, and

the maturity structure of Uruguay's official external debt still remains somewhat unsatisfactory. This makes it undesirable for Uruguay to undertake new net borrowing at commercial terms on a substantial scale. The financial program has been made consistent with a net recourse to external savings by Uruguay's public sector of no more than US$65 million in the second half of 1984 (consistent with a total of US$100 million for calendar year 1984 as a whole) and US$80 million in the 12-month period through June 1985. To agree with these projected borrowing requirements, net disbursements on foreign loans will be subject to quarterly limits.

24. The Government believes that the intensification of its stabilization efforts, as described in this memorandum, together with the considerable measure of adjustment that has been achieved in 1983, should provide the basis for sustained growth at low rates of inflation in the years ahead. Furthermore, the economic measures that have been adopted in recent months should be consistent with a marked reduction of inflation by the end of this year and the first half of 1985, and they should create an adequate environment for the recovery of output that began in the second half of 1983.

25. Despite an international context of increasingly restrictive trade and payments practices, Uruguay has maintained complete freedom of exchange transactions on both current and capital account. During the remaining period of the program, the authorities do not intend to introduce any multiple currency practice or any restrictions on payments and transfers for current international transactions. They also do not intend to introduce new or intensify existing restrictions on imports for balance of payments reasons, or to enter into any bilateral payments agreement with any member of the International Monetary Fund.

Government of Uruguay
July 23, 1984

Montevideo, Uruguay

July 23, 1984

MEMORANDUM OF UNDERSTANDING

1. This memorandum sets forth in greater detail the key targets and policy undertakings of the accompanying Memorandum of Economic Policy.

2. The overall balance of payments target is equilibrium in the period from December 31, 1983 through May 31, 1985. However, because of the uneven distribution over time of the foreign exchange expenditures that the Central Bank has to make on its own account or on behalf of the rest of the public sector, the intermediate targets are a deficit of no more than US$25 million in the period January 1-September 30, 1984; a deficit of no more than US$20 million in the period January 1-December 31, 1984; and a surplus of no less than US$20 million in the period January 1, 1984-March 31, 1985. However, should delays occur in the disbursements on the US$60 million loan now being negotiated with the World Bank or should Uruguay fail to collect arrears of US$40 million in respect of payments it made on behalf of the co-guarantor in 1982 on Salto Grande's external debt, these quarterly cumulative limits will be adjusted for the attendant shortfalls, with a limit to the adjustment of US$10 million in the period from December 31, 1983 until September 30, 1984; of US$20 million until December 31, 1984; and of US$30 million until both March 31, 1985 and May 31, 1985. For the purpose of this target, the balance of payments performance will be measured by changes in the net international reserves of the Central Bank of Uruguay. The Central Bank's net international reserves will be defined as the difference between the value of (a) its gold and SDR holdings, Fund reserve position, and all other claims on nonresidents and (b) all its liabilities to nonresidents at less than one year, regardless of their currency denomination, plus its outstanding purchases from the International Monetary Fund. For the purpose of this definition, all foreign assets and liabilities will be expressed in U.S. dollars. Gold will be valued at the fixed accounting rate of US$42 per troy ounce; all foreign assets and liabilities in other foreign currencies will be converted into U.S. dollars at the market rates of the respective currencies on December 31, 1983; and the Central Bank's SDR holdings and Uruguay's Fund position, be the latter positive or negative, will be valued in SDRs converted into U.S. dollars at the SDR value of the U.S. dollar on December 31, 1983. Also, for purposes of measuring actual balance of payments performance, the change in the Central Bank's net international reserves will be taken excluding the exchange gains or losses resulting from gold transactions, in the event that such transactions should continue.

3. The cumulative global deficit of the nonfinancial public sector will not exceed NUr$7.5 billion from January 1, 1984 until September 30, 1984; NUr$8.4 billion until December 31, 1984; NUr$7.9 billion until March 31, 1985; and NUr$9.1 billion until May 31, 1985. The deficit of the nonfinancial public sector will be defined as the sum of the net increase above their respective stocks in December 31, 1983, in (a) the

short-, medium-, and long-term external debt of the nonfinancial public sector denominated in foreign currencies, including foreign currency-denominated treasury bills and bonds to the exclusion of those in the hands of the domestic financial system, and converted into U.S. dollars if denominated in another foreign currency and with all U.S. dollar values converted into new Uruguayan pesos at the average interbank exchange rate for the U.S. dollar during the month of the transaction; (b) the net debt of the nonfinancial public sector to the domestic financial system, with the net movements in the foreign currency-denominated accounts converted into U.S. dollars, with all U.S. dollar values converted into new Uruguayn pesos at the average interbank exchange rate for the U.S. dollar during the month of these movements; and (c) the net placement of peso-denominated treasury bills and bonds with the nonbank private sector to the exclusion of those issued for purposes of open market operations. In addition, the cumulative global deficit of the Central Administration will not exceed NUr$6.9 billion from January 1, 1984 until September 30, 1984; NUr$7.4 billion until December 31, 1984; NUr$7.4 billion until March 31, 1985; and NUr$8.3 billion until May 31, 1985. The deficit of the Central Administration will be defined as the sum of the net increases above their respective stocks on December 31, 1983, in (a) the short-, medium-, and long-term external debt of the Central Administration denominated in foreign currencies, including foreign currency-denominated bills and bonds to the exclusion of those in the hands of the domestic financial system, and converted into U.S. dollars if denominated in another foreign currency and with all U.S. dollar values converted into new Uruguayan pesos at the average interbank exchange rate for the U.S. dollar during the month of the transaction; (b) the net debt of the Central Administration to the domestic financial system, with the net movements in the foreign currency-denominated accounts converted into U.S. dollars, and with all U.S. dollar values converted into new Uruguayan pesos at the average interbank exchange rate for the U.S. dollar during the month of these movements; and (c) the net placement of peso-denominated treasury bills and bonds with the nonbank private sector to the exclusion of those issued for purposes of open market operations.

4. The external borrowing of the public sector in 1984 and early 1985, including that of official banks but excluding the borrowing of the Central Bank of Uruguay at less than one year, will not exceed an amount that would raise the disbursed public external debt outstanding on December 31, 1983 (and estimated at US$2,725 million)--including that with maturities with less than one year to the exception of that of the Central Bank of Uruguay--by more than US$70 million from January 1, 1984 until September 30, 1984; by more than US$100 million until December 31, 1984; by more than US$105 million until March 31, 1985; and by more than US$120 million until May 31, 1985. These amounts will exclude any valuation adjustments due to alterations in the external values of foreign currencies. For purposes of the program any new medium-term external borrowing by the Central Bank undertaken to substitute for existing short-term foreign obligations will continue to be treated as a reserve liability. Moreover, the outstanding stock of public sector debts with

maturities of less than one year, excluding those of the Central Bank of Uruguay, but including U.S. dollar-denominated treasury bills held by nonresidents, will increase by no more than US$60 million in the period December 31, 1983-March 31, 1985 but by no more than US$40 million in the period December 31, 1983-May 31, 1985. This limit will be adjusted downward--including to negative values--for any substitution of medium-term external debts for existing short-term debts over the course of the program period.

5. The net domestic assets of the Central Bank of Uruguay will not during the third quarter of 1984, increase by more (decrease by less) than the increase (decrease) in base money above (below) its stock on December 31, 1983 plus NUr$1,504 million, but in no event by more than NUr$1,949 million; during the fourth quarter of 1984, increase by more (decrease by less) than the increase (decrease) in base money above (below) its stock on December 31, 1983 plus NUr$1,204 million, but in no event by more than NUr$4,433 million; during the first quarter of 1985 increase by more (decrease by less) than the increase (decrease) in base money above (below) its stock on December 31, 1983 minus NUr$1,196 million, but in no event by more than NUr$2,191 million; during the period April-May 1985 increase by more (decrease by less) than the increase (decrease) in base money above (below) its stock on December 31, 1983 but in no event by more than NUr$3,772 million. In case delays should occur in the disbursements on the US$60 million loan now being negotiated with the World Bank, or in case Uruguay should fail to collect arrears of US$40 million in respect of payments it made on behalf of the co-guarantor in 1982 on Salto Grande's external debt, this set of ceilings will be adjusted in each quarter for this shortfall with a limit of NUr$600 million through the end of the third quarter of 1984; of NUr$1,200 million through the end of the fourth quarter of 1984; and of NUr$1,800 million through the end of the first quarter of 1985 as well as through the end of May 1985. For the purposes of this ceiling the net domestic assets of the Central Bank of Uruguay will be defined as the difference between (a) base money and (b) the Bank's net international reserve holdings as defined in paragraph 2 above, with U.S. dollar values converted at all times into pesos at the accounting rate of NUr$60 per U.S. dollar. Also for purposes of this ceiling, base money will be defined as the sum of currency in circulation and of the central bank liabilities in local currency to the domestic banking system that are eligible to meet legal reserve requirements.

/s/
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