FOR AGENDA

EBS/83/43
Correction 1

CONFIDENTIAL

March 9, 1983

To: Members of the Executive Board

From: The-Acting Secretary

Subject: Uruguay - Staff Report for the 1982 Article IV Consultation and Request for Stand-By Arrangement

The following corrections have been made in EBS/83/43 (2/5/83):

Page 30, Table 7, line 5: for "External sector (in millions of U.S. dollars)"
read "External sector (in terms of U.S. dollars)"

Page 45, para. 11, line 6: for "associated with recent"
read "associated with the"

Corrected pages are attached.

Att: (2)

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

Stand-By Arrangement

1. The Government of Uruguay has requested a stand-by arrangement for the period March --, 1983 to March --, 1985 for an amount equivalent to SDR 378 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/43.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Table 7. Uruguay: Main Indicators

	Actual/Prel. 1981	Est. 1982	Proj. 1983	Proj. 1984
(Annual percentage changes, unless otherwise specified)				
National income and prices				
GDP at constant prices	-1.1	-8.5	1.0	4.0
GDP deflator	31.8	17.3	38.5	16.5
Consumer prices 1/	34.0	19.0	38.5	16.5
External sector (in terms of U.S. dollars)				
Exports, f.o.b.	14.9	-20.9	20.6	14.7
Imports, c.i.f.	-6.7	-30.3	3.2	10.3
Non-oil imports, c.i.f.	-11.6	-40.0	9.5	10.4
Export volume	15.1	17.5	10.0	8.4
Import volume	-14.2	-28.4	-10.5	4.6
Terms of trade (deterioration -)	-8.3	-1.9	-4.2	--
Nominal effective exchange rate (depreciation -)1/	-18.3	-28.4	...	...
Real effective exchange rate (depreciation -)1/	12.6	10.1	...	...
General government 2/				
Revenue and grants	42.5	-3.1	58.4	17.2
Total expenditure	52.0	30.0	20.3	12.0
Money and credit				
Domestic credit 3/	38.5	25.5	27.9	...
Public sector 3/	4.4	18.7	4.0	...
Private sector 3/	38.3	8.8	14.0	...
Money and quasi-money (M2)4/	27.5	9.8	32.1	...
Velocity (GDP relative to M2)	3.60	3.52	3.73	...
Money and quasi-money (M3)5/	43.3	0.2	17.5	...
Velocity (GDP relative to M3)	2.00	2.14	1.81	...
Interest rate (annual rate, six-month savings deposit)	49.8	65.0	...	...
(In per cent of GDP)				
Public sector saving 2/	3.7	-5.4	2.2	4.1
Public sector deficit (-)2/	-2.3	12.3	-3.0	-1.1
Central administration deficit (-)2/	-0.9	-9.0	-1.9	-0.7
Domestic bank financing	0.1	8.1	1.0	...
Foreign financing 6/	0.8	0.9	0.9	...
Gross domestic investment	15.6	13.2	12.6	13.8
Gross domestic savings	11.4	7.2	7.7	9.9
Current account deficit (BOP)7/	6.8	8.7	4.7	3.6
External public debt (medium and long term) inclusive of use of Fund credit 7/	19.1	32.6 8/	40.3 8/	37.3
Debt service ratio (in per cent of exports of goods and services)	9.4	32.4	30.9	36.0
Interest payments (in per cent of exports of goods and services)	6.2	15.5	16.0	17.1
(In millions of U.S. dollars)				
Overall balance of payments deficit (-)	12	-800	-100	--
Gross official reserves (months of imports)	4.3	2.6	3.5	5.0
External payments arrears	--	--	--	--

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

1/ Annual average.
2/ Includes foreign financed expenditure which is not registered in the central administration operations as officially reported.
3/ In relation to the stock of liabilities to the private sector at the beginning of the period.
4/ Includes only deposits and liabilities to the private sector in local currency.
5/ Includes foreign currency deposits valued at the annual average exchange rate of each year.
6/ Including dollar-denominated bills sold to residents and nonresidents.
7/ For the purpose of these ratios, U.S. dollar GDP has been estimated using an exchange rate for the Uruguayan peso that would keep the Uruguayan peso/U.S. dollar exchange rate constant in real terms at its average 1976 level.
8/ Includes short-term debt contracted in 1981 and 1982 but converted to medium term in 1983.

especially in the area of trade liberalization. In carrying out this program, the Government of Uruguay would like to count on the support of the International Monetary Fund in the form of a two-year stand-by arrangement in a total amount equivalent to SDR 378 million from ordinary and enlarged access resources.

11. The macroeconomic assumptions and objectives of our program, expressed in terms of GDP, are presented in attached Table 1. Foremost among our objectives are (1) the restoration of a balance of payments position that can be sustained over the medium-term; (2) a resumption of output and employment growth; and (3) a return to approximate price stability once the corrective price adjustments associated with the recent freeing of the exchange rate have worked their way throughout the economy. These objectives will be pursued by an appropriate mix of external, incomes, financial and resource allocation policies. The ultimate balance of payments target is a current account deficit consistent with Uruguay's external borrowing capacity, taking account of the difficulties now being encountered by Latin American countries in raising new funds--and at terms which are satisfactory--from the international capital market. The inflation target for 1983 is to hold price increases to around 40 per cent, and, for 1984, to achieve a gradual deceleration of inflation to a rate approximating that abroad by the last quarter of the year. We realize that the goal of reactivating the economy may be more elusive, but we hope that the decline in output of the last two years will come to a halt in the first half of 1983, and that a modest positive growth will be within reach for the year as a whole. A more robust rebound of real GDP is not expected until the second year of our program.

12. The central feature of the adjustment program is the abandonment of the exchange rate schedule (and of the exchange guarantee scheme managed by the state-owned Bank of the Republic) in favor of a float of the peso. After a period in which exchange rate oscillations are likely to be quite pronounced, and as other policies begin to take hold and the development of a forward exchange market allays uncertainties, hopes are that the exchange rate will stabilize within a narrow range. Once the exchange rate has moved to its equilibrium level, we intend to pursue a flexible exchange rate policy, which may consist either in a float with substantial Central Bank intervention or in a crawling peg, as balance of payments circumstances dictate.

13. With this exchange rate adjustment, and taking into account the prospective evolution of the terms of trade, the current account balance of payments deficit is expected to be reduced to US$345 million in 1983 and US$285 million in 1984. Assuming that Uruguay will be able to roll over or refinance all of its short-term debts which fall due in 1983 and to count on net external savings of about US$245 million in 1983, the program aims at an overall balance of payments deficit of no more than US$100 million in 1983 and at equilibrium in 1984. The quarterly targets, however, allow for temporarily larger deficits because

of the uneven distribution over the course of the year of certain Central Bank foreign exchange expenditures resulting from obligations acquired in 1982.

14. Reflecting prudent fiscal management in the 1970s, Uruguay's official external debt remained one of the lowest in the Western Hemisphere, amounting to no more than 12 per cent of GDP at the end of 1981; debt service payments, in terms of national income or export earnings, also were low. Under normal international economic conditions and with a fluid international capital market Uruguay should not have had difficulty in securing the amount of foreign savings needed to meet its requirements in 1982 and tie it over the adjustment period ahead. Access to foreign commercial bank lending, however, has become increasingly difficult, and the bulk of the foreign borrowing undertaken in 1982 was at less than one year. In these circumstances, we believe it to be important that (1) Uruguay's borrowing plans for the next two years, including refinancing of existing short-term loans, be made an integral part of our economic program; (2) these plans be presented as such to prospective lenders when we approach them in early 1983; (3) to the extent feasible, the Fund provide us with the assistance necessary vis-a-vis the international financial market to obtain new financing and substitute medium-term for short-term debt; and (4) after peaking in 1982, net access of the public sector to foreign loans decline gradually in absolute terms during 1983-84. Consistent with our fiscal program and with the prospective financial needs of the state-owned Mortgage Bank, net recourse to external savings by Uruguay's public sector, including official financial institutions, has been programmed at US$460 million in 1983 and US$100 million in 1984. To agree with the projected financing requirements of the public sector, net disbursements on foreign loans will be subject to quarterly limits.

15. For the recent exchange rate adjustment to produce a lasting improvement in the competitiveness of the Uruguayan economy, wage policy must remain prudent. Moreover, after two years of increase in unemployment, we would hope that any resumption of economic growth will translate into job creation rather than in real wage increases. Although the recent depreciation of the peso is expected to result in a marked increase in prices, the Government has kept the accompanying wage increase to 15 per cent for both the public and private sector, effective January 1, 1983. Social security benefits are to be raised by the same percentage in 1983, although adjustments are to be phased in two steps to lessen their impact on the General Government budget. Henceforth, save for the minimum wage which must be set by law, the Government does not intend to intervene in the process of wage determination. Wage levels thus will depend primarily on the economic position of each firm and on the labor market situation in general. Government salary raises are to be granted only to the extent that they can be accommodated without jeopardizing the goal of a sizable reduction in the Treasury's and in the overall public sector deficits.