Country update **URUGUAY**

Summary

Uruguay’s economy continued to grow quickly in 2011, although growth decelerated in the course of the year. The deceleration has been welcome, as the economy was close to overheating, with especially the labor market being very tight. The tight labor market has contributed to inflation, which rose to 8.1% in 2011. During 2011, the central bank tried to control inflation by raising its benchmark interest rate by 225 basis points to 8.75%. Meanwhile, the debt profile of the government has continued to improve, while the debt-to-GDP ratio has also declined further. Uruguay has maintained its investor friendly policies and the country continues to attract large inflows of FDI. However, the country might be hit by Argentina’s balance of payments problems and policies, as these are likely to result in less FDI inflows and tourism income. However, Uruguay’s large foreign reserve holdings provide an important cushion.

Things to watch:

- Balance of payments problems in Argentina
- Prices of agricultural commodities
- Stubbornly high inflation

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Uruguay

National facts	
Type of government	Constitutional republic
Capital	Montevideo
Surface area (thousand sq km)	176
Population (millions)	3.4
Main ethnic groups	White (88%)
	Mestizo (8%)
	Black (4%)
Main religions	Roman catholic (47%)
	Nondemoninational (23%)
Head of State & Government (president)	Jose Mujica Cordano
Monetary unit	Peso (UYU)

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	46	0.07
Nominal GDP at PPP	51	0.06
Export value of goods and services	13	0.06
IMF quotum (in mln SDR)	307	0.14
Economic structure	*2011*	*5-year av.*
Real GDP growth	5.8	5.8
Agriculture (% of GDP)	10	9
Industry (% of GDP)	22	23
Services (% of GDP)	69	68
Standards of living	*USD*	*% world av.*
Nominal GDP per head	13758	127
Nominal GDP per head at PPP	15057	122
Real GDP per head	7238	89

Social and governance indicators	rank / total
Human Development Index (rank)	48 / 187
Ease of doing business (rank)	90 / 183
Economic freedom index (rank)	29 / 179
Corruption perceptions index (rank)	25 / 183
Press freedom index (rank)	32 / 178
Gini index (income distribution)	42.42
Population below $1.25 per day (PPP)	0%

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Brazil	20	Argentina	15
China	13	Brazil	14
Argentina	7	China	14
Venezuela	6	US	9

Main export products (%)	2011
Meat & products	19
Processed rice	5
Wool & products	3
Hides & skins	3
Main import products (%)	2011
Intermediate goods	61
Consumer goods	24
Capital goods	16
Openness of the economy	2011
Export value of G&S (% of GDP)	28
Import value of G&S (% of GDP)	26
Inward FDI (% of GDP)	5.2

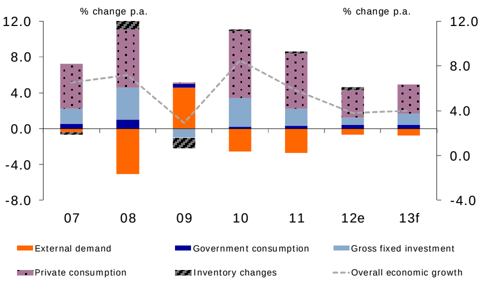
Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

Uruguay's economy has continued to perform well, with GDP growing by 5.7% in 2011. Investment and, particularly, consumption were the main drivers of growth (see figure 1). However, growth decelerated in the course of the year, with economy growing by only 3.5% year-on-year in the fourth quarter of 2011, due to the closure of a refinery and a drought. Beef exports, Uruguay's most important export product, fell by 8% in volume terms in 2011, but grew 18% in income terms (to USD 1.3bn) thanks to higher international prices. In 2012 and 2013, economic growth is likely to slow to roughly 4%, thanks to a less benign global environment and a tighter monetary policy. The slowdown is welcome, as Uruguay's economy has been close to overheating. For example, the labor market has become very tight, as unemployment reached historically low levels by falling below 6%. In January 2012 unemployed increased to 5.7%, up from 5.3% in December, but this might be partially related to seasonal factors and still leaves unemployment at a low level. The tight labor market has resulted in rapidly rising nominal wages and high inflation, which increased to 8.1% in 2011. During 2011, the central bank tried to control inflation by raising its benchmark interest rate by 225 basis points. The latest hike, a 75 basis points increase of the interest rate implemented on 29 December 2011, brought the rate to 8.75%. Afterwards, inflation has fallen from 8.6% year-on-year in December 2012 to 7.9% in February, which leaves it well above the 4% to 6% target range nonetheless. In its latest statement, the central bank noted that inflation started to ease, but also remarked that inflation has continued to remain "notoriously above the target range.

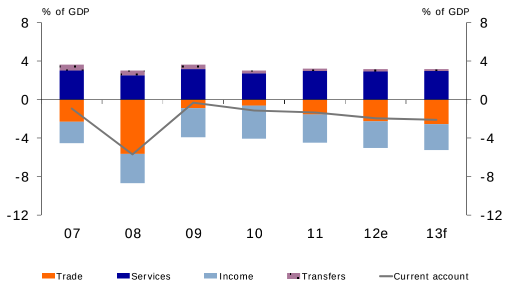
Meanwhile, partially thanks to a tight control on expenditures, the fiscal outcome over 2011 was above target. The fiscal deficit was 0.8% of GDP, whereas a deficit of 1.3% of GDP was budgeted. Uruguay's public debt is still sizeable, but has continued to decrease steadily, falling from 59% of GDP in 2010 to 53% of GDP in 2011. The profile of the outstanding debt has also improved. The government has recently been able to swap existing dollar debt into peso debt, which reduces currency risk. Before the latest swaps the dollarization rate of the public debt had already fallen from 69% in 2007 to 53% in June2011. At the same time, the government has also been able the improve the maturity profile of its debt.

Figure 1: Growth performance



Source: EIU

Figure 2: Current account



Source: EIU

Uruguay continues to attract investment

President José Mujica, a former guerrilla fighter, has continued the country's investment-friendly policies and the country continues to attract large inflows of Foreign Direct Investment (FDI). Inward FDI grew from 4.1% of GDP in 2010 to 5.2% of GDP in 2011 and is expected to stay at a high level in the coming years. Uruguay benefits from the large investments in a paper mill by the Finnish firm Metsa-Botnia, but this project is certainly not the only to attract FDI. Many subsectors of the economy have received foreign direct investments in recent years, with FDI being particularly strong in the manufacturing and services sectors. During 2011, important investments in an export oriented powdered milk and dairy plant, and a bio-ethanol plant were announced. The fact that inflows of FDI are large also implies that the widening of the current account deficit should not be a cause for concern. In 2011 Uruguay's current account deficit grew to 1.3% (see figure 2), with import growth being an important driver of the widening of the deficit. However, import growth has to a large extend been driven by the large FDI inflows that will boost the productive capacity of the economy. Uruguay's international investment position has become more negative in recent years, but the large inflows of FDI have helped to improve the profile of Uruguay's foreign liabilities, as the share of the FDI stock in the total foreign liabilities grew from 14% to 44% between 2005 and 2010. However, the high dollarization of the banking system remains a risk.

Impact of problems in Argentina

The impact of the balance of payments problems in neighboring Argentina have so far been somewhat limited. Argentina's trade policy has become extremely protectionist, but in 2010 only 7% of Uruguay's exports went to Argentina. Some industries are suffering though. Uruguay's room to retaliate is mitigated by the fact that it strongly relies on Argentina as a source of tourism income and FDI. Indeed, Uruguay's important tourist sector is rather vulnerable to shocks in Argentina, as Argentina accounts for more than half of Uruguay's tourism receipts. It seems that Uruguay is already feeling the impact of the recent tightening of capital and foreign currency controls by the Argentine government, as the total expenditure by foreign tourists in Uruguay fell by 20% to roughly USD 650mln in January and February 2012. As Argentina is also an important source of FDI, Uruguay might also suffer from the problems in Argentina through reduced inflows of FDI, in particular if the balance of payments problems in Argentina worsen once Argentina's soy export season ends mid-2012. However, the relatively high level of foreign exchange reserves (of roughly 10 months of imports) provides an important cushion.

Uruguay

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	6.5	7.2	2.9	8.5	5.8	3.8	4.0
Consumer prices (average % change pa)	8.1	7.9	7.1	6.7	8.1	6.9	6.3
Current account balance (% of GDP)	-0.9	-5.7	-0.3	-1.1	-1.3	-1.9	-2.1
Total foreign exchange reserves (mln USD)	4114	6353	8029	7644	10302	11100	11400
Economic growth							
GDP (% real change pa)	6.5	7.2	2.9	8.5	5.8	3.8	4.0
Gross fixed investment (% real change pa)	9.3	19.3	-4.9	16.7	9.1	3.9	6.0
Private consumption (real % change pa)	7.1	9.1	0.2	10.6	8.6	4.2	4.3
Government consumption (% real change pa)	4.7	9.3	3.9	2.2	2.9	3.6	3.6
Exports of G&S (% real change pa)	4.8	8.5	3.8	8.5	6.3	3.3	4.2
Imports of G&S (% real change pa)	5.9	24.4	-9.2	16.2	13.6	4.7	5.7
Economic policy							
Budget balance (% of GDP)	0.0	-1.5	-1.8	-1.2	-0.8	-1.1	-0.9
Public debt (% of GDP)	64	63	63	59	53	47	44
Money market interest rate (%)	4.1	9.8	8.6	6.3	6.1	7.0	6.6
M2 growth (% change pa)	31	17	15	31	22	17	17
Consumer prices (average % change pa)	8.1	7.9	7.1	6.7	8.1	6.9	6.3
Exchange rate LCU to USD (average)	23.5	20.9	22.6	20.1	19.3	19.4	19.6
Recorded unemployment (%)	9.2	7.6	7.3	6.7	6.0	6.0	5.9
Balance of payments (mln USD)							
Current account balance	-221	-1729	-105	-442	-614	-990	-1180
Trade balance	-545	-1715	-269	-251	-722	-1160	-1440
Export value of goods	5100	7096	6408	8069	9625	9520	9980
Import value of goods	5645	8810	6677	8320	10346	10680	11420
Services balance	704	754	959	1042	1360	1480	1650
Income balance	-516	-917	-933	-1351	-1371	-1430	-1510
Transfer balance	137	149	138	118	119	120	130
Net direct investment flows	1240	1820	1260	1633	2394	2530	2530
Net portfolio investment flows	155	92	-286	373	84	70	60
Net debt flows	1106	-327	548	62	151	-250	650
Other capital flows (negative is flight)	-1250	2382	260	-2008	647	-560	-1770
Change in international reserves	1031	2239	1678	-382	2661	800	300
External position (mln USD)							
Total foreign debt	11523	10985	12159	12248	12397	12150	12800
Short-term debt	908	817	1124	1460	1516	1420	1410
Total debt service due, incl. short-term debt	1967	2390	2720	2561	2817	2970	2860
Total foreign exchange reserves	4114	6353	8029	7644	10302	11100	11400
International investment position	-2029	-2047	-5065	-6764	n.a.	n.a.	n.a.
Total assets	20324	22602	26807	27222	n.a.	n.a.	n.a.
Total liabilities	22354	24648	31871	33985	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	-2.3	-5.6	-0.9	-0.6	-1.6	-2.3	-2.6
Current account balance (% of GDP)	-0.9	-5.7	-0.3	-1.1	-1.3	-1.9	-2.1
Inward FDI (% of GDP)	5.7	6.0	4.1	4.2	5.2	5.0	4.5
Foreign debt (% of GDP)	49	36	40	31	27	24	23
Foreign debt (% of XGSIT)	144	106	130	108	91	88	87
International investment position (% of GDP)	-8.7	-6.7	-16.6	-17.3	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	25	23	29	23	21	21	19
Interest service ratio incl. arrears (% of XGSIT)	9	6	6	5	4	5	5
FX-reserves import cover (months)	7.3	7.4	12.1	9.3	10.1	10.4	10.0
FX-reserves debt service cover (%)	209	266	295	298	366	374	399
Liquidity ratio	176	155	204	201	200	194	193

Source: EIU