**International Monetary Fund**

Uruguay and the IMF

**Press Release**:
IMF Executive Board Completes Final Review Under Uruguay's Stand-By Arrangement, Approves US$ 213.8 Million Disbursement
February 23, 2005

Country's Policy Intentions Documents

**E-Mail Notification**
Subscribe or Modify your subscription

# **Uruguay:** Letter of Intent

February 9, 2005

The following item is a Letter of Intent of the government of Uruguay, which describes the policies that Uruguay intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Uruguay, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Montevideo, Uruguay
February 9, 2005

Dear Mr. de Rato:

1. Uruguay's economic program, which has been supported by a three-year stand-by arrangement (SBA) approved on April 1, 2002, and modified in August of that year, has yielded excellent results. The economy is recovering sharply; inflation has been well contained; the external position has strengthened significantly; and the successful debt restructuring has lengthened significantly the maturity profile of the public debt (which has fallen from 105 percent of GDP in 2002 to 89 percent of GDP by 2004). Supported by a favorable external environment, these results were achieved through sound macroeconomic policy management, particularly by strengthening the public finances and in implementing a cautious monetary policy with a floating exchange rate.

2. In addition, implementation of a comprehensive banking sector reform program, supported by close technical cooperation with the Fund's Monetary and Financial Systems Department, has substantially strengthened the health of the banking system—the public commercial bank (BROU) is now showing profits, its balance sheet shows very low nonperforming loans, and its risk and credit management practices have been bolstered. The banking system has been streamlined, with four domestic banks and one savings & loan liquidated, and a new bank formed with the performing assets of three of these banks. The asset recovery of the liquidated banks is well underway (and the asset manager has met its end-January target of 700 approved payment agreements, a structural benchmark under the program). Moreover, we have made significant progress in improving the transparency of the liquidation process, with externally-audited semi-annual reports to begin being published in the first quarter of this year.

3. We are working for a smooth transition with the new government, which takes office on March 1. In particular, consistent with our commitment during the last review, spending authorization for the first quarter of 2005 limit expenditure growth to 1.5 percent in real terms (y/y), and we have secured funding of the public finances through June of this year. The incoming central bank president attended the December 2004 monetary policy meeting, at which time the 12-month target range for inflation was established at 5.5–7.5 percent.

4. Performance under the 2004 program was favorable. GDP growth was about 12 percent, inflation ended the year at 7.6 percent, and gross international reserves rose by around US$500 million to about US$2.5 billion. Preliminary data show that all end-December quantitative performance criteria (PCs) were observed (provision of final data on the primary fiscal balance and gross debt of the nonfinancial public sector is a prior action for this review). Also observed were structural PCs on completing the transfer of all new and remaining non-performing loans of BROU to its fiduciary trust (end-December 2004), completing semiannual financial reports of the liquidation funds for end-December 2004 (end-January 2005), and on ensuring the timely service of the BHU (housing bank) note to BROU.

5. Some reforms envisaged under the program took longer than expected, although the government has remained firmly committed to them. Incorporation of the information on nonperforming borrowers in the liquidation funds (whose loans were held by the liquidation funds) into the credit registry of the Banking Superintendency could not be finished by end-December (PC), owing to the need to ensure the accuracy of the information; this action will be implemented before February 17, 2005 as a prior action for completion of this review. Structural benchmarks for end-December were not observed on establishing a large taxpayers unit (LTU) at the tax administration department (DGI) and on congressional approval of reforms of the pension funds of the police, military, and bank employees. These reforms will need to be completed by the new government. Overall, however, our structural reform program (focused on banking and fiscal reforms) has been broadly successful.

6. Based on the progress made under the program, we request: (i) completion of the Seventh Review under the Stand-By Arrangement, with availability of a purchase equivalent to SDR 139.8 million; and (ii) a waiver on nonobservance of the end-December structural performance criterion on transferring loan information in the liquidated banks to the credit registry of the Banking Superintendency, on the basis that it will be implemented before completion of this review.

7. As this is the last review under the Fund arrangement, which expires on March 31, 2005, we would like to take the opportunity to thank the Fund for its crucial support in dealing with the 2002 financial crisis and its aftermath. With that support, the government of Uruguay put in place an economic program that has allowed the country to overcome the difficulties posed at the height of the crisis and to recover in a strong manner, leaving the incoming government with a solid basis on which to build. No doubt, Uruguay continues to face important challenges to ensure sustained rapid growth, reduce the public debt, and strengthen further the banking system. Nevertheless, we are convinced that with the improved fiscal position, the successful debt exchange of May 2003, and the good progress made in restructuring the financial system, the country is on the right path to managing these challenges.

Sincerely yours,

/s/
Julio de Brun
President
Central Bank of Uruguay

/s/
Isaac Alfie
Minister of Economy and Finance
Oriental Republic of Uruguay

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street NW
Washington DC 20431

## Table 1. Uruguay: Quantitative Performance Criteria and Indicative Targets Under the 2004-05 Economic Program 1/

| | Base | March 31, 2004 | | | | June 30, 2004 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Dec. 2003 | Target | Adj. Target | Actual | Margin (+) | Target | Adj. Target | Actual | Margin (+) |
| **A. Quantitative performance criteria** | | | | | | | | | |
| 1. Combined public sector primary balance (cumulative floor ) 2/ 3/ | | 1,897 | 1,722 | 4,200 | **2,478** | 3,605 | 3,379 | 7,536 | **4,157** |
| 2. General government noninterest expenditure (cumulative ceiling) 2/ 4/ | | 10,016 | 10,254 | 9,581 | **673** | 19,757 | 19,757 | 19,603 | **154** |
| 3. Change in the net domestic assets of the BCU (ceiling) 2/ 5/ | | 1,480 | 3,030 | -5,045 | **8,075** | -750 | 800 | -7,440 | **8,240** |
| 4. Net international reserves of the BCU (- decrease) (cumulative floor) 2/ 5/ | -1,723 | -30 | -80 | 140 | **220** | 50 | 0 | 201 | **201** |
| 5. Nonfinancial public sector gross debt (ceiling) 3/ 6/ | 8,772 | 8,853 | 8,810 | 8,780 | **30** | 8,864 | 8,797 | 8,788 | **9** |
| **B. Indicative targets** | | | | | | | | | |
| 1. Combined public sector overall balance (cumulative floor) 2/ 3/ 7/ | | -5,171 | -5,445 | -2,967 | **2,478** | -7,848 | -8,010 | -3,853 | **4,157** |
| 2. Change in the monetary base (ceiling) 8/ | 14,577 | 550 | 550 | -705 | **1,255** | 800 | 800 | -1,209 | **2,009** |

| | September 30, 2004 | | | | December 31, 2004 | | | |
|---|---|---|---|---|---|---|---|---|
| | Target | Adj. Target | Act. | Margin (+) | Target | Adj. Target | Prel. | Margin (+) |
| **A. Quantitative performance criteria** | | | | | | | | |
| | (In millions of Uruguayan pesos) | | | | | | | |
| 1. Combined public sector primary balance (cumulative floor ) 2/ 3/ | 10,238 | 10,216 | 12,004 | **1,788** | 12,525 | 12,444 | 13,828 | **1,384** |
| 2. General government noninterest expenditure (cumulative ceiling) 2/ 4/ | 30,592 | 30,700 | 29,956 | **744** | 41,525 | 41,742 | 40,936 | **806** |
| 3. Change in the net domestic assets of the BCU (ceiling) 2/ 5/ | -550 | 1,000 | -7,552 | **8,552** | -3,830 | -2,280 | -12,016 | **9,736** |
| | (In millions of U.S. dollars) | | | | | | | |
| 4. Net international reserves of the BCU (- decrease) (cumulative floor) 2/ 5/ | 50 | 0 | 187 | **187** | 180 | 130 | 438 | **308** |
| 5. Nonfinancial public sector gross debt (ceiling) 3/ 6/ | 9,035 | 8,921 | 8,842 | **79** | 9,040 | 8,977 | 8,934 | **43** |
| **B. Indicative targets** | | | | | | | | |
| | (In millions of Uruguayan pesos) | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 1. Combined public sector overall balance (cumulative floor) 2/ 3/ 7/ | -9,040 | -8,280 | -6,492 | **1,788** | -11,384 | -10,231 | -8,846 | **1,385** |
| 2. Change in the monetary base (ceiling) 8/ | 1,000 | 1,000 | -1,755 | **2,755** | 1,750 | 1,750 | 628 | **1,122** |

Sources: Ministry of Economy and Finance; and Central Bank of Uruguay.

1/ As defined in the Technical Memorandum of Understanding.
2/ Cumulative changes from end-December 2003.
3/ Adjusted upward/downward for changes in social security contributions, as defined in the TMU.
4/ Adjusted upward/downward for changes in collections of the Fondos de Libre Disponibilidad (FLD), as defined in the TMU.
5/ Adjusted upward/downward for changes in program disbursements from the World Bank and IDB, as defined in the TMU.
6/ All maturities. The 2003 base includes all loans guaranteed by the government. For December 2003, the debt ceiling has been adjusted upwards to reflect the transfer of Brady bonds from the central bank to the government.
7/ Adjusted upward/downward for changes in interest payments, as defined in the TMU.
8/ Cumulative change from December 2003 average.

Table 2. Uruguay: Structural Conditionality Under the 2004–05 Economic Program 1/

| Structural Conditionality | Expected timing | Status |
|---|---|---|
| **A. Prior actions** | | |
| Incorporate into the credit registry of the Banking Superintendency the information on nonperforming borrowers in the liquidation funds whose loans were held by the liquidation funds. | | |
| Submit final data for the primary surplus of the combined public sector and NFPS gross debt | | |
| **B. Structural performance criteria** | | |
| Completion of the transfer to the BROU fiduciary trust of all new and remaining Category 4 and 5 loans. | December 31, 2004 | Observed |
| Incorporate into the credit registry of the Banking Superintendency the information on nonperforming borrowers in the liquidation funds whose loans were held by the liquidation funds. | December 31, 2004 | Not observed |
| Complete semiannual financial reports of the liquidation funds for end-December 2004 for auditing and publication. | January 31, 2005 | Observed |
| Government to ensure timely service of BHU note to BROU. | Continuous | Observed |
| **C. Structural benchmarks** | | |
| Establishment of a Large Taxpayers Unit at the Tax Administration Department (DGI). | December 31, 2004 | Not observed |
| Approval by Congress of the reform of the pension funds for the police and the military. | December 31, 2004 | Not observed |
| Approval by Congress of the reform of the pension funds for bank employees. | December 31, 2004 | Not observed |
| Asset manager to reach 700 payment agreements approved by its creditor committee. | January 31, 2005 | Observed |

1/ As defined in the Technical Memorandum of Understanding.