International Monetary Fund

Uruguay and the IMF

Press Release:
IMF Executive Board Completes Third Review Under Uruguay's Stand-By Arrangement and Approves US$123.6 Million Disbursement
March 27, 2006

Country's Policy Intentions Documents

E-Mail Notification
Subscribe or Modify your subscription

Uruguay: Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding

March 13, 2006

March 13, 2006

Dear Mr. de Rato:

Performance under our program remains strong, with robust growth and low inflation. Both the primary fiscal balance and the overall balance exceeded the 2005 program objectives. Improved capital market access and buoyant exports have allowed Uruguay to significantly strengthen its official reserve position. Preliminary data suggest that all the end-2005 quantitative performance criteria (PCs) were met, some with large margins. Final data will be available before the Board meeting. Our structural reform agenda is progressing well: we have adopted a plan for the restructuring of the housing bank BHU, and we will submit a comprehensive tax reform to Congress by March 20 consistent with the program. We have also been advancing in other key reforms for 2006, including in the pension, tax administration, and financial sector areas. The growth commission is about to publish its recommendations, which will be a focus of the next review.

In light of this strong performance and in support the program objectives, we request: (i) completion of the Third Review under the SBA and purchase of SDR 85.82 million; (ii) modification of the 2006 fiscal PCs (primary balance, non-interest expenditure and debt) to accommodate critical public investment financed through privatization proceeds; (iii) waiver of nonobservance of the tax reform PC (to be submitted with a slight delay in March as a prior action for this review); (iv) modification of the end-June tax reform PC to move the approval date to end-October to accommodate expected bottlenecks in the congressional agenda; and (v) establishment of two structural performance criteria in banking sector restructuring. We have updated our economic and policy targets for 2006, as described in detail in the attached supplementary Memorandum of Economic and Financial Policies. The next review under the arrangement will be completed by June 2006. It will assess overall performance under the program and observance of the associated performance criteria and benchmarks (Tables 1 and 2). Should the external position turn out significantly stronger than we currently anticipate, we will consider reducing the net use of Fund resources by treating the arrangement as precautionary in the future or making advanced repurchases.

As usual, we will maintain a close policy dialogue with the Fund and stand ready to take additional measures as appropriate to ensure the achievement of the program's objectives.

Sincerely yours,

/s/	/s/
Walter Cancela	Danilo Astori
President	Minister of Economy and Finance
Central Bank of Uruguay	Oriental Republic of Uruguay

Attachments:
Supplementary Memorandum of Economic and Financial Policies
Technical Memorandum of Understanding

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES[1]

Recent developments

1. Economic performance remains strong. Growth in 2005 is likely to have exceeded the 6 percent target, led by strong consumption and exports. Inflation has increased to 6.6 percent in February 2006, and it is now within the central bank's (BCU) target range for March (5–7 percent). The 2005 fiscal primary surplus reached 3.8 percent of GDP and the overall deficit fell below 1 percent of GDP, both better than programmed. All quantitative performance criteria (PCs) for end-2005 are expected to have been met, some with large margins, and the end-March 2006 PCs are well within reach. While the indicative end-December base money target was exceeded, this was the result of temporary liquidity needs.

2. Near-term vulnerabilities have declined with a significant strengthening of the international reserve position, reflecting buoyant exports and improved capital market access. Taking advantage of appreciation of pressures on the peso, the BCU has also intervened in the foreign exchange market. Medium-term vulnerabilities, however, remain high, with the still high public debt, mainly in foreign currency and at floating rate, and large public financing needs (averaging 8 percent of GDP) over the next three years.

Fiscal policies

3. Achieving debt sustainability through continued fiscal consolidation and sustained growth remains at the core of our program. During July 2006–June 2007 we intend to undertake additional and carefully selected one-time investment outlays, to catalyze much larger private investment in key infrastructure bottlenecks and foster higher growth. This could temporarily reduce the primary surplus slightly (by up to about a ¼ percent of GDP), but would be fully financed by non-debt creating flows (i.e. privatization proceeds from the sale of NBC). The government will adequately share the risks in these projects with private partners and record any government guarantees (which are not expected to be issued) or fiscal contingencies in the fiscal accounts. Moreover, they are required to have a positive fiscal impact in the short term (through higher revenues or lower recurrent spending) and result in productivity gains for the economy and lasting infrastructure improvements. Projects identified so far include investments in the railroad system (to facilitate exports of the forestry sector) and dredging of the port of Montevideo.

4. Our 2006 fiscal program targets an increase in revenues of about one percent of GDP to ensure both appropriate spending in priority areas (including the social emergency plan) and meeting the primary surplus target. We are therefore pressing ahead with administrative reforms, expected to yield at least ½ percent of GDP this year (see below). The remaining ½ percent of GDP in additional revenue would come from an improvement in the current

[1] This memorandum supplements the Memorandum of Economic and Financial Policies (MEFP) of May 24 and its supplements of September 14 and December 27, 2005.

primary surplus of public enterprises as a result of the recovery from the drought in 2005, lower transfers to the central government, and adjusting tariffs to maintain appropriate margins and reflect cost developments.

5. We will closely monitor fiscal developments, execute expenditure cautiously, and stand ready to take measures as needed to ensure meeting the 2006 program targets. We reiterate our commitment to save any overperformance toward achieving the medium-term primary surplus target of 4 percent of GDP as soon as possible.

Structural fiscal reforms and debt management

6. ***Tax reform.*** We are about to submit to congress a comprehensive tax reform (with a slight delay with respect to the end-February performance criterion). While we are now envisaging congressional approval by October, instead of June, we will work in parallel to advance the preparation of implementing regulations and procedures to ensure that the reform becomes effective in January 2007. The draft bill is broadly in line with the proposal presented to the public last year, which aims at improving the system's equity and efficiency, including by: (i) introducing a personal income tax; (ii) revamping the corporate income tax; (iii) lowering VAT rates and broadening its base; (iv) eliminating sectoral exemptions and unifying rates for employers' social security contributions; and (v) streamlining the number of taxes. The proposal is designed to be at least revenue neutral, and envisages now a more gradual VAT rate reduction so as to safeguard the fiscal targets.

7. ***Revenue administration.*** We are pressing ahead with the reforms launched in 2005, including by ensuring an adequate cadre of human resources. The social security agency (BPS) is making good progress with its action plan. Work of the customs reform task group is on schedule to have a comprehensive reform plan by August 2006.

8. ***Budget process.*** We have established a committee to steer reforms in this area. The committee is preparing a comprehensive reform plan (structural benchmark for August 2006), including the preparation of a draft organic budget law to unify the framework regulating the formulation, coverage, classification, execution, control, and transparency of the budget process.

9. ***Debt management.*** While a detailed debt strategy will be prepared by the newly established debt management unit at the MEF, we have already started to improve the debt profile, including by replacing more expensive IDB/World Bank debt coming due next year by cheaper long-term market financing.

Monetary and exchange rate policies

10. We have maintained our monetary framework by targeting preannounced one-year-ahead inflation objectives within a flexible exchange rate regime, and remain committed to a 4½–6½ percent inflation in 2006. As part of our gradual move toward a full-fledged inflation regime, we recently modified our public communication strategy by replacing announcements of quarterly base money target ranges by indicative one-year M1 targets.

Since last December's announcement of the end-2006 target for M1 growth of 12.3 percent (in line with aggregate demand), inflationary pressures may have somewhat increased. While it is too early to assess whether the balance of risks has fundamentally shifted, we have begun to reassess policies and, in the interim, we maintain the program's more conservative indicative 2006 monetary targets. We will continue to monitor monetary and price developments closely and stand ready to adjust the monetary stance to attain our inflation objective. To continue to advance toward full-fledged inflation targeting, we are requesting TA from the Fund to improve our forecasting and policy analysis models.

11. Continued foreign exchange purchases by the BCU, and a recent US$500 million bond issue have contributed to a significant strengthening in our reserve position. While this also led temporarily to a relatively constant exchange rate with respect to the US dollar, it has since moved in line with market conditions, and consistent with our commitment to a flexible exchange rate. Nevertheless, with our reserve position still relatively low compared with other dollarized economies, we will continue to take advantage of favorable conditions to further build reserves, including through additional purchases in the foreign exchange market, while sterilizing their monetary impact. We will make sure that this remains consistent with our inflation objective.

Central bank and financial sector reforms

12. ***Housing bank BHU.*** We have adopted an action plan that envisages a fully capitalized and commercially run housing bank. Key steps include: (i) shifting nonperforming loans and their management responsibility to a fiduciary trust and adequately capitalizing the bank (new PC for end-August 2006); and (ii) transferring the remaining nonperforming assets in BHU and their management responsibility to a fiduciary trust and review the regulatory framework, and adopt changes if needed, to ensure that BHU limits its activities to residential mortgage lending on a commercial basis. We also plan to have the restructuring plan implemented by year's end, with BHU meeting all prudential limits and having a plan in place that demonstrates its ability to generate profits and a positive cash flows going forward (new PC for end-November 2006). In the interim, BHU will not resume its lending, unless the Superintendency for Banking Supervision concludes that sufficient progress has been made in implementing its restructuring that such lending does not pose a risk to the safety and soundness of the institution. BHU will continue to service the note to BROU on schedule, and if necessary, the government will honor its guarantee.

13. ***COFAC.*** Following large deposit withdrawals, this small cooperative was intervened in early 2006, but without any negative impact on the rest of the financial system. Since then, we have made significant progress, and announced that we will fully pay out insured deposits in early March. We have also retained a firm to find a possible buyer in the near future, and should a sale not materialize in the weeks ahead, we will follow the procedures foreseen by our legal and normative framework. In any case, we will not involve any government guarantees or public funds.

Improving the investment climate and competitiveness

14. The reform agenda prepared by the tripartite growth commission is expected to be published at end-March (structural benchmark). Proposals include, inter alia, measures to increase competition, enhance corporate transparency, improve bankruptcy legislation, strengthen the working of the judiciary system, simplify the tax and investment promotion regimes, improve public infrastructure and efficiency of public enterprises, and reduce red tape and the regulatory burden. Our program already contemplates measures in several of these areas, including through the tax reform, and new competition and bankruptcy laws. In addition, and as a focus of the next review, we will incorporate additional measures to improve investment climate into the program conditionality.

Program financing and safeguards

15. With a substantial amount of the 2006 capital market financing already secured, the 2006 financing is well in hand. We have advanced repayments to the World Bank and IDB of some US$400 million for 2006–07 and plan to continue to take advantage of market conditions to lock in the favorable terms in view of our large medium-term financing needs. We also expect significant new disbursements from the World Bank and IDB (about US$300 million) this year, and are firmly committed to implement associated reforms to ensure timely disbursements.

Table 1. Uruguay: Quantitative Performance Criteria and Indicative Targets for the 2005-08 Program

	Dec. 31	June 30				Sept. 30				Dec. 30			
	2004 Stock	PC	PC (adj.)	Actual	Margin (+)	PC	PC (adj.)	Actual	Margin (+)	PC	PC (adj.)	Prel.	Margin (+)
A. Quantitative performance criteria													
(In millions of Uruguayan pesos)													
1. Combined public sector primary balance (floor) 2/	...	5,471	5,372	6,394	**1,022**	9,687	9,490	10,351	**861**	14,647	14,397	15,477	**1,080**
2. General government noninterest expenditure (ceiling) 2/	...	23,561	23,539	22,080	**1,459**	34,643	34,665	32,996	**1,670**	46,561	46,683	45,137	**1,546**
3. Net domestic assets of the BCU (ceiling) 2/	74,079	3,983	3,983	-302	**4,284**	4,572	4,572	-16,424	**20,995**	-3,910	-8,416	-22,449	**14,033**
(In millions of U.S. dollars)													
4. Net international reserves of the BCU (floor) 2/	-2,218	-130	-130	18	**148**	-110	-110	592	**702**	280	451	1,052	**601**
5. Nonfinancial public sector gross debt (ceiling) 3/	12,189	12,510	12,495	12,229	**266**	12,575	12,566	12,496	**70**	12,550	12,745	12,650	**95**
6. Accumulation of external payment arrears of the public sector (on a continuous basis) 2/	0	0	0	0	**0**	0	0	0	**0**	0	0	0	**0**
B. Indicative targets													
(In millions of Uruguayan pesos)													
7. Combined public sector overall balance (floor) 2/	...	-5,086	-5,186	-2,794	**2,391**	-7,459	-7,656	-4,597	**3,059**	-7,072	-7,322	-3,269	**4,053**
8. Monetary base (ceiling) 2/	15,648	557	557	1,070	**-513**	1,673	1,673	498	**1,175**	3,468	3,468	4,460	**-992**
9. Floating debt of the central government (ceiling)	3,081	3,081	3,081	2,567	**514**	3,081	3,081	2,298	**783**	3,081	3,081	2,482	**599**

Table 1: Quantitative Performance Criteria and Indicative Targets for the 2005-08 program (concluded)

	2005 Stock	2006 Targets				2007 IT	2008 IT
	Sept. 30	Mar. 31	Jun. 30	Sept. 30	Dec. 31	Dec. 31	Dec. 31
A. Quantitative performance criteria							
(In millions of Uruguayan pesos)							
1. Combined public sector primary balance (floor) 2/	n.a.	2,651	5,196	10,434	16,473	19,311	20,748
2. General government noninterest expenditure (ceiling) 2/	n.a.	13,409	27,050	39,870	53,558	57,735	63,095
3. Net domestic assets of the BCU (ceiling) 2/ 3/	51,525	-3,136	-4,195	-8,003 5/	-7,130 5/	-16,203	-9,522
(In millions of U.S. dollars)							
4. Net international reserves of the BCU (floor) 2/ 3/	-1,546	250	333	414 5/	554 5/	544	395
5. Nonfinancial public sector gross debt (ceiling) 4/	12,309	12,882	13,074	13,082	12,995	13,150	13,286
6. Accumulation of external payment arrears of the public sector (on a continuous basis) 2/	0	0	0	0	0	0	0
B. Indicative targets							
(In millions of Uruguayan pesos)							
7. Combined public sector overall balance (floor) 2/	n.a.	-3,076	-5,528	6,255	-4,983	-2,966	-2,537
8. Combined public sector primary balance (extended) (floor) 2/	n.a.	2,651	5,196	10,434	16,473	19,311	20,748
9. Monetary base (ceiling) 2/ 3/	16,146	3,140	3,261	2,105	4,882	1,803	1,720

PC= Performance Criterion; IT=Indicative Target.

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

1/ As defined in the Technical Memorandum of Understanding.
2/ Cumulative changes from the previous calendar year.
3/ 2006 targets are cumulative from end-September 2005.
4/ All maturities.
5/ NDA and NIR targets for end-September and end-December 2006 are indicative targets.

Table 2. Uruguay: Structural Conditionality under the 2006-08 Program

Area	Structural Conditionality	Date	Status
A. Prior action			
Tax reform	Submit to congress a comprehensive tax reform as described in paragraph 7 of the MEFP.		
B. Structural performance criteria (EBS/05/202)			
Fiscal	Have in place a five-year spending plan, complemented with revenue projections and deficit targets consistent with the program's fiscal targets.	February 28, 2006	Observed.
Tax reform	Submit to congress a comprehensive tax reform as described in paragraph 7 of the MEFP.	February 28, 2006	Not observed; reset as PA.
Tax reform	Begin to implement the comprehensive tax reform. 1/	October 31, 2006	
Central Bank	Begin to implement the laws that: (i) give appropriate autonomy to the central bank (as described in paragraph 12 of the MEFP); (ii) strengthen the regulation of the financial system (as described in paragraph 13 of the MEFP and modified as specified in paragraph x of the December SMEFP); and (iii) provide a suitable bank resolution framework (as described in paragraph 14 of the MEFP).	June 30, 2006	
BROU & BHU	Government to ensure timely service of BHU note and BROU fiduciary notes to BROU in accordance with the current payment schedules.	Continuous	Observed.
Pensions	Begin to implement reform of the pension fund for the police.	May 31, 2006	
Pensions	Submit to Congress reform of the pension fund for the military and bank employees as described in paragraph 12 of the SMEFP.	November 30, 2006	
Pensions	Begin to implement the reform of the pension fund for the military and bank employees as described in paragraph 12 of the SMEFP.	May 31, 2007	
C. New structural performance criteria			
BHU	Move nonperforming loans into a fideicomiso and adequately capitalize BHU as specified in paragraph 11 of the TMU.	August 31, 2006	
BHU	Transform BHU into an institution with a viable business plan and a strong regulatory framework as specified in paragraph 12 of the TMU.	November 30, 2006	
D. Structural benchmarks (EBS/05/202)			
Tax administration	Formulate a plan to strengthen the auditing and enforced collection functions of the BPS.	June 30, 2006	
Tax administration	Finalize the design of a comprehensive reform plan for the customs agency (including establishing collection targets consistent with the program).	August 31, 2006	
Budget	Prepare recommendations, with a timetable, to improve legislation, coverage, classification, formulation, controls, and transparency of the budget process.	August 31, 2006	
Growth	Publish agenda of growth-enhancing reforms (including timetable for implementation) prepared by the business environment commission.	March 31, 2006	
Growth	Submit to Congress bankruptcy law (to include Chapter-11 type corporate restructuring).	June 30, 2006	
Financial sector	Adopt a detailed schedule for the implementation of the BHU action plan.	February 28, 2006	Observed.
Financial sector	Sell shares of NBC in amounts that yield managerial control to the private sector.	June 30, 2006	
Central Bank	Adopt plan to strengthen the central bank finances (outright capitalization or interest payment on government paper).	September 30, 2006	

PC= performance criterion; IT=Indicative target.
Sources: Ministry of Economy and Finance; and Central Bank of Uruguay.

1/ Modification requested to move approval date from June 30, 2006 to October 31, 2006.

TECHNICAL MEMORANDUM OF UNDERSTANDING

This memorandum presents the definitions of the variables included in the performance criteria and indicative targets and some structural performance criteria for the year 2006 annexed to the Memorandum of Economic and Financial Policies.

A. Quantitative Performance Criteria and Indicative Targets

1. **Cumulative floor on the overall balance of the combined public sector (indicative target).** The combined public sector comprises the non-financial public sector (NFPS) and the Central Bank (BCU). The NFPS comprises the central government,[1] the social security system (*Banco de Previsión Social, Caja Militar,* and *Caja Policial*), the local governments (*Intendencias*), the public enterprises (AFE, ANCAP, ANCO, ANP, ANTEL, INC, OSE, and UTE (including Salto Grande)). The below-the-line overall balance will be measured as the negative of the *sum* of: (a) the net financing of the NFPS[2] minus (b) the operating balance of the BCU.

> (a) The net financing of the NFPS would include the *sum* of: (i) increase in net claims of the domestic financial system on the NFPS (excluding government bonds and treasury bills); (ii) the increase in the net amount of NFPS bonds and treasury bills held outside the NFPS (excluding any debt issued for the capitalization of BCU and debt issued to finance the capitalization of the deposit insurance scheme up to a limit of US$20 million); plus (iii) external bank loans and external[3] supplier credits to the NFPS; plus (iv) the net increase in liabilities arising from the forward sale of NFPS assets; plus (v) the increase in net non-bank loans;[4] *minus* (vi) the net increase

[1] This includes the funds managed directly in the ministries (*Fondos de Libre Disponibilidad*).

[2] Excluding any cash outlays related to government guarantees (principal plus interest) on the BHU and BROU's fiduciary trusts notes; change in net debt associated with the assumption of financial liabilities of BHU and its recapitalization as part of its restructuring, and any cash inflows related to loan recoveries and sale of assets which were transferred from BHU to the government as the beneficiary in the restructuring; and the change in the net debt associated with the final outcome of the litigation/arbitration with the former shareholders of Banco Comercial.

[3] Based on the residency principle.

[4] Nonbank loans are defined in accordance with point No. 9 (a) (i) of the Fund's Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 6230-(79/140, August 3, 1979), as amended in 2000, but exclude those instruments listed in paragraph 1 (a) (i), (ii), (iii) and (iv) of this memorandum, and cover loans of the central government and public enterprises only.

of NFPS financial assets held by the NFPS outside the domestic financial system (including the loan component of the deposit insurance scheme); plus (vii) gross revenues from the sale of public assets (net of associated fees and commissions); plus (viii) all upfront payments related to future concessions (including the sale of mobile phone licenses); plus (ix) recoveries of financial assistance provided to the banking system.

(b) The operating balance of the BCU is defined as interest earnings on gross international reserves, as defined below, and other earnings including those on other foreign and domestic assets minus operating expenses, commissions paid, and interest paid on domestic and foreign debt administered by the BCU.

- The floor on the overall balance of the combined public sector will be adjusted downward for capital expenditure on identified projects in the period July 2006-June 2007.[5] The downward adjustment will be limited to the amount of gross revenues (net of any associated fees and commissions) from the sale of NBC (up to a limit of Ur$1,200 million)

2. **Cumulative floor on the primary balance of the combined public sector.** The combined public sector primary balance will be calculated as the overall balance measured from below the line plus interest payments. Interest payments are defined to exclude commissions and fees.

- The floor on the primary balance of the combined public sector will be adjusted downward (higher deficit) for capital expenditure on identified projects in the period July 2006-June 2007.The downward adjustment will be limited to the amount of gross revenues (net of any associated fees and commissions) from the sale of NBC (up to a limit of Ur$1,200 million).

3. **Cumulative floor on the extended primary balance of the combined public sector.** The combined public sector extended primary balance will be calculated as the primary balance of the combined public sector defined in paragraph 2 minus the change in the stock of floating debt of the central government. Floating debt of the central government is defined as expenditures from**:** the general treasury account ("Rentas Generales"), "Rentas de Afectación Específica", payment obligations with domestic suppliers for which external and domestic debt has been earmarked, investment funds of the Ministry of Transportation and Public Works, and own funds from agencies outside the budget (Casinos). It includes debt registered in the integrated information system (SIIF), and that has been authorized for execution and confirmed by the respective central accountants, and for which no checks for payment have yet been issued. Excluded are obligations for utilities, obligations related to

---

[5] Already identified projects include railway construction and dredging in the port of Montevideo. Further projects will be identified over the next few months and the TMU amended at the time of the next review to incorporate them.

subsidies (except for the forestry fund), judiciary debt and obligations falling under "*Inciso 24"* of the accounting plan of the *"Contaduria General de la Nacion"* (excluding debt with international organizations), domestic suppliers' credits of the Ministry of Housing, and overdue payments for wages and salaries (including all related labor benefits) of public sector contractual and permanent employees, provided such overdue payments do not exceed 10 days following the date on which payments are due.

- The floor on the extended primary balance of the public sector will be adjusted downward for capital expenditure on identified projects in the period July 2006-June 2007. The downward adjustment will be limited to the amount of gross revenues (net of any associated fees and commissions) from the sale of NBC (up to a limit of Ur$1,200 million).

4. **Cumulative ceiling on general government expenditure** applies to total (current and capital) non-interest expenditure of the central administration and the social security system (BPS) as recorded in the accounting system at the time that checks are delivered, a bank transfer is made, or the BCU notifies the receipt of a payment order.[6] The non-interest expenditure of BPS excludes benefit payments. The non-interest expenditure of the central administration includes *Fondos de Libre Disponibilidad* but excludes transfers to the social security system, automatic transfers to the private pension funds (AFAPs), and earmarked revenue as of December 31, 2004.

- The ceiling on general government expenditure will be adjusted downward for any expenses arising from pension adjustments, which exceed the increase in the legal minimum adjustment.

- The ceiling on general government expenditure will be adjusted upward for capital expenditure on identified projects in the period July 2006-June 2007, if those expenditure fall under this ceiling. The upward adjustment will be limited to the amount of gross revenues (net of any associated fees and commissions) from the sale of NBC (up to a limit of Ur$1,200 million).

5. **Cumulative ceiling on the monetary base (indicative target).** Money base is defined as the sum of (i) currency issue; (ii) nonremunerated and remunerated peso sight deposits of BROU, BHU, private banks, and other institutions defined below at the BCU; and (iii) call peso deposits of BROU, BHU, private banks, and other institutions at the BCU. Other institutions include pension funds (AFAPs), local governments, public enterprises, trust funds of the liquidated banks (FRPB), investment funds, offshore institutions (IFEs), insurance companies, exchange houses, stock brokers, and the nonfinancial private sector. The monetary base excludes central government and BPS peso deposits held at BROU subject to a 100 percent reserve requirement. The indicative target is defined as the cumulative change calculated using the monthly averages relative to the base month average.

---

[6] Expenditures by local governments are not included.

6. **Cumulative floor on the net international reserves (NIR) of the BCU.** NIR is defined as the difference between the gross international reserves and BCU reserve liabilities. Gross international reserves include all foreign exchange assets that are claims on non-residents and that are in the direct effective control of the BCU and are readily available for such purposes of the BCU as intervention or direct financing of payment imbalances. Such assets may be in any of the following forms, provided that they meet the test of effective control and ready availability for use: currency, bank deposits in nonresident institutions and government securities and other bonds and notes issued by nonresidents (with a rating not below “A” in the classification of Fitch and IBCA and Standard and Poor’s or “A2” in the classification of Moody’s). In addition, holdings of SDRs or of monetary gold would be included under gross international reserves (provided they meet the test of effective control and ready availability of use) as would the reserve position in the IMF, and liquid foreign assets set aside for the use of the government.

(a) Excluded from gross international reserves are all foreign currency claims arising from off-balance sheet transactions (such as derivatives instruments), capital subscriptions to international financial institutions, any assets in nonconvertible currencies, claims on any nonresident Uruguay-owned institutions, or any amounts (in all components of assets, including gold) that have been pledged in a direct or contingent way.

(b) BCU reserve liabilities include (i) all foreign currency-denominated liabilities of the BCU with original maturity of one year or less to residents and nonresidents (excluding government deposits); (ii) all certificates of deposit used to constitute reserve requirements against bank deposits; (iii) the total use of Fund credit by Uruguay; and (iv) any net position on foreign exchange derivatives vis-à-vis the peso with either residents or nonresidents undertaken directly by the BCU or by other financial institutions on behalf of the BCU, as measured in items II.2 and III.4 of the IMF’s Data Template on International Reserves and Foreign Currency Liquidity.

(c) For the purpose of the NIR calculation, (i) the gold holdings of the BCU will be valued at the accounting rate of US$42 per troy ounce; (ii) liabilities to the IMF will be valued at the rate of US$1.44946 per SDR; (iii) gains or losses from gold swaps and other operations will be excluded; and (iv) non-U.S. dollar denominated foreign assets and liabilities will be converted into U.S. dollars at the market exchange rates of the respective currencies as of September 30, 2005.

- The NIR floor will be adjusted upward (downward) by any excess (shortfalls in) net financing of the NFPS defined as the difference between the stock of debt of the NFPS, as defined in para. 8 but excluding central government foreign currency deposits in domestic commercial banks and excluding any liabilities to the Fund, and schedule A below, and which is not explained by the adjustments specified in para. 8, bullet 1 (i-ix). The downward adjustment of the NIR floor will be limited to US$400 million.

Schedule A (In millions of U.S. dollars)					
	Sept.-05	Mar.-06	Jun.-06	Sept. 06	Dec.-06
Stock of debt of the NFPS, excl. CG FX deposits in domestic commercial banks and Fund liabilities	10,136	10,530	10,706	10,828	10,884

7. **Cumulative ceiling on net domestic assets (NDA) of the BCU.** NDA is defined as the difference between end-of-period monetary base and net international reserves (NIR) of the BCU as defined in paragraphs 5 and 6. The flow of NIR will be valued at the accounting exchange rate of Ur$23.9 per US$1.

- The NDA ceiling will be adjusted downward (upward) by the Ur$ equivalent of any upward (downward) adjustment in the NIR target of the BCU.

8. **The overall nonfinancial public sector debt ceiling** refers to the outstanding stock of external debt[7] and domestic debt[8] measured on a *gross* basis[9] in domestic and foreign currency *owed or guaranteed by the NFPS*, valued in U.S. dollars at the accounting rates of Ur$23.9 per U.S. dollar, U.S. dollar 1.2026 per Euro, Yen113.46 per U.S. dollar, U.S. dollar 1.44946 per SDR, and Ur$1.4882 per UI. If the Ur$ to UI rate exceeds 1.5916 the UI debt will be valued at Ur$ 1.4882 plus the difference between the actual rate and Ur$1.5916. The debt ceiling will exclude (i) the government guaranteed note of BHU to BROU (with

[7] For the definition of external debt the term “debt” has the meaning set forth in point No. 9 of the Fund’s Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 6230-(79/140, August 3, 1979), as amended in 2000), and the term “external” is defined on the residency principle. The suppliers’ contracts of ANTEL with equipment providers Ericsson and NEC are expensed under goods and services as rental outlays and, therefore, excluded from the definition of nonfinancial public sector gross debt for program purposes.

[8] Domestic debt covers net claims of the domestic financial system on the NFPS; NFPS bonds and treasury bills held outside the NFPS and the domestic financial system; non-bank loans as defined in footnote 4; and lease arrangements of the central government and public enterprises, as defined in point No. 9 (a) (iii) of the Fund’s Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 6230-(79/140, August 3, 1979), as amended in 2000.

[9] Debt outstanding with the domestic financial system (excluding BCU) will be measured net of gross deposits.

outstanding obligations estimated at US$500.8 million at end-September 2005) and the government guaranteed notes issued by the fiduciary trusts associated with the transfer of BROU's nonperforming loans (with outstanding obligations estimated at US$400 million at end-September 2005); and (ii) net debt of the NFPS with the BCU. It will include the total stock of Fund credit outstanding to Uruguay.

- The NFPS debt ceiling will be adjusted (i) upward (downward) by revisions made to the actual nonfinancial public sector gross debt stock at end-September 2005; (ii) upward by a maximum of US$500 million for the amount of debt issued to recapitalize the BCU; (iii) upward by a maximum of US$133 million (downward) for the cumulative reduction (increase) in the net credit position of public enterprises with the BCU; (iv) upward by a maximum of US$150 million for the costs associated with the final outcome of the arbitration/litigation to the former shareholders of Banco Comercial; (v) upward by a maximum of US$82 million for debt issued to finance below-the-line operations of public enterprises (such as recapitalization of ANCAP's subsidiary abroad); (vi) upward by BHU restructuring costs related to the assumption of financial liabilities or capitalization up to a limit of US$1 billion; (vii) upward by a maximum of US$40 million for the amount of debt issued to onlend to the deposit insurance scheme; (viii) for capital expenditure on identified projects in the period July 2006-June 2007, up to a limit of US$50 million; (ix) downward by the amount of gross revenues (net of any associated fees and commissions) (excluding receipts in form of shares) from the sale of NBC; and (x) upward (downward) by the amount that the unadjusted NIR floor is exceeded (falls short) with the upward adjustment limited to the amount of the upward revision of the NIR target, up to a limit of US$500 million;

9. **External payments arrears of the public sector** are defined on the residency principle and relate to public sector debt with foreign creditors. This performance criterion is monitored on a continuous basis.

B. Structural Performance Criteria

10. **Continuous performance criterion on the timely service of bank restructuring debt to BROU in accordance with the current payment schedule**. The bank restructuring debt to BROU includes the notes to BROU guaranteed by the government and issued by the BHU and the fiduciary trusts that own and manage the nonperforming loans formerly on the books of BROU. Timely service is defined as the payment of agreed principal and interest by the BHU, the trusts, or the government in accordance with the timetable (and no later than the 10th of the subsequent month) and terms presented in Schedule B.

Schedule B. Scheduled Service of Bank Restructuring Debt to BROU
(In millions of U.S. dollars)

	BHU Note				Fiduciary Trusts 1/			
	Service			Balance 2/	I	II	III	Balance 2/
	Principal	Interest 3/	Total		Service			
2005 M 09	0.8	0.9	1.7	500.8				
2005 M 10	0.8	0.9	1.7	499.9				
2005 M 11	0.8	0.9	1.7	499.1				
2005 M 12	0.8	0.9	1.7	498.2	82.2	5.3	8.9	254.2
2006 M 01	1.3	0.9	2.2	497.0				
2006 M 02	1.3	0.9	2.2	495.7				
2006 M 03	1.3	0.9	2.2	494.4				
2006 M 04	1.3	0.9	2.2	493.1				
2006 M 05	1.3	0.9	2.1	491.9				
2006 M 06	1.3	0.9	2.1	490.6	81.6	5.3	8.9	158.4
2006 M 07	1.3	0.9	2.1	489.3				
2006 M 08	1.3	0.9	2.1	488.1				
2006 M 09	1.3	0.9	2.1	486.8				
2006 M 10	1.3	0.9	2.1	485.5				
2006 M 11	1.3	0.9	2.1	484.3				
2006 M 12	1.3	0.9	2.1	483.0	81.0	5.3	8.8	63.4
2007 M 01	1.7	0.9	2.6	481.3				
2007 M 02	1.7	0.9	2.6	479.6				
2007 M 03	1.7	0.9	2.5	477.9				
2007 M 04	1.7	0.9	2.5	476.2				
2007 M 05	1.7	0.8	2.5	474.5				
2007 M 06	1.7	0.8	2.5	472.8	40.4	2.5	6.3	14.2
2007 M 07	1.7	0.8	2.5	471.1				
2007 M 08	1.7	0.8	2.5	469.4				
2007 M 09	1.7	0.8	2.5	467.7				
2007 M 10	1.7	0.8	2.5	466.0				
2007 M 11	1.7	0.8	2.5	464.3				
2007 M 12	1.7	0.8	2.5	462.6	8.1	0.3	5.8	0.0
2008 M 01	2.1	0.8	2.9	460.5				
2008 M 02	2.1	0.8	2.9	458.4				
2008 M 03	2.1	0.8	2.9	456.3				
2008 M 04	2.1	0.8	2.9	454.2				
2008 M 05	2.1	0.8	2.9	452.1				
2008 M 06	2.1	0.8	2.9	449.9				

1/ Fiduciary trusts that own and manage the debt formerly on the books of BROU.
2/ Estimated balance of outstanding principal and interest obligations.
3/ Estimate. The contractual interest rate is the 60-day U.S. dollar-denominated time deposit rate of BROU plus 50 basis points, and is revised on June 30 and December 31 every year based on the rate prevailing on that date.

11. **Restructuring and Recapitalization of BHU.** The government will transfer ownership and management responsibility of nonperforming loans[10] in BHU to a fideicomiso (fiduciary trust).[11] The MEF will assume sufficient liabilities from BHU to recapitalize it to a level satisfactory to the Superintendency of Banks (August 31, 2006).

12. **Transform BHU into an institution with a viable business plan and a strong regulatory framework**. The government will transfer ownership and management responsibility of remaining problem assets[12] in BHU to a fideicomiso.[11] The government will review the regulatory framework, and modify it if needed, to ensure that BHU's business is limited to residential mortgage lending on a commercial basis. BHU will meet all prudential limits and adapt a business plan satisfactory to the Bank Superintendency that demonstrates BHU's ability to generate positive cash flows and profits, and maintain prudential capital and meet prudential regulations going forward (November 30, 2006).

[10] Nonperforming loans are defined to include those that are 90 days or more past due (except those that have been serviced over the last 12 months). Loans that have been serviced over the last five months could remain in BHU, but would be transferred to the fideicomiso if there are any interruptions in service.

[11] The MEF will be the grantor and beneficiary of the fideicomiso. The trustee (different from BHU) will be given the mandate and incentives to maximize the net present value of fideicomiso assets.

[12] Remaining problem assets are defined to include real estate associated with all nonperforming promitentes compradores and those that are performing but that have title problems.