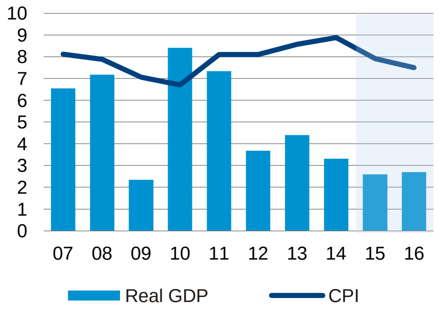
Deutsche Bank
Research

Uruguay

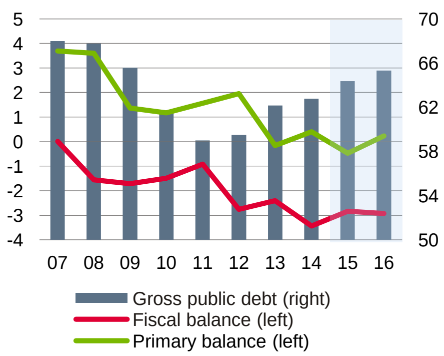
Frontier country report | October 12, 2015

Growth slowed down 1



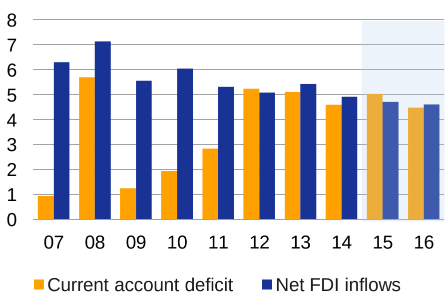
Source: IMF, Deutsche Bank Research

Public finances deteriorated 2



Sources: IMF, Deutsche Bank Research

Current account deficit is matched by net FDI inflows 3



Sources: IMF, EIU, Deutsche Bank Research

Economic growth has slowed down

Real GDP contracted by 0.1% yoy in Q2 2015, from an annual average growth rate of 5.4% over the last decade. We expect real GDP growth to remain below 3% this and next year (chart 1). As a commodity exporter (65% of exports are food items such as soy beans and meat) Uruguay also faces lower growth potential absent structural reforms. Further headwinds are decelerating growth in China and economic troubles in Brazil and Argentina, its largest trading partners.

Inflation remains above target

Despite lower energy prices (oil accounts for 16% of total imports), inflation remained close to double-digit numbers this year and ticked up to 9.5% yoy in August (target band: 3%-7%). Wage indexation and unanchored inflation expectations (at 9.2% for 2015, according to a central bank survey in August) drive above-target inflation, but pressures this year also stemmed from faster currency depreciation (19.8% YTD).

Financial dollarisation remains high

More than 80% of deposits in the banking sector and close to 60% of credit is denominated in foreign currency (as of July 2015). A quarter of foreign-currency denominated deposits are held by foreigners.

Public finances deteriorated

Gross public debt was at 64% in 2014, which is high compared to the region and to peers. Public debt dynamics started to worsen in 2012 on the back of deteriorating primary and total fiscal balances (chart 2). Other contributing factors have been lower growth and peso depreciation (around half of central government debt is FX-denominated). Nevertheless, prudent debt management has brought down the share of FX-denominated debt from 89% in 2004 and lengthened the average maturity of government debt to 15.5 years currently (as of Q2) from 7.4 years in 2004. We expect some fiscal consolidation under the new Vázquez administration which took office in March 2015.

Healthy external risk profile

External debt is moderate at 44% of GDP as of 2014. The current account deficit was relatively high at 4.6% of GDP last year, but was matched by high net FDI inflows, a trend that we expect to continue over this and next year (chart 3). FX reserves have declined by 8% over the last 4 months due to higher FX intervention. Nonetheless, external financing requirements are low at below 50% of FX reserves.

Political stability and good governance indicators

The Uruguayan middle class has increased rapidly as GDP per capita rose from USD 5,200 to above USD 16,000 in the last decade. Comparatively low levels of poverty and income inequality from a regional perspective as well as good governance indicators bode well for stability. Former president Vázquez won a second time in office last year and will likely continue sound macroeconomic policies. His political party Broad Front holds a majority in both chambers of Congress.

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