URUGUAY

Table 1	2020
Population, million	3.5
GDP, current US$ billion	54.7
GDP per capita, current US$	15752.3
International poverty rate ($1.9)[a]	0.1
Lower middle-income poverty rate ($3.2)[a]	0.5
Upper middle-income poverty rate ($5.5)[a]	3.2
Gini index[a]	39.7
School enrollment, primary (% gross)[b]	106.0
Life expectancy at birth, years[b]	77.8

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2019), 2011 PPPs.
(b) Most recent WDI value (2018).

Despite a 5.8 percent GDP contraction in 2020, Uruguay is poised for a rebound of over 3 percent in 2021 and 2022. While immediate fiscal consolidation plans were postponed, the Government's commitment to fiscal sustainability is reflected in the reduction of non COVID-19 expenditures and the adoption of a fiscal rule. The country's existing social safety net protected the most vulnerable from the economic downturn, but risks lie on the downside, notably from the closing of borders to foreign tourism.

Key conditions and challenges

The COVID-19 outbreak put an end to Uruguay's longest consecutive economic growth and poverty reduction period that had lasted for 17 years. In this period, the country's strong institutions were buttressed by prudent macroeconomic and fiscal management and trade diversification. Along with favorable external conditions, this generated substantial gains in economic growth and inclusion. In the process, the country achieved high-income status and its debt was classified as investment grade. Over time, the growth engines however began showing signs of exhaustion, with an average annual GDP growth rate of 0.9 percent since 2015 and a slowdown in poverty reduction. This trend brought GDP growth practically to a halt in 2019.

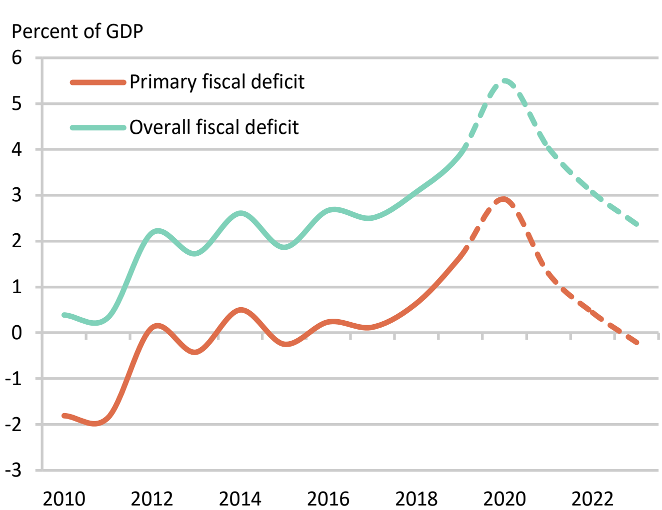
Uruguay's relatively effective handling of the pandemic did not prevent a sharp economic contraction in 2020. An effective containment strategy and the social safety net reinforced by emergency measures initially kept contagion under control, limited the economic impact on the most vulnerable, and allowed for a gradual reopening and economic recovery. In November, following an increase in COVID-19 cases, the Government closed borders to foreign tourism, a key driver of economic activity in the summer season. GDP fell an estimated 5.8 percent in 2020, larger than originally envisioned, but still among the mildest in the region.

The COVID-19 shock postponed the Government's immediate fiscal consolidation plans, seen as a precondition to increase potential growth. Yet, the Government advanced reforms to tackle long-standing structural growth bottlenecks. Most salient reforms are reflected in the Urgent Consideration Law, including the implementation of a fiscal rule, a plan to boost competitiveness that includes SOE reform, a call for a comprehensive pension reform, and a reform to the education system. The new Central Bank (CB) administration announced a new monetary framework, including a narrower inflation target range. Many of the details of these policies are still pending and the short-term outlook for Uruguay is subject to considerable risks, mainly tied to the evolution of the pandemic.

Recent developments

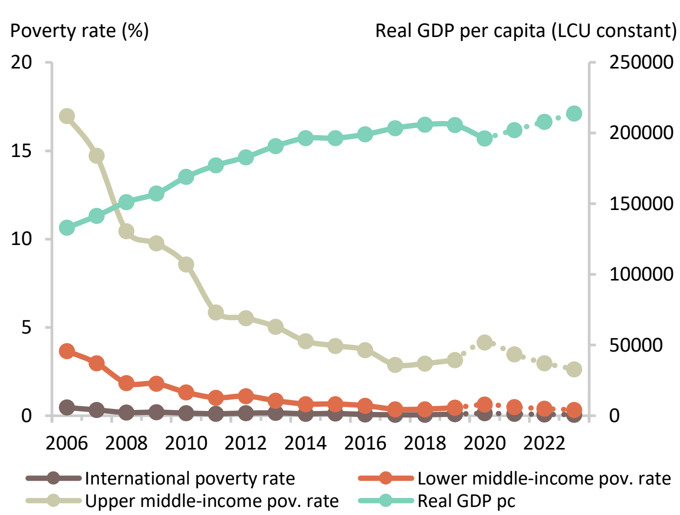
Economic activity fell sharply in the first half of 2020, led by sectors sensitive to social distancing, such as hospitality and retail. The CB issued new (rebased) national accounts, which resulted in higher GDP levels (9 percent on average for 2016-2019), but lower growth for the last 3 years (an average of -0.7pp per year). According to the new national accounts, GDP recovered 7.8 percent in 2020Q3 (qoq) favored by regained mobility, but it was still 5.8 percent below its previous peak. Acceleration in the spread of the pandemic in 2020Q4 and renewed containment measures buffered the prospects

FIGURE 1 Uruguay / Actual and projected primary and overall fiscal deficits



Sources: Ministry of Economy and Finance, Central Bank of Uruguay and World Bank staff calculations.

FIGURE 2 Uruguay / Actual and projected poverty rates and real GDP per capita



Sources: World Bank. Notes: see Table 2.

of a stronger recovery. Yet, labor participation recovered to 61.3 percent in December (from 57.7 percent in April) and the employment rate increased from 52.1 to 54.9 percent in the same period.

The current account deteriorated due to investments in an ongoing US$3bn paper mill project (UPM 2) and related import demand, coupled with a sharp fall in exports. The initial depreciation of the peso triggered a temporary rise in inflation that subdued once the exchange rate stabilized. Still, average inflation in 2020 reached 9.8 percent, its highest record since 2003. The CB shifted its policy focus from monetary aggregates to the interest rate, announced a tighter monetary policy stance once growth resumes, and lowered the inflation target range to 3-6 percent.

The COVID-19 shock postponed earlier plans for fiscal consolidation. The fiscal deficit grew from 3.9 percent of GDP in 2019 to 5.5 percent of GDP in 2020, due to lower revenues and COVID-19-related expenditures. A real reduction in public wages and capital expenditures, and exceptional taxes raised on public-sector high earners, helped mitigate the fiscal gap and signaled Government's continued commitment to fiscal prudence.

The existing social protection system and the Government's emergency measures mitigated COVID-19-related negative effects on labor income and welfare. Flexibilization of the unemployment insurance scheme has prevented households in the middle of the distribution from falling into vulnerability. Welfare losses in the lower end of the distribution were partly contained by increases in the benefit amounts of existing transfers, and a new transfer targeting informal workers not covered by other programs. Overall, 35,000 people are expected to have fallen under the international upper middle-income poverty line (from 3.2 in 2019 to 4.2 percent in 2020).

Outlook

The late COVID-19 flare-up and its effects on tourism lowered expectations of a strong economic recovery and emphasized the downside risks. However, the expected recovery in external demand conditions and domestic absorption results in a projected 3.4 percent GDP growth in 2021, with quarterly GDP reaching its pre-pandemic level in late 2021. The UPM 2 project is expected to contribute significantly to GDP growth through 2023, during construction and once operational. It will contribute to a larger current account deficit for the next two years, but is expected to boost exports starting in 2023. GDP growth is expected to gradually converge down to 2.5 percent by 2023, by when a stronger anti-inflationary stance is expected to bring inflation down.

The fiscal consolidation plan for 2021 in the quinquennial budget will be eased, given the deeper and longer than anticipated effects of the pandemic. Still, the fiscal deficit is expected to fall to 4 percent of GDP in 2021 and continue to improve going forward in the context of the newly enacted structural fiscal rule, based on the phasing out of COVID-19-related expenditures, stronger economic growth, and efficiency gains. A primary surplus is projected in the forecast horizon. A pension reform, currently under discussion by a multi-party technical committee, will also shape the longer-term fiscal prospects.

Despite a recovery in labor market performance in 2020Q3, the tourism-season shock is expected to deteriorate employment conditions. Recovery dynamics in labor-intensive sectors that fell behind overall economic activity may contribute to increased vulnerability and inequality, and prevent poverty from returning to pre-pandemic levels in 2021. Unemployment among women has been increasing since the onset of the pandemic and may continue this trend if difficult conditions in the hospitality industry persist.

TABLE 2 Uruguay / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	0.5	0.3	-5.8	3.4	3.1	2.5
Private Consumption	2.1	0.5	-5.6	2.4	2.1	1.4
Government Consumption	2.6	0.2	1.9	0.3	-0.4	0.6
Gross Fixed Capital Investment	-9.0	-1.7	-0.3	5.3	5.6	5.6
Exports, Goods and Services	-1.7	6.3	-13.0	11.1	7.9	3.3
Imports, Goods and Services	0.0	1.5	-5.9	8.5	5.6	1.5
Real GDP growth, at constant factor prices	0.4	0.6	-5.8	3.4	3.1	2.5
Agriculture	4.5	1.3	-5.8	4.0	3.1	2.5
Industry	5.8	-2.2	-6.0	4.5	3.9	2.0
Services	-0.7	1.0	-5.8	3.2	3.0	2.6
Inflation (Consumer Price Index)	7.6	7.9	9.8	7.5	6.9	6.3
Current Account Balance (% of GDP)	0.0	0.9	-0.5	-1.4	-0.7	-0.6
Net Foreign Direct Investment (% of GDP)	4.4	4.5	5.4	5.6	4.9	4.8
Fiscal Balance (% of GDP)[a]	-3.1	-3.9	-5.5	-4.0	-3.1	-2.4
Debt (% of GDP)	55.5	56.7	66.3	67.7	67.3	64.8
Primary Balance (% of GDP)[a]	-0.6	-1.7	-2.9	-1.3	-0.4	0.2
International poverty rate ($1.9 in 2011 PPP)[b,c]	0.1	0.1	0.1	0.1	0.1	0.1
Lower middle-income poverty rate ($3.2 in 2011 PPP)[b,c]	0.4	0.5	0.6	0.5	0.4	0.3
Upper middle-income poverty rate ($5.5 in 2011 PPP)[b,c]	3.0	3.2	4.2	3.5	3.0	2.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Non-Financial Public Sector. Excluding revenues associated with the "cincuentones".

(b) Calculations based on SEDLAC harmonization, using 2013-ECH, 2018-ECH, and 2019-ECH.Actual data: 2019. Nowcast: 2020. Forecast are from 2021 to 2023.

(c) Projection using point-to-point elasticity (2013-2018) with pass-through = 1 based on GDP per capita in constant LCU.