

The Fiscal and Monetary History of Uruguay (1960-2010)

First draft

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- 1. An economic perspective of the Uruguayan history**
2. Stylized facts
3. Concluding remarks
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A general overview of the 20th century

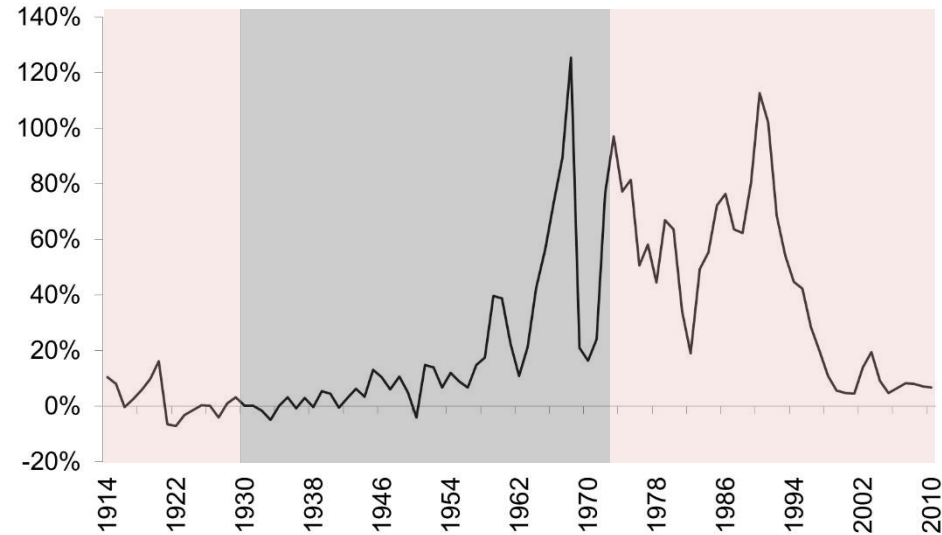
GDP per capita: Uruguay respect to average of Denmark and Finland (1870-2003)

Source: The Maddison-Project



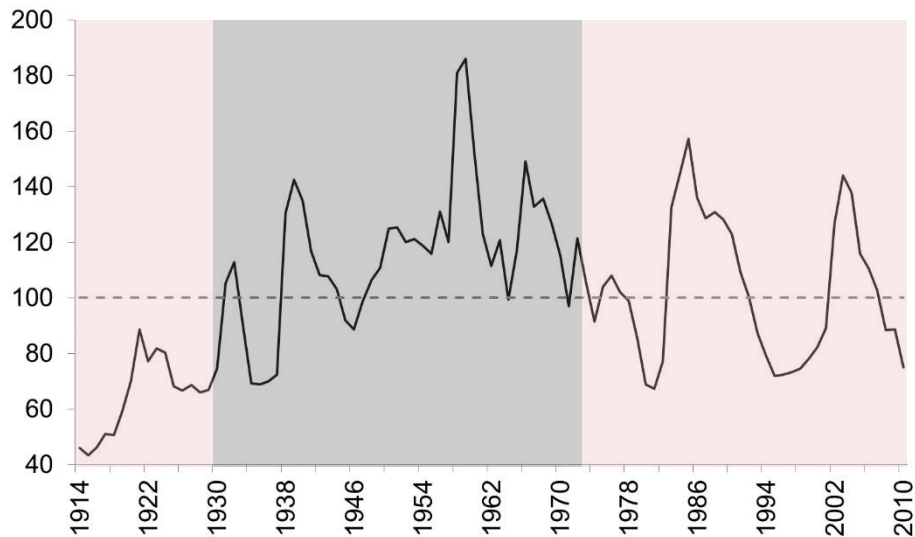
Inflation

Source: National Institute of Statistics



Real Exchange Rate with the U.S. (Index 100 = average 1913-2014)

Source: Diego Aboal (2003). Equilibrium Real Exchange Rate in Uruguay.



Central Government Overall Fiscal Balance

Source: Institute of Economics - Universidad de la República; Ministry of Economy and Finance

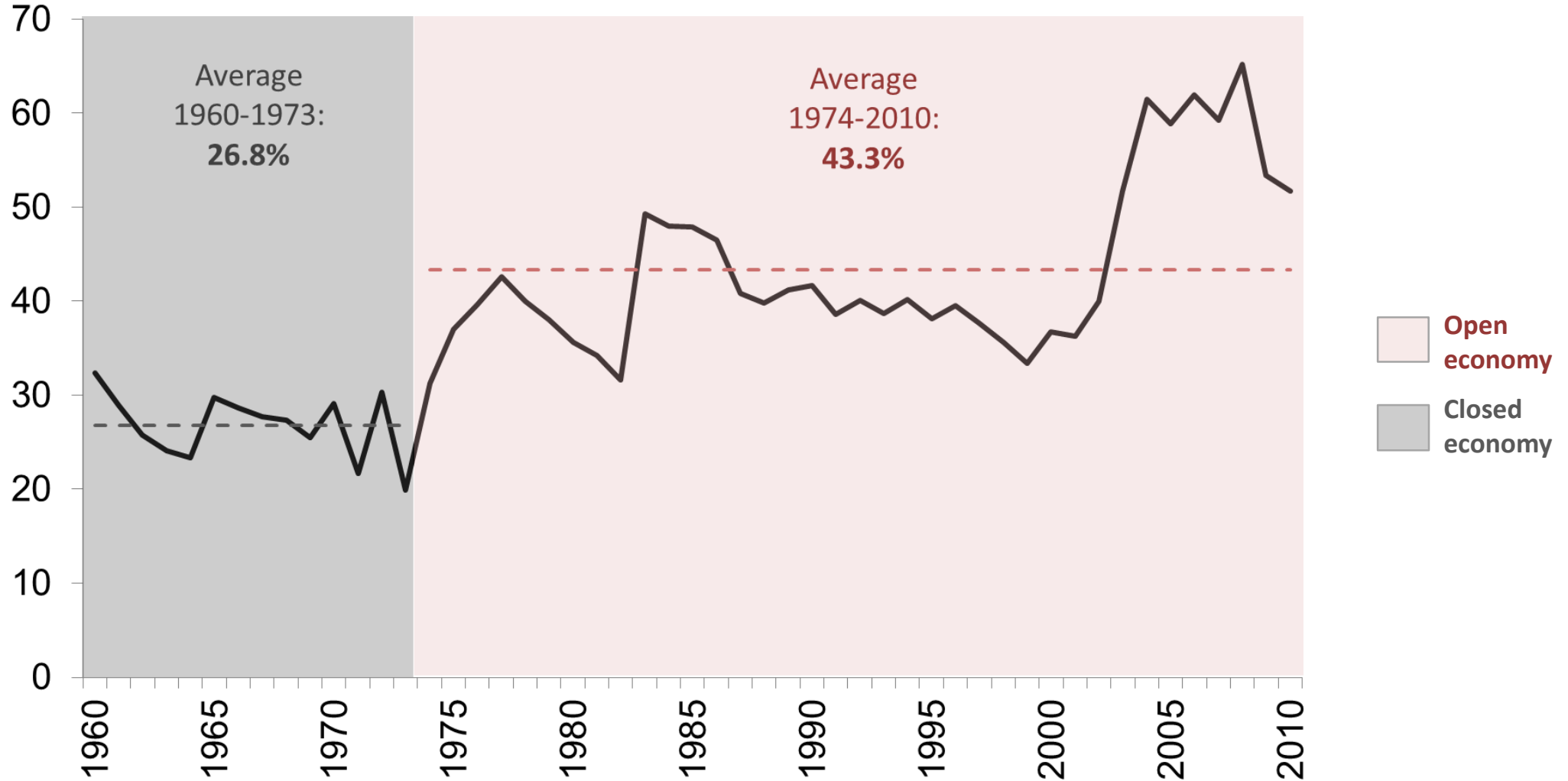


- Open economy
- Closed economy

From a closed to an open economy

Exports and imports of goods and services (% GDP)

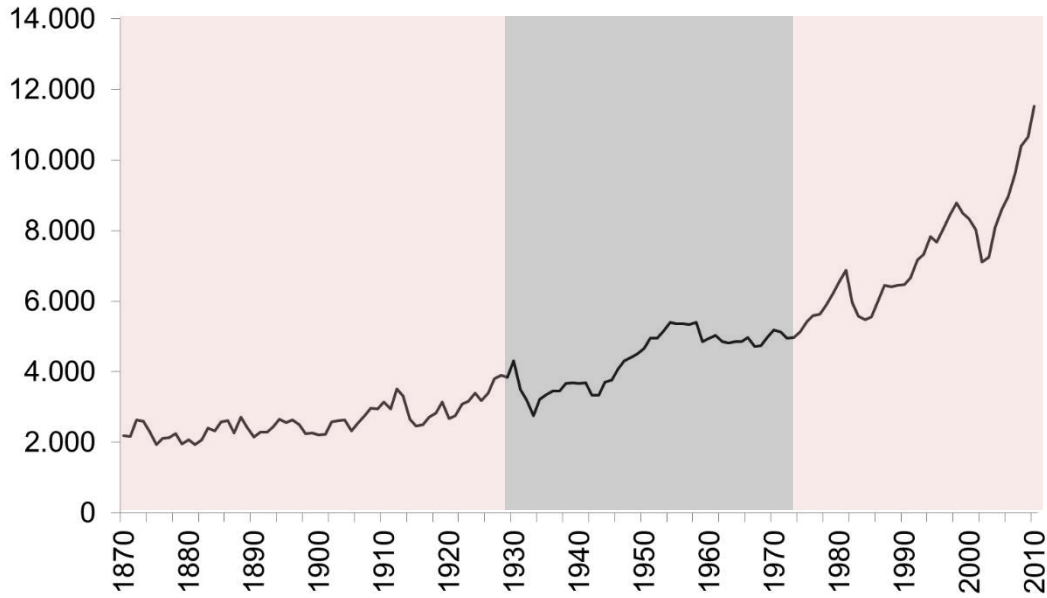
Source: World Bank



Low growth versus high volatility

GDP per capita (1990 Int. GK\$)

Source: *The Maddison-Project*



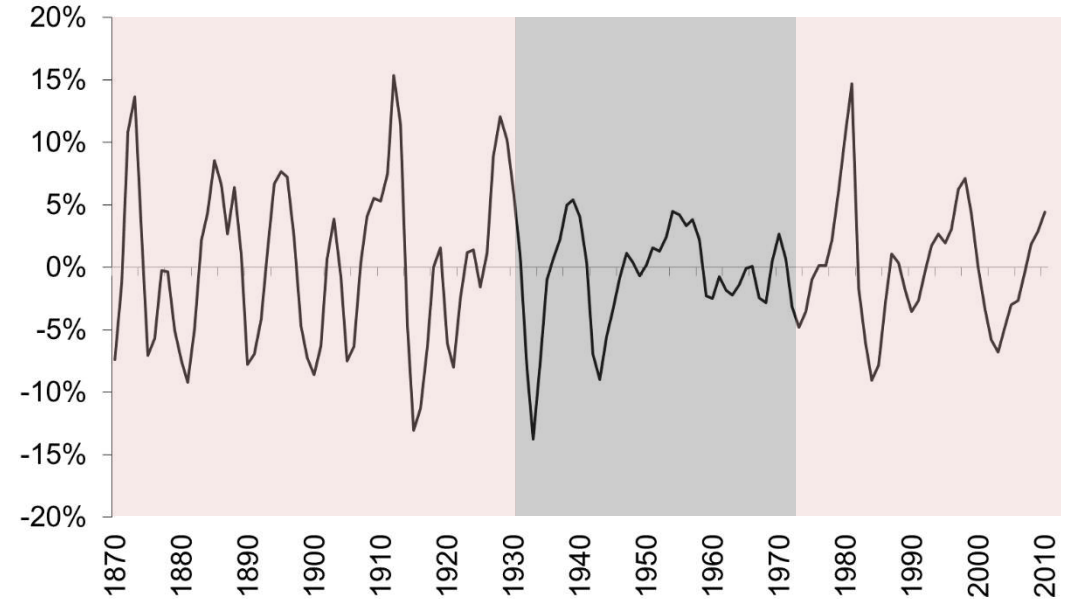
Growth
1870-1930:
1.6%

Growth
1931-1973:
0.5%

Growth
1974-2010:
2.4%

GDP per capita: Ratio cycle-trend (%)

Source: *own elaboration based on The Maddison-Project*



Standard deviation
1870-1930:
6.8%

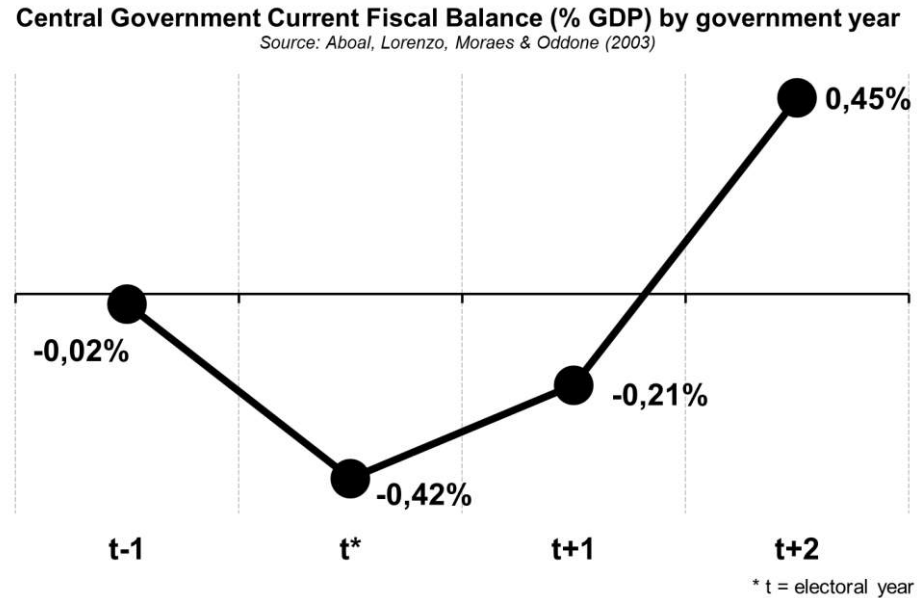
Standard deviation
1931-1973:
4.1%

Standard deviation
1974-2010:
5.0%

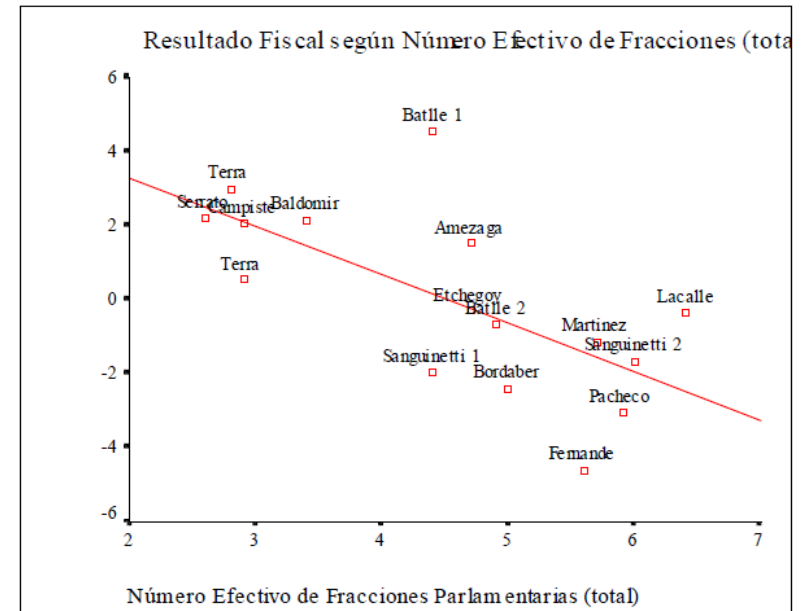
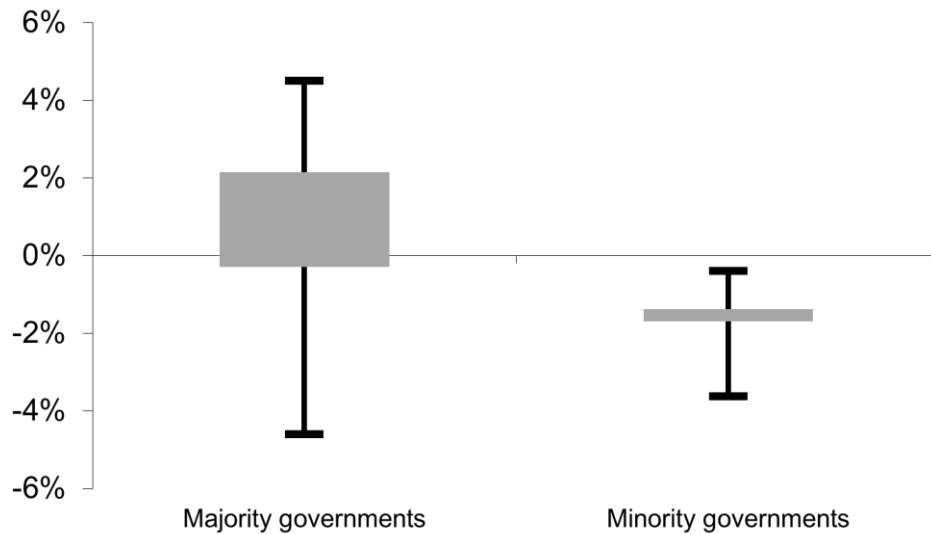
Open economy

Closed economy

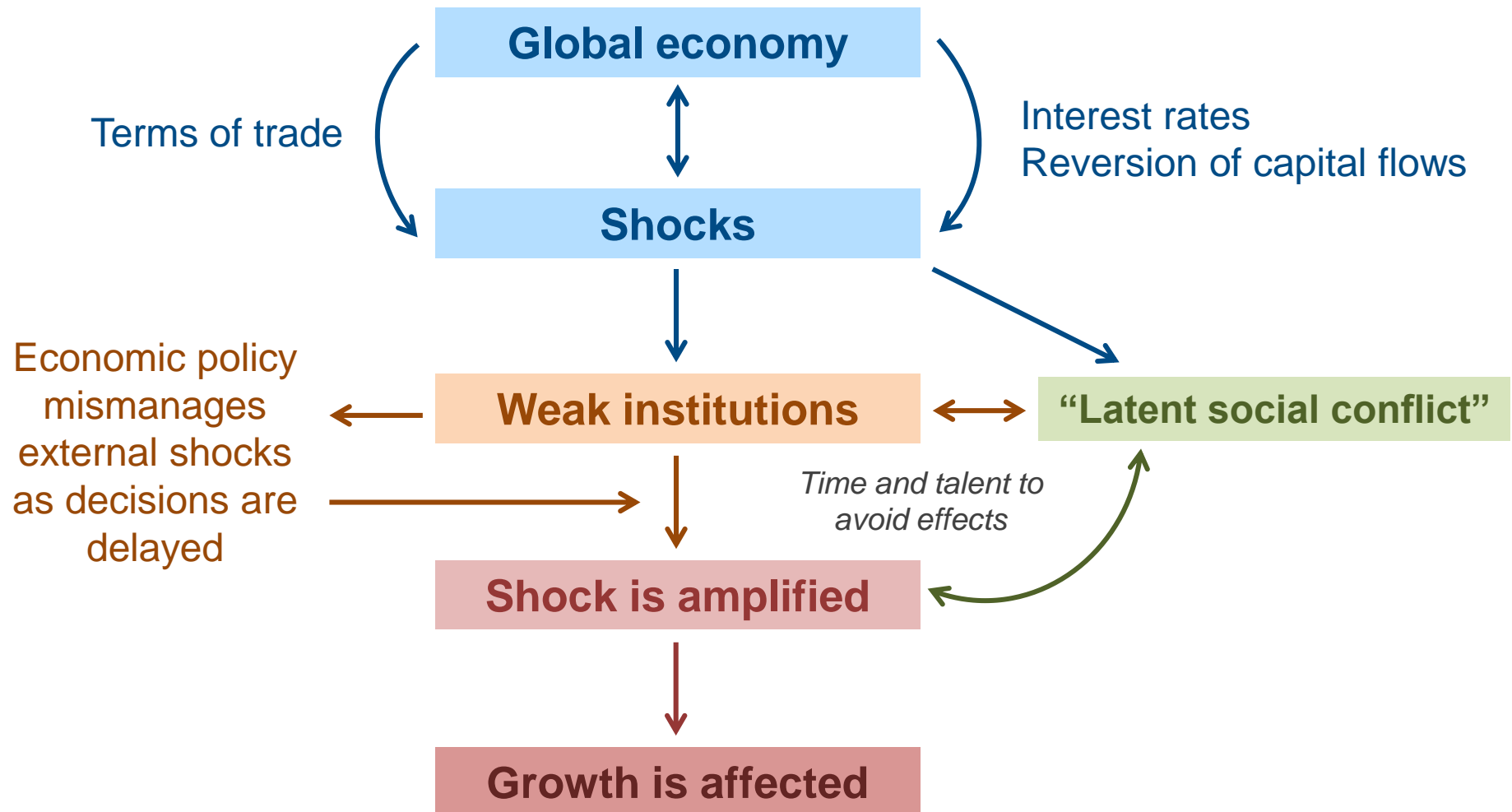
Political cycles, pro-cyclical policies and difficulties for stabilizing



Fiscal balance by majority and minority governments 1920 - 2014 (% GDP)
 Source: Aboal, Lorenzo, Moraes & Oddone (2003)



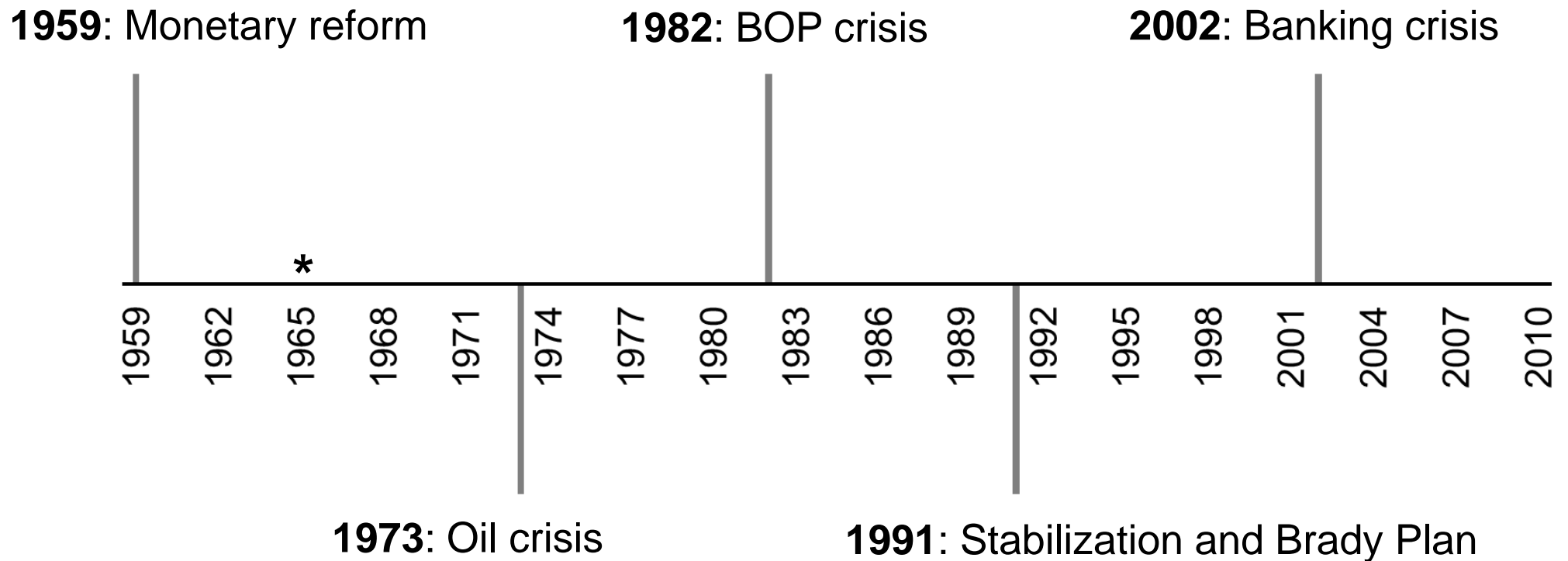
External shocks and weak institutions



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Milestones in the 1960-2010 period



* 1965: Banking crisis

Historical episodes

1960-1973: Stagflation

1974-1982: Opening, stabilization failed and BOP crisis

1983-1990: Democratic recovery and economic transition

1990-2002: New stabilization strategy, more opening and banking crisis

2003-2010: Vigorous recovery and fiscal strengths

	GDP p.c. growth	GDP p.c. cyclical volatility	Overall fiscal balance (% GDP)	Inflation	Total Public Debt (% GDP)	RER with the U.S. (100 = avg. 1913-2014)
	<i>average</i>	<i>SD of ratio cycle-trend</i>	<i>average</i>	<i>average</i>	<i>average</i>	<i>average</i>
1960-1973	0,2%	1,9%	-2,0%	51%	26%	122,0
1974-1982	2,2%	6,2%	-2,6%	55%	31%	89,3
1983-1990	1,1%	3,7%	-2,5%	71%	82%	135,1
1991-2002	0,9%	3,9%	-1,9%	33%	46%	87,0
2003-2010	6,2%	3,9%	-1,8%	9%	73%	107,9

Sources: The Maddison-Project; IECON - Institute of Economics; INE - National Institute of Statistics; Aboal (2013)

Stagflation: 1960-1973

1959: Monetary reform

1982: BOP crisis

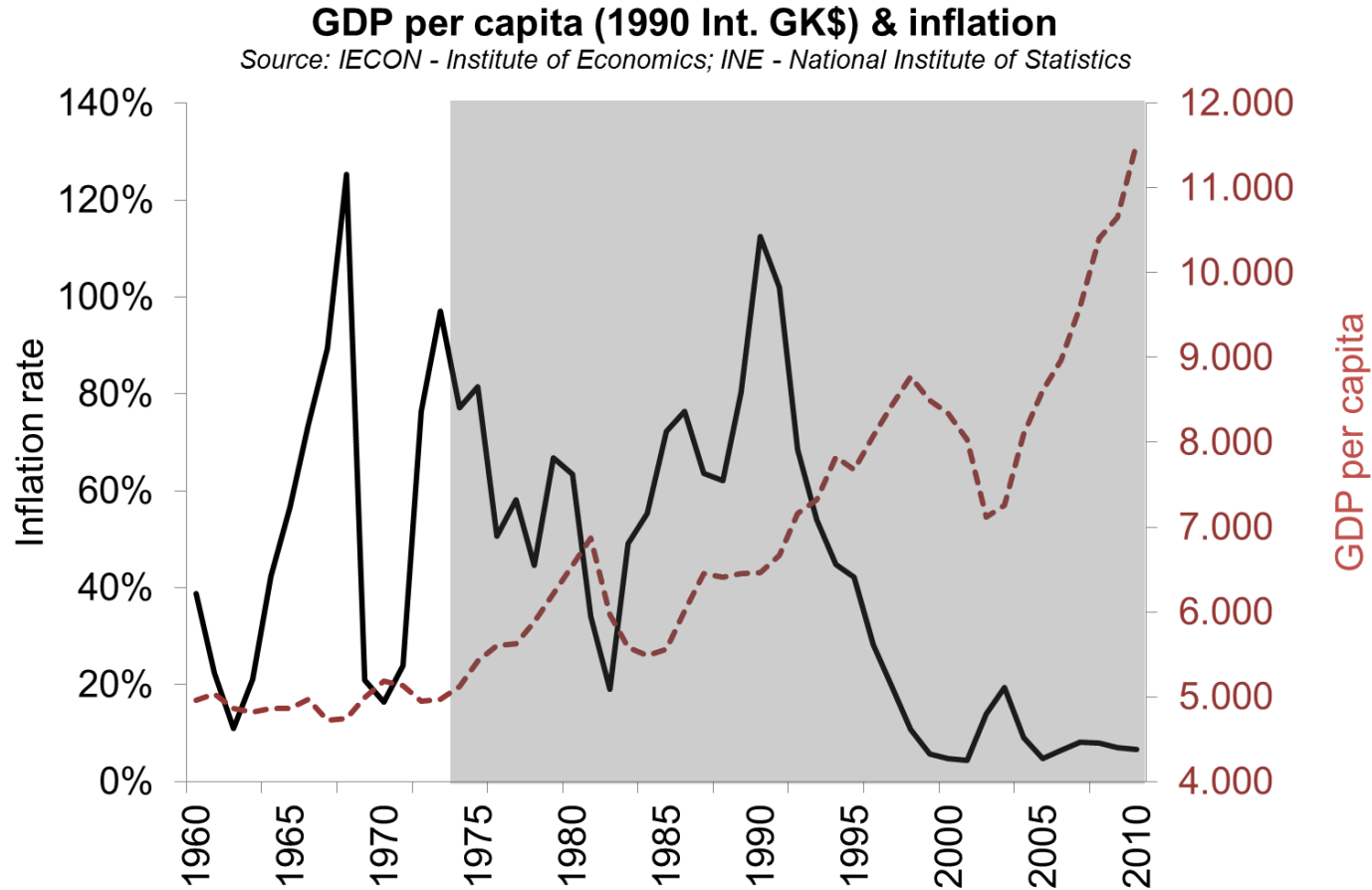
2002: Banking crisis



1973: Oil crisis

1991: Stabilization and Brady Plan

Stagflation: 1960-1973

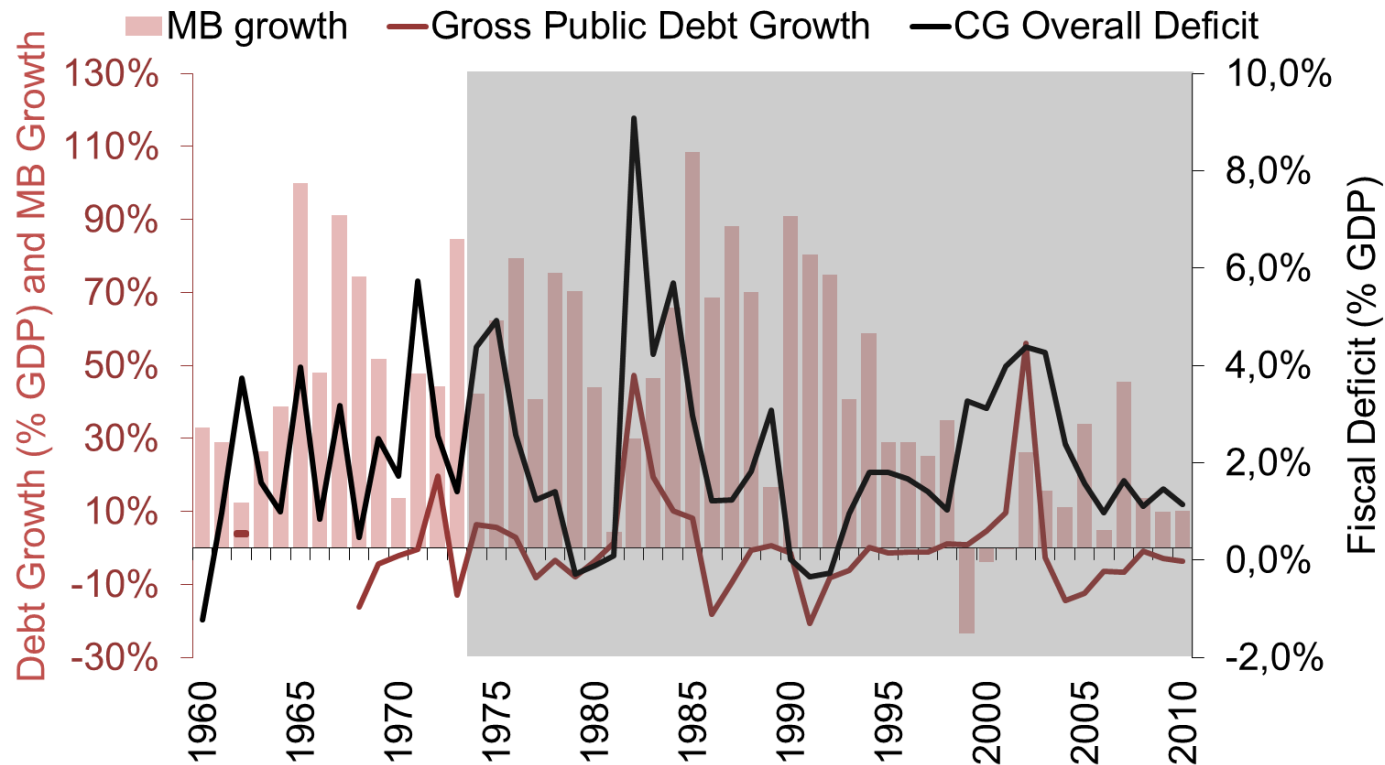


Between 1960 and 1973, stagflation caused a **deep social and political** crisis that led to the fall of the democratic government in 1973.

Stagflation: 1960-1973

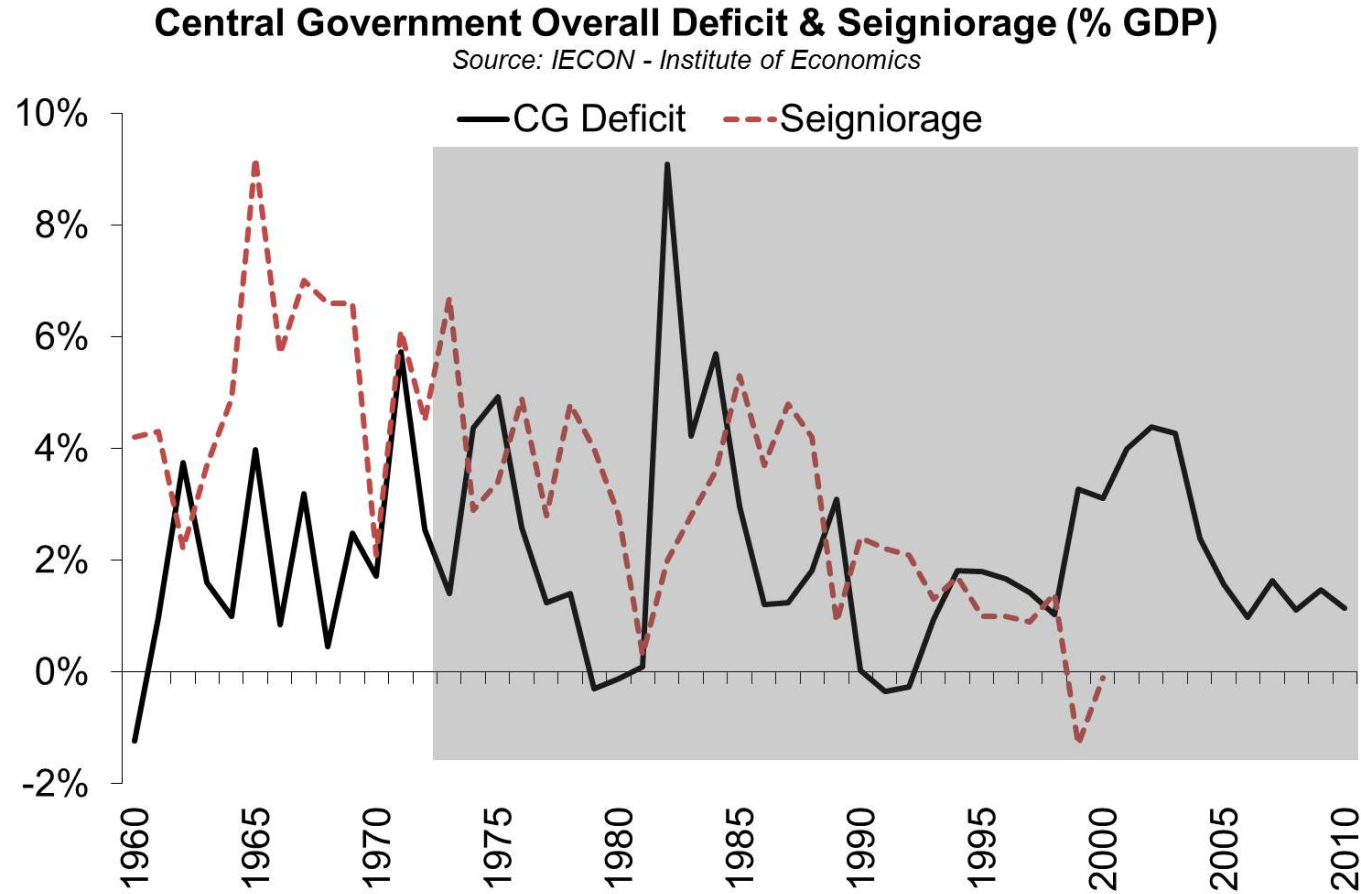
Gross Public Debt Growth, Central Government Overall Fiscal Deficit & Monetary Base Growth

Source: IECON - Institute of Economics



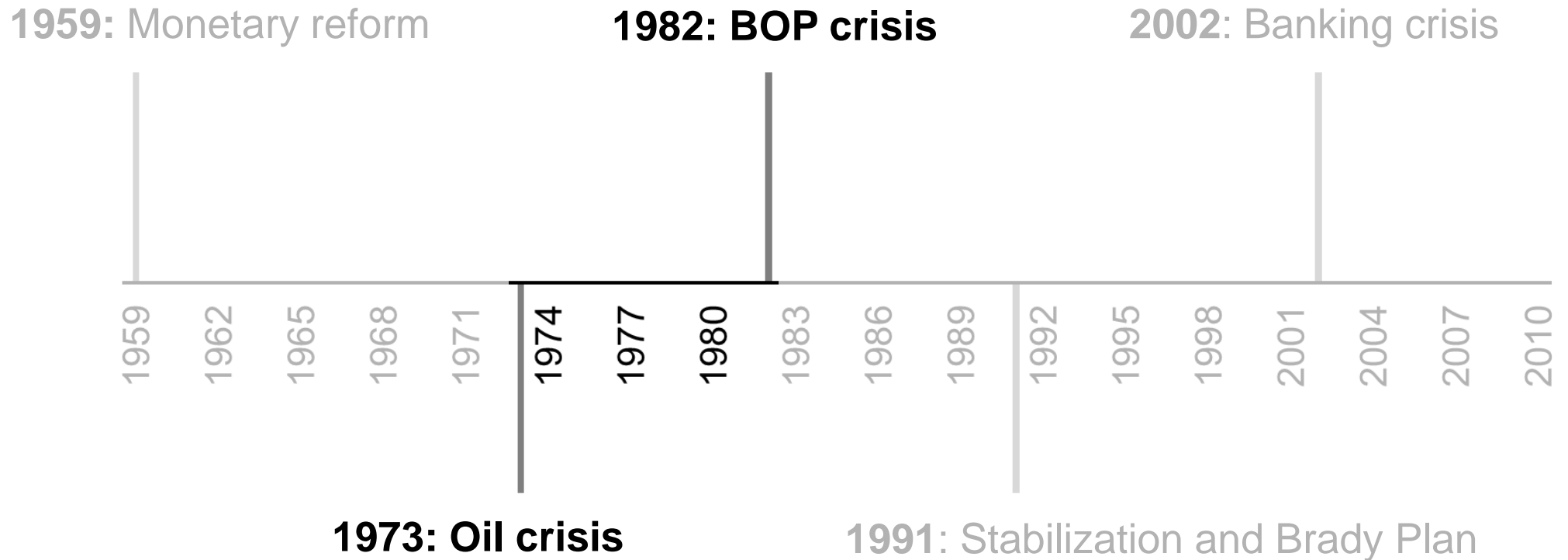
During the 1960s, public debt was not a tool to finance **fiscal deficits**. **Monetary expansions** were the way to finance them.

Stagflation: 1960-1973



As a result, **seigniorage** was important.

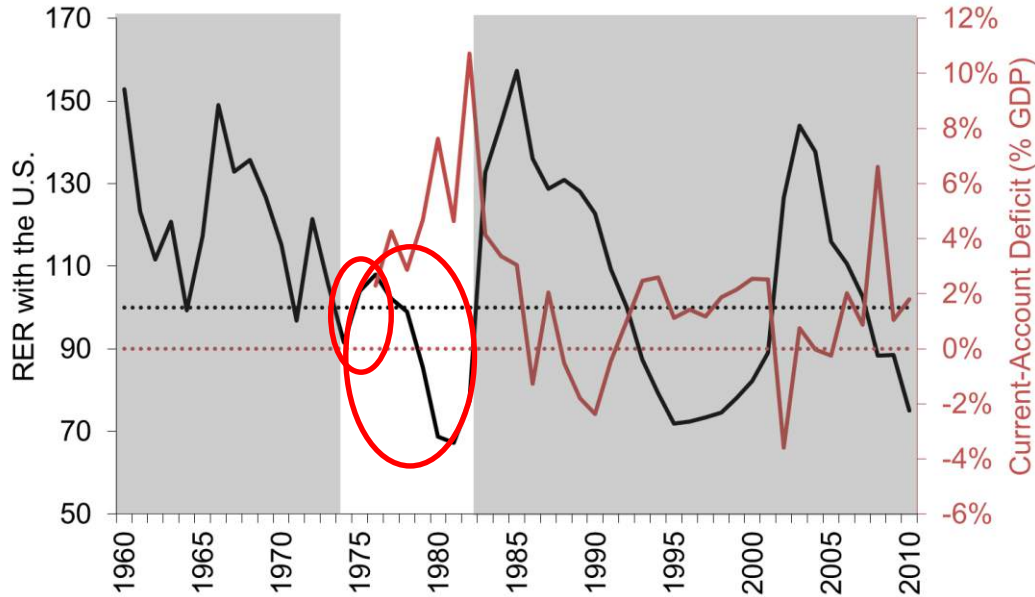
Opening, stabilization failed and BOP crisis: 1974-1982



Opening, stabilization failed and BOP crisis: 1974-1982

Current-Account Deficit & RER with the U.S. (100 = avg. 1913-2014)

Source: CINVE; Central Bank of Uruguay; Aboal (2003)



1974-1977: Trade opening, export promotion and “rebuilding of private profitability” as a response to the oil shock.

1978-1982: Financial liberalization, stabilization with a failing exchange-rate anchor due to sudden RER appreciation and worsening external balance.

1982: BOP crisis.

Real-Wage Index (100 = July 2008)

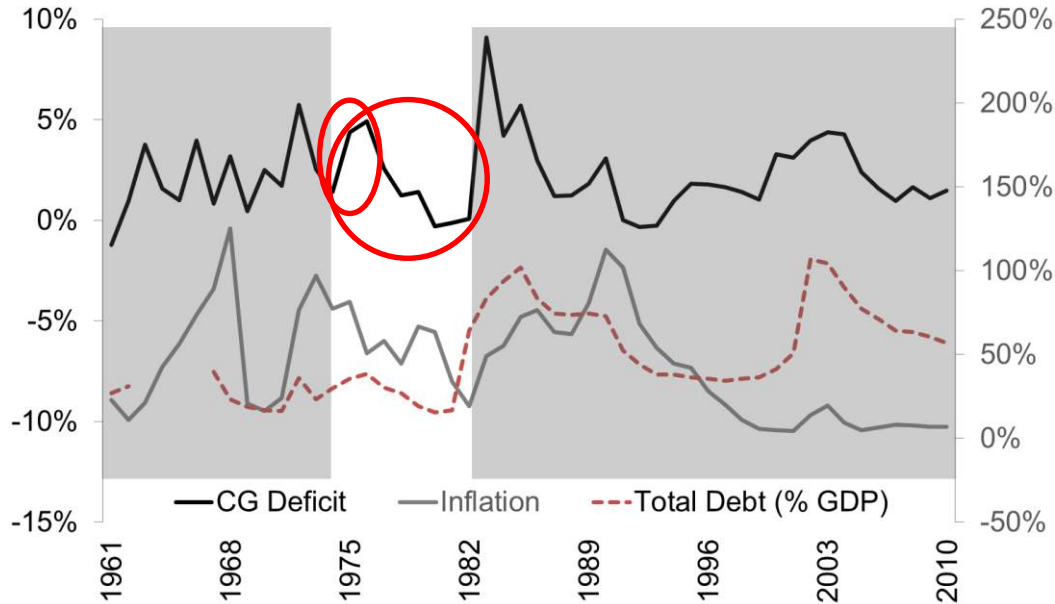
Source: INE - National Institute of Statistics



Opening, stabilization failed and BOP crisis: 1974-1982

Central Government Overall Deficit (% GDP) and Inflation Rate

Source: Institute of Economics (IECON) of Uruguay



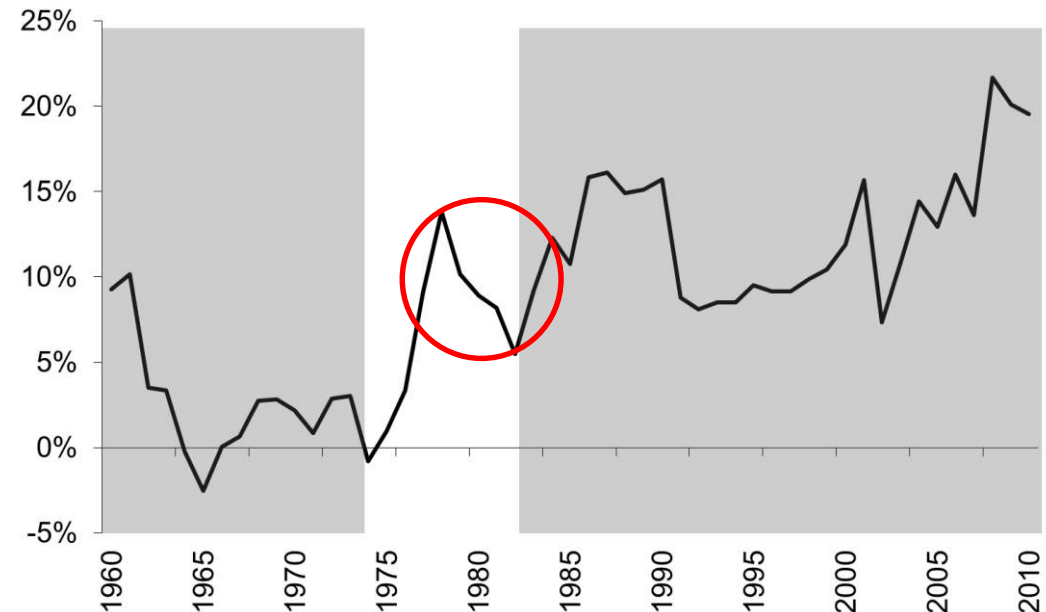
1974-1978: Fiscal deficit increases (shock) financed by money issuance (inflation).

1979-1981: Fiscal deficit falls (real anchor of the stabilization plan) and dollar-denominated private-sector debt increases.

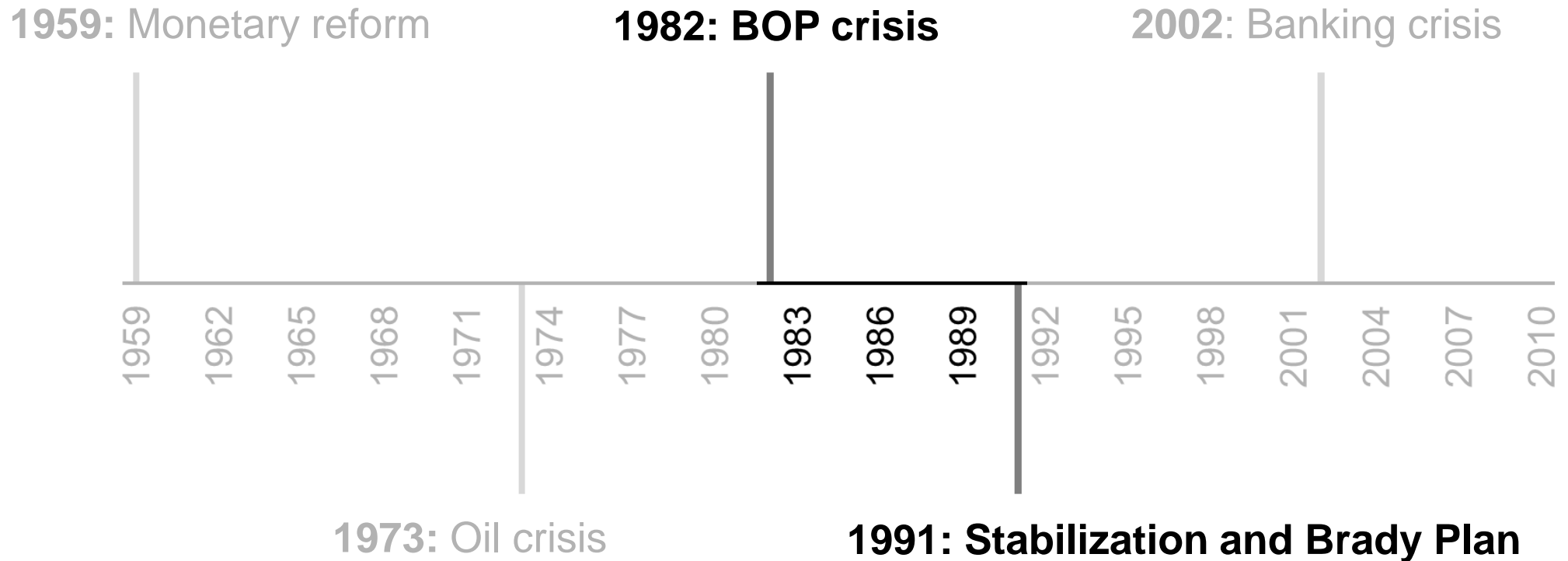
1982 Banking crisis: deposit runoff (Argentina) and private default causes loss of international reserves and rise of public debt (acquisition of bank portfolios).

Central Bank Reserves (% GDP)

Source: IECON - Institute of Economics



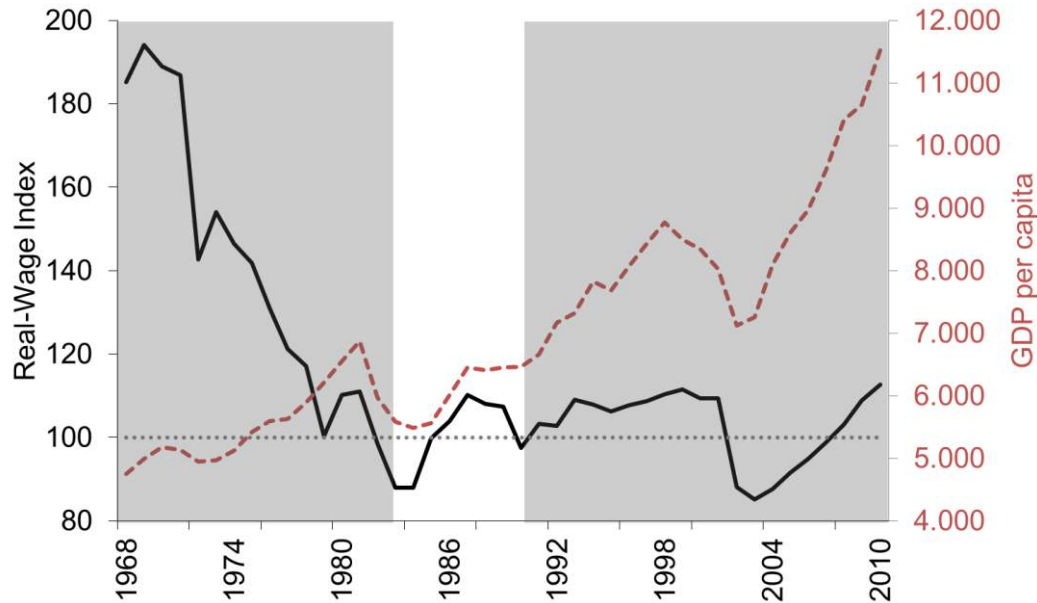
Democratic recovery and economic transition: 1983-1990



Democratic recovery and economic transition: 1983-1990

GDP per capita (1990 Int. GK\$) & Real-Wage Index (100 = July 2008)

Source: The Maddison-Project; INE - National Institute of Statistics



Policies prioritized:

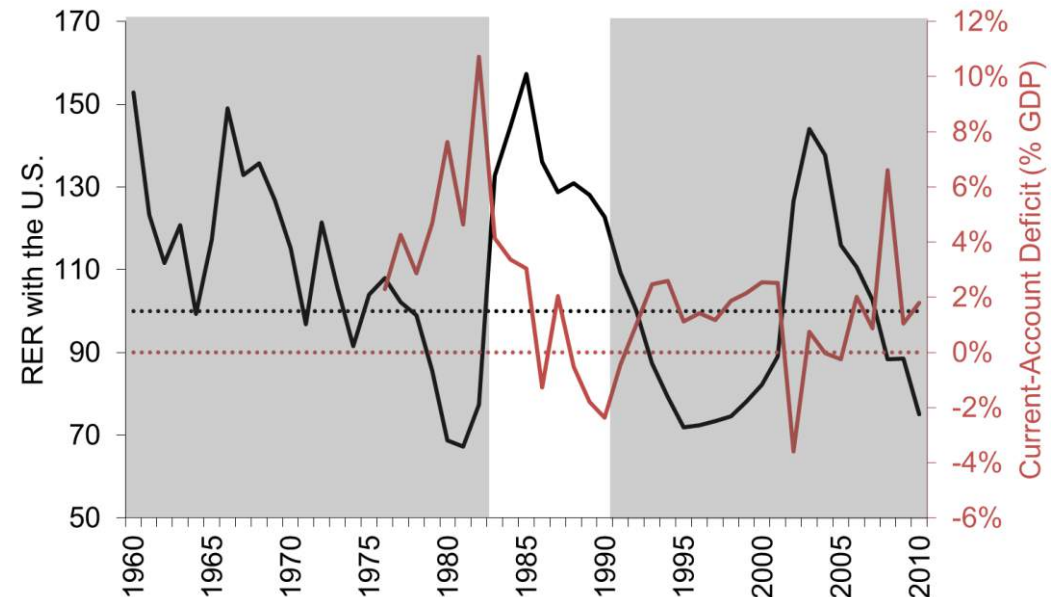
- i) political stability
- ii) fiscal sustainability
- iii) BOP equilibrium
- iv) financial stability
- v) compliance with foreign obligations

Wages as a nominal anchor lead to inflation and RER trajectory.

Fall in oil prices, greater trade integration with Brazil and effects of the *Cruzado* and *Austral* plans **recomposed the BOP.**

Current-Account Deficit & RER with the U.S. (100 = avg. 1913-2014)

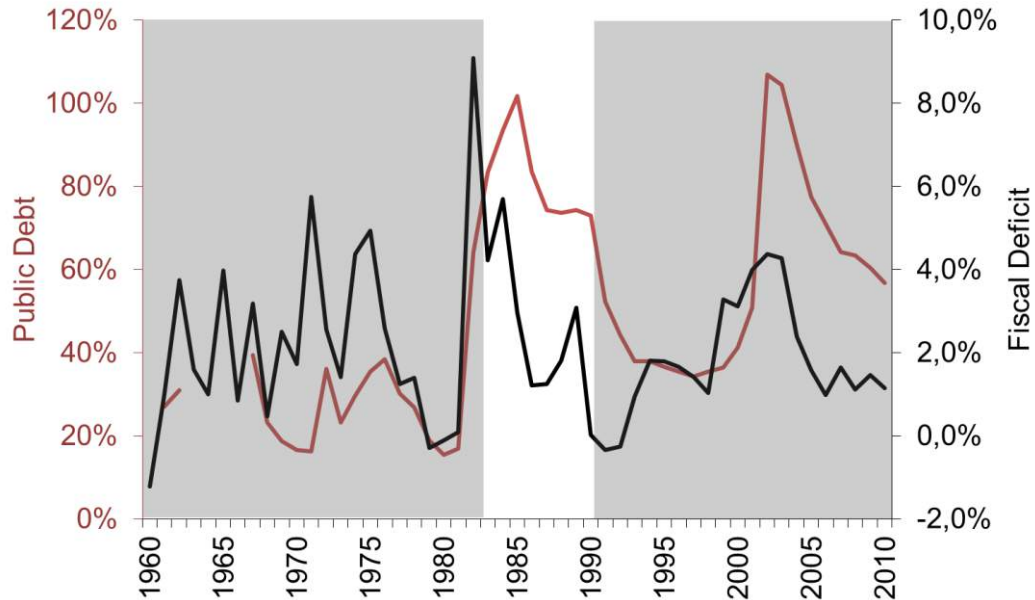
Source: CINVE; Central Bank of Uruguay; Aboal (2003)



Democratic recovery and economic transition: 1983-1990

Gross Public Debt and Central Government Overall Fiscal Deficit (% GDP)

Source: Institute of Economics (IECON) of Uruguay



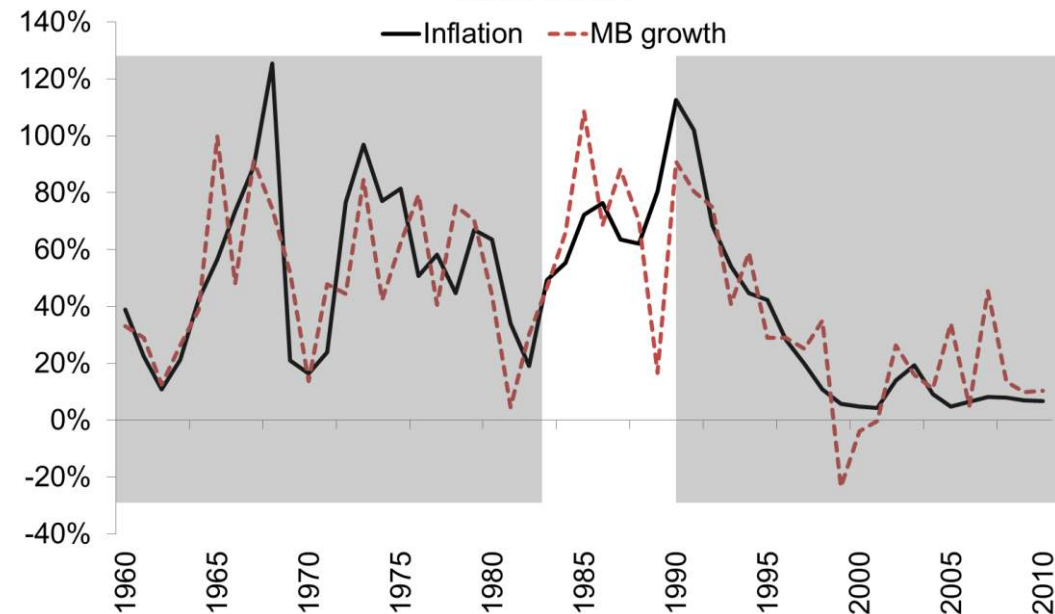
Fiscal deficit falls consistent with growth, and public debt consolidates into high levels after the 1982 crisis.

Money issuance aimed at financing wages, **inflation** “maintains” RER depreciated and helps absorb fiscal deficit.

Between 1983 and 1988, **seigniorage** was 4% of GDP, on average.

Inflation and Monetary Base Growth

Source: IECON; INE

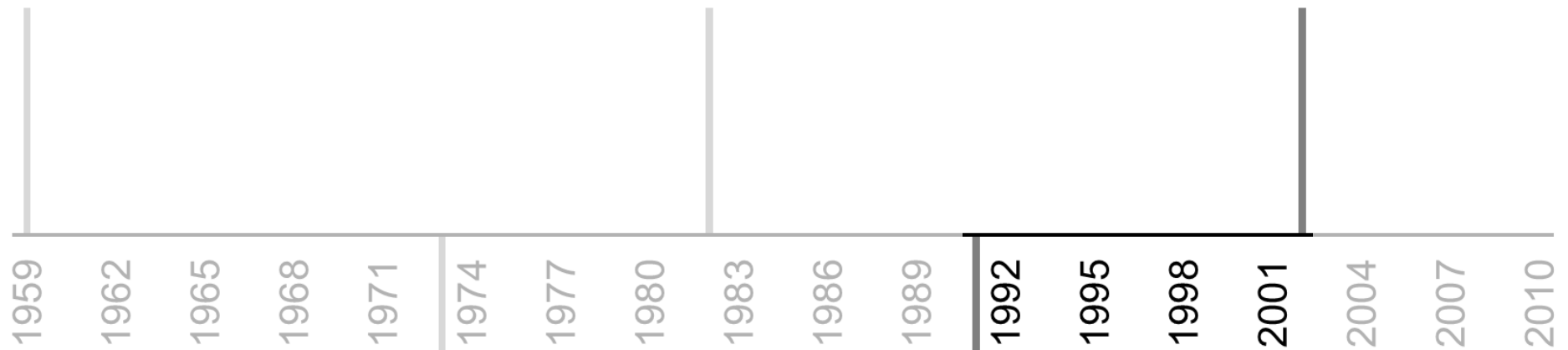


New stabilization strategy, more opening and banking crisis: 1990-2002

1959: Monetary reform

1982: BOP crisis

2002: Banking crisis



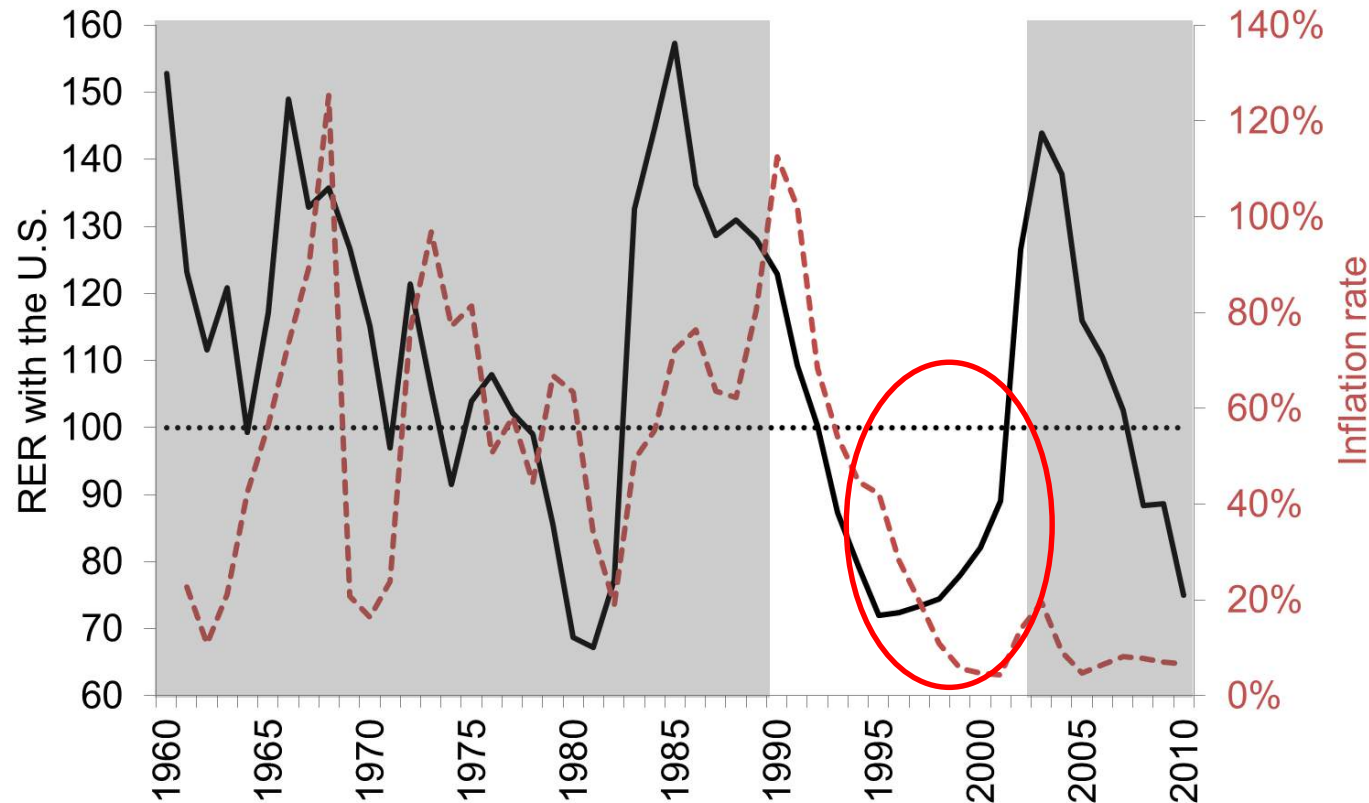
1973: Oil crisis

1991: Stabilization and Brady Plan

New stabilization strategy, more opening and banking crisis: 1990-2002

Inflation & Real Exchange Rate with the U.S. (Index 100 = avg. 1913-2014)

Source: INE - National Institute of Statistics; Aboal (2003)



Positive external shocks:

- i. Brady Plan
- ii. Interest rates fall and US dollar depreciation
- iii. Capital flows return to LATAM
- iv. Global trade expansion
- v. MERCOSUR
- vi. *Convertibilidad* and *Plan Real*

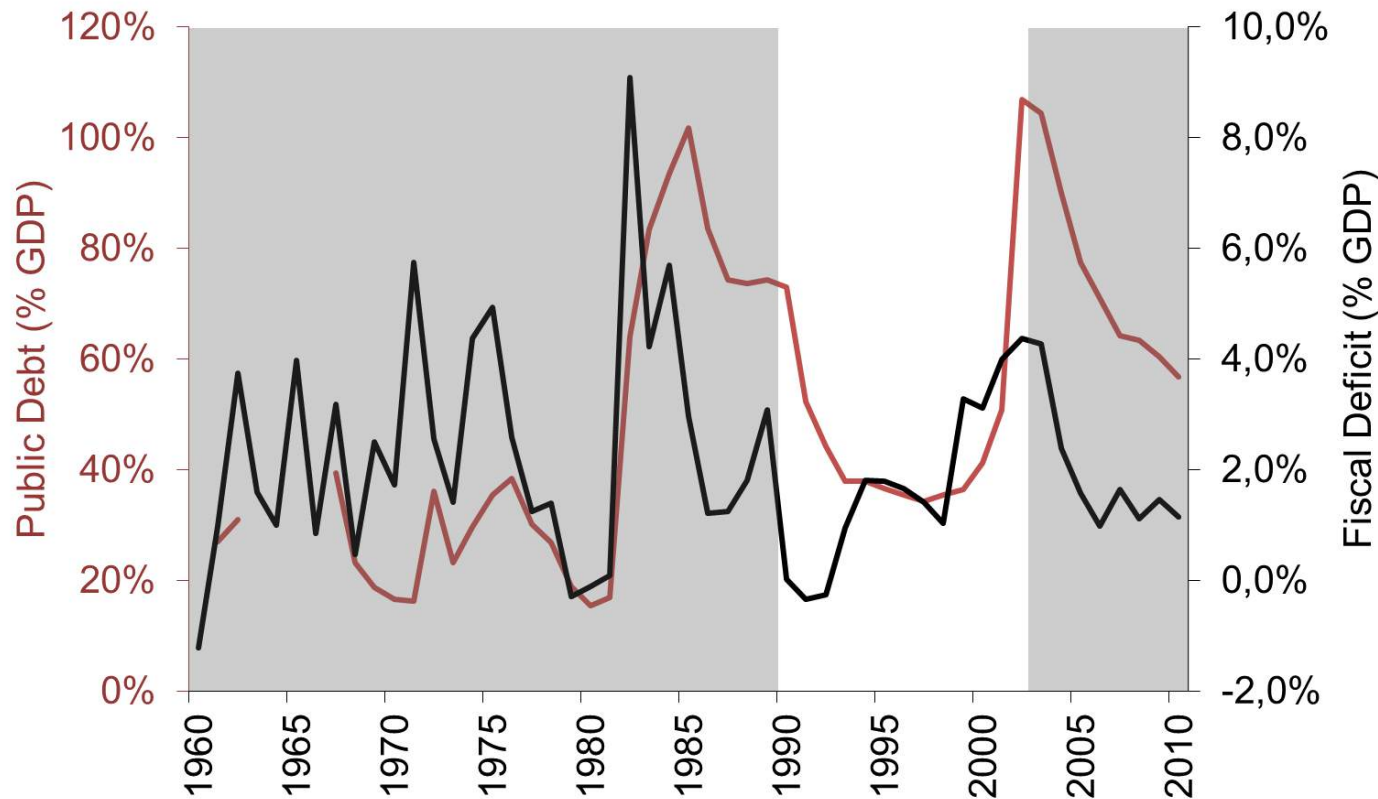
Stabilization Plan with exchange-rate anchor encourages disinflation with RER appreciation.

Macro inconsistency 1: Wage indexation in a disinflation context delays convergence of inflation for non-tradable goods into currency depreciation.

New stabilization strategy, more opening and banking crisis: 1990-2002

Gross Public Debt and Central Government Overall Fiscal Deficit

Source: Institute of Economics (IECON) of Uruguay

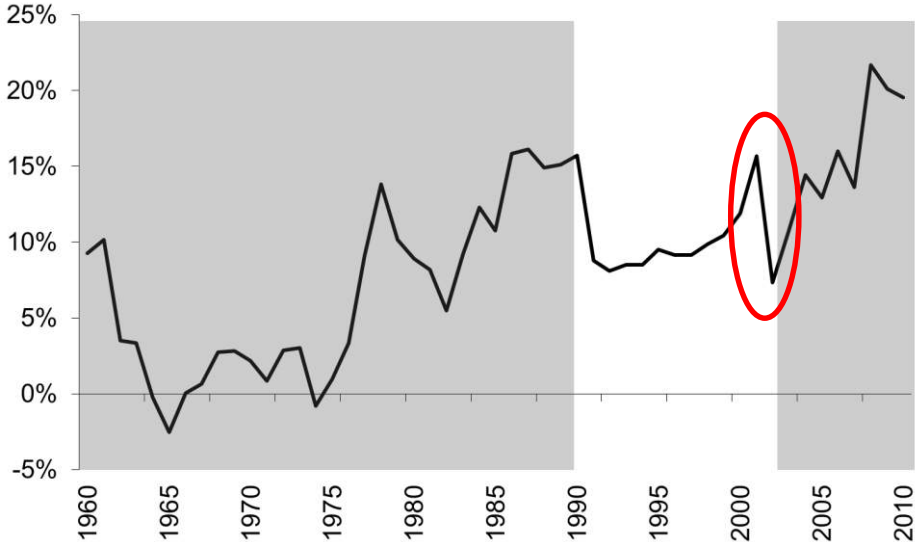


Macro inconsistency 2: Debt-financed fiscal expansion increases financial vulnerability of the public sector and slows down disinflation via aggregate-demand stimulus.

New stabilization strategy, more opening and banking crisis: 1990-2002

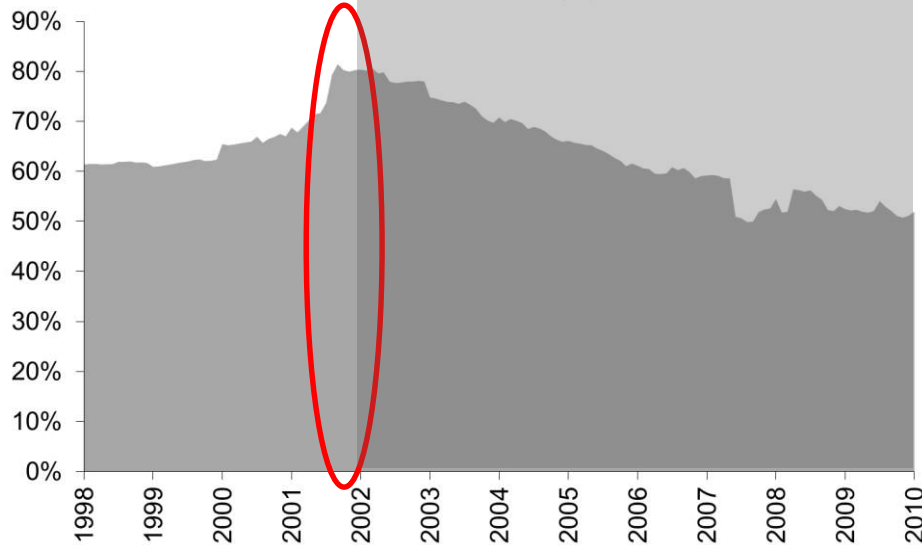
Central Bank Reserves (% GDP)

Source: IECON - Institute of Economics



Foreign-Currency Credit (% Credit to Private Sector)

Source: Central Bank of Uruguay

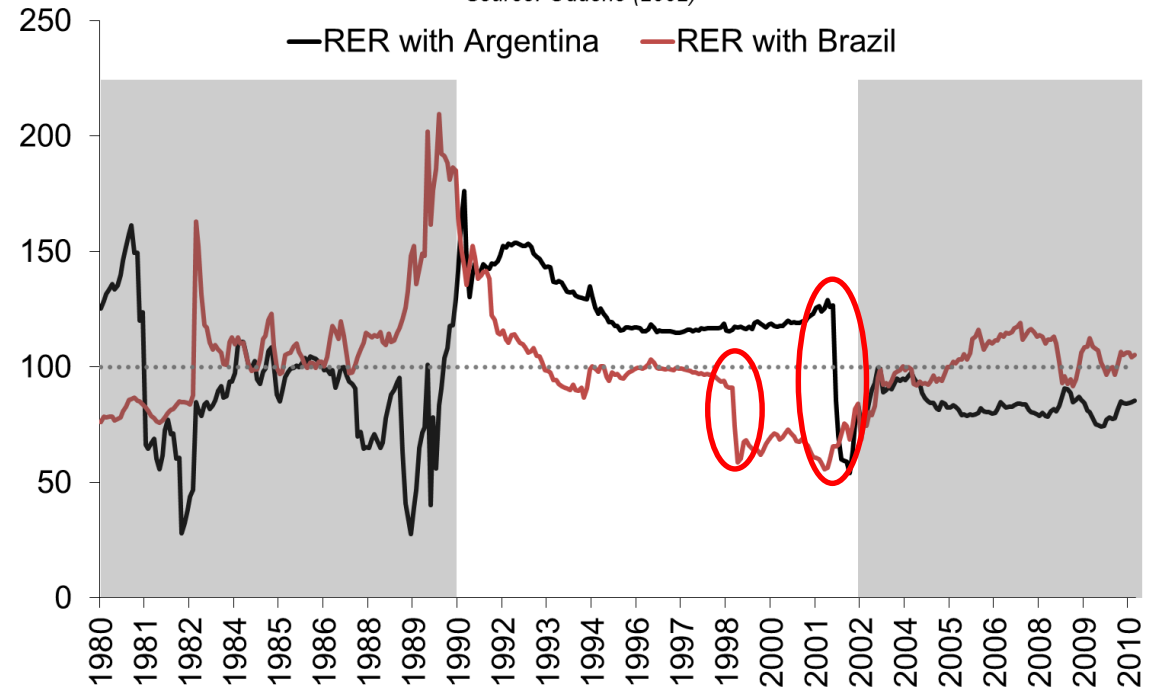


Macro risk 1: Growing exchange-rate misalignment with the region.

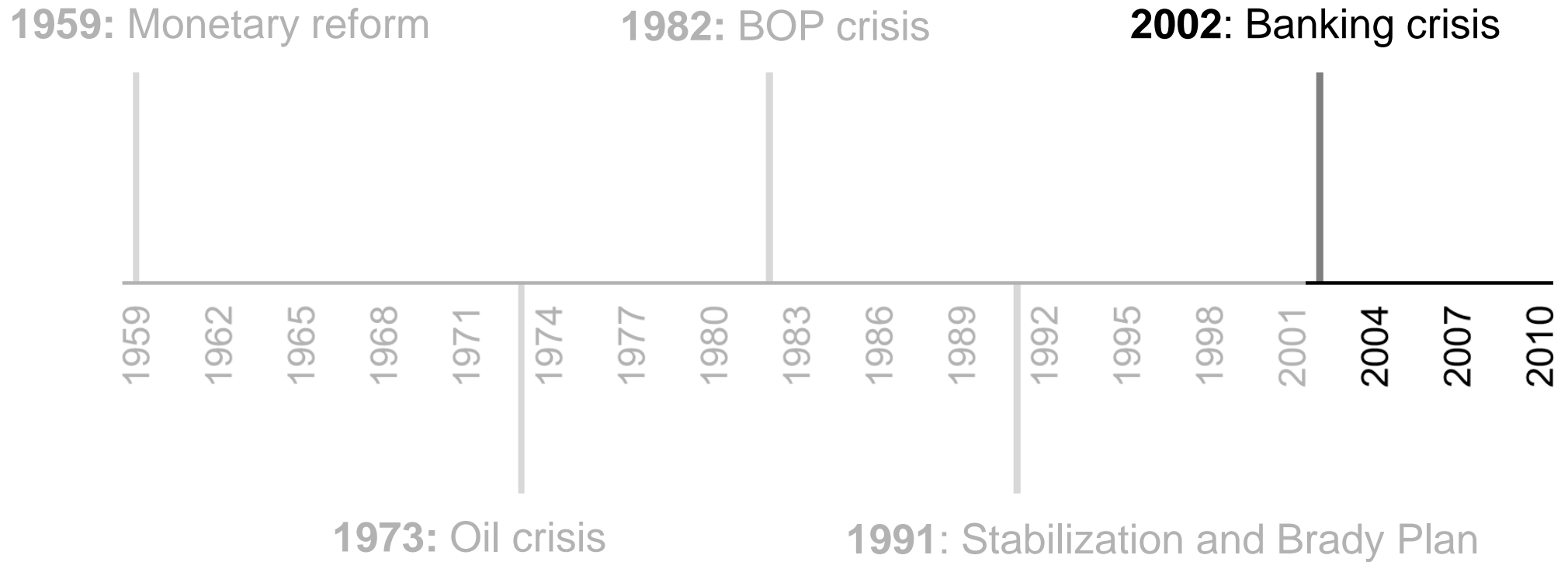
Macro risk 2: Growing dollar-denominated private-sector debt (increase of Central Bank's contingent liabilities).

Real Exchange Rate with Argentina and Brazil (Index 100 = avg. 1980-2014)

Source: Oddone (2002)



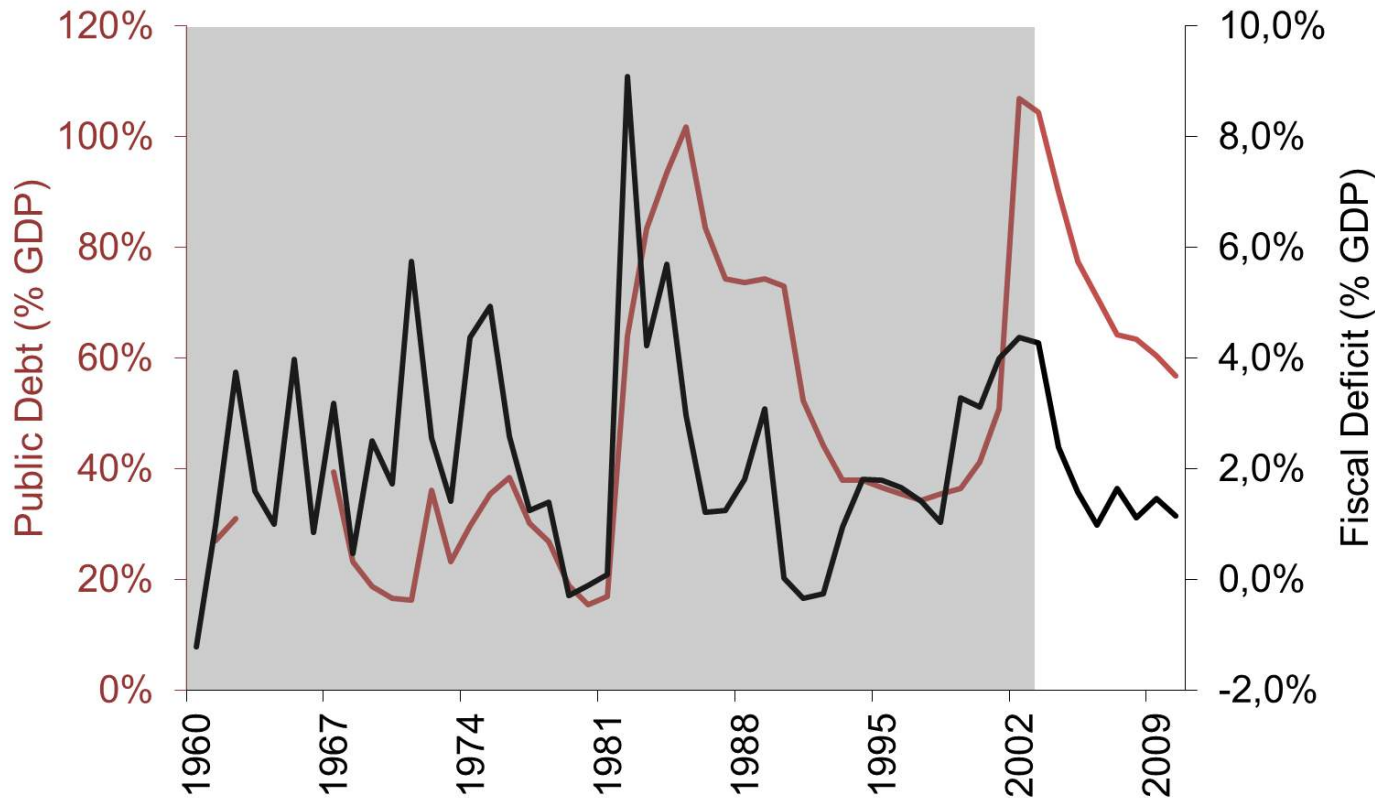
Vigorous recovery and fiscal strengths: 2003-2010



Vigorous recovery and fiscal strengths: 2003-2010

Gross Public Debt and Central Government Overall Fiscal Deficit

Source: Institute of Economics (IECON) of Uruguay



Economic policies prioritized:

- i. Primary fiscal surplus as a macroeconomic anchor
- ii. Public-debt restructuring
- iii. Strengthening of banking regulations
- iv. reduction of procyclicality of fiscal policy
- v. promotion of private investment

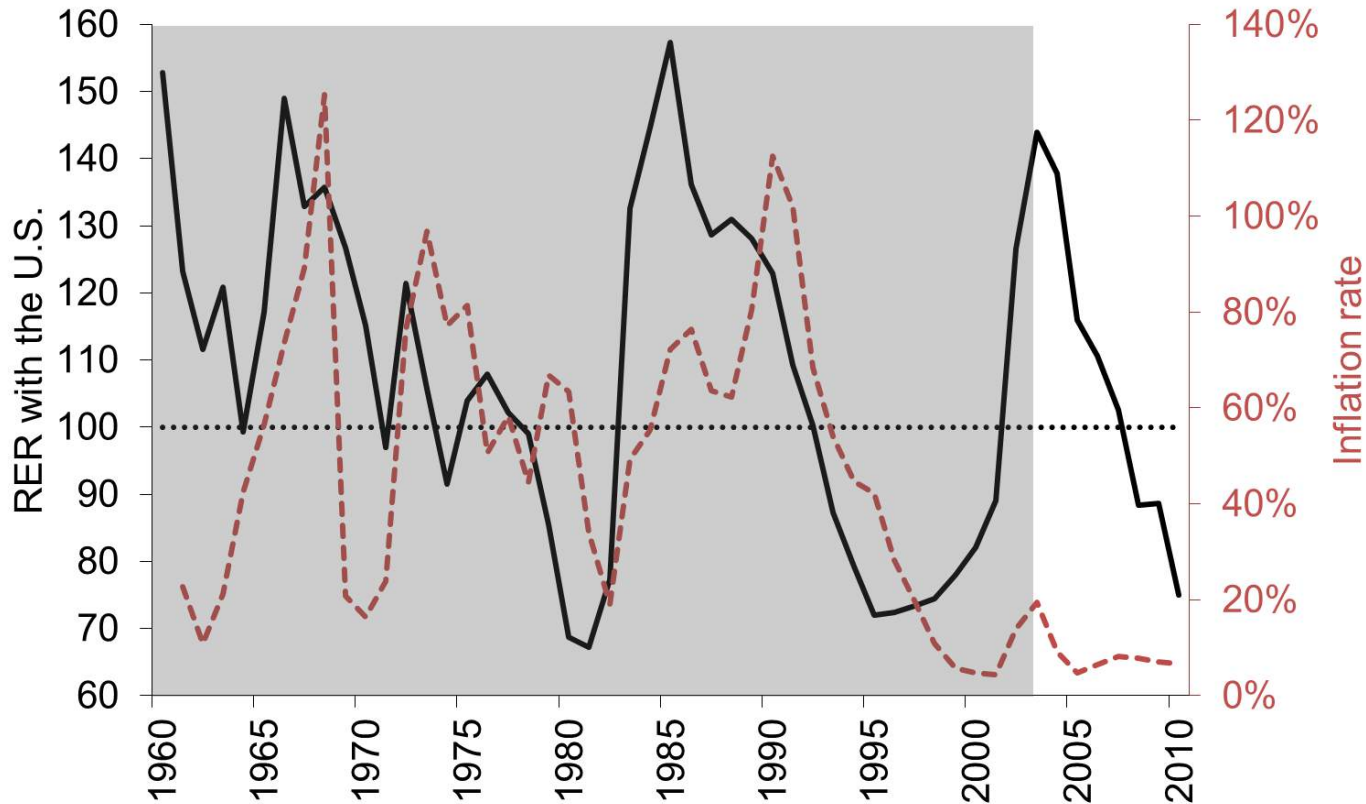
Positive external shock:

- i. Export prices
- ii. Fall of interest rates and US dollar depreciation
- iii. Regional recovery
- iv. "Policies" in Argentina

Vigorous recovery and fiscal strengths: 2003-2010

Inflation & Real Exchange Rate with the U.S. (Index 100 = avg. 1913-2014)

Source: INE - National Institute of Statistics; Aboal (2003)



Deep RER appreciation due to:

- Price shock
- Supply (human capital) and nominal (wages) rigidities.

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Fiscal deficit, inflation and external vulnerability

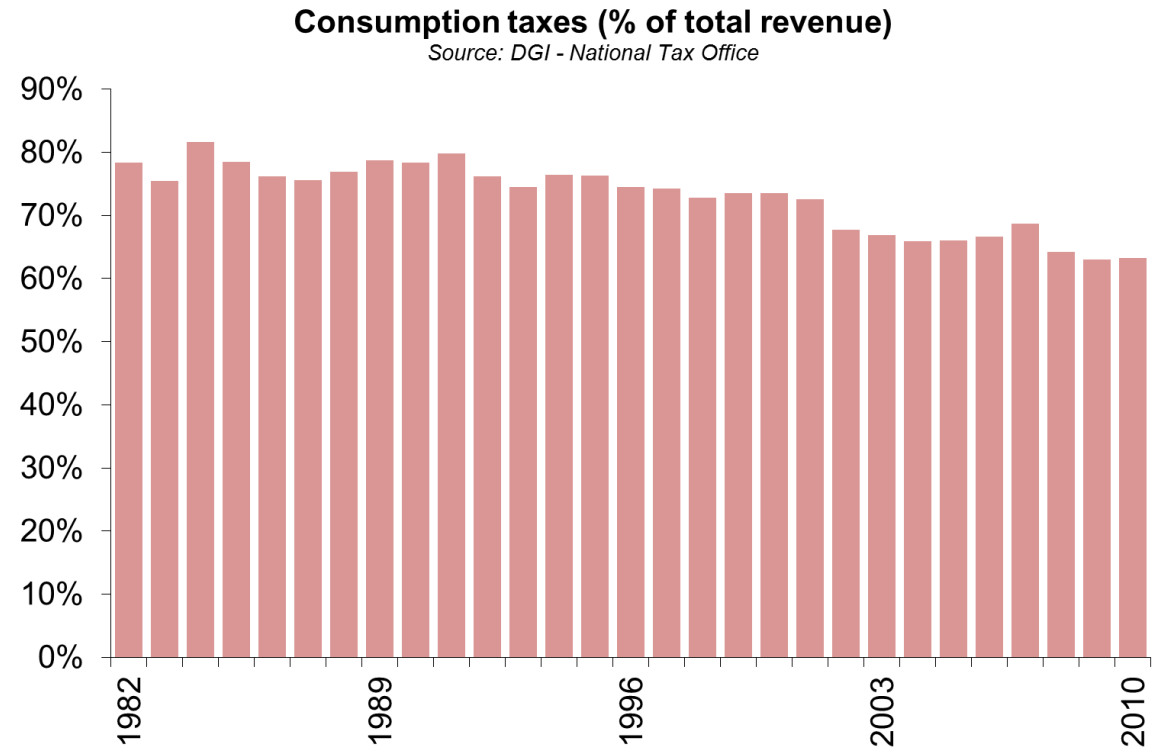
- **High inflation** in the 1960s was associated with persistent **fiscal deficits**.
- The opening of the economy **reduced discretionary** management of economic policy, which limited the inflationary financing of fiscal deficits and **increased public debt**.
- The demonetization of the economy and stabilization schemes, based on exchange-rate anchors, stimulated "**spurious**" **RER appreciations, bubbles in asset prices and dollarization of public and private debt**.
- External **vulnerability** expanded due to the increase and **dollarization** of public debt.
- **Abrupt RER corrections** associated with bottlenecks of the external sector caused **debt crisis and banking crises** (1982 and 2002).

Objectives, commitments and policy tools

- Price **formation in poorly competitive markets** (regionally tradable and non-tradable) foster **price-system tension**, especially in expansive phases of the economic cycle.
- Frequent shortcomings in the coordination of macroeconomic policies convert price tensions into inflation and / or RER distortions.
- Coordination failures are often the result of **over-identification of objectives** for the number of instruments available to pursue them (weakness of monetary policy).
- Anchoring expectations on price formation stimulates the assumption of commitments on nominal variables (exchange rate, inflation, wages) that are difficult to carry out in an economy that is prone to receive external price shocks and has a limited number of instruments.

Fiscal policy as a macroeconomic anchor

- Weak transmission mechanisms of monetary policy and exchange-rate flexibility to manage frequent external shocks make **fiscal policy the anchor of macroeconomic stability**.
- Pro-cyclical tax structure, political cycles of public spending and state-owned enterprises (SOEs) as an instrument of macroeconomic policy **limit the stabilizing role of fiscal policy**.



Fiscal policy as a macroeconomic anchor

- A **"fiscal rule"** could strengthen macroeconomic stability but choosing the variables to build it on is not a trivial matter. An alternative way may be:
 - Adopting the public accounting system 2001 version of the IMF manual.
 - Moving forward in the consolidation and/or **separation of SOEs from the current management of public finances.**
 - **Integrating the budget process** to ensure consistency between budget planning, financial planning and projection of taxable income.
 - Integrating **management systems** to automate tasks and integrate and consolidate information.

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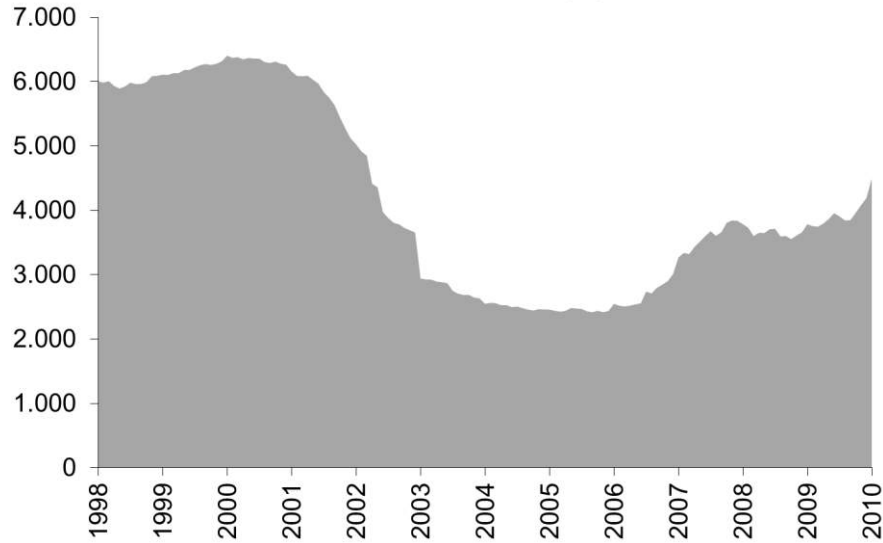
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Credit to the Non-Financial Sector

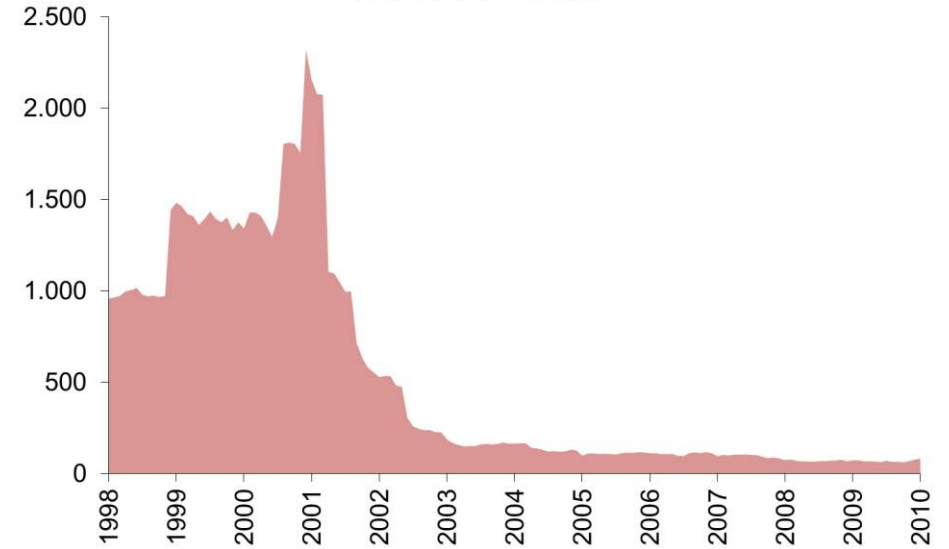
Foreign-Currency Credit to Private Sector (million USD)

Source: Central Bank of Uruguay



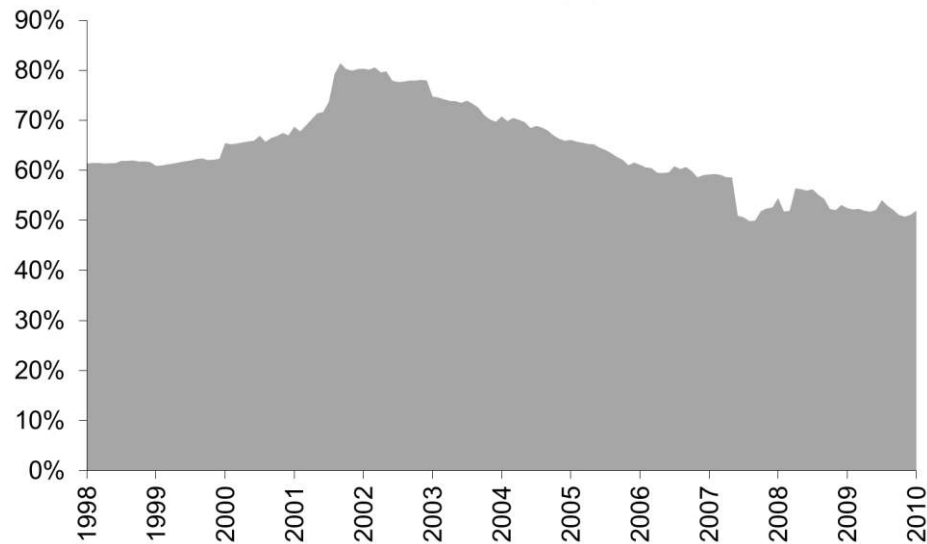
Credit to Non-Residents (million USD)

Source: Central Bank of Uruguay



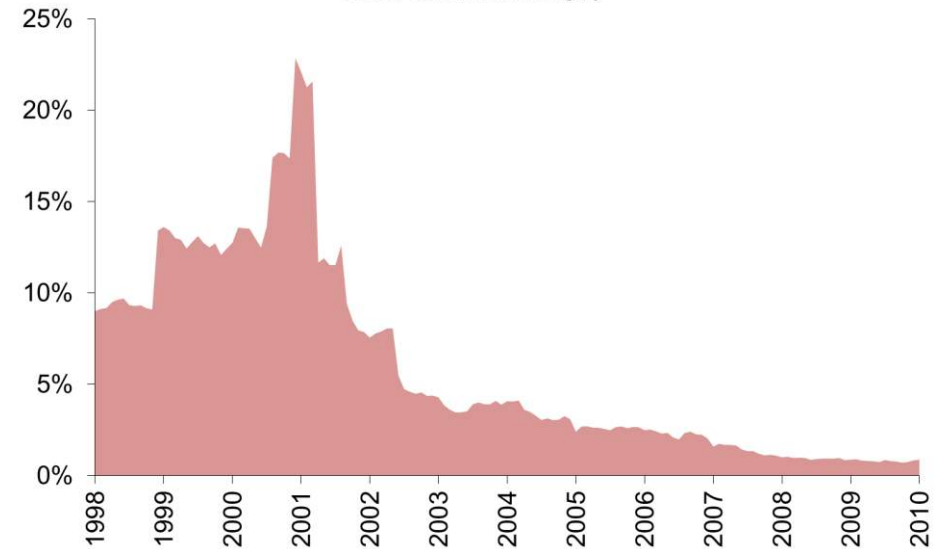
Foreign-Currency Credit (% Credit to Private Sector)

Source: Central Bank of Uruguay



Credit to Non-Residents (% of total)

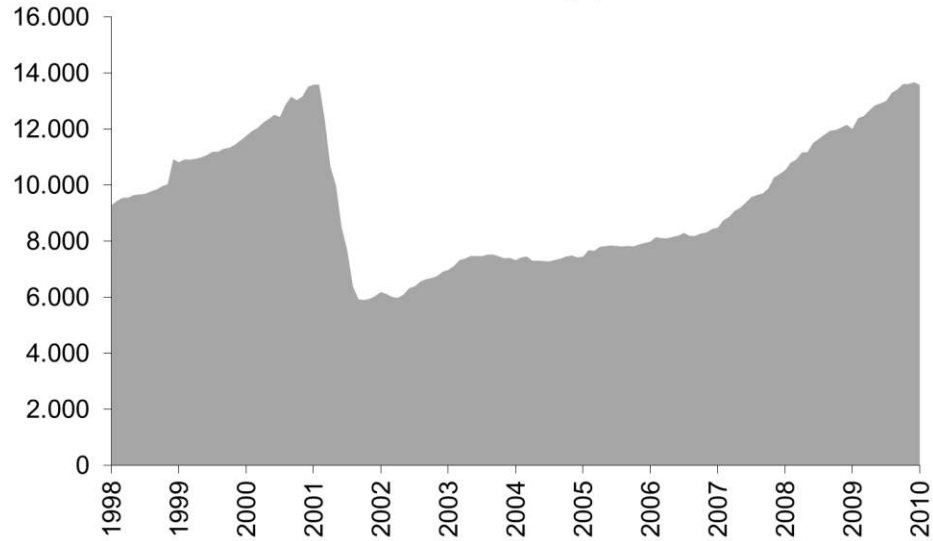
Source: Central Bank of Uruguay



Deposits of the Non-Financial Sector

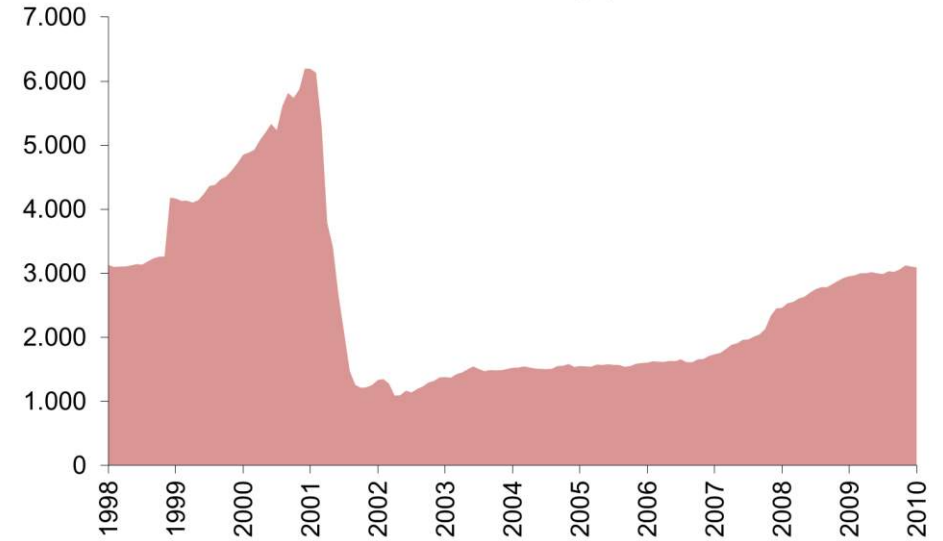
Foreign-Currency Deposits of the Private Sector (million USD)

Source: Central Bank of Uruguay



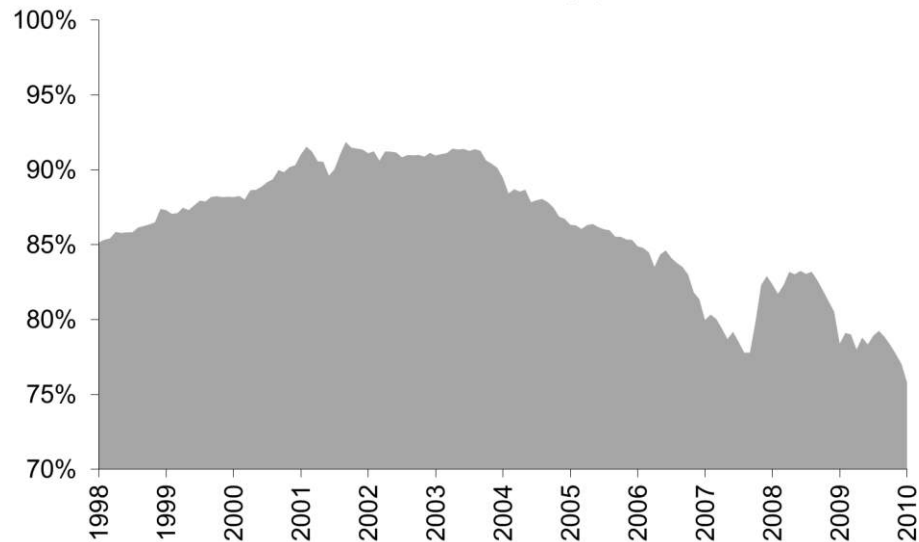
Deposits of Non-Residents (in foreign currency; million USD)

Source: Central Bank of Uruguay



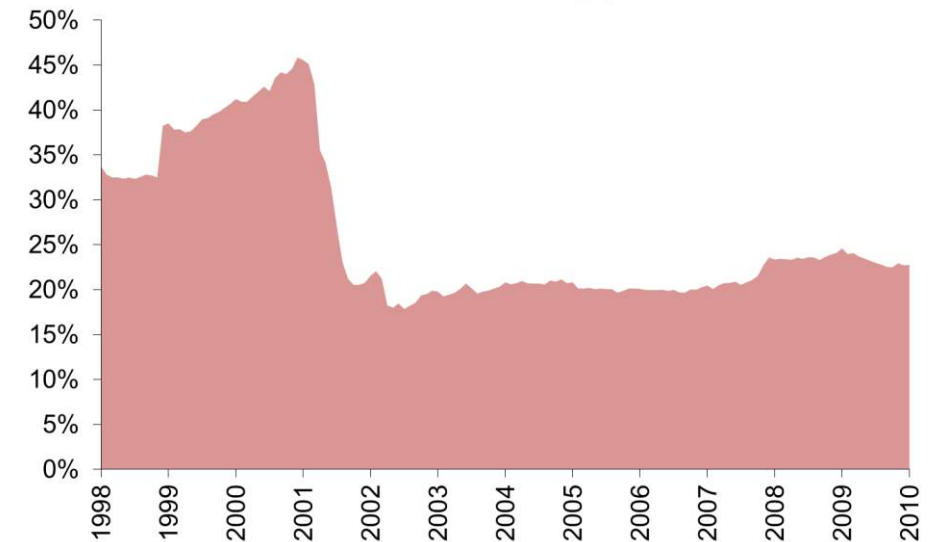
Foreign-Currency Deposits (% of Private-Sector Deposits)

Source: Central Bank of Uruguay



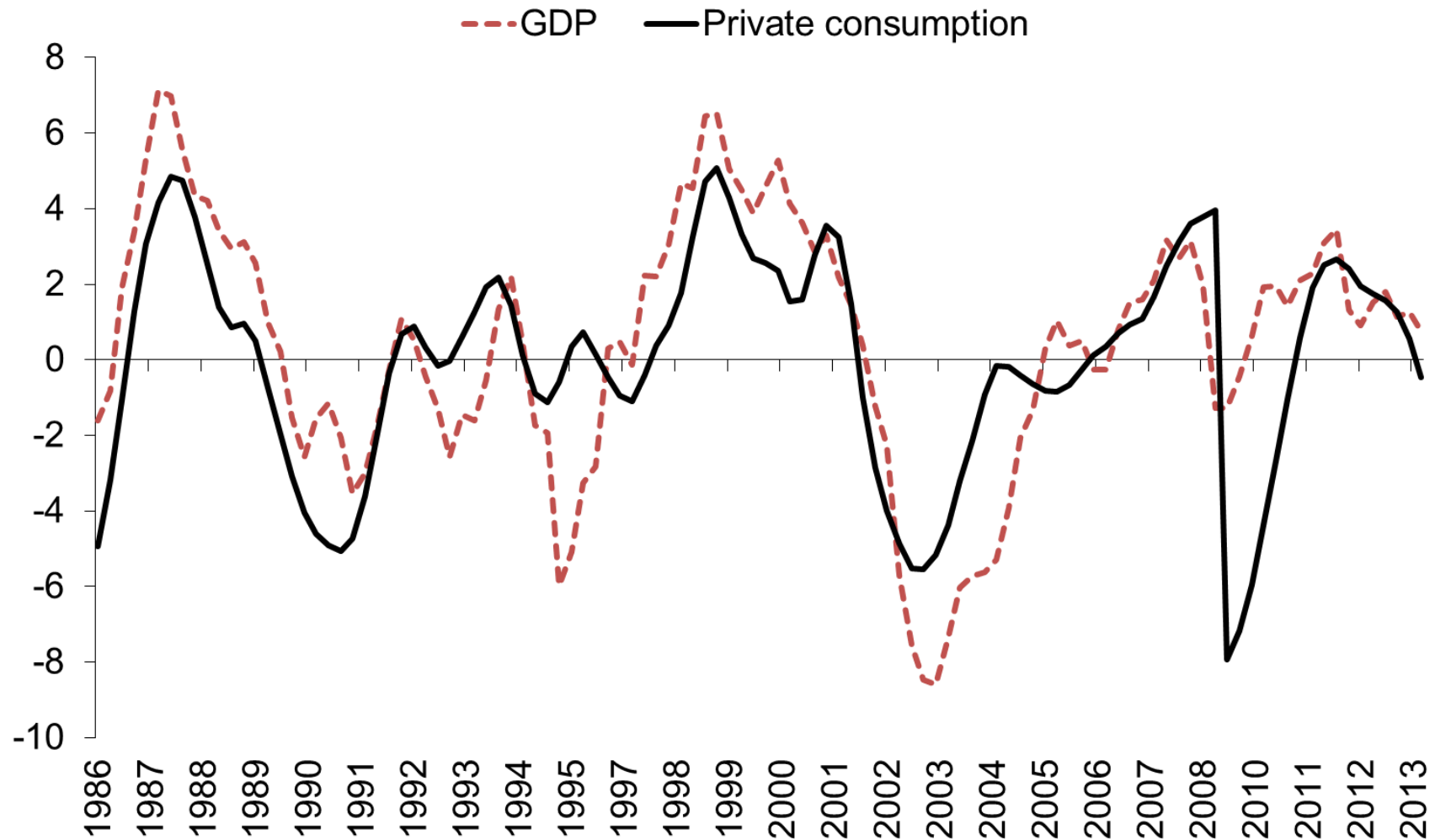
Deposits of Non-Residents (% of Foreign-Currency Deposits)

Source: Central Bank of Uruguay



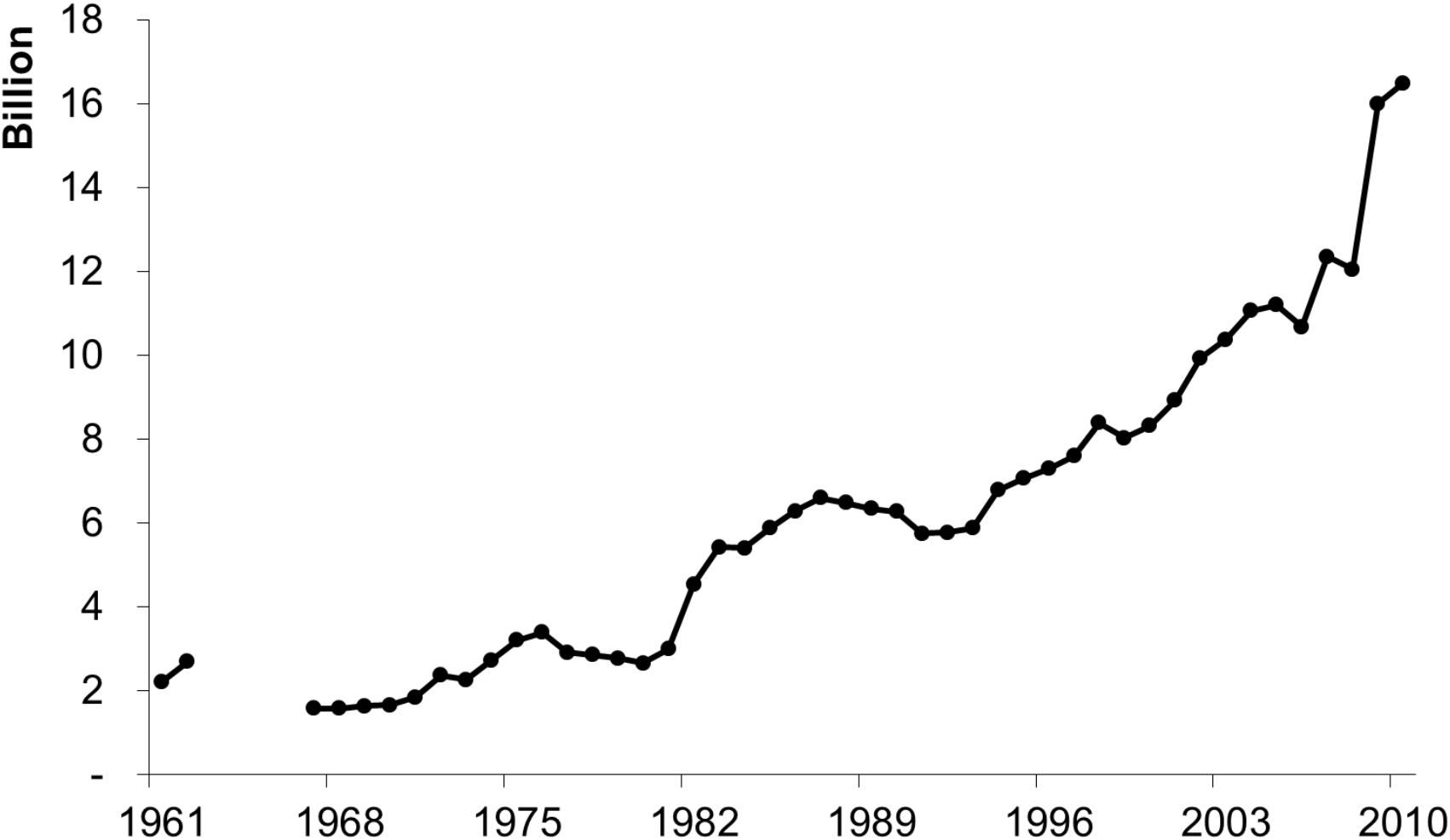
Cyclical Components of GDP and Private Consumption (% of trend)

Source: CINVE



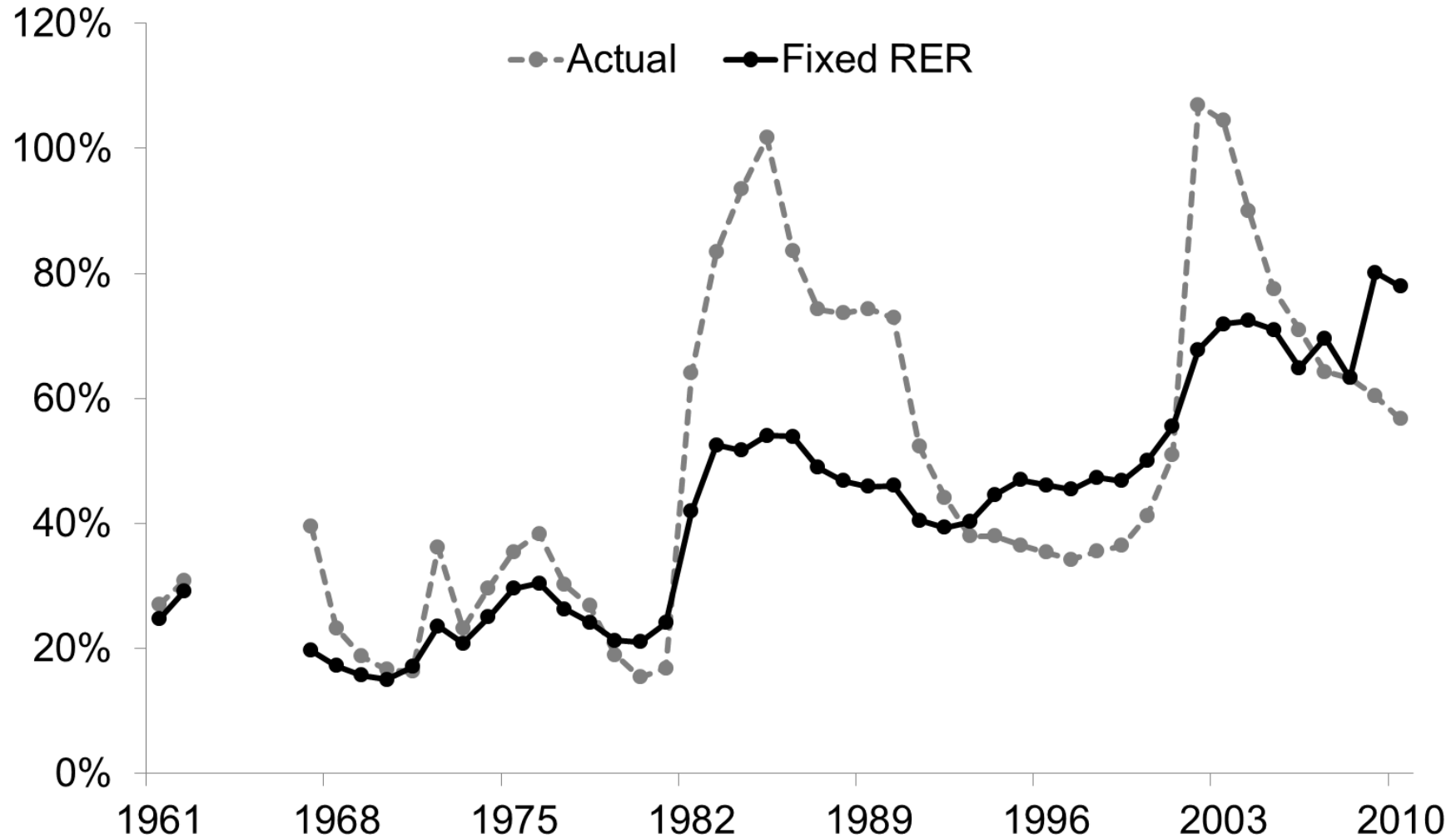
Gross Public Debt in 1996 US Dollars

Source: IECON - Institute of Economics



Simulated Total Public Debt, Fixing the Real Exchange Rate (% GDP)

Source: Institute of Economics (IECON) of Uruguay



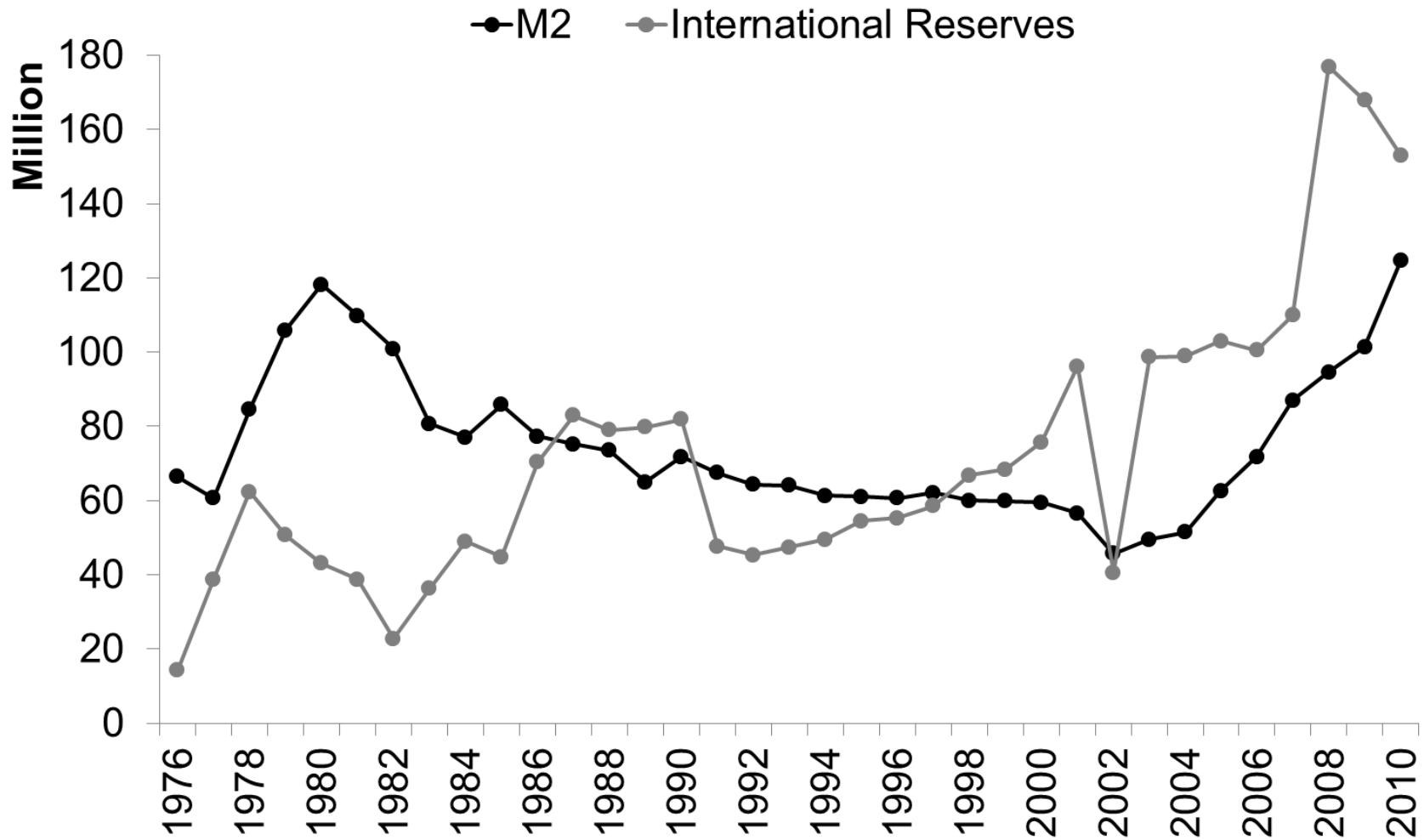
Calvo Ratio (M2 / International Reserves)

Source: IECON - Institute of Economics



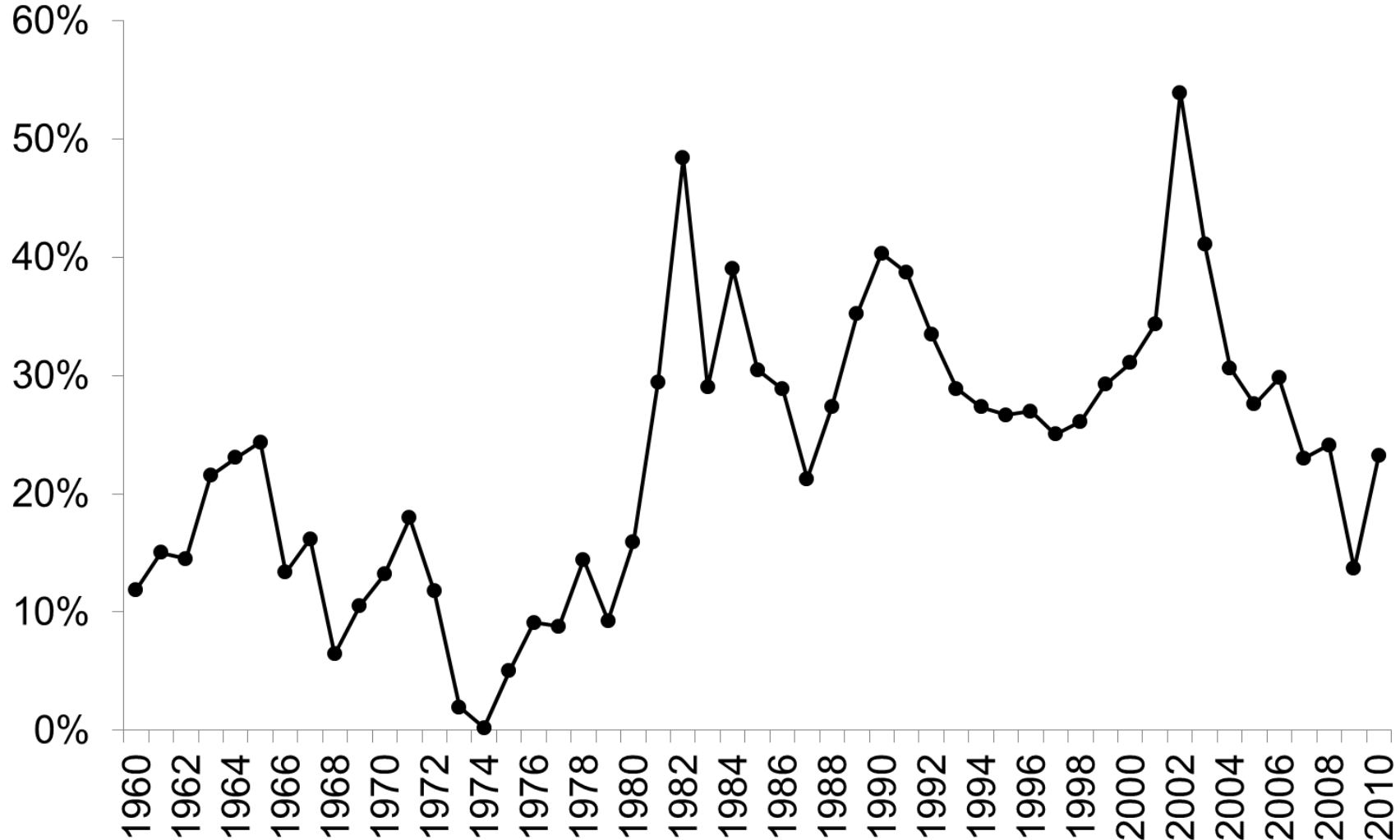
Components of the Calvo Ratio in 2010 Uruguayan pesos

Source: IECON - Institute of Economics



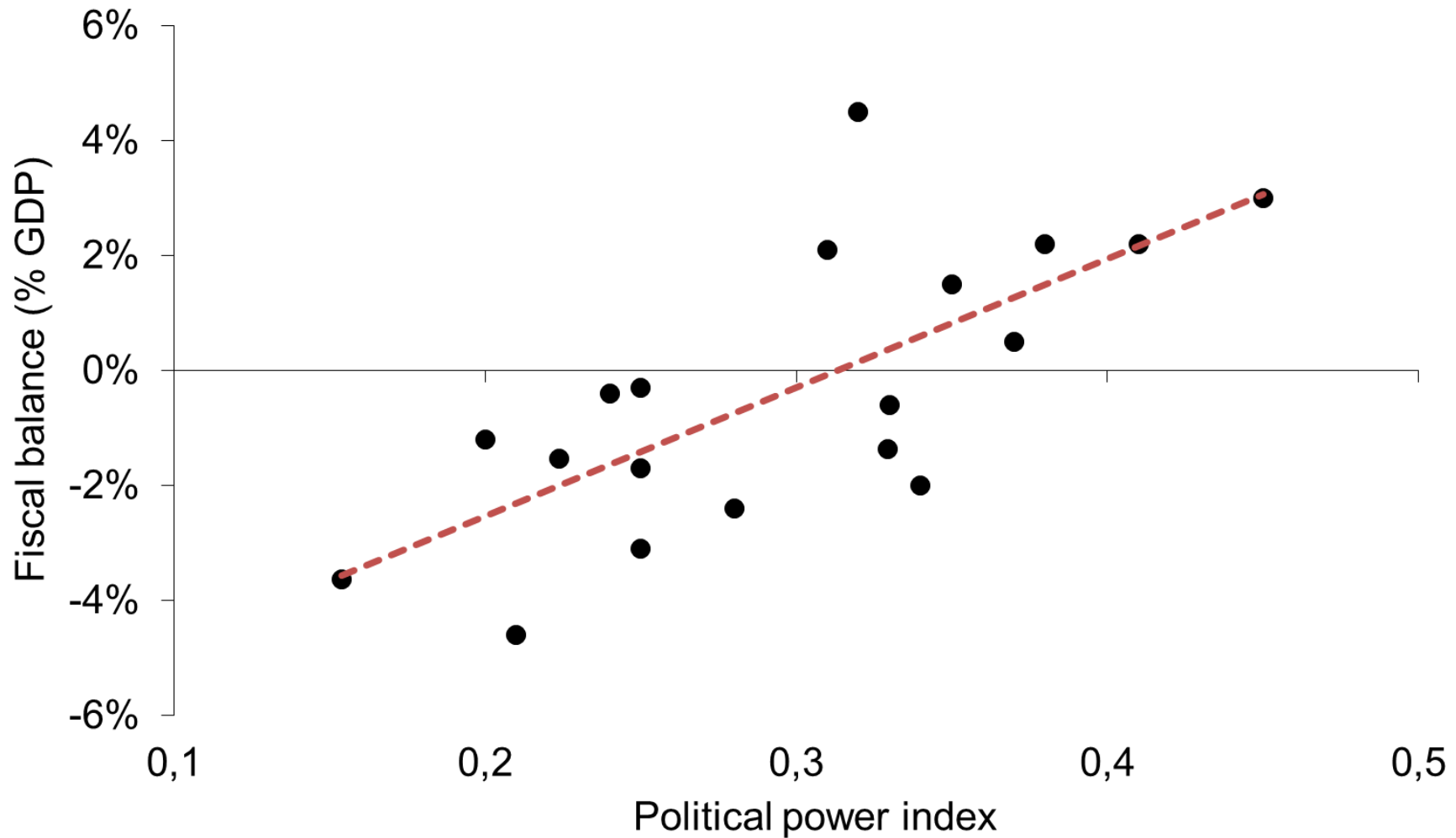
Financial Exposure as % GDP

Source: based on World Bank



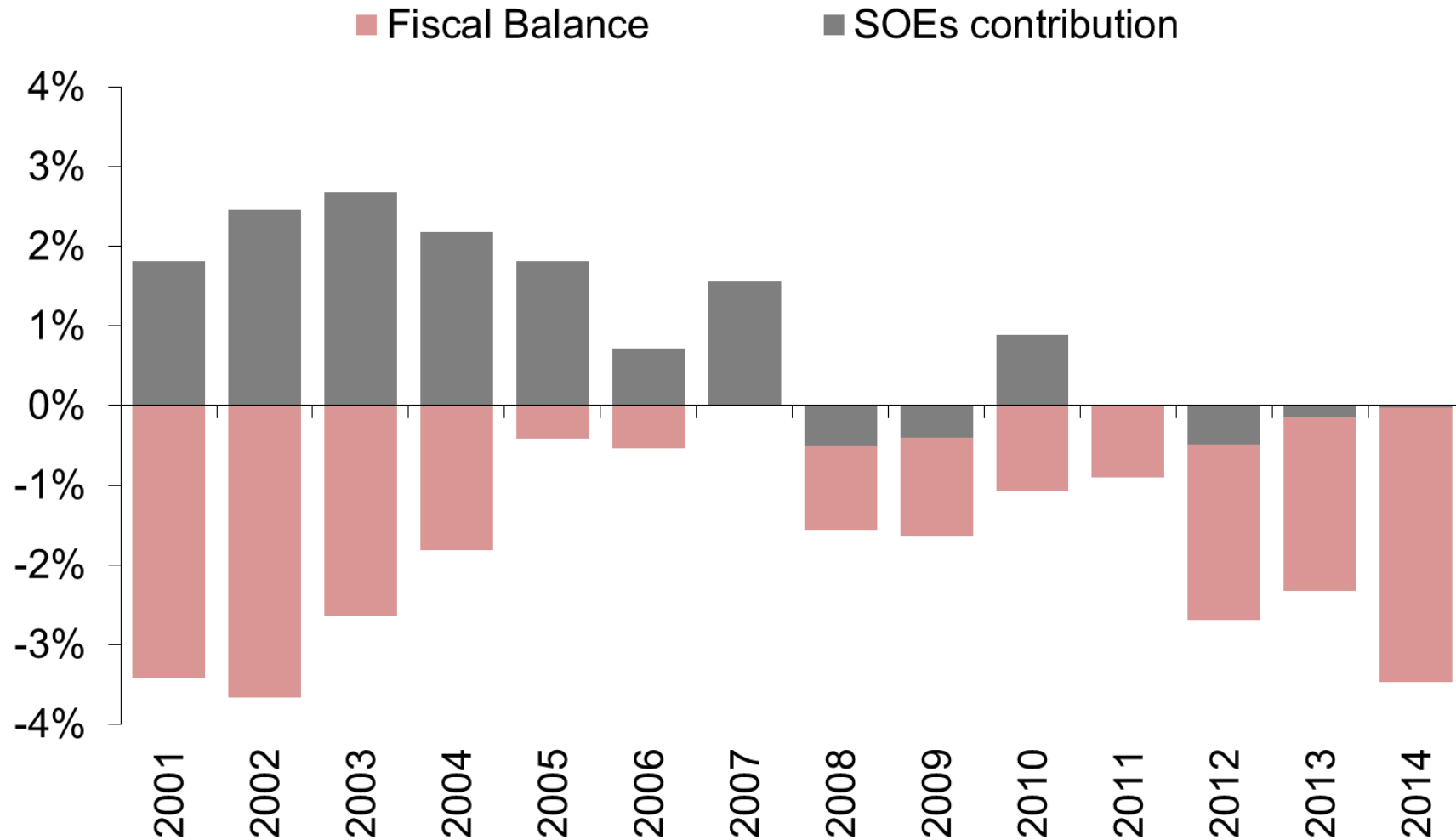
Central Government Fiscal Balance and Political Power 1920 - 2014

Source: Aboal, Lorenzo, Moraes & Oddone (2003)



SOEs Contribution to Government Overall Fiscal Balance (% GDP)

Source: based on the Ministry of Economy and Finance



The Fiscal and Monetary History of Uruguay (1960-2010)

First draft

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