

Liberalization and Financial Crisis in Uruguay, 1974–87

Juan Pérez-Campanero and Alfredo M. Leone

In 1982, a severe crisis emerged in the Uruguayan financial sector. This crisis undermined the country's financial stability and had far-reaching implications for the banking structure and the real economy in the subsequent five years.

This chapter provides an account of the main factors governing the crisis, tracing its causes, examining its major manifestations, and analyzing measures taken to deal with problem banks and borrowers. The consequences of some of the inconsistencies in the liberalization and stabilization policies during the 1970s are reviewed in order to highlight the linkages between stabilization, liberalization, and crisis.

Section I provides a general view of the characteristics of the economic environment and the progress of the stabilization and liberalization policies. The main traits of the recent economic history of Uruguay are recalled here, with special emphasis on the liberalization program implemented in 1974, and on the stabilization policies using the exchange rate as an anti-inflationary instrument. In Section II, the key features of the Uruguayan financial system are described. An account is given of the financial liberalization and the regulations governing the operation of financial intermediaries. Section III analyzes the effects of some of these policies on different economic variables and on the financial system, and, in the process, reviews some of the related empirical literature on Uruguay. The topics discussed include the growth of the financial sector, savings and investment, the behavior of interest rates, the repercussions on the financial structure of nonfinancial corporations, the market structure of the banking sector, and the process of currency substitution.

In Section IV the financial crisis and the policy responses to it are

described and analyzed. Two distinct approaches to the problem were tried. First, the Central Bank of Uruguay (CBU) came to the rescue of ailing institutions by providing emergency support funds, by arranging the sale of failed banks to healthy ones (while assuming the unrecoverable loan portfolio that caused the failure), and by purchasing the low-quality loan portfolio of any institution willing to make a seven-year loan in foreign currency. Later, the rights of debtors were favored over those of creditors when successive policy measures validated the generalized expectation of debt relief. These measures led financial intermediaries to an unsustainable position. One after another declared bankruptcy and was taken over by the Banco de la República (the state-owned commercial bank). Section V summarizes the findings and advances some conclusions.

I. Economic Environment and Financial Sector: Phases in Liberalization and Stabilization Policies

After nearly two decades of inward-looking economic policy and financial repression, the Uruguayan authorities began implementing bold liberalization reforms in the 1970s. These reforms, which included removal of trade restrictions and exchange controls and deregulation of financial markets, have received considerable attention in the literature.¹

The next three subsections briefly review the pre-reform economic environment; the sequencing of major reforms that were put in place during the mid-1970s and their stylized outcomes; and some policy inconsistencies of the reform period. The objective of this review is to bring out the linkages among the macroenvironment, the financial sector, and financial crisis.

The Uruguayan Economy Before 1974

For more than twenty years after the early 1950s, policymakers resorted to import substitution and wide-ranging controls on domestic goods and financial markets; these controls were reflected in high tariffs and other trade barriers, negative interest rates in real terms, and extensive price distortions. Those years were characterized by very low and decelerating real GDP growth; high, volatile, and accelerating inflation rates; a low

¹ On liberalization and policies in Southern Cone countries, see *World Development* (1985); *Economic Development and Cultural Change* (April 1986); the contributions by Hanson (1986), Harberger (1986), and Edwards (1986); "Panel Discussion on the Southern Cone," *Staff Papers* (March 1983); Díaz-Alejandro (1981, 1985); Calvo (1986); Rodríguez (1982); McKinnon (1982); Ardito Barletta, Blejer, and Landau (1984). Hanson and de Melo (1983, 1985); de Melo (1985); Tybout (1985); Larraín (1986); and Corbo, de Melo, and Tybout (1986) focus on the Uruguayan case.

level of domestic savings; recurrent balance of payments crises; increasing fiscal deficits; and high unemployment.

The rate of growth of real GDP decelerated from 5.4 percent a year between 1944 and 1951 to 3.0 percent between 1951 and 1956, 0.1 percent between 1956 and 1967, and increased to 1.6 percent between 1967 and 1974.^{2,3}

The inflation rate increased continuously, averaging 49.8 percent a year between 1965 and 1970 and 62.7 percent between 1971 and 1973, reaching 97 percent in 1973. The unemployment rate exceeded 8 percent between 1965 and 1973.

The balance of payments experienced recurrent difficulties owing to rising fiscal deficits, inadequate credit and exchange rate policies, and some external factors. The fiscal deficit, as a proportion of GDP, increased from an average of 1.9 percent during the 1965–70 period to 3.2 percent between 1971 and 1973.⁴ The inadequate credit and exchange rate policies and the persistence of negative real interest rates provided incentives for capital flight, leading to a contraction in the size of the regulated financial market over time. During most of these years, multiple exchange rates and restrictive exchange controls prevailed. In March 1972 the authorities adopted a crawling peg while maintaining the exchange controls. Two main external factors compounded the balance of payments difficulties in 1974: the effects of the first oil shock and the closure of European Economic Community (EEC) markets to beef imports, the main Uruguayan export.

In July 1974, a new economic team responded to the country's weak economic performance and growing imbalances by implementing a package of deregulation policies.

A brief description of the reform process follows; more attention is paid to the reforms in the financial sector in Section II.⁵

The 1974 Economic Reform: Phase I, 1974–78⁶

The economic reform implemented in Uruguay in 1974 included measures to liberalize international trade and capital transactions, to remove distortions in domestic markets, and to eliminate fiscal imbalances. The liberalization of capital transactions with the rest of the world proceeded at

² Hanson and de Melo (1983), p. 479.

³ Per capita output growth was also very low, averaging an annual rate of 0.7 percent from the end of World War II to 1973. See Larraín (1986), p. 4.

⁴ Corbo, de Melo, and Tybout (1986), Table 1.

⁵ A chronology of reforms is offered in Hanson and de Melo (1985), Appendix A.

⁶ The delimitation of phases is based on Hanson and de Melo (1985); Corbo, de Melo, and Tybout (1986); and Larraín (1986).

the fastest pace and occurred before other major policy changes. While domestic financial markets were also liberalized relatively quickly, the rest of the liberalization program proceeded at a slower pace and suffered transitory reversals. By the middle of 1977, capital transactions were virtually free, while remaining exchange restrictions on current transactions were relatively minor. In contrast, trade restrictions remained severe and complex, with imports subject to a multiplicity of charges and exports subject to an array of taxes and subsidies that severely distorted production patterns.

In September 1974, capital flows were liberalized, with domestic residents permitted to hold dollar accounts with domestic banks for the first time; moreover, exchange rate controls were eliminated, and Uruguayans were also free to buy and sell assets denominated in external currencies without restrictions. Capital transfers were freely permitted through the financial market. A liberal foreign investment law was also approved in 1974, which required government authorization only for investment in specified activities. Foreign investors were guaranteed the transfer of capital and profits through the financial market.⁷ During this phase of the reform, the exchange rate for financial transactions was freed, while the exchange rate for transactions in the goods market followed a passive crawling peg.

Although tariffs remained high and a number of restrictions on current payments or multiple currency practices prevailed, trade transactions were partially liberalized during this phase. From the middle of 1974 to early 1975, all quantitative restrictions on imports were removed. Imports of capital goods were further liberalized in early 1975, when they were exempted from special deposit requirements. On the export side, taxes on wool and beef exports were considerably reduced during 1974.

Further significant changes occurred in the trade and exchange system between 1975 and 1978. In 1975, import deposits and exchange taxes on beef exports were eliminated, and many trade taxes were reduced. In 1977, the system of import surcharges was further streamlined, leading to more uniform rates of effective protection. However, at the same time, a tax (*retención*) on beef exports was reintroduced, and export subsidies (*reintegros*) on nontraditional exports were reduced. In January 1978 a new tariff structure replaced the complex system of import duties and related charges with a basic rate of 20 percent and multiple rates ranging from zero percent to 150 percent. Export taxes continued to increase during 1978,

⁷ Amortization or proceeds from liquidation of investment registered under this law could not be transferred abroad until three years after the date on which the investment was approved.

while subsidies on nontraditional exports continued to be reduced.

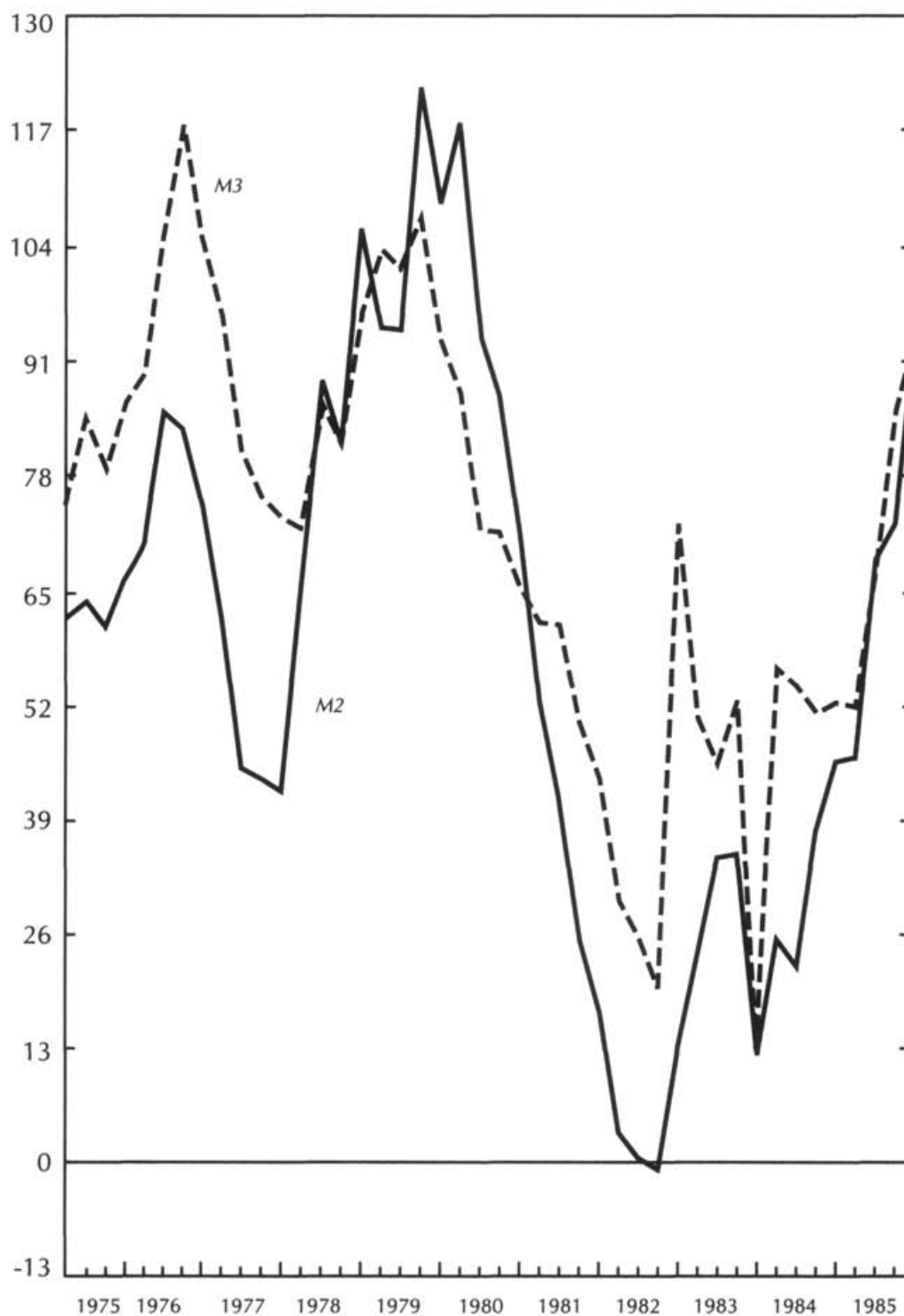
During this phase, the authorities began to remove the comprehensive price controls in the economy, but slowly. During 1974, controls were progressively eliminated or released on selected products and services, most of which were not included in the consumer price index (CPI). After a temporary reintroduction of price controls in 1975, all prices of goods considered to be competitively produced and not included in the CPI were freed in early 1976. Although price liberalization continued, by the end of 1978, 46 percent of products in the CPI basket were still subject to price control.

Tax reforms were also implemented to reduce tax evasion and simplify the tax system. Late in 1974, the tax on earned income and the inheritance tax were abolished, while the basic rate on the value-added tax was increased from 14 percent to 18 percent. During 1975, the coverage of the value-added tax was widened and its basic rate was increased to 20 percent, while the tax rate on income from industry and commerce was raised from 20 percent to 25 percent. During 1977 and 1978, the authorities strengthened tax administration and introduced severe penalties for tax evasion, together with indexation of late tax payments.

The stabilization strategy included an anti-inflationary policy based on reductions in fiscal deficits and in monetary growth. The fiscal position of the Central Government improved substantially owing to a strong rise in revenue collection and expenditure restraint. As a result, the overall deficit of the Central Government fell from the equivalent of 4.5 percent of GDP in 1975 to 1.3 percent of GDP in 1978 (see Statistical Appendix Table 1). However, monetary aggregates continued to grow rapidly (Chart 1). The stabilization plan also included an expenditure-switching policy, consisting mainly of a real devaluation followed by a passive crawling peg, and the promotion of nontraditional exports.

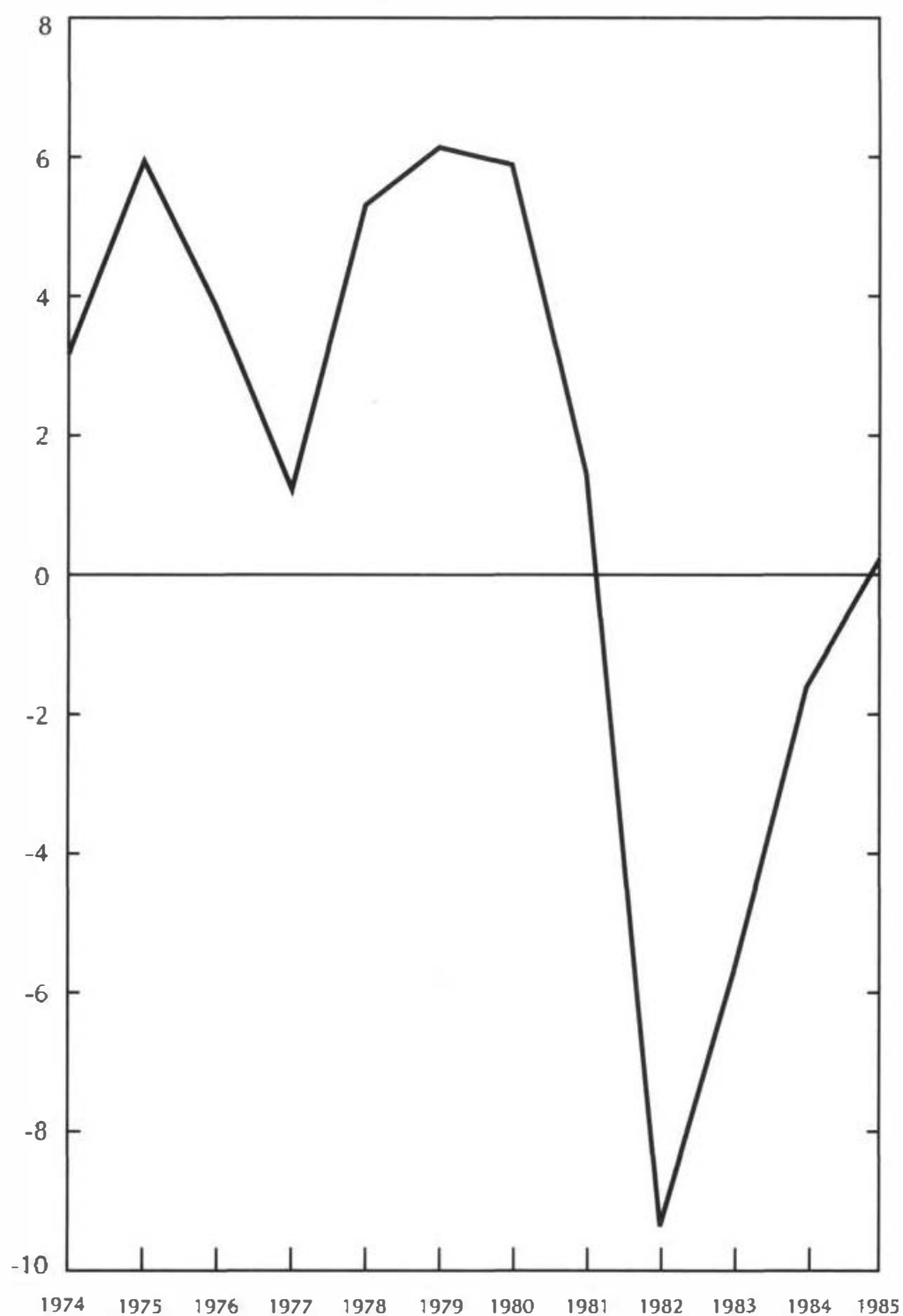
Economic performance clearly improved, despite an unfavorable evolution of the terms of trade. A period of rapid growth (Chart 2) replaced the pre-reform stagnation: real GDP grew at an average rate of 3.9 percent between 1974 and 1978. Inflation (Chart 3) declined from over 107 percent per annum in the last quarter of 1974 (CPI) to 41 percent by the end of the third quarter of 1978. The balance of payments strengthened substantially, with overall surpluses of US\$167 million in 1976, US\$102 million in 1977, and US\$286 million in 1978 (Chart 4). This increase was due partly to large inflows of foreign private capital, attracted by the removal of exchange controls, the introduction of foreign currency deposits in local banks, the uncertain political situation in Argentina, and the high interest rates in Uruguay. The current account also improved, reflecting mainly the strong growth of nontraditional exports. Both unemployment and real wages fell.

Chart 1. Monetary Aggregates: Growth Rates
(In percent per annum)



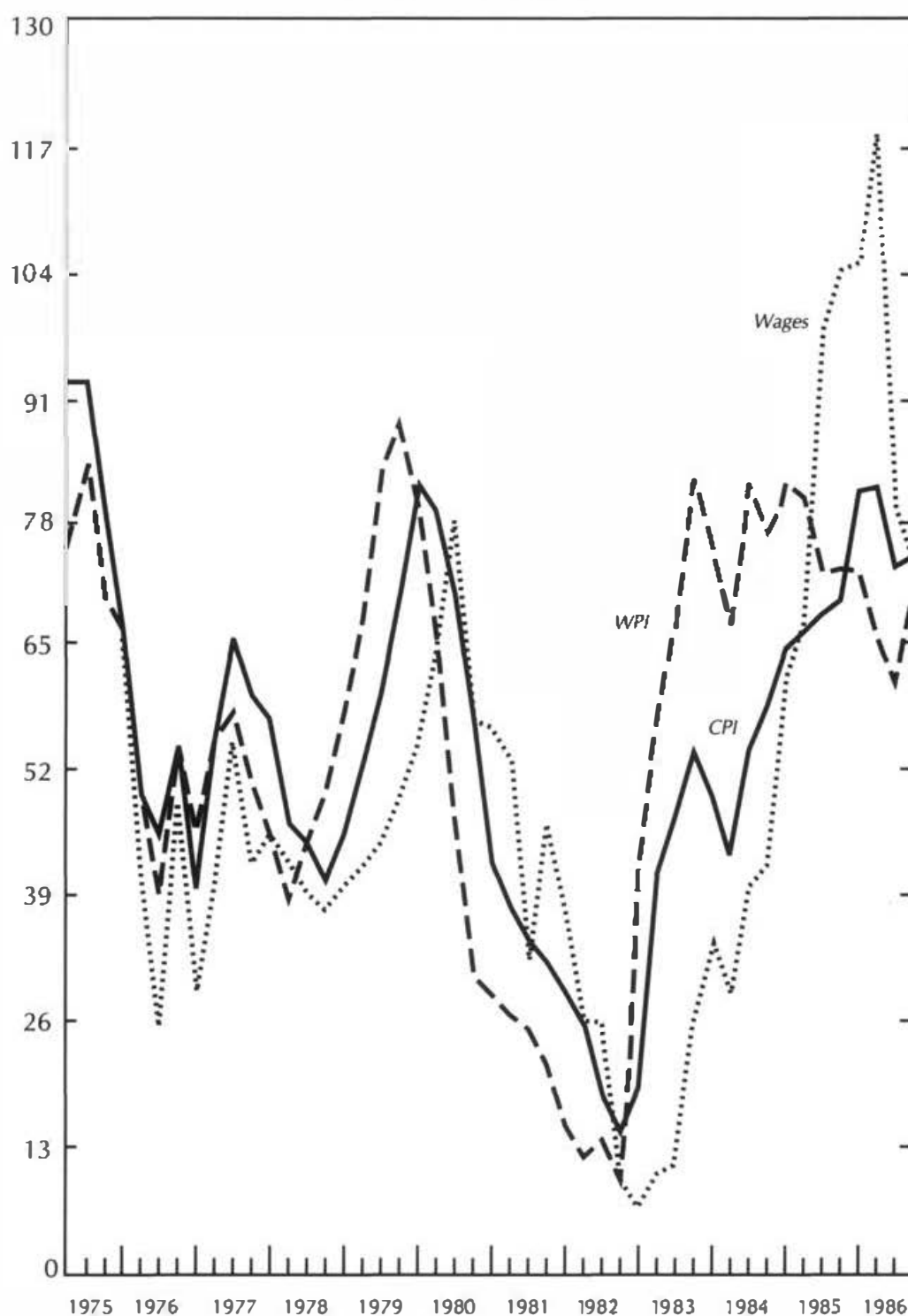
Source: Statistical Appendix Table 2.

Chart 2. Real GDP Growth Rates
(In percent per annum)



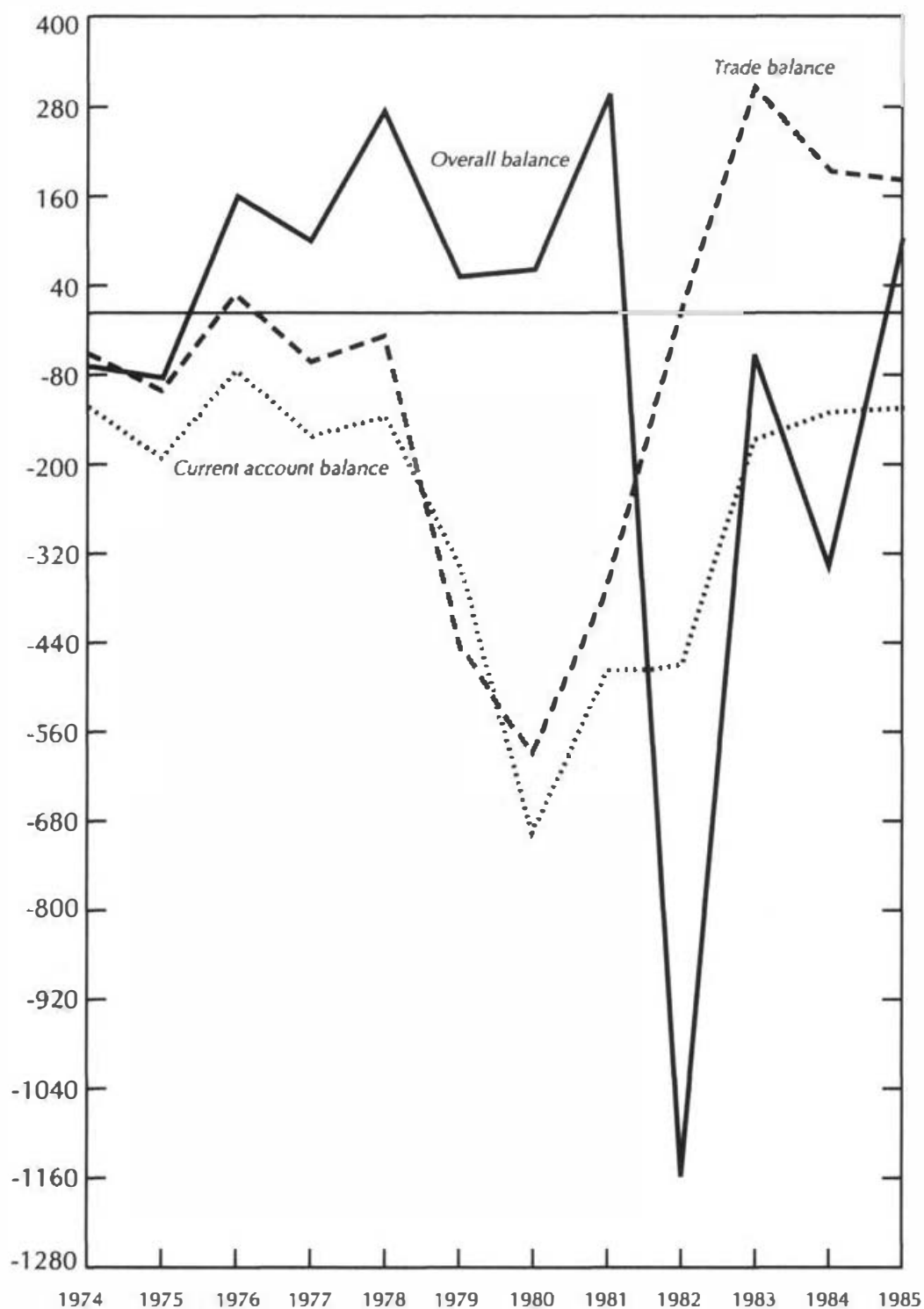
Source: International Monetary Fund, *International Financial Statistics*.

Chart 3. Price and Wage Inflation
(In percent per annum)



Source: Statistical Appendix Table 4.

Chart 4. Balance of Payments
(In millions of U.S. dollars)



Source: Statistical Appendix Table 5.

Phase II: 1979–82

The second phase of the economic reform had three key elements: (1) the implementation of an active crawling peg, (2) the starting of a process of unification of import tariffs, and (3) an important tax reform. In addition, deregulation of foreign trade, commodity prices, and financial markets continued.

The strategy underlying this phase reflected disappointment with the stabilization measures taken in Phase I, which had failed to lower inflation to an acceptable level. To deal with this problem, the new strategy relied on using the exchange rate to influence inflationary expectations. On October 17, 1978, the dual exchange market was de facto unified when the Central Bank announced that it would buy and sell any amount of foreign exchange at rates that would be adjusted from time to time. On October 26, 1978, the Central Bank indicated for the first time the future rate of devaluation through the sale of three-month treasury bills redeemable in domestic currency or U.S. dollars; the redemption value (principal and interest) in U.S. dollars was indicated on the bills. On December 28, 1978, the Central Bank published a preannounced schedule of devaluations (informally known as the *tablita*).⁸ This schedule indicated the daily exchange rates for the Uruguayan peso (in terms of U.S. dollars) through March 1979. On March 27, 1979, the schedule was extended through the end of 1979, and on July 10 through the first quarter of 1980. Thereafter, the schedules were announced six to nine months in advance.

Corbo, de Melo, and Tybout (1986) summarized the rationalization of this plan as provided by the Rodríguez (1982) model:

Interest rate parity obtains continuously because of the absence of controls on capital flows and the assumption of perfect asset substitutability. The law of one price holds for tradeables, and the rate of change in the prices of nontradeable goods is a function of inflationary expectations—which are assumed to form adaptively—and of excess demand for nontradeable goods. The model predicts that the implementation of the *tablita* should immediately reduce nominal interest rates and, to a lesser extent, inflation. The decline in real interest rates should first stimulate demand, creating an excess demand for nontradeable goods and thereby inducing a temporary appreciation of the real exchange rate. As inflation falls, both the real interest rate and the real exchange rate should increase, approaching their long-run equilibrium from below. The economy should stabilize without undergoing the recession associated with traditional contractionary measures (p. 616).

Tariff reductions were accelerated during this phase. Import duties on a large number of imports were reduced or eliminated during the second

⁸ Similar regimes were also adopted in Chile in February 1978 and in Argentina in December 1978.

half of 1978 and in 1979. Moreover, in December 1978, the Government announced a timetable to unify the numerous import taxes to a global tariff, and to reduce this global tariff gradually to an average level of 35 percent over the period January 1, 1980–January 1, 1985.⁹

Export subsidies were also reduced. On March 29, 1979, the system of export prefinancing (*preanticipos*) was eliminated. However, export subsidies for many products continued to be granted in the form of tax credit certificates.

In November 1979, a major tax reform went into effect. This reform included new taxes on agricultural income and sales, the merger of several excise taxes, the rationalization of a number of other taxes, and the substitution of higher value-added tax rates for several social security taxes. This tax reform's primary purpose was to increase the international competitiveness of Uruguayan products by lowering labor costs and eliminating taxes on exports of agricultural products.

Price deregulation continued during this phase, and the role of the price control agency gradually shifted from controlling prices to monitoring price movements and market behavior to protect consumer interests. Nevertheless, by March 1981, the prices of 24 percent of the goods and services constituting the consumer price index remained subject to control.

The foregoing measures succeeded for a time. The economic performance was impressive until the beginning of 1981. GDP growth exceeded 6 percent over the period 1979–80 (Chart 2). Moreover, after accelerating during 1979, the inflation rate receded from early 1980 until the third quarter of 1982 (Chart 3). The balance of payments was consistently in surplus (Chart 4), exports were greatly diversified, and official international reserves rose to a comfortable level. Balance of payments surpluses resulted mainly from capital inflows and tourism from Argentina. The peso appreciated in real terms with respect to the currencies of all major trading partners except Argentina (Statistical Appendix Table 6). Moreover, capital inflows fueled two booms, one in agricultural land, the other in real estate.¹⁰ Confidence in the peso strengthened, and substantial amounts of private savings flowed into the domestic banking system.

Certain policy inconsistencies and several external factors resulted in the steady deterioration of Uruguay's economic and financial performance beginning in late 1980. Demand for Uruguayan exports weakened as a consequence of the recession in the world economy and the policy adjustments undertaken by Argentina and Brazil. Moreover, the deterioration of the terms of trade and the rising world interest rates adversely affected the

⁹ However, to contain inflation, import duties on some products were lowered ahead of the planned timetable during the second half of 1979.

¹⁰ Hanson and de Melo (1983), p. 10.

current account of the balance of payments. The public sector financial position also deteriorated as a result of a decline in the tax base, a large increase in social security payments,¹¹ and a surge in the burden of servicing the public foreign debt.¹² Finally, the Argentine devaluations of March 1981 fueled the growing expectations that the Uruguayan *tablita* was becoming unsustainable.

These factors led to a crisis in confidence in the *tablita*, resulting in major capital outflows and capital flight—which were evident in large changes in errors and omissions items of the balance of payments (Chart 5)—and a deep recession. Real GDP growth decelerated to about 2 percent in 1981, and in 1982 GDP declined almost 10 percent (Chart 2). Finally, in November 1982, the Government dropped its commitment to maintain the *tablita* and a major devaluation followed (Chart 6).

II. The Financial Sector and Evolution of the Regulatory Process

Financial markets in Uruguay evolved within an environment of excessive regulations during the 1960s and early 1970s, and a deregulation process was initiated in the middle of 1974. During the early 1960s the persistence of interest rate controls led to nonprice competition for a dwindling pool of savings, reflected in the increases in the number of bank branches, real estate speculation, and high spreads between loan and deposit rates.¹³ Further regulation from the Government led to capital flight and loss of reserves, and the position of banks was weakened further.

In 1965, a generalized crisis of the banking system developed, and the number of bank failures multiplied. As a result, some very strict regulations were passed, including a ban on entry of new firms into the sector and a ceiling on the total number of branches (thus, if a bank wanted to increase the number of its branches, it could do so only if a competitor grew smaller); limitation of credit available to the private sector; direct subsidies; and interest rate controls.

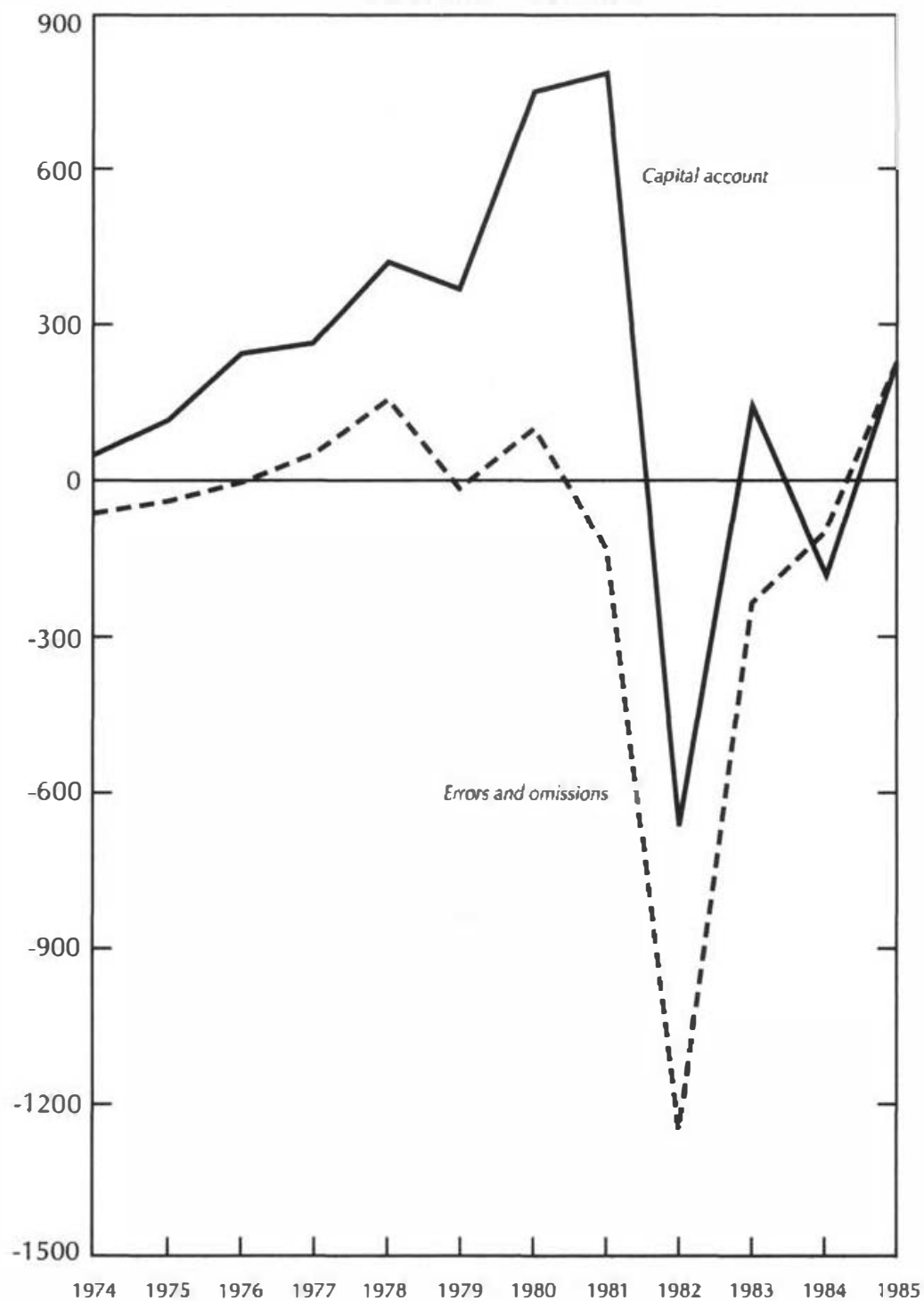
In 1971, another wave of bank mergers and bankruptcies developed, spurred by the deterioration of bank assets caused by high real interest rates. Heavy regulation pervaded the financial activity, including preferential credit programs, high reserve requirements, compulsory purchase of government securities, and interest rate ceilings. An informal lending market developed (the *parabancario* market), operating through public notaries who certified the transactions between borrower and lender, thereby creating a tradable financial instrument (certified promissory notes).

¹¹ Hanson and de Melo (1985), p. 10.

¹² Larraín (1986), p. 19.

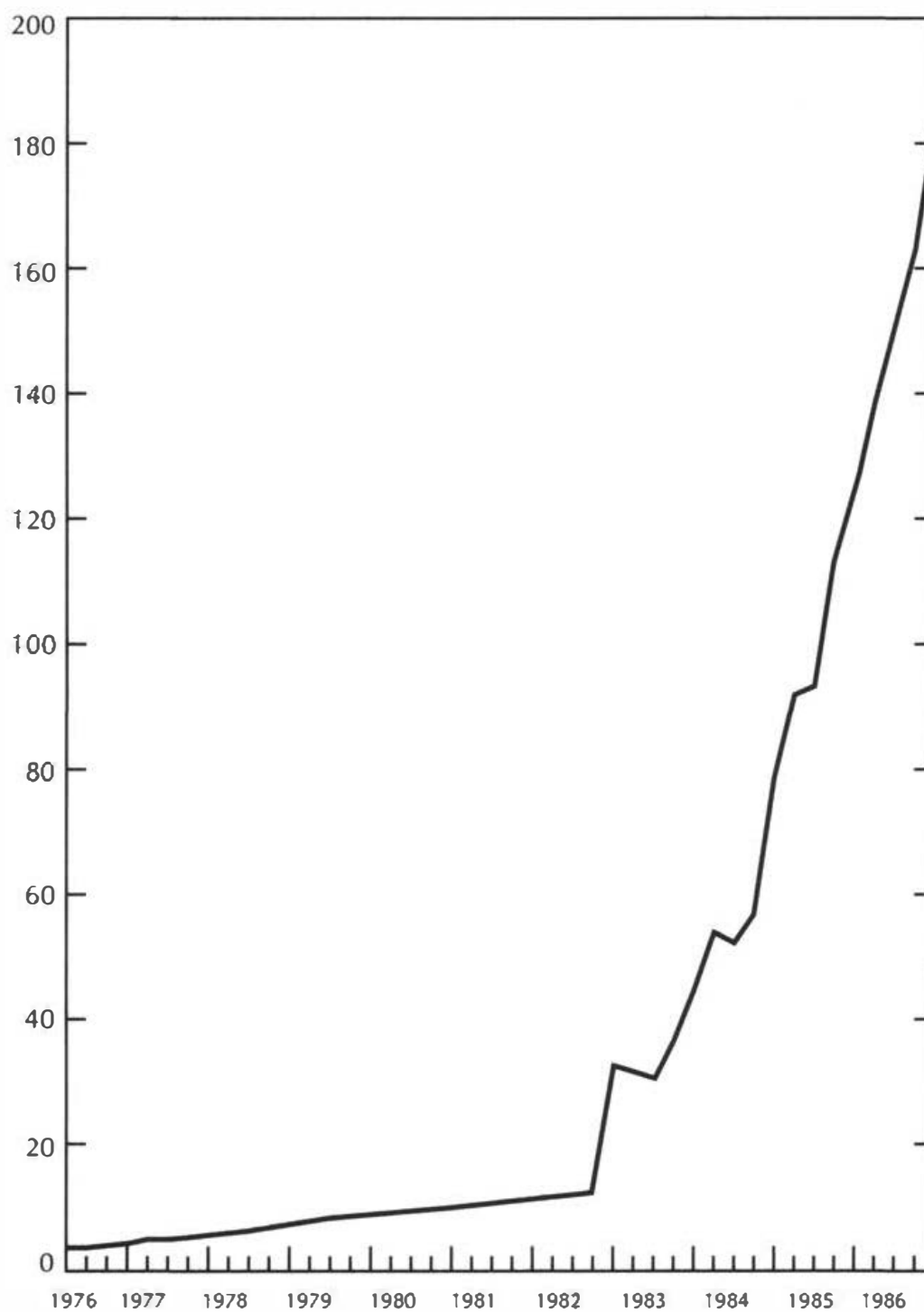
¹³ See Daly (1967).

**Chart 5. Balance of Payments: Capital Account and
Errors and Omissions**
(In millions of U.S. dollars)



Source: Statistical Appendix Table 5.

Chart 6. Nominal Exchange Rate
(Pesos per U.S. dollar, end of period)



Source: International Monetary Fund, *International Financial Statistics*.

As Larraín (1986) notes,

At the time of the reforms, the role of the banking system as intermediary of funds was reduced to a critically low level, at approximately 35 percent of the real value of loans and deposits that it had in the early fifties (pp. 8–9).

The structure of the Uruguayan financial system prior to the middle of 1974 is described below.

- The Central Bank of Uruguay (CBU) was established in 1967 and was in charge of currency issuance, managing of international reserves, formulation and execution of monetary and credit policies, and control of the banking system.¹⁴
- The two state-owned banks Banco de la República Oriental del Uruguay (BROU) and the Banco Hipotecario (BH). The BROU, which was established in 1896, was the largest commercial bank in Uruguay. It handled all financial transactions of the central and departmental governments, controlled foreign exchange proceeds from exports, and collected some excise duties and tariffs.¹⁵ The BH specialized in financing low- and middle-income housing.
- Private commercial banks: they could receive deposits in pesos and could extend loans in either pesos or foreign currency. Some of these banks were foreign owned.
- Banking houses (*casas bancarias*): they differed from commercial banks in that they were not allowed to accept deposits. They were allowed to intermediate in the bankers' acceptances market and in export-import operations. Their main activity was to borrow abroad and lend those funds in the domestic market.
- Financial intermediation cooperatives operated exclusively with their members.

There were significant differences in the evolution of these institutions between 1974 and 1985 (Statistical Appendix Table 7). The salient features were the small variation in the number of banks, the rapid increase in the number of banking houses after 1977, and the significant growth in the number of offices and employees.

Compared with banks in other countries, Uruguayan banks seemed to be relatively small: only 3 made the top 100 of Latin America as of 1986 (the BROU (No. 31), La Caja Obrera (No. 96), and Comercial (No. 99)).¹⁶

The share of "Banks, insurance, and other financial intermediaries" in nominal GDP at factor cost increased from 4.7 percent during 1975–77 to 6.5 percent during 1983–85 (Statistical Appendix Table 8).

¹⁴ For a legal analysis of the role and functions of the CBU, see Delpiazzi (1983).

¹⁵ This bank operated also as a monetary authority until the Central Bank was established.

¹⁶ See *The Banker* (October 1986), p. 91.

Against this background, we will review now the process of deregulation of the financial markets, in the context of the liberalization-cum-stabilization experience of 1974–82.

Liberalization of International Financial Transactions

As noted in Section I above, in September 1974 domestic residents were allowed to trade in any kind of assets denominated in any currency, since exchange controls were eliminated altogether, and banks were authorized to receive deposits denominated in foreign currency. Moreover, the abolition of the personal income tax in July 1974 eliminated the need to report these transactions. Also, nonfinancial firms were allowed to borrow in foreign currency at home or abroad with no limitation, and nonresidents were allowed to repatriate both earnings and capital with no limit.

As Larraín (1986) notes,

. . . this deregulation is all the more remarkable since before September of 1974 it was illegal for Uruguayans to hold dollars and stories are told about people sent to jail after being caught holding a hundred-dollar bill (pp.21–22).

Interest Rates

The economic reform that began in 1974 included various adjustments to the ceilings on interest rates, culminating eventually in full liberalization of interest rates.

Effective September 25, 1974, the maximum interest rate (payable in advance) on bank *peso* loans was raised from 24 percent to 32 percent per annum. At the same time, the ceiling on bank commissions (also payable in advance) was reduced from 10 percent to 6 percent, while the tax on financial transactions (which could be passed on to borrowers) was kept at 6 percent. These measures increased the effective cost to borrowers (including the said tax) from a maximum of 66.6 percent to 78.6 percent per annum. The annual interest rate for loans in *foreign currency* had already been increased in July 1974 from 14 percent to 16.5 percent. The BROU kept preferential interest rates for public sector loans, and for a few priority sectors.

Interest rates on *peso* deposits continued to be fixed by the Central Bank until March 1976. Effective October 1, 1974, an annual interest rate of 10 percent was set on demand deposits, which previously had been non-remunerated. However, this measure was reversed a few months later. At the same time, the interest rate for savings deposits was increased by 10 percentage points to 18 percent a year. For time deposits the annual rates were increased by 15–23 percentage points ranging from 30 percent (for 3- to 5-month deposits) to 48 percent (for deposits of 12 months and over).

Rates payable on deposits in *dollars* were free throughout the period.

During 1976, the authorities attempted to reduce interest margins, improve the interest rate structure and encourage efficiency in banking operations. From January 1, commissions were eliminated and all interest rates were made payable at maturity, whereas before they were payable in advance. From April 1, all rates of interest on deposits were freed, but maximum lending rates continued to be set by the Central Bank. These changes enabled banks to pay positive real interest rates on deposits for the first time in many years. Nevertheless, the BROU continued to charge promotional rates on loans for nontraditional exports and for meat packing; these loans were rediscounted with the Central Bank. However, from April 1, 1976, the annual rate for all *new* central bank rediscount facilities, which had ranged from 8 percent (for rediscounts to the BROU) to 12 percent (for regular facilities to commercial banks), was raised to 17 percent. In September 1976, rediscount was restricted only to emergency lending to banks facing temporary liquidity problems and carried a penal interest rate.

The ceilings on lending rates were increased again in late 1977 and 1978. In addition, in May 1979, the tax on bank loans was substantially reduced. Finally, on September 12, 1979, all interest rate ceilings were eliminated.

Reserve Requirements

The level and structure of reserve requirements varied throughout the period, and the requirements were generally reduced, simplified, and unified between 1975 and 1979. This reflected a changing balance between the needs of raising revenue for the Government, inducing a certain portfolio composition, and promoting the liberalization program. Both peso and foreign currency deposits were subject to reserve requirements, whose level depended on the maturity of deposits, and which could be partially satisfied with government bonds during certain periods. (For a chronology of adjustments in the reserve requirements, see Appendix I.)

To assist banks that were placed in a difficult financial position because of the new interest rates announced in September 1974 (which implied a smaller spread for the commercial banks), effective October 1, 1974, the Central Bank reduced the reserve requirements. Early in 1975, the monetary authorities established a 40 percent marginal reserve requirement on the excess of *peso* deposits over their average level in December 1974.

A major reform in regulations on reserve requirements took place at the beginning of 1976. An important change was to disallow the use of any assets except cash in vault or deposits with the Central Bank for the fulfillment of reserve requirements. At the same time, however, it was decided that private commercial banks would have to keep in their portfo-

lios government securities whose value was equivalent, at a minimum, to a certain proportion of their deposits. In June 1977 the requirement to hold government debt was eased, while reserve requirements were increased considerably.

Late in 1977 the authorities began to equalize the treatment of reserve requirements on local and foreign currency deposits. From January 1, 1979, all reserve requirements, both on *local and foreign currency* deposits, were unified at 20 percent of outstanding deposits at the end of 1978. All increments of deposits above that amount would have a zero reserve requirement. Finally, in May 1979, all basic reserve requirements were eliminated. After this measure, the only reserve requirement which remained in force was a marginal requirement of 100 percent, which applied to the amount of deposits in *local currency* exceeding 16 times a bank's capital and reserves. In June 1979, this limit was temporarily increased to 30 times capital and reserves, but was extended to *foreign currency* deposits, lines of credit, guarantees, and other obligations.

Entry Barriers

Under the 1965 law, no new banks were allowed, and a ceiling was set on the total number of branches. This law did not ban the establishment of new banking houses, but since they could not raise deposits, this was not a very important exception.

The first major change in entry regulations took place in 1976, when the Central Bank of Uruguay allowed banking houses to receive foreign currency deposits from nonresidents. This was a main factor in the rapid expansion of these houses after 1976, whose number increased from 2 in 1976 to 23 in 1981.

In November 1981 (Law 15207), the entry prohibition in the banking sector was lifted. New banks were allowed, in a number not to exceed each year 10 per cent of the number existing in the previous year; the ban on branch expansion was also lifted.¹⁷

Prudential Regulations

Uruguay's financial system was subject to a limited array of prudential regulations, most of which were in force for the whole reform period. No formal deposit insurance scheme existed at that time; banking supervision consisted primarily of control of capital and reserve requirements and on-site inspections; the accounting framework and off-site analysis were weak.

¹⁷ See Olivera García (1982a and b) for a description of the legal details.

Maximum liability/capital ratios limited banks' expansion. Liabilities exceeding the maximum ratio were subject to a 100 percent reserve requirement. In February 1974 it was established that domestic deposits should not exceed an amount equal to 15 times each bank's capital. That ratio was raised to 16 some months later, but only for local currency deposits. The maximum limit for bankers' acceptances was set at 50 percent of the bank capital. In 1979, the liabilities/capital ratio was set at 30 times for banks and 20 times for banking houses, and was extended to cover both domestic and foreign currency deposits.

Minimum capital requirements were in force, varying according to the type of institution (higher for banks, lower for banking houses) and the location (higher for offices in Montevideo, departmental capitals, and the cities of Las Piedras, Pando, and Punta del Este). These requirements were updated periodically, and were in force throughout the period.

Maximum financing limits existed until 1979. When the reforms started in 1974, a bank's credit to a single client could not exceed 20 percent of the bank's capital and reserves (except for export prefinancing). In 1975, this limit was raised to 25 percent. A 1977 regulation forbade financing above 25 percent of the bank capital to corporations whose boards were linked to the banks' boards or managements.

In March 1979, all regulations on maximum financing and risk concentration were eliminated. They were reinstated in December 1980, when they were set at 25 percent for individuals or single firms, and at 35 percent for conglomerates or groups of firms. They applied to disbursed and nondisbursed loans, endorsements, etc. In August 1981, these limits were abolished and were replaced by a requirement that each borrower be subject to a detailed analysis, using a uniform methodology. In September 1982, lending to managerial personnel of firms was prohibited.

Foreign exchange exposure was not regulated. Thus, banks could borrow in dollars and lend in pesos without any limits.

Asset immobilization limits were set at 60 percent of capital and reserves in 1976, and raised during 1977 first to 70 percent and then to 100 percent.

Banking Supervision and Early Warning Indicators

Table 1 provides information on the number of on-site bank supervision visits.

These data suggest that the number of inspections the Central Bank carried out each year exceeded the number of banks and banking houses in operation. However, these numbers should be interpreted with caution. The numbers alone do not provide any information on the quality of the inspection or the criteria used for the audit, the amount of information made available to the auditors, or the penalties that could be applied.

Table 1. On-Site Bank Supervision Visits, 1975–83

| Year | Number of Visits |
|------|---------------------|
| 1975 | 36 |
| 1976 | 40 |
| 1977 | 97 |
| 1978 | 82 |
| 1979 | 66 |
| 1980 | 74 |
| 1981 | ... |
| 1982 | 99 |
| 1983 | 96 |

Source: Central Bank of Uruguay, *Annual Report*, various issues.

According to Larraín (1986), supervision

has been mainly confined to the traditional control of capital and reserve requirements. Balance sheets and profit and loss statements are also reviewed to judge if they are appropriately drawn up so that they accurately reflect the financial situation of the bank (p. 29).

An interesting comment on this issue is made by J. Gil Díaz, President of the Central Bank of Uruguay from 1974 to 1982:

During my tenure . . . there was no legal norm that allowed the Central Bank to regulate the way in which the accounting information of financial institutions should be presented and evaluated.¹⁸

Similarly, there does not seem to have been any early warning indicators or other systematic or informal off-site analysis of banks in the Central Bank.¹⁹ Nevertheless, the Central Bank management might have been aware of banking difficulties well in time, as Gil Díaz states:

. . . the Central Bank of Uruguay, within the limits of its capacity, discharged its responsibility of controlling the national banking system. Through its supervision, auditing, analysis of periodical information and special information requests, it soon detected that a group of institutions was weaker than the rest.²⁰

¹⁸ *Búsqueda*, No. 361, December 12, 1986, p. 14.

¹⁹ See, for instance, the papers in Altman and Sametz (1977) for examples of alert indicators.

²⁰ *Búsqueda*, No. 361, December 12, 1986, p. 14.

III. Impact of Reforms on Macroeconomic Variables and the Financial Sector

Financial Intermediation and Growth of Financial Sector

Charts 7 and 8 illustrate the *financial deepening* process in Uruguay after 1974 by depicting the ratios of bank assets and liabilities relative to GDP.

The interest rate reforms and capital account liberalization generated important portfolio shifts and capital inflows with significant consequences for the Uruguayan financial sector after 1974. The ratio of M1 (currency in circulation plus sight deposits) to GDP declined from about 12 percent in 1974 to less than 8 percent in 1981, while the ratio of M3 (M1 plus savings and time deposits in foreign and domestic currency) to GDP increased from about 19 percent to about 43 percent over the same period.

The sequencing of the economic reform was also reflected in the evolution of the composition of M3. During the first years after the economic reform was initiated, liberalization of foreign currency deposits in Uruguay was quickly completed, while important regulations continued to prevail for domestic currency transactions. During this period, foreign currency deposits increased much faster than peso deposits. The ratio of foreign deposits to GDP increased about six times from 1974 to 1977 (with a large proportion held by nonresidents), while the ratio of domestic currency time and savings deposits to GDP increased only 33 percent over the same period.

After 1977, when interest rate ceilings were gradually removed and the authorities began to equalize the treatment of local and foreign currency deposits with regard to reserve requirements, domestic currency deposits became more attractive to investors. The ratio of savings and time peso deposits to GDP increased 2.5 times from 1977 to 1980, while the ratio of foreign currency deposits to GDP declined from 1978 to 1980. The factors that adversely affected the Uruguayan economy and contributed to the loss of confidence in the *tablita* reversed these trends after 1980.²¹

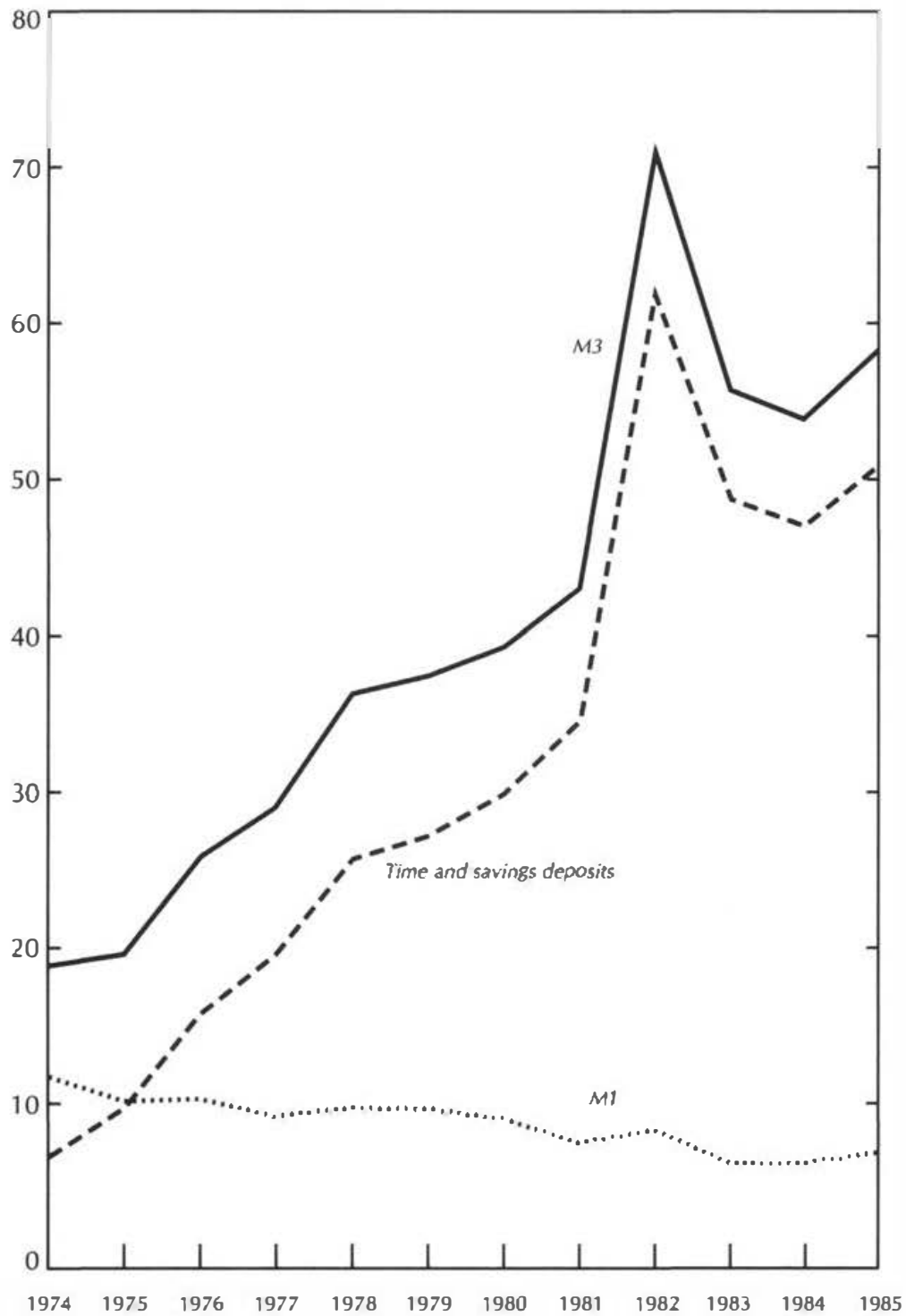
The question arises whether this growth of the financial sector translated into an increasing *availability of credit* to the private sector or whether funds were invested abroad or used to finance fiscal deficits.

Chart 8 shows a fast growth in credit to the private sector between 1974 and 1982. The remarkable reduction in fiscal deficits reduced government borrowing needs between 1974 and 1980. Most of the increase in private sector credit corresponds to credit in foreign currency, which, as a share of GDP, increased about five times over the period.

The problems faced in the early 1980s by the Uruguayan economy, and

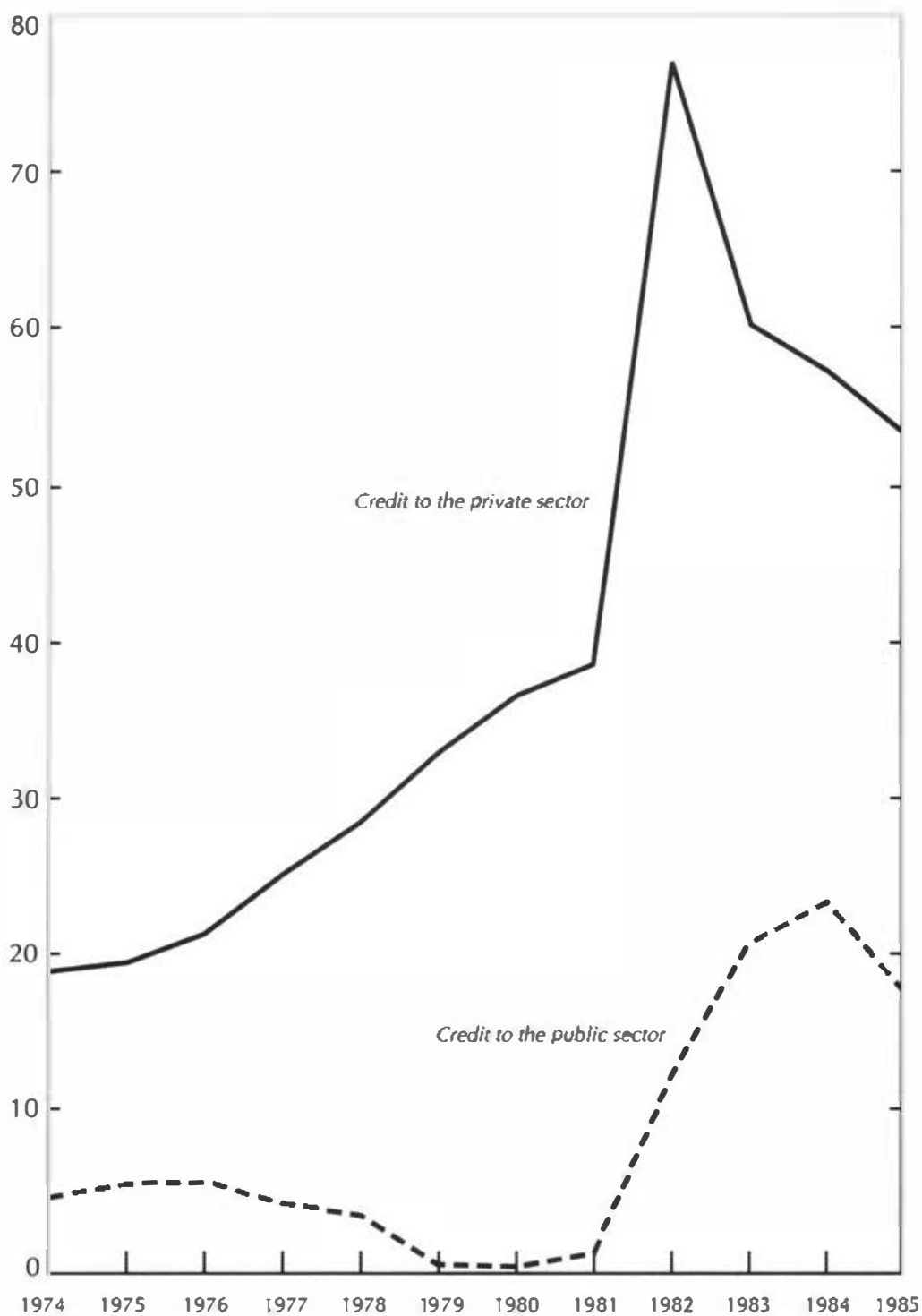
²¹ See also de Melo and Tybout (1986).

Chart 7. Financial Intermediation
(Liabilities of banking system as percentage of GDP)



Source: Statistical Appendix Table 9.

Chart 8. Credit of Banking System
(As percent of GDP)



Source: Statistical Appendix Table 9.

particularly by its financial sector, tightened credit conditions. Moreover, fiscal deficits, which had been negligible before 1980, absorbed a larger share of domestic credit. Thus, credit to the private sector, and particularly credit in domestic currency, decreased after 1982 as a share of GDP.²²

Hanson and de Melo (1985) stressed that a substantial share of private credit was in the form of consumer credit, whose share in total bank credit grew from 4 percent in 1979 to 12 percent in 1981. And that

another part went to finance, and made possible, two asset price bubbles. The first was the agricultural land boom after the fourfold increase in domestic beef prices between August 1978 and August 1979. . . . The second bubble—which followed immediately—was the real estate boom ignited by Argentine purchasers of real estate in Punta del Este (p. 12).

Effects on Savings, Investment, and Efficiency of Investment

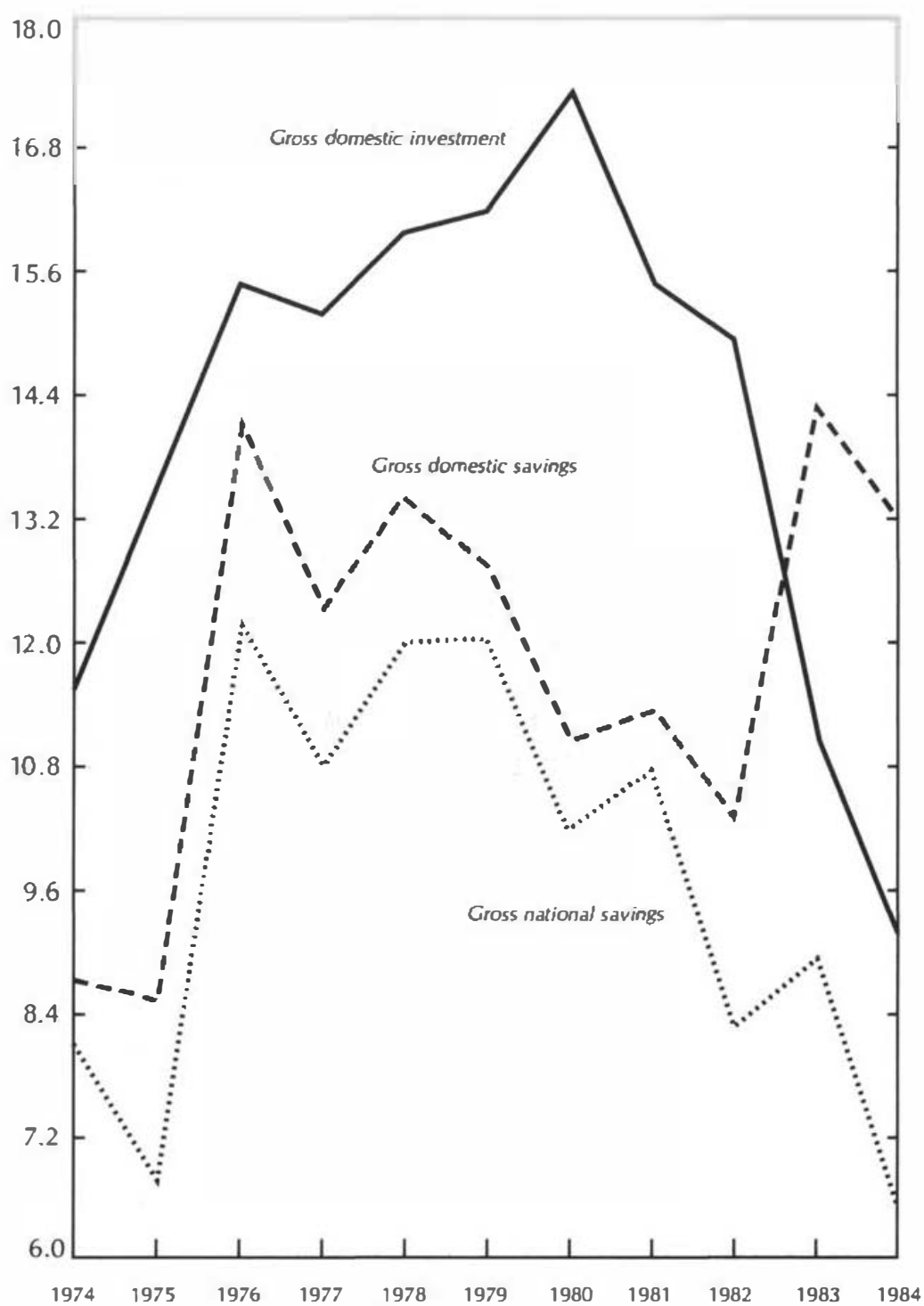
The question arises as to whether the financial deepening described in the previous subsection resulted from an increase in savings or simply reflected portfolio shifts (financial operations which were carried out in informal markets being absorbed by the formal financial sector under the new policy regime), and capital inflows (attracted by the new conditions prevailing in the formal financial sector but also responding to conditions prevailing in neighboring countries). This subsection also discusses the effects of the liberalization on investment behavior.

Chart 9 presents data on aggregate savings and investment. Also, de Melo and Tybout (1986, p. 568) provide the following period average data:

| | 1955–63 | 1964–73 | 1974–78 | 1979–83 |
|------------------------|---------|---------|---------|---------|
| Domestic savings/GDP | 11.9 | 12.5 | 11.0 | 11.7 |
| Private savings/GDP | ... | 11.3 | 9.6 | 9.6 |
| Foreign savings/GDP | 2.9 | –1.7 | 2.5 | 2.9 |
| Private investment/GDP | ... | 9.6 | 12.1 | 12.6 |

A straightforward reading of this evidence provides no support to the view that the domestic savings rate rose in response to interest rate deregulation. Although gross domestic savings seem to have been only slightly lower during the reform period, private savings fell during that period. Moreover, both gross domestic savings and gross national savings showed a declining trend after 1976, following two years of rapid increase (Chart 9).

²² The 1982 peak in assets and liabilities of the financial sector reflects the devaluation impact when the *tablita* was abandoned.

Chart 9. Savings and Investment as Percentage of GDP

Source: Statistical Appendix Table 10.

De Melo and Tybout (1986) analyzed the influence of the financial liberalization on savings rates, and concluded that the effect of real interest rates on the savings rate was statistically not significant, although the savings rate shifted upward in the post-reform period. Foreign capital inflows and real exchange rates had the dominant impact on savings.

With respect to *investment*, the ratio of private investment to GDP rose in the reform period.²³ This could also be attributed, as de Melo and Tybout (1986) point out, to the exceedingly low return on capital in the pre-reform period, as documented in Harberger and Wisecarver (1977).

However, the shift in period averages masks two distinct trends apparent in the yearly data. Investment ratios (in relation to GDP) increase steadily until 1980 (from 7.7 percent for private fixed capital formation and 11.6 percent for gross domestic investment in 1974 to 11.8 percent and 17.4 percent, respectively, in 1980), with a marked decline thereafter (to 5.2 percent and 9.3 percent, respectively, in 1984).

De Melo and Tybout (1986) document structural shifts in the investment function (an upward shift of the intercept term and more responsiveness of investment to interest rates and real exchange rates) but this is not interpreted as evidence in support of the McKinnon hypothesis. Rather, they interpret the finding of significant accelerator-type effects to be a sign that Uruguayan savings were not constrained, despite the presence of "financial repression" in the pre-reform years. Larraín (1986) points out that the rationalization and decrease of profit taxes as well as the elimination of quotas on imports of capital goods were major determinants of the shift in post-reform investment function.

On the issue of the *efficiency of investment*, Hanson and de Melo (1983) find a 40 percent rise in the ex post incremental output/capital ratio from 1967–1974 (0.18) to 1975–1981 (0.25). They argue that the improvement in efficiency probably reflected not only the improved allocation of credit but also the improved utilization of capacity, the rapid growth in less capital-intensive industries (which benefited from the goods and financial market reforms) and the easing of restrictions on capital goods imports.²⁴

Thus, even though the empirical evidence does not support a strong responsiveness of domestic savings to financial liberalization, the economic reforms implemented in Uruguay in the mid-1970s raised the level and efficiency of investment.

²³ This is in accordance with the McKinnon-Shaw thesis, which suggests that the dismantling of financial repression and the increase in real interest rates will contribute to increases in savings and investment, and in the average efficiency of investment, and will promote economic growth. See McKinnon (1973) and Shaw (1973).

²⁴ Further evidence on the allocative efficiency of investment is considered in the study by de Melo, Pascale, and Tybout (1985) using microeconomic data.

Behavior of Interest Rates

Nominal Interest Rates

Nominal interest rates fluctuated sharply as ceilings were lifted and economic conditions changed (Charts 10 and 11).

In general, nominal lending and deposit *peso* interest rates increased during the first years of the reform, but the ceilings continued to be binding until late 1977. Interest rates were relatively stable during the second phase (1979–82), particularly after late 1979. They jumped when the stabilization policy collapsed and inflation started to regain momentum. Nominal interest rates on *dollar* operations increased during the whole reform period, particularly during the second phase (under the active crawling peg regime). However, interest rate ceilings on dollar lending rates were also binding until late 1977. Nominal interest rates on dollar operations became highly volatile between the second half of 1979 and late 1982, when they started to fall steadily.

With regard to the second phase of the reform, Favaro (1985) also points out two stylized facts in relation to two nominal rates. First, the term structure of interest rates remained upward sloping (i.e., interest rates on short-term deposits were below the rates on longer-maturity deposits). Also, despite changes in economic circumstances and in the institutional scenario, domestic interest rates experienced little fluctuation.

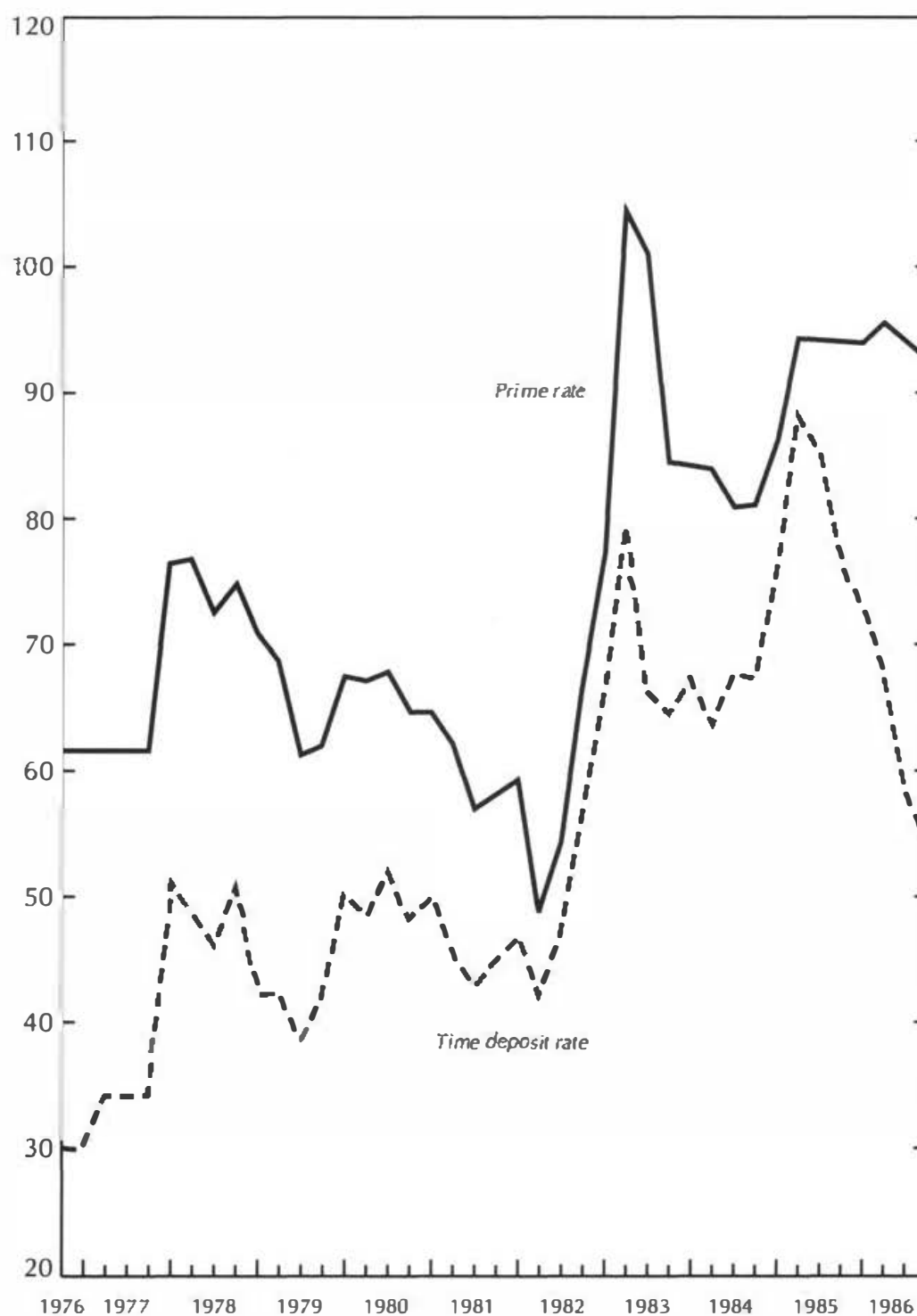
The authorities attempted to reduce the spread between lending and deposit rates after 1976. However, only after 1979 did spreads decline markedly (Charts 12 and 13), when the tax on bank loans was substantially reduced and basic reserve requirements were eliminated. Increased competition in banking also contributed to the decline in spreads.²⁵ Spreads, particularly those on *peso* rates, widened considerably in late 1982 and early 1983. This measure of spread does not indicate intermediation costs or performance of the banking industry, as the net spread—net of the impact of taxes, reserve requirements, etc.—would do.²⁶

However, there is not enough information available to analyze the evolution of costs of intermediation. Moreover, constantly evolving regulations on portfolio and reserve requirements for financial institutions make it difficult to construct a series on net spreads from the available information on gross spreads. Nevertheless, the available data show that the removal of different regulations greatly contributed to the reduction of financial spreads.

²⁵ Spiller and Favaro (1984) and Hanson and Neal (1986).

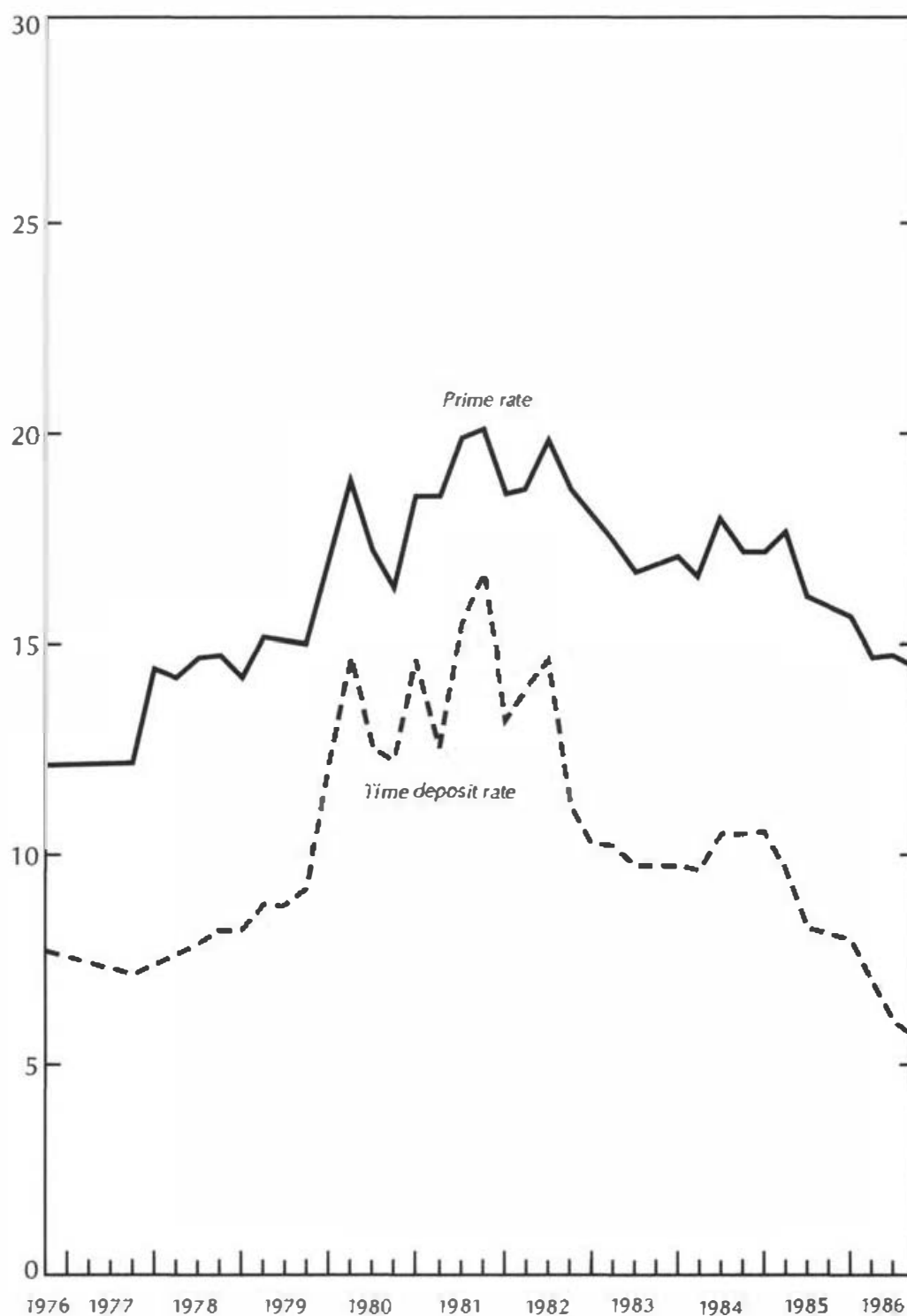
²⁶ For a study of different definitions of spread, see Hanson and Rocha (1986).

Chart 10. Annual Nominal Interest Rates (Peso)
(In percent)



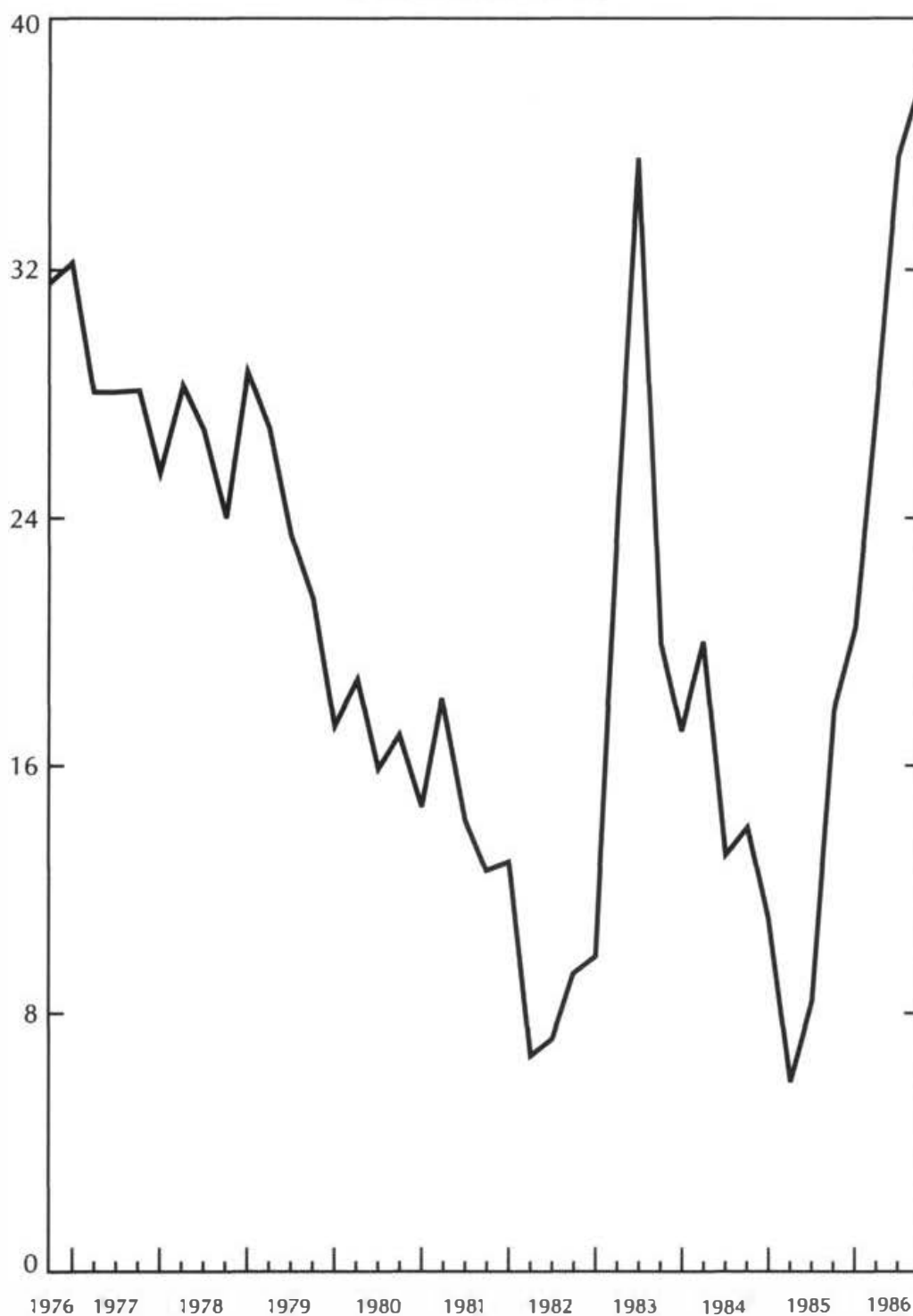
Source: Statistical Appendix Table 11.

Chart 11. Annual Nominal Interest Rates (Dollar)
(In percent)



Source: Statistical Appendix Table 11.

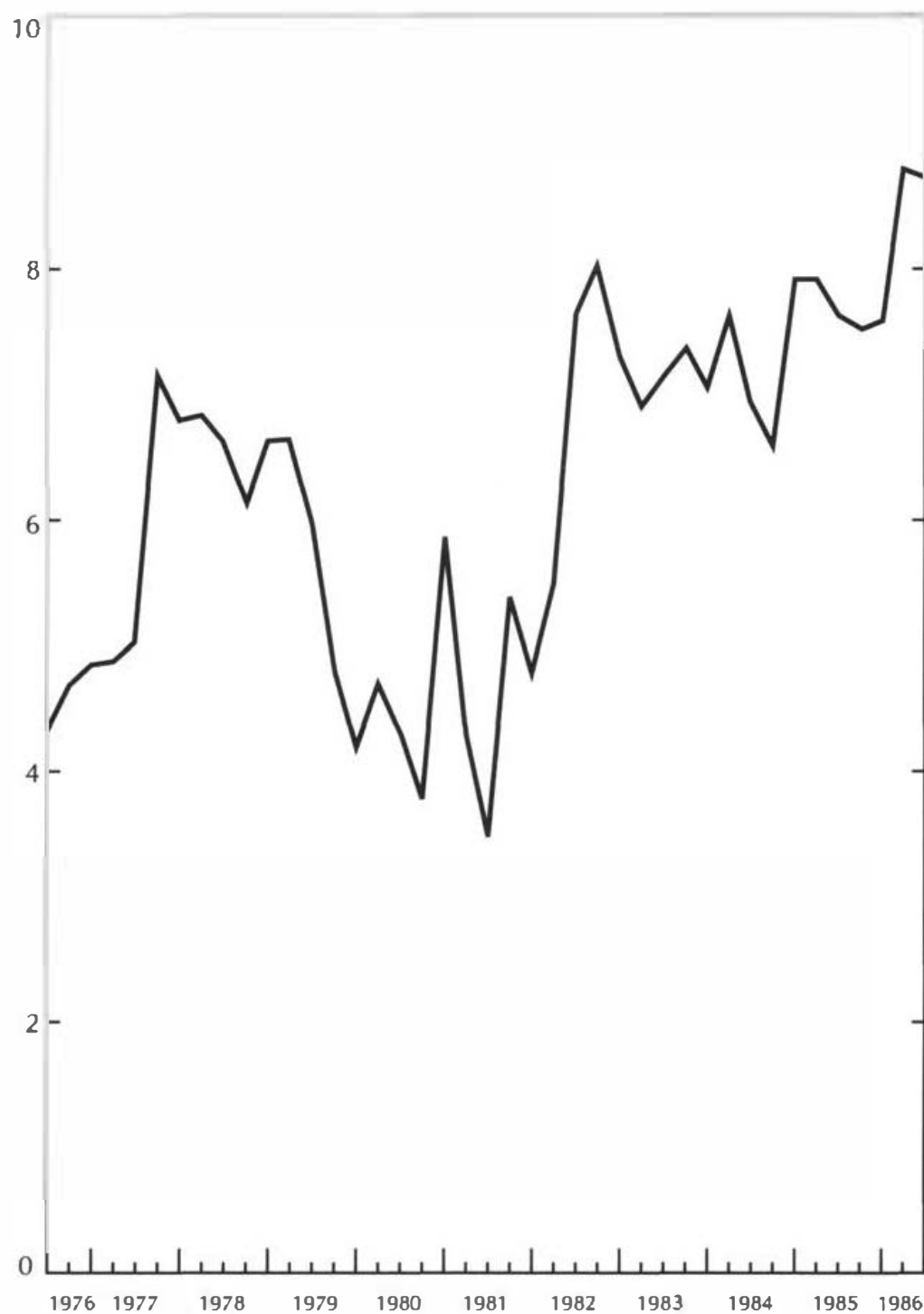
Chart 12. Spread in Interest Rates (Peso)¹
(In percent per annum)



Source: Statistical Appendix Table 11.

¹ Prime loan rate less interest rate on time deposits of up to six months.

Chart 13. Spread in Interest Rates (Dollar)¹
(In percent per annum)



Source: Statistical Appendix Table 11.

¹ Prime loan rate less interest rate on time deposits under six months.

The Spread Between Peso and Dollar Rates

With free convertibility of the peso and no interest rate ceilings, it was expected that interest parity conditions would obtain, owing to asset market arbitrage. Therefore, the domestic interest rate would be determined by the world interest rate, adjusted for exchange rate risk.

The ex post spread between the rates on peso deposits and peso equivalent rates on dollar deposits was high and varied throughout the period (Chart 14). It widened after the adoption of the *tablita*, remained about constant in 1980, and dropped “sharply during the period of exchange guarantees extending over seven months starting in February 1981.”²⁷

The evolution of the spread between peso and dollar rates raises two issues: (1) why the rate of interest on assets in pesos exceeded the rate of interest on assets in foreign currency, even when the assets were traded in the same domestic market (so that we can abstract from country risk considerations), and (2) why this ex post realized premium kept changing over time.

The most common explanation for the existence of the premium is that of expectations of devaluation, i.e., the lack of credibility of the public in the exchange rate policy. If this is true, then the variation in the premium could be traced to the factors that affect those expectations. Moreover, a positive spread implies that expected devaluation was higher than realized devaluation.

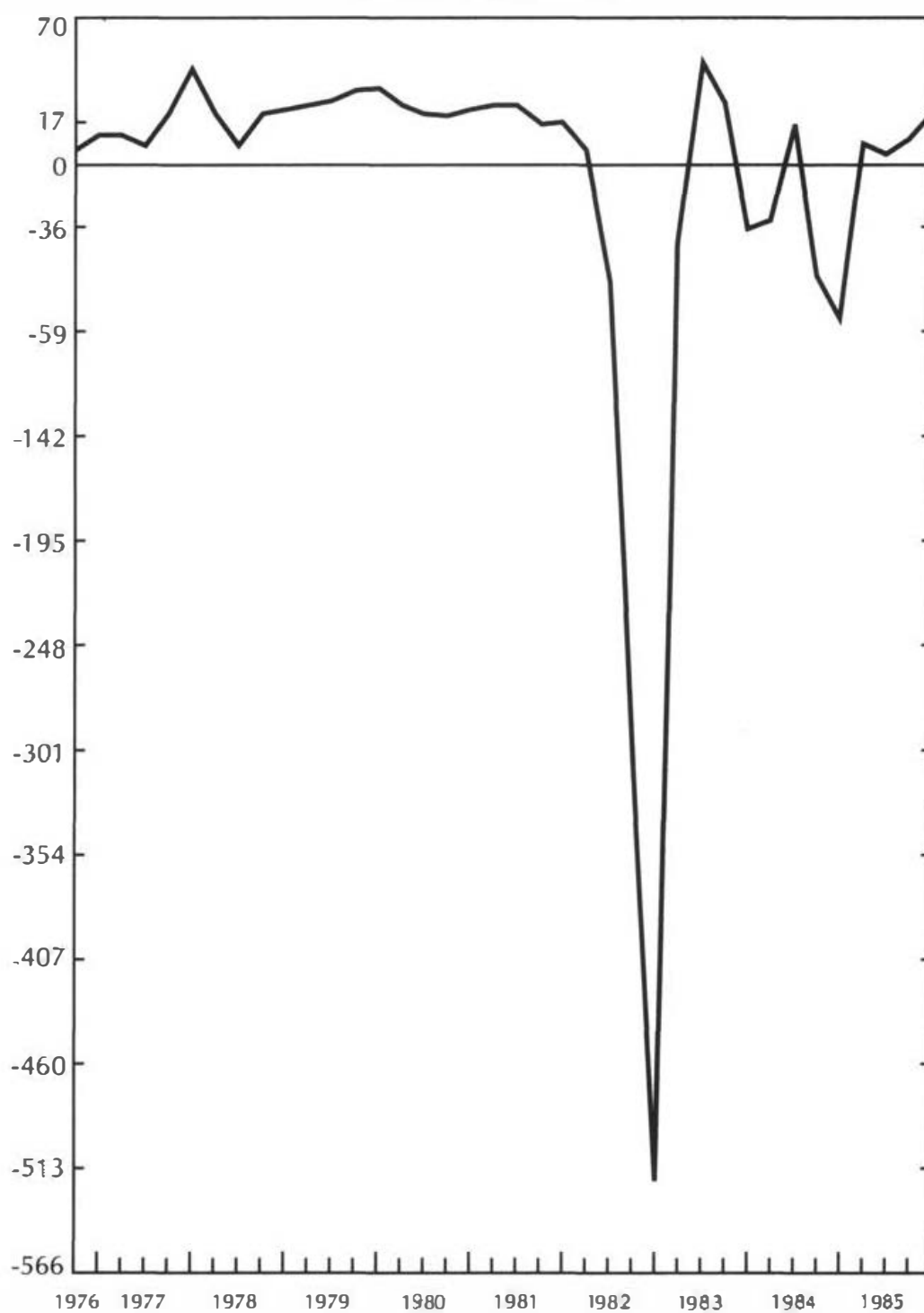
Hanson and de Melo (1985) tested a model of interest rate determination along these lines, based on the uncovered interest rate parity using monthly data for November 1978 to December 1981. They concluded that the long-run elasticity of the peso deposit rate with respect to the rate on foreign currency deposits, 0.98, was not significantly different from the unitary elasticity predicted by the interest parity theorem, suggesting a constant ex ante spread. Moreover, the ex post rate of devaluation seems to have had an insignificant effect on the ex ante spread.

Favaro (1985) found the expectations of devaluation hypothesis unsatisfactory and proposed an alternative explanation, based on a model of financial cost minimization that introduces the existence of real costs of adjusting a given net foreign asset position. He emphasized that, under certain policy rules, limited arbitrage opportunities may result in a wide gap between the nominal interest rate and the rate of inflation and hence in movements of the real rate of interest. He also concluded that differences between domestic and foreign interest rates do not necessarily mirror expectations of devaluations, but reflect the existence of real adjustment costs of the debt structure owing to uncertainty in the policy regime and incomplete futures markets.

²⁷ Hanson and de Melo (1985), p. 13. Favaro (1985) also discusses the evolution of spreads.

Chart 14. Interest Rate Differentials¹

(In percent per annum)



Source: Statistical Appendix Tables 11 and 12.

¹ Peso prime lending rate less peso equivalent of dollar prime lending rate.

Ex Post Real Interest Rates

Real interest rates (ex post) showed a high volatility between 1976 and 1985 (Charts 15 and 16). This volatility of real interest rates generated financing difficulties for the Uruguayan firms. Declining financial costs when real rates were negative (up to mid-1980) led to overindebtedness, which generated a large debt-service burden for Uruguayan firms when real rates went up to high levels in the next few years (up to mid-1982).

Blejer and Díaz (1986) conclude that external factors—foreign interest rates and tradable goods prices—were the major factors affecting the behavior of real interest rates in Uruguay, while monetary disequilibria and changes in the nominal exchange rate had insignificant effects on real rates. Also, they conclude that the exchange rate risk did not affect real interest rates.

Financing of Nonfinancial Sector Firms

A study by de Melo, Pascale, and Tybout (1985) discusses the interplay of real and financial shocks in the Uruguayan economy using financial statements of industrial firms. This study distinguishes three phases in the development of the financial crisis.

A first phase, of opportunities for nonoperating earnings,²⁸ is described as the time when “the seeds of disaster were sown.”²⁹ In this phase (up to the late 1970s), with the opening of the capital account and the economic recovery under way, firms (especially in the exportable sector) took exposed positions in dollars to expand their capacity and to take advantage of currency arbitrage opportunities. Real borrowing costs were highly negative, owing first to the controlled interest rates and then to borrowing in foreign exchange. The authors explain that at the time, rapid dollar indebtedness may not have seemed inordinately risky because “operating earnings were clearly improving, prevailing interest rates posed no major debt-service problem, and government reserves seemed adequate to maintain the exchange rate regime indefinitely.” These expectations would prove unwarranted in the end.

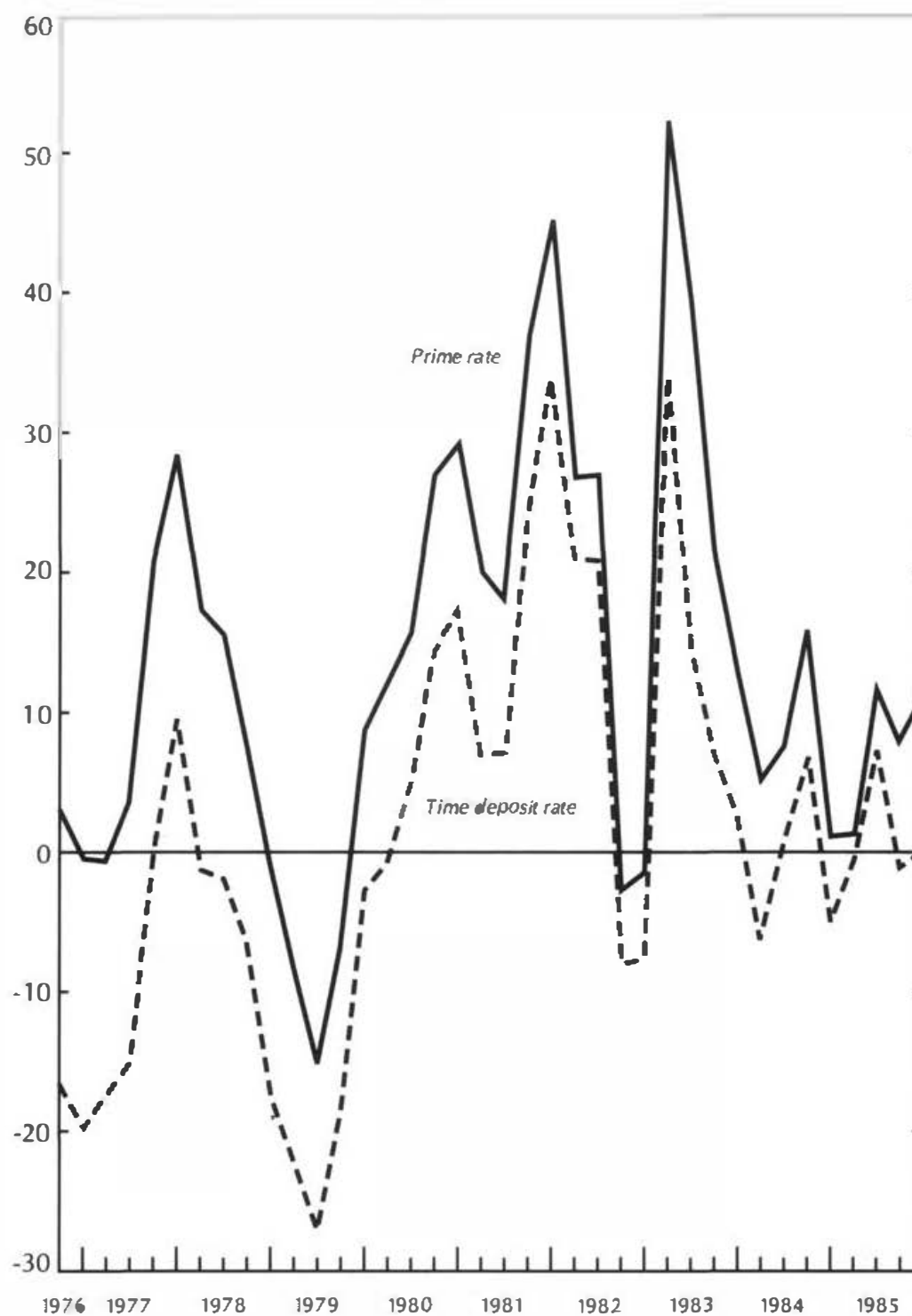
The second phase, of real side problems and rising financial costs, corresponds to the time when “the desire to survive . . . replaced the lure of easy money as the motive behind increasingly risky financial structures.”³⁰ When expectations of the abandonment of the Argentine *tablita*

²⁸ Defined as “all income from nonoperating assets, net of real financial costs. Hence, unlike under the standard accounting definition, nonoperating income accrues to firms whenever real financial costs are negative” (Tybout, 1985, p. 6).

²⁹ *Ibid.*

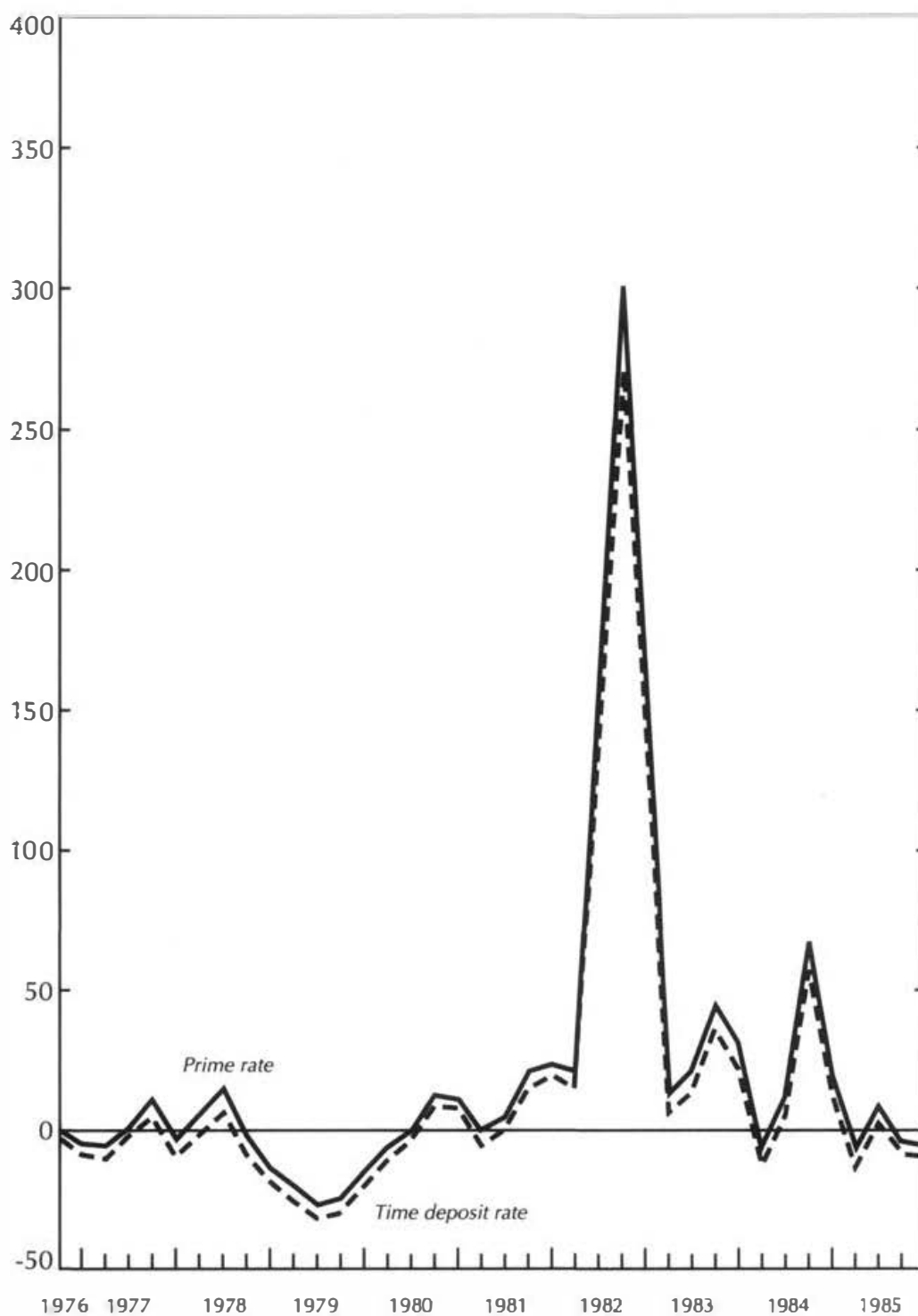
³⁰ Tybout (1985), p. 15.

Chart 15. Ex-Post Real Interest Rates (Peso)
(In percent)



Source: Statistical Appendix Table 13.

Chart 16. Ex-Post Real Interest Rates (Dollar)
(In percent)



Source: Statistical Appendix Table 13.

policy and devaluation generalized, confidence in the sustainability of the Uruguayan exchange rate regime waned. Interest rates started to climb, which induced firms to borrow in dollars in the hope that the exchange rate regime could be maintained. The authors explain that although operating earnings were stable, reflecting Argentine demand, net earnings dropped, reflecting increasing financial costs. Corporations stepped up their borrowing, partly to offset the reduction in internal sources of funds, but also, surprisingly, to finance increased fixed investment and the continuance of large dividend payments. This situation affected especially the exportable sector (with export subsidies reduced or eliminated). Thus, the scenario of the financial crisis was set, with overindebted firms left in an illiquid position and highly exposed in dollars.

The final phase corresponds to the financial crisis itself. The confidence crisis triggered by Argentina's devaluation caused rapid deterioration in the situation in Uruguay, and led to the final collapse of the exchange rate regime in November 1982, with the abandonment of the *tablita* and a 100 percent devaluation. This shock devastated the firms heavily indebted in dollars and made an important part of bank loans nonperforming, with many banks becoming technically insolvent.

Mezzerà and de Melo (1985) study the importance of different shocks based on interviews with managers in manufacturing, agricultural, and exporting firms. These subjective assessments also confirm the importance of financial shocks (impact of devaluation, rising costs of working capital, etc.).

Market Structure

Describing the situation before the banking crisis of 1965, Daly (1967) notes that the great expansion of bank branches represented nonprice competition in a context in which negative real deposit rates, liberal rediscounting policies, and real estate speculation allowed banks to sustain high profits, despite high operating costs and a small volume of deposits.

The 1965 law severely limited the installation of new banks and opening of new branches. Spiller (1984) notes that these restrictions to entry and the easy access to information on competitors' behavior (distributed by the Central Bank) promoted the development of cartel relationships.

Spiller and Favaro (1984) study the effects of the 1977 decree which allowed banks to raise deposits from nonresidents (see Section II above). The study focuses on interaction among oligopolistic firms. The authors' main conclusion is that the interaction among the four dominant banks was reduced after the legal change, and that firms in the fringe group (small firms with a market share of less than 2 percent) did not expect retaliation from dominant firms.

The effects of the 1981 law, which liberalized entry somewhat, have not been similarly studied. The effects of the banking crisis on the structure of the banking system have, however, overshadowed the effects of that law and other measures. Hanson and de Melo (1985) point out that 20 of 22 Uruguayan banks have changed hands since 1981. As the financial crisis worsened and the commercial banks were being intervened or capitalized directly or indirectly by the Banco de la República Oriental del Uruguay (BROU), the concentration in the sector has increased sharply, with the BROU and the banks owned by it holding more than 70 percent of the banking system deposits in 1986.

Currency Substitution

The share of foreign currency assets and liabilities in the Uruguayan banking system increased sharply between 1974 and 1985 (Charts 17 and 18).

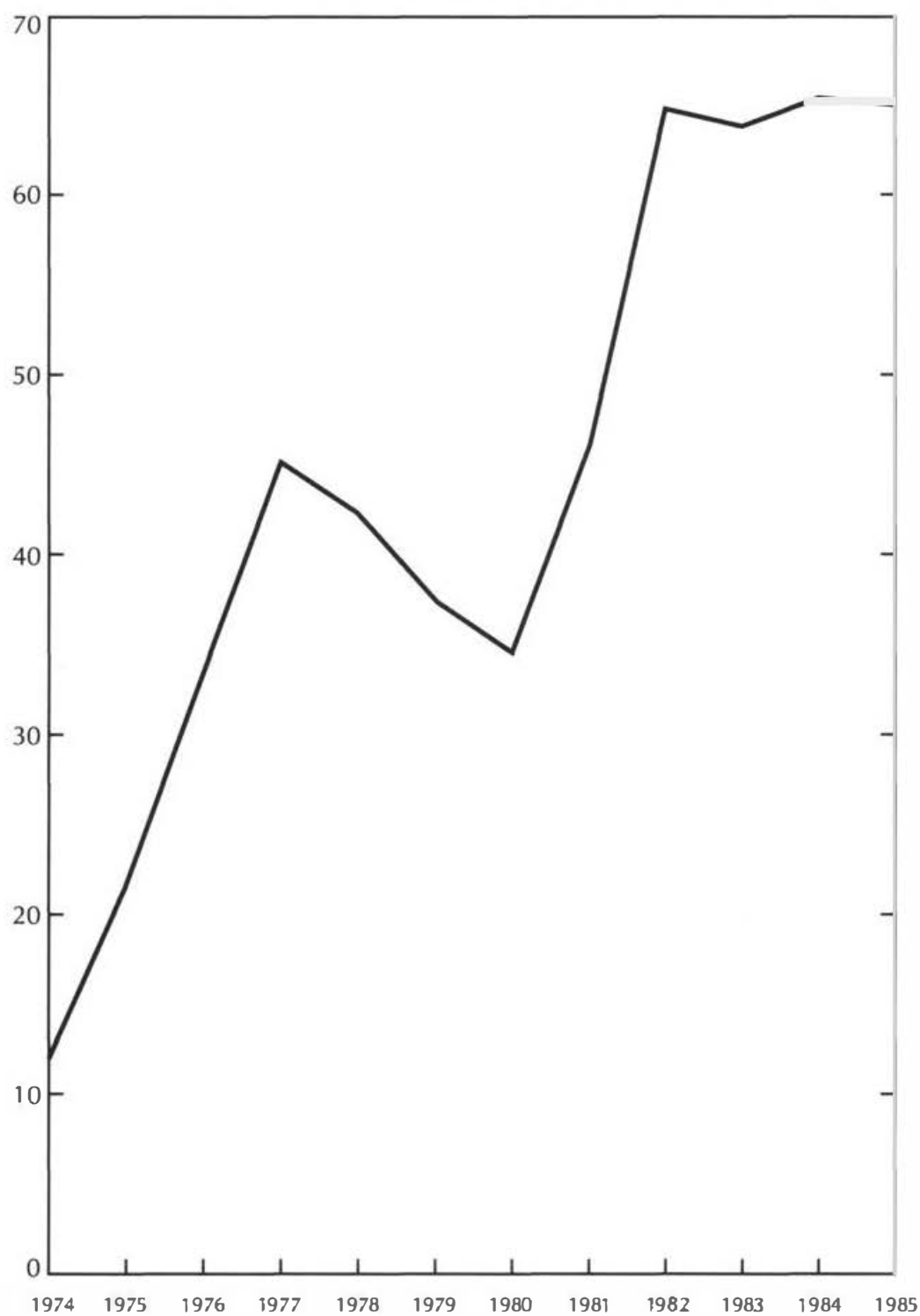
The share of foreign currency deposits jumped from 11.8 percent of M3 and 31.7 percent of total time and saving deposits in 1974 to 65.6 percent and 75.4 percent, respectively, in 1985. On the credit side, whereas only about 18 percent of the credit of the banking system to the private sector was denominated in foreign currency in 1974, this share amounted to 77.4 percent in 1985. Moreover, although no statistics exist on foreign currency deposits held abroad by domestic residents, an idea of the trend of these deposits can be obtained from the U.S. Treasury Department data on deposits in U.S. banks held by nonbank Uruguayan depositors. These deposits grew steadily from 1974 to 1976, declined from 1977 to 1979, and regained strength beginning in 1980 (Chart 19).

A high and increasing proportion of foreign currency deposits in Uruguay have been held by nonresidents (mostly Argentines). The fraction of foreign currency deposits in the private banking system held by nonresidents increased from 16.8 percent in 1974 to 49.3 percent in 1982, declining thereafter to 45.0 percent in 1985 (Chart 20).³¹

These huge portfolio shifts and the sharp process of dollarization are most remarkable and have potentially far-reaching implications for the implementation of monetary policy. Banda and Santo (1983) analyze empirically the domestic money substitutes and their importance for the effectiveness of monetary policy, concluding that the closest substitutes for a narrow money definition are savings and time deposits, denominated

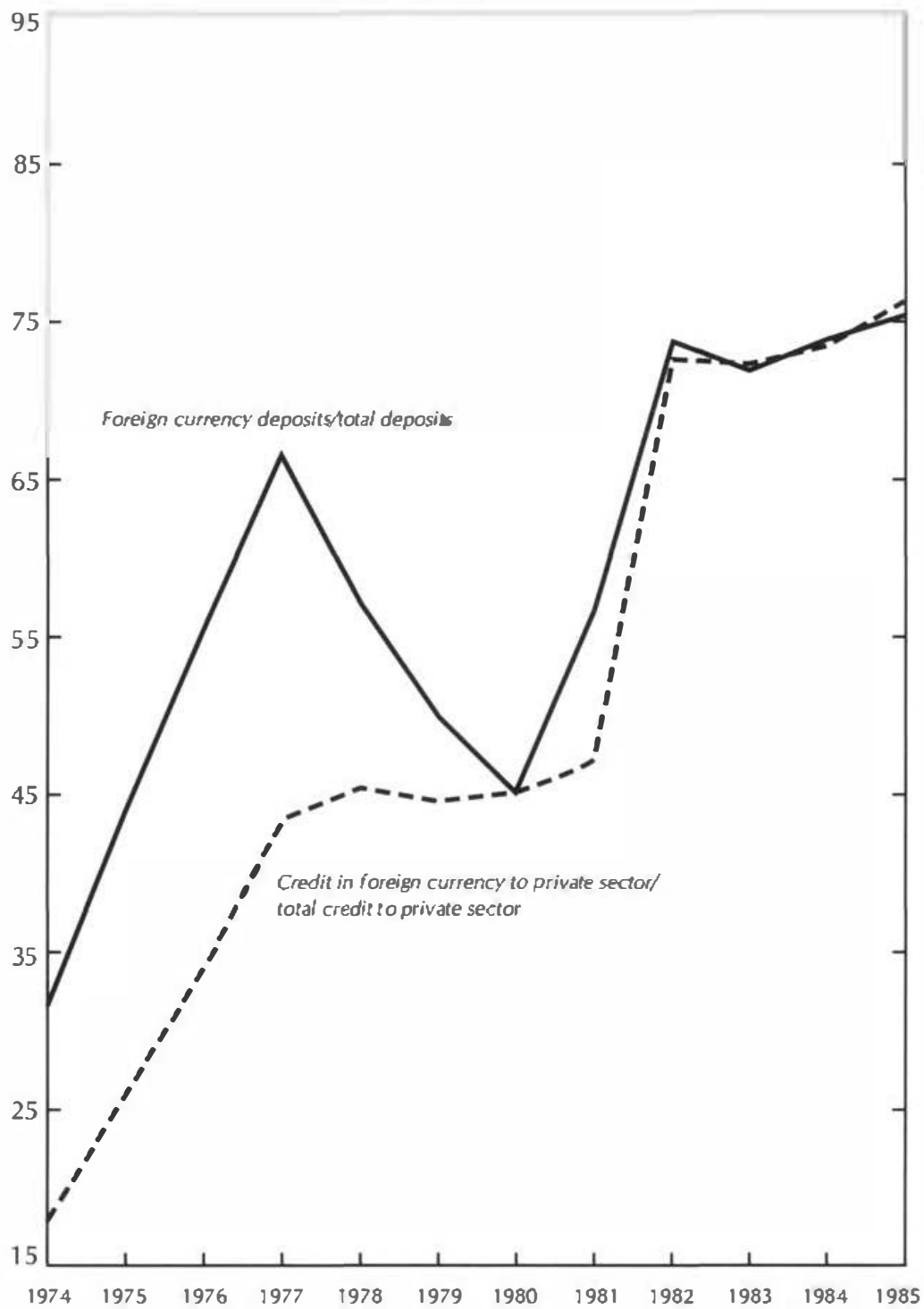
³¹ However, Hanson and de Melo (1985) point out that official statistics may not be a good measure of the importance of nonresident deposits because they have been subject to different treatment during the period. For example, they initially were subject to higher reserve requirements than resident deposits, which encouraged banks to request that nonresidents declare a Uruguayan address.

Chart 17. Foreign Currency Deposits as Percentage of M3
(In percent)



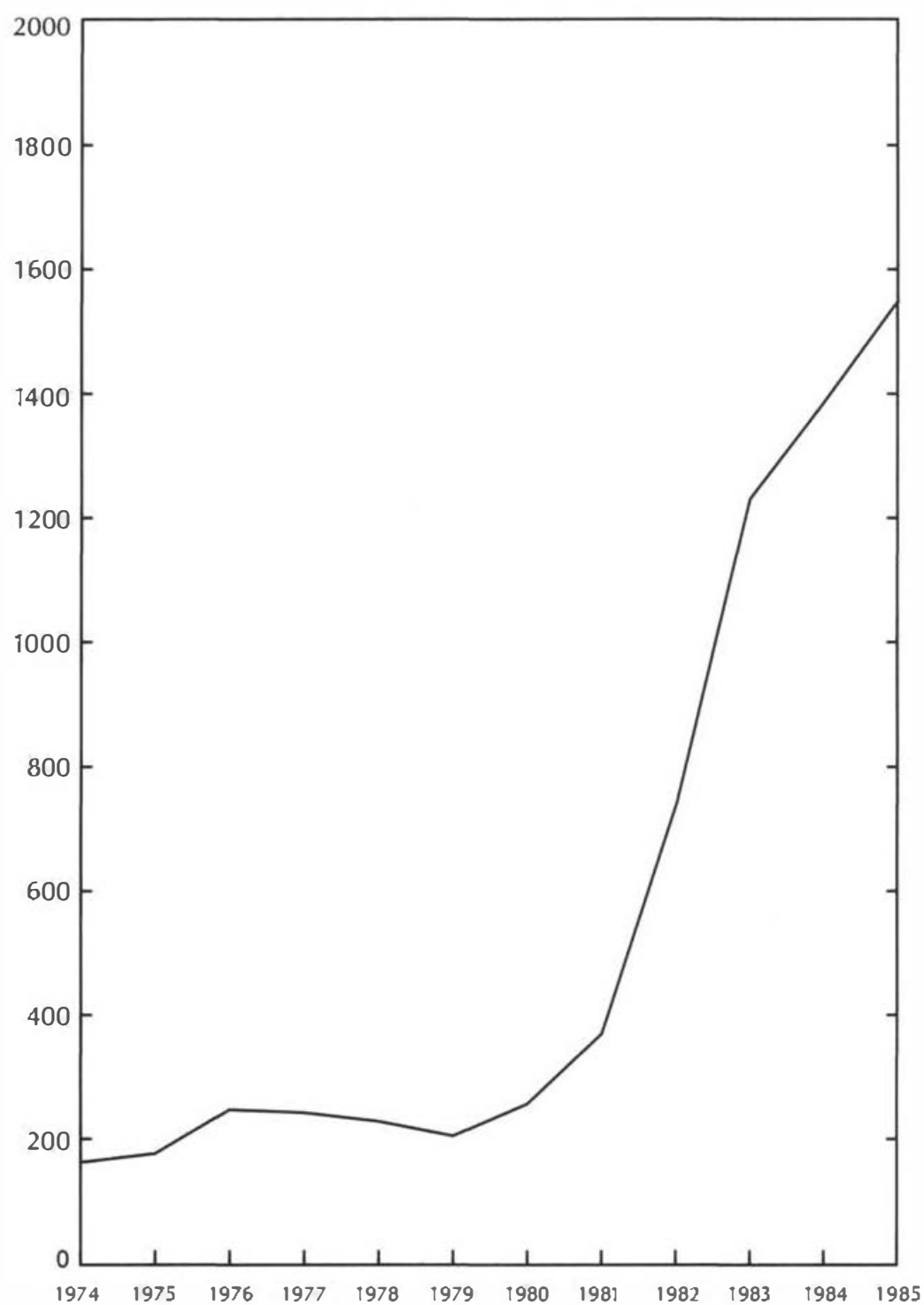
Source: Statistical Appendix Table 14.

Chart 18. Currency Substitution
(In percent)



Source: Statistical Appendix Table 14.

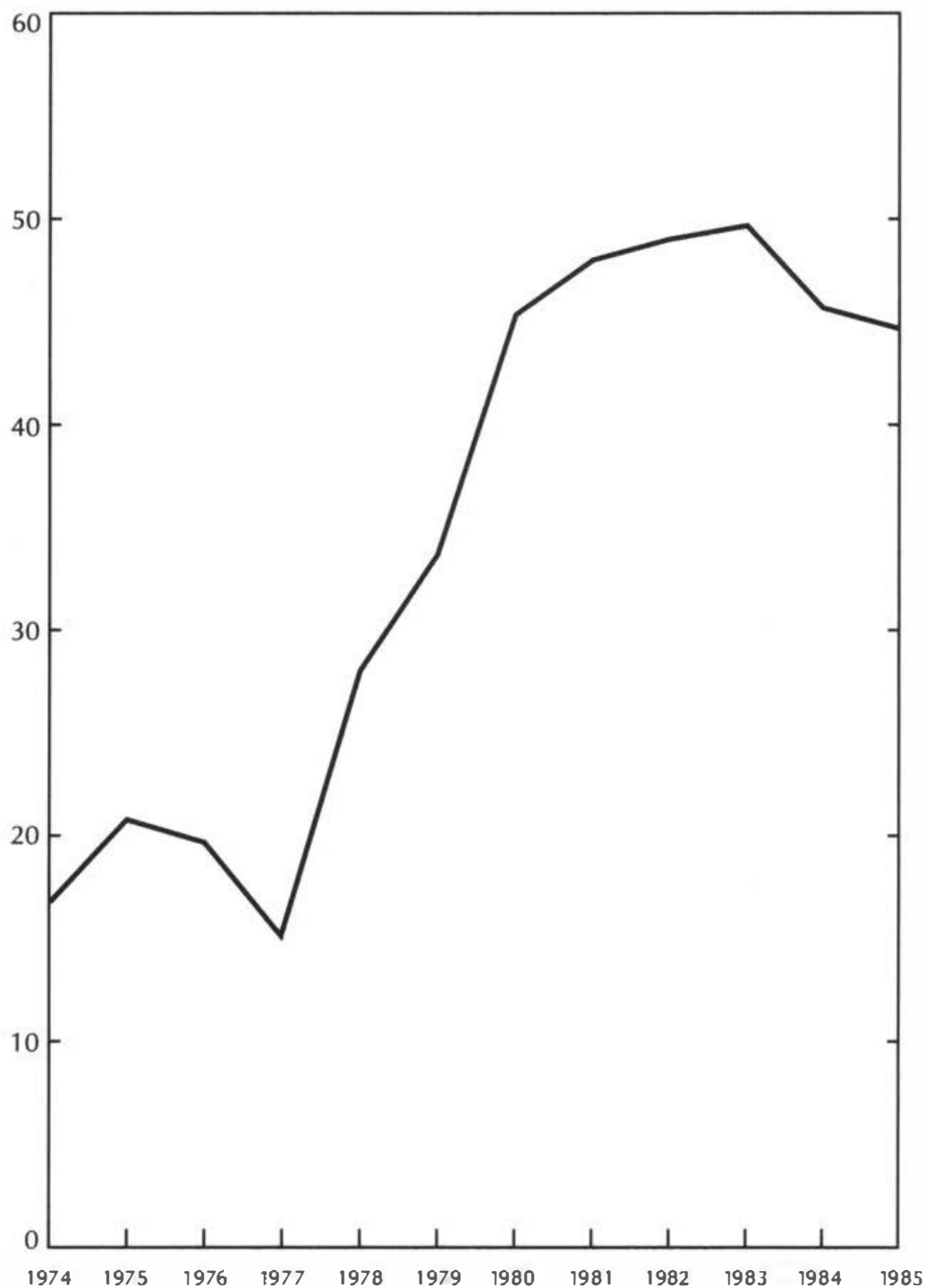
Chart 19. Deposits in U.S. Banks by Uruguayan Nonbank Private Sector
(In millions of U.S. dollars)



Source: *U.S. Treasury Bulletin*, various issues.

**Chart 20. Foreign Currency Deposits in Private Banks
Held by Nonresidents**

(Percent of foreign currency deposits)



Source: Statistical Appendix Table 14.

in pesos, with a low elasticity of substitution between foreign currency and domestic deposits. They argued that after the capital account was opened, increases in foreign currency deposits reflected speculative capital flows from Argentina rather than a portfolio shift by domestic residents, and that this capital inflow was often monetized—resulting in an increase in M1. In contrast, Ramirez-Rojas (1985) concludes that currency substitution—defined as the demand for foreign fiat money by domestic residents—was empirically important in Uruguay, and should be taken into account in the implementation of economic policy.³²

De Melo (1985) argues that a dollarization of the magnitude observed reflected more than an increase in the demand for fiat money. He suggests that it was caused by a portfolio adjustment between dollars abroad and dollars held in the Uruguayan financial system. He bases this contention on the evolution of the ratio of Uruguayan dollar deposits in the United States to dollar deposits in Uruguay. This ratio decreased sharply between 1974 (3.53 percent) and 1980 (0.24 percent) and then started rising again (0.85 in 1983) (Statistical Appendix Table 14). De Melo attributes these movements to changes in expectations about the evolution of the economy, and the maintenance of the exchange rate regime, and after 1982 to the impact of the domestic financial crises and insolvency of Uruguayan banks on people's confidence.

The turning point probably began during 1980 instead of 1982. At that time, deposits in U.S. banks by Uruguayans began to rise again (Chart 19) and at a faster pace than foreign currency deposits in Uruguay (see Statistical Appendix Table 14) while, at the same time, the share of foreign currency deposits in the domestic financial market also increased considerably (Charts 17 and 18). This evidence suggests that the external factors, which adversely affected the performance of the Uruguayan economy and more expansive fiscal policies, began to make the exchange rate policy less credible in 1980, promoting a new round of currency substitution.

IV. The Financial Crisis and Policy Responses

The Financial Crisis

As described above, the financial position of Uruguayan firms, especially in the tradables sector, deteriorated sharply between 1980 and 1982, owing to the increasing peso overvaluation, the rise in interest rates, and

³² For theoretical models of currency substitution, see Calvo and Rodríguez (1977), Frenkel and Rodríguez (1982), and Calvo (1985); for empirical studies, see Ortiz (1983) and Márquez (1984). On the issue of "symmetrical" currency substitution (residents and nonresidents holding both currencies) see, for instance, Cuddington (1983).

the historical buildup of debt denominated in foreign currency. The collapse of the *tablita* and the accompanying devaluation were a major blow for enterprises—especially producers of nontradables who lacked foreign exchange cover—and triggered the financial crisis by inducing loan defaults which made many financial institutions technically insolvent.

The devaluation of the Argentine peso (78 percent in March 1981) provoked a massive outflow of capital in Uruguay, owing to the lack of confidence in the sustainability of the Uruguayan *tablita* once Argentina had abandoned its own. The capital outflow and the drop in Argentine demand together reduced the price of assets in Uruguay,³³ thus also reducing the value of collateral on bank loans.

As Chart 21 shows, banks' loan portfolios were clearly affected (see also Statistical Appendix Table 15). The stage for the crisis was set. By the beginning of 1982, many banks were in serious difficulties and there was a threat of a generalized banking crisis. When the peso was finally devalued, firms indebted in dollars were devastated, and to make things worse for banks, the value of collateral had dropped, making foreclosures more difficult.

Policy Responses

The authorities attempted a series of measures to overcome the financial crisis, but their response was complicated by the ongoing political transition. Expectations of a general debt relief were generated, and the attitude of "hold off payments, wait and see" was reinforced by the evolution of the legal developments and the workings of the judicial system, which tended to favor debtors.

The Bailout: Special Credit Facilities and the Portfolio Purchase Scheme

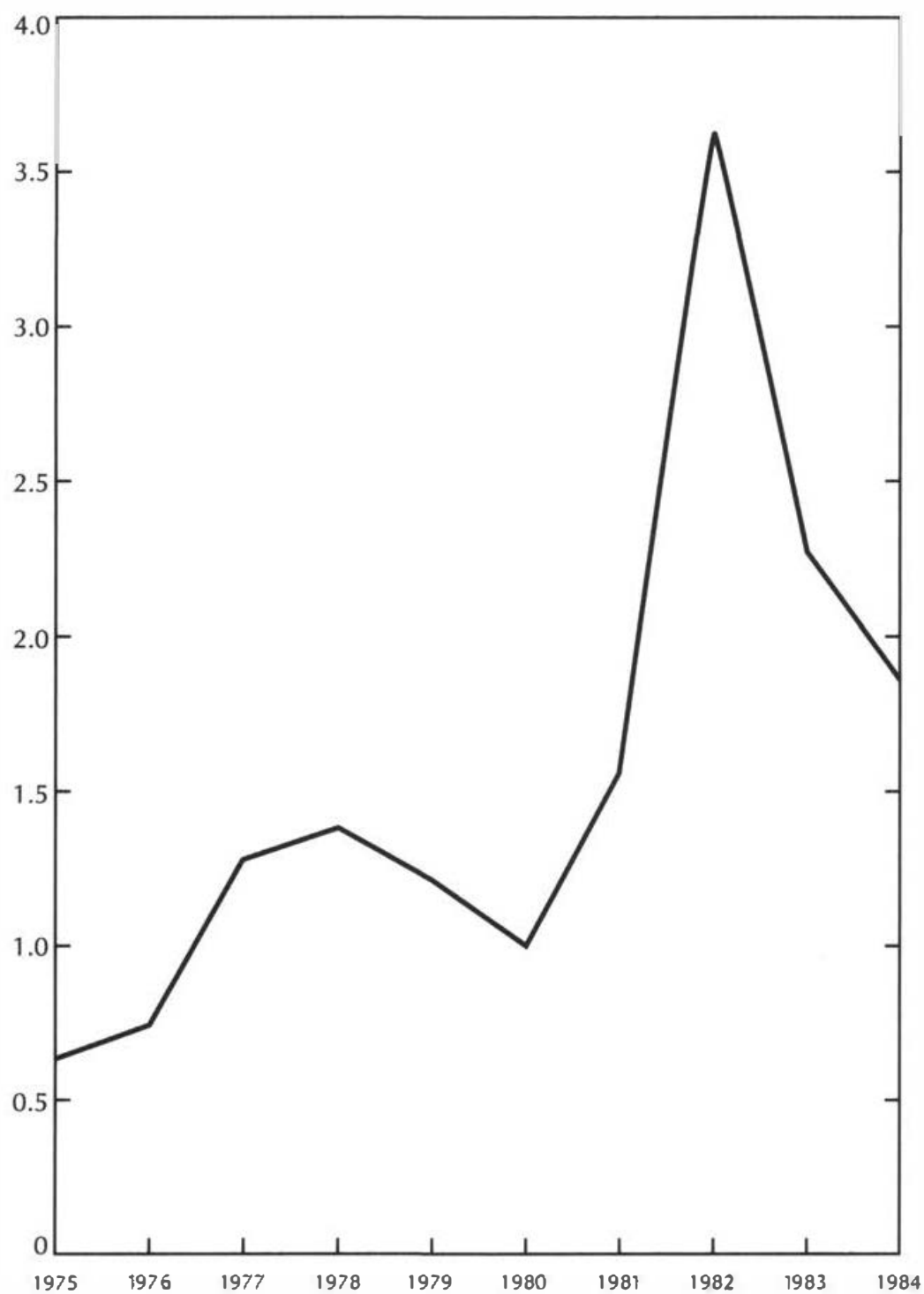
As nonperforming loans began to cause serious trouble for financial institutions, the Central Bank of Uruguay (CBU) devised a series of relief mechanisms.

In 1982, and particularly during the second half of the year, some emergency support funds were provided by the Central Bank of Uruguay to troubled financial institutions. The Banco Hipotecario received substantial financial assistance after early 1982. Net credit from the CBU to that institution increased over 1,500 percent from September 1981 to September 1982.³⁴

³³ Fossati mentions that the price of urban real estate dropped from US\$500 per square meter in 1982 to less than US\$200 in 1984; and the price of pasture land, from more than US\$600 to less than US\$220, *Búsqueda*, No. 374, March 12, 1987, p. 3.

³⁴ It increased over 1800 percent during 1982. See Central Bank of Uruguay, *Boletín Estadístico*.

Chart 21. Ratio of Bad Loans/Net Worth in Consolidated Banking System



Source: Statistical Appendix Table 15.

Another source of monetary expansion during 1982 (but prior to the abandonment of the *tablita*) was net credit to the Central Government. It increased about 400 percent from September 1981 to September 1982.³⁵ Moreover, two special facilities were established to assist private sector borrowers: the export prefinancing scheme and a voluntary refinancing scheme. These schemes involved subsidized interest costs which were mostly borne by the Central Bank and subsequently caused a substantial expansion of the monetary base.

The export prefinancing scheme, abolished in 1979, was reinstated in September 1982 and eliminated when the *tablita* was abandoned two months later. This amounted to an exchange guarantee and was made available only to nontraditional exporters. Under the scheme, dollar loans from commercial banks against future export revenues were deposited at the CBU (for a six-month term) for their peso equivalent, and when the deposit matured, the CBU would refund the original amount (minus a 10 percent annual charge). After the devaluation, capital gains were reaped by exporters, with the losses absorbed by the CBU. The *voluntary refinancing scheme* allowed debtors in the agricultural, industrial, and commercial sectors to reschedule their debt (up to a maximum of 33 percent of the outstanding private commercial bank credit to those sectors) for a period of five years, with a two-year grace period. Maximum interest rates were to be 2 points above the London interbank offered rate (LIBOR) (for 180-day maturities) on foreign currency loans, and 90 percent of the average rate charged by banks on peso loans. During the grace period, the borrower would pay only three fifths of the interest cost of the rescheduled loan to his bank, with CBU covering the rest. Thus two fifths of interest cost would be capitalized and repaid as part of the amortization payments, once the grace period expired. However, the most decisive relief measure was the portfolio purchase scheme, which comprised two different operations: the portfolio purchase linked to loans to the CBU (*compra de cartera vinculada a préstamos al Banco Central*), and the portfolio purchase linked to bank intervention (*compra de cartera vinculada a negociación de bancos*). These two measures provided for the CBU to purchase commercial banks' nonperforming loan portfolios with dollar-denominated bonds and promissory notes issued by the CBU. In the first operation, the banks were to arrange for medium-term external finance to the CBU in a multiple of the amount of the loan portfolio transferred to the CBU while, in the second case, the CBU arranged for the sale of a bankrupt local bank to a foreign financial institution, and purchased the bad loan portfolio with the issue of bonds and the write-off of previous financial assistance.

Under both operations, which took place from late 1982 to 1984, the

³⁵ Central Bank of Uruguay, *Boletín Estadístico*.

CBU acquired assets for the equivalent of US\$632 million³⁶ and received financing for the equivalent of US\$328 million against the issuance of bonds and promissory notes for US\$855 million and cancellation of financial assistance for US\$105 million (see Statistical Appendix Table 16). Thus, Table 2 shows the effects of the operation on the balance sheet of the CBU, abstracting from interest payments within this two-year period.

Table 2. Changes in Central Bank Balance Sheet
(In millions of U.S. dollars)

| Assets | | Liabilities | |
|---|-------|--|-------|
| Credit to the private sector (portfolio purchased) | + 632 | Long-term debt (bonds and promissory notes issued) | + 855 |
| International reserves (resulting from external financing to CBU) | + 328 | | |
| Claims on commercial banks (cancellation of financial assistance) | — 105 | | |

A disaggregation by currency of portfolios acquired by the Central Bank of Uruguay is given in Charts 22 and 23. It is shown that 74.5 percent of portfolios purchased through the scheme that involved loans to the CBU and 65.1 percent of those acquired through the scheme that involved bank interventions were denominated in foreign currency.³⁷

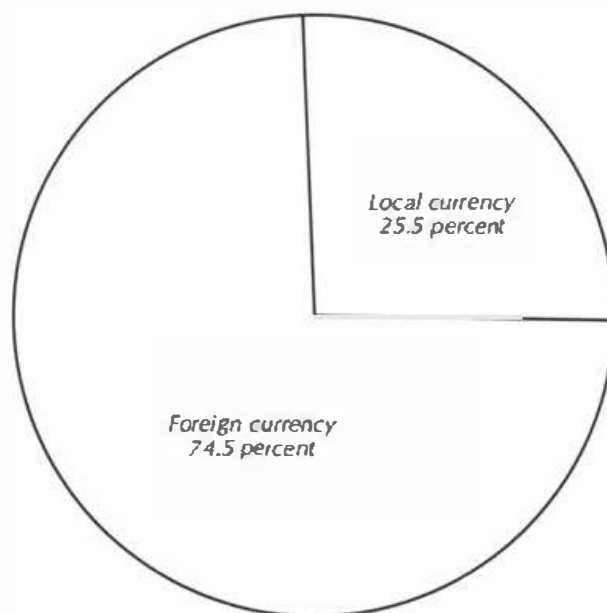
The loans purchased by the CBU were concentrated in the livestock sector (36.8 percent of peso portfolios and 25 percent of dollar portfolios), and the industrial sector (21.8 percent of peso portfolios and 37.8 percent of dollar portfolios) (Statistical Appendix Table 17).

The portfolios purchased by the CBU were highly concentrated in terms of the size of the debt. Less than 1.5 percent of borrowers (those

³⁶ This amount represented about 22 percent of total outstanding credit to the private sector granted by the consolidated banking system, and about 24 percent of total deposits in that system in 1983. It also represented about 60.5 percent of total 1983 Uruguayan exports.

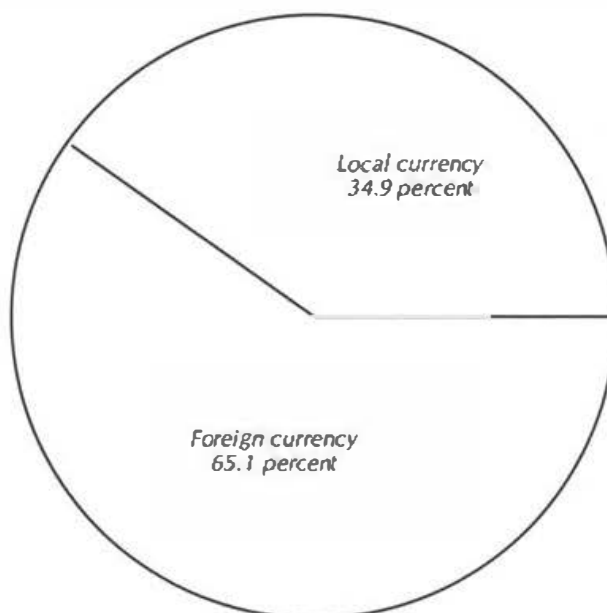
³⁷ As shown in Statistical Appendix Table 14 for the years 1982–84 the fraction of credit to the private sector denominated in foreign currency averaged 73.8 percent; therefore, the currency composition of portfolios purchased corresponds roughly to that of total credit to the private sector.

Chart 22. Currency Composition of Loans Purchased
(As percentage of portfolio purchases linked to loans to CBU)



Source: Central Bank of Uruguay.

Chart 23. Currency Composition of Loans Purchased
(As percentage of portfolio purchases linked to bank intervention)



Source: Central Bank of Uruguay.

with outstanding loans of more than US\$1 million) had debts totaling 48.3 percent of the debt purchased, and about 16.5 percent of borrowers (those with debt outstanding of US\$50,000 or more) had debts equivalent to almost 92 percent of the total debt purchased (Statistical Appendix Table 18). Unfortunately, no similar figures for total credit are available for comparison.³⁸ In any case, the available information suggests that prevailing prudential regulations on risk concentration and maximum financing limits proved insufficient to preserve loan quality.

The administration and management of the portfolios purchased by the Central Bank of Uruguay kept switching throughout the period, from CBU delegating them to the BROU and the foreign banks involved in the purchase of local banks, to assumption by CBU, to administration by BROU, and, finally, to administration by one of the newly nationalized commercial banks. This is partly attributable to the lack of appropriate human and technical resources at CBU for the difficult task of managing such huge and diversified portfolios. Loan recovery undoubtedly has suffered from the indecisive management policy. It turned out that a good part of the loans was unrecoverable, with far greater costs to the CBU than had been anticipated.

Whether it was appropriate for CBU to use long-term dollar debt to pay for a portfolio partly denominated in pesos gave rise to some debate. It was justified by the Government on the basis of (a) the spreading out of the monetary effects over several years, and (b) banks' unwillingness to hold long-term peso assets. For instance, the then president of the CBU declared later in parliamentary testimony that monetary conditions prevented a cash payment; in his view, a cash payment would have been immediately used to purchase dollars. He also argued that payment with long-term notes in domestic currency was not feasible either: the nonexistence of this type of assets was proof that they would not have been acceptable.³⁹

The portfolio purchase linked to loans to the Central Bank of Uruguay started in October 1982, when the Central Bank declared its readiness to purchase part of the loan portfolios of commercial banks, in return for foreign currency loans equivalent to 200-300 percent of the portfolio purchased. This proportion varied according to the quality of the loans purchased, of which at least 66 percent had to be of good quality—as judged by the CBU—or to be guaranteed by the selling bank. The operation was financed by the issue of promissory notes with seven years'

³⁸ Ideally, a time series of debt disaggregated by size would have provided information on the effects of regulatory changes on risk concentration, and its comparison with the bad loans data would have allowed to discuss whether or not banks' risk exposure was excessive.

³⁹ *Búsqueda*, No. 362, December 1986, p. 18-19.

maturity and three semesters' grace, which carried an interest rate of 1.5 points over the LIBOR, with repayment scheduled to be in 11 semestral installments, equal and consecutive.

The CBU did not select the portfolio, but did assess it. If according to this assessment, at least two thirds of the portfolio offered was not considered of good quality, offering banks could attempt a recomposition of the portfolio offered to CBU until that threshold was reached. For the election of transferable portfolios, banks would have to take into account borrowers' capabilities to meet the following conditions: (1) a minimum interest rate of two points over the LIBOR for dollar debts and 90 percent of the average market loan rate for peso debt, and (2) a maximum maturity of seven years, and a maximum grace period of three semesters.

As a result of the operation, the CBU purchased portfolios for the equivalent of US\$216 million, receiving fresh loans in foreign exchange for US\$328 million (i.e., the credit received from the commercial banks net of the purchased portfolio value) and financing the transaction with the issuance of notes for US\$544 million (see Statistical Appendix Table 16).

This operation was decided on because the CBU was facing an acute shortage of reserves, triggered by the lack of confidence in the *tablita* and the massive intervention required to sustain the exchange rate. In 1982, international reserves fell by about US\$1,000 billion (see Statistical Appendix Table 5).⁴⁰ Bertero (1985) argues that a feasible alternative would have been the sale of a part of the gold reserves, and her computations show that the CBU could have obtained the same amount of foreign exchange with the sale of about 21–25 percent (depending on market prices) of its gold reserves at international prices.

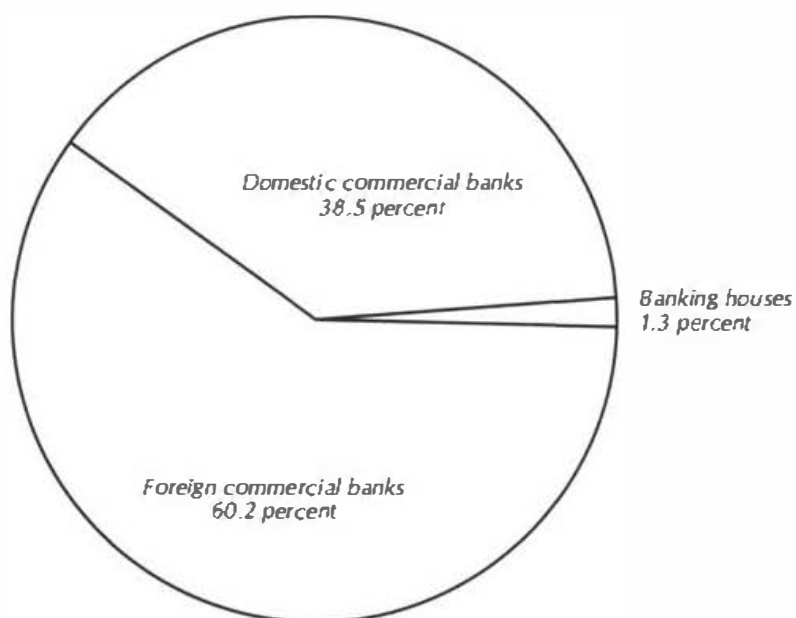
Charts 24 and 25 clearly show that the main sellers of the portfolios in this operation were the foreign commercial banks, with 60.2 percent of the loans denominated in pesos and 74.3 percent of the loans denominated in dollars. For comparison, only 24.8 percent of the peso-denominated assets and 24.6 percent of the assets denominated in dollars of the banking system were held by foreign banks in 1982.⁴¹

The more sizable portfolios acquired by the Central Bank of Uruguay under this operation were sold by the Citibank (the equivalent of US\$74.8 million) and the Bank of America (the equivalent of US\$49.9 million), totaling 58 percent of the portfolio purchased by CBU (against loans from the banks to CBU for US\$297.3 million) (see Statistical Appendix Table 20). It is noteworthy that Citibank and Bank of America were among the

⁴⁰ J.M. Puppo, who assumed the presidency of the CBU in July 1982, stated that "the operation of portfolio purchase linked to loans to the Central Bank of Uruguay was decided given its financial need at that time" (*Búsqueda*, No. 362, December 1986, p. 18).

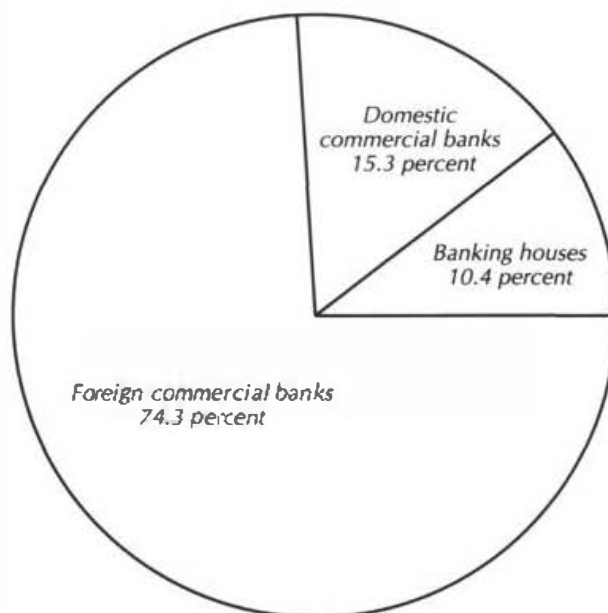
⁴¹ Information provided by the Central Bank of Uruguay.

Chart 24. Portfolio Purchases Linked to Loans, Peso Denominated
(As percentage of portfolio purchases linked to loans to CBU)



Source: Statistical Appendix Table 19.

Chart 25. Portfolio Purchases Linked to Loans, Dollar Denominated
(As percentage of portfolio purchases linked to loans to CBU)



Source: Statistical Appendix Table 19.

creditor banks negotiating the external debt of Uruguay at the time.⁴² The portfolio purchase transaction with Citibank was closed a month before the demise of the *tablita*, allowing this institution to make a sizable capital gain.⁴³

The portfolio purchase linked to bank intervention was of a different nature. As the position of local banks worsened, the Central Bank of Uruguay stepped in to forestall bankruptcies by arranging the sale of insolvent local banks to foreign banks. As a condition for buying those insolvent institutions, the foreign banks got the CBU to acquire the portfolio of poor quality loans (for the equivalent of US\$416 million) paying for it through the issue of bonds and promissory notes, denominated in U.S. dollars—with seven years' maturity, two years' grace, and at an interest one and a half points over LIBOR⁴⁴ (for a total of US\$311 million), and through writing-off the equivalent of US\$105 million in emergency financial assistance credits that had been granted to these institutions (no longer needed once they were taken over by the solvent foreign banks).

A total of five takeover operations took place. The ultimate rationale for these operations was the avoidance of a banking panic and the maintenance of the stability of the financial system. There have been claims of irregularities in some of these takeover deals, with the subsequent opening of parliamentary and judicial investigations.⁴⁵

The authorities had in mind a monetary approach to the theory of financial crisis and sought to implement the unavoidable bailout (after emergency financial assistance failed to save the banks in difficulties) in what seemed the most efficient way.⁴⁶ The main arguments advanced in favor of this means of implementing the bailout instead of some alternative like direct intervention of the affected banks were as follows:⁴⁷

- It allowed a case-by-case treatment, permitting more flexibility. Interventions cannot do this, owing to their adverse effect on expectations, which could trigger a generalized banking panic unless all interventions took place at the same time.
- Direct intervention amounts to a monetization of the deposits of insolvent banks with negative consequences for the conduct of mone-

⁴² For a heated debate at the Uruguayan parliament on the issue, see *Busqueda*, No. 275, pp. 12 and 32, April 1985.

⁴³ US\$34.8 million out of the US\$74.8 million of the portfolio sold to the Central Bank of Uruguay in October 1982 was peso-denominated (see Statistical Appendix Table 20).

⁴⁴ See *Busqueda*, No. 224, February 1984.

⁴⁵ See *Busqueda*, No. 275, April 1985, especially pp. 12 and 32.

⁴⁶ See *Busqueda*, No. 361, December 1986, containing a justification along these lines from Mr. J. Gil Díaz, President of the CBU from December 1974 until July 1982.

⁴⁷ *Ibid.*

tary policy. In addition, the operating costs of the intervened banks must be borne by the central bank. On the other hand, the adopted scheme allowed the spreading of the bailout losses over several years, and minimized the losses for the state, since previous financial assistance could be recovered and did not entail bearing the operating costs of the distressed banks. Unfortunately, hardly any data exist on the recovery of the loan portfolio purchased under both schemes.

According to press reports⁴⁸ the terms initially offered to the debtors under both operations, i.e., portfolio purchases linked to loans to the CBU, and portfolio purchases linked to bank intervention were one-year's grace, two-years' amortization, and rates going from 71 percent to 79 percent, for peso debt; and two-years' grace, three-years' amortization, and 13 percent interest for dollar debt.

Some measures were taken in April 1984 to attempt the recovery of part of these nonperforming assets.⁴⁹ A National Office of Asset Recovery was created to administer the portfolios. Also, borrowers were classified into two groups: *high-standard* and *low-standard borrowers*. High-standard borrowers were those who had paid in 1983 at least 60 percent of the interest accrued during six months of that year and would have to pay, before May 15, 1984, 60 percent of the interest accrued during 1983 as a whole. This classification applied to both peso- and dollar-denominated debts.

High-standard borrowers benefited from the following measures:

- The equivalent of 20 percent (for borrowers in local currency) and 40 percent (for borrowers in foreign currency) of the interest accrued during 1983 was written off.
- Maturity periods were extended to five years with one year of grace for portfolios denominated in local currency purchased before 1984; to four years for portfolios denominated in local currency purchased during 1984; to eight years with one year of grace for portfolios denominated in foreign currency purchased before 1984; and to seven years with one year of grace for portfolios denominated in foreign currency purchased during 1984.
- Borrowers in local currency could opt to convert their debt outstanding on December 31, 1983, into indexed debt, to be repaid in 14 six-month installments at an annual interest rate of 4 percent over the adjusted principal. For each period, the adjustment factor to be applied would be the lower of (a) the change during the period in the exchange rate or (b) the change in the corresponding sectoral price index.

⁴⁸ *La Semana Uruguaya*, May 8, 1984, p. 16.

⁴⁹ *La Semana Uruguaya*, May 8, 1984, p. 16; and Central Bank of Uruguay (1984).

- Borrowers in foreign currency could opt to convert their foreign-currency-denominated debt as of December 31, 1983 into local-currency-indexed debt, with the same interest rate and conditions given to debtors in local currency who opted for converting their debt into indexed debt.

In addition, all borrowers who, before September 30, 1984, made prepayments 180 days before the due date would benefit from a write-off equivalent to the prepaid amount, up to a maximum equivalent to 25 percent of the debt outstanding at the time of prepayment. Those debtors making prepayments (180 days before the due date) after September 30, 1984 would also benefit from a write-off equivalent to the prepaid amount, up to 15 percent of the debt outstanding at the time of prepayment.

These measures improved somewhat the debt collection: data on recovery of outstanding debt as of August 31, 1984⁵⁰ show that 30 percent of the recovery on dollar debt and 34 percent of the recovery on peso debt took place between May 1 and August 31, 1984. Nevertheless, the recovery pace remained dismal. By December 31, 1983 the Central Bank of Uruguay had recovered only US\$8.7 million (or 1.8 percent) of the dollar debt, and NUr\$409.9 million (or 6.4 percent) of peso debt (see Statistical Appendix Table 21). By August 31, 1984, these figures had risen to US\$13.7 million for dollar debt and NUr\$724.5 million for peso debt. The recovery pace seems to have slowed down afterwards, against the background described in the next subsection.

This poor performance can be attributed to a number of different factors: (1) Actual insolvency of debtors, aggravated by debt concentration; (2) unwillingness to pay on the part of debtors, on the expectation of a general debt amnesty; (3) inadequacies of the judicial system, which have tended to favor borrowers and made it difficult to attach their property; and (4) the belief that the future improvement of economic conditions would increase the real value of collateral, allowing a better recovery performance.

The long-term impact of this purchased portfolio on the accounts of the Central Bank of Uruguay is hard to assess, and there is no public information on issues such as how the loans are being accounted for, which part is in arrears, and whether interests are being capitalized. It seems, though, that an important part of this portfolio may have been written off. Moreover, the data on total credit of the Central Bank to the private sector show sharp falls in the months of December, suggesting that a portion of these loans are written off as operational losses at the end of every year.⁵¹

⁵⁰ See *El País*, November 11, 1984. This is the last time that data on recovery were made public.

⁵¹ See *Búsqueda*, August 28, 1986, p. 24.

The Backlash: The Domestic Debt Refinancing Law and BROU Takeovers

In the last few years of the period under study payment habits deteriorated. Growing expectations of a general forgiveness of debt pervaded society, with demands for a "political" solution to the debt problem becoming increasingly aggressive.

Regulations on compulsory selective credit to exporters were reinstated in 1984, and a forward exchange market linked to compulsory credit in pesos to exporters was also created.

Banks were confronted with an increase in arrears as debtors delayed payments in expectation of some sort of debt relief after the change in administration in March 1985 and, rather than lending to the private sector, preferred the safer returns from holding treasury bills. These expectations also affected the recovery of the portfolio purchased by the Central Bank of Uruguay under the schemes described above.

According to a local observer, the demise of the *tablita* influenced notably the deterioration of respect for any kind of jurisdiction. This was aggravated by the belief that the private banks had accumulated huge profits during the period of the *tablita*. As a result, the issue of the inability of corporations to pay began to be considered as having a political origin and later, with the return of democratic political activity, these problems were added to the revisionist and demanding-of-damage compensation claims attitude developed since then.⁵²

This climate is reflected in the figures on the fraction of loans in arrears and unpaid over the total liabilities of domestic debtors with private banks shown in Table 3.

Table 3. Loans Unpaid and in Arrears

| Date | Total Loans (in percent) |
|----------------|-----------------------------|
| September 1980 | 1.5 |
| September 1981 | 3.0 |
| September 1982 | 11.0 |
| September 1983 | 18.0 |
| September 1984 | 25.0 |
| September 1985 | 34.0 |
| March 1986 | 42.0 |
| June 1986 | 56.0 |
| September 1986 | 59.0 |

Source: *Búsqueda*, No. 374, March 12, 1987.

⁵² Fossati, *Búsqueda*, No. 374, March 12, 1987.

The demanded "political solution" was offered by the Domestic Debt Refinancing Law (Law No. 15786), passed in November 1985, and the decrees complementary to the law (Decree 83/986 on the refinancing regime for the agricultural sector and Decree 84/986 on the refinancing regime for industry and services), issued in February 1986.⁵³ The purpose of the law was to alleviate the debt burden of financially viable firms and provide the legal environment for an orderly rescheduling of that debt, in order to allow those firms new access to borrowing. The law in itself favored debtors, and provisions in the law allowed solvent firms to postpone payments. Moreover, the law included a transitory moratorium for all debtors that applied for classification under the law. Evaluation and classification of debtors according to the provisions of the law was left to a specially appointed Financial Analysis Commission, whose work was delayed with the result that loans were not serviced in the meantime.⁵⁴ Financial intermediaries were squeezed by the nonperformance of assets, and one after another domestically owned banks became technically insolvent, and were taken over by the BROU.

The law's refinancing schemes were optional for private debtors. For debtors to the banking system, a two-stage process was established. First, the Financial Analysis Commission had to determine which debtors were eligible for refinancing. Then, commercial banks had to proceed with the refinancing agreement, which entered into effect if the debtor accepted it. However, if the debtor disagreed or was delinquent in servicing the refinanced debt for more than six months, he was subject to judicial procedures to liquidate his/her assets. The law aimed at providing debt relief to economically viable firms in financial difficulties, excluding from its provisions firms considered "solvent," firms considered "nonviable" (except for some special cases), and foreign-owned firms. The provisions of the law were complicated, containing different criteria, circumstances, and terms of refinancing for different debtors.⁵⁵

The eligibility criteria to obtain refinancing differed across sectors. Solvent firms were excluded, as noted. For the agricultural sector, solvency was defined in terms of maximum indebtedness per hectare, which varied across subsectors. Firms exceeding that maximum limit (NUr\$4,000) had access to refinancing. For industry, firms were considered solvent if the sales/liabilities (with the financial system) ratio was greater than 2.5, except for small firms, which were considered solvent if

⁵³ For a comprehensive legal analysis of this legislation, see Ferrere and Olivera García (1986) and Rodríguez Olivera and Varela Artagaveytía (1987).

⁵⁴ The CBU appointed the three members of this commission, which was also in charge of settling disputes between borrowers and lenders.

⁵⁵ See Rodríguez Olivera and Varela Artagaveytía (1987).

indebtedness per employee was less than NUr\$20,000. For the commerce and services sector, firms were considered solvent if their liabilities were less than 60 percent of assets, except for small firms (indebtedness less than NUr\$25,000 per employee in this case). Nonviable firms in the agricultural sector were those whose indebtedness per hectare exceeded a certain maximum (which varied according to the subsector); in the industrial sector, nonviable firms were those with a sales/liabilities ratio of less than 0.9 (priority activities) or 1 (other activities). In the commerce and service sectors, nonviable firms were those with a negative operative margin (special activities) or that operated with a negative margin and had debt exceeding NUr\$2 million (general activities). All firms that were not solvent or nonviable were viable. Small agricultural and industrial nonviable firms were also eligible, as were debtors that refinanced their liabilities according to previous norms issued by the Central Bank of Uruguay.

In general, the conditions and terms of refinancing were contingent on the categorization of debtors. Debtors in the agricultural sector were classified in categories A, B, C, D, E, F, G, depending on the subsector, the size of the unit, and the amount of outstanding debt per hectare. For the industrial sector, categories included small firms, priority activities, nonpriority activities, and debtors that had rescheduled their liabilities under previous debt-relief programs and that had met the corresponding installments. The categories for the commerce and services sectors were small firms, special activities, general activities, and debtors that had refinanced their liabilities under previous debt-relief programs.⁵⁶

The amount subject to refinancing was computed in two steps. First, the total amount outstanding as of June 30, 1983 was computed. For this, interest was capitalized up to January 1983 at the terms originally contracted, and after that date, penalty rates were not to exceed the market loan rate for domestic debt, or the preferential rate for dollar debt. Second, the outstanding debt as of October 15, 1985 was computed taking account of the outstanding debt as of June 30, 1983 previously calculated and using pre-established interest rates: for the favored debtors (those that originally contracted loans at preferential interest rates), it was the basic rate charged by the BROU for domestic debt, and 12 percent for dollar debt; for all others, the normal rate for peso debt and the preferential rate for dollar debt. *The grace period* was between one and three years, depending on the sector of activity, while *the payment period* was between five and ten years, also depending on the sector and categorization of the debtor. The interest rates were generally lower than the market rate (from 33 percent to 90 percent of the average market rate) for peso debt, depending on the sector and category, and equal to the market rate for obligations in dollars.

⁵⁶ See Ferrere and Olivera García (1986), Chap. 5 for details.

Interest payments were in some cases only a fraction of the required amounts, with the unpaid portion subject to capitalization. A fraction of the interest unpaid between June 1983 and October 1985 (depending on sector and category) could be deferred to the latter years of the repayment period. A premium of up to 20 percent for prompt payment was established for some sectors and categories. The amortization was quarterly, with amounts increasing over time as a fraction of the outstanding debt, with the precise schedule depending on sector and category.

Also, firms were not allowed to pay dividends until debt was reduced to one third of the original amount, and dividend distribution required approval of the Financial Analysis Commission and a majority of creditors (dividends were not to exceed 20 percent of profits in any case).

The debt-relief scheme involved cumbersome procedures, which allowed borrowers legally to delay servicing their debts. One of the first measures of the new parliament had been approval of a law suspending court attachment of debtors' property for all debt contracted after July 1978 for a period of 35 days (Law 15741, of April 10, 1985).⁵⁷ This period was subsequently extended through November 20, 1985. The law of domestic debt refinancing extended this period for another 60 days. More important, it established that after this extension lapsed, the moratorium would continue for all debtors applying for refinancing for as long as their application was under study.

The commission had to determine whether a debtor was subject to automatic refinancing under the provision of the law (i.e., was a viable firm or otherwise eligible firm) or not (nonviable firm). The procedure was likely to lead to delays. A debtor could submit his application to anyone (but only to one) of his/her creditors. Then, all these applications had to be centrally processed, and all the creditors notified of all applications presented by all the firms against which they held any financial asset, after a comprehensive list had been produced. Taking into account the number of debtors (tens of thousands) and the applications presented (estimated to be about 9,000, according to press releases),⁵⁸ a formidable amount of paperwork was involved.⁵⁹ It is not surprising then that the work of the commission was delayed for more than a year, until mid-1987.

As a result, bank losses continued to increase, and a new phase of the crisis arrived, marked by the takeover of banks by the BROU resulting in progressive de facto nationalization of the banking sector.

The first episode of government participation in the banking sector took

⁵⁷ See Ferrere and Olivera García (1986), Chap. 11.

⁵⁸ See *Búsqueda*, Nos. 331, May 1986, and 341, July 1986.

⁵⁹ Often debtors had to be summoned to provide required additional information. See *Búsqueda*, No. 344, August 1986.

place much earlier, at the beginning of 1984, when the Banco del Plata was liquidated, with deposits being reimbursed.

At the beginning of 1985, before further takeovers by the BROU, the three largest private banks in Uruguay were the Banco Comercial (10.2 percent of deposits), the Banco Pan de Azúcar (9.9 percent), and the Banco de Italia (4.7 percent).⁶⁰

In May 1985, the Banco de Italia was taken over. It was the local branch of an Argentine bank that had been intervened by the Central Bank of Argentina. The local branch was solvent, though, according to press reports.⁶¹ The CBU ordered the intervention and the BROU assumed the majority of the equity.

In July 1985, the Banco Pan de Azúcar was taken over. It had become insolvent, and its head office in Chile was also in the process of liquidation. The BROU assumed the equity capital without indemnization.

In April 1986, Banco Pan de Azúcar and Banco de Italia merged, under the name of Banco Pan de Azúcar. About 83 percent of the equity of the new institution was held by the BROU.⁶²

In March 1987, the Banco Comercial, by then technically insolvent, was recapitalized by BROU in an operation ordered by the CBU. Its capital was raised from NUr\$750 million to NUr\$10,000 million (with a priority right for the acquisition given to former shareholders), and roughly 90 percent of the capital was held by the BROU at the end of the operation.⁶³

In June 1987, the Banco Pan de Azúcar—in which BROU had assumed the majority of shares—acquired Banco La Caja Obrera (which was the last domestically owned private commercial bank in Uruguay), following a run on the latter's deposits. As a result, 75 percent of deposits ended in government-owned banks, amounting to a sort of “de facto” nationalization of the banking sector.

This nationalization was a highly debated topic in Uruguay, with some arguing in favor of a de jure nationalization, integrating the purchased banks in the official bank system, and others in favor of a reprivatization.

Developments in the Late 1980s: New Measures to Deal with the Consequences of Portfolio Purchases by the CBU

In recent years both the BROU and the CBU have adopted measures to address the domestic debt problem. Most important among these measures are (a) the rescheduling of certain nonperforming loans by the BROU; (b) the introduction of a debt-to-debt conversion scheme by the CBU; and (c)

⁶⁰ See *Búsqueda*, No. 376, March 1987.

⁶¹ See *Búsqueda*, No. 334, June 1986, p. 21.

⁶² *Búsqueda*, March 20, 1986, p. 24.

⁶³ See *Búsqueda*, No. 376, March 1987, p. 13.

the strengthening of regulatory and supervisory procedures in the CBU.

In 1987, BROU began to reschedule loan order terms more favorable than those established in the 1985 refinancing law. This decision was triggered by the increasing share of nonperforming assets in the portfolio of the BROU following the takeover of Banco Comercial and Banco La Caja Obrera in early 1987. In selected cases, the BROU allowed debt-to-debt conversions, involving the repayment of domestic debt with external claims on BROU purchased abroad at a substantial discount. Moreover, the BROU resumed lending to those delinquent debtors who had rescheduled their debt.

The CBU has also addressed the problem of limited collection on its private loan portfolio which has become the major source of its quasi-fiscal losses in recent years. In late 1987, the CBU introduced its own debt-to-debt conversion scheme. Through this mechanism, private debtors are able to cancel their liabilities to the Central Bank with public external debt purchased in the secondary market. Moreover, in early 1988, the CBU transferred to the BROU the administration of its impaired private sector loan portfolio.

In 1989, the Government launched an extensive reform of the financial sector with assistance from the World Bank. The main objectives of this reform are the strengthening of the banking system and the restoring of necessary safeguards to normal credit operations to avoid a repetition of previous lending practices. The reform includes the rehabilitation of three of the failed banks absorbed by the BROU with a view to their subsequent privatization and the liquidation of a fourth insolvent bank. This reform is supported by a strengthening of the CBU's regulatory and supervisory procedures for evaluating credit applications, determining reserves for potential operational losses, and rating of uncollectible loans. New accounting procedures for commercial banks were introduced, including standardized balance sheets, guidelines for classifying credits in arrears, and special solvency and liquidity checks. At the same time, banking inspection was stepped up. In this context, the BROU is required to conform to the new banking and accounting standards applicable to private banks and to report separately to the CBU on its banking and nonbanking operations and their financing.

V. Summary and Conclusions

A major financial crisis developed in Uruguay in 1982 with far-reaching effects in subsequent years. A wide range of factors—both macroeconomic and regulatory—contributed to the crisis, which seriously disrupted the functioning of the Uruguayan economy.

In 1974 a profound economic reform was initiated. The reform implied a significant change in past policies and practices, and immediately improved the performance of the economy in terms of growth and efficiency. However, the sequencing of the reform—whereby the liberalization of capital transactions with the rest of the world was completed quickly, the liberalization of domestic financial markets was at a slower pace, and the removal of distortions in domestic commodity and labor markets and trade barriers proceeded at the slowest pace and suffered transitory reversals—together with prevailing conditions in neighboring countries (Argentina and Brazil) promoted important capital inflows that led to a surge in borrowing, particularly in foreign currency.

The reforms did not affect the CBU's supervisory techniques and procedures, which remained basically unchanged with respect to those prevailing during the pre-reform period. Supervision was confined to the traditional control of capital and reserve requirements. No legal norms regulated the way in which the accounting information of financial institutions had to be presented and evaluated. Most important, there were no early warning indicators or other systematic or informal schemes for off-site analysis of banks by the CBU.

Delays in removing trade barriers and other restrictions in domestic commodity and labor markets, together with the important capital inflows, complicated the management of monetary policy and contributed to high inflation during the first years of the reform process. In attempting to solve these problems, in late 1978 the authorities introduced an active crawling peg, announced a timetable to remove trade barriers, implemented an important tax reform, and continued to improve the fiscal position of the (nonfinancial) public sector and to liberalize domestic markets. Even though they succeeded in decelerating the inflation rate (particularly after late 1979), some adverse shocks affected the Uruguayan economy beginning in 1980.

The early 1980s was a time of recession in the world economy. It was also a time of important policy adjustments in Argentina and Brazil. As a result, demand for Uruguayan exports weakened and terms of trade deteriorated. At the same time, international interest rates increased. These developments caused a deterioration in the current account of the balance of payments. The public sector financial position also deteriorated owing to a shrinking tax base and large social security payments. Monetary management became more difficult because of the increasing financial needs of the Government and the deteriorating financial position of some financial institutions (mainly official banks). As a consequence, continuation of the active crawling peg regime (known as the *tablita*) became less credible and a renewed process of currency substitution began to develop. Domestic interest rates became highly positive in real terms (particularly

those on assets and liabilities denominated in local currency), reflecting the increasing risk of devaluation and adversely affecting the financial position of borrowers. This process was considerably fueled by the Argentine devaluation of early 1981, which created major capital outflows and capital flight.

When confidence in the *tablita* receded, and the expectation of a devaluation generalized, the position of nonfinancial firms, overindebted and exposed in dollars, was threatened. Already squeezed by rising real interest rates and by the fall of collateral prices after the reverse of the speculative upsurge caused by Argentine demand, the beginning of the peso float by a substantial devaluation represented a major blow. The financial sector saw the quality of its portfolio worsen rapidly, and the injection of emergency funds from the Central Bank was insufficient to revitalize the banks.

After the first indications of banking panics were detected and a generalized banking crisis was feared, the CBU bailed out depositors by arranging the sale of troubled banks to foreign banks, which only accepted the deal insofar as the CBU assisted the troubled banks by purchasing their bad loans. The CBU spread out the monetary effects of such purchases over a period of seven years.

In addition, the depletion of foreign exchange reserves at the Central Bank and the contemporaneous renegotiation of the external debt led the CBU to agree to purchase the poor-quality loan portfolio of some foreign banks in return for a loan in dollars. The deal was repeated later with a number of local banks, but the situation had deteriorated and the portfolios bought from local banks were of poorer quality. Owing to a number of factors, most of the debt that the CBU acquired through these schemes has proved so far impossible to recover.

The issue turned highly political, as debtors presented organized resistance to foreclosure procedures and resisted repayment in general, demanding a "political" solution. A law was passed in late 1985 that compromised between these demands and the need to resume normal lending operations by providing a legal framework for orderly rescheduling.

In the meantime, the position of banks became increasingly fragile, with some of them being affected also by the weak position of their head offices in other Latin American countries. One after the other, banks became insolvent, suffered bank runs, and the BROU stepped in, taking over failing banks by means of a recapitalizing operation sponsored by CBU. As a result, in 1987, the BROU held 75 percent of deposits while foreign banks held the rest.

The limited collection on the loan portfolio acquired by the CBU through the different portfolio purchase schemes during 1982–84 became a major source of losses in recent years. Also, the assistance provided by the

BROU to the troubled banks that it absorbed and its relief to delinquent debtors decreased its profitability. These factors have increased the financial needs of these official financial institutions, jeopardizing their autonomy, and complicating monetary management.

To address these problems, several measures were adopted in recent years. In late 1987, the CBU introduced a debt-to-debt conversion scheme under which over US\$50 million of its foreign liabilities were canceled. The BROU rescheduled certain nonperforming loans under terms more favorable than those provided for under the 1985 rescheduling law. It also implemented a selective debt-to-debt conversion scheme by allowing loan cancellations against its foreign liabilities purchased abroad at a discount.

Later, in June 1989, the Government launched an extensive financial sector reform. The main objectives have been the rehabilitation of three of the failed banks absorbed by the BROU and their subsequent privatization, and the liquidation of an insolvent bank. In addition, the CBU has started a review of the accounting rules for financial institutions and has strengthened its regulatory and supervisory role.

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APPENDIX I

Major Regulatory Changes in the Uruguayan Financial Sector, 1974–86

Interest Rates

Uruguayan financial regulations have traditionally included interest rate ceilings. This continued to be the case during the first few years of the reform process. Later, interest rates were freed for a few years, after which followed a period of more intervention ("moral suasion" or administrative ceilings on interest rates).

CBU Circular No. 524 (6/28/74) set the ceiling for foreign currency loan rates at 15.5 percent per annum paid at maturity; the ceiling was raised to 16.5 percent effective July 22, 1974.

CBU Circular No. 549 (9/24/74) set local currency maximum loan rates at 32 percent per annum, paid in advance (about 61.3 percent at maturity); the same circular set a 6 percent limit on commissions and fees paid in advance.

CBU Circular No. 550 (9/24/74) limited annual interest rates on domestic currency deposits as follows: 10 percent for checking accounts, with interest paid only if daily average balance exceeds NUr\$100,000; 18 percent for savings accounts; for time deposits above NUr\$50,000: 30 percent for 3- to 5-month deposits, 36 percent for 6- to 11-month deposits, and 48 percent for deposits with maturities of 12 months and over.

CBU Circular No. 614 (4/3/75) modified the ceiling for foreign currency loan rates, setting it at 14.5 percent per annum. Effective April 1, 1976, this rate was set at 12 percent per annum.

Beginning in March 1975, no interest was paid on checking account deposits.

CBU Circular No. 728 (3/5/76) set the maximum interest rate for lending operations in local currency with banks' own resources at 62 percent paid at maturity. At the same time, all interest rates on time and savings deposits could be fixed freely by banks. CBU Circular No. 730 (3/5/76) established that private financial intermediaries should communi-

...the most frequent interest rates charged or offered on their operations.

CBU Circular No. 869 (10/14/77) set maximum legal interest rates on loans at 90 percent for those in domestic currency and 15 percent for those in foreign currencies.

Effective June 1, 1978, the maximum interest rate on foreign currency loans was increased from 15 to 20 percent per annum.

CBU Circulars Nos. 941 and 950 (9/7/78 and 11/20/78) defined a "Basic Interest Rate," equal to an average of the more frequent deposit interest rates paid by the five most important banks.⁶⁴ These circulars also indicated that the basic rate would apply to export prefinancing schemes and to the lines of credit granted by the CBU to assist private banks.

In 1979, CBU Circular No. 990 (9/11/79) (based on Law 14887 and Decree 450/979) abolished all interest rate ceilings. A period of free interest rate determination followed.

Beginning in July 1983, CBU began using "moral suasion" with private banks to bring interest rates down from the prevailing levels at the time. Another brief period of formal administrative regulation followed soon thereafter.

In November 1984, an interest rate ceiling of 85 percent per annum was set for domestic currency loans. The ceiling was raised to 87 percent in December of the same year, to 90 percent in January 1985, and to 95 percent in February 1985.

Finally, interest rate ceilings were abolished again in December 1985. In the most recent period, and against the background of a stagnant financial system, the state commercial bank BROU played a major role in setting the market pace for interest rates.

Reserve Requirements

Reserve requirements were traditionally high, and continued to be so during the first few years of the liberalization period. In 1979, reserve requirements were eliminated, although they were reinstated later, and—together with compulsory investment coefficients—have been raised in recent years. All through this period the reserve requirement policy has been changing in terms of the percentages required, the type of assets that can satisfy the requirements, and the type of deposits subject to them. The main developments may be summarized as follows:

(CBU Circular No. 548 (9/24/74) set the following requirements, effective October 1, 1974:

“Importance was defined in terms of relative share in total deposits in domestic currency.

10 percent on time deposits with maturities exceeding 30 days. The requirement could be satisfied with cash in vault (up to 85 percent of the requirement); deposits with monetary authorities (with CBU or BROU); holdings of government bonds (up to 40 percent of the requirement, with a minimum of 10 percent in treasury notes and a minimum of 5 percent in adjustable mortgage bonds); and gold.

(ii) For foreign currency deposits, 20 percent, which could be satisfied with sight deposits in foreign currency at CBU or BROU (minimum 25 percent of the requirement); and government bonds denominated in foreign currency (up to 75 percent of the requirement).

CBU Circular No. 502 (2/12/74) established a 100 percent reserve requirement for all deposits exceeding 15 times the capital and reserves of the bank (see section on liabilities/capital ratios). This limit was later raised to 16 times (CBU Circular No. 548, 9/24/74), effective January 1, 1976.

CBU Circulars Nos. 593 and 595 (1/30/75 and 2/6/75) created an additional reserve requirement: 40 percent of the increase in deposits in local currency over the level of December 1984. The requirement could be satisfied with sight deposits with CBU, yielding 20 percent per annum interest rate; and special local currency treasury notes. These additional reserves were then reduced to 20 percent for domestic currency time deposits with maturities exceeding a year.

CBU Circular No. 703 (12/30/75) unified the basic and additional legal reserve requirements. Effective January 1, 1976, these requirements were 40 percent for sight deposits and deposits of less than 30 days; 20 percent for 30-day to 360-day time deposits; 5 percent for deposits of over 360 days; and 10 percent of capital for financial houses. This circular established that these reserve requirements could be fulfilled only with deposits with the CBU or cash.

Beginning in March 1976, private banks were forced to hold government bonds for 19 percent of local currency deposits, of which at least 11 percent were required to be in treasury bills, and at least 4 percent were required to be in mortgage bonds.

CBU Circular No. 679 (10/8/75) determined that government bonds held in fulfillment of foreign currency reserve requirements must be deposited exclusively with the CBU.

CBU Circulars Nos. 753 and 769 (6/3/76 and 6/30/76) eliminated the remunerated deposits in local currency as a form of holding reserves.

CBU Circular No. 799 (12/29/76) established a gradual increase in required reserves on foreign currency deposits, to 23 percent as of February 1977 and to 28 percent as of July 1977. At the same time, it established a remuneration on foreign currency of 2 percent over LIBOR, provided that the deposits were made for at least three months and for at least US\$100,000.

CBU Circular No. 808 (2/10/77) ordered a 100 percent reserve requirement for transitory deposits in banking institutions, to be met with cash and domestic currency deposits at the CBU.

CBU Circular No. 832 (5/9/77), which became effective as of June 1, 1977, established the following reserve requirements: 50 percent for sight deposits and time deposits with a maturity of less than 30 days; 35 percent for 30-day to 360-day time deposits; and 12 percent for deposits of more than 360 days.

CBU Circular No. 877 (10/14/77) ordered that, starting November 1, 1977, legal reserve requirements would be 50 percent for sight deposits and time deposits with a maturity of less than 12 months; 30 percent for 30-day to 360-day time deposits; 6 percent for deposits of more than a year; and 32 percent for foreign currency deposits.

Bankers' acceptances (including financial houses) were to be subject to the following reserve requirement ratios: 30 percent for acceptances of up to 12 months; and 6 percent for acceptances of more than a year.

CBU Circulars Nos. 840, 855, 865, and 876 (5/20/77, 7/28/77, 9/15/77, and 10/14/77) regulated the remuneration of reserves.

CBU Circular No. 875 (10/14/77), which came into effect as of November 1, 1977, set the required reserves for banks and financial houses at 32 percent on foreign currency deposits. Government bonds were eliminated from the required reserves.

Effective June 1, 1978, it was established that prevailing legal reserve requirements on all kinds of deposits would be applied to the monthly average deposits of each bank for the month of April 1978. All increments of deposits above this amount would have a unified reserve requirement of 20 percent.

At the same time, the legal reserve requirement for foreign currency deposits outstanding as of April 1978 was set at 28 percent. All increments of foreign currency deposits above this amount would also have a reserve requirement of 20 percent.

CBU Circular No. 945 (10/27/78) reduced the reserve requirement ratio for foreign currency deposits outstanding as of April 1978 from 28 percent to 24 percent.

CBU Circular No. 951 (12/7/78) unified (effective January 1, 1979) the reserve requirement ratio for both domestic and foreign currency deposits at 20 percent. These requirements applied to the stock of deposits of each bank outstanding at the end of 1978. All increments of deposits above this amount carried a zero reserve requirement.

CBU Circular No. 905 (3/8/78) established a remuneration for required reserves on domestic currency deposits of up to 15 percent a year for 30-day to 360-day liabilities subject to reserve requirements. The excess would also be remunerated up to an amount equal to 6 percent of domestic

currency deposits with maturities exceeding 360 days.

CBU Circular No. 936 (8/7/78) limited to 10 percent of liabilities subject to reserve requirements the fraction of reserves to be remunerated. CBU Circular No. 951 (12/7/78) set this limit at 2.5 percent, beginning in December 1978.

CBU Circular No. 976 (5/8/79) eliminated all reserve requirements, except those related to maximum liabilities/capital ratios: deposits over 16 times the capital and reserves became subject to 100 percent required reserves. CBU Circular No. 979 (6/27/79) raised this ratio from 16 to 30 times the capital and reserves.

Reserve requirement ratios were reintroduced after the failure of the preannounced devaluation regime. CBU Circular No. 1127 (12/29/82) established that, starting in 1983, reserve requirement ratios would be set at 5 percent for local currency deposits outstanding as of December 1982; and 20 percent on the increment in local currency deposits over those outstanding in December 1982. These reserves would be remunerated at a variable rate.

CBU Circular No. 1128 (1/5/83) increased reserve requirements to 10 percent of liabilities in domestic currency existing by the end of December 1982 (from 5 percent previously); and to 40 percent for increases over that level (from 20 percent). CBU Circular No. 1137 (3/10/83) increased from 10 percent to 13 percent the reserve requirement on liabilities in domestic currency, and CBU Circular No. 1149 (9/21/83) lowered the marginal requirement from 40 percent to 25 percent. CBU Circular No. 1153 (12/1/83) ended this transitory period by setting a 14 percent reserve requirement ratio and eliminating the marginal requirement.

CBU Circulars Nos. 1124 and 1149 (2/8/83 and 9/21/83) spelled out the penalties for not satisfying legal reserve requirements.

Entry and Branching Regulations

Law 13,330 of 1965, passed after the banking crisis of 1965, forbade both the installation of new banks and the opening of additional branches or offices of existing banks (a new branch could be opened only if another office was closed by the same or another institution).

Banking houses were not included in the prohibition, because at the time only one banking house existed, and its weight in the financial system was negligible.

CBU Circular No. 799 (12/29/76) allowed banking houses for the first time to receive foreign currency deposits from nonresidents.

Law 15,207 of 1981 lifted the entry prohibition in the banking sector. New banks were allowed to enter the sector, in a number not to exceed 10

percent of the number that had existed the previous year, and the ban on branch and office expansion was lifted.

Risk Concentration and Maximum Financing Limits

Before the reform, maximum financing limits to a single client were in force, and risk concentration regulations applied for most of the period except for a brief interval of less than two years.

CBU Circular No. 547 (9/24/74) maintained the prohibition against lending to a single client more than 20 percent of the bank capital and reserves, with the exception of export prefinancing.

CBU Circulars Nos. 640, 642, and 706 (6/15/75, 6/27/75, and 12/2/75) removed some pre-existing norms on banned lines of financing and on promoted lines of credit, and raised the maximum credit to a single person or firm to 25 percent of the bank capital (with some exceptions).

CBU Circular No. 860 (7/24/77) addressed the issue of interlocking boards of directors by forbidding financing above 25 percent of the bank capital to corporations whose board of directors included members of the bank board or management.

CBU Circular No. 964 (2/22/79) modified the regime of exceptions to the financing limit to a single customer.

CBU Circular No. 971 (3/29/79) eliminated all regulations on risk concentration and maximum financing. A deregulated period followed.

CBU Circular No. 1048 (12/10/80) reintroduced legal maximum risk concentration limits, which were set at 25 percent of the bank capital (as of the next-to-last month) for individuals or single firms and 35 percent for conglomerates or groups of firms (with no single firm within the group exceeding the 25 percent limit). The limits included disbursed and nondisbursed loans, banking acceptances, and endorsements.

Some exceptions were considered for guaranteed loans and loans with more than three years to maturity, if covered by the Credit Insurance Fund.

For a transition period of three months (January–March 1981), banks that did not satisfy the limits when the regulation was issued had to observe limits of 40 percent for single firms and 60 percent for conglomerates, to be gradually adjusted to the 25 percent and 35 percent limits.

The limits were abolished in August 1981, when restrictions were replaced by requirements for detailed information on borrowers, to be provided to the Central Bank of Uruguay according to a uniform methodology.

Liability to Capital Ratios

Throughout the period, the capacity of banks to take deposits or to incur liabilities was linked to the bank capital.

CBU Circular No. 501 (2/12/74) established a maximum bank deposits/capital ratio of 15 times. CBU Circular No. 548 (9/24/74) of the same year raised that ratio to 16, with a 100 percent reserve requirement for all deposits exceeding the limit.

CBU Circular No. 735 (4/1/76) regulated bankers' acceptances, setting a limit of 50 percent of the bank capital. It also set a maximum limit for discounting commercial paper.

CBU Circular No. 782 (5/25/76) set the limits on bankers' acceptances at either 50 percent of the bank capital or up to 20 percent of the deposits in local currency subject to reserve requirements.

CBU Circulars Nos. 971, 980, 982, and 999 (6/27/79, 7/6/79, 7/22/79, and 11/15/79) defined maximum legal limits to the liabilities in local currency or foreign currency that the financial intermediaries could have. This was set at 30 times the capital for banks. Also, for banks that, as of June 30, 1977, had liabilities in excess of 30 times their capital, and for banking houses with liabilities in excess of 20 times their capital, the following transitory regime was established, effective December 1, 1979: the 100 percent reserve requirement for liabilities above the limit was waived until March 1980; increases in liabilities above the level of June 10, 1979, were subject to a 100 percent reserve requirement.

CBU Circular No. 1150 (9/23/83) set a maximum level for bank liabilities equal to 20 times the sum of their capital plus reserves at the CBU plus holdings of government bonds not affected to meet reserve requirements.

Minimum Capital Requirements

Throughout the period, regulations on legal minimum net worth (capital and reserves) for banking firms were in force, and were updated periodically to take account of inflation.

Decrees 439 and 614 (of 1976) updated previous minimum capital requirements for financial intermediaries, setting basic requirements at NUr\$3.5 million for banks; NUr\$1.5 million for banking houses; NUr\$350,000 for *cajas populares*; and an additional minimum capital requirement of NUr\$300,000 for every office in Montevideo department, in the capitals of all other departments, and in the cities of Las Piedras, Pando, and Punta del Este; and NUr\$150,000 for each office in any other location.

Decree 540 and CBU resolution of October 14, 1977, redefined minimum capital requirements. The basic requirements were set at NUr\$6 million for banks; NUr\$3 million for banking houses; NUr\$6 million for *cajas populares*; and the additional minimum capital was set at NUr\$500,000 for offices in Montevideo department, in the capitals of other departments, and in the cities of Las Piedras, Pando, and Punta del Este; and

NUr\$250,000 for offices elsewhere.

CBU Circular No. 960 (1/23/79) again updated these minimum requirements. The basic requirements were set at NUr\$7.8 million for banks; NUr\$3.9 million for banking houses; and the additional ones at NUr\$650,000 for offices in Montevideo department, in the capitals of all other departments, and in the cities of Las Piedras, Pando, and Punta del Este; and NUr\$325,000 for offices at all other locations. Also, a requirement of NUr\$325,000 for exchange house offices was set.

CBU Circular No. 1007 (12/12/79) set the requirements at NUr\$46.5 million for banks; and NUr\$27.9 for banking houses.

CBU Circular No. 1032 (9/14/80) stated that holdings of domestic financial corporations equity would not count for the fulfillment of minimum capital requirements, and that general equity or bonds could be counted only up to 5 percent of capital.

CBU Circulars Nos. 1082, 1083, 1098, and 1110 (issued in 1982) raised the minimum capital requirements.

CBU Circulars Nos. 1140 and 1150 (5/6/83 and 9/27/83) again updated minimum requirements to NUr\$145 million for banks; NUr\$87 million for banking houses; NUr\$7.25 million for credit cooperatives.

The minimum capital requirement regulations continued in force afterward, and were periodically updated.

Asset Immobilization

CBU resolutions of January 7, 1977 (Circular No. 801), and February 16, 1977, established limits on immobilized assets in the balance sheets of banking firms at no more than 60 percent of the capital and reserves, to be raised to 70 percent after September 1977.

A CBU decision dated October 14, 1977, set this limit at 100 percent of capital and reserves.

APPENDIX II
Statistical Appendix

Statistical Appendix Table 1. Government Finance (Central Government), 1973–84

| | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|--------------------|--|--------|---------|-------|-------|-------|-------|--------|--------|---------|--------|---------|
| | <i>(In millions of new Uruguayan pesos)</i> | | | | | | | | | | | |
| Total revenue | 370.2 | 587.9 | 985.5 | 1,722 | 2,938 | 4,350 | 8,424 | 14,955 | 21,260 | 19,552 | 29,486 | 39,797 |
| Total expenditure | 406.5 | 789.5 | 1,348.8 | 2,048 | 3,179 | 4,751 | 8,301 | 14,880 | 21,377 | 30,761 | 36,897 | 55,473 |
| Current | 372.2 | 709.4 | 1,203.8 | 1,808 | 2,796 | 4,021 | 7,260 | 13,081 | 18,817 | 27,503 | 33,159 | 50,560 |
| Capital | 34.3 | 80.1 | 145.0 | 240 | 383 | 730 | 1,040 | 1,799 | 2,559 | 3,258 | 3,738 | 4,913 |
| Deficit or surplus | -36.3 | -201.6 | -363.3 | -326 | -241 | -401 | 123 | 75 | -117 | -11,210 | -7,411 | -15,676 |
| | <i>(Deficit or surplus as percent of GDP)</i> | | | | | | | | | | | |
| | 1.4 | -4.4 | -4.5 | -2.5 | -1.2 | -1.3 | 0.02 | 0.01 | -0.01 | -8.7 | -3.9 | -5.3 |

Source: Larraín (1986).

Statistical Appendix Table 2. Money Supply, 1974–85
(In millions of new Uruguayan pesos)

| Year | Quarter | Currency with Public | Demand Deposits | Peso Savings, Time, and Other | | | M2 | Ratio M2/M1 | Foreign Currency Deposits | M3 | Ratio M3/M1 |
|------|---------|----------------------------|--------------------|--|----------|--|----------|----------------|---------------------------------|----------|----------------|
| | | | | M1 | Deposits | | | | | | |
| 1974 | I | 214.7 | 166.6 | 381.3 | 169.6 | | 550.9 | 1.4 | 48.3 | 599.2 | 1.57 |
| | II | 217.3 | 159.4 | 376.7 | 197.2 | | 573.9 | 1.5 | 52.7 | 626.6 | 1.66 |
| | III | 235.7 | 180.7 | 416.4 | 217.3 | | 633.7 | 1.5 | 71.0 | 704.7 | 1.69 |
| | IV | 315.7 | 223.8 | 539.5 | 218.6 | | 758.1 | 1.4 | 101.2 | 859.3 | 1.59 |
| 1975 | I | 328.7 | 286.6 | 615.3 | 278.4 | | 893.7 | 1.5 | 155.2 | 1,048.9 | 1.70 |
| | II | 349.7 | 271.7 | 621.4 | 320.6 | | 942.0 | 1.5 | 215.1 | 1,157.1 | 1.86 |
| | III | 348.1 | 292.8 | 640.9 | 378.5 | | 1,019.4 | 1.6 | 240.8 | 1,260.2 | 1.97 |
| | IV | 469.8 | 351.5 | 821.3 | 434.3 | | 1,255.6 | 1.5 | 345.0 | 1,600.6 | 1.95 |
| 1976 | I | 520.1 | 410.2 | 930.3 | 587.9 | | 1,518.2 | 1.6 | 465.3 | 1,983.5 | 2.13 |
| | II | 598.6 | 435.6 | 1,034.2 | 713.0 | | 1,747.2 | 1.7 | 643.5 | 2,390.7 | 2.31 |
| | III | 626.2 | 464.4 | 1,090.6 | 784.4 | | 1,875.0 | 1.7 | 867.1 | 2,742.1 | 2.51 |
| | IV | 784.2 | 542.8 | 1,327.0 | 876.0 | | 2,203.0 | 1.7 | 1,091.4 | 3,294.4 | 2.48 |
| 1977 | I | 829.7 | 624.4 | 1,454.1 | 1,003.1 | | 2,457.2 | 1.7 | 1,458.3 | 3,915.5 | 2.69 |
| | II | 811.7 | 644.4 | 1,456.1 | 1,085.1 | | 2,541.2 | 1.7 | 1,788.1 | 4,329.3 | 2.97 |
| | III | 831.6 | 674.2 | 1,505.8 | 1,197.8 | | 2,703.6 | 1.8 | 2,135.3 | 4,838.9 | 3.21 |
| | IV | 1,112.4 | 745.4 | 1,857.8 | 1,273.9 | | 3,131.7 | 1.7 | 2,597.6 | 5,729.3 | 3.08 |
| 1978 | I | 1,120.7 | 865.2 | 1,985.9 | 1,975.7 | | 3,961.6 | 2.0 | 2,769.5 | 6,731.1 | 3.39 |
| | II | 1,347.8 | 940.2 | 2,288.0 | 2,514.2 | | 4,802.2 | 2.1 | 3,244.4 | 8,046.6 | 3.52 |
| | III | 1,271.8 | 903.4 | 2,175.2 | 2,742.6 | | 4,917.8 | 2.3 | 3,949.3 | 8,867.1 | 4.08 |
| | IV | 1,809.3 | 1,257.5 | 3,066.8 | 3,387.8 | | 6,454.6 | 2.1 | 4,712.6 | 11,167.2 | 3.64 |
| 1979 | I | 1,777.8 | 1,537.5 | 3,315.3 | 4,385.9 | | 7,701.2 | 2.3 | 6,016.2 | 13,717.4 | 4.14 |
| | II | 2,119.7 | 1,857.9 | 3,977.6 | 5,388.0 | | 9,365.6 | 2.4 | 6,865.1 | 16,230.7 | 4.08 |
| | III | 2,226.1 | 1,916.9 | 4,143.0 | 6,762.5 | | 10,905.5 | 2.6 | 7,571.5 | 18,477.0 | 4.46 |
| | IV | 3,105.2 | 2,597.8 | 5,703.0 | 7,811.9 | | 13,514.9 | 2.4 | 8,060.2 | 21,575.1 | 3.78 |

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Statistical Appendix Table 2 (concluded). Money Supply, 1974–85
(In millions of new Uruguayan pesos)

| Year | Quarter | Currency with | | Peso | | | Ratio M2/M1 | Foreign Currency Deposits | M3 | Ratio M3/M1 |
|------|---------|---------------|--------------------|----------|---------------------------------|-----------|----------------|---------------------------------|-----------|----------------|
| | | Public | Demand Deposits | M1 | Deposits, Time, and Other | M2 | | | | |
| 1980 | I | 3,671.5 | 2,521.5 | 6,193.0 | 10,614.0 | 16,807.0 | 2.7 | 8,797.4 | 25,604.4 | 4.13 |
| | II | 3,344.9 | 2,730.8 | 6,075.7 | 12,104.8 | 18,180.5 | 3.0 | 9,739.7 | 27,920.2 | 4.60 |
| | III | 3,439.6 | 2,927.4 | 6,367.0 | 14,196.5 | 20,563.5 | 3.2 | 11,166.6 | 31,730.1 | 4.98 |
| | IV | 5,089.7 | 3,571.2 | 8,660.9 | 14,939.7 | 23,600.6 | 2.7 | 12,489.5 | 36,090.1 | 4.17 |
| 1981 | I | 4,747.8 | 3,600.4 | 8,348.2 | 17,771.7 | 26,119.9 | 3.1 | 15,599.5 | 41,719.4 | 5.00 |
| | II | 5,312.1 | 3,371.7 | 8,683.8 | 17,706.9 | 26,390.7 | 3.0 | 19,236.4 | 45,627.1 | 5.25 |
| | III | 5,019.4 | 3,252.2 | 8,271.6 | 17,675.9 | 25,947.5 | 3.1 | 22,004.3 | 47,951.8 | 5.80 |
| | IV | 6,146.2 | 3,523.6 | 9,669.8 | 18,495.1 | 28,164.9 | 2.9 | 24,350.5 | 52,515.4 | 5.43 |
| 1982 | I | 5,523.0 | 3,142.2 | 8,665.2 | 18,619.2 | 27,284.4 | 3.1 | 27,520.4 | 54,804.8 | 6.32 |
| | II | 5,442.5 | 2,951.7 | 8,394.2 | 18,290.4 | 26,684.6 | 3.2 | 32,261.7 | 58,946.3 | 7.02 |
| | III | 5,305.6 | 2,560.8 | 7,866.4 | 17,890.6 | 25,757.0 | 3.3 | 32,858.0 | 58,615.0 | 7.45 |
| | IV | 7,879.3 | 3,589.9 | 11,469.2 | 20,362.0 | 31,831.2 | 2.8 | 59,423.6 | 91,254.8 | 7.96 |
| 1983 | I | 7,543.9 | 2,848.4 | 10,392.3 | 22,915.3 | 33,307.6 | 3.2 | 50,767.5 | 84,075.1 | 8.09 |
| | II | 6,139.5 | 3,200.1 | 9,339.6 | 26,992.1 | 36,331.7 | 3.9 | 50,236.5 | 86,568.2 | 9.27 |
| | III | 5,854.7 | 3,476.6 | 9,331.3 | 25,809.1 | 35,140.4 | 3.8 | 54,974.2 | 90,114.6 | 9.66 |
| | IV | 8,405.1 | 4,378.3 | 12,783.4 | 24,383.8 | 37,167.2 | 2.9 | 66,559.4 | 103,726.6 | 8.11 |
| 1984 | I | 8,363.4 | 4,387.2 | 12,750.6 | 29,421.4 | 42,172.0 | 3.3 | 89,839.3 | 132,011.3 | 10.35 |
| | II | 8,861.4 | 4,294.7 | 13,156.1 | 31,891.3 | 45,047.4 | 3.4 | 89,801.2 | 134,848.6 | 10.25 |
| | III | 9,359.4 | 4,202.1 | 13,561.5 | 34,361.2 | 47,922.7 | 3.5 | 89,763.6 | 137,686.3 | 10.15 |
| | IV | 12,105.2 | 7,499.6 | 19,604.8 | 35,091.2 | 54,696.0 | 2.8 | 104,806.7 | 159,502.7 | 8.14 |
| 1985 | I | 14,984.0 | 6,234.0 | 21,218.0 | 40,805.7 | 62,023.7 | 2.9 | 139,521.0 | 201,544.7 | 9.50 |
| | II | 16,725.0 | 8,974.3 | 25,700.1 | 49,969.9 | 75,670.0 | 2.9 | 146,086.4 | 221,756.4 | 8.63 |
| | III | 15,413.9 | 10,220.0 | 25,633.9 | 57,673.8 | 83,307.7 | 3.2 | 172,373.2 | 255,680.9 | 9.97 |
| | IV | 23,274.8 | 16,886.8 | 40,161.6 | 66,122.4 | 106,284.0 | 2.6 | 203,086.3 | 309,370.3 | 7.70 |

Source: Central Bank of Uruguay, *Boletín Estadístico*, various issues.

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Statistical Appendix Table 3. Exchange Rates, 1976-84
(In new Uruguayan pesos)

| | 1 U.S. Dollar | | 1 Argentine Peso | | 1 Brazilian Cruzeiro | |
|----------|---------------|--------|------------------|--------|----------------------|--------|
| | Buyer | Seller | Buyer | Seller | Buyer | Seller |
| 1976 | | | | | | |
| Average | 3.30 | 3.34 | 0.0153 | 0.0155 | 0.2701 | 0.2727 |
| December | 3.94 | 3.98 | 0.0150 | 0.0150 | 0.2700 | 0.2700 |
| 1977 | | | | | | |
| Average | 4.65 | 4.68 | 0.0117 | 0.0118 | 0.2774 | 0.2779 |
| December | 5.38 | 5.39 | 0.0093 | 0.0093 | 0.2740 | 0.2746 |
| 1978 | | | | | | |
| Average | 6.05 | 6.06 | 0.0077 | 0.0077 | 0.2820 | 0.2826 |
| December | 6.97 | 6.98 | 0.0070 | 0.0070 | 0.2688 | 0.2693 |
| 1979 | | | | | | |
| Average | 7.84 | 7.86 | 0.0060 | 0.0061 | 0.2526 | 0.2534 |
| December | 8.41 | 8.43 | 0.0052 | 0.0052 | 0.1921 | 0.1930 |
| 1980 | | | | | | |
| Average | 9.08 | 9.10 | 0.0049 | 0.0049 | 0.1613 | 0.1623 |
| December | 9.92 | 9.95 | 0.0050 | 0.0050 | 0.1497 | 0.1507 |
| 1981 | | | | | | |
| Average | 10.79 | 10.82 | 0.0025 | 0.0026 | 0.1079 | 0.1089 |
| December | 11.50 | 11.53 | 0.0010 | 0.0011 | 0.0729 | 0.0739 |
| 1982 | | | | | | |
| Average | 13.85 | 13.91 | 0.0006 | 0.0006 | 0.0545 | 0.0553 |
| December | 28.21 | 28.51 | 0.0004 | 0.0005 | 0.0704 | 0.0718 |
| 1983 | | | | | | |
| Average | 34.38 | 34.54 | 2.7860 | 2.8680 | 0.0426 | 0.0433 |
| December | 42.50 | 42.73 | 1.7410 | 1.7490 | 0.0343 | 0.0346 |
| 1984 | | | | | | |
| Average | 55.89 | 56.12 | 0.7822 | 0.7892 | 0.0286 | 0.0289 |
| December | 71.98 | 72.23 | 0.3970 | 0.4020 | 0.0200 | 0.0201 |

Source: Central Bank of Uruguay, *Boletín Estadístico*, various issues.

Statistical Appendix Table 4. Price and Wage Inflation, Fourth Quarter, 1974—Third Quarter, 1986
(Annual percentage change in end-of-period indices)

| Year | Quarter | Consumer Prices | | | | | Wholesale Prices | | | | | |
|------|---------|-----------------|-------|----------|---------|-------|------------------|---------------|-------------|--------------|-------|------|
| | | CPI¹ | Food | Clothing | Housing | Other | WPI² | Manufacturing | Agriculture | Construction | Wages | |
| 1974 | IV | 107.4 | 105.5 | 72.7 | 111.4 | 129.5 | 87.5 | | | | | 96.9 |
| 1975 | I | 92.9 | | | | | 75.6 | 88.7 | 45.1 | 75.1 | | |
| | II | 93.0 | | | | | 84.4 | 93.7 | 60.9 | 69.1 | | |
| | III | 79.7 | | | | | 70.6 | 82.2 | 40.6 | 62.1 | | |
| | IV | 66.8 | 53.1 | 68.0 | 88.6 | 77.3 | 65.0 | 75.9 | 35.8 | 46.2 | 61.6 | |
| 1976 | I | 49.9 | | | | | 49.2 | 54.4 | 33.5 | 39.8 | 41.2 | |
| | II | 44.8 | | | | | 39.3 | 44.4 | 23.8 | 29.5 | 24.6 | |
| | III | 53.9 | | | | | 55.2 | 57.1 | 49.0 | 41.6 | 49.9 | |
| | IV | 39.9 | 38.5 | 36.4 | 43.5 | 41.1 | 45.1 | 45.1 | 45.3 | 44.3 | 29.2 | |
| 1977 | I | 56.0 | | | | | 55.8 | 56.8 | 52.5 | 46.1 | 41.4 | |
| | II | 65.7 | | | | | 59.0 | 60.8 | 52.6 | 53.2 | 55.9 | |
| | III | 59.4 | | | | | 49.8 | 50.6 | 46.9 | 46.8 | 43.0 | |
| | IV | 57.3 | 59.5 | 46.6 | 66.5 | 50.1 | 44.8 | 41.7 | 55.8 | 44.9 | 45.6 | |
| 1978 | I | 54.9 | | | | | 39.2 | 34.4 | 56.7 | 39.0 | 42.5 | |
| | II | 44.7 | | | | | 45.3 | 38.4 | 71.4 | 40.4 | 39.3 | |
| | III | 40.8 | | | | | 51.4 | 39.0 | 96.5 | 38.3 | 38.1 | |
| | IV | 46.0 | 48.4 | 39.5 | 45.6 | 44.9 | 59.6 | 49.3 | 92.0 | 40.8 | 41.0 | |
| 1979 | I | 55.2 | | | | | 70.4 | 57.0 | 112.1 | 49.8 | 42.8 | |
| | II | 62.9 | | | | | 84.7 | 72.6 | 121.1 | 65.1 | 45.3 | |
| | III | 73.4 | | | | | 88.5 | 80.5 | 109.0 | 76.7 | 50.6 | |
| | IV | 83.1 | 86.0 | 95.2 | 78.8 | 76.9 | 77.1 | 82.7 | 63.4 | 93.6 | 56.8 | |
| 1980 | I | 78.1 | | | | | 62.8 | 74.3 | 36.7 | 88.9 | 68.8 | |
| | II | 67.8 | | | | | 40.5 | 51.9 | 13.5 | 74.3 | 78.8 | |
| | III | 56.6 | | | | | 30.7 | 41.3 | 7.1 | 51.5 | 57.4 | |
| | IV | 42.8 | 33.5 | 27.7 | 63.7 | 47.9 | 28.6 | 32.9 | 16.7 | 35.7 | 57.0 | |

| | | | | | | | | | | |
|------|-----|------|------|-------|------|-------|------|-------|------|-------|
| 1981 | I | 38.7 | | | | 26.5 | 33.8 | 5.1 | 38.0 | 52.7 |
| | II | 34.8 | | | | 25.0 | 29.8 | 9.9 | 28.3 | 32.2 |
| | III | 32.7 | | | | 25.2 | 29.7 | 11.9 | 33.5 | 48.2 |
| | IV | 29.4 | 25.2 | 18.8 | 42.9 | 26.3 | 18.1 | 5.2 | 21.1 | 30.3 |
| 1982 | I | 22.3 | | | | 11.9 | 12.4 | 10.1 | 12.7 | 26.5 |
| | II | 18.9 | | | | 14.0 | 13.4 | 16.2 | 12.8 | 25.5 |
| | III | 14.7 | | | | 9.3 | 10.2 | 6.1 | 8.6 | 10.3 |
| | IV | 20.5 | 13.3 | 8.0 | 28.8 | 27.9 | 37.9 | 17.9 | 30.7 | 7.0 |
| 1983 | I | 42.9 | | | | 60.0 | 59.3 | 62.6 | 45.0 | 10.8 |
| | II | 47.2 | | | | 67.0 | 67.0 | 67.1 | 44.1 | 11.3 |
| | III | 55.1 | | | | 84.1 | 81.0 | 95.3 | 50.7 | 29.8 |
| | IV | 51.5 | 59.7 | 64.76 | 30.9 | 59.8 | 62.9 | 118.6 | 38.8 | 35.2 |
| 1984 | I | 43.9 | | | | 67.7 | 63.1 | 84.7 | 39.9 | 29.9 |
| | II | 56.2 | | | | 84.0 | 77.4 | 108.0 | 52.7 | 41.9 |
| | III | 60.4 | | | | 78.3 | 73.9 | 92.5 | 61.6 | 41.8 |
| | IV | 66.1 | 77.5 | 89.6 | 38.9 | 68.0 | 82.0 | 90.3 | 65.8 | 66.1 |
| 1985 | I | 67.9 | | | | 81.8 | 80.6 | 85.7 | 78.7 | 69.2 |
| | II | 70.5 | | | | 73.7 | 80.4 | 52.8 | 88.2 | 99.2 |
| | III | 72.0 | | | | 73.7 | 85.1 | 40.2 | 95.8 | 106.8 |
| | IV | 83.0 | 72.2 | 92.0 | 77.1 | 102.9 | 85.5 | 41.1 | 93.3 | 107.7 |
| 1986 | I | 83.2 | | | | 68.0 | 73.4 | 50.7 | 81.5 | 120.9 |
| | II | 74.8 | | | | 63.1 | 62.1 | 67.1 | 69.2 | 82.0 |
| | III | 76.5 | | | | 72.3 | 59.3 | 122.8 | 57.9 | 75.6 |

Source: Central Bank of Uruguay, *Reseña de la Actividad Económica Financiera*, various issues.

¹Consumer price index (CPI)

²Wholesale price index (WPI)

Statistical Appendix Table 5. Balance of Payments, 1974–85
(In millions of U.S. dollars)

| | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 |
|----------------------------------|--------|--------|--------|--------|--------|----------|----------|----------|----------|---------|--------|--------|
| Current account balance | -118.0 | -189.5 | -73.6 | -159.8 | -127.0 | -316.8 | -692.0 | -478.2 | -468.2 | -171.1 | -129.2 | -120.2 |
| Trade balance | -52.3 | -109.1 | 28.4 | -68.1 | -23.7 | -437.8 | -592.3 | -384.0 | -15.5 | 305.4 | 192.3 | 178.2 |
| Exports (f.o.b.) | 381.2 | 385.0 | 565.0 | 611.6 | 686.1 | 788.1 | 1,058.5 | 1,215.4 | 1,022.9 | 1,045.1 | 924.6 | 853.6 |
| Imports (c.i.f.) | -433.5 | -494.1 | -536.6 | -679.7 | -709.8 | -1,125.9 | -1,650.8 | -1,599.4 | -1,038.4 | -739.7 | -732.3 | -675.4 |
| Net service payments | -40.5 | -16.1 | -37.3 | -30.4 | -33.6 | 71.7 | -8.0 | -30.1 | -266.2 | -199.7 | 30.1 | 41.7 |
| Net investment income | -42.6 | -71.2 | -72.4 | -67.9 | -76.8 | -57.8 | -100.4 | -73.8 | -187.6 | -196.9 | -361.6 | -350.9 |
| Net transfers | 17.4 | 6.9 | 7.7 | 6.6 | 7.1 | 7.1 | 8.7 | 9.7 | 10.4 | 11.0 | 10.0 | 10.8 |
| Capital account balance | 49.3 | 104.1 | 240.7 | 261.7 | 413.4 | 360.3 | 745.6 | 779.7 | -681.1 | 136.7 | -198.1 | 232.4 |
| Public sector | 53.0 | 119.4 | 101.0 | 35.2 | 54.2 | 114.2 | 174.3 | 289.4 | 857.7 | 506.8 | 73.9 | 157.9 |
| Private sector | | | | | | | | | | | | |
| (Excluding errors and omissions) | 64.3 | 27.7 | 149.7 | 183.3 | 199.9 | 269.4 | 476.8 | 631.9 | -277.3 | -121.4 | -158.6 | -164.7 |
| Errors and omissions | -68.0 | -43.0 | -10.0 | 43.2 | 159.3 | -23.3 | 94.5 | -141.6 | -1,261.5 | -248.7 | -113.4 | 239.2 |
| Allocation of SDRs | — | — | — | — | — | 11.4 | 11.5 | 10.9 | — | — | — | — |
| Overall balance | -68.7 | -85.4 | 167.1 | 101.9 | 286.4 | 54.9 | 65.1 | 312.4 | -1,149.3 | -34.4 | -327.3 | 112.2 |
| Gold valuation adjustment | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 9.7 | 150.7 | 71.6 | 3.1 | 0.4 |
| Change in reserves | -68.7 | -85.4 | 167.1 | 101.9 | 286.4 | 54.9 | 65.1 | 322.1 | -998.6 | 37.2 | -324.2 | 112.6 |

Source: Central Bank of Uruguay. *Reseña de la Actividad Económica Financiera*, various issues.

Statistical Appendix Table 6. Real Effective Exchange Rates, 1978–84
(Index 1978 = 100)

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | 1985 ¹ |
|---------------|-------|-------|-------|-------|-------|-------|-------|-------------------|
| Argentina | 100.0 | 141.0 | 185.2 | 170.8 | 94.9 | 80.5 | 95.0 | 90.1 |
| Brazil | 100.0 | 90.4 | 80.7 | 99.1 | 104.5 | 84.8 | 85.1 | 86.4 |
| Mexico | 100.0 | 105.9 | 118.2 | 133.5 | 95.6 | 84.3 | 98.0 | 109.7 |
| United States | 100.0 | 97.5 | 98.0 | 111.2 | 124.7 | 129.1 | 139.6 | 153.4 |
| Uruguay | 100.0 | 108.6 | 135.7 | 152.7 | 164.3 | 103.8 | 98.9 | 95.8 |

Source: World Bank, "Country Economic Memorandum on Uruguay, 1986," Table 9.7.
¹January–June.

Statistical Appendix Table 7. Banking System Structure, 1974–85

| Year | Government-Owned Banks | Commercial Banks Domestic | Commercial Banks Foreign | Casas Bancarias | Number of Offices | Number of Employees |
|------|------------------------|---------------------------|--------------------------|-----------------|-------------------|---------------------|
| 1974 | 2 | 12 | 8 | 2 | 248 | 5,718 |
| 1975 | 2 | 13 | 8 | 2 | 263 | 5,336 |
| 1976 | 2 | 13 | 8 | 2 | 248 | 5,718 |
| 1977 | 2 | 13 | 8 | 4 | 261 | 5,777 |
| 1978 | 2 | 13 | 8 | 11 | 274 | 6,280 |
| 1979 | 2 | 13 | 8 | 17 | 299 | 6,655 |
| 1980 | 2 | 13 | 8 | 20 | 316 | 7,500 |
| 1981 | 2 | 13 | 8 | 23 | 318 | 7,980 |
| 1982 | 2 | 12 | 10 | 20 | 325 | 7,839 |
| 1983 | 2 | 13 | 9 | 19 | 332 | 7,856 |
| 1984 | 2 | 13 | 9 | 17 | ... | ... |
| 1985 | 2 | 13 | 9 | 16 | ... | ... |

Source: Central Bank of Uruguay.

**Statistical Appendix Table 8. Value-Added of the
Financial Sector Relative to GNP, 1975--85**
(In percent)

| | |
|------|------|
| 1975 | 4.61 |
| 1976 | 5.08 |
| 1977 | 4.35 |
| 1978 | 5.18 |
| 1979 | 4.97 |
| 1980 | 5.06 |
| 1981 | 5.28 |
| 1982 | 6.08 |
| 1983 | 6.47 |
| 1984 | 6.44 |
| 1985 | 6.72 |

Source: Central Bank of Uruguay.

Statistical Appendix Table 9. Financial Intermediation, 1974–85
(Assets and liabilities of the banking system as a percent of GDP)

| Year | Peso Savings, Time, and Other Deposits | | M2 | Foreign Currency Deposits | Total Savings and Time Deposits | | M3 | Net Public Sector Credit | Private Sector Credit | | Domestic Credit | M3/ Domestic Credit | M3/Credit Private and Public Sector |
|------|--|-------|-------|---------------------------|---------------------------------|-------|-------|--------------------------|-----------------------|--------|-----------------|---------------------|-------------------------------------|
| | M1 | | | | | | | | Peso | Dollar | | | |
| 1974 | 11.87 | 4.81 | 16.68 | 2.23 | 7.04 | 18.91 | 4.59 | 15.35 | 3.38 | 18.73 | 19.92 | 0.95 | 0.81 |
| 1975 | 10.06 | 5.32 | 15.38 | 4.22 | 9.54 | 19.60 | 5.54 | 14.39 | 5.09 | 19.48 | 17.51 | 1.12 | 0.78 |
| 1976 | 10.50 | 6.93 | 17.43 | 8.64 | 15.57 | 26.07 | 5.50 | 14.16 | 7.30 | 21.46 | 18.97 | 1.37 | 0.97 |
| 1977 | 9.33 | 6.40 | 15.73 | 13.04 | 19.44 | 28.77 | 4.33 | 14.14 | 11.03 | 25.17 | 16.77 | 1.72 | 0.98 |
| 1978 | 9.92 | 10.95 | 20.87 | 15.24 | 26.19 | 36.11 | 3.45 | 15.33 | 13.09 | 28.41 | 16.11 | 2.24 | 1.13 |
| 1979 | 9.90 | 13.56 | 23.46 | 13.99 | 27.55 | 37.45 | 0.70 | 18.15 | 14.91 | 33.06 | 23.73 | 1.58 | 1.11 |
| 1980 | 9.39 | 16.20 | 25.59 | 13.55 | 29.75 | 39.14 | 0.48 | 20.16 | 16.88 | 37.04 | 28.39 | 1.38 | 1.04 |
| 1981 | 7.90 | 15.10 | 23.00 | 19.89 | 34.99 | 42.89 | 1.66 | 20.19 | 18.68 | 38.87 | 30.74 | 1.40 | 1.06 |
| 1982 | 8.91 | 15.82 | 24.73 | 46.17 | 61.99 | 70.90 | 12.70 | 20.37 | 57.18 | 77.55 | 63.41 | 1.12 | 0.79 |
| 1983 | 6.91 | 13.18 | 20.09 | 35.98 | 49.16 | 56.07 | 21.50 | 16.45 | 44.59 | 61.04 | 45.27 | 1.24 | 0.68 |
| 1984 | 6.66 | 11.92 | 18.58 | 35.61 | 47.53 | 54.19 | 24.26 | 14.71 | 43.17 | 57.88 | 47.14 | 1.15 | 0.66 |
| 1985 | 7.60 | 12.52 | 20.12 | 38.45 | 50.97 | 58.57 | 18.35 | 12.23 | 41.82 | 54.05 | 48.17 | 1.22 | 0.81 |

Sources: Central Bank of Uruguay, *Boletín Estadístico*, various issues, and International Monetary Fund, *International Financial Statistics*, various issues.

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Statistical Appendix Table 10. Savings and Investment as a Percent of GDP, 1974–84

| | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---------------------------|------|------|------|------|------|------|------|------|------|------|------|
| Gross domestic savings | 8.7 | 8.5 | 14.1 | 12.3 | 13.4 | 12.8 | 11.0 | 11.4 | 10.3 | 14.4 | 13.3 |
| Gross national savings | 8.0 | 6.7 | 12.2 | 10.8 | 12.0 | 12.1 | 10.2 | 10.8 | 8.3 | 9.0 | 6.7 |
| Net domestic savings | 5.6 | 4.5 | 9.2 | 7.5 | 8.4 | 5.9 | 4.1 | 4.1 | 2.0 | 5.2 | |
| Net national savings | 4.8 | 2.7 | 7.4 | 6.0 | 7.0 | 5.2 | 3.2 | 3.6 | 0.0 | -0.3 | |
| External financing | 3.6 | 6.7 | 2.7 | 4.4 | 4.0 | 5.3 | 7.8 | 4.3 | 6.2 | 1.0 | 3.2 |
| Gross domestic investment | 11.6 | 13.4 | 15.5 | 15.2 | 16.0 | 16.2 | 17.4 | 15.6 | 15.1 | 11.0 | 9.3 |
| Fixed capital formation | 10.3 | 13.3 | 15.5 | 15.2 | 16.0 | 16.2 | 17.4 | 15.6 | 15.1 | 11.0 | 9.3 |
| Public sector | 2.6 | 4.6 | 6.5 | 7.0 | 8.0 | 6.5 | 5.6 | 5.7 | 7.2 | 4.1 | 4.1 |
| Private sector | 7.7 | 8.7 | 9.0 | 8.2 | 8.0 | 9.7 | 11.8 | 9.9 | 7.9 | 6.9 | 5.2 |
| Changes in stocks | 1.3 | 0.1 | -0.6 | -0.0 | 0.0 | 1.2 | 0.6 | -0.5 | -0.6 | -1.0 | 0.6 |
| Depreciation | 3.2 | 4.0 | 4.9 | 4.8 | 5.0 | 6.9 | 7.0 | 7.2 | 8.3 | 9.3 | |
| Net domestic investment | 8.4 | 9.4 | 10.0 | 10.4 | 11.0 | 10.5 | 11.0 | 7.9 | 6.2 | 0.7 | |

Source: World Bank (1986).

Statistical Appendix Table 11. Nominal Interest Rates, 1974–86

| Year | Quarter | Loan Rates | | | Deposit Rates | | | | |
|-------------------------|---------|----------------|-------|------------------|----------------|------------|------------------|------|-------|
| | | Local currency | | Foreign currency | Local currency | | Foreign currency | | |
| | | Preferential | Prime | Preferential | Prime | 1–6 months | Above 6 months | Time | Sight |
| (In percent per annum) | | | | | | | | | |
| 1974 | IV | ... | ... | ... | ... | 30.0 | 41.4 | 8.0 | 5.5 |
| 1975 | IV | ... | ... | ... | ... | 30.0 | 41.4 | 8.0 | 5.5 |
| 1976 | III | 45.0 | 61.5 | ... | 12.0 | 30.0 | 41.4 | 7.6 | 5.6 |
| | IV | 47.6 | 62.0 | ... | 12.0 | 30.2 | 45.2 | 7.4 | 5.6 |
| 1977 | I | 45.9 | 62.0 | ... | 12.0 | 34.0 | 45.2 | 7.2 | 5.5 |
| | II | 50.0 | 62.0 | ... | 12.0 | 33.8 | 45.6 | 7.1 | 5.2 |
| | III | 50.3 | 62.0 | ... | 12.0 | 34.1 | 46.4 | 7.0 | 5.2 |
| | IV | 65.2 | 76.6 | 13.6 | 14.3 | 51.4 | 63.0 | 7.2 | 5.4 |
| 1978 | I | 65.8 | 76.9 | ... | 14.2 | 48.9 | 56.8 | 7.4 | 4.9 |
| | II | 61.6 | 72.8 | 12.7 | 14.6 | 46.4 | 51.2 | 7.7 | 4.6 |
| | III | 62.6 | 74.6 | 13.3 | 14.6 | 50.8 | 52.6 | 8.0 | 5.0 |
| | IV | 59.7 | 71.2 | 13.3 | 14.2 | 42.6 | 45.4 | 8.0 | 5.5 |
| 1979 | I | 50.1 | 69.2 | 13.5 | 15.2 | 42.6 | 43.0 | 8.6 | 6.0 |
| | II | 46.8 | 62.0 | 12.6 | 15.2 | 38.9 | 40.4 | 8.6 | 5.5 |
| | III | 47.1 | 62.6 | 12.7 | 15.0 | 41.4 | 43.0 | 9.0 | 6.0 |
| | IV | 49.9 | 68.1 | 15.8 | 16.8 | 50.6 | 49.2 | 11.9 | 5.5 |
| 1980 | I | 49.3 | 67.4 | 15.9 | 18.8 | 48.8 | 49.4 | 14.6 | 5.9 |
| | II | 52.0 | 68.3 | 15.0 | 17.1 | 52.2 | 52.6 | 12.5 | 5.6 |
| | III | 48.9 | 65.6 | 14.4 | 16.4 | 48.8 | 51.8 | 12.1 | 6.0 |
| | IV | 49.8 | 65.1 | 18.1 | 18.5 | 50.3 | 52.7 | 14.6 | 5.7 |

Statistical Appendix Table 11 (concluded). Nominal Interest Rates, 1974–86

| Year | Quarter | Loan Rates | | | | Deposit Rates | | | |
|------|---------|----------------|-------|------------------|-------|----------------|----------------|------------------|-------|
| | | Local currency | | Foreign currency | | Local currency | | Foreign currency | |
| | | Preferential | Prime | Preferential | Prime | 1–6 months | Above 6 months | Time | Sight |
| 1981 | I | 49.4 | 63.7 | 17.3 | 18.4 | 46.0 | 46.3 | 12.5 | 6.0 |
| | II | 44.1 | 57.4 | 16.5 | 19.9 | 43.3 | 43.0 | 15.5 | 5.3 |
| | III | 45.5 | 58.6 | 19.0 | 20.1 | 45.8 | 46.4 | 16.6 | 5.6 |
| | IV | 46.5 | 59.8 | 16.8 | 18.4 | 47.4 | 49.8 | 13.1 | 5.5 |
| 1982 | I | 44.0 | 49.0 | 17.3 | 18.7 | 42.5 | 42.6 | 13.9 | 5.0 |
| | II | 47.7 | 54.8 | 18.5 | 20.0 | 47.6 | 47.4 | 14.5 | 5.7 |
| | III | 53.2 | 65.9 | 18.5 | 18.8 | 56.8 | 57.2 | 11.1 | 4.3 |
| | IV | 56.7 | 76.3 | 17.2 | 18.2 | 66.2 | 67.3 | 10.2 | 5.8 |
| 1983 | I | 75.7 | 105.5 | 16.6 | 17.6 | 80.8 | 75.0 | 10.3 | 6.7 |
| | II | 67.9 | 102.0 | 15.3 | 16.8 | 66.6 | 61.6 | 9.8 | 6.0 |
| | III | 70.2 | 85.0 | 15.3 | 17.0 | 65.2 | 59.6 | 9.8 | 6.3 |
| | IV | 65.5 | 85.0 | 15.5 | 17.2 | 67.8 | 66.0 | 9.8 | 6.2 |
| 1984 | I | 64.3 | 84.4 | 15.1 | 16.8 | 64.4 | 64.2 | 9.7 | 6.2 |
| | II | 65.0 | 82.0 | 17.0 | 18.2 | 68.4 | 72.6 | 10.5 | 6.2 |
| | III | 68.2 | 82.0 | 15.8 | 17.5 | 68.0 | 73.8 | 10.5 | 6.5 |
| | IV | 69.3 | 86.6 | 14.2 | 17.3 | 75.2 | 79.0 | 10.6 | 6.5 |
| 1985 | I | 80.1 | 95.0 | 14.5 | 17.8 | 89.2 | 93.2 | 9.8 | 6.2 |
| | II | 74.4 | 95.0 | 13.6 | 16.3 | 86.2 | 86.4 | 8.3 | 6.0 |
| | III | 78.6 | 95.0 | 12.4 | 16.0 | 77.0 | 79.6 | 8.1 | 5.1 |
| | IV | 80.0 | 95.0 | 12.5 | 15.8 | 74.4 | 76.2 | 8.1 | 5.4 |
| 1986 | I | 76.0 | 97.0 | 12.9 | 15.0 | 69.0 | 68.8 | 7.3 | 5.2 |
| | II | 82.0 | 95.0 | 12.5 | 15.0 | 59.2 | 57.4 | 6.1 | 5.0 |
| | III | 75.8 | 93.6 | 12.7 | 14.7 | 55.8 | 54.6 | 5.8 | 3.9 |

Sources: Central Bank of Uruguay, *Boletín Estadística*, and *Reseña de la Actividad Económica Financiera*, several issues.

Note: Domestic currency loan rates are for loans of up to six months; foreign currency loan rates are for commercial operations; foreign deposit rates are for deposits of up to six months.

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