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THE WORLD BANK
Treasury

CASE STUDY

Local Currency Financing in Uruguay

OVERVIEW

The World Bank provides local currency financing to a client by directly funding in that client's own currency. The bond issue contributes to the deepening of domestic capital markets and allows domestic pension funds and international investors to diversify their portfolios. The transaction allows the government of Uruguay to manage its foreign currency exposure in the absence of a sufficiently developed swap market.

Background

Uruguay has made substantial progress in achieving macroeconomic stability since the economic crisis of 2002. As it consolidated its macroeconomic stability, the main challenge for the country was to transition to sustained growth by improving its business climate and setting the conditions for private sector-led growth. Capital markets reform was, therefore, an important priority for the government.

With reasonable access to funding in both US dollar (USD) and Uruguayan peso (UYU), it was important for Uruguay to have a sound debt management strategy. The authorities had strengthened their debt management policies and gradually improved the structure of public debt.

Financing Objectives

Uruguay approached IBRD for a loan to support the implementation of priority economic and social sector reforms. The World Bank's Executive Board of Directors approved the First Programmatic Reform Implementation Development Policy Loan in May 2007 in support of reforms in Uruguay's tax structure; business climate and capital markets; and the social protection system.

Uruguayan authorities were keen to reduce their exposure to foreign currencies by increasing the percentage of local currency debt in their portfolio based on their debt management strategy. Therefore, they wanted the IBRD loan proceeds to be

denominated in UYU rather than USD.

IBRD Financial Solution

IBRD generally provides local currency conversions on loans if it can hedge its foreign currency risk through the swap market. In this case, the swap market in UYU was not sufficiently developed. Therefore, the Treasury had to adopt an alternative strategy to meet Uruguay's needs without exposing IBRD to currency risk. It issued a UYU1,982 million (USD 100 million) inflation-indexed Euronote, carrying a coupon of 3.4% and maturing on April 15, 2017, and passed on the proceeds to the Uruguay government as a loan.

The terms of the loan exactly replicated the bond (i.e. bullet maturity, payment dates, etc.). A 30 basis point contractual spread was added.

Outcome

This was the first time that the World Bank provided local currency financing to a member country by directly funding in that country's own currency. The bond issue was very well received by both domestic and international investors. The transaction was oversubscribed, with demand reaching three times the fixed notional amount on offer. Due to IBRD's superior credit rating (AAA), the bond was ultimately priced lower than the government of Uruguay's own cost of funding.

Uruguay's largest pension fund, República AFAP, purchased a significant portion of the issue, allowing the country's pension fund system to diversify the credit risk of its portfolio by investing in a AAA-rated investment denominated in local currency.

This transaction also played an important role in helping Uruguay limit its foreign currency exposure and generate greater international awareness about the potential of its capital markets.

Terms & Conditions

Amount	UYU 1,981.53 million (USD 100 million)
Start Date	June 4, 2008
Maturity	April 15, 2017
Bond Coupon	3.40%
Loan Interest Rate	Bond coupon plus 0.30%
Notional	Linked to inflation in Uruguay

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