

## Fitch Affirms Uruguay at 'BBB-'; Outlook Negative

Fitch Ratings - New York - 27 June 2019: Fitch Ratings has affirmed Uruguay's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB-' with a Negative Rating Outlook.

A full list of rating actions is at the end of this rating action commentary.

### Key Rating Drivers

The Negative Rating Outlook reflects growth underperformance and fiscal deterioration, which are lifting the government debt burden. Fitch projects Uruguay will see the largest increase in debt/GDP in the 'BBB' category in the five years through 2019, constraining policy space to manage shocks. Growth has fallen to one of the lowest levels in the 'BBB' category, although it has remained relatively resilient to shocks from neighbouring economies. The scope, nature and timing of potential measures to address these negative fiscal and macroeconomic trends remain uncertain, but could become clearer after the October 2019 elections.

Uruguay's ratings are supported by strong social and institutional development, high external liquidity and solvency metrics, and long-dated public debt and liquidity buffers. These factors are balanced by weak public finances, reflected in a poor track record in meeting fiscal targets, a large stock of foreign-currency debt rendering the sovereign balance sheet sensitive to exchange rate shocks, and persistently high inflation.

Upcoming general elections in October are poised to be competitive, following three terms and fifteen years of government under the center-left Frente Amplio. Broad policy continuity is likely in any outcome, but the elections will be important for prospects for fiscal adjustment to arrest rising public debt and structural reforms to boost a weak economy.

Growth slowed to 1.6% in 2018 from 2.6% in 2017, and to -0.2% in first-quarter 2019. Private sector activity has been contracting as a whole, as public utilities and telecom services (which has an outsized impact in GDP series) have propped up growth. External headwinds have explained part of the slowdown, namely the hit to Uruguay's tourism sector from Argentina's currency crisis and recession. On the internal front, a weak labor market and low confidence have weighed on consumption, and structural issues have continued to weigh on investment (which has contracted around 30% cumulatively since 2014).

Fitch expects growth to slow to 0.5% in 2019 as a whole, and rise to 1.5% in 2020 and 2.5% in 2021 on ramp-up in construction activity of a large pulp plant and related railway infrastructure, as well as a pipeline of other PPP projects. Growth net of the pulp megaproject is likely to remain subdued, however, given low investment in recent years. Business groups and surveys point to high local production costs (salaries, utility rates, taxes) as a key factor weighing on investment appetite. Economic reactivation has been a key theme in the 2019 election campaign, but the outlook for reforms is unclear and concrete proposals have been limited so far.

The fiscal position has weakened beyond Fitch's prior projections, net of a transitory statistical impact of the cincuentones law allowing persons in their 50s and recent retirees to bring their private pension funds into the public system (booked as revenue in accordance with IMF data standards). The central government deficit rose to 3.7% of GDP in 2018 from 2.9% of GDP net of the cincuentones impact and a 0.3 percentage point (pp) transfer from an energy fund, but fell to 2.1% with these effects. Fitch expects it to reach 4.3% in 2019. The fiscal slippage mainly reflects structural spending pressures that have continued to far exceed budget projections, and some cyclical impact on tax collections from weak growth. Fitch projects the public sector deficit will reach 5.4% of GDP in 2019, above the 2.8% target.

Fitch projects general government debt will reach 64.3% of GDP at the end of 2019, up from 59.6% at end-2018 and compared with the historic 'BBB' median of 36%. Fitch's debt figures consolidate out holdings of central government bonds

by the new cincuentones fund (1% of GDP at end-2018) and include bonds issued to the central bank (BCU) for recapitalisation (8.2% of GDP). Debt forecasts are sensitive to exchange rate assumptions, possible cancelation of recapitalization bonds and the size of further cincuentones transfers in the next three years.

Fitch estimates a fiscal adjustment of around 2.5% of GDP could stabilise debt/GDP, but the outlook for this is likely to remain unclear and plans vague until after the elections. Candidates have advocated for budget austerity, and the opposition has detailed a particularly ambitious set of cuts it hopes to achieve, but a rigid spending profile could make a spending-focused adjustment strategy challenging and slow. There is broad consensus around the need for social security reform, but this will take time to negotiate and at best is likely to contain further upward pressure on the deficit rather than contribute to reduction. There is narrow appetite for tax hikes to reduce the deficit more quickly given a weak economic backdrop, and candidates have focused instead on lifting revenues by fostering stronger economic growth.

Long-dated debt and liquidity buffers help mitigate financing risks in the context of relatively high reliance on external funding. Maturities averaging 2.8% of GDP in 2019-2021 are low, and cash holdings and contingent credit lines cover debt service for over a year. The authorities have made progress in deepening local funding, recently via issuance of wage-indexed bonds.

Inflation stood at 7.7% as of May, above the target range (5%±2pp) and the highest among investment-grade sovereigns. Fitch expects it to remain stable by year-end, balancing weak domestic demand with pass-through pressure from recent peso depreciation. The BCU has recently dialled back the contractionary bias of monetary policy despite above-target inflation, given a weak growth backdrop. A major round of wage negotiations concluded last year in which sector-level councils largely adopted official guidelines establishing nominal wage increases on a declining path rather than real increases (ie reducing backward-looking indexation to inflation), which could help moderate inertial inflation pressures going forward.

External finances remain sound. The current account balance shifted back into deficit in 2018 (0.6% of GDP). Fitch expects it will rise but remain moderate at 2.0% of GDP in 2019 as the full impact of Argentina's currency crisis on tourism inflows is felt, and rise further in the following years as construction of the pulp plant progresses (financed by corresponding FDI). The large stock of FX reserves provides ample coverage of current external liabilities and imports, and has offered scope for the BCU to intervene in FX markets in recent months to manage the depreciation of the peso.

## Derivation Summary

### SOVEREIGN RATING MODEL (SRM) and QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Uruguay a score equivalent to a rating of 'BBB+' on the Long-Term, Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to rated peers, as follows:

--Macro: -1 notch, to reflect a relatively poor track record of compliance with inflation and fiscal targets, which weighs on policy credibility and narrows counter-cyclical policy scope, despite relatively strong governance indicators that feed into the SRM;

--Public Finances: -1 notch, to reflect a highly rigid expenditure profile dominated by heavily indexed and constitutionally protected social entitlements, with a low share of capital spending. This poses challenges to fiscal consolidation goals. A large stock of foreign-currency debt makes Uruguay's debt metrics sensitive to exchange-rate risk.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within the criteria that are not fully quantifiable and/or not fully reflected in the SRM.

## Key Assumptions

--Fitch assumes that construction of a new pulp mill project will begin as soon as 2020, following initiation of related infrastructure investments in 2019, supporting growth during the construction phase and once production begins;  
 --Fitch projects Argentina's economy will contract -1.7% in 2019 and grow 1.5% in 2020, and that Brazil's economy will grow 1.0% in 2019 and 2.2% in 2020.

**RATING SENSITIVITIES**

The main risk factors that, individually or collectively, could trigger a downgrade are:  
 --Failure to reduce fiscal deficits and/or improve the trajectory of government debt-to-GDP;  
 --Persistently weak economic growth;  
 --Sustained erosion of central bank international reserves.

The Rating Outlook is Negative. Consequently, Fitch does not currently anticipate developments with a high likelihood of leading to a positive rating change. However, the main factors that, individually or collectively, could lead to a stabilization of the Outlook are:

--Greater confidence in a fiscal consolidation path that would support stabilization of debt metrics in the medium term;  
 --A sustained reduction in inflation and better anchoring of inflation expectations;  
 --Evidence of investments or productivity gains that lift medium-term growth prospects.

**RATING ACTIONS**

ENTITY/DEBT	RATING	PRIOR
Uruguay	LT IDR BBB-  Affirmed	BBB- 
	ST IDR F3 Affirmed	F3
	LC LT IDR BBB-  Affirmed	BBB- 
	LC ST IDR F3 Affirmed	F3
	Country Ceiling BBB+ Affirmed	BBB+
senior unsecured	LT BBB- Affirmed	BBB-

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

**FITCH RATINGS ANALYSTS**

Primary Rating Analyst  
 Todd Martinez  
 Director  
 +1 212 908 0897  
 Fitch Ratings, Inc.  
 33 Whitehall Street  
 New York 10004

Secondary Rating Analyst

Christopher Dychala  
Analyst  
+1 646 582 3558

Committee Chairperson  
Ed Parker  
Managing Director  
+44 20 3530 1176

## **MEDIA CONTACTS**

Elizabeth Fogerty  
New York  
+1 212 908 0526  
elizabeth.fogerty@thefitchgroup.com

## **Applicable Criteria**

Country Ceilings Criteria (pub. 19 Jul 2018)  
Sovereign Rating Criteria (pub. 26 May 2019)

## **Additional Disclosures**

Dodd-Frank Rating Information Disclosure Form  
Solicitation Status  
Endorsement Policy

## **DISCLAIMER**

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM). PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

## **COPYRIGHT**

Copyright © 2019 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other

sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers. For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

## **SOLICITATION STATUS**

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

## Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

## Fitch Updates Terms of Use & Privacy Policy

We have updated our Terms of Use and Privacy Policies which cover all of Fitch Group's websites. [Learn more.](#)