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Rating Action: Moody's affirms Uruguay's Baa2 sovereign rating; outlook stable

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New York, May 21, 2015 -- Moody's Investors Service has today affirmed Uruguay's Baa2 government bond ratings and stable outlook.

The key drivers of today's rating action are the following:

1) The fact that the gradual economic deceleration has not uncovered any major macroeconomic imbalances, and vulnerabilities remain contained.

2) The new government's commitment to ensuring the sustainability of public finances and the likelihood that it will pursue fiscal consolidation to stabilize debt ratios despite a less favorable macroeconomic environment.

Moody's has also affirmed the sovereign's senior unsecured ratings at Baa2, as well as the senior unsecured program rating at (P)Baa2.

Uruguay's long-term local-currency country risk ceilings and the foreign currency bond ceiling remain unchanged at A2. The foreign-currency bank deposit ceilings is also unchanged at Baa2. The short-term foreign currency bond and deposit ceilings remain at P-2. These ceilings reflect a range of undiversifiable risks to which issuers in any jurisdiction are exposed, including economic, legal and political risks. These ceilings act as a cap on ratings that can be assigned to the foreign and local-currency obligations of entities domiciled in the country.

RATINGS RATIONALE

The principal driver of Moody's decision to affirm Uruguay's sovereign rating is the absence of macroeconomic imbalances that could negatively impact the rating despite the gradual economic slowdown. The lack of imbalances suggest that the economic outlook will be benefiting from sustainable -- albeit lower -- growth. Real GDP growth has continued to moderate from an average of over 5.5% over the past decade to 3.5% in 2014. Moody's forecasts that growth will slow to 2.6% in 2015 due to continued weak external conditions that will outweigh the benefits of lower energy prices on private consumption. Economic activity will likely accelerate to 3.1% in 2016 and remain near the economy's 3%-3.5% potential in 2017 and beyond.

Corporate and household leverage remains subdued as does the external indebtedness of the economy. Moreover, Moody's expects the external and financial buffers built up over the previous decade will continue to keep vulnerabilities in check. Official foreign exchange reserves reached 30% of GDP at the end of 2014, among the highest levels for sovereigns rated in the 'Baa' category, providing ample coverage for external payments in the event of a sudden stop. Although Uruguay's economy retains important trade and investment linkages with regional neighbors Argentina (Caa1 negative) and Brazil (Baa2 negative), economic activity in Uruguay has been resilient to the substantial slowdown in both economies. Fiscal reserves constitute a key credit strength that support sovereign creditworthiness. Government precautionary cash reserves amounting to 3.8% of GDP at year-end 2014 cover maturing principal payments on both domestic and external debt for the next two years, significantly reducing Uruguay's exposure to market closure events.

The second driver of the affirmation is the new administration's commitment to fiscal consolidation and to ensuring the sustainability of public finances. During the previous administration strong increases in current spending on wages and salaries, social transfers and subsidies were partially offset by increased revenues derived from above-trend growth as the central government deficit widened to 2.3% of GDP in 2014 from 1.5% in 2013. Moody's believes that as the economy shifts to a lower path for GDP growth, higher revenues will no longer be available to offset increased growth in current expenditures.

Although the five-year budget has not yet been submitted to congress and specific consolidation measures have yet to be identified, the incoming administration has a proven track record of fiscal prudence during its previous term in office in 2005-10. The new economic team believes that expenditure restraint will be key to decreasing the fiscal imbalance, and is likely to focus its efforts on curbing wage and pension spending growth. Moody's forecasts that the 2015 central government deficit will remain virtually unchanged, as consolidation measures would be implemented beginning 2016 once the new five-year budget framework is approved. As a result, the central government deficit will likely reach 2.4% of GDP in 2015 and decrease to 2% in 2016. Moody's expects that central government debt will peak at just under 41% of GDP in 2015 and remain broadly stable at around 40% through 2017 given a slow but steady pace of fiscal consolidation.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook on Uruguay's Baa2 ratings balances underlying strengths derived from the sovereign's robust credit profile against potential risks associated with (1) a degree of dollarization that continues to be higher than that found in other 'Baa'-rated sovereigns, and (2) the country's small open economy and relatively high commodity exposure. Credit risks related to the level of debt dollarization constrain the upside potential for Uruguay's sovereign ratings. Regional contagion remains a challenge for policy makers, and fluctuations in commodity markets pose non-negligible risks. Nevertheless, Moody's believes that existing large financial and external buffers are an important factor in mitigating Uruguay's credit vulnerabilities.

WHAT COULD MOVE THE RATING UP/DOWN

Upward rating pressure could result from (1) a significant strengthening of the government's balance sheet through a reduction of the sovereign's debt and interest burden, (2) a reduction in vulnerabilities through a significant decrease of government debt dollarization, and (3) addressing structural rigidities in the economy to achieve a higher level of potential growth.

Conversely, downward rating pressure could result from (1) a continued deterioration of structural fiscal balances and a weakening of the government balance sheet, or (2) a sustained and material erosion of external and financial buffers.

GDP per capita (PPP basis, US$): 20,556 (2014 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 3.5% (2014 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 8.3% (2014 Actual)

Gen. Gov. Financial Balance/GDP: -2.3% (2014 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -4.6% (2014 Actual) (also known as External Balance)

External debt/GDP: n/a

Level of economic development: Moderate level of economic resilience

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 20 May 2015, a rating committee was called to discuss the rating of Uruguay, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed.

The principal methodology used in these ratings was Sovereign Bond Ratings published in September 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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Jaime Reusche
Vice President - Senior Analyst
Sovereign Risk Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Anne B Van Praagh
MD - Sovereign Risk
Sovereign Risk Group
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

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