

Rating Action: Moody's changes outlook on Uruguay's rating to negative; affirms government bond rating at Baa2

Global Credit Research - 22 Jun 2016

New York, June 22, 2016 -- Moody's Investors Service has today affirmed the government of Uruguay's Baa2 issuer and government bond ratings and changed the outlook to negative from stable. The government's senior unsecured government bond ratings were affirmed at Baa2, as was the senior unsecured shelf program rating at (P)Baa2.

Two key drivers underpin the negative outlook:

- 1) The announced fiscal consolidation measures that seek a 1% of GDP deficit reduction, primarily through revenue increases, will be challenged by macroeconomic weakness.
- 2) Downside risks stemming from larger-than-expected regional spillovers and structural expenditure rigidities remain.

The affirmation of the Baa2 rating reflects a balance of credit strengths and weaknesses including moderate government financing needs and a favorable debt maturity profile, large external and financial buffers, and a strong institutional framework and a firm commitment to arrest the deterioration in debt metrics. Alternatively, credit weaknesses include a relatively high share of foreign currency-denominated government debt, and a high degree of financial dollarization in the banking system and persistently high inflation that detracts from policy credibility.

Uruguay's long-term local currency country risk ceilings remain unchanged at A2. The foreign currency bond ceiling and the foreign currency bank deposit ceiling also remain unchanged at A2 and Baa2, respectively.

RATIONALE FOR THE CHANGE TO NEGATIVE OUTLOOK

-- FIRST DRIVER: MACROECONOMIC WEAKNESSES INTRODUCE POTENTIAL CHALLENGES TO GOVERNMENT FINANCES

The first driver of Moody's decision to change the outlook to negative from stable is the potential challenges to reverse the deterioration in government finances due to the increasingly weak macroeconomic environment and a rigid expenditure structure. The consolidated central government deficit reached 2.8% of GDP in 2015 from 2.3% in 2014. Moody's expects that consolidated central government deficit will increase to 3.3% of GDP in 2016. Gross central government debt increased to 47.2% of GDP at the end of 2015 from 39.3% in 2014, and Moody's forecasts it will continue to rise reaching more than 50% of GDP by 2017. Although partly a result of exchange rate weakness, the increase in Uruguay's debt ratio is likely to continue until 2017-18, when debt metrics are likely to stabilize if the announced consolidation measures come into effect in full force and no additional adverse shocks disrupt the adjustment path.

Uruguay's real GDP growth slowed to 1.0% in 2015 from 3.2% in 2014. Moody's forecasts growth will decelerate further to 0.5% in 2016 before recovering to 1%-2% in 2017. Despite sluggish economic activity, inflation and inflation expectations are likely to remain entrenched coming well above the central bank's target. Twelve-month inflation through May rose to 11%, the highest level since November 2003 and four percentage points above the upper limit of the central bank's target range.

The government announced a series of fiscal measures focused on the revenue side that target a 1% of GDP deficit reduction. Absent these measures, the consolidated central government deficit could widen to nearly 4% of GDP in 2016-17. Considering that the government's current fiscal adjustment plan incorporates a ratio of revenue measures to spending cuts of 2:1, there is a risk that tax revenues may not respond as forcefully as the authorities expect.

-- SECOND DRIVER: DOWNSIDE RISKS STEMMING FROM LARGER-THAN-EXPECTED REGIONAL SPILLOVERS AND STRUCTURAL EXPENDITURE RIGIDITIES

The second driver of the outlook change is related to the potential for continued regional, and as a result, domestic economic weakness. Spillover risks given still-weak economic prospects in Brazil suggest that material downside risks remain present and could negatively affect the government's fiscal consolidation efforts. The brunt of the consolidation program will be enacted in 2017, suggesting a gradual implementation on the expenditure side that leaves little room for slippage in the event of unanticipated adverse shocks through the end of next year. Were these risks to materialize, it is unlikely Uruguay's debt ratio would peak in 2017. Instead, it could continue increasing well above the 42% of GDP 'Baa' category median.

Structural rigidities on government expenditures and the unfeasibility of pursuing more forceful revenue measures, reflect the constraints that the authorities face as they attempt to pursue deficit reduction. Even though the authorities have signaled their commitment to enact further fiscal consolidation measures in the event of weaker-than-expected economic growth, Moody's assessment is that, at present, risks remain firmly skewed to the downside.

AFFIRMATION OF Baa2 RATING SUPPORTED BY STRONG INSTITUTIONAL FRAMEWORK, FINANCIAL BUFFERS

Uruguay's creditworthiness is supported by the authorities' commitment to implementation of fiscal consolidation measures that seek to reduce the central government deficit. These measures, if approved by congress, should contribute to improve fiscal prospects. The consolidation program will be complemented by structural measures that focus on existing expenditure rigidities that should support medium-term fiscal sustainability. These include fixing wage increases to nominal targets, effectively abandoning the backward-looking mechanism of increases set in real terms (adjusting for past and expected inflation), and a reform of military pension payouts. The new wage-setting guidelines and reduced military pension outlays will bring about fiscal savings and reduce wage inertia that contributed to inflation persistence, in addition to increasing the sustainability of first-pillar pensions.

Moody's believes that the announced fiscal adjustment program seeks to strike a balance between consolidation and the authorities' intent to soften the effect of the slowdown on living standards. The fiscal measures will be submitted to congress by the end of June, where the ruling political coalition (Frente Amplio) holds a majority, and the authorities expect them to be approved before November. Measures that require congressional approval will be implemented in 2017, but some involving expenditure cuts will likely begin to be implemented in the second half of 2016. The government has revised down its growth projections to 0.5% in 2016, 1% in 2017, 2% in 2018 and 3% in 2019. Their revised estimates match Moody's expectation for 2016, and are even lower than Moody's in future years. These will be reflected in the government's upcoming update to their medium-term fiscal framework.

Moreover, Moody's notes that ample government financial buffers continue to support Uruguay's Baa2 rating. Additionally, the sovereign's credit profile retains various elements that help mitigate underlying credit risks, including one of the longest debt maturity profiles among emerging market sovereigns (approximately 15 years), two-years of debt service (interest and principal) in cash reserves and precautionary credit lines that significantly reduce rollover risk derived from market closure events.

WHAT COULD MOVE THE RATING UP/DOWN

Over the coming 12 to 18 months, Moody's will evaluate the progress achieved on fiscal consolidation against the backdrop implementation risks related to weaker-than-anticipated economic growth, a factor that may diminish the effectiveness of the adjustment measures, in assessing the possibility of changing the outlook back to stable.

Although unlikely given the negative outlook, upward rating pressure could result from (1) a significant strengthening of the sovereign's balance sheet through a reduction of the government 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) consolidation measures falling short of achieving the authorities' targets to arrest a continued increase in debt ratios, (2) a continued deterioration of structural fiscal balances and a weakening of the government balance sheet, or (3) a sustained and material erosion of external and financial buffers.

GDP per capita (PPP basis, US\$): 21,507 (2015 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 1% (2015 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 9.4% (2015 Actual)

Gen. Gov. Financial Balance/GDP: -2.8% (2015 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -3.6% (2015 Actual) (also known as External Balance)

External debt/GDP: 58.7% (2015 Actual)

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 17 June 2016, a rating committee was called to discuss the rating of the Uruguay, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially decreased. The issuer's fiscal or financial strength, including its debt profile, has materially decreased.

The principal methodology used in these ratings was Sovereign Bond Ratings published in December 2015. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this rating action, and whose ratings may change as a result of this rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

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 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



© 2016 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE. MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or

the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.