MOODY'S
INVESTORS SERVICE

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.

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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 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