**Michael Heydt**
+1 212 806 3210
mheydt@dbrs.com

**Yolanda Ngo**
+1 212 806 3276
yngo@dbrs.com

**Thomas R. Torgerson**
+1 212 806 3218
ttorgerson@dbrs.com



COMMENTARY

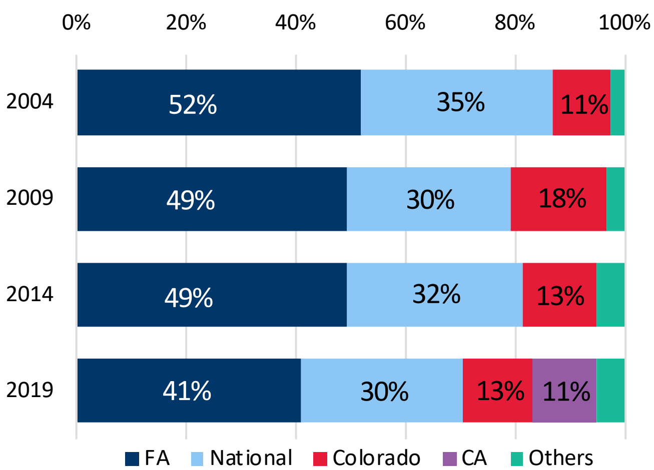
# Uruguay Tacks To The Center

Uruguay's general election on Sunday marks a shift toward the political center. The left-leaning coalition *Frente Amplio*, which has dominated Uruguayan politics for the last 15 years, lost its parliamentary majority. The next congress will be more fragmented with no single party in control.

In the presidential elections, the *Frente Amplio* candidate Daniel Martínez garnered the most votes but fell short of the majority needed to win in the first round. Martínez will face Luis Lacalle Pou of the National Party in a run-off election on November 24th. Regardless of who wins the run-off, advancing legislation will depend on building a congressional coalition.

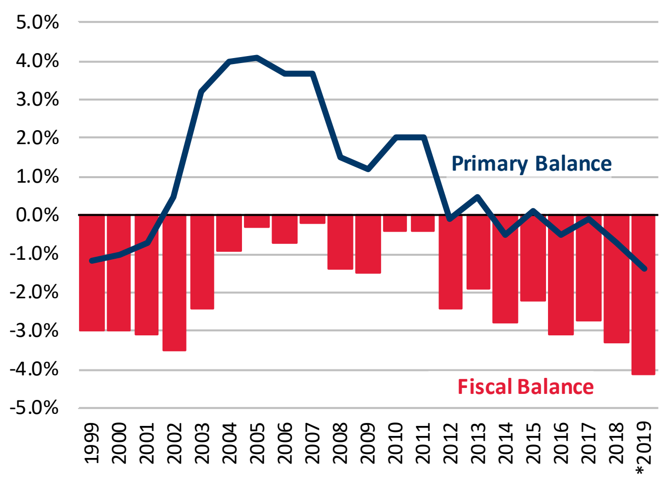
DBRS Morningstar views the risks to Uruguay's BBB (low) rating as two-sided and broadly balanced. The central challenge for the next administration will be to reduce the fiscal deficit, which reached 4.1% of GDP in August. Both presidential candidates recognize the need for a fiscal adjustment but propose different deficit-reduction strategies. The evolution of the ratings – up or down – will depend on the next government's ability to put public finances on a more sustainable trajectory.

**Exhibit 1. General Election Results**




Source: Corte Electoral, DBRS.

**Exhibit 2. Fiscal Balance (% GDP)**




Source: Ministerio de Economia y Finanzas, Haver. *12m thru August 2019

## Building Consensus

The election results show that the electorate has tacked to the center. The *Frente Amplio* won more votes than any other party, but its share of the vote declined 8 percentage points compared to five years ago. Support for the center-right parties – the National Party and the Colorado Party – remained roughly the same. However, with the emergence of the right-wing *Cabildo Abierto*, right-leaning parties increased their cumulative share by 9 percentage points. The rightward shift sets the stage for a competitive presidential run-off election, as supporters of centrist and right-leaning parties could coalesce around Lacalle Pou.

Unlike neighboring Argentina, the election results do not pose a risk to the basic pillars of macroeconomic policy. All of Uruguay's major parties recognize the need for sustainable public finances, price stability, and sound regulation of the financial system. However, the next administration will have a minority in congress and, therefore, it will need to build coalitions in order to advance its agenda. The emergence of *Cabildo Abierto* poses some uncertainty about how coalition dynamics will play out, but the relatively centrist platforms presented by the National and Colorado parties – combined with Uruguay's moderate electorate – suggest there will be limited support for far-left or far-right policies.

## Candidates Propose Different Fiscal Strategies

The key challenge facing the next government is the fiscal deficit. Stabilizing public debt dynamics requires pension reform and a fiscal adjustment of about 2 percentage points of GDP. While both presidential candidates agree on the need for pension reform, the candidates' deficit-reduction strategies differ in terms of timing and structure. National candidate Lacalle Pou proposes up-front spending cuts, while Frente Amplio candidate Martinez calls for a more gradual approach based a cyclical recovery of revenues and tight expenditure control.

Both strategies entail trade-offs. Expenditure is concentrated in social security, healthcare, and education, all of which have legal protections or strong political support. Significant expenditure cuts could increase the risk of social protests. A rapid fiscal adjustment could strengthen Uruguay's credit fundamentals, but only if the administration can maintain the public's support for such actions. On the other hand, a slower adjustment might preserve broad public support, but deficit-reduction plans would depend on a robust economic recovery, which might not materialize.

## Risks To The Ratings Remain Two-Sided

Following the general election, risks to Uruguay's sovereign rating remain two-sided and broadly balanced. The key downside risk relates to implementation. If the post-election environment is characterized by policy inaction, fiscal imbalances could continue to widen. In such a scenario, deteriorating public debt dynamics could put pressure on Uruguay's "investment grade" rating.

The post-election political and economic conditions in Uruguay also present upside risk. There is consensus across Uruguay's political parties on the need for fiscal reforms to ensure sustainability. The divided nature of congress should push policymaking toward the center rather than the extremes. Moreover, economic conditions are expected to strengthen modestly in 2020 and 2021, underpinned by a large investment in the pulp and paper sector and a pipeline of public-private infrastructure projects. This could provide the incoming administration, regardless of who wins on November 24th, with a political opening to advance the necessary reforms.

**Notes**:
All figures are in US dollars unless otherwise noted.