PRESS RELEASE

JANUARY 30, 2020

DBRS Morningstar Confirms Uruguay at BBB (low), Stable Trend

SOVEREIGNS

DBRS Inc. (DBRS Morningstar) confirmed the Oriental Republic of Uruguay's Long-Term Foreign and Local Currency – Issuer Ratings at BBB (low). At the same time, DBRS Morningstar confirmed the Short-Term Foreign and Local Currency – Issuer Ratings at R-2 (middle). The trend on all ratings is Stable.

KEY RATING CONSIDERATIONS

The BBB (low) ratings incorporate Uruguay's strong political and economic fundamentals, offset by its ongoing fiscal pressures. The political environment is characterized by high-quality public institutions, low levels of corruption, and predictable macroeconomic policymaking, all of which constitute an important source of credit strength. Ample foreign exchange reserves, conservative public debt management, and sound regulation of the banking system also bolster the economy's defenses to external shocks. Despite a deep and protracted recession in neighboring Argentina, Uruguay posted positive growth in the first three quarters of 2019. Economic activity is expected to accelerate in 2020 and 2021 on the back of a large investment in the pulp and paper sector as well as increased spending on infrastructure projects.

The key challenge facing Uruguay's credit profile is the fiscal deficit. The underlying source of pressure is rising current spending: higher education and healthcare costs combined with greater social security expenses. In the absence of budgetary tightening, public debt ratios are expected to gradually increase over the medium term. 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. The incoming Lacalle Pou administration aims to tighten fiscal policy and pass pension reform, which could materially improve the outlook for public finances. However, implementing the reform agenda could be politically challenging.

RATING DRIVERS

The Stable trend reflects DBRS Morningstar's view that risks to the ratings are balanced. Uruguay's credit profile would benefit from greater fiscal space and counter-cyclical capacity. If the next administration implements a durable consolidation in the fiscal accounts, the ratings could experience upward pressure. On the other hand, the ratings could experience downward pressure if budget dynamics continue to deteriorate or if external buffers erode over time, thereby weakening Uruguay's resilience to adverse shocks.

RATING RATIONALE

Strong and Credible Institutions Underpin Uruguay's Ratings

Uruguay is a stable liberal democracy with an effective government and low levels of corruption. A centrist electorate facilitates moderate politics and pragmatic policymaking. The basic pillars of macroeconomic policy are broadly supported across the political spectrum. The predictability of the policy framework fosters a favorable environment for economic growth.

Uruguay's 2019 general election marked a shift toward the political center. The left-leaning Frente Amplio coalition lost its parliamentary majority after dominating Uruguayan politics for the last 15 years, and Luis Alberto Lacalle Pou of the National Party defeated the Frente Amplio candidate in the presidential run-off election. The new administration, which will take office on March 1, 2020, aims to reduce the fiscal deficit, pass pension reform, and strengthen the fiscal framework. However, with a more fragmented congress, the Lacalle Pou administration will need to seek support from coalition partners in order to advance its agenda.

Prudent Debt Management and Substantial Reserves Enhance Resilience to External Shocks

Creditworthiness is supported by Uruguay's conservative public debt management. Rollover and liquidity risks are minimal. Liquid assets held by the central government amounted to $1.3 billion in September 2019. This is complemented by another $2.2 billion in contingent credit lines from multilateral organizations. Taken together, available resources are in excess of the $3.3 billion in debt servicing needs for 2020. Exposure to interest rate risk is also limited due to the long average maturity of government debt (14 years) and the high share of debt that carry fixed rates (94%).

Sound external accounts and large liquidity buffers also bolster the economy's defenses against potential shocks. The current account is in a modest surplus position. Exchange rate flexibility has helped the economy adjust to evolving global conditions without generating excessive stress on balance sheets in the private sector. Reserves are high at $14.5 billion, or 25% of GDP. This provides the central bank with substantial foreign exchange liquidity in the event of a temporary shock.

Growth Has Slowed In Recent Years But A Modest Acceleration Is Expected in 2020

The Uruguayan economy has expanded at a modest pace for four years following a decade of rapid expansion. GDP growth averaged 5.4% from 2004 to 2014, but slowed to just 1.6% from 2015 to 2018. The slowdown has been partly due to lower commodity prices and deep recessions in neighboring Brazil and Argentina, but weak underlying domestic dynamics are also contributing factors. The two most salient features of the slowdown are higher unemployment and lower investment. However, several large investments should cushion the growth outlook in the near term. The Finnish firm UPM plans to invest $3 billion, or 5% of GDP, in a new pulp mill in central Uruguay. Near-term growth will also be supported by a pipeline of public-private infrastructure projects.

Volatility in the external environment poses risks to the outlook. The small and open nature of the Uruguayan economy leaves it exposed to shifts in global commodity prices and the economic cycles of its large neighbors. Slower-than-expected recoveries in Brazil or Argentina could negatively affect Uruguay through the trade channel, specifically weaker demand for goods exports and tourism services. Outside of the region, a sharper-than-expected deceleration in China could affect Uruguay's outlook directly through the terms of trade channel, as well as indirectly through weaker demand from Uruguay's commodity-exporting neighbors.

The Next Administration Will Inherit Fiscal and Monetary Policy Challenges

The fiscal deficit continues to widen despite consolidation efforts by the Vazquez administration. The non-financial public sector deficit reached 4.3% of GDP in November 2019 (rolling 12 months), after excluding the one-off transfers from workers who chose to switch from their private pension to the public pension scheme via the "Cincuentones Law." In addition to a fiscal adjustment, which is complicated by the rigidity of key expenditure items, pension reform is needed to preserve the sustainability of public finances. In the absence of deficit-reduction measures, budget dynamics will remain challenging with public debt ratios set to gradually increase over the medium term. Moreover, the high share of public debt denominated in foreign currency leaves public finances vulnerable to exchange rate shocks. To incorporate these material downside risks, negative adjustments are applied to the "Fiscal Management and Policy" building block and the "Debt and Liquidity" building block.

Anchoring inflation expectations around the mid-point of the central bank's 3-7% target range is another policy challenge. Consumer prices increased 8.8% in December 2019 relative to one year ago, and 12-month inflation expectations remain above the upper limit of the target range. The challenge of anchoring expectations is complicated by the weak transmission of monetary policy amid high financial dollarization and low financial intermediation.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments. http://www.dbrs.com/research/356226

Notes:
All figures are in U.S. dollars unless otherwise noted. Public finance statistics reported on a general government basis unless specified. The non-financial public sector includes: the central government (including the Social Security public fund), local governments, public enterprises, and the state-owned insurance bank.

The principal methodology is the Global Methodology for Rating Sovereign Governments, which can be found on the DBRS Morningstar website www.dbrs.com at http://www.dbrs.com/about/methodologies. The principal applicable rating policies are Commercial Paper and Short-Term Debt, and Short-Term and Long-Term Rating Relationships, which can be found on our website at http://www.dbrs.com/ratingPolicies/list/name/rating+scales.

The primary sources of information used for this rating include the Ministerio de Economía y Finanzas, Banco Central del Uruguay, Instituto Nacional de Estadística, Superintendencia de Servicios Financieros, the IMF, the Conference Board Total Economy Database, the World Bank, NRGI, Brookings, Bank for International Settlements, UNDP, Transparency International, and Haver Analytics. DBRS Morningstar considers the information available to it for the purposes of providing this rating was of satisfactory quality.

The rated entity or its related entities did participate in the rating process for this rating action. DBRS Morningstar did not have access to the accounts and other relevant internal documents of the rated entity or its related entities in connection with this rating action.

For more information on this credit or on this industry, visit www.dbrs.com.

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Ratings

Uruguay, Oriental Republic of

Date Issued	Debt Rated	Action	Rating	Trend	Issued
30-Jan-20	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB (low)	Stb	US
30-Jan-20	Long-Term Local Currency - Issuer Rating	Confirmed	BBB (low)	Stb	US
30-Jan-20	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (middle)	Stb	US

Date Issued	Debt Rated	Action	Rating	Trend	Issued
30-Jan-20	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (middle)	Stb	US

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