Research Update:

Uruguay 'BBB/A-2' Ratings Affirmed; Outlook Remains Stable

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Overview

- We expect recent fiscal adjustment and the phasing out of pandemic support will help stabilize Uruguay's debt levels after several years of increases.
- Large investments in the country will boost growth in the near term, while reforms in the pipeline could gradually improve the economic outlook.
- We affirmed our 'BBB/A-2' sovereign credit ratings on Uruguay.
- The stable outlook indicates our expectation that moderate economic growth and recent corrective fiscal policy will limit increases in debt over 2022-2025, while progress on addressing structural issues will be key to putting debt on a downward path.

Rating Action

On April 21, 2022, S&P Global Ratings affirmed its 'BBB' long-term and 'A-2' short-term foreign and local currency sovereign credit ratings on Uruguay. The outlook on the long-term ratings remains stable.

The transfer and convertibility assessment remains 'A-'.

Outlook

The stable outlook reflects our expectation that continuation of moderate economic growth and recent corrective fiscal policy will limit increases in debt over 2022-2025 after several years of debt increases. We expect growth to be solid in 2022-2023 as large investment projects are finalized and then decline to 2.5% in 2024-2025, supported by a diversified pool of investments in the pipeline.

Downside scenario

We could lower the ratings on Uruguay over the next two years if worse-than-expected long-term growth prospects limit the government's ability to contain general government fiscal deficits. In this scenario, the already high net general government debt burden could continue to rise beyond our expectations. Moreover, a sustained weaker long-term growth trajectory could dampen Uruguay's per capita income, weighing on its economic resilience and leading to a lower rating.

Upside scenario

A structural improvement in fiscal and debt dynamics beyond our current expectations, along with continued GDP growth, could lead to a higher rating over the next two years. Greater-than-expected fiscal consolidation could stem from advancement in a social security reform, if it narrows the fiscal deficit and places the government's debt burden on a downward path. At the same time, a sustained decline in inflation and further deepening of local capital markets could help the government increase the share of local currency in its debt stock. Falling exposure to foreign currency-denominated debt could reduce the impact of exchange rate fluctuations on the sovereign's balance sheet.

Rationale

Our ratings on Uruguay are supported by its track record of moderate and predictable economic policies and its well-established institutions, which have underpinned consistent economic growth for over 15 years. Uruguay also has a strong external position and the highest per capita GDP in Latin America, at an estimated US$18,200 in 2022.

Uruguay's fiscal deficits and persistently high debt burden are constraints on the sovereign ratings, as are its relatively high inflation and still-high dollarization in the financial system, both significantly limiting monetary policy flexibility.

Institutional and economic profile: Broad political consensus and stable and well-established institutions will continue to anchor economic stability

- Following the 4.4% rebound in economic growth in 2021, we expect growth of 4.2% in 2022 and an average of just over 2.5% in 2023-2025.
- We expect broad political consensus on key economic policies to continue, which will be key in implementing needed structural measures.
- Uruguay's strong checks and balances and low perceived corruption, which sustain investor confidence, continue to support economic outcomes.

We estimate Uruguay's GDP per capita at US$18,200 in 2022, up from US$17,000 in 2021, which compares favorably with regional peers (and is similar to Chile).

We expect real GDP will increase 4.2% in 2022 following the 4.4% rebound in 2021 (5.9% contraction in 2020). A high statistical carryover (estimated at 3.6 percentage points) and higher commodities prices, in conjunction with the impact from the recent investment of Finland-based forest and paper UPM-Kymmene Corp. (UPM 2) and related infrastructure projects (total of US$4 billion), will continue to boost growth. The UPM 2 mill is expected to fully start operations in March 2023.

Diversified investments--presented to receive tax benefits under the Investment Law regime--could also support growth, if they materialize. These investments total over US$3 billion in sectors such as real estate, commerce, transport, software, and agribusiness. Development of projects related to green hydrogen, which are currently being explored, would also contribute to growth and support the country's carbon neutrality objectives. We forecast growth of 2.9% in 2023 and 2.5% in 2024-2025.

We think Uruguay's broad political consensus and stable and well-established institutions will continue to support economic stability. Uruguay has a vibrant democracy and ranks high in global institutional quality rankings. Institutional strength sustains investor confidence in the country despite adverse economic and political events in neighboring Argentina and Brazil. Uruguay is a largely middle-class society with a relatively strong social contract that emphasizes consensus and social cohesion.

The current administration took office in 2020 with a plan to contain government spending and improve efficiency and governance of public-sector companies. The pandemic refocused priorities to the short term, but the administration remained committed to addressing structural weaknesses in public finances through fiscal framework enhancements and transparency, as well as first steps toward a social security reform.

Policy preferences are divided, but we believe these are not polarizing and that broad consensus on key policies and the importance of institutional stability remains. On March 27, 2022, the administration and political coalition faced a referendum to repeal 135 of the 476 articles of the Urgent Consideration Law (LUC) mostly related to security, education, housing, and labor. But that also included economic items like the new fiscal rule and approach toward the determination of local fuel tariffs. The main difference between the two political coalitions is on the role of the state. The ruling coalition won by a close margin of 51.16% (including blank votes) versus 48.82%. We believe that the result paves the way to continue advancing with reforms, while reflecting that the opposition maintains its strength.

Flexibility and performance profile: Fiscal adjustment is underway, although structural enhancements are important to help lower debt levels

- We expect net general government debt to remain around 65% of GDP in 2022-2025, stabilizing after several years of sustained increases. (Net general government debt was 43% of GDP in 2012.)
- We expect a current account deficit in 2022 and slightly positive results in 2023-2025, sustaining Uruguay's balanced external position.
- Our base case assumes inflation will remain above the central bank target range in the next couple of years.

We expect the general government deficit to decline to 2.8% of GDP in 2022 from 4.4% in 2021 as pandemic support fades and after corrective fiscal measures. Government expenditure (excluding COVID-19-related support) decreased by 2.1% and 2.3% in real terms in 2020 and 2021, respectively, with decreases in virtually all items. While we expect spending will remain under control, pressures will emerge, notably from salaries given the administration's commitment to the full recovery of real wage losses by the end of its administration--which will prove tough amid high inflation. Our definition of general government debt includes the central bank and excludes public-sector enterprises.

Net general government debt remained at 65.2% in 2021 after increasing 10 percentage points amid the pandemic. Half of that rise was due to adverse exchange rate movements (over 50% of debt is denominated in foreign currency). Our base case assumes net general government debt will stabilize around 65% of GDP, on average, over 2022-2025 owing to relatively stable fiscal deficits along with foreign currency depreciation and inflation. We estimate an increase in net general government debt of about 6.2% in 2022 and just below 6% over 2022-2024. We expect the central bank of Uruguay's debt, typically issued for open-market operations in response to changes in the foreign currency market, to remain at about 10% of GDP over this period. We also expect general government interest payments to average 7.0% of general government revenue between 2022 and 2025.

The government is likely to continue meeting its financing needs mainly through local and international bond issuance. The government's main source of funding in 2021 was bond issuances in local and international debt markets, of which 75% was denominated in local currency. Foreign currency borrowing in 2021 included a global issuance in the Japanese market for an equivalent of $422 million.

The government implements active prefunding policies, a key supporting factor for the rating. Its current liquid assets and credit lines with multilaterals cover debt service obligations over the next 12 months. In recent years, Uruguay accumulated ample external liquidity to manage potential financing disruptions. Liquidity buffers as of year-end 2021 included contingent credit lines for a total of US$1.9 billion (3% of GDP) with multilateral institutions (World Bank, Corporación Andina de Fomento, and Fondo Latinoamericano de Reservas), as well as government liquid assets, for a total of about 5% of GDP. While the strategy of prefunding amortization payments by holding substantial liquid assets provides insulation against Uruguay's external vulnerabilities, it also has a fiscal cost.

Effective debt management has significantly reduced the risks in Uruguay's debt profile, as indicated by continued increases in average maturities, to 12.9 years currently, from eight years in 2005. Bonds compose 88% of central government debt, and loans make up 12%. Exposure to foreign currency is currently at 52.7%, compared with 88.5% in 2005.

Inflation has remained above the central bank's target for the past 10 years (with the exception of 2017) and increased to 9.38% in March 2022 (from 7.96% in December 2021) amid new pressures stemming from the Russia-Ukraine conflict. The central bank decided to hike the policy rate by 125 basis points to 8.5% in April and signaled additional tightening is required to lower inflation expectations, which, over the next 24 months, remain above the target range of 3%-6%.

The central bank has been focused on anchoring expectations through increased communication and transparency with the market and especially with business chambers. Aside from external factors, local tariff and wage adjustments, inertia, and the closing of the GDP gap will pose a strain. We expect inflation will gradually decline and reach the upper bound of the central bank target by 2025 (3%-6%).

High inflation and still-high dollarization continue to limit Uruguay's monetary policy flexibility. They also pose risks to the financial sector, in the case of potential sudden spikes in the exchange rate. Over 50% of resident loans and more than 70% of resident deposits are denominated in dollars.

Despite the high dollarization, the Uruguayan banking system has remained relatively healthy and resilient thanks to financial institutions' strong liquidity and capital. Regulation since the 2002 crisis aimed at strengthening the balance sheet and avoiding currency mismatches put Uruguay in a better position to manage the impact of the pandemic. Credit to the private sector, however, remains relatively low at just under 30% of GDP.

Asset quality metrics remained stable. Nonperforming loans improved to 1.5% in 2021 from 2.7% at year-end 2020 (including public and private banks). We classify Uruguay in group '5' of our Banking Industry Country Risk Assessment, or BICRA (see "Banking Industry Country Risk

Assessment: Uruguay," published Oct. 12, 2021). BICRAs are grouped on a scale from '1' to '10', ranging from what we view as the lowest-risk banking systems, or group '1', to the highest risk, or group '10'.

Uruguay's external sector has remained balanced despite unfavorable regional and global conditions. We expect a deficit in the current account in 2022 and slightly positive results in 2023-2025 as:

- The services sector fully recovers, particularly tourism, and
- The beginning of production of the cellulose plant in 2023 provides a boost for exports (per estimations from the company, it would add US$1.1 billion in exports).

The impact of higher commodity prices (amid the Russia-Ukraine conflict) on Uruguay's external accounts is positive in net terms, at least in the short run, but it could maintain imports at higher levels than before the pandemic.

Gross external financial needs should remain below 100% of current account receipts (CAR) plus usable reserves in 2022, then fall to 95% of GDP by 2025. We expect narrow net external debt to hover around 14% of CAR over 2022-2025. We expect the government to continue to finance part of the fiscal deficit with external sources through bond issuance and multilateral institution loans. At the same time, CARs will likely increase with the start of operations of the cellulose plant in 2023.

Key Statistics

Table 1

Uruguay--Selected Indicators

	2016	2017	2018	2019	2020	2021	2022f	2023f	2024f	2025f
Economic indicators (%)										
Nominal GDP (bil. LC)	1,726.41	1,842.00	1,982.24	2,158.73	2,253.12	2,584.00	2,902.55	3,189.82	3,482.08	3,783.28
Nominal GDP (bil. $)	57.24	64.23	64.52	61.23	53.63	59.33	63.67	67.28	70.62	73.78
GDP per capita ($000s)	16.6	18.6	18.6	17.7	15.4	17.0	18.2	19.2	20.1	21.0
Real GDP growth	1.7	1.6	0.5	0.4	(6.1)	4.4	4.2	2.9	2.5	2.5
Real GDP per capita growth	1.3	1.3	0.3	0.4	(6.4)	4.1	3.9	2.6	2.2	2.2
Real investment growth	(1.6)	0.4	(9.0)	0.8	1.6	15.2	12.0	(2.0)	(1.0)	2.5
Investment/GDP	17.5	16.1	15.4	15.0	17.1	19.2	20.5	19.6	18.9	18.9
Savings/GDP	18.3	16.1	15.0	16.6	16.2	17.3	18.0	20.1	19.4	19.2
Exports/GDP	27.0	26.1	26.4	27.8	25.1	31.5	33.1	35.2	34.2	34.7
Real exports growth	(0.2)	4.9	(1.7)	3.6	(16.0)	14.4	10.3	10.1	(0.4)	4.2
Unemployment rate	7.8	7.9	8.6	9.2	10.5	7.0	7.0	7.2	7.5	7.5

Table 1

Uruguay--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022f	2023f	2024f	2025f
External indicators (%)										
Current account balance/GDP	0.8	0.0	(0.4)	1.6	(0.8)	(1.8)	(2.5)	0.6	0.5	0.3
Current account balance/CARs	2.8	0.0	(1.4)	5.1	(3.1)	(5.4)	(7.2)	1.6	1.4	0.9
CARs/GDP	29.4	29.2	29.6	31.3	27.1	34.1	35.2	37.3	36.2	36.7
Trade balance/GDP	3.6	3.0	3.6	5.0	3.9	6.7	5.6	9.3	9.8	9.8
Net FDI/GDP	3.2	3.2	1.1	(2.3)	(1.8)	(2.3)	4.7	0.8	(0.3)	(0.3)
Net portfolio equity inflow/GDP	3.0	(3.4)	(2.0)	1.9	2.6	1.4	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	100.3	101.1	90.5	85.8	98.8	96.7	97.4	89.8	88.8	89.3
Narrow net external debt/CARs	34.2	26.3	27.6	30.9	25.5	16.7	12.9	11.8	15.4	14.3
Narrow net external debt/CAPs	35.2	26.3	27.3	32.6	24.8	15.9	12.1	12.0	15.6	14.4
Net external liabilities/CARs	106.4	89.9	87.2	78.3	93.6	74.9	78.6	72.7	74.3	70.0
Net external liabilities/CAPs	109.4	89.9	86.0	82.5	90.8	71.0	73.4	73.9	75.3	70.7
Short-term external debt by remaining maturity/CARs	47.9	38.0	37.3	33.3	44.3	33.8	31.0	27.7	27.2	25.7
Usable reserves/CAPs (months)	5.5	4.4	6.3	6.3	5.7	5.0	4.7	4.9	5.1	4.8
Usable reserves (mil. $)	6,844	10,183	9,465	7,150	8,882	9,388	10,152	10,662	10,747	10,780
Fiscal indicators (general government; %)										
Balance/GDP	(4.9)	(3.3)	(3.5)	(4.2)	(5.2)	(4.4)	(2.8)	(2.9)	(2.9)	(2.9)
Change in net debt/GDP	3.0	7.9	6.0	7.0	11.7	7.6	6.2	6.0	6.0	5.9
Primary balance/GDP	(2.0)	(0.4)	(0.4)	(1.7)	(2.8)	(2.4)	(0.8)	(0.5)	(0.5)	(0.4)
Revenue/GDP	33.3	35.3	36.6	35.6	35.1	34.4	33.4	33.4	33.4	33.4
Expenditures/GDP	38.1	38.5	40.1	39.9	40.2	38.7	36.2	36.3	36.3	36.3
Interest/revenues	8.7	8.2	8.2	7.1	6.9	5.6	6.1	7.3	7.4	7.4
Debt/GDP	53.1	57.1	59.2	60.6	71.4	70.1	68.9	69.0	69.4	70.0
Debt/revenues	159.6	161.9	161.7	170.1	203.6	203.8	206.1	206.4	207.8	209.6

Table 1

Uruguay--Selected Indicators (cont.)

	2016	2017	2018	2019	2020	2021	2022f	2023f	2024f	2025f
Net debt/GDP	46.8	51.8	54.2	56.8	66.0	65.2	64.2	64.4	65.0	65.7
Liquid assets/GDP	6.3	5.3	5.0	3.8	5.3	4.9	4.7	4.5	4.4	4.3
Monetary indicators (%)										
CPI growth	8.1	6.6	8.0	8.8	9.4	8.0	7.8	6.8	6.5	6.0
GDP deflator growth	7.3	5.0	7.1	8.5	11.2	9.9	7.8	6.8	6.5	6.0
Exchange rate, year-end (LC/$)	29.26	28.76	32.39	37.34	42.34	44.70	46.48	48.34	50.28	52.29
Banks' claims on resident non-gov't sector growth	1.2	0.5	11.6	10.7	12.3	12.4	12.0	9.0	9.0	9.0
Banks' claims on resident non-gov't sector/GDP	26.6	25.1	26.0	26.4	28.4	27.9	27.8	27.5	27.5	27.6
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	77.3	73.3	73.6	76.2	77.4	77.2	77.2	77.2	77.2	77.2
Real effective exchange rate growth	0.9	6.1	1.5	(3.2)	(5.3)	(1.5)	N/A	N/A	N/A	N/A

Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. f--Forecast. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Uruguay--Ratings Score Snapshot

Key rating factors	Score	Rationale
Institutional assessment	3	Stable democracy, predictable policies, free press, and peaceful changes of government. No external threats. Largely middle-class society with consensus on key economic policies. Policymaking during the past 15 years has remained generally effective. Strong institutional checks and balances, low perception of corruption, and respect for the rule of law.

Table 2

Uruguay--Ratings Score Snapshot (cont.)

Key rating factors	Score	Rationale
Economic assessment	3	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1. We estimate GDP per capita growth over our forecast period will be in line with that of countries with similar levels of development.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR plus usable reserves) as per Selected Indicators in table 1.
Fiscal assessment: flexibility and performance	5	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in table 1.
		Over 40% of gross government debt is denominated in foreign currency.
Monetary assessment	5	The Uruguayan peso is a free-floating currency with central bank intervention in foreign-exchange markets. CPI as per Selected Indicators in table 1. The central bank has a track record of independence and has the ability to act as lender of last resort for the financial system.
		Resident deposits/loans in foreign currency account for more than 50% of the total.
Indicative rating	bbb	As per table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BBB	
Notches of uplift	0	
Local currency	BBB	Default risks do not apply differently to foreign currency and local currency debt.

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Global Sovereign Rating Trends: First-Quarter 2022, April 13, 2022
- Sovereign Ratings History, April 5, 2022
- Sovereign Debt 2022: Borrowing Will Stay High On Pandemic And Geopolitical Tensions, April 5, 2022
- Banking Industry Country Risk Assessment Update: February 2022, Feb. 25, 2022
- Banking Industry Country Risk Assessment: Uruguay, Oct. 12, 2021
- Uruguay 'BBB/A-2' Ratings Affirmed; Outlook Remains Stable, April 20, 2021

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Uruguay	
Sovereign Credit Rating	
Foreign Currency	BBB/Stable/A-2
Local Currency	BBB/Stable/A-2
Transfer & Convertibility Assessment	A-
Uruguay	
Senior Unsecured	BBB
Short-Term Debt	A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such