Rating Report

Report Date:
May 30, 2014

Previous Report:
May 7, 2013

Insight beyond the rating.

Oriental Republic of Uruguay

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Ratings

Issuer	Debt Rated	Rating	Trend
Uruguay, Oriental Republic of	Long-Term Foreign Currency– Issuer Rating	BBB (low)	Stable
Uruguay, Oriental Republic of	Long-Term Local Currency– Issuer Rating	BBB (low)	Stable
Uruguay, Oriental Republic of	Short-Term Foreign Currency – Issuer Rating	R-2 (middle)	Stable
Uruguay, Oriental Republic of	Short-Term Local Currency – Issuer Rating	R-2 (middle)	Stable

Rating Rationale

DBRS, Inc. (DBRS) has confirmed the Oriental Republic of Uruguay's long-term foreign and local currency issuer ratings at BBB (low). DBRS has also confirmed the short-term foreign and local currency issuer ratings at R-2 (middle). The trend on all ratings is Stable.

The Stable trends reflect DBRS's view that risks to the outlook are broadly balanced. High inflation and pro-cyclicality in public expenditures are concerns and weigh on economic prospects. In addition, the Uruguayan economy remains exposed to regional and global spillovers via the terms of trade, tourism, and financial channels. However, due to ongoing economic diversification from high levels of investment, prudent debt management, and large financial buffers, DBRS believes the credit fundamentals in Uruguay are stable.

Upward pressure on the ratings could occur if steps are taken to ensure that revenues related to future commodity production or economic growth are used to build a countercyclical fiscal buffer, or if there is further progress on de-dollarization and on returning inflation to within the policy target range. Conversely, deterioration in Uruguay's macroeconomic management that weakens the economy's resilience to adverse shocks could put downward pressure on the ratings. (Continued on page 2)

Rating Considerations

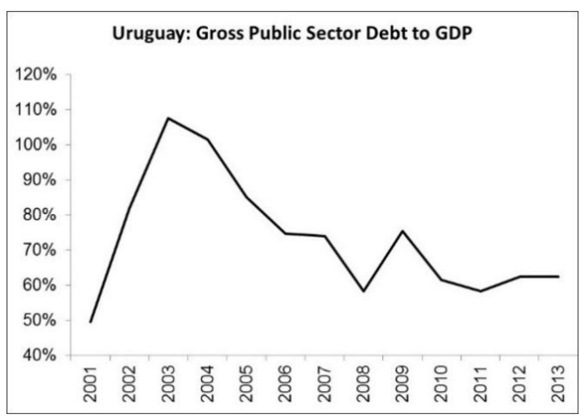
Strengths
(1) Strong growth performance
(2) High foreign direct investment
(3) Effective debt management
(4) Strong and stable public institutions

Challenges
(1) High inflation and interest rate volatility
(2) Financial dollarization
(3) Limited fiscal flexibility
(4) Risks from external volatility

Summary Statistics

For the year ended December 31	2011	2012	2013	2014F
Nominal GDP (US$ billions)	47.2	50.1	55.7	58.3
GDP per capita (US$)	13,972	14,729	16,609	17,121
Real GDP (% change yoy)	7.3	3.7	4.4	2.8
Unemployment rate (year end, %)	5.6	5.6	6.0	6.8
Inflation (year end, %)	8.6	7.5	8.5	8.5
Current account balance (% GDP)	-3.0	-5.4	-5.7	-5.5
External debt (% GDP)	38.9	42.2	41.1	na
Central gov't balance (% GDP)	-0.9	-2.8	-2.4	-3.1
Primary balance (% GDP)	2.0	-0.2	0.5	0.2
Gross public debt (% GDP)	57.3	62.2	59.5	61.2
Human Development Index	0.817	0.819	na	na

Note: 2014 are IMF forecasts.



Rating Rationale (Continued from page 1)

Supply and demand factors have contributed to Uruguay's strong economic performance of the last decade. From 2005 to 2013, Uruguay expanded at an average annual real rate of 5.7%, above the Latin American regional average of 3.8%. On the supply side, higher levels of investment boosted productivity in the agricultural sector, expanded production into higher value-added agribusiness, and diversified the economy. Positive demand factors include favorable terms of trade and strong regional demand for tourism services. This solid growth performance has been accompanied by a rising employment rate and substantial real wage gains. Slowing from its long-run average in tandem with its two large neighbors, Uruguay's economy expanded by a real 3.7% in 2012 and 4.4% in 2013. The economy is expected to continue a cyclical deceleration over the next two years before converging back to its potential growth rate of roughly 4%.

Higher levels of investment bode well for growth over the medium-term. Total investment averaged 20.3% of GDP from 2008-2013, up from a low of 15.2% in 2003. FDI in particular, having averaged 5.9% of GDP from 2005 to 2013, is among the highest in its peer group. Once operational, recent agriculture and impending mining investments will likely improve the country's growth prospects. Furthermore, ongoing efforts to increase infrastructure and energy investments are vital for Uruguay to sustain high rates of economic growth.

Favorable economic performance combined with persistent primary surpluses and proactive debt management led to a significant improvement in Uruguay's debt profile over the last decade. Gross public debt declined to 59.4% of GDP in 2013 from 107.5% of GDP in 2003. The IMF expects gross debt to GDP to remain stable at around 62% over its five year forecast. Higher than expected debt issuance related to sterilization of Uruguay's rapidly growing foreign exchange reserves has caused the government to abandon its goal to reduce gross debt to 40% of GDP by 2015. Instead, it set a target for net-debt-to-GDP of 24% by end-2014. With net debt of 23.5% of GDP in 2013, this target has already been achieved.

Debt management operations have also reduced refinancing and exchange rate risk. With limited debt maturing and 3.8% of GDP in precautionary savings, the government has adequate resources to cover gross financing needs for well over 12 months. This financial cushion is supplemented by contingent credit lines of $2 billion (3.9% of GDP) from multilateral lending institutions. Gross international reserves rose to $16.5 billion in March 2014, up $3 billion from a year prior.

Offsetting these strengths are several challenges. Reducing persistent high inflation while tempering excessive capital inflows has remained a key policy concern over the last few years. To address this dual challenge, authorities deployed a series of macro-safeguards, including tightening the monetary policy stance, increasing reserve requirements on deposits and additional capital inflows, price control agreements on basic goods with retailers, and in June 2013 the Central Bank of Uruguay's (BCU) shifted to a money supply growth target from an interest rate target. Consequently, the government has had some success at containing the inflow of short-term capital. However, inflation has remained near or above the upper limit of the BCU target range and short term interest rates have become more volatile. Higher and less predictable interest rates have proven challenging for public debt issuances in pesos and for the extension of bank lending to the private sector.

Moreover, high levels of dollarization and low financial intermediation hinder the transmission of monetary policy, as the BCU has no control over dollar interest rates. The high level of dollarization in the economy also creates currency mismatches, and exchange rate and liquidity risks. The share of total dollarized credit and deposits in Uruguay remains well above the average for its peer group.

Despite ample liquidity buffers that provide space for automatic fiscal stabilizers to function, DBRS believes that the scope for discretionary stimulus or countercyclical policy intervention in the event of an adverse shock is somewhat limited. Economic output over the last decade has been above trend, resulting in primary surpluses and a declining debt burden, but the public sector balance remained in a deficit position. Central government expenditures have increased to 26.5% of GDP in 2013, from 22.2% in 2003, while revenues have remained broadly flat at around 21% of GDP over the decade. As GDP growth rates moderate, the increases seen in rigid social expenditure items could continue to pressure the fiscal position.

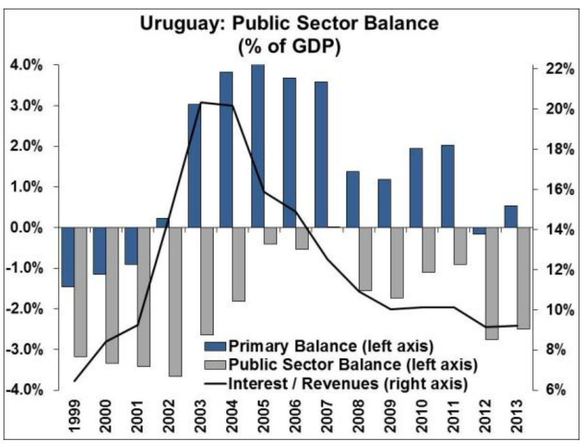
Uruguay remains exposed to external volatility – primarily risks stemming from volatile global capital flows, a strong real effective exchange rate, and weaker global and regional economic growth – that could further widen the 5.7% of GDP current account deficit. Trade disruptions or an economic downturn in Brazil or Argentina would directly affect economic activity through weaker demand for tourism services and lower levels of direct investment. A sharp deceleration in China also presents a downside risk to commodity prices and Uruguay's outlook for growth in trade. Agricultural products account for more than 60% of exports and therefore are exposed to fluctuations in world prices. However, the current account deficit remains fully funded by FDI and anticipated growth in exports from agriculture and mining investments is expected to reduce the deficit over the medium term. Moreover, foreign exchange reserve assets exceed most international benchmarks for adequate reserve levels, cushioning the impact of an external shock.

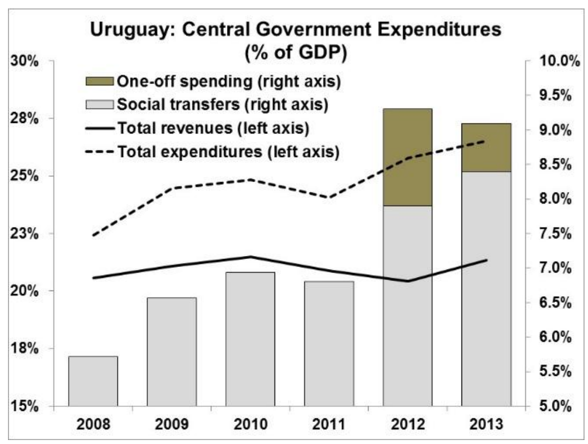
Local and Foreign Currency Ratings

DBRS rates Uruguay's local and foreign currency ratings at the same level because the domestic financial market is shallow. In addition, the country has accumulated a large stock of foreign currency reserves. This helps the capacity to service foreign currency debt.

Fiscal Management and Policy

Uruguay's commitment to responsible fiscal policy has helped lower public debt ratios and foster macroeconomic stability since the 2002 financial crisis. Primary surpluses averaged 2.3% of GDP from 2003 to 2013, aided by reforms that broadened the tax base and improved tax administration. The debt servicing burden over that time fell to 9.2% of public sector revenues from 20.4%. However, the public balance has deteriorated in recent years due to increases in primary spending, in addition to some extraordinary one-off expenditures. Slowing the pace of real expenditure growth could improve fiscal flexibility and help ease inflationary pressures.





Sources: Ministry of Economy and Finance, Haver, DBRS

The public balance has underperformed the targets established in the government's five-year budget plan (2010-14). In 2013, the overall deficit overshot the budget target of 0.9% of GDP by widening to 2.4% from 0.9% in 2011. The primary balance returned to a surplus of 0.5% of GDP after logging its first deficit over the last decade in 2012, but it also underperformed the 2.1% surplus target. Year-to-date fiscal performance suggests there is a risk that the fiscal stance overshoots the 2014 deficit targets for the third consecutive year. Budgets are indeed subject to seasonality; however, the deterioration of the overall deficit to 3.2% of GDP in March 2014 is far removed from the 0.8% of GDP deficit target set for this year by the 2010-2014 budget. A central bank survey of independent analysts projects a 2014 deficit of 2.8% of GDP.

Along with an anticipated increase in revenue from pulp production, the government expects commodity-based windfalls from mining activity over the medium-term. A recent law enables the exploitation of iron ore deposits and the expectation is that the proven reserves could generate an additional $1-2 billion in exports per year. The law also establishes a taxation and revenue allocation framework for managing excess receipts from mining, and it creates a new sovereign intergenerational investment fund (FSII) where 70% of mining revenues will flow. The fund is designed to be used to pay down debt and for financing research and development projects. The remaining 30% would be earmarked for economic development projects around the mining areas.

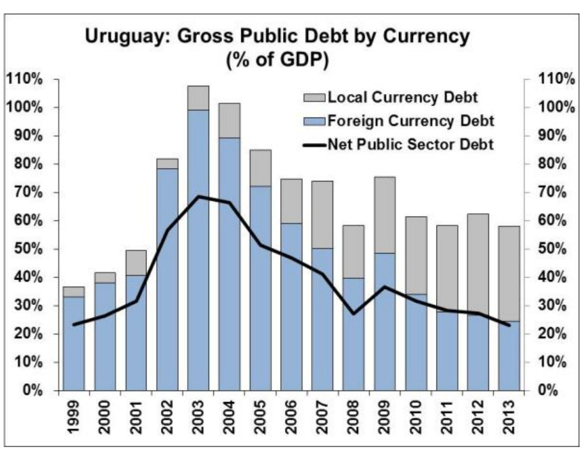
However, the evolution of the price, cost, and export of a main agricultural commodity plays less of a role in revenue generation in Uruguay. The high degree of export diversification presents a challenge for authorities to adopt a fiscal rule linked to the commodity cycle, as seen in other commodity exporting countries. Revenue volatility is mostly associated with economic cyclicality. Efforts by the new administration to establish a framework to ensure fiscal targets based on structural estimates for GDP and revenues could strengthen the government's track record on fiscal management.

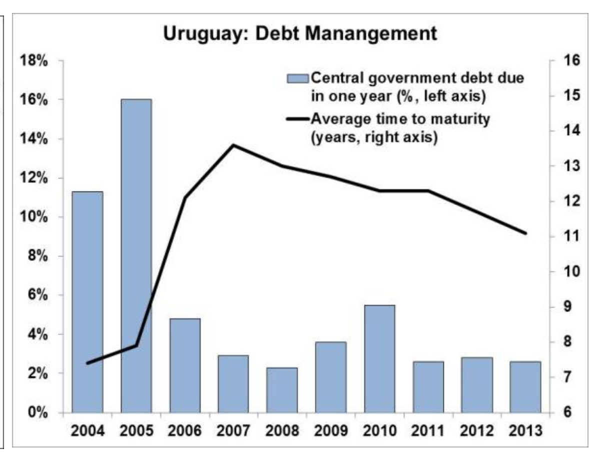
The increase in expenditures since 2011 is explained by increased primary and one-off spending. Primary expenditures rose 2.5% of GDP between 2011 and 2013, 1.6% from an increase in social transfers. Spending on health insurance in particular increased substantially since the 2007 reform expanded coverage, and an aging population will continue to drive health related public costs. The public salary bill now costs the government over 5% of GDP. In addition, there were several one-off outlays since 2011. The contingent liabilities associated with a legal settlement to creditors of a bank liquidated in 2002 and obligations related to the closure of Pluna, Uruguay's national airline, cost the government 0.4% of GDP in 2012. The impact of drought conditions on Uruguay's energy bill is estimated to have cost 1.7% of GDP between 2012 and 2013. Moreover, Uruguay's state oil company ANCAP made a lump payment of 0.4% of GDP in January 2013 towards debt incurred from Venezuela's state oil firm PDVSA.

Rising real expenditures limit fiscal flexibility and have intensified inflationary pressures. While liquidity buffers and precautionary credit lines provide adequate space for automatic fiscal stabilizers to function, future deficits could limit Uruguay's scope for discretionary fiscal stimulus in the event of a shock. Furthermore, average annual real growth in primary expenditures of 8.5% since 2008 has outpaced average annual real GDP growth of 5.6% over the same period, increasing domestic demand and pushing inflation above the central bank's target. Moderation in economic growth prospects could pressure the fiscal balance, particularly if forthcoming commodity revenues underperform expectations.

Debt and Liquidity

Primary surpluses, strong growth, and skillful debt management have led to a significant improvement in the level and composition of Uruguay's debt over the last decade. Gross public debt declined from a post-crisis peak of 107.5% of GDP in 2003 to 59.5% of GDP in 2013. Though the IMF projects a slight increase in gross debt this year from downward growth revisions and wider deficits, debt to GDP is expected to be stable around 62% over the five year forecast period. The government had earlier set a goal of reducing gross debt to 40% of GDP by 2015. Due to central bank sterilization of its foreign exchange reserve accumulation – reserves increased to $16.3 billion (29.3% of GDP) in 2013 from $6.4 billion in 2008 – additional debt issuance was necessary. The administration subsequently established a new target of achieving debt net of public sector assets of 24% of GDP by 2014. Net debt reached 23.5% of GDP in 2013.





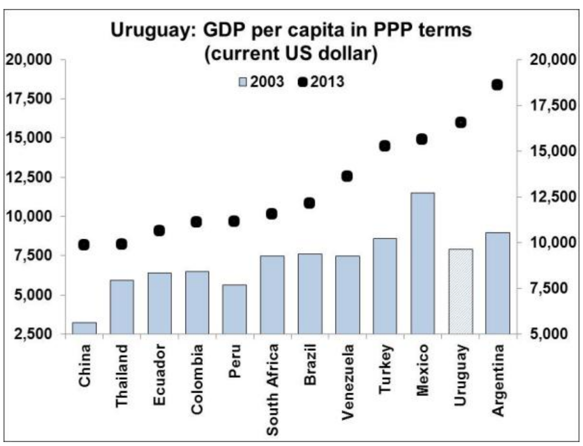
Sources: BCU, Ministry of Economy and Finance, Haver, DBRS

Proactive debt management has significantly reduced rollover risk by smoothing the amortization schedule, extending the maturity structure, and implementing a 12-month pre-financing policy. As of March 2014, the average maturity of central government debt was 11.9 years, among the longest in either emerging or advanced economies. Central government debt maturing over the next 12 months amounts to an equivalent of just 2.4% of GDP. Additionally, the pre-financing policy sets aside liquid assets sufficient to cover gross financing needs for at least the next 12 months, net of the expected primary surplus. At 3.8% of GDP, present liquid assets are well in excess of 2014 financing needs. Contingent credit lines with multilateral lending institutions (World Bank, CAF, FLAR, and IADB) offer an additional 3.9% of GDP in financial buffers. Thus, Uruguay has ample funding flexibility in the event of market turbulence, as illustrated between September 2013 and April 2014 when the Ministry of Economy and Finance abstained from issuing debt in the local market due to peso interest rate volatility from the recent shift in the monetary policy framework.

The government has also made substantial progress reducing exchange rate risk. The share of central government debt denominated in local currency increased to 55% in March 2014 from roughly 8% in 2003. Further still, three-quarters of market debt in foreign currency is hedged against foreign exchange risk. The government plans to continue its medium-term strategy of debt de-dollarization by issuing peso denominated debt and buying back foreign currency denominated bonds.

Economic Structure and Performance

Uruguay's economy has been a strong performer among its BBB-range rated peer group, expanding at an average real annual rate of 5.2% since 2003. This performance took place in the context of favorable commodity prices and strong regional and domestic demand. It was also the result of prudent macroeconomic policies, higher rates of investment, and increasing competitiveness in the agriculture sector. However, the IMF expects real growth to decelerate to 2.8% this year and 3.0% in 2015, from regional and global cyclical slowdowns, before gradually increasing towards the economy's 4% potential by the end of the decade. Ongoing efforts at increasing infrastructure and energy investments should help sustain high rates of economic growth.



Source: IMF, INE, Haver, DBRS. Note: GDP per capita are IMF estimates

Large FDI inflows and technological advances have contributed to a structural transformation of Uruguay's exports, the agriculture sector in particular. Uruguay has benefited from its comparative advantage in traditional sectors such as beef and dairy products while rapidly expanding into new markets, particularly soy, rice, and other cereals. The development of the pulp and paper industry is also broadening the export base. Merchandise exports increased on average by 16.3% per year from 2003 to 2013 as a result of higher volumes, product diversification, and rising commodity prices.

Strong economic growth has contributed to a significant improvement in labor market conditions. The employment rate has increased to well above pre-2002 crisis levels at 61.1% in February 2014. Unemployment has edged up in recent months to 7.0%, but it remains close to historical lows. Robust job growth has been accompanied by gains in real wages. Salaries recovered to pre-2002 levels in 2010 and have continued expanding. Shortages of skilled labor, recent changes to the collective bargaining process, and the prevalence of wage indexation help explain the rise in salaries. The annual growth rate of real wages has averaged nearly

4% since end-2011 and has exceeded the growth of labor output per hour worked, contributing to inflation. DBRS is encouraged by recent wage-setting guidelines that reduce backward wage indexation and attempts to limit the annual growth of real wages to less than 3%. If left unchecked, continued rapid wage growth could weaken competitiveness for some sectors and increase the adjustment cost in the event of a shock.

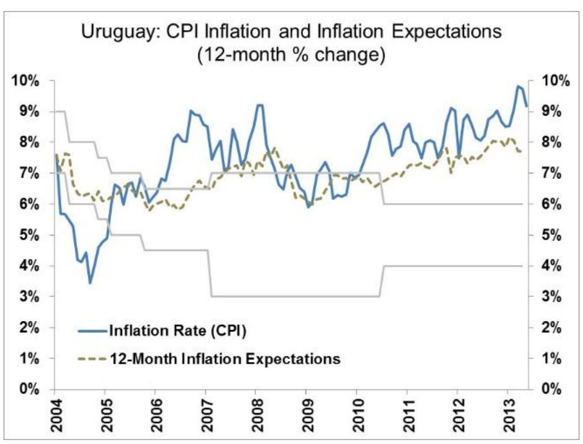
Higher levels of investment bode well for growth in the coming years. Total investment averaged just 16.5% of GDP in the 1990s and declined to 15.2% in 2003. Since then, investment has significantly increased to average 20.3% of GDP from 2008 to 2013. Transport infrastructure, however, has not kept up with the economy's expansion. In order to narrow the infrastructure deficit, Congress passed legislation in June 2011 to facilitate the creation of public-private partnerships (PPPs) to focus on roads, railways, and ports.

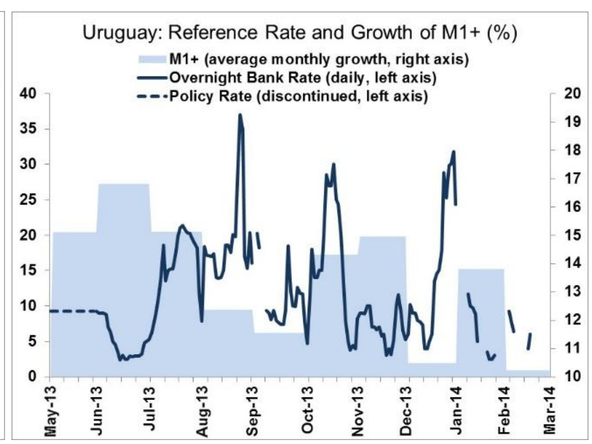
A substantial expansion of energy infrastructure could also improve prospects for sustained economic growth. Uruguay imports over half of its energy consumption, and hydro-electric generation supplies a majority of domestic electricity. In periods of inadequate rainfall, as in 2008 and 2012, Uruguay imports expensive substitutes. Recent climate insurance bought from the World Bank should partially protect the Uruguayan electric power company (UTE) against exposure to droughts and high oil prices. Going forward, the government is planning significant public and private investment in energy-related infrastructure to meet the economy's growing energy needs – including a connection to Brazil's electricity grid, a series of wind parks, and the expansion of biomass power. The objective is to gradually reduce dependency on imported petroleum, diversify suppliers, and limit fiscal exposure.

Monetary Policy and Financial Stability

Despite changes to Uruguay's monetary policy framework and significant policy tightening, the central bank has thus far been unsuccessful in lowering inflation. For the last seven years, annual inflation has remained near or above the upper limit of the BCU's target range due to reasons which are not entirely within the BCU's control. These include rising public expenditures, strong domestic demand, droughts, rising international food and energy prices, financial dollarization, and capital inflows. Authorities have responded by accumulating reserves, tightening the monetary policy stance, increasing reserve requirements on deposits and additional capital inflows, price control agreements on basic goods with retailers, and changing the policy framework to target money growth rather than the interest rate. Thus far, capital inflows have steadied, but inflation remains high and the new framework has led to market confusion and interest rates volatility.

Between July 2010 and 2013, inflation increased from 6.4% to 8.7%. In response, the BCU raised the benchmark policy rate 300 basis points to 9.25% over that period. It also increased the reserve requirement on peso bank deposits to 25% from 20% and the marginal requirement on foreign currency deposits to 45% from 40%. The effort did not significantly calm the rise in prices but the higher interest rate played a role in attracting substantial capital inflows. The REER strengthened 19.7% during that time and provoked some competitiveness concerns of an overvalued peso. In this context, reserve accumulation, to the extent it reduces appreciation pressures on the peso, may be working against lowering the inflation rate.





Sources: INE, BCU, Haver, DBRS

To counter these challenges, the BCU announced in June 2013 new controls on capital inflows and a reformulated inflation target. A new reserve requirement of 50% was placed on nonresidents' purchase of locally issued Treasury notes, and the existing capital requirement on central bank sterilization notes was increased 10 basis points to 50%. The BCU also widened the inflation target band from 4-6% to 3-7% starting in July 2014. Perhaps of most importance, the BCU replaced the interest rate target with a money supply – plus saving deposits (M1+) – growth target, reverting to its target prior to 2007. The average growth of M1+ has moderated from 15.7% in 2Q13 to 11.5% in 1Q14. Authorities envisage a reduction to 8% by 2015.

The new policy framework has made interest rates volatile and has created some market confusion. The market initially interpreted the new framework as expansionary and the overnight interbank rate fell to an average 4.8% in July 2013. The BCU tightened liquidity over subsequent months and the rate overcorrected to an average of 14.1% from early August through January 2014, occasionally spiking above 30%. Such volatility has caused banks to maintain higher liquid reserves and tap the overnight market less frequently – thus constricting already low levels of lending in the economy. Credit does not appear to be a main catalyst for inflation, but rising market rates have implications for weaker economic growth. The average interest rate for firms and families borrowing in local currency rose to 22.2% in March 2014, from 14.8% in July of last year. Interest rate volatility also dissuaded the government from issuing debt in local currency from September 2013 to April 2014.

Despite the contractionary monetary policy shift, inflation accelerated to reach 9.8% in March 2014. Tripping the 10% annual inflation threshold could be disruptive, as salary agreements are possibly cancelled and wage negotiations could be triggered. Most recently, authorities agreed with retailers on a price freeze of basic goods through May 2014. Accompanied by the slower pace of money growth, the price freeze served to temporarily calm the annual inflation rate in April 2014 to 9.2% of GDP. Inflation expectations for the next 12 months also edged down from the January peak, suggesting some signs that rising inflationary pressures could be tempered. However, structural issues that perpetuate the high inflation rate, such as rising public expenditures and wage indexation, persist and could continue to complicate a reduction in price pressures.

High dollarization is a feature of the Uruguayan economy and it has two main implications. First, dollarization blunts the effectiveness of monetary policy. The BCU has no control over dollar interest rates and, therefore, has less ability to affect aggregate saving and demand through changes in the local money supply. Second, dollarization creates currency mismatches and balance sheet vulnerabilities that carry exchange rate and liquidity risks. The share of dollarized credit to total loans in Uruguay is 62%, and the share of total dollarized deposits is 75%. Although gradually declining, these results remain well above the median dollarized share of credit and deposits for Pacific Alliance[1] countries, of 22% and 18%, respectively.

The Uruguayan financial system is small but emerged from the global financial crisis in a healthy position to support economic growth. The banking system is liquid and highly capitalized with a very low level of non-performing loans. Nevertheless, financial intermediation in Uruguay is low. Growth in total credit to the non-financial sector fell to 9.4% y-o-y in January 2014 from an average annual 16.9% increase since January 2011. Total credit amounted to only 26.7% of GDP in 2013 compared against roughly 32% of GDP in Pacific Alliance countries. This low level of credit reflects the limited utilization of financial services since the 2002 crisis.

Due to a series of reforms and prudential measures that have been implemented over the last decade, the financial system is better prepared to withstand external shocks. Prudential measures include higher reserve requirements on foreign currency deposits, higher capital requirements on foreign currency credit, and strengthened surveillance of systemic macro-financial risks. The presence of two large Spanish banks poses a potential risk of negative spillovers if crisis returns or intensifies in the Euro area. However, the local subsidiaries benefit from strong balance sheets, rely on local funding, and face limitations on net lending to parent banks – all of which reduce downside risks to the domestic banking system.

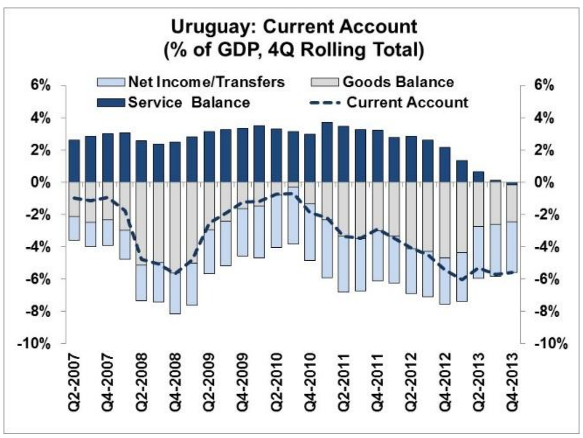
Non-resident deposits, which were a source of vulnerability in the past, also remain at low levels. At the onset of the Argentine crisis in 2001, non-resident deposits accounted for 41% of total deposits. The crisis spread to Uruguay when Argentines withdrew their money from Uruguayan banks, causing a run by both resident and non-resident depositors. Since then, the level of non-resident deposits has remained stable at roughly 15% of total deposits and is more than matched by banks' liquid foreign currency assets and reserve requirements.

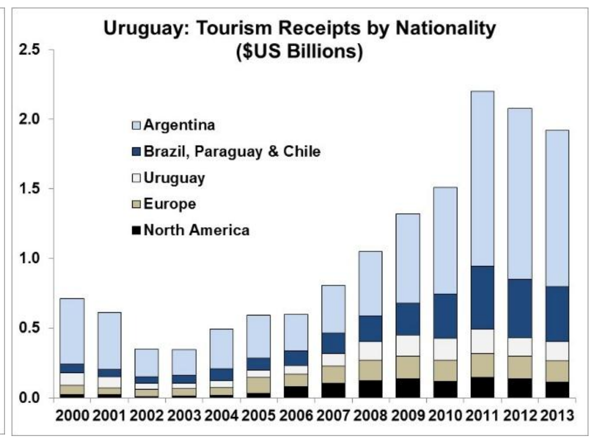
[1] Pacific Alliance countries are Colombia, Chile, Peru and Mexico. Data 2012 averages.

Balance of Payments

Uruguay's balance of payments remains stable, despite the widening current account deficit since 2010 and risks stemming from a strong real effective exchange rate, volatile global capital flows, and weaker global and regional economic growth. While capital goods imports and a rise in energy imports have made a significant but temporary impact on the current account deficit, expected export growth is likely to help reduce this deficit over the medium-term. Meanwhile, the deficit remains fully funded by FDI and foreign exchange reserve assets exceed most international benchmarks for adequate reserve levels – cushioning the impact of an external shock.

At 5.7% of GDP, the country's current account deficit has widened in recent years due to a variety of transient factors. These include higher than normal capital imports (due to the construction of the Montes de Plata pulp mill) and energy imports (due to droughts), as well as weaker export performance (due to lower tourists receipts and slower growth among trading partners). As these temporary factors diminish and if exports rise in line with expectations, the consensus view is that the current account deficit should narrow back towards the five year historical average of 3.5% of GDP. Even at current deficits, the current account continues to be financed by FDI inflows, at 5.1% of GDP last year. The Montes de Plata pulp mill should begin operations this year and is expected to add to the increase in annual exports. Furthermore, the passage of a law last year provides guidelines for investment in large scale mining and enables the exploitation of the 18 million tons of proven iron deposits in central Uruguay. The expectation is that these reserves have the potential to create an additional $1-2 billion (roughly 2-4% of 2013 GDP) in annual export revenue over the 20-30 year life cycle of the project.





Source: BCU, Haver, DBRS

The real effective exchange rate (REER) strengthened by 40% over the last decade. Much of the appreciation since the 2002 crisis reflects the country's improved fundamentals, including the high quality and price of commodity exports, productivity gains, and strong FDI inflows. However, as international market sentiment improved since 2012, the currency strengthened from high levels of nonresident portfolio capital inflows. That trend slowed last summer due to stricter capital requirements imposed on nonresident purchases of short-term central government securities and the concordant 'taper' announcement by the US Federal Reserve. As such, the peso depreciated by 16% against the dollar since April 2013. The REER nevertheless remains strong as its main emerging market trading partners have also depreciated against the dollar. By using the Equilibrium Real Exchange Rate approach, the IMF claims that in June 2013 Uruguay's REER was 8.8% stronger than levels consistent with its fundamentals. The real rate has since strengthened another 5% through March 2014.

Geographical and product diversification have reduced concentration risks. Uruguay's small open economy has historically been correlated with its two large neighboring economies, Argentina and Brazil. More recently, extra-regional partners have increased in importance. Brazil and Argentina account for roughly 24% of total exports. European countries accounts for another 17% and the rest of the Americas 18%. China has emerged over the last decade as a vital export market with 14% of the total. Meat and dairy products continue to make up over half of export goods. Crude materials like soybean sold to China have also increased in significance, as well as exports of other primary products, cereals, agribusiness, wood & pulp products, and chemicals.

Weaker growth from regional and global partners increases vulnerabilities to spillovers through three important channels: trade, tourism, and investment. First, exports fell to 24% of GDP in 2013 from 27% in 2011. The expectation of supply-side support to export performance, from new agriculture and mining FDI projects, could be challenged on the demand-side by slower economic growth from its trading partners. Real average growth in economic output of Uruguay's main partners (Argentina, Brazil, EU, USA, China, and Chile) slowed to 3.2% in 2012-2013 from 5.8% during 2004-2008. Consequently, goods exported from Uruguay fell to an average annual growth of 6.9% from 25.9% over the same periods.

Second, as the principal service export, tourism has also moderated since 2011. Receipts from tourism to GDP accounted for 3.4% in 2013, down from 4.7% in 2011. The decline in receipts since 2011 largely reflects the significant slowdown among neighbors and in the global economy. Argentina is by far the main source of tourism revenues, contributing to more than half of tourist arrivals and receipts during 2006-2013. Tourism from Argentina appears to have been supported in part by efforts of Argentine residents to get around foreign exchange restrictions. Macroeconomic instability in Argentina and further efforts by the Argentine government to restrict spending by Argentine residents abroad will likely have a significant impact on tourism in Uruguay.

Third, the high level of investment, which has provided the economy with a stable source of external financing and helped diversify the export sector, is also vulnerable to volatility from external markets. FDI increased from 1.4% of GDP in 2001 to 5.0% in 2013. Attracted by Uruguay's stable regulatory and policy framework and predictable macroeconomic policies, foreign investment has flowed into a variety of sectors, including agriculture, construction, and manufacturing. As Uruguay integrates into the world economy, it is positioning itself to benefit from productivity spillovers and industry innovation, enabling the economy to expand at a faster rate. However, Argentina has increased its importance as a source of direct investment and accounted for 37% of total FDI inflows in 2012, up from 19% in 2002 and 28% in 2007. As with tourism, further restrictions by Argentine authorities that impede regional capital flows could negatively affect FDI in Uruguay.

While Uruguay growth remains sensitive to external factors, the country has built a reserve buffer to manage shocks. At $16.6 billion, reserves equal 12 months of 2013 imports, roughly 30% of GDP, and over 250% of short term debt. The moderate international investment position of -15.1% of GDP has slightly widened from the -7.7% of GDP average from 2004-2009, but this reflects higher FDI liabilities. Conversely, liabilities from portfolio investments and nonresident deposits have substantially declined. These factors increase Uruguay's resilience to withstand external shocks.

Political Environment

Last election:	October 25, 2009
Next election:	October 26, 2014
Party in power:	Coalition – Broad Front (Frente Amplio)
Senate:	Broad Front holds 16 of 31 seats
Chamber of Deputies:	Broad Front holds 50 of 99 seats
President:	José Mujica – Broad Front

Since the 1984 general elections ended Uruguay's civic-military dictatorship, national elections (held every five years) have resulted in peaceful political transitions. Power has alternated between the National Party (NP), Colorado Party (CP), and the leftist coalition Broad Front (BF). The combination of a proportional representation system that encourages coalitions within the legislature, a centrist electorate and relatively infrequent elections provides a strong sense of stability and encourages a focus on long-term policy goals. Transparency International's 2013 Corruption Perceptions Index ranks Uruguay as the least corrupt country in Latin America and placed it as 19^{th} least corrupt of 177 countries.

The basic pillars of macroeconomic and social policy enjoy broad support across the political spectrum. Uruguay is holding elections for the presidency and the General Assembly in October of this year. According to the May 2014 CIFRA opinion poll, the BF has a strong majority lead against the main opposition NP. 44% of eligible voters said they would vote for the Broad Front candidate, compare against 30% for the NP and 18% for the CP. Likely Broad Front candidate and former president Tabaré Vázquez has overwhelming support within the coalition and among the public. Polling suggests that Vázquez is expected to face Pedro Bordaberry (CP) and Jorge Larrañaga (NP).

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Uruguay: Selected Indicators
For the year ended December 31

(US$ billions unless otherwise noted)	2008	2009	2010	2011	2012	2013
Public Sector Debt						
Pubic Sector Debt	17.7	23.0	23.9	27.0	31.1	33.1
% GDP	58.2%	74.8%	61.4%	57.3%	62.2%	59.5%
Non-Financial Public Sector Debt	14.9	18.3	17.8	19.5	23.5	23.0
% GDP	48.9%	59.5%	45.8%	41.2%	46.9%	41.2%
Net Public Sector Debt	8.3	11.2	12.3	13.2	13.7	13.1
% GDP	27.1%	36.4%	31.6%	27.9%	27.3%	23.5%
Domestic Debt						
Public Sector	6.6	9.8	10.7	12.6	14.5	15.1
% GDP	21.8%	32.1%	27.5%	26.7%	28.9%	27.1%
External Debt						
Public Sector	11.1	13.1	13.2	14.4	16.7	18.1
% GDP	36.4%	42.7%	33.9%	30.6%	33.3%	32.4%
Private Sector	4.4	4.9	5.2	3.9	4.5	4.8
% GDP	14.3%	15.8%	13.5%	8.3%	8.9%	8.7%
Total External Debt	15.4	18.0	18.4	18.3	21.1	22.9
% GDP	50.7%	58.5%	47.4%	38.8%	42.2%	41.1%
Fiscal Balances (% GDP)						
Revenues	26.9%	29.0%	30.2%	29.0%	28.5%	33.1%
Expenditures	25.7%	28.2%	28.5%	27.2%	28.7%	32.7%
Interest Payments	2.9%	2.9%	3.1%	2.9%	2.6%	3.0%
Interest Payments (% Revenues)	10.9%	10.0%	10.1%	10.1%	9.1%	9.2%
Central Government Primary Balance	1.4%	1.2%	1.9%	2.0%	-0.2%	0.5%
Central Government Balance	-1.6%	-1.7%	-1.1%	-0.9%	-2.8%	-2.4%
Balance of Payments & Liquidity						
Current Account Balance	-1.7	-0.4	-0.7	-1.4	-2.7	-3.1
% GDP	-5.7%	-1.2%	-1.9%	-2.9%	-5.4%	-5.6%
Trade Balance (% GDP)	-3.2%	1.7%	1.6%	0.2%	-2.6%	-2.4%
Net Foreign Direct Investment (% GDP)	7.0%	4.9%	6.0%	5.3%	5.4%	5.0%
External Liquidity Ratio (%)	131.9%	165.4%	148.8%	155.1%	90.7%	80.0%
International Reserve	6.4	8.0	7.7	10.3	13.6	16.3
International Investment Position	-2.0	-3.2	-2.5	-4.8	-7.6	na
% GDP	-6.7%	-10.4%	-6.4%	-10.2%	-15.1%	na
External Assets	22.6	26.9	28.8	29.1	33.1	na
External Liabilities	24.6	30.1	31.3	34.0	40.6	na

Source: Central Bank of Uruguay, Ministry of Economy and Finance, National Statistics Institute, DBRS.
Note: Public sector includes the central government, public companies, local governments and the Central Bank of Uruguay. Non-financial public sector includes the central government, public companies and local governments. Net public sector debt is gross public sector liabilities minus liquid financial assets. External liquidity ratio = (International reserves + Exports of goods, services and income + Net transfers) / (Amortizations + Short-term external debt + Imports of goods, services and income).

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Ratings History

Issuer	Debt Rated	Current	2013	2012	2011
Uruguay, Oriental Republic of	Long-Term Foreign Currency Debt – Issuer Rating	BBB (low)	BBB (low)	BB (high)	BB
Uruguay, Oriental Republic of	Long-Term Local Currency Debt – Issuer Rating	BBB (low)	BBB (low)	BB (high)	BB
Uruguay, Oriental Republic of	Short-Term Foreign Currency Debt – Issuer Rating	R-2 (middle)	R-2 (middle)	R-3	NA
Uruguay, Oriental Republic of	Short-Term Local Currency Debt – Issuer Rating	R-2 (middle)	R-2 (middle)	R-3	NA

Notes:
All figures are in US Dollars unless otherwise noted.

This rating is endorsed by DBRS Ratings Limited for use in the European Union.