Uruguay *Debt Report*

A quarterly report issued by the Debt Management Unit January 2010

Executive

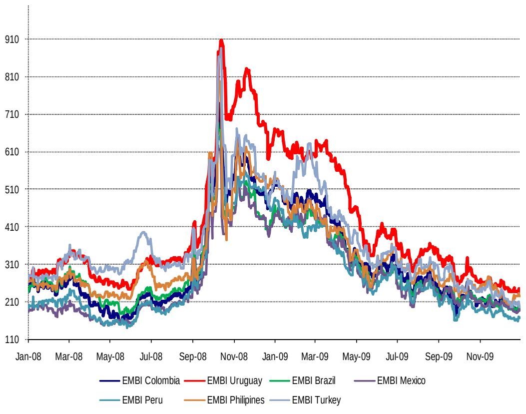
Uruguay was able to sail successfully through the financial turbulence in 2009 thanks to its precautionary financing strategy which focused in the <u>reduction of the roll-over risk</u>.

At the beginning of 2009, Uruguay had a solid financial position, a web of contingent credit lines with multilateral organizations and had reduced its debt amortizations due in the short term through liability management operations and private buybacks. A pre-financing policy had been put in place, so that the central government had at every moment, enough liquid assets to cover the financial needs for the next twelve months. This pre-funding rule together with a smooth debt amortizations profile enabled Uruguay to be well prepared to face the consequences of the Lehman event. Uruguay was able to keep out of the private markets during the first semester of 2009 until its funding costs reached pre-crisis levels.

After the Lehman event in September the financial turbulence had spilled to emerging economies and Uruguay was also being hit. This is clearly illustrated by Uruguay´s Emerging Markets Bond Index (EMBI) performance which was around 300 bps in the first half of 2008 and after the Lehman collapse reached 900 bps, closing the year at 685 pbs. (Graph 1)

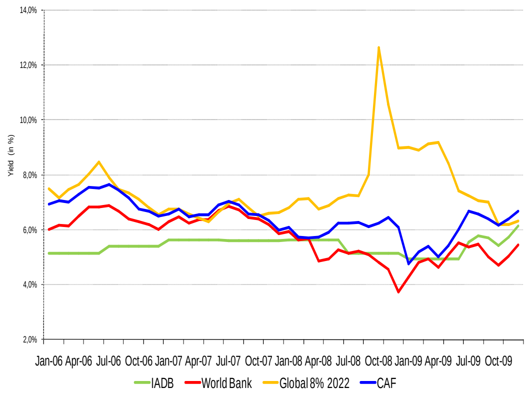
At the beginning of 2009, Uruguay´s cost of funding in the private capital market for a 10 year dollar bond, which was the instrument by then demanded by investors, was around 10%. At that time, disbursing resources from the multilateral institutions was much cheaper than from the private capital market (Graph 2). Uruguay quickly drew the contingent credit lines negotiated in the second half of 2008 with the Inter-American Development Bank (IADB), World Bank (WB) and Corporación Andina de Fomento (CAF). During the first half of 2009, Uruguay disbursed more than 1 billion USD from these banks at an annual average cost of around libor + 49 pbs and an average maturity of seventeen years. The amount disbursed constitutes a track record that reflects Uruguay´s ability to work with multilateral institutions and their willingness to support Uruguay.

Graph 1
Emerging Markets´ and Uruguay´s Spread
In basis points



Source: Bloomberg

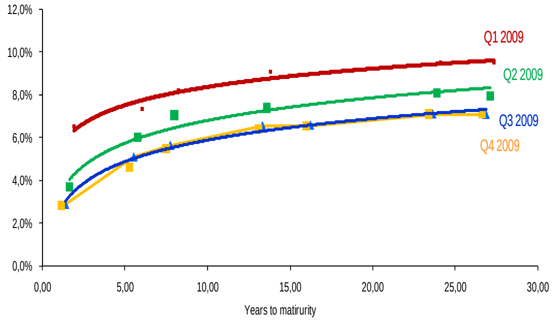
Graph 2
Uruguay´s Funding Cost
Dollar Swap Rate Equivalent (Annual, %)



Source: DMU calculations based on rates from IADB, World Bank, CAF and Bloomberg's quotations for 2022

Gradually, Uruguay´s performance in the capital markets improved at a higher pace than the rest of emerging markets, since it had been more punished than other sovereign bonds that traded at similar levels (Graph 1). Uruguay´s EMBI started 2009 in 685 bps and showed a descending path during the year, closing at 238 pbs. This level is practically aligned with the pre-Lehman country risk level (Graph 3).

Graph 3
Uruguay´s Dollar Yield Curve
Annual Rates (%)



Source: Bloomberg

Given that fact, in July 2009 Uruguay restarted its weekly bonds` auctions in the domestic market. The instrument offered was a 10 year bullet USD Bond whose yield evolved aligned with Uruguay´s USD Global Bond curve. The resources provided by the local capital markets for the whole 2009 were around 120 million USD. The return to the domestic market helped in the price discovery for the issuance of a new bond in the international market. In September Uruguay issued a USD 2025 Global Bond, with a size of 500 million USD, at a yield of 6.875% and a spread of 340.3 bps over the corresponding US benchmark. It is worth noting that the coupon of the Global 2025 is the lowest fixed coupon in dollars paid by Uruguay for a Global Bond.

The second main guideline in the 2009 financial strategy was to reduce the interest rate risk. At the beginning of that year, 19% of the central government´s indebtedness was contracted at floating interest rate. Most of them pertained to loans with multilateral institutions. In the third quarter of 2009, a steeper interest rate curve for United States´ instruments and the ascending evolution of the swap rate throughout the year justified swap operations to fix floating rates. Moreover, these actions made feasible to set fixed long term rates at very low levels. At the end of 2009, the percentage of the portfolio with variable rate had been halved.

Ratings Improvement in spite of International Events

Throughout 2009 Uruguay´s credit risk measured by Rating Agencies improved, in spite of the uncertainty in the financial world. At the beginning of the year, Moody´s upgraded the foreign and local currency bond ratings of Uruguay´s government to Ba3 from B1, in line with the rest of the ratings. This movement was supported by a steady improvement in the government´s overall debt profile. In July, the Japanese Rating R&I assigned a BB rating to the foreign currency issuer, which was previously BB-. In the second half of the year, Fitch and DBRS changed Uruguay´s outlook to Positive from Stable, while S&P reaffirmed the Stable Outlook.

The improvement in Uruguay´s creditworthiness position shows its continuous commitment to fiscal discipline and a prudent management of its financial liabilities.

Central Government Risk Indicators

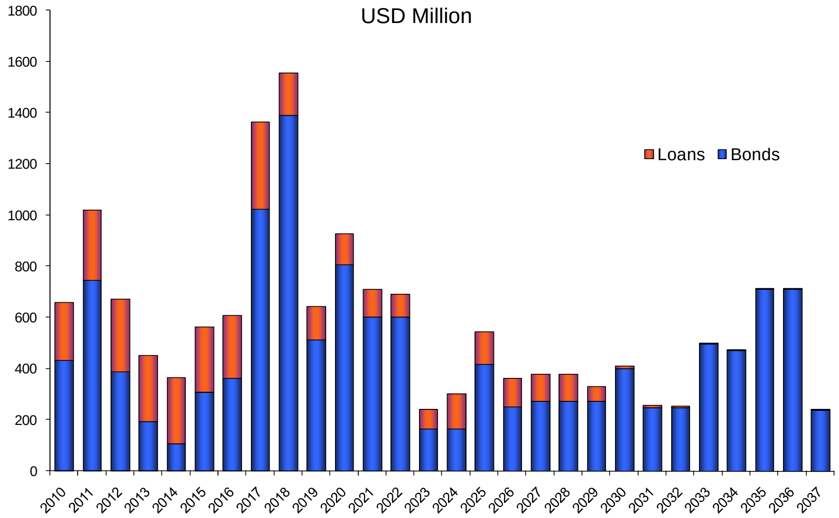
	IV.2004	IV.2005	IV.2006	IV.2007	IV.2008	IV.2009
Roll Over Risk						
ATM (years) (1)	7.4	7.9	12.1	13.6	13.0	12.7
% debt due in one year	11.3%	16.0%	4.8%	2.9%	2.3%	3.6%
Interest Rate Risk						
% debt that refixes rate in one year	32%	34%	22%	18%	20%	11%
ATR (years) (2)	4.9	6.6	11.1	12.3	11.8	11.9
Duration (years)	4.6	8.0	8.9	10.4	9.8	10.3
% debt with Fixed Rate	77%	78%	82%	83%	81%	90%
% debt with Floating Rate	23%	22%	18%	17%	19%	10%
Foreign Currency Risk						
% debt in Units linked to CPI	11%	11%	15%	26%	28%	31%
% debt in dollars	62%	64%	77%	65%	64%	63%
% debt in other currencies	26%	25%	8%	9%	8%	7%
Debt Composition by Instrument						
Loans	44%	40%	18%	17%	19%	21%
Bonds	56%	60%	82%	83%	81%	79%
Debt Composition by Jurisdiction						
Local Market	22%	22%	23%	21%	16%	16%
External Market	78%	78%	77%	79%	84%	84%
Average Interest Rate (annual % by currency)						
Dollars	6.1	7.8	7.0	7.1	7.0	6.4
Units Linked to CPI	7.1	5.4	5.3	4.4	4.3	4.3
Euros	6.9	6.9	6.9	6.9	6.9	6.9
Yens	2.5	2.5	2.5	2.3	2.3	2.3

(1) Average time to Maturity

(2) Average time to Refix

Central Government Debt Profile

USD Million



Central Government Flow of Funds

USD Million

	2009	2010
USES	**1388**	**1807**
Interests Payments	857	970
Amortizations	363	669
Loans	199	229
Bonds	164	440
Others	169	168
SOURCES	**1388**	**1807**
Primary Surplus	370	350
Multilaterals Disbursements	1107	400
Local Market Issuances	123	150
International Market Issuances	500	0
Others	93	184
Use of Assets*	-805	723

***Positive indicates a reduction in reserves**

Source: Debt Management Unit

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