Aug 09, 2013

R&I Affirms BB+, Stable: The Oriental Republic of Uruguay

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **The Oriental Republic of Uruguay**
Foreign Currency Issuer Rating: BB+, Affirmed
Rating Outlook: Stable

RATIONALE:

Uruguay has a certain growth potential thanks to solid foreign direct investments. The fiscal and financial systems remain sound, and its resilience to external shocks has been strengthened. These improving trends in the economic base are broadly in line with R&I's expectation when it upgraded the Foreign Currency Issuer Rating for Uruguay to BB+ in July 2012. Accordingly, R&I has affirmed the rating. The Rating Outlook is Stable. Nevertheless, the prospects for the global economy are becoming increasingly uncertain, as emerging market economies are slowing down. Attention needs to be paid to whether Uruguay will be able to sustain its investment-led growth even in such circumstances. The inflation rate remains stubbornly high, and its impact on the country's competitiveness and financial environment continues to be watched closely. Although inflation controlling measures have been enhanced recently, their effects are unknown. R&I will keep an eye on future developments.

Uruguay is the only country in South America that minimized the economic downturn caused by Lehman Brothers' bankruptcy. In 2012, its economy grew 3.8% supported by solid foreign investment inflows, while neighboring Brazil and Argentina experienced a significant slowdown. Although the drought that hit the country in that year led to a sudden increase in fuel imports and increased pressure on fiscal and balance of payments positions, the government fiscal deficit including that relating to public corporations was held to less than 3% of GDP. As of end-June 2013, the country's international reserves reached approximately US$14.8 billion, the equivalent of more than 12 months of imports of goods and services. Since the diversification of export destinations has increased with China becoming the largest export market, Uruguay's economy is expected to grow about 3% in 2013, in contrast to sluggish growth in neighboring countries.

Uruguay has been struck by heavy drought three times since 2008. The government spending that ballooned every time the disaster occurred has been an issue to be addressed. In order to revise the current energy mix, of which hydropower accounts for 90%, "Energy Policy 2030" has been formulated under the agreement of all political parties. The Policy aims to promote the use of other energy sources such as wind, biomass and LNG. The public-private joint investment project for "Energy Policy 2030" will start in 2013, and related investments are expected to total US$7 billion (equivalent to 17% of nominal GDP for 2012) over the next five years. R&I is paying attention to the government's ability to implement such investment project steadily and achieve economic growth with investment and consumption as key drivers. While the current account balance will remain in deficit for several years due to an increase in imports of capital equipment, etc., about 60% of the investments are projected to come from the private sector beginning with foreign companies. Concerns over the balance of payments are thus small, and the impact on the fiscal position is also limited.

Meanwhile, it will require considerable time for Uruguay to move away from dollarized economy. Whenever the Central Bank of Uruguay tried to control inflation through interest rate policy, which appeared not very effective, the inflation rate had almost hovered above its upper limit of 6%. In July 2013, the tolerance range for inflation was returned to 3 to 7%, the target that had been adopted until two years ago, and in order to achieve the inflation target, numerical targets such as growth in the money supply were set as a yardstick instead of policy rate adjustments. Prior to that change, the framework for wage increases, which used to be linked to past inflation rates, was revised to the one that reflects future inflationary expectations to some extent, and the new framework has already been introduced, mainly in

■Contact : Investors Service Division TEL.+81-(0)3-3276-3511 E-mail. infodept@r-i.co.jp
■Media Contact : Corporate Planning Division (Public Relations) TEL.+81-(0)3-3276-3438
Rating and Investment Information, Inc. Nihonbashi 1-chome Bldg., 1-4-1, Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan http://www.r-i.co.jp

the private sector. If these institutional changes lead to lower inflationary expectations, the rating would be positively affected.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
http://www.r-i.co.jp/eng/cfp/about/methodology/index.html

ISSUER:	**The Oriental Republic of Uruguay**
	Foreign Currency Issuer Rating
RATING:	**BB+, Affirmed**
RATING OUTLOOK:	**Stable**

■Contact : Investors Service Division TEL.+81-(0)3-3276-3511 E-mail. infodept@r-i.co.jp
■Media Contact : Corporate Planning Division (Public Relations) TEL.+81-(0)3-3276-3438
Rating and Investment Information, Inc. Nihonbashi 1-chome Bldg., 1-4-1, Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan http://www.r-i.co.jp