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CREDIT OPINION
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Update

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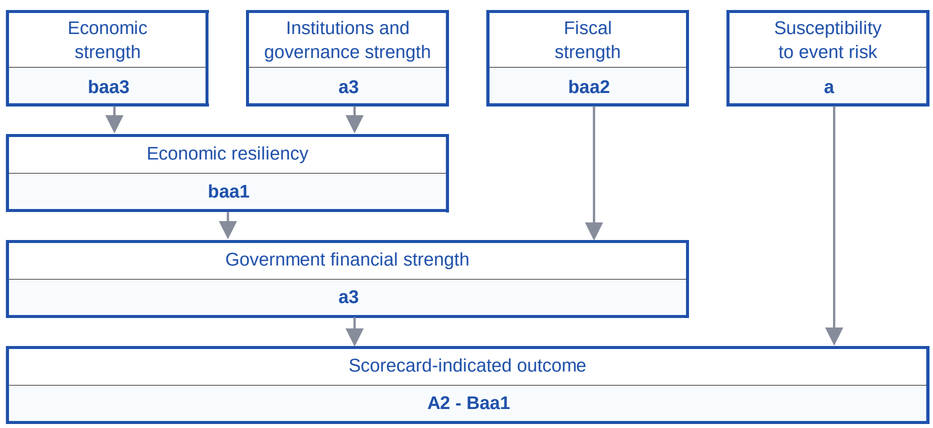
Government of Uruguay – Baa2 positive

Regular update

Summary

The credit profile of Uruguay is supported by its robust institutional strength. Its economic growth in 2022-23 will outpace the weak growth in 2015-19. Prudent fiscal management supports the strengthening fiscal policy credibility. The government is progressing on its reform agenda to address its structural challenges, including relatively low levels of investment and spending rigidities. Compliance with the new fiscal rules will help reduce the government's debt burden over the next two years.

Exhibit 1
Uruguay's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» Strong institutional framework

» Favorable debt maturity profile and moderate government financing needs

» Robust government liquidity buffers

Credit challenges

» Structural rigidities in government spending

» Relatively high share of foreign-currency-denominated government debt

» Low investment levels

Rating outlook

The positive rating outlook reflects a balance between the structural economic and fiscal challenges that Uruguay faced before the pandemic and our expectation that the government will effectively address these issues by implementing reforms and policies. In the five years preceding the pandemic, Uruguay's economic performance lagged that of rating peers partly because of declining levels of investment and a significant loss of jobs; however, since the second half of 2019 this trend is being reversed. The construction of the country's third-largest pulp mill plant will change the trend in terms of investment, and we expect additional government measures to incentivize private investment and drive employment to support a broader recovery.

On the fiscal front, although government spending has a relatively rigid structure, the authorities identified savings and efficiency gains in 2022, and we expect the government to remain compliant with the spending limits set by the new fiscal rule. Over the coming decades, the pension reform will also help address some of these issues.

Factors that could lead to an upgrade

We would upgrade Uruguay's credit rating if the government remains in compliance with fiscal rules that would help stabilize the debt burden. An improved and sustained growth performance, backed by a steady rebound in private investment, would also support a rating upgrade.

Factors that could lead to a downgrade

We could change the outlook back to stable if the reversal of recent fiscal reforms lead to renewed fiscal pressures, or if banking system-related contingent liabilities materialize and require sovereign support. A return to persistently low growth rates would also be credit negative.

Key indicators

Exhibit 2

Uruguay	2018	2019	2020	2021	2022	2023F	2024F	2025F
Real GDP (% change)	0.2	0.7	-6.3	5.3	4.9	0.7	3.2	2.6
Inflation rate (% change average)	7.6	7.9	9.8	7.7	9.1	6.6	5.5	5.8
Gen. gov. financial balance/GDP (%)[1]	-3.1	-3.9	-5.8	-4.1	-3.2	-3.2	-2.7	-2.5
Gen. gov. primary balance/GDP (%)[1]	-0.5	-1.4	-3.0	-1.9	-0.9	-0.8	-0.3	-0.1
Gen. gov. debt/GDP (%)	47.5	50.9	61.7	59.3	55.9	57.3	57.5	57.5
Gen. gov. debt/revenues (%)	177.5	195.4	233.5	234.2	215.0	221.8	224.5	225.8
Gen. gov. interest payment/revenues (%)	9.7	9.5	10.5	8.8	8.8	9.3	9.3	9.4
Current account balance/GDP (%)	-0.5	1.2	-0.8	-2.5	-3.7	-4.1	-3.7	-2.9
External debt/CA receipts (%)[2]	223.4	236.1	315.8	230.6	217.5	213.0	210.1	203.9
External vulnerability indicator (EVI) [3]	107.5	98.8	108.9	97.7	106.1	138.0	130.3	--

[1] Excludes pension transfers and includes interest payments related to the 'cincuentones' law starting in 2018.
[2] Current Account Receipts
[3] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves

Source: Moody's Investors Service

Detailed credit considerations

Uruguay's credit quality incorporates our "baa3" **economic strength** assessment on a global basis, reflecting its moderate growth potential and relatively high income per capita, counterbalanced by the small size of the economy. At $71 billion in 2022, the Uruguayan economy was smaller than the Baa-rated peer median of around $245 billion. The economy expanded by around 4.9% in real terms in 2022, and we expect real GDP to continue to grow by an average of 2.9% per year in 2024 and 2025. UPM-Kymmene's (Baa1 stable) pulp mill plant project has lifted investment levels from the lows registered in 2019 and earlier, and we expect the government's pro-investment agenda to help maintain the current investment levels.

Our “a3” assessment for Uruguay's **institutions and governance strength** balances the country’s strong institutional framework, which reinforces policy predictability, against its still-evolving capabilities to effectively and credibly implement such policies. The government introduced a new fiscal policy framework in 2020 that features a fiscal rule with structural balance targets, restraints on current expenditure growth and debt ceilings. The government met all of its fiscal rule targets for three consecutive years (2020-22), establishing a limited but growing track record of strong fiscal management. Building a long track record of compliance under this new framework would help reduce fiscal imbalances, and bolster fiscal policy credibility and effectiveness. The authorities have also faced challenges in managing comparatively high inflation rates, which have historically been above the official target range. The central bank in 2020 revamped its monetary policy framework, including the reintroduction of a more proactive policy rate, and was the first in the region to start tightening monetary policy in 2021.

Uruguay's “baa2” **fiscal strength** assessment balances its moderately high government debt burden, very strong asset-liability management practices and fiscal reserve assets with lingering vulnerabilities from a high, although improving, proportion of foreign-currency debt. The government's debt burden of 56% in 2022, when measured as a share of GDP, was in line with the Baa-rated peer median, while its interest burden of 8.8% of revenue was above the Baa-rated peer median of 6.6%. Although the government has managed to reduce the share of foreign-currency-denominated debt over the past two decades, it remained relatively high at 44% as of September 2023, down from 52.7% in December 2021. This exposes the overall debt stock to fluctuations from an exchange-rate depreciation, which, in turn, can lead to a deterioration in the debt-to-GDP ratio. This exchange-rate risk is mitigated by the government's financial assets, which are mostly denominated in foreign currency and provide around 12 months of debt service coverage as of September 2023.

We assess Uruguay's **susceptibility to event risk** at “a,” driven by banking sector risk, government liquidity risk and external vulnerability risk. The banking sector risk assessment of “a” reflects the system’s relatively large size for a Latin American economy, with domestic bank assets equivalent to 79% of GDP in 2022, and a Baseline Credit Assessment of baa3 for the banks we rate, which informs the risk assessment of potential contingent liabilities on the government’s balance sheet.

Uruguay's external vulnerability risk assessment of “a” reflects its large external buffers that mitigate the exchange-rate risks stemming from the country's still-significant degree of financial dollarization. The current account deficit expanded to 3.7% of GDP in 2022 from 2.5% in 2021 because of growth in imports of metals and capital goods linked to major investment and infrastructure projects.

Uruguay's government liquidity risk assessment of “a” balances the government's relatively low gross borrowing requirements — favored by a long maturity profile — against a relatively high share of external debt in total government debt.

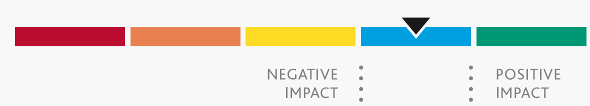
The country's political risk assessment is “aa.” The risk of political events compromising the economic, institutional or fiscal features of Uruguay's credit profile is very low.

ESG considerations

Uruguay's ESG credit impact score is CIS-2

Exhibit 3
ESG credit impact score

CIS-2

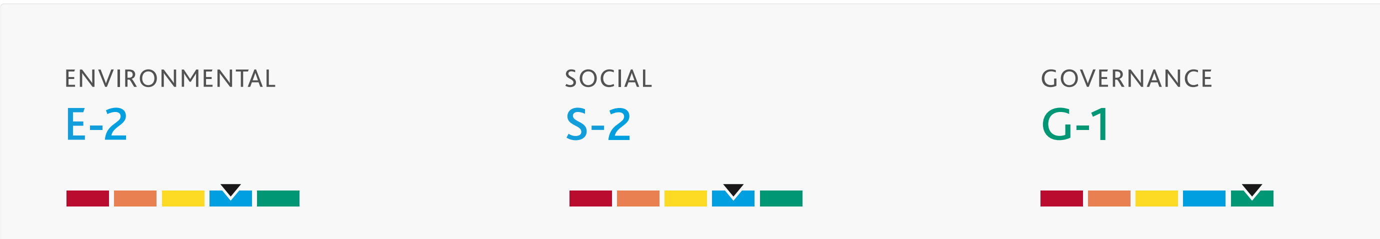


ESG considerations do not have a material impact on the current rating.

Source: Moody's Investors Service

Uruguay's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting its exposure to social risks, exposure to environmental risks and broad societal consensus that supports its governance.

Exhibit 4
ESG issuer profile scores



Source: Moody's Investors Service

Environmental
Uruguay's exposure to environmental risks as neutral-to-low (**E-2** issuer profile score). The country's large coastline is not susceptible to major flooding, and extreme weather events are rare in the region. The main risk is disruptive weather effects like excessive rains or droughts, which would affect the agricultural sector.

Social
Exposure to social risks is neutral-to-low (**S-2** issuer profile score). The country's aging population, coupled with the population's predilection for social expenditure, will weigh on public finances in the coming years absent policies to address the challenges faced by the social security system. A deterioration in the labor market, for the younger population in particular, also poses social risks. However, adequate provision of social services and a mature political system that develops policies based on consensus help mitigate social risks.

Governance
The influence of governance on Uruguay's credit profile is positive (**G-1** issuer profile score). The country has a long history of strong institutions and a consensus-based tradition that leads to durable policy decisions and supports social cohesion.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

The central bank continues the easing cycle in latest Monetary Policy Committee decision
The Monetary Policy Committee (COPOM) cut its policy rate by 25 basis points (bps) to 9.25% in November 2023, bringing the total cut to 225 bps in 2023. As of October 2023, year-over-year inflation in Uruguay was 4.3%, up from 3.9% in September, the lowest inflation point in the last 18 years. It also marked the fifth consecutive month of inflation remaining within the central bank's target range of 3%-6%. The inflation result in October was driven by increases in the transportation and housing sectors. We expect inflation to end 2023 at around 5%, before gradually increasing to the top of the target range at 6% for 2024.

Uruguay reopens sustainability-linked bond for second issuance
On 6 November 2023, Uruguay issued $700 million in a reopening of its sustainability-linked bond with an interest rate of 5.75% due in 2034. The bond features a unique step-down/step-up coupon payment tied to climate and environmental targets that align Uruguay's sovereign debt policy with its Nationally Determined Contribution in the Paris Agreement. Additionally, Uruguay released its first annual report on the bond's two key performance indicator (KPI) targets for the reduction in greenhouse gas (GHG) emissions per real GDP unit and the maintenance of the native forest area. For the former KPI, Uruguay achieved a 41% reduction in the intensity of aggregate gross GHG emissions per real GDP unit in 2021 from the 1990 levels and, for the latter KPI, attained 100% maintenance

of native forest area in 2021 with respect to 2012 (the baseline year). The main reasons cited for not achieving the 50% target for the GHG emissions KPI were export of electricity sourced by fossil fuels to neighbors Brazil (Ba2 stable) and Argentina (Ca stable), and the use of synthetic nitrogen fertilizers in the expanded production of certain crops like wheat and barley, among others.

12-month headline fiscal deficit for September remained at 4%

The Ministry of Economy and Finance reported a headline fiscal deficit of 4% for the 12 months that ended in September 2023, unchanged from the August result. Weaker-than-expected revenue and lower-than-expected inflation drove this result, but both metrics are likely to reverse in the last quarter of 2023. The year-end result for the structural deficit (pillar one of the fiscal rule) should be close to the target of -2.5% but will ultimately depend on GDP growth. We maintain our forecast of a 3.2% fiscal deficit for 2023, which will decrease slightly to 2.7% of GDP in 2024, with chances of a higher deficit for 2023 if the economic recovery is not as robust or if inflation remains low.

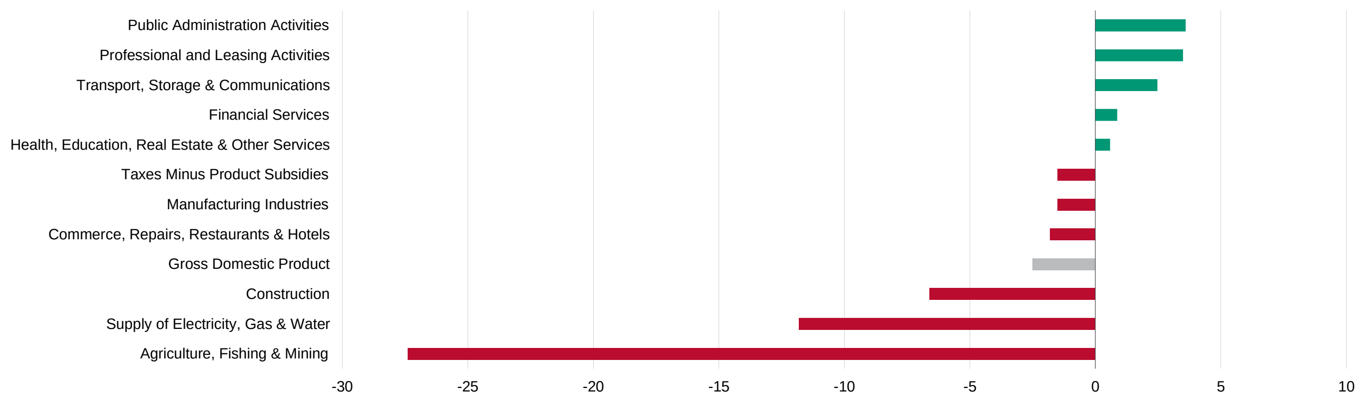
Economic growth in Q2 2023 slowed significantly because of drought conditions

GDP data for Q2 2023 showed a 2.5% contraction from Q2 and a 1.4% contraction from Q1. In its report, the central bank highlighted that the country's drought, now the longest on record, adversely affected the agriculture, fishing and mining sector, which contracted 27.4% year-on-year in terms of economic activity (see Exhibit 5). In 2023, we expect the economy to grow by 0.7%, with production declines in soybeans, beef and other agricultural products mitigated by increased tourism and pulp production.

Exhibit 5

The drought led to a large decline in economic activity in the agriculture, fishing and mining sector

Year-on-year change in economic activity by sector (in percentage terms)



Sources: Central Bank of Uruguay and Haver Analytics

This most recent drought in Uruguay began in 2020. It indicates the potential effects of climate change and weather phenomenon, such as El Niño, on the duration and intensity of these disruptive weather events. We assign an issuer profile score of E-2 to Uruguay's exposure to environmental risks, with the main risk being disruptive weather events like excessive rain or drought. The latest monthly economic activity indicator (IMAE) from September illustrated inter-annual decline of 0.2%, after an expansion of 0.1% in August and highlights that the impact of the drought on economic activity may finally be subsiding given that in the four months prior to August, the IMAE averaged an inter-annual decline of 2%.

Moody's rating methodology and scorecard factors: Uruguay - Baa2 positive

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				baa3	baa3	50%
Growth dynamics	Average real GDP growth (%)	2018-2027F	1.6	ba3		25%
	MAD Volatility in Real GDP Growth (%)	2013-2022	1.7	ba2		10%
Scale of the economy	Nominal GDP ($ billion)	2022	71.2	ba1		30%
National income	GDP per capita (PPP, Intl$)	2022	27,769.8	a1		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				a3	a3	50%
Quality of institutions	Quality of legislative and executive institutions			a		20%
	Strength of civil society and the judiciary			aa		20%
Policy effectiveness	Fiscal policy effectiveness			baa		30%
	Monetary and macroeconomic policy effectiveness			baa		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				baa1	baa1	
Factor 3: Fiscal strength				baa2	baa2	
Debt burden	General government debt/GDP (%)	2022	55.9	baa2		25%
	General government debt/revenue (%)	2022	215.0	baa1		25%
Debt affordability	General government interest payments/revenue (%)	2022	8.8	a2		25%
	General government interest payments/GDP (%)	2022	2.3	a3		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-2	-2	max ±6
	Debt Trend - Historical Change in Debt Burden	2014-2022	19.2	0	0	
	Debt Trend - Expected Change in Debt Burden	2022-2024F	1.5	0	0	
	General Government Foreign Currency Debt/ GDP	2022	26.5	-2	-2	
	Other non-financial public sector debt/GDP	2022	2.5	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2022	2.4	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				a3	a3	
Factor 4: Susceptibility to event risk				a	a	Min
Political risk				aa		
	Domestic political risk and geopolitical risk			aa		
Government liquidity risk				a	a	
	Ease of access to funding			a		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	baa3	baa3		
	Total domestic bank assets/GDP	2022	67.1	<80		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				a	a	
	External vulnerability risk			a		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				A2 - Baa1	A2 - Baa1	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

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