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Morningstar DBRS Confirms Uruguay at BBB, Stable Trend

Industry Group: Public Finance – Sovereigns
Region: Americas

DBRS, Inc. (Morningstar DBRS) confirmed the Oriental Republic of Uruguay's (Uruguay) Long-Term Foreign and Local Currency – Issuer ratings at BBB. At the same time, Morningstar DBRS confirmed Uruguay's Short-Term Foreign and Local Currency – Issuer ratings at R-2 (high). The trend on all ratings is Stable.

KEY CREDIT RATING CONSIDERATIONS

The confirmation of the Stable trend reflects Morningstar DBRS' view that risks to Uruguay's credit ratings are balanced. The Uruguayan economy is rebounding after being hit by several shocks in 2023, including a severe drought and weak demand from Argentina. The IMF expects GDP to expand by 3.2% this year, supported by recoveries in the agricultural and energy sectors. The labor market is healthy, with the employment rate reaching its highest level since 2015 and real income increasing at a solid pace. Inflation stood at 5.0% (year-over-year) in October 2024, marking the 17th consecutive month of inflation running within the central bank's target range. In the first 9 months of the year, the central government deficit (excluding cincuentones transfers) was 3.4% of GDP, which is slightly higher than budgeted. Lower-than-expected inflation led to lower tax receipts while expenditures were committed with higher inflation expectations. The government debt-to-GDP ratio is somewhat high at 65% but is expected to remain stable over the next five years as fiscal policy gradually tightens. The second round of the presidential election is scheduled for November 24. We do not expect the direction of macroeconomic policy to change regardless of who wins the presidency.

Uruguay's credit ratings are supported by predictable macroeconomic policymaking and strong governing institutions, which counterbalance the country's moderate levels of productivity, partially dollarized financial system, and limited financial depth. As a small economy focused on agricultural commodity exports, Uruguay is subject to global price shocks. The greater likelihood of frequent and severe weather events may also pose a risk to the country. Recent reforms, such as enhancements to the fiscal framework and the passage of pension reform, have strengthened the country's public finances and the debt-to-GDP trajectory looks sustainable over the forecast horizon. Additionally, ample foreign exchange reserves, conservative public debt management, and sound regulation of the banking system bolster the economy's defenses to shocks.

CREDIT RATING DRIVERS

The credit ratings could be upgraded if one or a combination of the following factors occurs: (1) continued fiscal consolidation, which places the public debt ratio on a firm downward trajectory over the medium term and provides greater fiscal space; or (2) increased levels of investment which boost medium-term growth prospects.

The credit ratings could be downgraded if (1) there is a sustained deterioration in the fiscal trajectory, or (2) external buffers erode over time, thereby weakening Uruguay's resilience to adverse shocks.

CREDIT RATING RATIONALE

Moderate Electorate Rejects Social Security Plebiscite

Uruguayan general elections were held on October 27, 2024. In the presidential election, Yamandú Orsi (of the center-left Frente Amplio coalition) won 43.9% of the vote, ahead of the National Party's Álvaro Delgado with 28.8% and Andrés Ojeda of the Colorado Party with 16.9%. Since no candidate secured a majority in the first round, a runoff election between Orsi and Delgado will take place on November 24, 2024. In the General Assembly, control of the Senate flipped to the Frente Amplio, while neither coalition achieved a majority in the lower house. Given the composition of the General Assembly, passing legislation will require cross-party cooperation regardless of who wins the presidency. Additionally, voters rejected a plebiscite to reform the social security system which would have lowered the retirement age to 60, raised the lowest pensions to equal the minimum wage, and eliminated private pension administrators. The failure of the social security plebiscite avoided a significant strain on public finances over the medium term, as well as potential legal challenges for the incoming government.

Uruguay's political environment is a key credit strength. Regardless of who wins the presidency, there is broad consensus across the political spectrum on Uruguay's sound macroeconomic policy framework. The presidential candidates are broadly aligned on the importance of sustainable public finances, price stability, and sound regulation of the financial system. In addition, both candidates aim to improve Uruguay's competitiveness through micro reforms and increased trade openness, although the candidates' specific proposals may differ. Uruguay is a stable liberal democracy with an effective government and low levels of corruption. The country scores highly across a range of international governance measures. A centrist electorate facilitates political moderation and pragmatic policymaking. The predictability of the policy framework through the electoral cycle fosters a favorable environment for economic growth.

Robust Economic Recovery Supported By The Rebound In The Agricultural Sector, Outlook For Growth Is Positive

Uruguay's economy is experiencing a robust economic recovery after one of the most severe droughts in the country's history. The drought, which impacted the agricultural and energy sectors into first half of 2023, resulted in a sharp decline agricultural exports and energy production. As a result, Uruguay registered a modest growth rate of 0.4% in 2023. However, weather conditions normalized in 2024. Agricultural commodity exports have risen sharply, registering year-on-year growth of 23% in the second quarter of 2024. Private consumption moderated in the first half of the year as real wage growth decelerated from high rates in 2023. Labor market conditions remain robust, with the employment rate reaching its highest level since 2015. The IMF expects GDP to grow by 3.2% in 2024 and 3.0% in 2025. Growth could outperform expectations if large investment projects, such as the planned green hydrogen plant by Chilean company HIF Global, are realized over the medium-term.

Uruguay's external accounts do not exhibit any large imbalances. The current account deficit narrowed to 1.9% of GDP in the second quarter of 2024 (rolling 4 quarters) from 3.4% in the same period last year. The decline can be attributed to the completion of the construction phase of the pulp mill and subsequent commencement of production. Construction-related imports declined, while exports of pulp products increased. Agricultural commodity exports, particularly soybeans, also increased as the economy recovered from the drought. The depreciation of the real effective exchange rate relative to Argentina also contributed to a decline in imports and tourism-related expenditures from Uruguayan citizens travelling abroad. Exchange rate flexibility continues to help the economy adjust to evolving global conditions. Additionally, USD 18 billion (24% of GDP) in reserves provides the central bank with substantial foreign exchange liquidity in the event of turbulence in global financial markets.

Inflation Continues to Run Within the Target Range

Annual inflation stood at 5.0% as of October 2024, marking 17 consecutive months within the central bank's target range of 3-6%. Twelve-month inflation expectations are gradually declining and are now just under 6%. The central bank, aiming to bring inflation closer to the midpoint of the target range, has maintained a slightly contractionary stance by keeping the policy rate at 8.5% since April 2024. While tradable goods inflation has declined substantially, inflationary pressures for non-tradable goods have been slower to fall. The challenge of anchoring expectations for the central bank is complicated by the weak transmission of monetary prices policy amid high financial dollarization and low financial intermediation.

The banking system has weathered the COVID-19 shock and the global interest rate shock relatively well. Uruguayan banks are profitable, highly liquid, and well-capitalized. Risks to the banking system stemming from events in Argentina are also contained, with non-resident deposits accounting for less than 8% of total bank deposits and only 5% of loans directed to non-residents.

The Next Administration Will Inherit Limited Fiscal Space; Prudent Debt Management Reduces Risks To Debt Sustainability

The government has made substantial progress in fiscal consolidation relative to 2020. After the deficit widened in the wake of the COVID-19 pandemic, the government tightened policy primarily by limiting public sector wage growth and controlling discretionary spending. The headline central government deficit (excluding the 'cincuentones' pension transfers) narrowed from 5.8% of GDP in 2020 to 3.3% in 2022. However, the deficit came in at 3.3% in 2023 and increased modestly through the first 9 months of this year, largely due to the impact of the drought on tax revenues and lower-than-budgeted inflation.

The next administration will inherit relatively limited fiscal space. Pension and transfer payments account for close to 70% of central government expenditures. Backward-looking indexation of wages and pension benefits restrict the headroom to pursue policy objectives without additional fiscal reform. Both presidential candidates have indicated their intention to maintain the fiscal framework introduced by the Lacalle Pou administration, with the potential for minor modifications, which should help to foster prudent fiscal policy. The IMF projects a gradual fiscal consolidation over the next five years. However, given rigidities in the spending profile, Morningstar DBRS believes that the risks to the projected deficit trajectory are skewed to the upside. This view, combined with the statistical effect of the 'cincuentones' transfers, accounts for the adjustment to the Fiscal Management and Policy building block assessment.

The government debt-to-GDP ratio is expected to remain on stable trajectory over the medium term. According to the IMF, the non-financial public sector debt increased from 60% of GDP in 2019 to 68% in 2020 due to the pandemic-related fiscal response and economic recession. The ratio is expected to increase to 65% this year and stabilize at that level over the forecast horizon. This represents a slight improvement in the expected debt trajectory relative to past expectations (for example, in October 2021 the IMF projected the debt ratio to stabilize around 71% (see DBRS Morningstar Changes Trend on Uruguay to Positive, Confirms at BBB (low)). However, the currency composition of the debt stock presents some risk. Although the share of central government debt denominated in foreign currency declined from 55% in 2020 to 44% in the second quarter of 2024, it remains somewhat elevated and leaves public finances vulnerable to exchange rate shocks.

Nevertheless, conservative public debt management supports Uruguay's credit profile. Rollover and liquidity risks are minimal. Liquid assets held by the central government combined with loans and contingent credit lines from multilateral organizations largely cover 69% of debt servicing needs for the next 12 months. Exposure to interest rate risk is also limited due to the long average maturity of government debt (12.3 years) and the high share of debt that carry fixed rates (92%). The government continues to prioritize growing the share of local currency issuances in the domestic market, which should gradually reduce exchange rate risk.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

ESG Considerations had a significant effect on the credit analysis.

Environmental (E) Factors

The following Environmental factor had a relevant effect on the credit analysis: Climate and Weather Risks. Uruguay faces occasional droughts which impact agriculture output and electricity generation. This factor has been taken into account in the Economic Structure and Performance building block.

Social (S) Factors

The following Social factor had a significant effect on the credit analysis: Human Rights and Human Capital. Uruguay's per capita GDP is relatively low at USD 23,053 in 2024, reflecting a low level of labor productivity. This factor has been taken into account in the Economic Structure and Performance building block.

There were no Governance factors that had a relevant or significant effect on the credit analysis.

A description of how Morningstar DBRS considers ESG factors within the Morningstar DBRS analytical framework can be found in the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Factors in Credit Ratings (August 13, 2024) https://dbrs.morningstar.com/research/437781

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments.

Notes:
All figures are in US dollars unless otherwise noted. Public finance statistics reported on a general government basis unless specified.

The principal methodology is the Global Methodology for Rating Sovereign Governments (July 15, 2024) https://dbrs.morningstar.com/research/436000. In addition Morningstar DBRS uses the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Factors in Credit Ratings https://dbrs.morningstar.com/research/437781 in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: https://dbrs.morningstar.com/about/methodologies.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. Morningstar DBRS' outlooks and credit ratings are monitored.

The primary sources of information used for these credit ratings include Ministerio de Economía y Finanzas, Banco Central del Uruguay, Instituto Nacional de Estadística, Superintendencia de Servicios Financieros, the IMF, the World Bank, Bank for International Settlements, and Macrobond.

Morningstar DBRS considers the information available to it for the purposes of providing these credit ratings was of satisfactory quality.

The credit rating was initiated at the request of the rated entity.

The rated entity or its related entities did participate in the credit rating process for this credit rating action.

Morningstar DBRS did not have access to the accounts, management and other relevant internal documents of the rated entity or its related entities in connection with this credit rating action.

This is a solicited credit rating.

The last credit rating action on this issuer took place on November 20, 2023.

Lead Analyst: Michael Heydt, Senior Vice President, Sector Lead, Global Sovereign Ratings
Rating Committee Chair: Thomas R. Torgerson, Managing Director, Global Sovereign Ratings
Initial Rating Date: February 28, 2008

For more information on this credit or on this industry, visit dbrs.morningstar.com.

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Issuer	Debt Rated	Credit Rating Action	Credit Rating	Trend
Uruguay, Oriental Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB	Stable
Uruguay, Oriental Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	BBB	Stable
Uruguay, Oriental Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (high)	Stable
Uruguay, Oriental Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (high)	Stable

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Uruguay

Scorecard Indicators

Fiscal Management and Policy	2018	2019	2020	2021	2022	2023	2024	2025	2026	Source	Current Scorecard Input	
Overall Fiscal Balance (% of GDP)	-1.9%	-2.7%	-4.7%	-2.6%	-2.5%	-3.1%	-3.0%	-2.6%	-2.5%	IMF WEO	13 year average	-2.7%
Government Effectiveness (Percentile Rank)	70.5	73.3	75.2	75.2	77.4	79.2	-	-	-	World Bank	5 year average	76.1
Debt and Liquidity	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**			
General Government Gross Debt (% of GDP)	57.9%	59.6%	68.1%	64.1%	60.3%	64.5%	64.7%	65.0%	65.2%	IMF WEO	5 year projection	64.8%
Interest Costs (% of GDP)	2.4%	2.2%	2.6%	2.0%	2.0%	2.1%	2.3%	2.1%	2.0%	IMF WEO	5 year average	2.1%
Economic Structure and Performance	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**			
GDP per Capita (USD thousands)	18.6	17.7	15.2	17.1	19.7	21.7	23.1	24.1	25.1	IMF WEO	10 year average	18.0
Output Volatility (%)	4.4%	4.3%	4.2%	4.0%	3.3%	3.2%	3.2%	3.1%	3.1%	IMF WEO	Latest	3.2%
Economic Size (USD billions)	65	62	54	61	70	77	82	86	90	IMF WEO	5 year average	65
Monetary Policy and Financial Stability	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**			
Rate of Inflation (%, EOP)	8.0%	8.8%	9.4%	8.0%	8.3%	5.1%	5.4%	5.3%	5.1%	IMF WEO	13 year average	7.4%
Total Domestic Savings (% of GDP)	12.1%	11.8%	13.7%	13.6%	13.3%	14.7%	-	-	-	IFS/IMF	Latest[1]	15%
Change in Domestic Credit (% of GDP)	1.2%	1.6%	1.1%	-0.8%	0.7%	2.4%	-	-	-	IFS/IMF	7 year average[1]	0.8%
Net Non-Performing Loans (% of Capital)	-6.9%	-7.8%	-7.1%	-10.2%	-9.8%	-10.6%	-	-	-	IMF IFS	Latest[1]	-10.6%
Change in Property Price/GDP Index (%)	-9.1%	-6.6%	-22.2%	53.4%	-10.9%	16.2%	-	-	-	INE/IMF	7 year average[1]	3.5%
Balance of Payments	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**			
Current Account Balance (% of GDP)	-0.5%	1.2%	-0.7%	-2.5%	-3.9%	-3.8%	-2.7%	-2.6%	-2.4%	IMF WEO	8 year average	-2.2%
International Investment Position (% of GDP)	-23.8%	-25.2%	-30.1%	-24.0%	-20.8%	-21.4%	-	-	-	IMF	5 year average[1]	-24.3%
Share of Global Foreign Exchange Turnover (Ratio)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-	-	-	BIS/IMF	Latest	0.0%
Exchange Rate Classification (see footnote)	3	3	3	3	3	2	-	-	-	IMF	Latest	2
Political Environment	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**			
Voice and Accountability (Percentile Rank)	89.3	88.9	93.7	92.3	92.3	92.2	-	-	-	World Bank	5 year average	91.9
Rule of Law (Percentile Rank)	71.4	73.3	72.9	73.8	75.9	75.9	-	-	-	World Bank	5 year average	74.4

See Morningstar DBRS' Global Methodology for Rating Sovereign Governments for additional details on the methodology behind the scorecard indicators and associated scoring thresholds. Exchange Rate Classifications: Freely floating exchange rate = 1; Float = 2; Crawls, banded pegs, and other managed = 3; Stabilized = 4; Pegs, currency unions and dollarized arrangements = 5.

[1] Scores for 2023 have been computed using the most recent data when year-end data is not available.

Rating Committee Date: 15-Nov-2024

Uruguay

Building Block Assessments and Rating Committee Summary

15-Nov-2024

Building Blocks	Scorecard Result	Quantitative Assessment	Net Impact of Qualitative Factors	Building Block Assessment
Fiscal Management and Policy	15.12	Strong/Good	- 2 Categories	Good/Moderate
Debt and Liquidity	12.32	Good/Moderate	N/A	Good/Moderate
Economic Structure and Performance	5.93	Poor	N/A	Poor
Monetary Policy and Financial Stability	11.39	Good/Moderate	N/A	Good/Moderate
Balance of Payments	12.57	Good/Moderate	N/A	Good/Moderate
Political Environment	18.23	Strong	N/A	Strong
Overall Assessment	**Composite Scorecard Result**	**Scorecard Rating Range**	**Composite Building Block Assessment**	**Indicative Rating Range**
	63.0	A - BBB (high)	59.6	A (low) - BBB

Uruguay's Long-Term Foreign Currency - Issuer Rating BBB

Main topics discussed in the Rating Committee include: the fiscal position and outlook, prospects for economic growth, and the inflation performance. For additional details on Morningstar DBRS analysis and opinions, please see the accompanying rating report.

Morningstar DBRS Scorecard: Scoring Ranges and Associated Assessment Categories

Lower Bound	0.00	1.00	3.00	5.00	7.00	9.00	11.00	13.00	15.00	17.00	19.00
Upper Bound	0.99	2.99	4.99	6.99	8.99	10.99	12.99	14.99	16.99	18.99	20.00
Assessment Category	Very Weak	Weak	Weak/ Poor	Poor	Poor/ Moderate	Moderate	Good/ Moderate	Good	Strong/ Good	Strong	Very Strong

Uruguay, Oriental Republic of

ESG Checklist

ESG Factor		ESG Credit Consideration Applicable to the Credit Analysis: Y/N		Extent of the Effect on the ESG Factor on the Credit Analysis: Relevant (R) or Significant (S)*
Environmental		**Overall:**	**Y**	**R**
	Emissions, Effluents, and Waste	Do the costs or risks result in changes to a government's financial standing or relationship with other governments, and does this affect the assessment of credit risk?	N	N
	Carbon and GHG Costs	Does a government face coordinated pressure from a higher-tier government or from numerous foreign governments as a result of its GHG emissions policies, and does this affect the assessment of credit risk?	N	N
		Will recent regulatory changes have an impact on economic resilience or public finances?	N	N
		Carbon and GHG Costs	**N**	**N**
	Resource and Energy Management	Does the scarcity of key resources impose high costs on the public sector or make the private sector less competitive?	N	N
		Is the economy reliant on industries that are vulnerable to import or export price shocks?	N	N
		Resource and Energy Management	**N**	**N**
	Land Impact and Biodiversity	Is there a risk to a government's economic or tax base for failing to effectively regulate land impact and biodiversity activities?	N	N
	Climate and Weather Risks	Under key IPCC climate scenarios will climate change and adverse weather events potentially destroy a material portion of national wealth, weaken the financial system, or disrupt the economy?	Y	R
	Passed-through Environmental credit considerations	Does this rating depend to a large extent on the creditworthiness of another rated issuer which is impacted by environmental factors (see respective ESG checklist for such issuer)?	N	N
Social		**Overall:**	**Y**	**S**
	Human Capital and Human Rights	Compared with regional or global peers, is the domestic labour force more or less competitive, flexible and productive?	Y	S
		Are labour or social conflicts a key source of economic volatility?	N	N
		Are individual and human rights insufficiently respected or failing to meet the population's expectations?	N	N
		Is the government exposed to heavy, coordinated international pressure as a result of its respect for fundamental human rights?	N	N
		Human Capital and Human Rights	**Y**	**S**
	Access to Basic Services	Does a failure to provide adequate basic services deter investment, migration, and income growth within the economy?	N	N
	Passed-through Social credit considerations	Does this rating depend to a large extent on the creditworthiness of another rated issuer which is impacted by social factors (see respective ESG checklist for such issuer)?	N	N
Governance		**Overall:**	**N**	**N**
	Bribery, Corruption, and Political Risks	Does widespread evidence of official corruption and other weaknesses in the rule of law deter investment and contribute to fiscal or financial challenges?	N	N
	Institutional Strength, Governance, and Transparency	Compared with other governments, do institutional arrangements provide a higher or lesser degree of accountability, transparency, and effectiveness?	N	N
		Are regulatory and oversight bodies insufficiently protected from inappropriate political influence?	N	N
		Are government officials insufficiently exposed to public scrutiny or held to insufficiently high ethical standards of conduct?	N	N
		Institutional Strength, Governance, and Transparency	**N**	**N**
	Peace and Security	Is the government likely to initiate or respond to hostilities with neighbouring governments?	N	N
		Is the government's authority over certain regions contested by domestic or foreign militias?	N	N
		Is the risk of terrorism or violence sufficient to deter investment or to create contingent liabilities for the government?	N	N
		Peace and Security	**N**	**N**
	Passed-through Governance credit considerations	Does this rating depend to a large extent on the creditworthiness of another rated issuer which is impacted by governance factors (see respective ESG checklist for such issuer)?	N	N
		Consolidated ESG Criteria Output:	**Y**	**S**

* A Relevant Effect means that the impact of the applicable ESG Factors has not changed the rating or rating trend on the issuer.
A Significant Effect means that the impact of the applicable ESG Factors has changed the rating or trend on the issuer.

Oriental Republic of Uruguay: ESG Considerations

November 19, 2024

Environmental

The following Environmental factor had a relevant effect on the credit analysis: Climate and Weather Risks. This primarily relates to weather-related risks that Uruguay faces in the form of occasional droughts which can impact agriculture output and electricity generation. Between the last quarter of 2022 and the first half of 2023, Uruguay experienced one of the most severe droughts in its history, which saw the primary sector (which includes agriculture, fishing and mining activities) contract by almost 40% YOY in 2022. With regards to climate policy, Uruguay expects to be a net carbon sink in the forestry sector by 2030 through the expansion of tree plantations. Uruguay has also set targets to reduce the emissions intensity of the cattle industry. More than 90% of the electricity generated within the country comes from renewable sources such as wind, solar, hydropower, and biomass. Additionally, efforts are underway to transition to electric vehicles and to become a green hydrogen producer. In Morningstar DBRS' view, the fiscal, regulatory, and enforcement measures required to achieve the country's climate goals are unlikely to impact sovereign credit quality. In October 2022, the government issued a new sovereign sustainability-linked bond issuance, which includes coupon step-downs(step-ups) for meeting(missing) certain environmental sustainability metrics.

Social

The following Social factor had a significant effect on the credit analysis: Human Rights and Human Capital. Uruguay's per capita GDP is relatively low at USD 23,053 in 2024, reflecting a low level of labor productivity. The Access to Basic Services factor does not affect the ratings. Uruguay has a robust social welfare system, and the government provides for relatively high-quality healthcare, education, and social assistance.

Governance

There were no Governance factors that had a significant or relevant effect on the credit analysis. Uruguay has independent and transparent governing institutions, which provide a stable environment for investment relative to regional peers. Uruguay scores above the 70th percentile rank in all the Worldwide Governance Indicators and is a particularly strong performer in the Control of Corruption indicator and in the Voice and Accountability indicator (both ranking in the 92nd percentile).

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