Date of Release: **2011-02-15**

Uruguay, Oriental Republic of

DBRS Puts Uruguay on Positive Due to Improving Debt Profile

DBRS Inc. (DBRS) has today confirmed the ratings on the Oriental Republic of Uruguay’s long-term foreign and local currency debt at BB and changed the trend to Positive from Stable. The trend change is merited due to clear improvements in the public debt profile and strong medium-term economic growth prospects. The Positive trend signals the likelihood of an upgrade in six to 12 months, if fiscal discipline is sustained and debt levels continue on a downward trajectory.

Although gross public debt remains high and exposed to exchange rate risk, persistent primary surpluses and proactive debt management have led to an improvement in Uruguay’s debt profile. Gross public debt to GDP declined from 69.3% in 2009 to 58.6% in September 2010, and financing and exchange rate risks have been reduced. The average maturity of central government debt is 11.9 years, among the longest in either advanced or emerging economies. A 12-month pre-financing policy provides funding flexibility in the event of market turbulence. In addition, liability management operations, debt buybacks and increased local-currency issuance have reduced the share of debt denominated in foreign currency and supported the development of a sovereign yield curve in the domestic market.

Positive debt dynamics are supported by strong economic growth. From 2003 to 2010, the economy expanded at an annual rate of 5.1%, among the fastest in Latin America. While growth decelerated in 2009 amid the global economic downturn, domestic and external factors have powered a robust recovery. Uruguay is likely to have grown 8% in 2010 with 5% growth expected for 2011. Record low unemployment and rising real incomes are fueling private consumption, while higher levels of investment, supported by government initiatives to develop the country’s infrastructure, bode well for medium-term growth prospects. On the external side, rising commodity prices and an improving regional outlook, particularly in Brazil, have led to strong export growth. High inflows of FDI continue to help diversify the export base, increase productivity and provide a stable source of external financing.

Uruguay’s strengthened policy framework has enhanced the resilience of the economy and the financial system to external shocks. During the global economic downturn, exchange rate flexibility facilitated an adjustment in the external account, cushioned the impact of the external shock on the real economy and helped preserve competitiveness. High international reserves provided additional support, and Uruguay’s well-regulated banking system remains liquid and highly capitalized with low levels of non-performing loans. Another strength is Uruguay’s stable political environment, which has supported prudent and consistent macroeconomic policies through the economic crisis.

In addition to a still-high public debt burden, Uruguay faces several structural challenges. First, Uruguay is a small open economy and commodity-based exporter with strong linkages to its neighbors, particularly Argentina. Despite trade diversification and strengthened financial regulation, an economic downturn in Argentina could significantly reduce the demand for Uruguayan exports and tourism services, thereby slowing growth.

Second, the financial system is highly dollarized. The high level of financial dollarization blunts the effectiveness of monetary policy and creates balance sheet vulnerabilities throughout the economy. Third, inflation at 7.3% in January 2011 has remained near or above the upper limit of the Central Bank of Uruguay (BCU) target range for the last four years. Given strong domestic demand and upward pressure on food and fuel prices, continued vigilance will be needed to anchor expectations within the target range. Measures that enhance the credibility of monetary policy could support de-dollarization and increase policy flexibility.

Over the medium term, an additional increase in the ratings to investment grade will be influenced by meaningful progress in strengthening monetary policy credibility, in addition to a significant reduction in public debt levels which would create greater space for a more counter-cyclical fiscal policy.

Notes:
All figures are in U.S. Dollars unless otherwise noted.

The applicable methodology is Rating Sovereign Governments, which can be found on the DBRS website under Methodologies.

The sources of information used for this rating include the Uruguayan Ministry of Economy and Finance, the Central Bank of Uruguay, INE and IMF. DBRS considers the information available to it for the purposes of providing this rating was of satisfactory quality.

This is an endorsed rating.

This rating was disclosed to the issuer and amended.

Lead Analyst: Michael Heydt
Rating Committee Chair: Alan G. Reid
Approver: Alan G. Reid
Initial Rating Date: 28 February 2008
Most Recent Rating Update: 8 April 2010

For additional information on this rating, please refer to the linking document below.

For more information on this credit or on this industry, visit www.dbrs.com or contact us at info@dbrs.com.

Related Research

- Sovereigns Linking Document
- Rating Sovereign Governments

Related Issuers

- Uruguay, Oriental Republic of

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Ratings

Issuer	Debt Rated	Rating Action	Rating	Trend	Notes	Published
Uruguay, Oriental Republic of	Long-Term Foreign Currency	Confirmed	BB	Stb		15 Feb 2011
Uruguay, Oriental Republic of	Long-Term Foreign Currency	Trend Change	BB	Pos		15 Feb 2011
Uruguay, Oriental Republic of	Long-Term Local Currency	Confirmed	BB	Stb		15 Feb 2011
Uruguay, Oriental Republic of	Long-Term Local Currency	Trend Change	BB	Pos		15 Feb 2011

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