Tagging Info

Fitch Affirms Uruguay's IDR at 'BBB-'; Outlook Remains Stable

Ratings Endorsement Policy

04 Mar 2014 12:10 PM (EST)

Fitch Ratings-New York-04 March 2014: Fitch Ratings has affirmed Uruguay's ratings as follows:

--Long-term foreign currency Issuer Default Rating (IDR) at 'BBB-'; Outlook Stable;
--Long-term local currency IDR at 'BBB'; Outlook Stable;
--Senior unsecured foreign and local currency bonds at 'BBB-' and 'BBB' respectively ;
--Country Ceiling at 'BBB+';
--Short-term foreign currency IDR at 'F3'.

KEY RATING DRIVERS

The affirmation reflects the following:
Uruguay's strengthened external balance sheet, improved government debt composition and disciplined economic policies continue to underpin the country's economic resilience in difficult external conditions. Social and political stability, strong institutions and governance as well as relatively high per capita income are fully in line with investment-grade sovereigns.

The government's strategy implemented in recent years to shield the economy against external shocks and reduce refinancing risks has been tested during the recent period of financial volatility hitting emerging markets. The existence of large external and fiscal liquidity buffers, substantial contingency lines with multilateral organizations, improved debt profile, and a floating exchange-rate regime as the first line of defense puts Uruguay in a strong position relative to other countries in the 'BBB' rating category.

Uruguay's five-year average growth rate is twice the 'BBB' median thanks to employment creation and considerable investment in the primary sector as well as in large scale initiatives in manufacturing. A tight labor market, high growth in real wages and skilled-labor shortages are likely to limit future growth unless new investments and productivity gains materialize. Economic activity has been slowing down in recent quarters, dragged by a more negative contribution of net exports and a significant deceleration in private investment as works in large projects are completed. Fitch expects growth to average 3.3% in 2014-2015 with downside risks arising from slower growth in Brazil and deteriorating economic conditions in Argentina.

Annual consumer inflation reached 8.5% in December 2013, well above the 3% median in the 'BBB' category. While previous automatic triggers forcing contract negotiations when annual inflation exceeded 10% have been lifted, bringing inflation towards the current target band (5% +/- 1pp) and anchoring inflation, expectations could be more difficult if the double-digit barrier is breached. Changes in the use of monetary policy tools implemented in 2013 have resulted in higher interest rates that could weaken domestic demand.

Challenges from a more disruptive economic adjustment in Argentina remain present, although financial and trade channels are weaker than a decade ago. Exports to Argentina represent only 5% of total exports, while non-resident deposits in Uruguayan banks amount to 14% of total deposits in 2013. Linkages remain strong in certain industries such as logistics, automotive, and tourism. Another transmission channel is investment, with 36% of total annual Foreign Direct Investment (FDI) flows to Uruguay coming from Argentina and mostly to real estate. Negative spillovers could be amplified by the adverse effects that a disorderly adjustment in Argentina could have on Brazil, Uruguay's main trading partner.

Uruguay's external liquidity surpassed those of its peers in the 'BBB' rating category in 2013, and could strengthen further during the next two years. The current account deterioration observed in recent years is partially the response to large imports of capital goods and oil derivatives for energy generation due to adverse weather conditions. More recently the deterioration in the current account was partially driven by a weaker balance of tourism, reflecting the exposure of this industry to Argentina. Fitch expects the current account deficit to remain elevated and FDI to fall short of covering the current account imbalances in 2014 and 2015.

The consolidated public sector deficit is expected to increase to 2.7% of GDP in 2014 from 2.3% in 2013 in response to weaker activity levels and high level of budget execution in an electoral year. Public debt reached 44.2% of GDP in 2013, above the 'BBB' median estimated at 39.8%. Counterbalancing high debt ratios, Uruguay's amortization schedule is among the lightest in the category at only 1.2% and 2.1% of GDP in 2014 and 2015, respectively, and are fully covered by the government's liquid assets.

Presidential elections are to be held in October 2014. Polls suggest that ruling Frente Amplio (FA) will extend its mandate for another five years under former President Tabare Vazquez (2005-2010), who is expected to win FA primaries in June. Fitch does not foresee important changes in policymaking under a new FA administration.

RATING SENSITIVITIES

The Stable Outlook reflects Fitch's assessment that upside and downside risks to the rating are currently well balanced. Consequently, Fitch's sensitivity analysis does not currently anticipate developments with a high likelihood of leading to a rating change.

The main factors that, individually or collectively, could lead to positive rating action are:

--Improvements in the macroeconomic policy framework that would reduce inflation and bring inflation expectations in line with the announced targets;
--Progress in reducing government indebtedness and public deficits;
--Evidence of increasing investment flows and fast economic growth.

The main factors that, individually or collectively, could lead to negative rating action are:

--A material deterioration in the government's fiscal position and debt burden;
-- A sustained period of increased macroeconomic instability that materially erodes external buffers.

KEY ASSUMPTIONS
The ratings and Outlooks are sensitive to a number of assumptions:

--Fitch assumes that Argentina's economic difficulties will have a limited spillover in Uruguay due to Uruguay's strengthened external buffers and the reduced trade and financial links between the two countries. In addition, Fitch expects economic growth in Brazil to remain sluggish in 2014;
--Fitch expects some improvement in the policy mix, whereby a conservative fiscal policy and a prudent wage policy will be supportive of the monetary authorities' objective of reducing inflationary pressures;
--Fitch expects that the conservative nature of Uruguay's policymakers will continue in 2014 and under the next administration, meaning that high fiscal deficits are unlikely unless there is a large economic shock;
--Fitch assumes that China will avoid a hard landing and that commodity prices will remain at relatively high levels.

Contact:
Primary Analyst
Santiago Mosquera
Director
+1-212 908 0271
Fitch Ratings, Inc.
One State Street Plaza
New York, NY 1004

Secondary Analyst
Lucila Broide
Director
+1-212-908-0898

Committee Chairperson
Shelly Shetty
Senior Director
+1-212-908-0324

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: elizabeth.fogerty@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria and Related Research:
--'Sovereign Rating Criteria' dated Aug. 13, 2012;
--'Country Ceilings' dated Aug. 9, 2013.

Applicable Criteria and Related Research:
Country Ceilings
Sovereign Rating Criteria

Additional Disclosure
Solicitation Status

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2014 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries.