MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades Uruguay's sovereign ratings to Baa3 from Ba1; outlook remains positive

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New York, July 31, 2012 -- Moody's Investors Service has upgraded to Baa3 from Ba1 the government of Uruguay local- and foreign-currency bond ratings. The outlook remains positive.

Key drivers of today's rating action include:

1. A sovereign credit profile that, in general terms, has come in line with that of Baa-rated investment-grade countries;

2. Steady improvement in Uruguay's fiscal metrics coupled with a significant strengthening of the government's balance sheet;

3. Reduced credit vulnerabilities to regional shocks in light of increased diversification and ample liquidity buffers.

RATINGS RATIONALE

Uruguay's income level is above the median for the Baa peer group. The economy's performance has been characterized by robust growth over an extended period of time with GDP reporting average annual growth of more than 6% during 2004-2011.

Uruguay's economic fundamentals have strengthened and potential growth has increased underpinned by an upward shift in total factor productivity. As a result, the economy is capable of reporting higher growth rates on a sustained basis, a condition that benefits Uruguay relative to peers.

Fiscal metrics have shown steady improvement reporting gradual convergence with Baa medians. The government accounts reflect a strong commitment to fiscal responsibility and strict compliance with targets set in the multi-year budget framework. Since 2004, government deficits have been on the order of 1% to 2% of GDP, with primary balances exceeding 1% of GDP. The central government's debt ratio has moved below 40% of GDP after reaching nearly 80% in 2004.

Moody's anticipates that positive trends will persist, leading to additional reductions in government debt indicators in the coming years.

The credit resiliency of the government's balance sheet is strongly supported by a debt structure that incorporates a maturity profile exceeding that of most Baa-rated countries - average debt maturity stands at some 11 years. The government faces moderate refinancing risks: gross financing needs are among the lowest for all sovereigns rated by Moody's coming to 3% of GDP annually.

A strong institutional feature of Uruguay is its conservative fiscal management. An attitude of extreme risk aversion on the part of the authorities has led to a substantial build up of financial buffers that make the government capable of handling adverse shocks, including those associated with severe stress scenarios.

A high level of precautionary liquidity reserves -- equivalent to 6% of GDP -- combined and contingent credit lines with multilateral banks provide ample coverage against events that could restrict government access to markets, placing Uruguay in a stronger position when compared to similarly rated countries.

While potential credit risks derived from the country's character as a small open economy and its commodity dependence are lower than before, vulnerabilities continue to be present. Moody's recognizes that the country's exposure to some of its less-stable neighbors has been reduced and that diversification of its export base mitigates concentration risks. Still, regional contagion remains an important challenge for policy makers and fluctuations in commodity markets pose non-negligible risks.

Moody's indicated that credit vulnerabilities derived from the government's exposure to foreign currency-denominated debt are mitigated in part by asset holdings that reduce the potential impact of exchange rate shocks on the sovereign's balance sheet. Additionally, liability management operations have been effective in lowering the share of foreign-currency debt with two transactions carried during the last eight months moving it to the 50% mark.

While credit risks related to the level of debt dollarization are already captured by both the current rating and the positive outlook, Moody's indicated that dollarization will likely constrain the potential upside for Uruguay's ratings over the medium term.

WHAT COULD MOVE THE RATING UP/DOWN?

While no single condition would be sufficient to modify Uruguay's sovereign rating, elements that will be monitored on an ongoing basis to determine if the positive outlook can eventually lead to higher ratings include:

• The economy's ability to avoid sharp growth deceleration in an environment that will be characterized by less favorable economic and financial external conditions during the next 12-18 months, the time period associated with the current outlook horizon;

A fiscal performance associated - at most - with modest deviations on the government accounts with respect to targets set in the medium-term budget framework;

• Evidence of continued diversification in Uruguay's export base that contributes to reduce further concentration risks.

Even though a downgrade is unlikely given the positive rating outlook, elements that could trigger negative rating actions include:

• A reversal of the declining trend in foreign currency-denominated debt that takes the corresponding share above the 50% mark;

• Growing macroeconomic imbalances (i.e., current account deficit, inflation, etc.) associated to persistent above-trend growth;

• Deterioration of the underlying (structural) fiscal balance

As part of the rating action, Uruguay's country ceiling for foreign-currency deposits was upgraded to Baa3 from Ba2 in line with Moody's practice of aligning foreign-currency deposit ceilings with government ratings for investment grade countries -- the country ceiling foreign-currency bonds remains at Baa1.

The local currency country ceilings for both bond and deposits were downgraded to Baa1 from A3 to reflect a relatively high degree of correlation between foreign-currency and local-currency ratings, given a highly dollarized financial system.

Additionally, the short-term foreign-currency country ceiling for deposits was changed to P3 from NP, and the foreign-currency country ceiling for bonds to P2 from P1.

The last rating action on the government of Uruguay was implemented on January 26, 2012 when Moody's assigned a positive outlook to Uruguay's sovereign ratings.

The principal methodology used in this rating was Moody's Sovereign Bond Methodology published in 2008. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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