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Research Update:

Uruguay Ratings Affirmed At 'BBB-/A-3'; Outlook Remains Stable

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Overview

- High levels of investment that boosts economic growth and diversification together with effective debt management limit Uruguay's vulnerability to negative external shocks.
- We are affirming our 'BBB-/A-3' foreign and local currency ratings on Uruguay.
- The outlook remains stable, reflecting our expectation for continuity and stability in macroeconomic policies following national elections later this year.

Rating Action

On June 2, 2014, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term and its 'A-3' short-term foreign and local currency ratings on the Oriental Republic of Uruguay. The outlook remains stable. We also affirmed our transfer and convertibility (T&C) assessment at 'BBB+'.

Rationale

The ratings on Uruguay reflect its stable political system, predictable economic policies, robust medium-term growth prospects, and favorable government debt amortization profile. The ratings also incorporate Uruguay's limited fiscal and monetary flexibility, which a still highly dollarized economy exacerbates, and its vulnerability as a small, open economy in a region that is undergoing economic stress.

On a per capita basis, Uruguay's economy has grown 5.4% on average since 2006. We expect GDP per capita to approach $17,000 in 2014 from just over $5,000 in 2005. The country's growing middle class, along with a stable political system, should sustain predictable economic policies regardless of potential changes in government.

Uruguay's economy is likely to grow in a balanced manner in the next couple of years, with the exception of a persistently high inflation rate that will likely remain above the central bank's targeted level. At the same time, the central bank's real effective exchange rate has appreciated 21% from 2010 to March 2014, indicating a loss of competitiveness compared with its trade partners.

We project that GDP will grow about 3% in 2014. Continued efforts to diversify the economy, as well as attract large-scale investment projects, should sustain GDP growth at that rate or higher over the next three years. Foreign direct investment (FDI) is likely to largely fund the country's current account deficit, thereby containing external indebtedness. The National Industry Unit (Dirección Nacional de Industrias) projects total investment--both public and private--will reach up to $20 billion for 2013-2020 (a little over one-third of 2014 GDP), including the private sector's third pulp and paper mill with an investment of $2.5 billion. However, the current account remains vulnerable to higher oil imports when drought reduces the generation of electricity from hydropower plants. Still, policies such as the insurance agreement with the World Bank, the incorporation of new sources of wind energy, and strengthening the energy stabilization fund (Fondo de Estabilización Energética) reduce the level of vulnerability.

The share of dollar-denominated assets and liabilities in the financial system remains about 80%, while inflation remains high, running above a 9% annualized rate in recent months. Limited monetary flexibility, a rigid expenditure structure that limits fiscal flexibility, and vulnerability to adverse external developments constrain the ratings.

The most visible risk of contagion emanates from Argentina (CCC+/Negative/C), with which Uruguay has trading and financial links. However, our ratings on Uruguay reflect our assessment that these links are less tight than a decade ago, when a sovereign payment default in Argentina contributed to Uruguay engaging in a distressed debt exchange to smooth out its debt profile. We believe that the Uruguayan authorities' efforts to lengthen the average maturity of government debt, to diversify the economy, to reorient exports away from the Mercosur trading block, and to strengthen the financial system will enable it to weather volatility in its bilateral exchange rate with Argentina or worsening economic conditions there.

Outlook

The stable outlook reflects our expectation for continuity and stability in macroeconomic policies following national elections later this year. We expect that Uruguay will maintain pro-investment policies to sustain GDP growth and diversify its productive base while pursuing cautious debt management policies to contain the risk of adverse external developments.

The government's ability to make timely adjustments in fiscal, monetary, and other policies in the event of an adverse external shock will influence the credit rating over the coming years. Continued GDP growth and economic diversification, along with a declining debt burden and improvement in monetary and fiscal flexibility, would provide Uruguay with greater capacity to withstand negative external shocks. A declining level of dollarization, along with lower inflation, would boost the effectiveness of monetary policy. The resulting improvement in economic resilience could lead to an upgrade.

Conversely, a weakening commitment to policies that sustain macroeconomic stability, or an inadequate response to adverse external developments that could reduce the country's external liquidity and raise its debt burden, could result in a downgrade.

Key Statistics

Table 1

Selected Indicators											
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014e**	**2015f**	**2016f**	**2017f**
Nominal GDP (US$ bil.)	23.4	30.4	30.5	38.9	47.2	50.0	53.2	57.7	59.7	62.2	66.3
GDP per capita (US$)	7,011	9,075	9,073	11,542	13,976	14,880	15,830	17,175	17,754	18,506	19,721
Real GDP growth (%)	6.5	7.2	2.4	8.4	7.3	3.7	4.4	3.0	3.5	3.5	3.5
Real GDP per capita growth (%)	6.3	7.0	2.0	8.0	7.0	4.3	4.4	3.0	3.5	3.5	3.5
Change in general government debt/GDP (%)	2.4	8.2	2.0	4.0	5.1	5.8	9.1	4.0	4.2	3.0	2.9
General government balance/GDP (%)	(0.9)	(0.8)	(1.2)	(1.4)	(0.7)	(2.1)	(1.9)	(2.0)	(2.0)	(2.0)	(2.0)
General government debt/GDP (%)	63.1	62.7	60.1	57.0	53.8	54.1	57.2	55.0	53.3	51.2	49.1
Net general government debt/GDP (%)	48.1	51.3	50.0	50.3	45.5	46.1	50.2	48.5	47.4	45.5	44.1
General government interest expenditure/revenues (%)	10.7	8.3	7.8	8.1	7.7	6.9	7.1	7.2	7.2	7.2	7.2
Other dc claims on resident nongovernment sector/GDP (%)	24.3	28.6	22.3	23.7	24.0	24.8	27.6	28.2	28.8	29.6	30.4
CPI growth (%)	8.1	7.9	7.1	6.9	8.6	7.5	8.5	9.0	8.0	7.0	7.0
Gross external financing needs/CARs + usable reserves (%)	128.1	136.9	124.3	108.5	106.1	100.0	98.3	98.1	98.6	97.4	99.2
Current account balance/GDP (%)	(0.9)	(5.7)	(1.3)	(1.9)	(2.9)	(5.4)	(5.9)	(5.8)	(4.7)	(4.2)	(4.1)
Current account balance/CARs (%)	(2.7)	(16.8)	(4.1)	(6.6)	(10.1)	(19.4)	(22.1)	(23.5)	(17.7)	(15.0)	(14.7)
Narrow net external debt/CARs (%)	52.6	26.4	13.5	(3.7)	(11.7)	(13.1)	(28.3)	(20.8)	(15.9)	(13.9)	(12.2)
Net external liabilities/CARs (%)	24.1	18.3	20.3	18.7	32.4	39.3	43.3	70.8	84.2	95.1	106.2

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. CARs--Current account receipts. e--Estimate. f--Forecast.

Related Criteria And Research

Related Criteria

- Sovereign Government Rating Methodology And Assumptions, June 24, 2013
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009
- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013

Related Research

- Research Update: The Republic of Argentina Ratings Affirmed At 'CCC+/C'; Outlook Remains Negative, April 4, 2014
- Oriental Republic of Uruguay, July 2, 2013
- Sovereign Defaults And Rating Transition Data, 2013 Update, April 18, 2014
- Banking Industry Country Risk Assessment: Uruguay, Dec. 27, 2013

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Ratings Affirmed

Uruguay (Oriental Republic of)	
Sovereign Credit Rating	BBB-/Stable/A-3
Transfer & Convertibility Assessment	BBB+
Senior Unsecured	BBB-
Short-Term Debt	A-3

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