Press Release

Insight beyond the rating.

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DBRS Confirms Uruguay at BBB (low), Stable Trend

Industry: Public Finance--Sovereigns

DBRS, Inc. has confirmed the Oriental Republic of Uruguay's long-term foreign and local currency issuer ratings at BBB (low). DBRS has also confirmed the short-term foreign and local currency issuer ratings at R-2 (middle). The trend on all ratings is Stable.

Uruguay's credit fundamentals are supported by highly effective debt management, strong public institutions, and ample external buffers. Counterbalancing these strengths are limited fiscal flexibility, persistently above target inflation, and exposure to external developments. The Stable trends reflect DBRS's view that risks to the outlook are broadly balanced.

Real economic growth decelerated to 1.0% in 2015, from an average of 5.4% from 2004-2014. The slowdown was due to less favorable external conditions and less dynamism in domestic demand. Economic stagnation in Argentina, a deep and protracted recession in Brazil, decelerating growth in China, and rising interest rates globally affected Uruguay via trade and financial channels. Weak external demand spilled over to the domestic economy. Gross fixed capital formation contracted by 8.2% last year and unemployment reached 8.0% in February 2016, up from 7.1% a year earlier. The government adjusted its growth projections downward in May 2016 and now expects growth of 0.5% this year and 1% in 2017.

Uruguay's ratings are anchored by strong public institutions and effective public debt management. The country ranks first, second, or third in Latin America on various social and institutional stability indices, including the World Bank governance indicators and the Economic Freedom Index. Furthermore, skillful debt management strengthens the sovereign credit profile. Rollover risk is contained because redemptions are low and liquid assets are high. Uruguay has a long average maturity profile of 15 years. Treasury cash and precautionary credit lines with multilateral organizations totaled 9.7% of GDP as of April 2016, well in excess of the 4.3% of GDP in debt servicing coming due over the next 12 months. Uruguay has taken advantage of favorable market conditions, evident by two large dollar denominated debt issuances last year.

Despite economic weaknesses among key global and regional partners, lower export prices, and global financial volatility, external accounts have improved. The current account deficit moderated in 2015 to 3.6% of GDP. As a net energy importer, the lower price of oil has offset the decline in the price of some agricultural exports. As such, the terms of trade has been improving since mid-2014, unlike the large term of trade shock experienced by many of Uruguay's regional peers. In the year to April 2016, reserves fell by $4.8 billion, as the central bank used reserve assets to reduce its monetary liabilities and intervene in the foreign exchange market to smooth peso depreciation. The currency still proved an effective shock absorber, declining 28.9% against the dollar from January 2015 to March 2016. At $13.9 billion in reserve assets, or 24% of GDP, the government maintains ample reserve coverage to manage further external shocks.

Uruguay has limited fiscal space to support the economy without altering stable public sector debt dynamics. The consolidated public sector deficit widened to 3.5% of GDP in 2014 and 2015, after average deficits of 0.9% from 2005-2011. The current administration responded to the deterioration with significant fiscal tightening in 2015. Real primary spending by the public sector contracted by 1.7%, after growing at an average pace of 8.6% from 2012-2014. Constrained public spending reflects slower growth in public sector salaries and social transfers, and a sharp reduction in capital expenditure. This was offset by higher interest costs and cyclically lower revenues. The five year budget targets a public sector deficit of 2.5% and a 1% primary surplus by 2019. DBRS views the fiscal targets as attainable, given the five year budget calls for only a 1% of GDP adjustment. However, optimistic growth assumptions in the budget could challenge compliance with fiscal targets while leaving public finances more exposed to domestic and external shocks.

Above target inflation is another main policy challenge. Annual inflation has remained well outside the central bank's current 3-7% policy band for nearly a decade. In April 2016, headline CPI reached 10.5% (y/y) and 12-month inflation expectations reached 9.6%. The recent surge in prices is the result of pass-through from peso depreciation and utility rate hikes. The central bank has countered these pressures with substantial monetary tightening. The money supply on a year-over-year basis contracted in March 2016. Beyond monetary tightening, re-anchoring of inflation expectations within the BCU policy band will likely depend on successful implementation of the new wage setting guidelines and the path of the exchange rate.

As a small, open, and commodity exporting economy, Uruguay remains exposed to an increase in external volatility. Risks stem from volatile global capital flows, abrupt shifts to the exchange rate, and weaker global and regional economic growth. Trade disruptions and economic downturns in Brazil or Argentina have directly affected economic activity through weaker demand for tourism services and lower levels of direct investment. A steeper deceleration in China or other major economies presents downside risk to the outlook through commodity price channels and through weaker real demand for exports. A sharp increase in the price of oil without off-setting increases in the price of exports could also pose a shock to the country's terms of trade.

RATING DRIVERS
Reducing fiscal deficits and aligning inflation with official targets could put upward pressure on the ratings. Authorities constrained primary spending and significantly tightened monetary policy over the last year to confront fiscal and price pressures associated with external shocks. While results are not yet evident in headline data, consolidating fiscal accounts in a durable manner and re-anchoring inflation expectations within the target band would be credit positive. In contrast, downward pressure on the ratings could occur if external buffers erode and weaken Uruguay's resilience to adverse shocks.

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

The principal applicable methodology is Rating Sovereign Governments, which can be found on the DBRS website under Methodologies. The principal applicable rating policies are Commercial Paper and Short-Term Debt, and Short-Term and Long-Term Rating Relationships, which can be found on our website under Rating Scales.

The sources of information used for this rating include the Central Bank of Uruguay, Ministry of Economy and Finance, National Statistics Institute, International Monetary Fund, The Conference Board Total Economy Database, and Haver Analytics. DBRS considers the information available to it for the purposes of providing this rating was of satisfactory quality.

The rated entity or its related entities did participate in the rating process. DBRS had access to the accounts and other relevant internal documents of the rated entity or its related entities.

This rating is endorsed by DBRS Ratings Limited for use in the European Union.

For further information on DBRS' historic default rates published by the European Securities and Markets Administration ("ESMA") in a central repository see http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

Generally, the conditions that lead to the assignment of a Negative or Positive Trend are resolved within a twelve month period while reviews are generally resolved within 90 days. DBRS's trends and ratings are under constant surveillance.

Lead Analyst: Jason Graffam

Rating Committee Chair: Roger Lister
Initial Rating Date: 28 February 2008
Most Recent Rating Update: 29 May 2015

For additional information on this rating, please refer to the linking document under Related Research.

Issuer	Debt Rated	Rating Action	Rating	Trend	Latest Event
Uruguay, Oriental Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB (low)	Stb	May 27, 2016
Uruguay, Oriental Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	BBB (low)	Stb	May 27, 2016
Uruguay, Oriental Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (middle)	Stb	May 27, 2016
Uruguay, Oriental Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (middle)	Stb	May 27, 2016

The full report providing additional analytical detail is available by clicking on the link under Related Research at the right of the screen or by contacting us at info@dbrs.com.

Jason Graffam
Assistant Vice President – Global Sovereign Ratings
+1 212 806 3220
JGraffam@dbrs.com

Thomas Torgerson
Senior Vice President - Global Sovereign Ratings
+1 212 806 3218
ttorgerson@dbrs.com

Fergus J. McCormick
Senior Vice President - Head of Sovereign Ratings, Global Sovereign Ratings
+1 212 806 3211
FMcCormick@dbrs.com

Alan G. Reid
Group Managing Director – Financial Institutions and Sovereign Group
+1 212 806 3232

areid@dbrs.com

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