Uruguay

Full Rating Report

Ratings

Foreign Currency	
Long-Term IDR	BBB-
Short-Term IDR	F3
Local Currency	
Long-Term IDR	BBB-
Short-Term IDR	F3
Country Ceiling	BBB+

Outlooks

Long-Term Foreign-Currency IDR	Negative
Long-Term Local-Currency IDR	Negative

Financial Data

Uruguay

(USDbn)	2018
GDP	58.9
GDP per head (USD 000)	17.0
Population (m)	3.5
International reserves	16.0
Net external debt (% GDP)	-17.9
Central government total debt (% GDP)	62.4
CG foreign-currency debt	15.7
CG domestically issued debt (UYUbn)	384.8

Rating Derivation

Component	Outcome
Sovereign Rating Model (SRM)[a]	BBB+
Qualitative Overlay (QO)	-2
Macroeconomic	-1
Structural features	+0
Public finances	-1
External finances	+0
Long-Term Foreign-Currency IDR (SRM + QO)	BBB-

Source: Fitch Ratings

Related Research

Global Economic Outlook (September 2018)

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Key Rating Drivers

Negative Outlook: Persistent fiscal deficits and a high, rising debt burden are eroding policy space to confront shocks, against a more challenging economic backdrop. Uruguay has seen one of the largest rises in public debt-to-GDP in the 'BBB' category since reaching investment grade in 2013. Growth has underperformed 'BBB' peers in this period and rising regional headwinds pose additional downside, although the economy should remain broadly resilient.

The ratings are supported by high social development and strong institutions, healthy external finances, and long-dated public debt and liquidity buffers mitigating fiscal financing risks.

Slow Growth Until Pulp Plant: Fitch Ratings projects real GDP growth will fall to 2.0% in 2018 and 1.5% in 2019, with risks tilted to the downside. Consumption is cooling off as cyclical drivers have worn off, and investment may be bottoming out after a multi-year contraction but is not yet showing a firm recovery. Exports face headwinds from the recession and currency sell-off in Argentina, which will primarily affect tourism flows, but direct financial links are narrow.

A large pulp plant should provide a significant boost to the investment and growth outlook as construction begins in 2020, but investment prospects beyond the megaproject face challenges.

Above-Target Inflation: Inflation was 8.3% in September, having risen back above the 7% upper limit of the official target (5%+/-2pp) in 2018 as favourable base effects have worn off. Core inflation and expectations have also moved above target. Above-target inflation has posed a difficult backdrop for a major round of private-sector wage negotiations.

Fiscal Slippage: Public finances have begun to deteriorate again in 2018 after improving in 2017 on revenue-focused adjustment measures. Fitch projects that the central government deficit will rise to 3.1% of GDP in 2018 and 3.6% in 2019, preventing the government from meeting its targets. A revenue boost expected by the government appears unlikely in our view given a weaker growth outlook, and spending could overshoot government projections as it has done for several years. A clearer consolidation strategy could emerge after 2019 elections.

Rising Debt, Strong Profile: Fitch projects general government debt will jump to 62.7% of GDP in 2018 from 57.7% in 2017, and rise further thereafter on persisting fiscal deficits. A large stock of debt in foreign currency makes fiscal metrics highly sensitive to exchange-rate movements. Financing risks are low, however, given a long-dated maturity profile and liquidity buffers including multilateral credit lines and liquid government assets.

Strong External Finances: A balanced current account position and strong external liquidity, supported by ample central bank foreign-exchange (FX) reserves, help mitigate vulnerabilities amid tightening global financing conditions. A peso that is significantly stronger than its long-term average in real effective terms poses competiveness challenges and policy trade-offs.

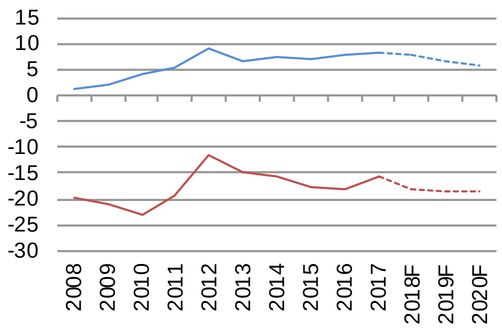
Rating Sensitivities

Fiscal Slippage, Weaker Growth: The main risk factors that could trigger a downgrade are failure to reduce fiscal deficits and/or improve the trajectory of government debt metrics, further economic underperformance relative to peers, or erosion of external buffers.

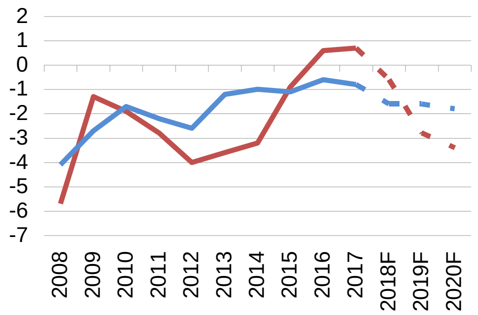
Growth, Fiscal Turnaround: The main factors that could help stabilise the Outlook are greater confidence in a fiscal consolidation path supporting stabilisation of debt metrics, structurally lower inflation and anchoring of expectations, and evidence of stronger growth prospects.

Peer Comparison

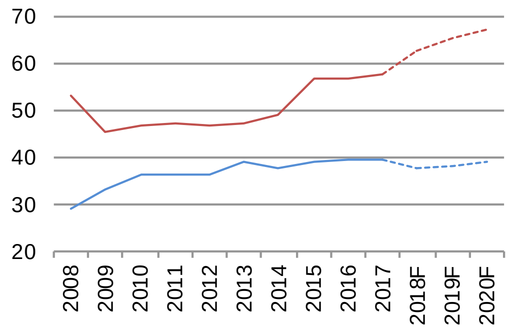
Net External Debt
% of GDP



Current Account Balance
% of GDP



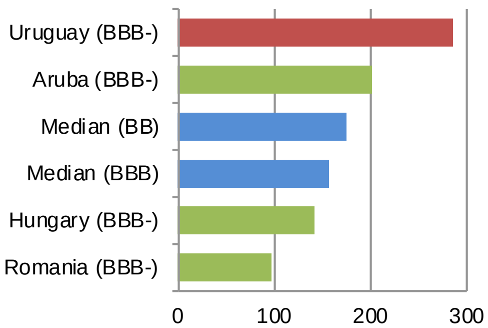
General Government Debt
% of GDP



General Government Balance
% of GDP

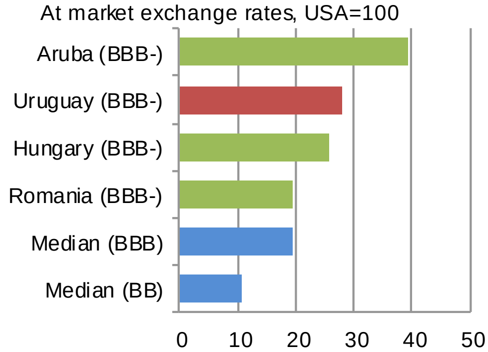
Uruguay   Median(BBB)

International Liquidity Ratio, 2018F
%



GDP per capita Income, 2018F

At market exchange rates, USA=100



Note: Medians based on data for sovereigns in the respective rating category at the end of each year. Latest ratings are used for the current year and forecast period.

Related Criteria

Sovereign Rating Criteria (July 2018)

Country Ceilings Criteria (July 2018)

Peer Group

Rating	Country
BBB	Bulgaria
	Colombia
	Indonesia
	Italy
	Kazakhstan
	Panama
	Philippines
	Portugal
BBB-	**Uruguay**
	Aruba
	Hungary
	India
	Morocco
	Oman
	Romania
	Russia
	San Marino
BB+	Azerbaijan
	Croatia
	Republic of Cyprus
	Namibia
	South Africa

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
22 Jul 16	BBB−	BBB−
7 Mar 13	BBB−	BBB
14 Jul 11	BB+	BBB−
27 Jul 10	BB	BB+
27 Jul 07	BB−	BB
07 Mar 05	B+	BB−
29 Mar 04	B	B+
17 Jun 03	B−	B
19 May 03	D	B
10 Apr 03	C	CCC−
12 Mar 03	CCC−	CCC−
07 Jan 03	B−	B
30 Jul 02	B	B
28 May 02	B+	BB−
13 Mar 02	BB+	BBB−
19 May 00	BBB−	BBB+
23 Jan 97	BBB−	NR
26 Oct 95	BB+	NR

Rating Factors

Summary: Strengths and Weaknesses

Rating factor	Macroeconomic	Public finances	External finances	Structural issues
Status	Weakness	Weakness	Neutral	Strength
Trend	Negative	Negative	Stable	Stable

Note: Relative to 'BBB' category
Source: Fitch Ratings

Strengths

- Strong institutions and relatively high social development indicators and per-capita income underpin creditworthiness and support policy continuity.
- A favourable current account balance, ample liquidity buffers and exchange-rate flexibility support external finances in the context of high commodity dependence. The net external creditor position and liquidity ratio are among the highest in the 'BBB' category. Banks and corporates are net external creditors, and the sovereign has a strong FX liquidity position despite being a net external debtor. Foreign reserve levels are high (even after netting out USD bank reserve requirements), and their coverage of liquid external liabilities has improved on lower non-resident deposits and holdings of local debt.
- Proactive public debt management has reduced refinancing risks. Debt maturities in the coming years are low and an average maturity of about 14 years is high. Financing flexibility is supported by precautionary multilateral credit lines and liquid assets, which cover debt servicing needs for over a year, and help mitigate vulnerabilities from relatively high reliance on external financing sources.

Weaknesses

- Inflation is the highest in investment-grade space, having averaged 8.2% in the five years through 2018. Structurally high inflation, prevalent indexation, dollarisation and low financial depth constrain the credibility and counter-cyclical flexibility of monetary policy. The authorities are working to reduce inertial price pressures by de-indexing wage contracts.
- General government debt projected to reach 63% of GDP in 2018 is above the historic 'BBB' median of 36%, even net of 9pp in recapitalisation bonds held by the central bank (entailing no effective debt service, but included by Fitch for consistency with other sovereigns). FC debt is the highest among 'BBB' peers with flexible exchange rates at 29% of GDP (46% of the total, or 54% net of recapitalisation bonds), exposing the sovereign balance sheet to exchange-rate risk. The authorities have made recent progress in deepening peso funding.
- Fiscal policy credibility is relatively weak. Deficit targets have been frequently overshot in recent years, and frequent hikes to a legal cap on increases in net debt (again in 2018) have rendered it ineffective as a fiscal anchor. Spending is highly rigid and dominated by legally mandated and indexed social entitlements, with a very low share of capex.
- Uruguay's five-year average growth rate of 2.0% is below the 'BBB' median, but has shown resilience to volatility in large neighbouring economies. The investment rate estimated at 17% in 2018 is among the weakest in the category, and the Ease of Doing Business score is low.

Local Currency Rating

Uruguay's Long-Term Local-Currency IDR is in line with the Long-Term Foreign-Currency IDR. Public finances do not represent a strength relative to external finances, and there is no track record of preferential treatment of local-currency creditors vis-à-vis foreign-currency creditors.

Country Ceiling

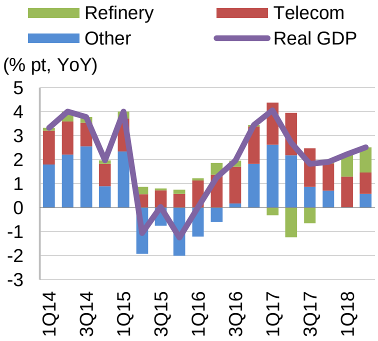
Uruguay's Country Ceiling of 'BBB+' reflects the absence of capital controls or current account restrictions that could lead to transfer/convertibility risks. Vulnerability to external pressures is reduced by increased exchange-rate flexibility, strong bank supervision and high liquidity.

Strengths and Weaknesses: Comparative Analysis

2018	Uruguay BBB-	BBB median[a]	BB median[a]	Aruba BBB-	Hungary BBB-	Romania BBB-
Macroeconomic performance and policies						
Real GDP (5yr average % change)	2.0	3.7	4.2	0.4	3.6	4.6
Volatility of GDP (10-year rolling SD)	2.1	2.9	2.5	4.3	3.3	3.8
Consumer prices (5-year average)	8.2	4.2	5.8	0.3	1.2	1.1
Volatility of CPI (10yr rolling SD)	1.1	2.4	3.5	2.0	2.0	2.6
Unemployment rate (%)	7.9	7.9	9.2	7.3	4.0	4.2
Type of exchange rate regime	Managed float	n.a.	n.a.	Peg (USD)	Free float	Managed float
Dollarisation ratio (% of bank deposits)	76.0	16.9	39.4	19.5	31.0	34.4
REER volatility (10-year rolling SD)	3.6	5.2	6.6	1.6	2.7	3.9
Structural features						
GDP per capita (USD, mkt exchange rates)	16,979	10,657	6,600	24,695	15,896	12,035
GNI per capita (PPP, USD, latest)	21,090	20,090	14,395	-	25,360	22,370
GDP (USDbn)	58.9	n.a.	n.a.	2.8	154.0	235.6
Human development index (percentile, latest)	71.1	67.3	52.0	-	77.5	73.7
Governance indicator (percentile, latest)[b]	79.3	58.5	43.7	87.7	66.4	59.6
Broad money (% GDP)	51.6	59.4	46.8	87.7	59.7	39.5
Default record (year cured)[c]	2003	n.a.	n.a.	-	-	1984
Ease of doing business (percentile, latest)	50.8	71.3	51.4	-	75.2	76.8
Trade openness (avg. of CXR + CXP % GDP)	32.7	46.2	47.1	90.5	96.2	45.4
Gross domestic savings (% GDP)	19.1	22.5	17.6	15.0	30.4	22.3
Gross domestic investment (% GDP)	16.6	23.7	21.9	23.7	21.5	24.7
Private credit (% GDP)	27.8	57.1	35.0	67.1	32.7	31.1
Bank systemic risk indicators[d]	bb/1	n.a.	n.a.	-/1	bb/1	bb/1
Bank system capital ratio (% assets)	18.0	14.9	15.5	31.8	21.5	18.8
Foreign bank ownership (% assets)	51.0	35.7	35.4	100.0	60.0	90.4
Public bank ownership (% assets)	49.0	13.4	16.3	0.0	6.5	8.4
External finances						
Current account balance + net FDI (% GDP)	-1.2	0.4	0.8	2.5	3.8	-1.2
Current account balance (% GDP)	-0.6	-1.9	-2.6	-0.2	2.2	-3.6
Net external debt (% GDP)	-17.9	6.7	9.5	4.6	13.1	17.4
Gross external debt (% CXR)	221.1	115.6	113.1	82.4	109.5	109.6
Gross sovereign external debt (% GXD)	47.8	31.7	47.3	60.3	28.1	38.5
Sovereign net foreign assets (% GDP)	-7.0	2.7	-2.7	-10.9	-8.3	1.7
Ext. interest service ratio (% CXR)	6.1	4.3	3.9	4.6	2.4	3.5
Ext. debt service ratio (% CXR)	13.7	15.3	13.5	13.3	10.7	23.3
Foreign exchange reserves (months of CXP)	9.9	4.9	4.4	4.5	2.5	4.9
Liquidity ratio (latest)[e]	285.1	143.7	154.5	184.3	141.0	99.2
Share of currency in global reserves (%)	0	n.a.	n.a.	0	0	0
Commodity export dependence (% CXR, latest)	50.7	21.4	21.8	6.0	9.7	13.5
Sovereign net foreign currency debt (% GDP)	-0.4	-5.5	2.2	-1.4	-2.2	3.4
Public finances[f]						
Budget balance (% GDP)	-3.1	-2.4	-2.7	-3.3	-2.4	-3.4
Primary balance (% GDP)	-0.2	-0.3	-0.3	2.1	0.2	-2.3
Gross debt (% revenue)	214.4	129.5	155.3	284.3	157.6	115.9
Gross debt (% GDP)	62.7	36.0	38.3	72.4	71.7	36.0
Net debt (% GDP)	56.4	30.2	32.7	70.1	67.4	30.2
Foreign currency debt (% total debt)	46.0	36.1	61.4	45.0	25.0	62.4
Interest payments (% revenue)	9.9	7.0	9.4	19.0	5.7	3.7
Revenues and grants (% GDP)	29.2	32.1	24.7	25.5	45.5	31.0
Volatility of revenues/GDP ratio	0.9	6.6	6.1	7.1	2.8	4.4
Central Govt. debt maturities (% GDP)	2.9	5.5	5.0	10.0	16.9	4.0

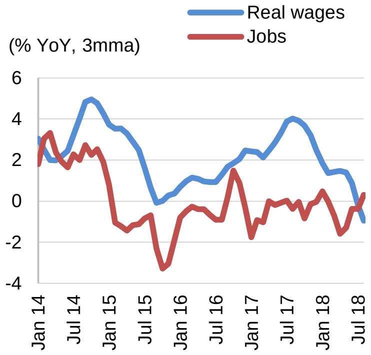
[a] Medians based on actual data since 2000 (excl. forecasts) for all sovereign-year observations where the sovereign was in the respective rating category at year-end. Three-year centred averages are used for the more dynamic variables (e.g. current account and fiscal balance)
[b] Composite of six World Bank Governance Indicators used in the Sovereign Rating Model; Government Effectiveness; Rule of Law; Control of Corruption; Voice and Accountability; Regulatory Quality; and Political Stability and Absence of Violence
[c] Uruguay concluded an exchange offer for all foreign-currency bond debt on 22 May 2003
[d] Bank systemic indicator, which equates to a weighted average Viability Rating; and macro prudential indicator, with 1 'low' systemic risk through to 3 'high'
[e] Ratio of liquid external assets, defined as the stock of official FX reserves including gold at the end of the previous calendar year plus banks' liquid external assets, to liquid external liabilities, defined as scheduled external debt service in the current year, plus the stock of short-term external debt and all non-resident holdings of marketable medium- and long-term local-currency debt at the end of the previous calendar year
[f] General government unless stated
Note: Abbreviations used: Consumer price inflation (CPI), gross domestic product (GDP), current external receipts (CXR), current external payments (CXP), gross national income (GNI), purchasing power parity (PPP), standard deviation (SD), foreign direct investment (FDI)
Source: Fitch Ratings

Real GDP Growth



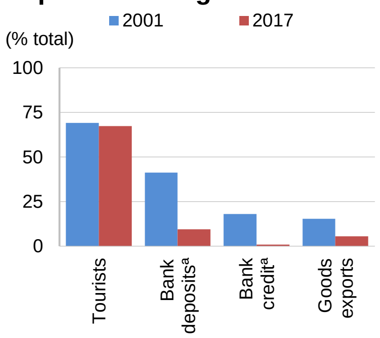
Source: Fitch Ratings based on BCU, INE

Weak Labour Market



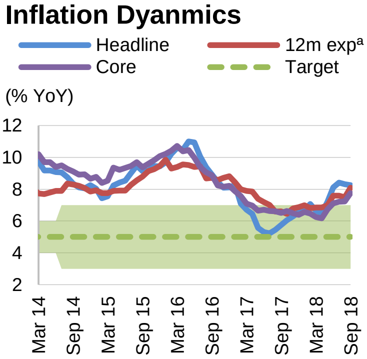
Source: Fitch Ratings, INE

Exposure to Argentina



[a] Non-resident stocks as proxy for Argentina
Source: INE, BCU

Inflation Dyanmics



[a] Survey median
Source: BCU, CINVE

Key Credit Developments

Domestic, External Headwinds Weigh on Growth

Uruguay's economy is slowing in 2018. Growth eased to 2.4% yoy in 1H18, from 2.7% in 2017, and the slowdown was more pronounced net of a favourable base effect (around 0.9pp) from the reopening of an oil refinery and a continuing heavy contribution from the telecom sector due to measurement issues (1.1pp)[1]. A weak labour market is further evidence of the sluggish economy, and a trend of net job destruction since 2014 has lifted unemployment and reduced labour force participation.

Slower growth reflects the dissipation of cyclical tailwinds that had supported consumption and exports. Peso depreciation, a real wage slowdown amid rebounding inflation, job losses and low confidence are weighing on purchasing power and consumption. Net exports have contributed negatively to growth, mostly due to a drought affecting agricultural output. Investment is not yet showing a firm recovery after a 25% decline from its 2014 peak, but could be bottoming out as recovering public investment balances still sluggish private investment.

Fitch projects these factors to slow real GDP growth to 2.0% in 2018 and 1.5% in 2019. These projections also include a moderate impact from Argentina's sharp currency selloff and incipient recession, but this could pose further downside risk. Tourism represents the key channel for potential spill-overs, as Argentines represent two-third of tourist spending in Uruguay. However, direct financial linkages to Argentina are narrow: banks' credit exposure to Argentina is negligible, and Argentine deposits are now a small share of the total and not used as a funding source. More broadly, Uruguay's banking sector is sound in terms of liquidity and capitalisation.

Medium-term prospects are supported by a pulp mill slated to begin construction in 2020 and a related railway project expected to ramp up in 2019. Investment prospects beyond this megaproject appear lacklustre, however, reflected in a low investment rate (16% in 2017). Business groups and global surveys point to high taxes and utility rates, a rigid labour market, and lack of progress on major free trade agreements as key bottlenecks. The government has modified its investment incentives regime and hopes to push PPP projects more quickly to boost investment. However, fiscal constraints, labour union opposition and political headwinds ahead of 2019 elections limit scope for more decisive reforms to tackle competitiveness issues.

Inflation Firmly Above Target as Major Wage Talks Take Place

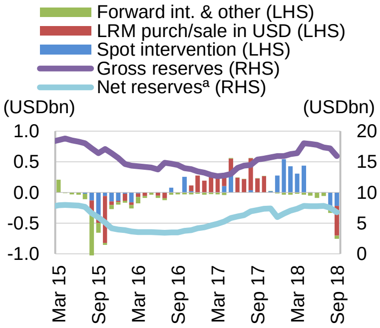
Inflation stood at 8.3% as of September, having risen above the 7% upper bound of the target band (5%+/−2pp) in 2018 as favourable base effects have worn off and peso depreciation has applied additional pressure. Core inflation and 12-month inflation expectations have also breached 7% in recent months, and respectively stood at 7.8% and 8.1% in September.

The rise in inflation has contributed to a difficult backdrop for a major round of private-sector wage negotiations taking place in 2018, which have important implications for the government's goal of reducing inertial pressures behind Uruguay's structurally high inflation. Disagreement between unions and businesses over the size of wage hikes and frequency of backward-looking inflation correctives have delayed some agreements (eg commerce, agriculture), and others that have been reached have defied the executive guidance (eg construction). However, the trend of job losses could help moderate union wage demands and facilitate talks.

The central bank (BCU) has officially maintained a contractionary policy bias to help contain inflationary pressures, but has not tightened the stance as inflation measures have drifted back above target (real interest rates have stayed at 2%-3%). Monetary policy faces constraints from policy trade-offs, given a tighter stance could add further pressure on an already strong peso, as well as weak transmission channels due to dollarisation and shallow financial markets.

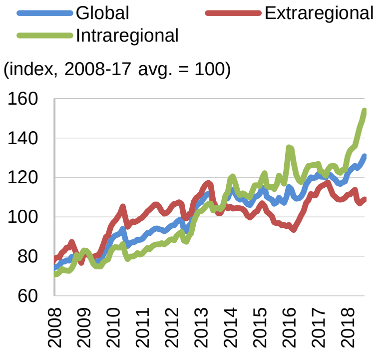
[1] Telecom's high growth rates (19% on average in 2008-17) lifted its weight in real GDP to 15% by 2017 even as its weight in nominal GDP fell to 1.6%, thus explaining a large portion of headline real GDP growth. An upcoming national accounts revision will update the base year to 2014.

FX Intervention & Reserves



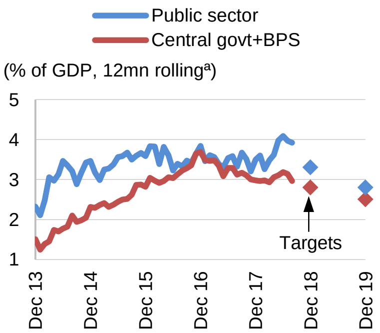
[a] Ex. govt & bank deposits
Source: BCU

Real Effective XR



Source: BCU

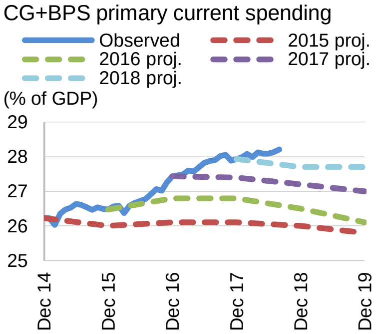
Fiscal Balances and Targets



[a] Calendar effects fixed
Source: MEF

Spending Pressures

CG+BPS primary current spending



Source: MEF, official projections from annual Rendicion de Cuentas

Balanced Current Account, Liquidity Buffers Mitigate External Vulnerability

Sound external finances help mitigate vulnerabilities amid tightening global liquidity conditions, in the absence of significant scope for countercyclical fiscal and monetary policy. The current account shifted into a small surplus in 2016 and stood at 0.2% of GDP in the four quarters through 2Q18, reflecting a private sector that remains little reliant on external funding amid adjustments and investment cuts since 2014, compensating for a public sector that remains a net external borrower. Net foreign direct investment (FDI) remains negative, as Uruguayan investment abroad has surpassed inbound non-resident investment since 2016.

The BCU has intervened to smoothen volatility as the Uruguayan peso has depreciated, both by selling US dollars in the spot market and buying back maturing peso-denominated sterilisation instruments (LRMs) directly with dollars to pre-empt FX market pressures. This has involved a drawdown of reserves, but the stock is high and offers ample coverage of liquid external liabilities (including non-resident deposits and holdings of local bonds) and imports.

The peso depreciated considerably by 13% in 2018 through September, albeit by less than the Brazilian real (18%) and Argentine peso (55%). The real effective exchange rate as measured by the BCU was 30% stronger than its 10-year average as of August. The BCU estimated the peso was 10%-15% overvalued relative to fundamentals as of June, and private estimates hover around 20%-25%. The strong peso poses a competitiveness issue for some tradables sectors, but not a major macroeconomic imbalance given a healthy current account position.

Strained Public Finances Unlikely to See Relief Through Election Cycle

The fiscal position has begun to deteriorate again in 2018 after an improvement in 2017 driven by tax hikes. The central government deficit stood at 3.0% of GDP in the 12 months through August, in line with 3.0% in 2017, although the underlying position worsened net of a 0.35pp one-off revenue transfer from an energy stabilisation fund (FEE)[2]. The broad public sector deficit targeted by the government (also including the BCU and public utility companies) has seen a greater deterioration, having risen to 3.9% of GDP in August from 3.5% in 2017.

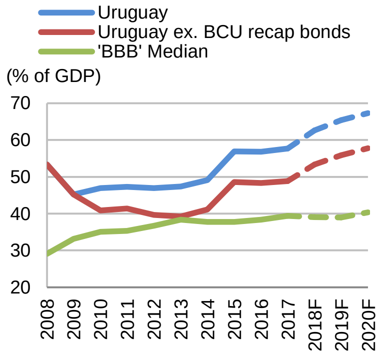
Fitch projects the CG deficit will rise from 3.1% of GDP in 2018 to 3.6% in 2019, preventing the government from achieving its public-sector deficit target of 2.8% in 2019 (recently hiked from 2.5%). The 2019 budget expects cyclical revenue gains, dividends from the state-owned bank (BROU), and better SOE balances to drive a 0.8pp-of-GDP consolidation in 2018 and 2019, but Fitch believes this is unlikely given a flat revenue trend seen so far in 2018 and downside risks posed by a weaker economic outlook. Spending has overshot official projections repeatedly for many years, posing additional risks. In 2018 so far, salaries have inched higher despite a policy to fill two of every three public-sector vacancies, as have capex and goods and services. Social spending faces continued inertial pressure, albeit less so in 2018 given a smaller automatic pension increase (linked to wages) and completion of a health insurance expansion.

The fiscal outlook beyond 2019 will depend upon the policy stance of a new government set to take office in March 2020, following elections in late 2019. In any election scenario, a new fiscal consolidation package could face challenges from narrow appetite for further tax increases amid rising competitiveness concerns, as well as a highly rigid spending profile.

The authorities have indicated that fiscal metrics will be affected in the coming years by a one-time transfer of private pension funds to the public social security bank (BPS), stemming from a new law allowing persons near retirement (the "cincuentones") to exit the private pillar and enter fully into the public system. These funds must be saved in a trust, and thus will not lower the sovereign's borrowing needs. Fitch's headline fiscal projections do not yet incorporate the

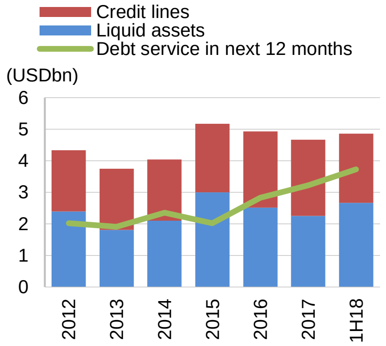
[2] The energy stabilisation fund (FEE) was build up from surpluses of the state electricity company, but deemed to have excess funds given diversification in the energy matrix. In 2018 the congress approved a law allowing excess funds to be transferred to the Treasury, and a transfer of USD194 million (0.35% of GDP) of the USD300 million total was made in August.

General Government Debt



Source: Fitch Ratings based on BCU, INE

Financing Buffers



Source: MEF, Debt Management Unit

impact from this reform given its magnitude is not fully clear. The authorities have indicated that compliance with the official fiscal targets will be assessed net of this.

The reform could also have a slightly positive net fiscal impact for a few years as the continuing payroll contributions of this cohort exceed benefit pay-outs, but the impact will eventually turn negative in the long term and add to the imbalance in the social security system in the absence of broader parametric adjustments. There is growing political consensus around the need for a social security reform in the next government, but this could take some time to negotiate and would most likely yield fiscal savings gradually. The current government is close to passing a reform of the military pension system, which could help contain medium-term fiscal pressures.

Debt on an Upward Path

Fitch projects general government debt will jump to 62.7% of GDP in 2018 from 57.7% (or to 53.5% from 48.8% net of debt issued to the BCU for recapitalisation[3]), driven by a sharp depreciation of the peso after two years in which real appreciation had flattened the trajectory. Fitch projects debt will continue rising to 67.3% by 2020, diverging further from the current 'BBB' median of around 40%, lifted by persisting fiscal deficits and assuming a pace of peso depreciation in line with relative inflation. In the five years since 2013, Uruguay has seen one of the largest rises in debt-to-GDP in the 'BBB' category along with Oman and Aruba.

Proactive debt management efforts and liquidity buffers help to mitigate fiscal financing risks, in the context of tightening global liquidity conditions and a less developed local capital market that renders Uruguay's government relatively reliant on external funding. Debt maturities in 2018-2020 are low, averaging 3.1% of GDP, and the average maturity of debt is especially high at 14.4 years as of June. Liquid central government assets of USD2.7 billion (4.5% of GDP) and precautionary credit lines with multilateral entities of USD2.2 billion (3.7% of GDP) as of end-June cover debt service needs for over twelve months.

[3] Bonds issued to the BCU for recapitalisation (9% of GDP at end-2017) are excluded from official debt statistics but included by Fitch for consistency with data reported by sovereigns that have conducted similar operations. A law passed in 2016 now allows the BCU to cancel these bonds with profits so long as its equity remains above a statutory minimum, which has become more likely in the context of peso depreciation. This would lower Fitch-reported government debt-to-GDP.

Fitch uses stylised projections for a sovereign's gross general government debt/GDP ratio to illustrate the sustainability of its debt burden and its sensitivity to economic growth, the cost of borrowing, fiscal policy and the exchange rate.

Public Debt Dynamics

In Fitch's baseline scenario, general government debt jumps to 62.7% of GDP and surpasses 67% of GDP by 2020. This assumes the primary CG deficit rises instead of falling toward government's 2019 target (a 0.3%-of-GDP surplus), and that the peso depreciates in line with the inflation differential. The main risks to the debt trajectory would be greater-than-expected fiscal slippage, or a larger exchange-rate shock given the sizeable stock of debt in FC.

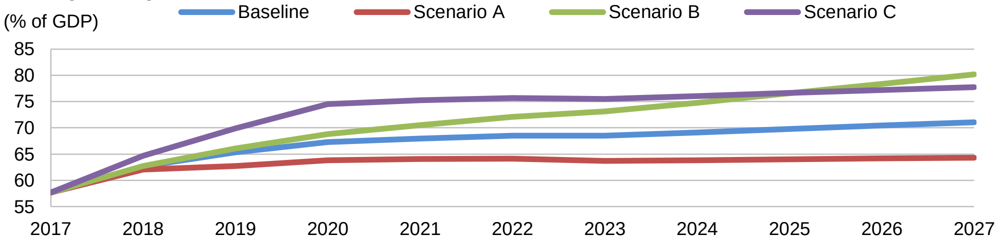
Debt Dynamics: Fitch's Baseline Assumptions

	2017	2018	2019	2020	2021	2022	2027
Gross general government debt (% GDP)	57.7	62.7	65.4	67.3	68.0	68.5	71.0
Primary balance (% of GDP)	-0.3	-0.2	-0.6	-0.2	0.0	0.0	0.0
Real GDP growth (%)	2.7	2.0	1.5	2.7	3.2	3.2	2.8
Avg. nominal effective interest rate[a] (%)	5.1	5.4	5.4	5.5	5.5	5.6	5.6
Local currency/USD (annual avg.)	28.7	31.3	34.6	36.5	38.5	40.6	52.9
GDP deflator (%)	4.0	6.5	7.2	6.4	6.4	6.4	6.4

[a] Capitalising interest on bonds in inflation-indexed units (UI) captured as stock-flow adjustments rather than in effective IR

Sensitivity Analysis

Gross general government debt



Source: Fitch Ratings debt dynamics model

Debt Sensitivity Analysis: Fitch's Scenario Assumptions

Scenario A	Government achieves consolidation target of a 0.3%-of-GDP CG primary surplus by 2019 (2.5% total deficit); higher growth in line with official projections (2.9% average in 2018-2020).
Scenario B	Pace of real GDP growth 1pp below the baseline, failure to reduce the primary deficit below 2017 level of 0.3% of GDP after 2019.
Scenario C	Additional 20% depreciation in the Uruguayan peso beyond the baseline in 2018-2020.

Forecast Summary

	2014	2015	2016	2017	2018f	2019f	2020f
Macroeconomic indicators and policy							
Real GDP growth (%)	3.2	0.4	1.7	2.7	2.0	1.5	2.7
Unemployment (%)	6.6	7.5	7.9	7.9	7.9	7.9	7.6
Consumer prices (annual average % change)	8.9	8.7	9.6	6.2	7.8	8.2	7.7
Short-term interest rate (bank policy annual avg.) (%)	14.4	13.5	13.5	10.4	9.5	9.5	9.5
General government balance (% of GDP)	-2.3	-2.8	-3.7	-3.0	-3.1	-3.6	-3.4
General government debt (% of GDP)	49.1	56.9	56.8	57.7	62.7	65.4	67.3
UYU per USD (annual average)	23.25	27.33	30.16	28.68	31.28	34.57	36.53
Real effective exchange rate (2000 = 100)	101.4	105.1	109.6	117.3	120.8	123.2	123.2
Real private sector credit growth (%)	7.4	11.8	-5.4	-3.7	8.0	0.3	1.0
External finance							
Current account balance (% of GDP)	-3.2	-0.9	0.6	0.7	-0.6	-2.8	-3.4
Current account balance plus net FDI (% of GDP)	1.2	0.6	-1.5	-3.0	-1.2	-1.4	-1.2
Net external debt (% of GDP)	-15.6	-17.6	-18.1	-15.6	-17.9	-18.5	-18.4
Net external debt (% of CXR)	-46.0	-56.6	-61.0	-52.5	-55.2	-55.6	-54.4
Official international reserves including gold (USDbn)	17.6	15.6	13.5	16.0	16.0	16.4	16.8
Official international reserves (months of CXP cover)	9.9	11.0	10.5	11.1	9.9	9.4	9.0
External interest service (% of CXR)	5.8	7.3	7.4	6.4	6.1	6.2	6.0
Gross external financing requirement (% int. reserves)	25.8	14.1	5.5	11.3	11.3	17.2	19.9
Real GDP growth (%)							
US	2.5	2.9	1.6	2.2	2.9	2.6	2.1
China	7.3	6.9	6.7	6.9	6.6	6.1	6.1
Eurozone	1.4	2.1	1.9	2.4	2.0	1.8	1.6
World	2.8	2.8	2.5	3.2	3.3	3.1	3.0
Oil (USD/barrel)	98.9	52.4	45.1	54.9	70.0	65.0	57.5

Source: Fitch Ratings

Fiscal Accounts Summary

(% of GDP)	2015	2016	2017	2018f	2019f	2020f
General government						
Revenue	**27.2**	**27.8**	**29.0**	**29.2**	**29.0**	**29.0**
Expenditure	**30.0**	**31.5**	**32.0**	**32.3**	**32.6**	**32.4**
O/w interest payments	2.3	2.7	2.7	2.9	3.1	3.2
Primary balance	-0.5	-1.0	-0.3	-0.2	-0.6	-0.2
Overall balance	**-2.8**	**-3.7**	**-3.0**	**-3.1**	**-3.6**	**-3.4**
General government debt	**56.9**	**56.8**	**57.7**	**62.7**	**65.4**	**67.3**
% of general government revenue	209.5	204.3	199.0	214.4	225.2	231.9
Central government deposits	7.1	7.0	5.7	5.8	5.9	5.8
Net general government debt	49.1	50.0	51.9	56.4	59.3	61.4
Central government						
Revenue	**19.7**	**20.3**	**21.3**	**21.5**	**21.3**	**21.3**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**22.5**	**24.0**	**24.2**	**24.6**	**25.0**	**24.7**
O/w current expenditure and transfers	19.0	20.0	20.2	20.4	20.5	20.2
- Interest	2.3	2.7	2.7	2.9	3.1	3.2
O/w capital expenditure	1.2	1.4	1.3	1.3	1.4	1.3
Current balance	-1.6	-2.3	-1.7	-1.7	-2.3	-2.1
Primary balance	-0.5	-1.0	-0.3	-0.2	-0.6	-0.2
Overall balance	**-2.8**	**-3.7**	**-3.0**	**-3.1**	**-3.6**	**-3.4**
Central government debt	56.7	56.5	57.5	62.4	65.1	67.1
% of central government revenue	287.8	278.1	270.3	289.9	305.3	314.5
Central government debt (UYUbn)	**825.3**	**898.6**	**975.1**	**1,150.0**	**1,305.2**	**1,469.2**
By residency of holder						
Domestic	358.0	453.0	521.2	602.1	686.4	775.9
Foreign	467.2	445.6	453.9	547.9	618.9	693.2
By currency denomination						
Local currency	439.0	478.7	572.7	621.2	707.9	800.1
Foreign currency	386.2	419.9	402.4	528.9	597.4	669.1
In USD equivalent (eop exchange rate)	12.9	14.4	14.0	15.7	16.8	17.8
Average maturity (years)	14.4	13.8	13.0	-	-	-
Memo						
Nominal GDP (UYUbn)	1,455.8	1,589.2	1,697.1	1,842.8	2,004.3	2,190.3

Source: Fitch Ratings, Ministry of Finance

External Debt and Assets

(USDbn)	2013	2014	2015	2016	2017	2018f
Gross external debt	**38.5**	**42.1**	**43.5**	**40.3**	**40.7**	**42.2**
% of GDP	66.9	73.5	81.6	76.5	68.7	71.7
% of CXR	195.1	216.6	262.0	257.3	230.8	221.1
By maturity						
Medium- and long-term	29.3	32.7	34.1	33.1	34.6	36.2
Short -term	9.2	9.4	9.3	7.2	6.1	6.1
% of total debt	23.9	22.4	21.5	17.8	14.9	14.4
By debtor						
Sovereign	**16.7**	**17.7**	**16.6**	**16.2**	**18.4**	**20.2**
Monetary authorities	1.6	1.7	1.1	0.7	0.8	0.8
General government	15.1	16.1	15.5	15.4	17.6	19.4
O/w central government	14.4	15.1	15.6	15.2	15.8	18.1
Banks	**5.1**	**5.5**	**6.0**	**4.6**	**3.8**	**3.8**
Other sectors	**16.7**	**18.8**	**20.8**	**19.6**	**18.5**	**18.3**
Gross external assets (non-equity)	**46.9**	**51.0**	**52.9**	**49.8**	**49.9**	**52.8**
International reserves, incl. gold	16.3	17.6	15.6	13.5	16.0	16.0
Other sovereign assets nes	0.1	0.1	0.1	0.0	0.0	0.0
Deposit money banks' foreign assets	8.3	8.7	11.0	10.6	9.7	10.2
Other sector foreign assets	22.3	24.7	26.2	25.7	24.3	26.6
Net external debt	**-8.4**	**-8.9**	**-9.4**	**-9.5**	**-9.2**	**-10.5**
% of GDP	-14.6	-15.6	-17.6	-18.1	-15.6	-17.9
Net sovereign external debt	0.3	0.1	0.9	2.7	2.4	4.2
Net bank external debt	-3.1	-3.2	-5.0	-6.1	-5.9	-6.4
Net other external debt	-5.6	-5.9	-5.4	-6.1	-5.8	-8.3
Net international investment position	**-15.3**	**-17.2**	**-15.0**	**-15.6**	**-17.1**	**-15.8**
% of GDP	-26.6	-30.0	-28.2	-29.7	-28.9	-26.8
Sovereign net foreign assets	**-0.3**	**-0.1**	**-0.9**	**-2.7**	**-2.4**	**-4.2**
% of GDP	-0.6	-0.2	-1.8	-5.1	-4.1	-7.0
Debt service (principal & interest)	**3.1**	**3.5**	**3.2**	**2.3**	**3.1**	**2.6**
Debt service (% of CXR)	15.6	18.1	19.3	15.0	17.6	13.7
Interest (% of CXR)	5.4	5.8	7.3	7.4	6.4	6.1
Liquidity ratio (%)	167.0	158.6	172.5	194.9	220.2	285.1
Net sovereign FX debt (% of GDP)	-11.2	-11.8	-5.1	1.7	-3.2	-0.4
Memo						
Nominal GDP	57.5	57.2	53.3	52.7	59.2	58.9
Inter-company loans	9.8	11.4	13.8	12.9	12.1	12.1

Sources: Fitch Ratings, central bank, IMF and World Bank

External Debt Service Schedule on Medium- and Long-Term Debt at 30 June 2018

(USDm)	2018	2019	2020	2021	2022	2023+
Sovereign: Total debt service	**1,899**	**1,429**	**1,524**	**1,856**	**2,959**	**31,876**
Amortisation	726	240	347	701	1,885	19,157
Official bilateral	-	-	-	-	-	-
Multilateral	135	172	163	157	150	1,748
O/w IMF	-	-	-	-	-	-
Other	-	-	-	-	-	-
Bonds placed in foreign markets	591	68	184	544	1,735	17,409
Interest	1,173	1,189	1,177	1,155	1,074	12,719
Non-sovereign public sector	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**

Sources: Fitch Ratings, Ministry of Finance and central bank

Balance of Payments

(USDbn)	2015	2016	2017	2018f	2019f	2020f
Current account balance	**-0.5**	**0.3**	**0.4**	**-0.4**	**-1.6**	**-2.0**
% of GDP	-0.9	0.6	0.7	-0.6	-2.8	-3.4
% of CXR	-2.9	2.1	2.5	-1.9	-8.4	-9.9
Trade balance	**1.3**	**1.9**	**2.1**	**2.4**	**2.6**	**2.4**
Exports, fob	11.1	10.4	10.8	12.2	13.2	13.8
Imports, fob	9.8	8.5	8.7	9.8	10.6	11.4
Services, net	**0.4**	**0.8**	**1.5**	**1.2**	**0.6**	**0.6**
Services, credit	4.5	4.2	5.1	5.0	4.7	5.0
Services, debit	4.1	3.3	3.6	3.8	4.2	4.4
Income, net	**-2.4**	**-2.6**	**-3.3**	**-4.2**	**-4.9**	**-5.2**
Income, credit	0.7	0.9	1.5	1.6	1.1	1.2
Income, debit	3.1	3.5	4.8	5.8	6.1	6.4
O/w: Interest payments	1.2	1.2	1.1	1.2	1.2	1.2
Current transfers, net	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Capital and financial accounts						
Non-debt-creating inflows (net)	-0.2	1.3	0.0	1.7	1.8	2.3
O/w equity FDI	-0.4	1.0	0.2	1.7	1.8	2.3
O/w portfolio equity	0.2	0.3	-0.2	0.0	0.0	0.0
O/w other flows	0.2	0.0	0.0	0.0	0.0	0.0
Change in reserves	1.7	2.2	-2.4	-0.1	-0.3	-0.4
Gross external financing requirement	2.5	0.9	1.5	1.8	2.8	3.3
Stock of international reserves, incl. gold	15.6	13.5	16.0	16.0	16.4	16.8

Sources: Fitch Ratings, IMF

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