MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Uruguay's Baa2 ratings; maintains stable outlook

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New York, August 06, 2019 -- Moody's Investors Service ("Moody's") has today affirmed the Government of Uruguay's Baa2 foreign-currency and local-currency long-term issuer and senior unsecured ratings. The senior unsecured shelf ratings were also affirmed at (P)Baa2. Concurrently, Moody's has maintained the stable outlook.

Moody's decision to affirm Uruguay's Baa2 ratings is underpinned by the following drivers:

1. Uruguay's moderate economic strength, with the expected recovery in economic growth in the coming two years, mainly relating to investment in a new large pulp mill plant, countering a structural decline in growth potential;

2. The country's low fiscal strength that, while slowly eroding, remains for now broadly in line with that of its Baa2-rated peers;

3. Moody's expectation that Uruguay's history of policy-consensus building will support the adoption of measures to confront its structural economic and fiscal challenges in the coming years.

The stable outlook balances negative underlying fiscal and economic pressures against Moody's assumption that the next administration will implement structural economic and fiscal reforms which will counter the ongoing erosion in Uruguay's economy and fiscal strength.

Uruguay's long-term foreign currency bond and deposit ceilings remain unchanged at A2 and Baa2, respectively. The local currency bond and deposit ceilings remain unchanged at A2. The short-term foreign currency bond ceiling and short-term foreign currency deposit ceiling remain at Prime-2 (P-2).

RATINGS RATIONALE

RATIONALE FOR AFFIRMING THE Baa2 RATING

URUGUAY'S MODERATE ECONOMIC STRENGTH, WITH THE EXPECTED RECOVERY IN ECONOMIC GROWTH IN THE COMING TWO YEARS, MAINLY RELATING TO INVESTMENT IN A NEW LARGE PULP MILL PLANT, COUNTERING A STRUCTURAL DECLINE IN GROWTH POTENTIAL

Moody's expects that economic growth will decelerate to about 0.5% in 2019 from 1.6% in 2018. Growth will average 1.8% in 2017-20, compared to a Baa median of 3.5%. Structural issues have afflicted investment, labor markets, and competitiveness, in turn weighing on the potential growth of the economy. Private sector gross fixed capital formation has declined to 13% of GDP from a peak of 18% in 2012-13. Concurrently, labor market participation rates have also declined during that period, with a rise in unemployment, and the economy's international competitiveness has also eroded negatively affecting companies' profitability and limiting their ability and appetite to invest.

Nonetheless, a series of cyclical factors will support higher level of economic activity during the 2020-22 period. First and foremost, Moody's believes that economic growth will be boosted by the development of the country's third large pulp mill plant by Finnish company UPM-Kymmene (Baa2 positive). The project, whose contractual agreement with the government was signed on 23 July, will represent an investment of $2.7 billion to build the pulp plant and an additional $350 million in port operations and local facilities (together equal to about 5.1% of GDP). An additional railroad project to connect the plant, located in the center of the country, with the port of Montevideo will add another $0.8 billion in investment. Moody's forecasts growth will recover to about 2.5% in 2020-22 supported by this project, while balancing the potential negative effect of a fiscal adjustment on growth.

Moody's growth forecast for the next two to three years is also informed by the expected recovery in Argentina and an acceleration of growth in Brazil, combined with looser international financial conditions as central banks

in developed markets adopt more accommodative stances.

THE COUNTRY'S LOW FISCAL STRENGTH THAT, WHILE SLOWLY ERODING, REMAINS FOR NOW BROADLY IN LINE WITH OF ITS BAA2-RATED PEERS

Uruguay's fiscal strength deteriorated in previous years in the context of weak economic activity as debt metrics worsened. Moody's considers that fiscal adjustment in Uruguay is constrained by a relatively inflexible spending structure because a large share of expenditures are indexed and/or mandated by the constitution. Overall, about two thirds of total spending, including pensions (31% of total spending), transfers (28%) and interest payments (9%), is generally considered difficult to adjust unless large efficiency gains or reforms are pursued.

The fiscal deficit for the consolidated central government rose to 3.4% of GDP in 2018 (excluding revenue from so-called "cincuentones" transfers of pension assets) from 3.0% in 2017, and Moody's estimates that the deficit widened to about 3.9% by June 2019. These relatively large imbalances, combined with the impact of the exchange rate shocks on the government's balance sheet due to its still significant foreign currency debt exposure, have caused Uruguay's debt burden to rise to 52% of GDP in 2018, up from 41% in 2014.

Still, Moody's notes that Uruguay's debt metrics remain broadly aligned with those of its Baa2-rated peers. At 53% of GDP in 2019, Uruguay's debt burden will be in line with the Baa median while moderately above the 46% median for Baa2 peers but below the median for Baa3-rated peers, which stands at 58%. In terms of debt affordability, Uruguay's interest burden on budgetary revenues of 9.6% remains below the Baa2 median of 12.5%.

MOODY'S EXPECTATION THAT URUGUAY'S HISTORY OF POLICY-CONSENSUS BUILDING WILL SUPPORT THE ADOPTION OF MEASURES TO CONFRONT ITS STRUCTURAL ECONOMIC AND FISCAL CHALLENGES IN THE COMING YEARS

Political risk is very low in Uruguay given the country's mature and consensus-building political system. This has contributed to the development of strong institutions, particularly with regards to rule of law, control of corruption and government effectiveness. In the context of general elections taking place in October 2019, these features of Uruguay's credit profile support Moody's view that policy measures and reforms focusing on the country's structural challenges are likely to be implemented in the coming years. Moody's notes that most political forces have identified Uruguay's fiscal weaknesses as one of the most urgent macroeconomic challenges that the next administration, set to take office in March 2020, will face. In that sense, there is broad consensus among political parties that a pension reform has to be pursued by the next government. Additionally, Moody's believes that the next government will likely enact measures to bolster competitiveness and support economic dynamism by supporting investment and labor markets.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook balances risks against opportunities. On the one hand, Uruguay's economic strength is gradually eroding as, in consequence, is its fiscal strength. Should that trend continue, the country's credit profile will erode relative to peers and its rating will come under downward pressure in the relatively near future. Set against that, the structural challenges appear to be recognized by all the principal political actors, and there seems to be broad political support for structural reforms that counter the erosion in economic and fiscal strength. The stable outlook reflects Moody's assumption that the next administration will indeed implement economic and fiscal reforms, including some focused on the labor market and the pension system, which counter the ongoing erosion in Uruguay's economy and fiscal strength.

WHAT COULD CHANGE THE RATING UP/DOWN:

Upward credit pressure could result from (1) a reduction in structural rigidities of Uruguay's credit profile including those associated to low and declining productivity which affect potential growth as well as relatively rigid government spending structure; (2) a material strengthening of the government balance sheet through a reduction in the sovereign's debt and interest burdens; and (3) a reduction in vulnerability through a significant decrease in the share of foreign-currency government debt.

Downward credit pressure would emerge were Moody's to conclude that structural fiscal and economic challenges were not likely to be addressed, denoting a weakening in policy responsiveness, and likely leading to economic growth underperforming and fiscal strength deteriorating further in the medium term, with a continued increase in debt ratios and/or a sustained, material erosion in external and financial buffers.

GDP per capita (PPP basis, US$): 23,274 (2018 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 1.6% (2018 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 8% (2018 Actual)

Gen. Gov. Financial Balance/GDP: -3.4% (2018 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -0.6% (2018 Actual) (also known as External Balance)

External debt/GDP: 70.5% (2018 Actual)

Level of economic development: Moderate level of economic resilience

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 01 August 2019, a rating committee was called to discuss the rating of the Government of Uruguay. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have decreased. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. The issuer has become less susceptible to event risks.

The principal methodology used in these ratings was Sovereign Bond Ratings published in November 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

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