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ISSUER COMMENT
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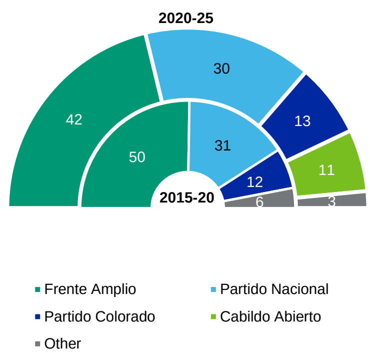
Government of Uruguay

Consensus-building coalition will be key to passing reforms after elections

On 27 October, Uruguay (Baa2 stable) held general elections in which the Frente Amplio's presidential candidate Daniel Martinez won 39.2% of the votes and the Partido Nacional's Luis Lacalle Pou won 28.6%, effectively setting them up for a runoff election on 24 November.[1] No party obtained a majority in either chambers of congress. As a result, regardless of the outcome of the runoff election, the new government will need to form a coalition to be able to pass key measures that address the structural rigidities currently weighing on Uruguay's economic and fiscal dynamics.

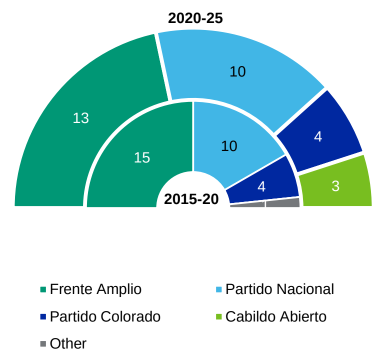
Congress will be the most fragmented it has been in the past 15 years, and for the first time in this period the Frente Amplio will not have a majority. Altogether, current opposition parties will have the greatest number of seats in both chambers of congress. As opposition parties had somewhat similar electoral platforms, we think there is a high likelihood they will be able to reach political agreements to push forward key legislative measures if the candidate from Partido Nacional gets elected.[2]

Exhibit 1
Lower chamber composition
Number of seats; 50 seats for simple majority



Sources: Electoral Court of Uruguay, Moody's Investors Service

Exhibit 2
Senate chamber composition
Number of seats; 16 seats for simple majority



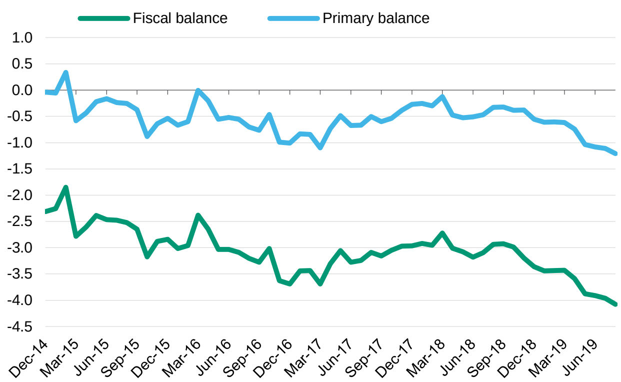
Sources: Electoral Court of Uruguay, Moody's Investors Service

Uruguay has faced significant economic and fiscal challenges over the past five years which have led to weak economic growth and limited fiscal consolidation due to constraints imposed by a very rigid expenditure structure.

As a small open economy, an adverse regional economic environment with Argentina (Caa2 RUR-) in recession and weak growth in Brazil (Ba2 stable) has weighed on Uruguay's growth prospects, in addition to external challenges coming from a global slowdown. Uruguay's investment ratio has been decreasing steadily moving to 16.5% of GDP in 2018 from 22.9% in 2012, while unemployment has been rising weighing on household consumption.

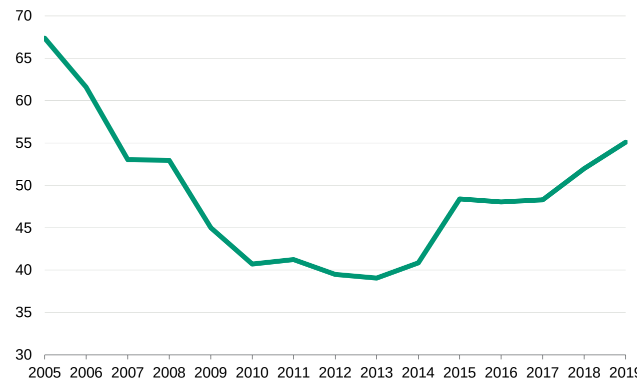
On the fiscal front, despite adjustment measures announced in 2016 by the administration of President Tabare Vazquez that focused mostly on government revenue, the deficit remains relatively elevated. We expect a fiscal deficit of about 4.0% of GDP at the consolidated central government level[3] up from 2.8% in 2015. Furthermore, the depreciation of the peso (about 15% year-to-date) has had a material impact on debt metrics as more than half of the government's debt stock is foreign currency-denominated, pushing the debt ratio to 55% of GDP in 2019 from 41% in 2014.

Exhibit 3
Uruguay's fiscal deficit has widened...
% of GDP, 12-month rolling sum



Sources: Ministry of Finance, Central Bank of Uruguay, Moody's Investors Service

Exhibit 4
...and debt-to-GDP is on an upward trajectory
% of GDP



Sources: Ministry of Finance, Central Bank of Uruguay, Moody's Investors Service

In August, we affirmed Uruguay's Baa2 rating with a stable outlook reflecting our expectation that cyclical factors would provide the new government time to implement measures to address ongoing fiscal and growth challenges.

In July, the government announced the conclusion of a deal with UPM-Kymmene (Baa2 positive), granting the Finnish company the right to build a second large pulp mill plant in the country (the third overall) starting in 2020. Because of the large size of this project relative to Uruguay's economy ($3 billion equivalent to 5.1% of GDP) and an associated railway project ($0.8 billion equivalent to 1.5% of GDP) we expect growth will increase to 2.5% in 2020 from 0.5% in 2019. Still, we note that additional government revenue will be limited as the authorities provided large tax benefits to UPM as investment incentives. Therefore, a revenue-based fiscal consolidation is unlikely to lead by itself to a material improvement of Uruguay's fiscal accounts.

During the presidential campaign, all candidates mentioned the next administration should prioritize fiscal consolidation and there appears to be broad consensus among political parties on the need to tackle pension reform. With the next administration set to take office in March 2020, we will closely monitor its policy proposals to assess the potential effect on key sovereign credit metrics.

Moody's related publications

» **Issuer In-Depth:** Government of Uruguay – Baa2 stable: Annual credit analysis, 14 August 2019

» **Credit Opinion:** Government of Uruguay – Baa2 stable: Update following rating affirmation, outlook unchanged, 7 August 2019

» **Rating Action**: Moody's affirms Uruguay's Baa2 ratings; maintains stable outlook, 6 August 2019

» **Issuer Comment:** Government of Uruguay: Weaker growth outlook will intensify fiscal challenges, 10 April 2019

» **Country Statistics**: Uruguay, Government of, 3 June 2019

» **Rating Methodology:** Sovereign Bond Ratings, 27 November 2018

Endnotes

1 In Uruguayan elections, a presidential candidate needs to win over 50% of the vote to avoid a runoff election.

2 The other two candidates to receive over 10% of votes were the Colorado Party's Ernesto Talvi (12.3%) and the Cabildo Abierto's Guido Manini Rios (10.9%). Both have stated their support to Mr. Lacalle Pou.

3 We exclude revenue from the so-called "cincuentones" law for our analysis of Uruguay's fiscal accounts.

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