FitchRatings

Uruguay

Key Rating Drivers

Negative Outlook: Sluggish growth and structural fiscal deterioration are driving a rise in public debt at already high levels. The new centre-right government of Luis Lacalle Pou has expressed a clearer and more credible commitment to reverse these trends, but faces a weaker-than-expected starting point, difficult trade-offs, and implementation challenges.

New Government, New Focus: In his five-year term beginning March 2020, Lacalle pledges to lift low growth and reduce the budget deficit. His party's coalition with four other parties has a legislative majority, supporting prospects for his agenda, but inter-party negotiations and ideological diversity pose uncertainty about what they can achieve.

Weaker Fiscal Starting Point: The central government deficit reached 4.3% of GDP in 2019 (excluding extraordinary pension revenues), and was higher net of some extraordinary factors. The primary deficit of 1.6% far surpassed even the most recent budget projections, driven by a persisting trend of spending overruns compounded by a recent moderate ebb in tax revenues.

Fiscal Pledge to Be Tested: Lacalle has pledged to reduce the budget deficit via spending cuts. A rigid spending profile dominated by social entitlements could make this challenging, as could potential resistance from social groups and within the public sector. The government's five-year budget, to be submitted mid-year, will indicate how it expects to balance competing fiscal and growth objectives. A pledge not to raise taxes could narrow policy options.

Rising Debt: General government debt reached 62.6% of GDP in 2020, (2014: 49.5%); in the past two years a larger rise has been avoided by a drawdown in government deposits and the accumulation of intra-public 'cincuentones' bond holdings (consolidated in Fitch Ratings' figures). Fitch estimates a 2.5%-of-GDP correction in the primary balance would stabilise debt.

Anaemic Growth: Real GDP growth fell to an estimated 0.3% in 2019 and has averaged 1.3% since 2014, below the 'BBB' median of 3.0%, driven by public utilities (mainly telecom) as private activities have largely contracted or stagnated. Fitch expects growth to reach 1.5% in 2020 and 2.5% in 2021 as a large pulp mill project and related railway ramp up. Lacalle's proposed "urgent consideration law" has many proposals to address long-standing concerns regarding the business climate and boost low investment (16% of GDP in 2019).

Tough Monetary Trade-Off: Inflation rose well above the target (5% +/-2pp) to 8.8% by end-2019, fuelled by surging global meat prices. Expectations remain above 8%. The central bank faces a difficult balance to improve weak inflation-targeting credibility without adding to perceived concerns around peso overvaluation, after some improvement in 2020.

External, Financial Stability: The current account is in a roughly balanced position, and should shift to a moderate deficit in 2020 as the pulp project ramps up (but financed by corresponding FDI). The central bank has ample reserves, allowing it to actively intervene in FX markets to manage peso volatility. The banking sector remains sound in terms of solvency and liquidity.

Rating Sensitivities

Growth, Fiscal Disappointment: The ratings could be downgraded if the country fails to reduce fiscal deficits and set out a credible medium-term plan sufficient to improve the trajectory of government debt/GDP; persistent weak economic growth prospects, for example reflecting an absence of a cyclical recovery or reforms to improve medium-term potential.

Credible Fiscal Plan: The Outlook could be stabilised on greater confidence in a consolidation plan that would support improvement of the trajectory of government debt/GDP; improvement in medium-term growth prospects (eg supported by structural reforms).

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

Rating Derivation

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

Applicable Criteria

Sovereign Rating Criteria (May 2019)

Country Ceilings Criteria (July 2019)

Related Research

Latin America Sovereigns 2020 Outlook (February 2020)

Global Economic Outlook (December 2019)

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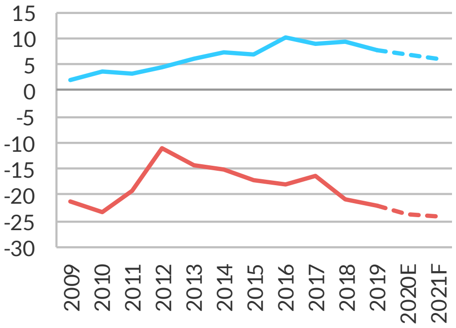
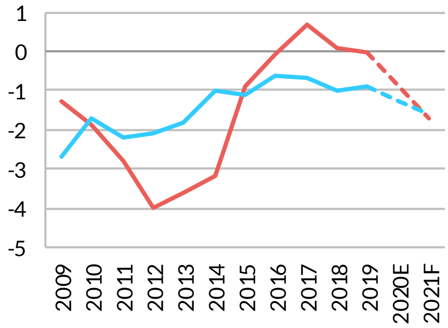
Peer Comparison

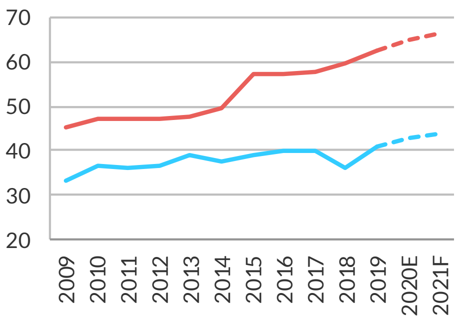
Net External Debt
% of GDP



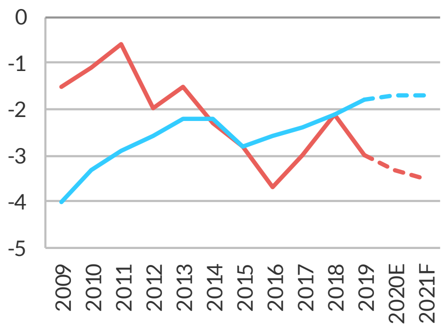
Current Account Balance
% of GDP



General Government Debt
% of GDP

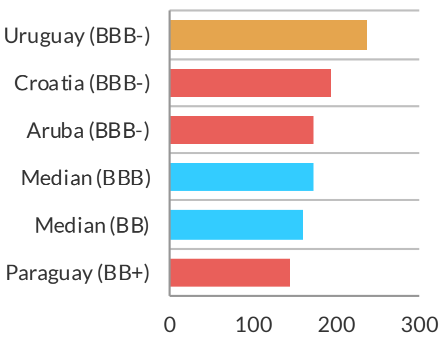


General Government Balance
% of GDP

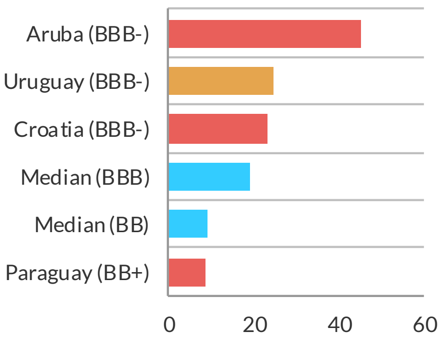


Uruguay   Median (BBB)

International Liquidity Ratio, 2019
%



GDP per Capita Income, 2019
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.
Source: Fitch Ratings

Financial Data

Uruguay	
(USDbn)	2019
GDP	55.9
GDP per head (USD, 000)	16.1
Population (m)	3.5
International reserves	14.5
Net external debt (% GDP)	-22.2
Central government total debt (% GDP)	63.8
CG foreign-currency debt	16.7
CG domestically issued debt (UYUbn)	384.8

Source: Fitch Ratings

Rating Factors

Summary: Strengths and Weaknesses

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

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

Strengths

- Indicators of governance, per-capita income and social development are strong, and are reflected in political stability and policy predictability.
- Macroeconomic volatility is low (real GDP growth, inflation, real effective exchange rate) despite commodity dependence, small size, and instability in neighbouring economies.
- A roughly balanced current account indicates a sound external position, although this presently reflects low weak investment and FDI inflows.
- External solvency metrics are sound. Banks and corporates support a strong net external creditor position, although the sovereign is a net external debtor.
- The liquidity ratio is among the highest of 'BBB' peers due to ample FX reserves, long-dated external debt, and manageable liquid liabilities (non-resident deposits).
- Low near-term public debt maturities and a long-dated debt stock reflect prudent debt-management practices. Multilateral credit lines offer an important financing buffer.
- Fiscal revenue volatility is low, and direct fiscal commodity dependence is negligible.

Weaknesses

- Policy flexibility is narrow. High dollarization, low financial penetration and prevalent indexation restrain monetary policy efficacy. Fiscal space is constrained.
- Policy credibility is weak due to persistent deviation from fiscal and inflation targets.
- High fiscal deficits have driven general government debt to 63% of GDP in 2019, far above the 'BBB' median (even net of 7pp in central bank recapitalisation bonds).
- Spending is highly rigid, dominated by indexed social entitlements and with a very low share of capex, explaining past fiscal slippage and posing challenges to consolidation.
- The sovereign balance sheet is vulnerable to XR swings given the stock of foreign-currency debt is the largest among 'BBB' peers at 32% of GDP in 2019 (51% of the total).
- Five-year average growth of 1.3% is one of the weakest in the 'BBB' category, although a pulp project is expected to provide a boost in the coming years.
- Growth potential is weak, reflecting very low investment (around 16% of GDP in 2019) and competitiveness issues (seen in a low Ease of Doing Business score).
- Inflation is the highest in investment-grade space, averaging 8.0% in the past five years. The authorities have worked to de-index wages to reduce inertial price pressures.

Local-Currency Rating

Uruguay's Long-Term Local-Currency Issuer Default Rating (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 record of preferential treatment of local-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.

Peer Group

Rating	Country
BBB	Bulgaria
	Colombia
	Hungary
	Indonesia
	Italy
	Kazakhstan
	Mexico
	Panama
	Philippines
	Portugal
	Russia
BBB-	**Uruguay**
	Aruba
	Croatia
	Cyprus
	India
	Morocco
	Romania
	San Marino
BB+	Azerbaijan
	North Macedonia
	Oman
	Paraguay
	Serbia
	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

Strengths and Weaknesses: Comparative Analysis

2019	Uruguay BBB-	BBB median[a]	BB median[a]	Aruba BBB-	Croatia BBB-	Paraguay BB+
Structural features						
GDP per capita (USD, mkt exchange rates)	16,135	12,152	5,735	29,362	15,001	5,537
GNI per capita (PPP, USD, latest)	21,900	22,300	14,560	38,333	-	13,180
GDP (USDbn)	55.9			3.3	60.9	38.7
Human development index (percentile, latest)	69.6	66.4	51.3	-	76.0	41.4
Governance indicator (percentile, latest)[b]	80.1	58.1	43.9	86.6	66.5	37.9
Broad money (% GDP)	54.3	59.3	47.7	75.5	75.6	37.8
Default record (year cured)[c]	2003	-	-	-	1996	2004
Ease of doing business (percentile, latest)	47.1	70.9	52.2	-	73.6	34.4
Trade openness (avg. of CXR + CXP % GDP)	32.3	46.4	46.5	81.8	62.3	37.8
Gross domestic savings (% GDP)	18.6	22.7	17.9	26.7	22.3	23.3
Gross domestic investment (% GDP)	16.1	23.7	21.6	20.6	22.1	22.1
Private credit (% GDP)	28.2	56.9	36.7	57.3	54.7	45.7
Bank systemic risk indicators[d]	bb/1			-/1	-/1	-/1
Bank system capital ratio (% assets)	17.5	15.1	15.7	32.2	22.6	18.0
Foreign bank ownership (% assets)	49.3	33.0	35.4	100.0	90.1	39.1
Public bank ownership (% assets)	50.7	13.4	16.5	0.0	6.1	6.4
Macroeconomic performance and policies						
Real GDP (5yr average % change)	1.3	3.6	4.2	2.6	2.9	3.2
Volatility of GDP (10yr rolling SD)	2.3	3.0	2.5	2.7	2.1	3.5
Consumer prices (5yr average)	8.0	4.0	5.6	1.1	0.6	3.5
Volatility of CPI (10yr rolling SD)	1.0	2.4	3.3	2.1	1.2	1.6
Unemployment rate (%)	8.9	7.6	8.9	8.0	7.0	4.6
Type of exchange-rate regime	Floating			Peg (USD)	Stabilised	Floating
Dollarisation ratio (% of bank deposits)	74.1	17.1	40.4	17.3	55.0	44.7
REER volatility (10yr rolling SD)	4.4	5.1	6.4	1.7	4.2	4.4

Source: Fitch Ratings

Strengths and Weaknesses: Comparative Analysis (Cont.)

2019	Uruguay BBB-	BBB median[a]	BB median[a]	Aruba BBB-	Croatia BBB-	Paraguay BB+
Public finances[e]						
Budget balance (% GDP)	-3.0	-2.3	-2.7	-0.9	0.1	-2.0
Primary balance (% GDP)	-0.4	-0.2	-0.6	3.5	2.2	-1.3
Gross debt (% revenue)	208.1	134.2	155.0	250.3	152.3	115.1
Gross debt (% GDP)	62.6	35.9	38.4	60.5	71.3	20.1
Net debt (% GDP)	58.6	30.7	32.9	58.4	65.7	11.9
Foreign currency debt (% total debt)	50.7	36.0	60.7	33.3	73.2	80.4
Interest payments (% revenue)	8.6	6.9	9.2	16.2	4.5	4.3
Revenues and grants (% GDP)	30.1	32.0	25.0	24.2	46.8	17.5
Volatility of revenues/GDP ratio	1.3	6.5	6.2	7.3	4.8	4.4
Central govt. debt maturities (% GDP)	6.4	5.1	4.8	6.3	8.0	0.8
External finances						
Current account balance + net FDI (% GDP)	-1.2	0.6	0.8	5.0	3.6	0.2
Current account balance (% GDP)	0.0	-1.8	-2.6	2.0	1.4	-1.1
Net external debt (% GDP)	-22.2	6.6	9.6	2.3	16.0	8.5
Gross external debt (% CXR)	250.5	111.0	114.0	79.8	112.6	115.4
Gross sovereign external debt (% GXD)	45.1	31.3	47.2	46.0	39.8	40.6
Sovereign net foreign assets (% GDP)	-10.5	2.7	-2.5	3.2	9.8	2.4
Ext. interest service ratio (% CXR)	8.4	4.3	3.9	4.0	3.3	5.5
Ext. debt service ratio (% CXR)	20.9	15.1	14.7	14.0	20.4	10.5
Foreign-exchange reserves (months of CXP)	9.6	4.9	4.3	5.0	7.0	6.0
Liquidity ratio (latest)[f]	242.9	148.0	149.0	173.4	194.2	143.9
Share of currency in global reserves (%)	0	0	0	0	0	0
Commodity export dependence (% CXR, latest)	51.4	20.9	21.8	4.7	12.6	76.6
Sovereign net foreign currency debt (% GDP)	4.0	-5.8	2.3	-13.3	16.4	-3.1

[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] General government unless stated
[f] 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
Note: Acronyms 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

Key Credit Developments

A Change in Government After 15 Years

Luis Lacalle Pou of the centre-right Partido Nacional assumed the presidency in March 2020 after his narrow victory in late-2019 elections, marking a change in government after 15 years under the centre-left Frente Amplio. Lacalle has pledged to lift anaemic economic growth and reduce the high fiscal deficit. Achieving both growth and fiscal objectives will be challenging given difficult trade-offs between the two, but the Lacalle agenda aims to do so primarily though improving efficiency in the country's large public sector.

To advance its agenda, the Partido Nacional has formed a coalition with four parties, including the more left-leaning Partido Colorado and new right-leaning Cabildo Abierto, which together will have a majority in parliament (56 of 99 seats in the lower chamber; 17 of 30 in the senate).

Given the coalition is new and composed of parties that are not all traditional allies, and with diverse ideological positions, marshalling consensus around some initiatives could be difficult or result in dilution. The coalition will face an early legislative test from Lacalle's proposed "urgent consideration law" (LUC), which broaches wide-ranging issues and must receive fast-track legislative consideration. Lacalle submitted a draft LUC in January, containing many proposals in line with campaign pledges, which must now be considered by coalition partners.

New Government Faces Difficult Fiscal Task After Years of Slippage

The central government deficit (CG) rose to 4.3% of GDP in 2019 from 3.4% in 2018, net of the extraordinary pension inflows related to the 'cincuentones' law. This was well above the 1.9% goal set by the Vazquez administration in 2015 in its five-year budget and its updated 3.7% projection in mid-2019. The deficit was even higher net of a 0.3pp fall in interest costs that reflects an accounting change (albeit one in line with IMF standards) rather than a genuine fiscal improvement[1]. The headline public sector deficit rose to 4.7% of GDP in 2019 from 4.2% in 2018 net of the 'cincuentones' effect, balancing the wider CG outturn with a lower quasi-fiscal deficit of the central bank (BCU) and a stable aggregate balance of the utility companies.

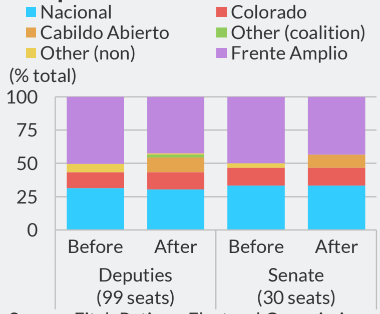
As in prior years, the fiscal slippage was driven by spending that widely surpassed budget projections, as tax collections fell moderately amid slow growth. Primary current spending rose 0.7pp of GDP in 2019, far overshooting the projected 0.1pp increase in the July budget update, due to salary hikes and greater pension outlays associated with the 'cincuentones' law.

Fitch estimates a primary CG surplus of 1% of GDP would stabilise rising debt metrics, entailing a roughly 2.5pp correction from the 1.6% deficit observed in 2019. Fitch projects a gradual consolidation in the primary central government deficit to 1.2% of GDP in 2020 and 0.7% in 2021, and to 4.5% in 2020 and 4.1% in 2021 for the overall deficit, but the path will depend on the policy plans of the new government that are still being formulated. Lacalle has expressed a clear commitment to fiscal consolidation, but fiscal targets may only be made explicit mid-year upon submission of the five-year budget.

The Lacalle administration has identified USD900 million (1.5% of GDP) in spending cuts it plans to achieve via executive action instead of legislation, but these may face pushback from unions and within the public bureaucracy. Major efforts may also be needed to stabilise pension costs, which are rising on indexation, demographics, and the 'cincuentones' law. A pledged pension reform will likely take time to pass (the LUC gives a commission through 2021 to study the issue, and parliamentary debate may take longer) and many years to yield savings, but the new administration expects to achieve near-term savings via stricter enforcement of retirement rules. It has ruled out tax increases in light of concerns around weak competitiveness, which could limit its policy options should spending cuts face challenges.

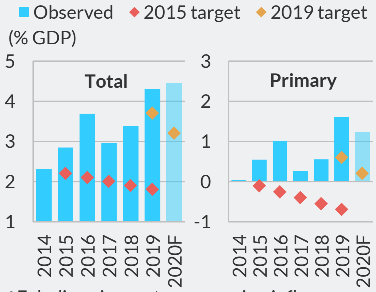
[1] Beginning in 2019, proceeds in excess of (short of) par on bond issuance will be netted out of (added to) interest payments. Buybacks will not receive symmetric treatment. As a result, an October re-tap of the Global 2055 bond generated 0.3pp-of-GDP in above-par proceeds netted out of interest, but this also entails future coupon payments above prevailing market rates and thus no fiscal gain in NPV terms.

Composition of Parliament



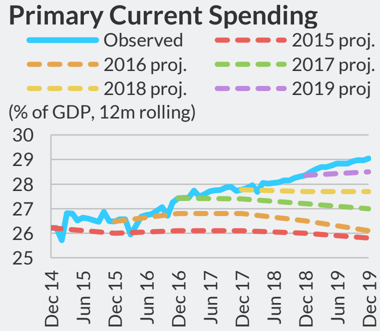
Source: Fitch Ratings, Electoral Commission.

Central Government Deficits[a]



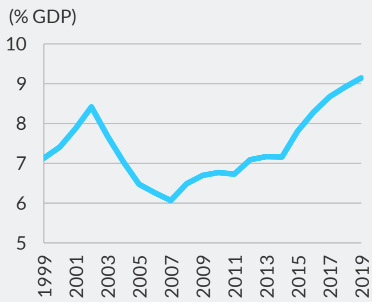
[a] Exluding cincuentones pension inflows
Source: Fitch Ratings, MEF

Primary Current Spending



Source: Fitch Ratings, projections from MEF annual Rendicion de Cuentas.

Social Security (BPS) Deficit



Source: Fitch Ratings, MEF.

A proposed fiscal rule centred on a structural balance and spending cap could serve as an institutional anchor for consolidation. Enforcement and accountability mechanisms will be key, given a rule already exists that caps increases in net debt but has been rendered ineffective by repeated relaxations. The authorities' (and IMF's) shift to fiscal reporting under a non-financial public sector (NFPS) concept, excluding the volatile BCU deficit, could also improve accountability given that past falls in the BCU deficit were viewed as space to allow a higher NFPS deficit but rises were, asymmetrically, used to justify relaxing fiscal targets.

Adverse Debt Dynamics Persist

General government debt rose to 62.6% of GDP in 2019, up about 3pp from 2018 and 13pp since 2014, well above the current 'BBB' median of 40%. A large drawdown in deposits of more than USD800 million (1.5% of GDP) prevented a greater rise in gross debt in 2019, but meant a sharper rise in net debt, as did accumulation of 1pp in government bonds in the 'cincuentones' fund (2% of GDP by end-2019, consolidated in Fitch's figures). Peso depreciation drove an increase in debt given a large stock in foreign currency, but it also allowed for an offsetting cancelation of 1%-of-GDP in bonds issued for recapitalisation of the BCU.

Proactive liability management efforts and a long-dated debt profile help to mitigate financing risks. Debt service is in line with the 'BBB' median at around 6% of GDP on average in 2020-2021, balancing lower maturities with higher interest payments. The drawdown of deposits in recent years reduced the pre-financing ratio (coverage of 12-month debt service) to 36% by end-2019, although this rose to 63% by end-January after borrowing and liability management operations. Strong capital market access and USD2 billion in multilateral credit lines offer an important financial buffer. High peso interest rates pose a challenge to reducing the foreign-currency share of debt, which inched up to 51% in 2019, but the sovereign has made progress in deepening peso funding sources, recently via issuance of wage-linked notes.

Modest Growth Recovery Driven by Pulp Mill

Fitch estimates economic growth fell to 0.3% in 2019 from 1.6% in 2018, continuing a streak of weak performance. Public utilities and telecom activity (which has a high weight in GDP series) have explained most of the growth in recent years, while private activity has been largely stagnant. This is evidenced in the labour market, as unemployment reached its highest level in over a decade in 2019 at 8.9%, and an estimated 55,000 jobs have been lost since 2014 (a 4% decline). Labour market slack restraining consumption, competitiveness issues driving a fifth year of contraction in investment, and a weak regional backdrop all contributed to sluggish growth in 2019, although better 3Q19 GDP across sectors could indicate an incipient rebound.

Fitch expects growth to recover to 1.5% in 2020 and 2.5% in 2021 as construction of the UPM pulp mill and related railway ramp up, along with other PPP projects. Improved business confidence related to the agenda of the new government could offer further upside. On the other hand, high unemployment, real wage growth that has turned negative and fiscal adjustment could restrain consumption. Uncertainties in China (Uruguay's top export market) could affect agricultural prices and export volumes, and Argentina's recession and currency controls could affect tourist spending (although arrivals in January beat bearish expectations).

Estimates of medium-term potential growth beyond the UPM project hover around 2.0%-2.5%, reflecting constraints in demographics, capital investment, and productivity. The draft LUC proposes many measures to address long-standing business concerns: liberalisation of fuel imports to break the monopoly of the state refinery, efforts to lower high utility rates (mainly via better governance at SOEs), enhancing business protections from union activism (the subject of complaints to the ILO), and tax incentives for SMEs. There are auspicious signs around new trade agreements, but even the most advanced prospect, the EU-Mercosur FTA, faces an uncertain approval path in both trade blocks and a long phase-in period.

High Inflation, Stable External Finances

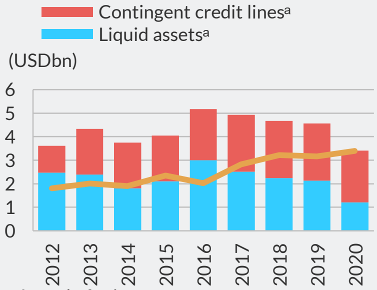
Inflation accelerated to 8.8% by end-2019 from 8.0% the prior year, above the 7% upper bound of the target band (5% +/-2pp). A rise in meat prices driven by record demand from China (linked to African swine fever) explained much of the rise in inflation in 2019 (it ended 2019 below 7% net of this effect). However, prevalent indexation mechanisms will cause the high end-2019 inflation print to produce inertial pressures, and inflation expectations have drifted upward. Monetary policy remains 'moderately contractionary', balancing persistently

Consolidated General Govt Debt

(% of GDP)	2018	2019	2020F
CG market debt	**52.0**	**56.6**	**59.2**
+ BCU recap bond	*8.2*	*7.3*	*7.4*
= CG debt	**60.1**	**63.8**	**66.6**
+ LG/BPS debt	*0.7*	*0.7*	*0.7*
– BPS holdings	*1.0*	*2.0*	*2.7*
= GG debt	**59.8**	**62.6**	**64.7**
– Govt deposits	*5.4*	*4.0*	*3.9*
= GG net debt	**54.4**	**58.6**	**60.8**

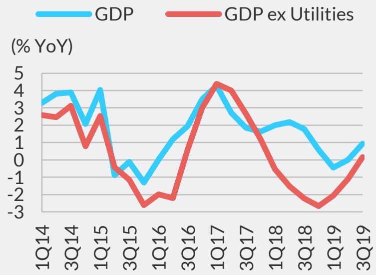
Source: Fitch Ratings based on MEF, BCU.

Debt Service, Financing Buffers



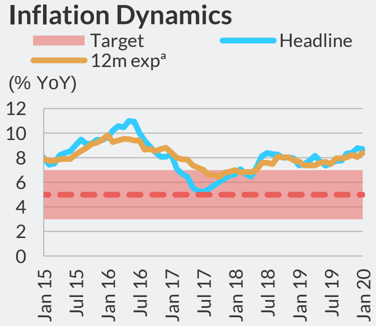
[a] At end of prior year
Source: Fitch Ratings, Debt Mgmt Unit (UGD)

Real GDP Growth



[a] Inc. oil refinery, telecom, electricity, social services
Source: Fitch Ratings, BCU;

Inflation Dynamics



[a] Survey median
Source: Fitch Ratings, BCU

above-target inflation with a weak economy and labour market and concerns around stoking further appreciation pressure on the peso.

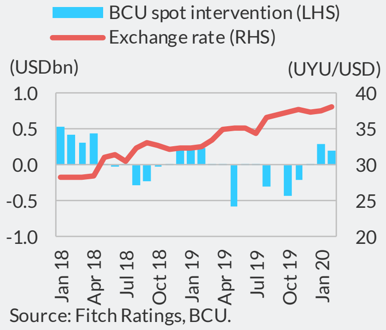
Fitch estimates the current account remained broadly balanced in 2019, as growth in exports (2.4%) and a sharp contraction in imports (-6.8%) improved the trade balance, offsetting a weaker tourism balance due to Argentina's crisis. Net FDI remains negative, as Uruguayan FDI abroad surpassed modest inbound FDI, though this gap has narrowed. Fitch expects the current account to move into deficit and rise moderately to 1.7% of GDP through 2021 as construction of the pulp plant begins, though this will be accompanied by corresponding FDI.

The peso was among the region's currencies that depreciated the most in 2019 (-13%), helping to offset the impact of high inflation and improve the real effective exchange rate (REER). The BCU estimates the currency has depreciated to levels in line with fundamentals, but worries around currency overvaluation persist in the private sector and in the new government, in the context of greater REER improvements among regional peers.

The BCU has continued to actively intervene in FX markets to manage peso volatility. In 2019 it sold nearly USD1 billion to manage peso depreciation, but in early 2020 is has purchased FX to manage appreciation pressures amid sizeable reported carry-trade inflows taking advantage of high local rates. The stock of reserves remains large at USD14.5 billion at end-2019, but was USD4.8 billion net of corresponding BCU FX liabilities (eg bank reserve requirements). Reserves offer ample coverage of liquid external liabilities (including non-resident deposits and holdings of local bonds) and the money supply.

Uruguay's banking system remains sound, with favourable solvency and liquidity metrics. Channels of potential financial contagion from instability in neighbouring Argentina have been greatly contained in the past two decades.

FX Intervention and Reserves



Source: Fitch Ratings, BCU.

Public Debt Dynamics

In Fitch's baseline, gross general government debt will surpass 66% by 2021 and flatten as fiscal consolidation efforts (offsetting loss of 'cincuentones' inflows) advance and the pulp mill project supports higher growth, but would resume a gradual upward path thereafter as growth moderates. Fitch's figures consolidate holdings of government bonds in the 'cincuentones' fund (2% of GDP as of end-2019) and assume no new net issuance/cancelation of central bank recapitalisation bonds (7.3% of GDP at end-2019). They assume a pace of peso depreciation in line with relative inflation (ie a stable real exchange rate). Key risks include failure to contain the primary deficit, a weaker-than-expected growth recovery, or an exchange-rate shock given a large stock of foreign-currency debt (32% of GDP in 2019).

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.

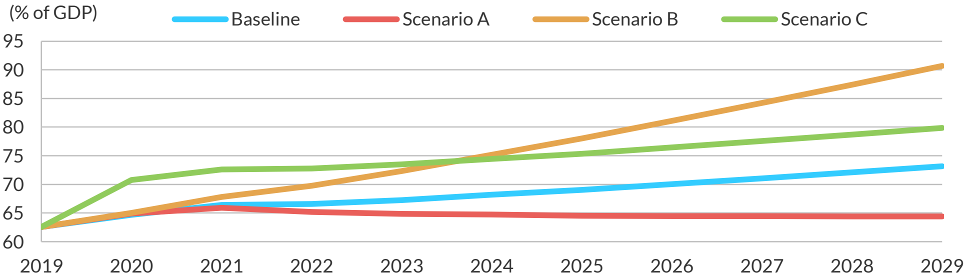
Debt Dynamics: Fitch's Baseline Assumptions

	2019	2020	2021	2022	2023	2024	2029
Gross general government debt (% of GDP)	62.6	64.7	66.5	66.6	67.3	68.2	73.2
Primary balance (% of GDP)	-0.4	-0.2	-0.3	-0.1	-0.1	-0.1	-0.1
Real GDP growth (%)	0.3	1.5	2.5	3.0	2.5	2.5	2.5
Avg. nominal effective interest rate (%)[a]	8.6	8.4	7.9	7.6	7.5	7.5	7.6
UYU/USD (annual avg.)	35.3	38.5	40.8	43.1	45.3	47.5	60.7
GDP deflator (%)	7.2	7.9	7.1	7.2	6.7	6.4	6.3

[a] Captures cash interest as well as interest accruing on principal on inflation- and wage-indexed local bonds.
Source: Fitch Ratings.

Sensitivity Analysis

Gross general government debt



Source: Fitch Ratings, debt dynamics model

Debt Sensitivity Analysis: Fitch's Scenario Assumptions

Scenario A	Achievement of a 0.9%-of-GDP primary surplus by 2022 (debt-stabilising level).
Scenario B	Failure to improve the primary balance from 2019 level (-1.6% of GDP net of 'cincuentones' inflows), accumulation of a 100bp risk premium on new FC borrowing.
Scenario C	An additional 15% depreciation of the peso in 2020 beyond the baseline.

Source: Fitch Ratings

Forecast Summary

	2015	2016	2017	2018	2019	2020f	2021f
Macroeconomic indicators and policy							
Real GDP growth (%)	0.4	1.7	2.6	1.6	0.3	1.5	2.5
Unemployment (%)	7.5	7.9	7.9	8.3	8.9	8.5	8.0
Consumer prices (annual average % change)	8.7	9.6	6.2	7.6	7.9	8.6	8.0
Short-term interest rate (bank policy annual avg.) (%)	13.5	13.5	10.4	9.4	10.0	10.0	10.0
General government balance (% of GDP)	-2.8	-3.7	-3.0	-2.1	-3.0	-3.3	-3.5
General government debt (% of GDP)	57.3	57.2	57.8	59.8	62.6	64.7	66.5
UYU per USD (annual average)	27.33	30.16	28.68	30.73	35.26	38.51	40.84
Real effective exchange rate (2000 = 100)	94.7	95.6	101.4	102.9	99.9	99.9	99.9
Real private sector credit growth (%)	11.8	-5.4	-4.3	6.4	3.4	0.7	1.5
External finance							
Current account balance (% of GDP)	-0.9	-0.1	0.7	0.1	0.0	-0.9	-1.7
Current account balance plus net FDI (% of GDP)	0.6	-1.5	-3.1	-1.7	-1.2	-1.1	-1.4
Net external debt (% of GDP)	-17.2	-17.9	-16.2	-20.9	-22.2	-23.7	-24.1
Net external debt (% of CXR)	-55.1	-60.2	-54.1	-68.2	-68.8	-72.1	-73.2
Official international reserves including gold (USDbn)	15.6	13.5	16.0	15.6	14.5	14.4	14.6
Official international reserves (months of CXP cover)	11.0	10.3	11.0	10.2	9.6	9.1	8.7
External interest service (% of CXR)	7.4	7.6	6.8	7.8	8.4	8.4	8.3
Gross external financing requirement (% int. reserves)	14.2	8.0	12.2	14.1	14.5	12.9	18.5
Real GDP growth (%)							
US	2.9	1.6	2.4	2.9	2.3	1.7	1.7
China	6.9	6.7	6.9	6.6	6.1	5.9	5.8
Eurozone	2.1	2.0	2.4	1.9	1.2	1.1	1.2
World	2.9	2.6	3.4	3.2	2.6	2.5	2.7
Oil (USD/barrel)	53.0	45.1	54.9	71.6	65.0	62.5	60.0

Source: Fitch Ratings

Fiscal Accounts Summary

(% of GDP)	2016	2017	2018	2019	2020f	2021f
General government						
Revenue	**27.8**	**28.8**	**30.6**	**30.1**	**30.1**	**29.5**
Expenditure	**31.5**	**31.8**	**32.7**	**33.1**	**33.4**	**33.0**
O/w interest payments	2.7	2.7	2.8	2.6	3.1	3.2
Primary balance	-1.0	-0.3	0.7	-0.4	-0.2	-0.3
Overall balance	**-3.7**	**-3.0**	**-2.1**	**-3.0**	**-3.3**	**-3.5**
General government debt[a]	**57.2**	**57.8**	**59.8**	**62.6**	**64.7**	**66.5**
% of general government revenue	205.9	200.4	195.8	208.1	215.1	224.9
Central government deposits	6.7	5.7	5.4	4.0	3.9	3.7
Net general government debt	50.5	52.0	54.4	58.6	60.9	62.7
Central government						
Revenue	**20.3**	**21.1**	**21.7**	**21.2**	**21.3**	**21.4**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**24.0**	**24.1**	**25.1**	**25.6**	**25.8**	**25.4**
O/w current expenditure and transfers	20.0	20.1	20.8	21.4	21.1	20.7
- Interest	2.7	2.7	2.8	2.7	3.2	3.3
O/w capital expenditure	1.4	1.3	1.5	1.5	1.4	1.4
Current balance	-2.3	-1.6	-1.9	-2.8	-3.0	-2.6
Primary balance	-1.0	-0.3	-0.6	-1.6	-1.2	-0.7
Overall balance	**-3.7**	**-3.0**	**-3.4**	**-4.3**	**-4.5**	**-4.1**
Central government debt	56.5	57.1	60.1	63.8	66.7	68.5
% of central government revenues	278.1	270.3	277.4	300.6	312.4	320.5
Central government debt (UYUbn)	**898.6**	**975.1**	**1,101.3**	**1,257.7**	**1,438.8**	**1,624.8**
By residency of holder						
Domestic	453.0	520.6	562.1	644.9	738.8	827.6
Foreign	445.6	454.5	539.3	612.8	700.0	797.2
By currency denomination						
Local currency	478.7	571.1	589.6	632.9	724.3	810.6
Foreign currency	419.9	404.0	511.8	624.8	714.5	814.2
In USD equivalent (eop exchange rate)	14.4	14.0	15.8	16.7	18.0	19.4
Average maturity (years)	13.8	13.0	13.8	-	-	-
Memo						
Nominal GDP (UYUbn)	1,589.2	1,707.1	1,831.1	1,970.0	2,158.2	2,370.6

[a] Includes central government debt (including recapitalization bonds held by central bank), local government and social security institute debt, and consolidates intra-public holdings of the 'cincuentones' fund.
Source: Fitch Ratings estimates and forecasts, Ministry of Finance

External Debt and Assets

(USDbn)	2014	2015	2016	2017	2018	2019
Gross external debt	**42.3**	**43.7**	**40.3**	**43.1**	**42.5**	**45.2**
% of GDP	74.0	82.1	76.4	72.3	71.3	80.8
% of CXR	217.9	263.4	257.3	241.4	232.2	250.5
By maturity						
Medium- and long-term	32.9	34.4	33.0	36.2	35.9	38.6
Short-term	9.4	9.3	7.2	6.8	6.6	6.6
% of total debt	22.3	21.4	17.9	15.9	15.5	14.6
By debtor						
Sovereign	**17.7**	**16.6**	**16.2**	**18.5**	**17.7**	**20.4**
Monetary authorities	1.5	1.0	0.7	0.8	0.5	0.5
General government	16.2	15.6	15.5	17.7	17.2	19.9
O/w central government	15.1	15.6	15.2	15.8	16.7	16.4
Banks	**5.5**	**6.0**	**4.6**	**3.8**	**3.8**	**3.8**
Other sectors	**19.1**	**21.1**	**19.5**	**20.8**	**21.0**	**21.0**
Gross external assets (non-equity)	**51.0**	**52.9**	**49.7**	**52.7**	**55.0**	**57.6**
International reserves, incl. gold	17.6	15.6	13.5	16.0	15.6	14.5
Other sovereign assets nes	0.0	0.1	0.0	0.0	0.0	0.0
Deposit money banks' foreign assets	8.7	11.0	10.6	9.7	10.0	11.8
Other sector foreign assets	24.8	26.2	25.6	27.1	29.4	31.3
Net external debt	**-8.7**	**-9.1**	**-9.4**	**-9.7**	**-12.5**	**-12.4**
% of GDP	-15.2	-17.2	-17.9	-16.2	-20.9	-22.2
Net sovereign external debt	0.1	0.9	2.7	2.5	2.2	5.9
Net bank external debt	-3.2	-5.0	-6.1	-5.9	-6.2	-8.0
Net other external debt	-5.6	-5.1	-6.0	-6.3	-8.4	-10.3
Net international investment position	**-17.4**	**-15.3**	**-15.7**	**-16.5**	**-15.5**	**-15.6**
% of GDP	-30.4	-28.7	-29.9	-27.7	-26.0	-27.9
Sovereign net foreign assets	**-0.1**	**-0.9**	**-2.7**	**-2.5**	**-2.2**	**-5.9**
% of GDP	-0.2	-1.8	-5.1	-4.2	-3.6	-10.5
Debt service (principal & interest)	**3.5**	**3.2**	**2.4**	**3.3**	**3.7**	**3.8**
Debt service (% of CXR)	18.2	19.4	15.2	18.4	20.4	20.9
Interest (% of CXR)	5.9	7.4	7.6	6.8	7.8	8.4
Liquidity ratio (%)	160.1	172.1	194.3	215.7	235.4	242.9
Net sovereign FX debt (% of GDP)	-11.8	-5.1	1.7	-3.2	0.4	4.0
Memo						
Nominal GDP	57.2	53.3	52.7	59.5	59.6	55.9
Inter-company loans	11.4	13.8	12.8	13.6	13.4	13.4

Source: Fitch Ratings estimates and forecasts, Central Bank, IMF, World Bank

Debt Service Schedule on Medium- and Long-Term Debt at end-2019

(USDmn)	2020	2021	2022	2023	2024	2025	2026+
Amortisation	**1,695**	**1,645**	**2,150**	**1,091**	**1,086**	**1,958**	**20,214**
Loans	149	213	211	206	292	256	1,411
External bonds	155	524	1,437	395	395	856	16,879
Foreign currency	*155*	*524*	*492*	*395*	*395*	*568*	*11,670*
Local currency	*0*	*0*	*945*	*0*	*0*	*288*	*5,208*
Local bonds	1,390	908	502	489	399	846	1,923
Foreign currency	*23*	*0*	*0*	*0*	*0*	*0*	*0*
Local currency	*1,367*	*908*	*502*	*489*	*399*	*846*	*1,923*
Non-sovereign public sector	-	-	-	-	-	-	-

Source: Fitch Ratings Ministry of Finance

Balance of Payments

(USDbn)	2016	2017	2018	2019	2020f	2021f
Current account balance	**-0.1**	**0.4**	**0.1**	**0.0**	**-0.5**	**-1.0**
% of GDP	-0.1	0.7	0.1	0.0	-0.9	-1.7
% of CXR	-0.4	2.4	0.4	0.0	-2.8	-5.1
Trade balance	**1.9**	**2.4**	**2.4**	**3.0**	**2.8**	**2.5**
Exports, fob	10.4	11.1	11.5	11.7	12.1	12.5
Imports, fob	8.5	8.7	9.1	8.7	9.3	10.0
Services, net	**0.8**	**1.3**	**0.9**	**0.3**	**0.1**	**0.2**
Services, credit	4.2	5.0	4.9	4.4	4.3	4.6
Services, debit	3.3	3.8	4.0	4.1	4.2	4.4
Income, net	**-3.0**	**-3.4**	**-3.4**	**-3.4**	**-3.6**	**-3.8**
Income, credit	0.9	1.5	1.6	1.7	1.8	1.8
Income, debit	3.8	4.9	5.0	5.1	5.4	5.7
O/w: Interest payments	1.2	1.2	1.4	1.5	1.6	1.6
Current transfers, net	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Capital and financial accounts						
Non-debt-creating inflows (net)	2.0	0.0	0.7	0.6	1.4	1.7
O/w equity FDI	1.6	0.2	0.5	0.6	1.4	1.7
O/w portfolio equity	0.3	-0.2	0.2	0.0	0.0	0.0
O/w other flows	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves	2.2	-2.4	0.4	1.1	0.1	-0.1
Gross external financing requirement	**1.2**	**1.6**	**2.2**	**2.3**	**1.9**	**2.7**
Stock of international reserves, incl. gold	**13.5**	**16.0**	**15.6**	**14.5**	**14.4**	**14.6**

Source: Fitch Ratings estimates and forecasts, IMF

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