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Update

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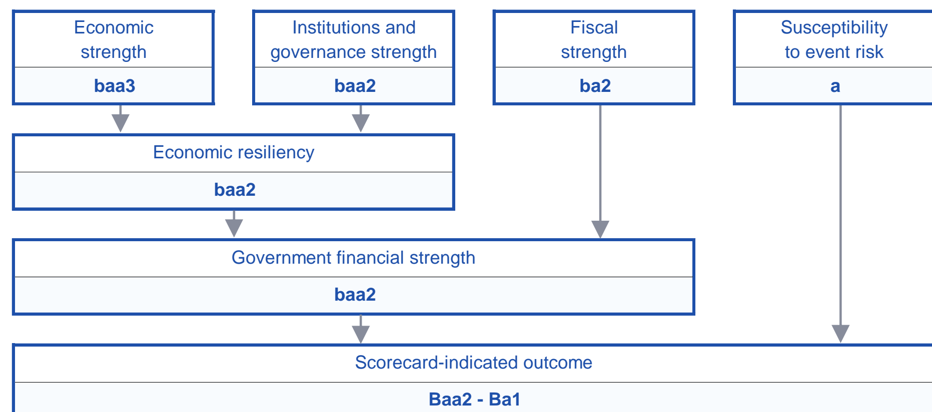
Government of Uruguay – Baa2 stable

Update following forecast change

Summary

The credit profile of Uruguay is supported by its moderate economic and institutional strength. Uruguay has relatively high income levels and a growth potential of about 2.5%. Growth has been weak in recent years and we forecast a coronavirus-induced recession in 2020. Lower-than-potential growth and significant expenditure rigidity limit the authorities' ability to meet fiscal targets. Debt metrics have deteriorated in recent years, and fiscal consolidation plans beyond 2020 remain key in supporting the sovereign's credit profile.

Exhibit 1
Uruguay's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» Favorable debt maturity profile and moderate government financing needs

» Large government financial buffers

» Strong institutional framework

Credit challenges

» Structural rigidities in the composition of government spending

» Still-significant share of foreign-currency-denominated government debt

» Modest medium-term growth prospects

Rating outlook

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

Factors that could lead to an upgrade

Upward credit pressure could result from (1) a reduction in structural rigidities in Uruguay's credit profile including those associated with low and declining productivity, which affect potential growth, as well as the relatively rigid government spending structure; (2) a significant 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-denominated government debt.

Factors that could lead to a downgrade

Downward credit pressure would emerge if we were 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 underperformance and further deterioration in fiscal strength in the medium term, with a continued increase in debt ratios and a sustained, significant erosion in external and financial buffers.

Key indicators

Exhibit 2

Uruguay	2014	2015	2016	2017	2018	2019	2020F	2021F
Real GDP (% change)	3.2	0.4	1.7	2.6	1.6	0.2	-2.5	1.5
Inflation (CPI, % change, Dec/Dec)	8.3	9.4	8.1	6.6	8.0	7.5	9.0	8.3
Gen. gov. financial balance/GDP (%)[1]	-2.3	-2.8	-3.7	-3.0	-3.4	-4.3	-5.6	-4.2
Gen. gov. primary balance/GDP (%)	0.0	-0.5	-1.0	-0.3	-0.6	-1.6	-2.6	-1.1
Gen. gov. debt/GDP (%)	40.9	48.4	48.0	48.3	52.0	56.4	63.3	63.9
Gen. gov. debt/revenues (%)	148.2	178.1	172.9	167.6	177.6	195.6	226.7	223.4
Gen. gov. interest payment/revenues (%)	8.3	8.5	9.6	9.3	9.6	9.3	10.8	10.7
Current account balance/GDP (%)	-3.2	-0.9	0.6	0.7	0.1	0.7	2.0	-0.1
External debt/CA receipts (%)[2]	212.0	263.6	255.7	231.4	226.3	236.1	234.0	220.8
External vulnerability indicator (EVI) [3]	91.3	84.9	108.9	107.1	88.1	83.9	87.2	89.8

[1] Excludes pension transfers related to the 'cincuentones' law starting in 2018
[2] Current Account Receipts
[3] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves

Source: Moody's Investors Service

Detailed credit considerations

Uruguay's credit profile incorporates our "baa3" **economic strength** assessment on a global basis, reflecting moderate potential growth and a relatively high income per capita, counterbalanced by the small size of the economy, which at $56 billion in 2019 was smaller than the "Baa" median of around $240 billion. In 2019, the economy grew 0.2% in real terms, and we expect a coronavirus-induced contraction of 2.5% in 2020, followed by a 1.5% annual average expansion in 2021-22. Investment levels have remained low over the past five years and while this rate is likely to rebound in 2020-22 because of the new UPM pulp mill plant, without a broader recovery, potential growth is likely to remain low.

Our final score for Uruguay's **institutions and governance strength** is "baa2." This assessment balances Uruguay's strong institutional framework, which reinforces policy predictability, with still-evolving capabilities to effectively and credibly conduct these policies. The authorities have faced challenges in meeting policy goals, as exemplified by the stubbornly high inflation rates that have often been above the official target range. Since January 2013, inflation has routinely exceeded the target's upper bound, including every month since February 2018. Current institutional arrangements guiding fiscal policy have not provided a strong anchor for the

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overall fiscal policy, which has led to a deterioration in the structural deficit and a procyclical policy stance. The new administration has proposed a fiscal rule that would address these issues.

Uruguay's "ba2" **fiscal strength** assessment balances its moderate government debt burden, very strong liability management practices and fiscal reserve assets, with lingering vulnerabilities from a high proportion of foreign-currency debt. Debt ratios are now higher than the "Baa" medians, including weaker-than-peer debt affordability, as measured by the interest payment-to-revenue ratio. Although the government managed to reduce the share of foreign-currency-denominated debt over the past two decades, this remains at a relatively high level at over 50%. This exposes the overall debt stock to fluctuations caused by exchange rate depreciation, which in turn can lead to a worsening of the debt-to-GDP ratio. This exchange rate risk is mitigated by the government's financial assets, which are mostly denominated in foreign currency and provide 12 months of debt service coverage. For this reason, we adjust the score up to "ba2" from the initial score of "b1."

We assess Uruguay's **susceptibility to event risk** at "a," driven by banking sector risk, government liquidity risk and external vulnerability risk. The banking sector risk assessment is "a," which reflects the system's relatively large size for a Latin American economy, with assets equivalent to 72% of GDP in 2019, and a Baseline Credit Assessment of ba1, which informs the risk assessment of potential contingent liabilities materializing on the government's balance sheet.

Uruguay's external vulnerability risk assessment is "a," reflecting its large external buffers that partially mitigate the exchange-rate risks stemming from the country's still-significant degree of financial dollarization. Uruguay's current account has posted surpluses since 2015, although these have narrowed since 2017, with this trend reflecting the decrease in investment levels.

Uruguay's government liquidity risk assessment is "a," balancing the government's relatively low gross borrowing requirements — favored by a long maturity profile — against a relatively high share of external debt in total government debt.

The country's political risk assessment is "aa." We consider the risk of political events developing in a manner that could compromise the economic, institutional or fiscal features of Uruguay's credit profile very low.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Uruguay

We take account of the impact of environmental (E), social (S) and governance (G) factors when assessing sovereign issuers' economic, institutions and governance, and fiscal strength and their susceptibility to event risk. In the case of Uruguay, the materiality of the ESG factors to the credit profile is as follows:

Environmental factors affect Uruguay's credit profile in a limited manner. The country's large coastline is not susceptible to major flooding, and extreme weather events are rare in the region. The main risk is disruptive weather effects like excessive rains or droughts, which would affect the agricultural sector.

Social considerations, in particular an aging population, affect Uruguay's credit profile. The outbreak of the coronavirus will have an economic and fiscal impact on Uruguay, notwithstanding the government's efforts to keep the outbreak's impact to the minimum. The country's aging population, coupled with the population's predilection for social expenditure, will weigh on public finances in the coming years. A recent example of how this situation manifests is the so-called *cincuentones* law, which absorbed private fully funded would-be pensioners into the public system after their forecast pensions were deemed insufficient.

We do not consider governance risks material to Uruguay's credit profile. Uruguay has strong institutions and a broad societal consensus on retaining the country's institutional arrangements.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how ESG risks influence sovereign credit profiles and our cross-sector methodology General Principles for Assessing ESG Risks.

Recent developments

Coronavirus outbreak will have fiscal and economic implications

The first coronavirus cases were confirmed in mid-March (see Exhibit 4), and as of April 22, Uruguay had reported 549 cases, including nine casualties. While the authorities shut schools, they have shied away from instating a countrywide "shelter in place" policy. Instead, they have opted to incentivize businesses to temporarily suspend activities and suggested that citizens stay home, citing the importance of not "stopping" the economy fully. A staggered "restarting" of the economy started on April 13, when construction workers returned to work following a tripartite agreement among the union, employers and the government.

Authorities have announced stimulus plans, ranging from unemployment insurance to increased liquidity in the financial sector (see Exhibit 3). Although the authorities have announced the "coronavirus fund," which will be effectively funded by cutting the salaries of highly paid public officials, we expect the coronavirus outbreak to affect both fiscal and economic metrics. For 2020, we expect a real GDP contraction of 2.5% and a fiscal deficit of 5.6% of GDP for the consolidated central government (excluding *cincuentones*-related revenue). The deterioration of the fiscal deficit will be driven by a loss of revenue caused by lower economic activity, additional spending linked to the response to the coronavirus outbreak as well as the automatic stabilizers built into Uruguay's tax regime and social spending (e.g. unemployment insurance) that get triggered during an economic downturn. For 2021, we expect an economic recovery of 1.5%, primarily supported by the construction of the second UPM pulp mill plant. We note that there is upside to this forecast if there is a broader recovery in investment levels in the country after several years of declining private investment. The fiscal deficit would decline next year as revenue collection improves in line with the economy and some of the cyclical spending falls.

Exhibit 3

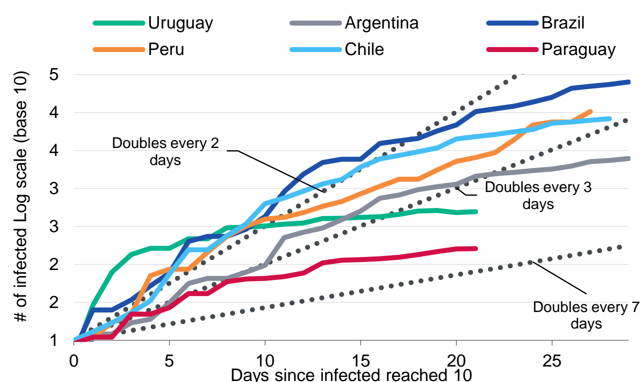
List of key measures announced by the government
(As of April 15)

Date	Description
15-Mar	Classes are suspended countrywide
19-Mar	Tax Payments and contributions to social security defered until May. Unemployment benefits requirements eased
19-Mar	Central Bank authorised financial sector to defer payments on interest and principal on loans for up to 180 days
19-Mar	BROU to give soft loans, up to USD125M. The National Guarantee System (SiGa) is being expanded, the objective is to facilitate lending to SMEs.
27-Mar	The elegibility for social transfer schemes eased.
27-Mar	Part of the cost of the coronavirus response will be paid by effectively reducing wages of highly paid public servant
01-Apr	Central Bank to lower reserve requirements
03-Apr	National mortgage bank and housing authority will postpone charging for 2 months
08-Apr	Clases to re-start in rural schools on April 22nd. Economy "re-opens" (construction activity re-starting on April 13th)

Source: Moody's Investors Service

Exhibit 4

Uruguay has slowed the spread of infection



Sources: World Health Organization and Moody's Investors Service

The government maintains its plans to implement an expenditure-focused fiscal consolidation. A measure to reduce ministries' budgeted spending, excluding coronavirus-related expenditure and wages, by 15% remains in place. The government has also expressed its plans to go through with a planned increase in utilities' rates, as part of a rationalization of state-owned companies.[1] In addition, the government's omnibus bill, dubbed the "Urgent Law," also foresees the introduction of cap on real expenditure growth that would be tied to the economy's potential growth rate. However, at present, details are limited, and any reforms have been postponed because of the coronavirus outbreak. The "Urgent Law" will be complemented by the new administration's multiyear fiscal framework, to be presented by mid-2020. In terms of the sovereign's creditworthiness, the principal issue will be to observe fiscal results under the new rules and compliance with consolidation targets.

We expect the combination of an economic contraction, currency depreciation and wider fiscal deficit to contribute to a deterioration in the government's fiscal strength. We forecast its debt-to-GDP ratio will be about 63% in 2020, above the "Baa" median of 56%. The

likely decline in government revenue will weigh on Uruguay's debt affordability as the interest-to-revenue ratio will increase to 11% in 2020, compared with the “Baa” median of 7%. Therefore, the government's plans for fiscal consolidation beyond 2020 will be key to supporting the sovereign's credit profile.

Moody's rating methodology and scorecard factors: Uruguay - Baa2 stable

				Initial	Final	Weights
				Factor score		
Factor 1: Economic strength				baa3	baa3	50%
Growth dynamics	Average real GDP growth (%)	2014-2023F	1.4	b1		25%
	Volatility in real GDP growth (%)	2009-2018	2.1	baa2		10%
Scale of the economy	Nominal GDP ($ billion)	2018	59.6	ba2		30%
National income	GDP per capita (PPP, Intl$)	2018	23,158	a3		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				a3	baa2	50%
Quality of institutions	Quality of legislative and executive institutions			a		20%
	Strength of civil society and the judiciary			aa		20%
Policy effectiveness	Fiscal policy effectiveness			baa		30%
	Monetary and macroeconomic policy effectiveness			baa		30%
Specified adjustment	Government default history and track record of arrears				-2	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				baa1	baa2	
Factor 3: Fiscal strength				b1	ba2	
Debt burden	General government debt/GDP (%)	2018	52.0	baa1		25%
	General government debt/revenue (%)	2018	177.6	a2		25%
Debt affordability	General government interest payments/revenue (%)	2018	9.6	a3		25%
	General government interest payments/GDP (%)	2018	2.8	baa2		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-6	-5	max ±6
	Debt trend	2015-2020F	14.9	-1	0	
	Foreign currency debt/general government debt	2018	53.8	-5	-5	
	Other non-financial public sector debt/GDP	2018	3.4	0	0	
	Public sector assets/general government debt	2018	0.0	0	0	
Other adjustment to factor 3	*# notches*				1	max ±3
F1 x F2 x F3: Government financial strength				baa1	baa2	
Factor 4: Susceptibility to event risk				a	a	Min
Political risk				aa		
	Domestic political risk and geopolitical risk			aa		
Government liquidity risk				a	a	
	Ease of access to funding			a		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	baa3	ba1-ba2		
	Total domestic bank assets/GDP	2018	66.3	<80		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				a	a	
	External vulnerability risk			a		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				Baa1 - Baa3	Baa2 - Ba1	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories** for quantitative sub-factors: aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Moody's related publications

- **Credit Opinion:** Credit Opinion: Government of Uruguay – Baa2 stable: Regular update, 14 February 2020
- **Country Statistics**: Uruguay, Government of, 27 November 2019
- **Issuer Comment:** Government of Uruguay: Consensus-building coalition will be key to passing reforms after elections, 28 October 2019
- **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
- **Rating Methodology**: Sovereign Ratings Methodology, 25 November 2019

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Such measures would not affect the fiscal accounts we take into account because we use central government plus social security. Regardless, an improvement in state-owned companies' finances would result in lower contingent liabilities, strengthening the sovereign's credit profile.

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