Research Update:

Uruguay 'BBB/A-2' Ratings Affirmed; Outlook Remains Stable

April 20, 2021

Overview

- Proactive government health care policies, along with fiscal and liquidity support, should continue to mitigate the economic and social impact of the pandemic on Uruguay.
- We expect that gradual fiscal correction and stabilizing debt will improve the economic outlook for Uruguay.
- We affirmed our 'BBB/A-2' sovereign credit ratings on Uruguay.
- The stable outlook balances short-term economic and fiscal setbacks with an expected recovery in GDP growth, along with a solid external position and well-established institutions.

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Rating Action

On April 20, 2021, S&P Global Ratings affirmed its 'BBB' long-term and 'A-2' short-term foreign and local currency sovereign credit ratings on Uruguay. The outlook on the long-term ratings remains stable.

The transfer and convertibility assessment remains 'A-'.

Outlook

The stable outlook reflects our view that economic recovery and corrective fiscal policy will contribute to reversing the near-term deterioration in the sovereign's fiscal and debt profiles from the COVID-19 pandemic, limiting the long-term negative impact on its finances.

Downside scenario

We could lower the ratings on Uruguay over the next two years if lower-than-expected long-term growth prospects, which depend partly on advancing important investment projects, limit the government's ability to correct fiscal deficits and reverse the near-term erosion in public finances. In this scenario, the already high general government deficit and net general government debt burden could continue to rise beyond our expectations. Moreover, a sustained weaker long-term growth trajectory could dampen Uruguay's per capita income, weakening its economic resilience and leading to a lower rating.

Upside scenario

A sustained decline in inflation, along with further deepening of local capital markets, could facilitate the government's ongoing efforts to increase the share of local currency in its debt stock. Falling exposure to foreign-currency-denominated debt could reduce the impact of exchange rate fluctuations on the sovereign's balance sheet. The resulting improvement in debt dynamics, along with continued GDP growth, could lead to a higher rating over the next two years. We could also raise the ratings if a combination of good GDP growth and greater-than-expected fiscal consolidation measures narrows the fiscal deficit and decreases the government's debt burden beyond our current expectations.

Rationale

Our ratings on Uruguay are supported by its track record of moderate and predictable economic policies and its well-established institutions, which have underpinned consistent economic growth for over 15 years. The ratings also benefit from Uruguay's strong external position and reflect the sovereign's per capita GDP of an estimated US$16,500 in 2021, the highest in Latin America.

Uruguay's persistently high fiscal deficits and debt burden are constraints on the sovereign ratings, as are its relatively high inflation and still-high dollarization in the financial system.

Institutional and economic profile: Boosting medium-term growth is a key challenge for the administration

- Following a 5.9% contraction in 2020, we expect an economic rebound of 3.2% in 2021 and average growth of just over 2.5% in 2022-2024.
- We expect broad political consensus on key economic policies to remain, which will be key to implementing needed structural measures.
- Uruguay's strong checks and balances and low perceived corruption, which sustain investor confidence in the country, continue to support economic outcomes.

We expect real GDP to increase 3.2% in 2021 and average just over 2.5% in 2022-2024, following the 5.9% drop in 2020 as a result of the pandemic and weakened global and regional demand. Recovery in external demand and higher commodity prices will contribute to the rebound in the short term, as well as gradual recovery in consumption and steady progress in Uruguay's vaccination program. At the same time, recovery in key sectors such as tourism will be slower due to COVID-19-related restrictions and high dependence on recovery in Argentina and Brazil.

We estimate Uruguay's GDP per capita at US$16,500 in 2021, up from US$15,400 in 2020, which compares favorably to regional peers. At the end of 2020, Uruguay made a national accounts revision that resulted in higher GDP figures by about 8%, while growth rates in some years were more sluggish than previously estimated.

Uruguay has been growing consistently over the past 15 years. However, growth had recently decelerated to 0.9% on average in 2015-2019 from 4.9% over 2010-2014. The stagnation was because of deceleration in consumption, in part due to unemployment levels and persistently high inflation, as well as lower public and private investment. Investment by Finland-based forest and paper company UPM-Kymmene Corp. for US$3 billion (5% of GDP) is expected to fully start operations in 2023. The project, and related infrastructure projects with US$1 billion in investments, will have a positive impact on economic growth, employment, and balance of payments over the next couple of years.

We believe Uruguay's broad political consensus and its stable and well-established institutions have anchored--and will continue to anchor--economic stability. Uruguay continues to have a vibrant democracy and ranks high in global institutional quality rankings. Institutional strength sustains investor confidence in the country despite adverse economic and political events in neighboring Argentina and Brazil. Uruguay is a largely middle-class society with a relatively strong social contract that emphasizes consensus and social cohesion.

The administration of President Luis Lacalle Pou took office in 2020 with a plan to contain government spending through nonrenewal of public employment vacancies, cuts in administration, and measures to improve efficiency and governance of public-sector companies. The pandemic refocused priorities to the short term. Following a generally quiet 2020 in terms of cases, the country experienced its first wave of COVID-19 in mid-November. There was no countrywide lockdown during the pandemic, although social-distancing measures were promoted and movement restrictions were put in place. Fiscal and monetary authorities announced measures focused on the more vulnerable sectors and on providing support to small businesses. Measures to inject liquidity into the financial sector were also introduced.

On July 9, 2020, Congress approved the Law of Urgent Consideration, with just over 500 articles covering different areas. It included the creation of a fiscal rule that was incorporated in the budget for 2020-2024, as well as a committee to recommend reforms to the social security system--discussions are at a preliminary stage, but we expect the process to conclude in 2022. We believe this signals commitment to addressing structural weaknesses in public finances. At the same time, we expect fiscal consolidation will be only gradual, given high unemployment following this year's economic slump and structural rigidities that will limit the ability of the government to make substantial adjustments in 2021 and 2022.

Flexibility and performance profile: Gradual fiscal consolidation, with debt remaining at high levels

- We expect net general government debt will stabilize around 65% of GDP.
- We expect a moderate surplus of the current account on average over 2021-2023, sustaining Uruguay's balanced external position.
- Our base case assumes inflation will remain above the central bank target range in the next couple of years.

We expect the general government fiscal deficit will gradually lower to 3%-4% of GDP over 2022-2024 from a peak of 5.1% in 2020 (or 5.7% excluding one-off revenue from the pension system) as economic growth contributes to higher revenue, while temporary spending measures are scaled back and the administration continues to focus on generating additional savings in non-COVID-19 items. Our definition of general government debt includes the central bank and excludes public-sector enterprises.

In late 2017, Congress approved changes to the social security system enabling certain groups of future retirees in private pension plans to return to the public-sector pension system. This resulted in one-off revenue for the government over 2018-2021. While this revenue lowers the general government deficit, it does not change the government's financing needs because the funds that it receives due to the shift are deposited in a ring-fenced trust.

Government countercyclical support totaled 2.3% of GDP in 2020, made up of 1.3% of GDP in fiscal measures and 1% government guarantees for small and midsize enterprise loans. While support was comparatively limited, this was partly explained by the quality of health services and social security coverage, as well as already-high debt.

Net general government debt increased by 10 percentage points to 65.9% of GDP in 2020 from 56.8% in 2019. Half of the rise was due to adverse exchange rate movements (almost 55% of debt is denominated in foreign currency). Our base case assumes net general government debt will stabilize around 65% of GDP on average over 2021-2024 due to expected gradually decreasing fiscal deficits along with foreign currency depreciation. We estimate an increase in net general government debt of about 6.6% in 2021, which, as in 2020, we consider extraordinary, with underlying increases in debt of around 4.7% over 2022-2024. We expect the central bank of Uruguay's debt, typically issued for open-market operations in response to changes in the foreign currency market, to remain at about 10% of GDP over this period. We expect general government interest payments to average 7.7% of general government revenue between 2021 and 2024.

We expect the government to continue to meet its overall financing needs mainly through local and international bond issuance. The government's main source of funding in 2020 was bond issuances in the international and local market, of which 90% was in local currency. At the same time, existing and new contingent credit lines with multilaterals were called upon, especially at the onset of the pandemic and amid some market volatility.

The government implements active prefunding policies; its current liquid assets and credit lines with multilaterals cover debt service obligations over the next 12 months. In recent years, Uruguay accumulated ample external liquidity to manage potential financing disruptions, which represented about 4% of GDP as of 2019. Liquidity buffers as of year-end 2020 included contingent credit lines for a total of US$1.7 billion (3% of GDP) with multilateral institutions (World Bank, Corporación Andina de Fomento, and Fondo Latinoamericano de Reservas), as well as government liquid assets, for a total of about 5% of GDP as of December 2020. While the strategy of prefunding amortization payments by holding substantial liquid assets provides insulation against Uruguay's external vulnerabilities, it also has a fiscal cost.

Effective debt management has significantly reduced the risks embedded in Uruguay's debt profile. This is reflected in the central government's debt management milestones, which show that average maturities have continued to increase and are now 13.5 years, from eight years in 2005. About 95% of the central government debt is at a fixed rate, compared with 78% 14 years ago, and bonds compose 88% of central government debt, while loans make up 12%.

Inflation closed at 9.4% in 2020 and has remained above the target set by the central bank for the past 10 years (with the exception of 2017). While accumulated inflation moderated to 8.3% in March, expectations over the next 12 months remain above the central bank target range of 3%-7%.

The government changed the monetary policy instrument back to interest rates in September 2020 (rate is currently 4.5%) after using monetary aggregates since June 2013. The central bank has been focused on anchoring expectations through increased communication and transparency with the market and especially with business chambers. We expect inflation to fall in the coming years, although depreciation of the Uruguayan peso and pass-through effects to the tradable sector, as well as recovering demand and potential increases in tariffs from higher oil prices, could pose challenges.

High inflation and still-high dollarization continue to limit Uruguay's monetary policy flexibility. They also pose risks to the financial sector, should there be potential sudden spikes in the exchange rate. Over 50% of resident loans are denominated in dollars, while more than 70% of resident deposits are denominated in dollars.

Despite the high dollarization, the Uruguayan banking system has remained relatively healthy and resilient thanks to financial institutions' strong liquidity and capital starting point, and measures from the central bank that provided additional liquidity. Regulation since the 2002 crisis aimed at strengthening the balance sheet and avoiding currency mismatches contributed to a better standing in the face of COVID-19.

Asset quality metrics remained stable. Nonperforming loans were of 1.9% for private banks and 4.5% for development bank BROU as of December 2020, in line with previous years. We classify Uruguay in group '6' of our Banking Industry Country Risk Assessment, or BICRA (see "Banking Industry Country Risk Assessment: Uruguay," published Aug. 3, 2020). BICRAs are grouped on a scale from '1' to '10', ranging from what we view as the lowest-risk banking systems, or group '1', to the highest risk, or group '10'.

Uruguay's external sector has remained balanced despite unfavorable regional and global conditions. We expect moderate deficits in the current account over 2021 and 2022 and slightly positive results in 2023 and 2024 as the services sector fully recovers and the beginning of production of the cellulose plant in 2023 provides a boost for exports (per estimations from the company, it would add US$1.1 billion in exports).

Gross external financial needs should remain below 100% of current account receipts (CAR) plus usable reserves in 2021, then fall to 85% of GDP by 2024. We expect narrow net external debt to hover around 30% of CAR, similar to previous years. We expect the government to continue to finance part of the fiscal deficit with external sources through bond issuance and multilateral institution loans. At the same time, CAR is set to recover as global demand and commodity prices contribute to higher goods exports, while services exports recover at a slower pace. Uruguay has been financing half of its central government deficit abroad over the past couple of years.

Key Statistics

Table 1

Uruguay--Selected Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Economic indicators (%)											
Nominal GDP (bil. LC)	1,445.38	1,581.55	1,726.41	1,842.00	1,982.24	2,158.73	2,253.12	2,499.62	2,760.18	3,013.08	3,260.93
Nominal GDP (bil. $)	62.18	57.87	57.24	64.23	64.52	61.23	53.63	57.60	60.87	63.89	66.49
GDP per capita (000s $)	18.3	16.9	16.6	18.6	18.6	17.7	15.4	16.5	17.4	18.3	19.0
Real GDP growth	3.2	0.4	1.7	1.6	0.5	0.4	(5.9)	3.2	3.2	2.5	2.1
Real GDP per capita growth	2.9	(0.4)	1.3	1.3	0.3	0.4	(6.2)	2.9	2.9	2.2	1.9
Real investment growth	2.4	(9.2)	(1.6)	0.4	(9.0)	0.8	(0.5)	6.0	(2.0)	(2.0)	0.0

Table 1

Uruguay--Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Investment/GDP	19.0	17.6	17.5	16.1	15.4	15.0	17.0	17.4	16.5	15.8	15.4
Savings/GDP	16.0	17.4	18.2	16.1	14.9	16.4	16.5	17.1	16.9	18.1	18.1
Exports/GDP	29.6	28.3	27.0	26.1	26.4	27.8	25.4	26.9	28.5	29.2	30.6
Real exports growth	3.5	(0.6)	(0.2)	4.9	(1.7)	3.6	(16.2)	10.0	10.2	5.3	7.4
Unemployment rate	6.6	7.5	7.8	7.9	8.6	9.2	10.5	9.5	9.0	8.7	8.1
External indicators (%)											
Current account balance/GDP	(3.0)	(0.3)	0.7	(0.0)	(0.5)	1.3	(0.6)	(0.3)	0.4	2.3	2.7
Current account balance/CARs	(9.1)	(0.8)	2.6	(0.1)	(1.8)	4.3	(2.0)	(0.9)	1.3	7.0	8.0
CARs/GDP	32.4	30.9	29.3	29.1	29.6	31.0	27.7	29.5	31.8	32.5	33.9
Trade balance/GDP	3.0	2.3	3.6	3.1	3.6	5.0	4.1	4.3	3.2	5.1	6.1
Net FDI/GDP	(3.6)	(1.3)	3.2	3.2	0.8	(2.0)	(4.9)	(0.2)	0.6	(0.2)	(0.5)
Net portfolio equity inflow/GDP	(0.4)	2.1	3.0	(2.8)	(2.4)	2.2	2.9	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	96.9	93.6	100.5	104.1	91.3	86.6	97.7	92.5	92.1	87.4	85.1
Narrow net external debt/CARs	30.4	35.7	35.3	23.6	28.4	33.8	28.5	26.7	26.1	23.7	15.3
Narrow net external debt/CAPs	27.9	35.4	36.2	23.6	27.9	35.3	27.9	26.4	26.4	25.5	16.6
Net external liabilities/CARs	96.8	104.4	110.2	89.8	92.6	90.1	102.7	90.7	84.3	77.3	64.7
Net external liabilities/CAPs	88.7	103.5	113.1	89.7	91.0	94.2	100.7	89.9	85.4	83.1	70.3
Short-term external debt by remaining maturity/CARs	36.7	43.8	48.1	42.1	38.3	34.1	42.7	39.8	35.0	32.6	30.1
Usable reserves/CAPs (months)	5.6	6.5	5.5	4.4	6.3	6.3	5.7	6.2	5.5	5.6	5.7
Usable reserves (mil. $)	9,754	7,508	6,844	10,183	9,465	7,150	8,882	8,720	9,058	9,779	10,578
Fiscal indicators (general government; %)											
Balance/GDP	(2.6)	(3.2)	(2.2)	(3.3)	(3.5)	(4.2)	(5.1)	(4.3)	(3.5)	(3.5)	(3.4)
Change in net debt/GDP	4.7	5.6	2.9	7.9	6.0	7.0	11.6	6.6	4.9	4.7	4.6

Table 1

Uruguay--Selected Indicators (cont.)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Primary balance/GDP	(0.2)	(0.1)	0.7	(0.4)	(0.4)	(1.7)	(2.3)	(1.5)	(0.8)	(0.8)	(0.7)
Revenue/GDP	32.5	33.0	33.3	35.3	36.6	35.6	35.0	35.5	36.0	35.7	35.7
Expenditures/GDP	35.2	36.3	35.5	38.5	40.1	39.9	40.2	39.8	39.5	39.2	39.1
Interest/revenues	7.6	9.4	8.7	8.2	8.2	7.1	8.2	8.0	7.7	7.6	7.6
Debt/GDP	52.0	55.1	53.1	57.1	59.2	60.6	71.4	70.3	68.5	67.5	67.0
Debt/revenues	159.9	166.9	159.6	161.9	161.7	170.1	203.7	197.8	190.4	188.9	187.6
Net debt/GDP	46.3	47.9	46.8	51.8	54.2	56.8	65.9	66.0	64.7	64.0	63.8
Liquid assets/GDP	5.7	7.3	6.3	5.3	5.0	3.8	5.4	4.2	3.8	3.5	3.2
Monetary indicators (%)											
CPI growth	8.3	9.4	8.1	6.6	8.0	8.8	9.4	7.5	7.0	6.5	6.0
GDP deflator growth	9.4	9.0	7.3	5.0	7.1	8.5	10.9	7.5	7.0	6.5	6.0
Exchange rate, year-end (LC/$)	24.33	29.87	29.26	28.76	32.39	37.34	42.34	44.46	46.24	48.08	50.01
Banks' claims on resident non-gov't sector growth	18.0	22.3	1.2	0.5	11.6	10.7	10.3	8.0	9.9	9.0	9.0
Banks' claims on resident non-gov't sector/GDP	25.7	28.7	26.6	25.1	26.0	26.4	27.9	27.2	27.1	27.0	27.2
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	77.7	80.9	77.3	73.3	73.6	76.2	77.4	77.4	77.4	77.4	77.4
Real effective exchange rate growth	(3.9)	0.6	0.9	6.1	1.5	(3.2)	(5.3)	N/A	N/A	N/A	N/A

Sources: None.
Adjustments: None.
Definitions: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Ratings Score Snapshot

Key rating factors	Score	Rationale
Institutional assessment	3	Stable democracy, predictable policies, free press, and peaceful changes of government. No external threats. Largely middle-class society with consensus on key economic policies. Policymaking during the past 15 years has remained generally effective. Strong institutional checks and balances, low perception of corruption, and respect for the rule of law.
Economic assessment	3	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1. We estimate GDP per capita growth over our forecast period will be in line with that of countries with similar levels of development.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR + usable reserves) as per Selected Indicators in table 1.
Fiscal assessment: flexibility and performance	5	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1 and the use of paragraph 164 of our "Sovereign Rating Methodology" applied for years 2020 and 2021. We estimate the underlying increase in net general government debt (% of GDP) excluding one-off events at around 4%-5%.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in table 1.
		Over 40% of gross government debt is denominated in foreign currency.
Monetary assessment	5	The Uruguayan peso is a free-floating currency with central bank intervention in foreign-exchange markets. CPI as per Selected Indicators in table 1. The central bank has a track record of independence and has the ability to act as lender of last resort for the financial system.
		Resident deposits/loans in foreign currency account for more than 50% of the total.
Indicative rating	bbb	As per table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BBB	
Notches of uplift	0	
Local currency	BBB	Default risks do not apply differently to foreign currency and local currency debt.

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, March 10, 2021
- Sovereign Ratings List, March 10, 2021
- Credit Conditions Emerging Markets Q2 2021: Brighter Prospects Prone To Setbacks, March 31, 2021
- Banking Industry Country Risk Assessment: Uruguay, Aug. 3, 2020
- Uruguay 'BBB/A-2' Ratings Affirmed; Outlook Remains Stable, April 30, 2020

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
Uruguay	
Sovereign Credit Rating	BBB/Stable/A-2
Transfer & Convertibility Assessment	
Local Currency	A-
Uruguay	
Senior Unsecured	BBB
Short-Term Debt	A-2