NEWS RELEASE

Jun 21, 2021

R&I Affirms BBB, Positive: Oriental Republic of Uruguay

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Oriental Republic of Uruguay**

Foreign Currency Issuer Rating: BBB, Affirmed
Rating Outlook: Positive

RATIONALE:

Uruguay has a high level of income and stands out in Latin America for its institutional and political stability. R&I expects economic prospects to pick up in the medium term, primarily underpinned by a large foreign capital investment project. Further, it is becoming more likely that the current administration's multi-faceted structural reforms will help bolster the economy. In consideration of these factors, along with the need to ascertain the economic and fiscal impact of the ongoing COVID-19 pandemic, R&I has affirmed the Foreign Currency Issuer Rating at BBB, leaving the Positive Rating Outlook unchanged. There are no particular disrupting factors emanating from the external position. R&I will keep an eye on whether the government can ensure economic recovery and carry out reforms that enhance fiscal sustainability.

Uruguay's political and social stability is among the highest in Latin America. More than 90% of the country's electricity is generated by renewable sources, and the government sees strategic value in advancing environmentally friendly policies, including redesigning tax policies to reduce carbon emissions and promoting green hydrogen production. Growing global momentum to reduce environmental impacts acts as a tailwind for the country, which has strength in natural resource-driven sectors, including tourism, agribusiness and forestry. UPM-Kymmene Corp., a major paper manufacturer in Finland, is constructing its second mill in Uruguay, and public investments in the construction of related infrastructures, such as railways and port facilities, have been underway ahead of the project. Private investments have actively responded to new fiscal incentives as well. These will support medium-term economic growth.

The current account has been holding steady in recent years. The country ran a slight deficit in 2020 due to a sharp decline in exports of services, particularly tourism. The trade balance is susceptible to exchange rates and terms of trade, and economic recovery and an increase in capital and intermediate goods imports are expected to drag down the balance. The current account deficit itself, however, will not be a major problem, as long as it is caused mainly by a surge in imports related to foreign direct investment. There is no liquidity concern, with foreign reserves remaining sufficient relative to external short-term debts and imports.

Since 2012, fiscal deficits have continued to widen. Recognizing fiscal consolidation as one of its priority policy issues, the current administration is working to curtail spending by introducing new fiscal rules, a challenge that the previous administration failed to take on. Despite a significant fiscal impact from the pandemic, R&I expects deficits to be put on a downward trajectory over the medium term. Maintaining a sound fiscal position is essential to the stability of Uruguay's economy, which is small and exposed to changes in the external environment. The focal point is on whether the government will be able to implement initiatives such as a pension reform which awaits the submission of a comprehensive proposal from an expert committee, and thereby rein in structural expenditures.

The non-financial public sector's outstanding debt is relatively high as a share of gross domestic product (GDP), standing at 67.5% as of end-2020. If, however, current assets accumulated through, among others, the government's preliminary borrowings to cover redemptions for the next 12 months are excluded, the ratio was 57.5%. Given this, together with credit lines from multilateral development banks, fiscal risk has been mitigated.

While the Central Bank of Uruguay (BCU) will work to ensure liquidity supply to the economy for the near term, its key agenda for the medium to long term is to curb inflation that has stayed in the high single

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digit range. Under new leadership, the BCU shifted its monetary policy instrument to an interest rate in September 2020 for the first time in seven years. To make the measure more effective, it intends to step up efforts for the economy's dedollarization more than ever. Eyes are on whether the BCU will be able to firmly anchor inflation expectations, as well as on the outcome of the government's ongoing initiatives to narrow fiscal deficits and keep the rate of wage growth in check.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
https://www.r-i.co.jp/en/rating/about/rating_method.html

R&I RATINGS:

ISSUER:	**Oriental Republic of Uruguay**
	Foreign Currency Issuer Rating
RATING:	**BBB, Affirmed**
RATING OUTLOOK:	**Positive**

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