Uruguay

This report does not constitute a new rating action for this issuer. It provides more detailed credit analysis than the previously published Rating Action Commentary, which can be found on www.fitchratings.com.

Key Rating Drivers

Negative Outlook: Uruguay's Negative Outlook reflects high, rising public debt/GDP and uncertain prospects for fiscal consolidation and stronger economic growth needed to arrest this trend. Strong governance, per capita GDP and external liquidity support the rating, and balance low economic growth, high inflation, structural issues constraining policy flexibility, and high foreign-currency debt rendering public finances sensitive to exchange-rate movements.

Gradual Recovery: Fitch Ratings expects real GDP to grow by 2.5% in 2021 and 2.7% in 2022 after contracting by 5.9% in 2020, slower than the 'BBB' median. Covid-19 cases and deaths have surged, but a fast vaccine roll-out should limit the economic effects. Domestic challenges, including real wage declines, job losses and fiscal austerity, may hinder the economy. A large pulp mill project, strong external demand and surging commodity prices should support it.

Competitiveness Challenges: Average real GDP growth in 2015-2019 was lowered to 0.8% in a recent national accounts revision, the lowest in the 'BBB' category, highlighting weak growth potential. The Lacalle Pou administration has identified key competitiveness issues it hopes to tackle, but the amount of progress it can make on reforms is still uncertain.

Fiscal Resilience: Resilient revenues and tight spending control have resulted in a small fiscal deterioration during the pandemic, but from a weak starting point. The swift consolidation expected by the authorities could be hard to deliver amid a slow economic recovery, challenges in delivering deep cuts to already low discretionary spending, and offsetting spending pressures. Fitch projects the central government deficit will fall to 5.1% of GDP in 2021, from 5.8% in 2020.

Fiscal Rules Face Test: Three new fiscal rules face an important test in 2021. The authorities complied with spending and net borrowing caps in 2020. They estimate a small decline in the structural deficit, but retain discretion over the criteria used to calculate this, as a fiscal council meant to do so has yet to be formed. A much larger structural improvement is targeted for 2021.

Good External Financing Flexibility: Strong external market access and multilateral credit lines (used actively in 2020) support sovereign financing flexibility in the context of a shallow, but improving, local market. The authorities recently issued a US dollar bond at a record-low spread, and progressed on debt de-dollarisation efforts via a global peso issuance.

Disinflation Challenge: Inflation entered the target range (5% +/- 2pp) in April for the first time since 2018, but it is unclear whether this is the start of a structural disinflation process, in Fitch's view. This year's wage negotiations will be key: the authorities face a trade-off between a pledge for a recovery of real wage losses and conservative increases to facilitate disinflation.

Robust External Finances: The current account balance shifted to a modest deficit in 2020, in part due to initiation of the pulp project accompanied by corresponding FDI. International reserves rose to USD16.3 billion in 2020, further bolstering an already strong liquidity position.

Rating Sensitivities

Lack of Structural Progress: Weaker confidence in implementation of a medium-term fiscal adjustment that would support the broad stabilisation of debt/GDP and evidence of a weak economic recovery or post-recovery growth, due to domestic or external challenges or lack of progress on structural reforms, could result in negative rating action.

Improved Debt Dynamics: Confidence in fiscal consolidation supporting broad stabilisation of debt/GDP in the medium term, a strong economic recovery supported by better prospects for private investment and exports, and evidence of progress on disinflation, de-dollarisation and financial-sector deepening that improve policy flexibility could result in a positive rating action.

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)	-1
Structural features	-
Macroeconomic	-1
Public finances	-
External finances	-
Long-Term Foreign-Currency IDR	BBB-

Source: Fitch Ratings

Applicable Criteria

Sovereign Rating Criteria (April 2021)
Country Ceilings Criteria (July 2020)

Related Research

Global Economic Outlook (March 2021)
Latin America Sovereign Credit Overview 2Q21 (April 2021)

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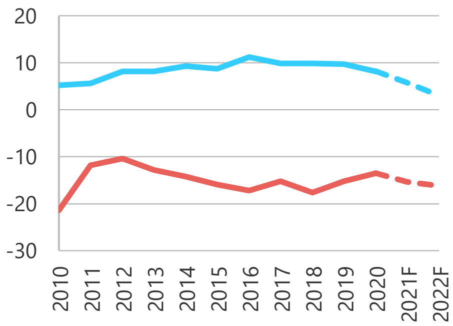
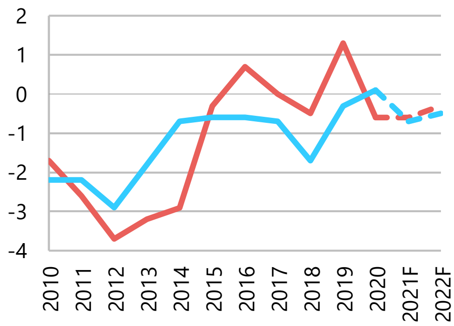
Peer Comparison

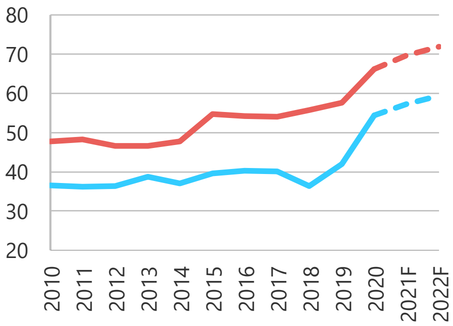
Net External Debt
% of GDP



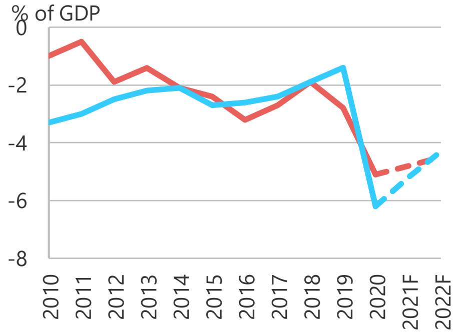
Current Account Balance
% of GDP



General Government Debt
% of GDP

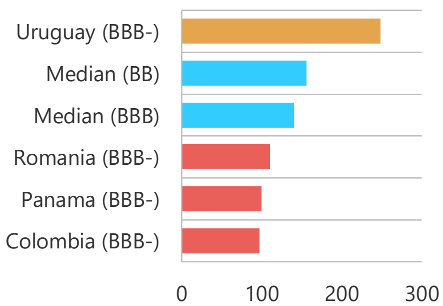


General Government Balance
% of GDP

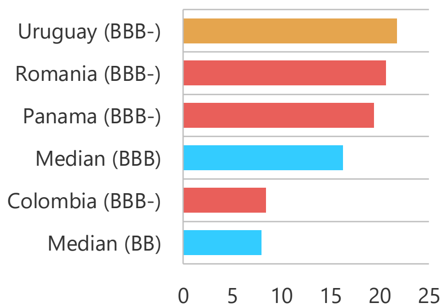


Uruguay   Median (BBB)

International Liquidity Ratio, 2020
(%)



GDP Per Capita Income, 2020
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)	2020
GDP	53.6
GDP per head (USD 000)	15.4
Population (m)	3.5
International reserves	16.3
Net external debt (% GDP)	-13.5
Central government total debt (% GDP)	67.9
CG foreign-currency debt	18.0
CG domestically issued debt (UYUbn)	445.0

Source: Fitch Ratings

Rating Factors

Strengths

- Uruguay's governance scores are among the highest in the 'BBB' category and of all emerging markets, reflected in strong social and political stability.
- Per capita GDP and human development indicators are above the peer medians.
- High FX reserves provide ample coverage of imports, broad money, and short-term external liabilities, buffering the small, open, commodity-dependent economy to shocks.
- A high net external creditor position (13.5% of GDP in 2020) reflects strong private-sector balance sheets that offset a large sovereign external debtor position (16.2%).
- Strong external market access, precautionary credit lines, and long-dated debt support sovereign financing flexibility in the presence of fairly shallow local markets.

Weaknesses

- Real GDP growth was the lowest among 'BBB' peers in 2015–2019 before the pandemic, but it has been relatively stable and fell less than the 'BBB' median in 2020.
- Uruguay's ease-of-doing-business score and investment rate have been the lowest in the 'BBB' category, highlighting competitiveness challenges that weaken potential growth.
- Inflation has been the highest out of all investment-grade peers and has regularly exceeded the target range, although the central bank is focused on improving this.
- High dollarisation of around 76% of deposits (the highest among 'BBB' peers with their own legal tender) and low financial penetration constrain policy flexibility.
- Government debt/GDP of 66% in 2020 is above the peer median and projected to continue rising. The interest/revenues ratio is high and rising moderately.
- Foreign-currency debt of 34% of GDP in 2020 (or 52% of the total) is one of the highest among 'BBB' peers, rendering fiscal metrics sensitive to exchange-rate movements.

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 and convertibility risks. Vulnerability to external pressures is reduced by increased exchange-rate flexibility, strong bank supervision, and high external liquidity.

Peer Group

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

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
22 Jul 16	BBB–	BBB–
07 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

Source: Fitch Ratings

Strengths and Weaknesses: Comparative Analysis

2020	Uruguay BBB-	BBB median[a]	BB median[a]	Colombia BBB-	Panama BBB-	Romania BBB-
Structural features						
GDP per capita (USD, mkt exchange rates)	15,438	10,200	5,009	5,333	12,269	12,906
GNI per capita (PPP, USD, latest)	21,180	24,050	14,360	15,510	30,690	32,860
GDP (USDbn)	53.6			271.3	52.9	248.3
Human development index (percentile, latest)	71.2	67.9	52.7	56.3	70.2	74.4
Governance indicator (percentile, latest)[b]	80.5	58.4	44.2	46.6	54.4	58.4
Broad money (% GDP)	59.1	59.2	47.8	61.8	84.2	46.3
Default record (year cured)[c]	2003	-	-	-	1996	1986
Ease of doing business (percentile, latest)	47.1	70.7	53.6	65.1	55.1	71.5
Trade openness (avg. of CXR + CXP % GDP)	28.0	46.5	46.6	21.3	43.5	44.9
Gross domestic savings (% GDP)	21.4	22.8	18.4	12.5	35.4	20.1
Gross domestic investment (% GDP)	17.0	23.6	21.7	18.8	32.9	24.3
Private credit (% GDP)	27.6	56.7	37.1	59.7	92.4	33.4
Bank systemic risk indicators[d]	bb/1			bbb/1	bb/1	bb/1
Bank system capital ratio (% assets)	17.0	15.2	16.1	15.4	16.3	22.8
Foreign bank ownership (% assets)	50.9	30.0	36.3	25.7	47.7	73.8
Public bank ownership (% assets)	49.1	16.1	19.1	3.7	18.4	8.2
Macroeconomic performance and policies						
Real GDP (5yr average % change)	-0.4	3.6	4.0	0.5	-0.2	3.4
Volatility of GDP (10yr rolling SD)	3.3	2.9	2.5	3.7	8.1	2.9
Consumer prices (5yr average)	8.2	4.0	5.5	4.2	0.1	2.1
Volatility of CPI (10yr rolling SD)	1.0	2.3	3.2	1.6	2.6	2.1
Unemployment rate (%)	10.3	7.7	8.9	15.6	18.5	5.0
Type of exchange rate regime	Floating			Floating	Dollarised	Stabilised
Dollarisation ratio (% of bank deposits)	75.5	20.3	42.5	0.0	100.0	39.0
REER volatility (10yr rolling SD)	3.8	5.0	6.2	6.9	3.5	3.2

Source: Fitch Ratings

Strengths and Weaknesses: Comparative Analysis (Cont.)

2020	Uruguay BBB-	BBB median[a]	BB median[a]	Colombia BBB-	Panama BBB-	Romania BBB-
Public finances[e]						
Budget balance (% GDP)	-5.1	-2.3	-2.8	-7.0	-10.1	-9.8
Primary balance (% GDP)	-2.4	-0.3	-0.7	-3.7	-7.5	-8.4
Gross debt (% revenue)	244.8	138.3	154.4	215.4	337.4	150.9
Gross debt (% GDP)	66.2	35.9	39.1	59.8	62.1	47.4
Net debt (% GDP)	61.3	30.2	32.7	53.8	37.8	42.0
Foreign currency debt (% total debt)	51.7	33.8	61.2	36.8	100.0	58.9
Interest payments (% revenue)	9.9	6.9	9.0	11.9	14.5	3.6
Revenues and grants (% GDP)	27.0	30.6	24.8	27.8	18.4	31.4
Volatility of revenues/GDP ratio	1.2	6.1	5.6	4.7	6.3	4.6
Central govt. debt maturities (% GDP)	4.1	5.0	5.3	1.3	2.6	6.1
External finances						
Current account balance + net FDI (% GDP)	4.3	0.6	0.9	-1.2	3.5	-3.9
Current account balance (% GDP)	-0.6	-1.8	-2.6	-3.3	-0.3	-5.0
Net external debt (% GDP)	-13.5	9.0	10.5	16.5	59.8	21.6
Gross external debt (% CXR)	361.6	115.8	115.7	326.1	495.8	135.1
Gross sovereign external debt (% GXD)	46.7	29.2	45.3	48.7	25.5	46.0
Sovereign net foreign assets (% GDP)	-16.2	2.9	-2.7	-9.6	-36.4	-5.1
Ext. interest service ratio (% CXR)	9.1	4.2	3.9	14.1	11.4	2.9
Ext. debt service ratio (% CXR)	24.1	16.0	15.2	34.6	30.1	17.0
Foreign exchange reserves (months of CXP)	12.9	5.0	4.3	11.3	4.8	5.3
Liquidity ratio (latest)[f]	248.6	141.2	140.5	96.9	99.9	110.4
Share of currency in global reserves (%)	0	0	0	0	0	0
Commodity export dependence (% CXR, latest)	53.6	20.3	22.6	47.7	5.3	11.1
Sovereign net foreign currency debt (% GDP)	3.6	-6.0	2.3	0.5	35.2	9.4

[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

Steadfast Policy Stance Despite Sharp Reversal of Coronavirus Fortunes

Uruguay's management of the coronavirus has turned from one of the best in the world in 2020 to one of the worst in 2021, as registered cases and deaths have surged to global highs. A fast (albeit late) vaccination campaign should help contain the virus in 2021. Almost 36% of the population was fully vaccinated as of mid-June.

The pandemic has not greatly affected the Lacalle Pou administration's strong political standing, social stability, or the policy stance. The authorities have stuck to an approach of "responsible freedom" in appealing to voluntary social distancing measures rather than strict restrictions. They have kept a conservative approach in fiscal relief efforts despite political pressures. However, the authorities face difficult policy challenges in 2021. Their plans to lower high fuel prices and shift from a discretionary to a rules-based price policy have faced difficulty amid rising oil costs. The authorities increased fuel prices in June less than global oil prices after a four-month freeze, avoiding a greater drag on the economy but at a fiscal cost for state oil refiner ANCAP. Upcoming wage councils will be another key policy challenge: the government faces trade-offs between its pledge for restitution of real wage losses and its objectives for disinflation and job creation.

Recovery Balances Strong External Demand, Challenges to Domestic Demand

Uruguay's economy contracted by 5.9% in 2020, less than regional peers and in line with the 'BBB' median. This outturn balanced Uruguay's success in containing the pandemic in its early stages and construction of the UPM pulp mill (which added around 1pp to the headline growth figure) with weak growth going into the crisis and a relatively small counter-cyclical fiscal effort.

Fitch projects real GDP to recover gradually by 2.5% in 2021 and 2.7% in 2022, in line with the regional median but more slowly than the 'BBB' median. The coronavirus surge in early 2021 has likely slowed the recovery but not derailed it. Mobility restrictions have been limited except for strict border closures, which weighed heavily on tourism during the 1Q21 high season, and normalisation of this important sector may take time. Real wage declines, job losses, and fiscal austerity could restrain the domestic demand recovery. The UPM pulp project should contribute positively to growth again in 2021 and negatively in 2022 as construction ends, before production begins in 2023. Strong external demand is supporting goods exports, and surging commodity prices should support growth by improving tight profit margins in the agriculture sector and encouraging investment. Higher oil prices pose an offsetting challenge.

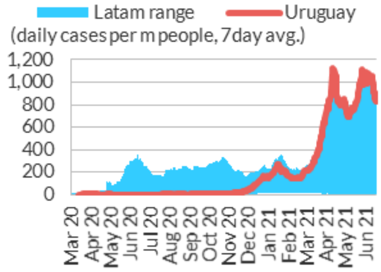
A recent national accounts revision resulted in 10% higher nominal GDP but lower historical real growth rates, underscoring the pre-pandemic trend of economic stagnation. Average real GDP growth in 2015–2019 was revised to 0.8% in the new series, the weakest in the 'BBB' category, from 1.3% due to the re-weighting of the telecommunications sector that had outsized influence in the prior series. Investment/GDP of 16.4% on average in 2015–2019 is also the weakest among 'BBB' peers. These revisions could negatively affect estimates of potential growth (2.3% in the budget, 2.5% according to the BCU).

The authorities hope to address key competitiveness issues to lift growth, but it remains to be seen how much progress they will be able to make. Plans to address inefficiencies and cross-subsidies behind high public utility rates may become clearer soon, but fiscal constraints complicate swift rate reductions. Mercosur has not yet approved Uruguay's request to seek trade agreements outside the block, and these would take time to negotiate. On the other hand, Uruguay's stability in a volatile region could support its attractiveness despite high costs, as could its strong human capital. The authorities hope to bolster human capital strengths via reforms to arrest slipping educational outcomes. A commission to study measures to deepen the shallow local capital market was recently launched. Expanded tax incentives for investment could offer a near-term boost.

Tight Fiscal Control During Pandemic, Structural Challenges Persist

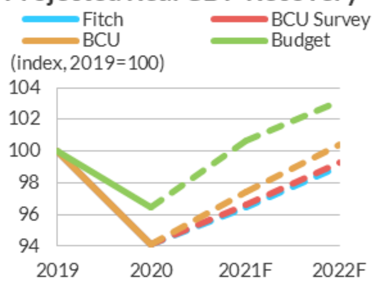
Uruguay's fiscal position has worsened only modestly during the pandemic, but from a weak starting point. The central government deficit rose to 5.8% of GDP in 2020 from 4.0% in 2019, excluding one-off "cincuentones" pension revenues. This relatively small increase reflected resilient tax revenues (which fell half as much as real GDP) and small, targeted pandemic-related spending (0.9% of GDP) funded mostly by dividends from the public commercial bank (BROU)

Coronavirus Cases



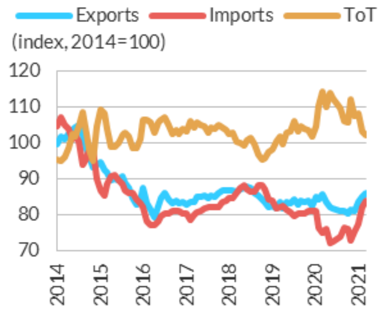
Source: Fitch Ratings, Johns Hopkins University CSSE COVID-10 Data accessed at ourworldindata.org.

Projected Real GDP Recovery



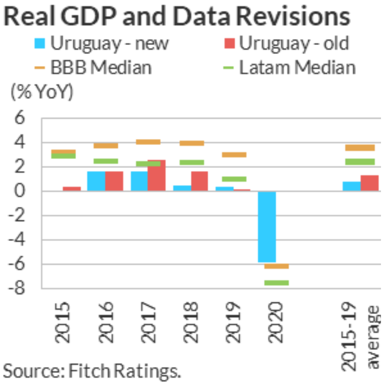
Source: Fitch Ratings; data from 2Q21 except budget (from 3Q20).

Terms of Trade



Source: Fitch Ratings, BCU

Real GDP and Data Revisions



Source: Fitch Ratings.

and other extraordinary revenues. Austerity efforts focused on investment and operating expenditures and high inflation lowered primary spending (net of pandemic outlays) by 2.5% in real terms, helping arrest a longstanding trend of structural fiscal deterioration.

Fitch expects the deficit will fall to 5.1% of GDP in 2021 and 4.6% in 2020, much more slowly than assumed in the five-year budget due to a weaker economic recovery and spending pressures. Tax collections continue to outperform real GDP, posing an upside, but social security contributions remain weak. Pandemic-related spending should end in 2021, after the authorities extended and upsized it to a projected 1.8% of GDP for the year, but there could be pressure to extend some aid should economic dislocations persist. The authorities expect to achieve an important structural consolidation via deep cuts in investment and operating expenditure, but these could be difficult to achieve as these outlays are already low. Rising pensions and payments on PPP projects will be sources of offsetting pressure. A 5% real cut to public wages in 2021 could offer lasting savings, as the government outlined a formula by which this would reverse only gradually.

The authorities also plan to submit a pension reform this year. It is unlikely to ease near-term fiscal pressures, as it will not affect persons near retirement, but will be key for fiscal credibility and long-term solvency. In the near-term, lower real wages will weigh on social security contributions but also offer relief to the system by reducing the wage index (IMSN) to which benefits are linked.

The government introduced three new fiscal rules in 2020 – a structural fiscal balance, a primary spending growth cap, and a net borrowing cap. The spending and borrowing caps were obeyed in 2020. The authorities estimate they reduced the structural deficit by 0.2pp of GDP but retain discretion over the criteria used to calculate it, as a Fiscal Advisory Council meant to do so has yet to be formed. The rules will face a much greater test in 2021 when the bulk of the structural consolidation targeted in the budget (1.4% of GDP out of a 2.1% total in 2020–2024) must take place. The authorities expect they will only invoke a 30% let-out in the net borrowing cap.

Partial pass-through of higher global oil prices to consumers has a fiscal cost, which the authorities estimate totalled USD90 million during the February–May price freeze and will be USD10 million per month after the June price increase. Thus far, the executive has chosen to have ANCAP borrow to cover this financial burden rather than compensate the company, so this will affect the fiscal metrics of the non-financial public sector (NFPS) but not those of the central government.

Debt Projected to Continue Rising at High Levels

Central government debt excluding bonds and loans held by the central bank (BCU) – the focus of the authorities' new fiscal framework – rose to 61.8% of GDP in 2020 from 51.6% in 2019 due to the wider deficit and real GDP contraction. A large real depreciation of the peso with respect to the US dollar in early 2020 narrowed to just 4.8% by the end of the year, lifting debt/GDP but by less than in previous years. Fitch's general government debt metric rose by a smaller amount, to 66.2% of GDP in 2020 from 57.6% in 2019, given this also includes BCU recapitalisation bonds that were partially cancelled (a 1.5% of GDP effect) and consolidates government bonds accumulating in the "cincuentones" trust fund.

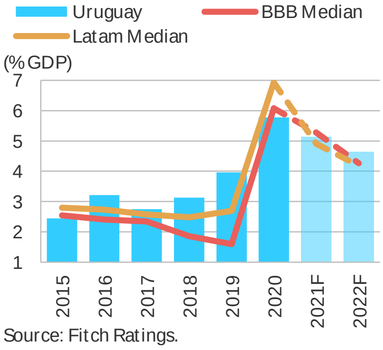
Fitch projects general government debt will rise to 69.7% of GDP in 2021 and 71.9% in 2022. Debt is high compared to the 'BBB' median of 54% of GDP in 2020, but the gap narrowed as a result of higher nominal GDP following the national accounts revision. Lower local and global interest rates are helping to improve debt dynamics, albeit gradually given a long maturity profile.

Sovereign financing flexibility remains supported by strong external market access and liquidity buffers in the presence of a shallow but improving local market. The sovereign has drawn down its cash buffers in recent years and used a portion of its multilateral credit lines in 2020, but together these still covered nearly twelve months of debt service as of end-2020. The sovereign recently re-tapped a 10-year US dollar bond at record low spread (80bp over US treasuries) and issued a new global peso bond, advancing debt de-dollarisation efforts. It also has USD700 million in loans approved from the World Bank and IDB, but it has yet to sign these.

Window of Opportunity for Disinflation

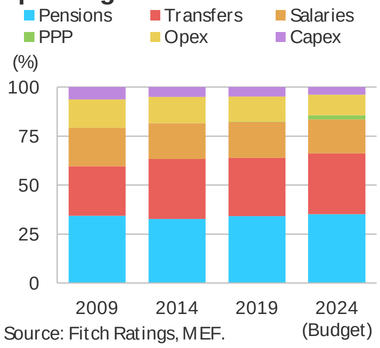
Inflation fell to 6.6% in May 2021 from a high of 11.1% in May 2020, having entered the target range (5%+/-2pp) in April for the first time since 2018. It not yet clear if the fall in inflation is a transitory trend or the start of a lasting disinflation process, in Fitch's view. Base effects explain much of the recent sharp fall in inter-annual inflation. Core inflation is around 8.0% in inter-

General Government Deficit



Source: Fitch Ratings.

Spending Profile



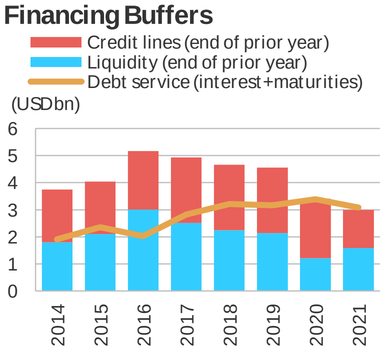
Source: Fitch Ratings, MEF.

Uruguay Debt Metrics (% GDP)

	2014	2019	2020	2021F
CG debt (MEF)	37.5	51.6	61.8	65.5
+ BCU bonds/loans	9.8	7.1	6.2	6.2
CG debt (Fitch)	47.3	58.8	67.9	71.6
+ local/BPS debt	0.6	0.7	0.6	0.6
– BPS trust fund	-	1.8	2.4	2.6
GG debt (Fitch)	47.8	57.6	66.2	69.7
NFPS debt (BCU)	51.1	60.5	68.2	71.7
Public debt (BCU)	56.5	64.3	75.1	-

Source: Fitch Ratings, MEF, BCU, IMF.

Financing Buffers



Source: Fitch Ratings, Debt Management Unit.

annual and annualised monthly terms. Inflation expectations have moved closer to the target, according to financial market breakevens and the BCU survey of analysts, but remain high in a newly published survey of businesses. Prospects for lasting disinflation will hinge on the outcome of upcoming wage negotiations in mid-2021. The authorities will soon submit their guidelines for these talks, and face a difficult trade-off between their pledge for a gradual restitution of real wage losses during the pandemic with the need for conservative wage increases and paring back of indexation mechanisms to facilitate the disinflation process.

The BCU has kept its policy rate (TPM) at 4.5%, an expansionary level that is minus 2%-3% in real terms (ex ante and ex post), since adopting it as its main policy instrument in September 2020. It expects to raise the TPM gradually later in 2021 as the economy recovers, toward an estimated neutral real rate of +2%. The BCU also hopes to reduce high financial dollarisation (75% of deposits, 48% of credit in 2020) to improve weak policy transmission channels. Its plan to do so will focus on anchoring inflation at lower levels, financial education, and incentives to increase peso usage rather than strong disincentives or restrictions against dollar usage.

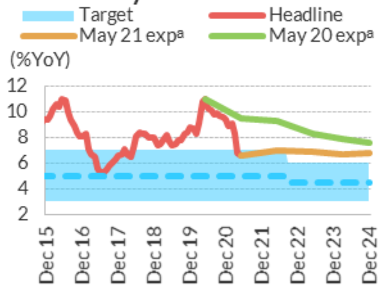
Robust External Position and Liquidity

Uruguay's current account shifted into a 0.6%-of-GDP deficit in 2020 from a 1.3% surplus in 2019, driven by a loss in tourism receipts and lower trade surplus reflecting a larger fall in exports (-15%) than in imports (-10%). Higher capital imports related to the UPM project are a key factor behind the re-emergence of a current account deficit, but this entails even larger corresponding FDI, which rose to 5.2% of GDP in 2020 from an average of 2.5% in 2015–2019.

A stronger current account and FDI balance and substantial sovereign external borrowing drove an increase in the BCU's FX reserves to USD16.3 billion, and net reserves (excluding FX liabilities to the public sector and domestic banks) to USD6.8 billion – their highest levels since 2014 before the large-scale divestment of non-residents from local public debt securities.

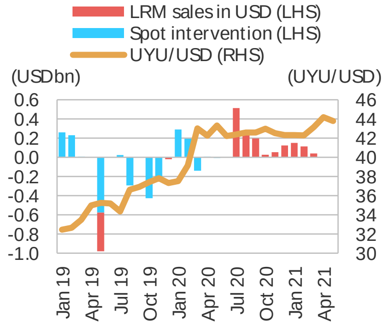
The BCU has refrained from direct FX intervention in the spot market since some US dollar sales at the onset of the pandemic, and has instead sought to pre-empt peso appreciation pressures by allowing its peso sterilisation notes (LRMs) to be purchased directly in US dollars. Eventual monetary tightening could put further pressure on the peso, as the BCU has emphasised the primacy of its inflation objective over other considerations such as peso competitiveness. The authorities and business groups have voiced concern over the strength of the peso in recent years, but the BCU estimates it is only slightly stronger than the level implied by fundamentals.

Inflation Dynamics



[a] Implied inflation expectation in bond market
Source: Fitch Ratings, BCU, BEVSA.

Peso and FX Intervention



Source: Fitch Ratings, BCU.

Public Debt Dynamics

In Fitch's baseline scenario, gross general government debt (GGGD) will continue to rise in the coming years from 66.2% in 2020, as gradual fiscal consolidation, economic recovery, and lower marginal interest rates slow but do not fully arrest its upward path. This assumes peso depreciation in line with relative inflation. Lower inflation after the surge in 2020 should have a neutral effect, reducing both the GDP deflator and accruing interest on inflation-indexed debt. Stronger growth in line with the projections in the five-year budget would be consistent with the faster fiscal consolidation, and both effects could stabilise GGGD at around 70% of GDP. Key risks to debt dynamics include a slower-than-expected economic recovery or fiscal consolidation, or an exchange-rate shock that increases the large stock of FC-denominated debt in terms of GDP. Long-dated debt buffers debt dynamics from interest-rate shocks.

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.

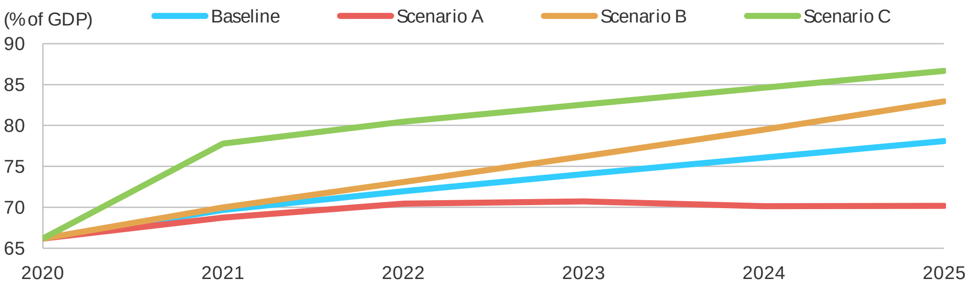
Debt Dynamics: Fitch's Baseline Assumptions

	2020	2021	2022	2023	2024	2025
Gross general government debt (% of GDP)	66.2	69.7	71.9	74.1	76.1	78.1
Primary balance (% of GDP)	-2.4	-2.2	-1.8	-1.6	-1.5	-1.4
Real GDP growth (%)	-5.9	2.5	2.7	2.5	2.2	2.0
Avg. nominal effective interest rate (%)[a]	9.1	7.0	7.0	6.7	6.5	6.5
LCU/USD (annual avg.)	42.0	44.4	46.7	49.4	52.3	55.4
GDP deflator (%)	10.9	7.0	7.0	7.0	7.0	7.0

[a] Captures interest accruing on capital of bonds in inflation-indexed units (UIs) and wage-indexed units (UPs).
Source: Fitch Ratings.

Sensitivity Analysis

Gross general government debt



Source: Fitch Ratings, Debt Dynamics Model

Debt Sensitivity Analysis: Fitch's Scenario Assumptions

Scenario A	Faster growth (averaging 1pp higher) in line with projections from BCU (2021–2022) and budget (2023–2024) that drives faster consolidation to primary balance by 2024.
Scenario B	Failure to reduce the primary deficit from 2020 level, and accumulation of a 150 basis point risk premium on new borrowing.
Scenario C	A 20% depreciation of the peso by the end of 2021.

Source: Fitch Ratings.

Forecast Summary

	2016	2017	2018	2019	2020	2021F	2022F
Macroeconomic indicators and policy							
Real GDP growth (%)	1.6	1.6	0.5	0.4	-5.9	2.5	2.7
Unemployment (%)	7.9	7.9	8.3	8.9	10.3	10.3	9.8
Consumer prices (annual average % change)	9.6	6.2	7.6	7.9	9.8	7.3	7.0
Short-term interest rate (bank policy annual avg) (%)	9.1	7.4	6.8	8.0	5.1	6.0	8.0
General government balance (% of GDP)	-3.2	-2.7	-1.9	-2.8	-5.1	-4.8	-4.5
General government debt (% of GDP)	54.2	54.0	55.8	57.6	66.2	69.7	71.9
UYU per USD (annual average)	30.16	28.68	30.73	35.26	42.01	44.37	46.71
Real effective exchange rate (2000 = 100)	95.6	101.4	102.9	99.7	95.0	95.5	95.5
Real private sector credit growth (%)	-5.7	-4.6	4.8	2.1	1.0	0.0	0.0
External finance							
Current account balance (% of GDP)	0.7	0.0	-0.5	1.3	-0.6	-0.6	-0.3
Current account balance plus net FDI (% of GDP)	-2.4	-3.3	-1.3	3.4	4.3	3.7	2.8
Net external debt (% of GDP)	-17.2	-15.3	-17.6	-15.2	-13.5	-15.4	-16.2
Net external debt (% of CXR)	-58.7	-52.4	-59.6	-49.0	-48.7	-50.6	-51.4
Official international reserves including gold (USDbn)	13.5	16.0	15.6	14.5	16.3	16.7	17.1
Official international reserves (months of CXP cover)	9.9	10.2	9.6	9.6	12.9	11.6	11.1
External interest service (% of CXR)	7.4	6.6	7.5	7.3	9.1	8.3	7.9
Gross external financing requirement (% int. reserves)	4.9	18.5	17.5	13.1	17.4	14.5	15.3
Real GDP growth (%)							
US	1.7	2.3	3.0	2.2	-3.5	6.2	3.3
China	6.7	6.9	6.8	6.0	2.3	8.4	5.5
Eurozone	2.0	2.4	1.9	1.3	-6.6	4.7	4.5
World	2.6	3.4	3.2	2.6	-3.4	6.1	3.9
Oil (USD/barrel)	45.1	54.8	71.5	64.1	43.3	58.0	53.0

Source: Fitch Ratings

Fiscal Accounts Summary

(% of GDP)	2017	2018	2019	2020	2021F	2022F
General government						
Revenue	**26.7**	**28.2**	**27.5**	**27.0**	**26.6**	**25.7**
Expenditure	**29.5**	**30.2**	**30.3**	**32.1**	**31.4**	**30.3**
O/w interest payments	2.5	2.6	2.4	2.7	2.6	2.8
Primary balance	-0.2	0.7	-0.4	-2.4	-2.2	-1.8
Overall balance	**-2.7**	**-1.9**	**-2.8**	**-5.1**	**-4.8**	**-4.5**
General government debt	**54.0**	**55.8**	**57.6**	**66.2**	**69.7**	**71.9**
% of general government revenue	202.1	197.5	209.9	244.8	261.7	279.3
Central government deposits	5.3	5.0	3.8	4.8	4.8	4.8
Net general government debt	48.7	50.7	53.8	61.3	64.8	67.1
Central government						
Revenue	**19.6**	**20.0**	**19.4**	**19.8**	**19.9**	**19.2**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**22.3**	**23.1**	**23.3**	**25.6**	**25.0**	**23.8**
O/w current expenditure and transfers	18.6	19.2	19.5	21.5	21.0	19.7
- Interest	2.5	2.6	2.5	2.8	2.7	2.9
O/w capital expenditure	1.2	1.4	1.4	1.3	1.3	1.2
Current balance	-1.5	-1.8	-2.6	-4.5	-3.9	-3.4
Primary balance	-0.2	-0.5	-1.5	-3.0	-2.4	-1.8
Overall balance	**-2.7**	**-3.1**	**-4.0**	**-5.8**	**-5.1**	**-4.6**
Central government debt	53.4	56.1	58.8	67.9	71.6	73.9
% of central government revenues	272.9	280.1	303.1	343.4	360.9	385.6
Central government debt (UYUbn)	**984.2**	**1,111.1**	**1,268.3**	**1,530.9**	**1,769.2**	**2,004.8**
By residency of holder						
Domestic	566.0	614.7	660.1	694.4	810.0	924.0
Foreign	418.2	496.4	608.2	836.5	959.2	1,080.8
By currency denomination						
Local currency	578.0	597.3	632.8	769.8	901.8	1,028.4
Foreign currency	406.2	513.8	635.5	761.1	867.4	976.3
In USD equivalent (eop exchange rate)	14.1	15.9	17.0	18.0	19.1	20.3
Average maturity (years)	13.0	13.8	14.0	13.5	-	-
Memo						
Nominal GDP (UYUbn)	1,842.0	1,982.2	2,158.7	2,253.1	2,469.7	2,712.5

Source: Fitch Ratings estimates and forecasts, Ministry of Finance

External Debt and Assets

(USDbn)	2015	2016	2017	2018	2019	2020
Gross external debt	**44.5**	**41.5**	**44.6**	**43.8**	**47.8**	**53.7**
% of GDP	77.0	72.6	69.4	67.9	78.1	100.2
% of CXR	248.6	247.6	238.4	229.8	251.9	361.6
By maturity						
Medium- and long-term	35.1	34.1	37.2	36.9	41.0	46.9
Short-term	9.3	7.4	7.4	6.9	6.8	6.8
% of total debt	21.0	17.9	16.5	15.8	14.2	12.6
By debtor						
Sovereign	**16.7**	**16.2**	**18.5**	**17.7**	**20.6**	**25.1**
Monetary authorities	1.1	0.7	0.8	0.5	0.5	0.8
General government	15.5	15.4	17.6	17.2	20.1	24.3
O/w central government	14.5	13.8	14.5	15.3	16.3	19.8
Banks	**6.0**	**4.6**	**3.8**	**3.8**	**4.0**	**4.3**
Other sectors	**21.8**	**20.8**	**22.3**	**22.3**	**23.2**	**24.3**
Gross external assets (non-equity)	**53.6**	**51.4**	**54.4**	**55.2**	**57.1**	**61.0**
International reserves, incl. gold	15.6	13.5	16.0	15.6	14.5	16.3
Other sovereign assets nes	0.1	0.0	0.0	0.0	0.1	0.2
Deposit money banks' foreign assets	11.0	10.6	9.7	10.0	11.3	13.4
Other sector foreign assets	26.9	27.2	28.8	29.6	31.2	31.2
Net external debt	**-9.2**	**-9.8**	**-9.8**	**-11.4**	**-9.3**	**-7.2**
% of GDP	-15.9	-17.2	-15.3	-17.6	-15.2	-13.5
Net sovereign external debt	1.0	2.7	2.5	2.2	6.0	8.7
Net bank external debt	-5.0	-6.1	-5.9	-6.2	-7.3	-9.1
Net other external debt	-5.2	-6.5	-6.4	-7.3	-8.1	-6.8
Net international investment position	**-15.9**	**-16.1**	**-17.0**	**-15.5**	**-15.5**	**-17.3**
% of GDP	-27.5	-28.1	-26.5	-24.1	-25.4	-32.2
Sovereign net foreign assets	**-1.0**	**-2.7**	**-2.5**	**-2.2**	**-6.0**	**-8.7**
% of GDP	-1.7	-4.7	-3.9	-3.4	-9.9	-16.2
Debt service (principal & interest)	**3.2**	**2.4**	**3.7**	**3.9**	**4.3**	**3.6**
Debt service (% of CXR)	18.1	14.5	19.8	20.4	22.4	24.1
Interest (% of CXR)	7.0	7.4	6.6	7.5	7.3	9.1
Liquidity ratio (%)	172.5	193.6	203.8	221.8	225.6	248.6
Net sovereign FX debt (% of GDP)	-3.6	2.5	-2.5	0.8	4.1	3.6
Memo						
Nominal GDP	57.7	57.2	64.2	64.5	61.2	53.6
Inter-company loans	14.4	13.4	14.2	14.4	15.8	17.5

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

External Debt Service Schedule on Medium- and Long-Term Debt at end-March 2021

(USDm)	2021	2022	2023	2024	2025	2026	2027+
Sovereign: Total debt service	1,590	2,586	1,721	1,783	2,143	2,594	30,265
Amortisation	**655**	**1,455**	**654**	**741**	**1,135**	**1,635**	**18,695**
Official bilateral	-	-	-	-	-	-	-
Multilateral	130	214	259	346	345	384	2,257
Bonds	525	1,241	395	395	790	1,251	16,438
Interest	935	1,131	1,067	1,042	1,008	959	11,571
Non-sovereign public sector	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**

Source: Fitch Ratings, Ministry of Finance, Central Bank

Balance of Payments

(USDbn)	2017	2018	2019	2020	2021F	2022F
Current account balance	**0.0**	**-0.3**	**0.8**	**-0.3**	**-0.3**	**-0.2**
% of GDP	0.0	-0.5	1.3	-0.6	-0.6	-0.3
% of CXR	-0.1	-1.8	4.3	-2.0	-1.8	-0.9
Trade balance	**2.0**	**2.3**	**3.1**	**2.2**	**2.6**	**2.8**
Exports, fob	11.1	11.6	11.7	10.0	12.5	13.1
Imports, fob	9.1	9.3	8.7	7.8	9.9	10.3
Services, net	**1.5**	**0.9**	**0.6**	**0.1**	**0.0**	**0.1**
Services, credit	5.7	5.4	5.3	3.6	3.0	3.8
Services, debit	4.2	4.5	4.6	3.5	3.0	3.7
Income, net	**-3.6**	**-3.7**	**-3.0**	**-2.7**	**-3.1**	**-3.2**
Income, credit	1.6	1.7	1.5	0.9	1.0	1.1
Income, debit	5.1	5.3	4.6	3.6	4.1	4.3
O/w: Interest payments	1.2	1.4	1.4	1.3	1.4	1.5
Current transfers, net	**0.1**	**0.1**	**0.2**	**0.2**	**0.1**	**0.1**
Capital and financial accounts						
Non-debt-creating inflows (net)	0.0	1.2	-1.0	0.8	1.6	1.0
O/w equity FDI	0.2	0.9	-0.7	1.0	1.6	1.0
O/w portfolio equity	-0.2	0.2	-0.3	-0.3	0.0	0.0
O/w other flows	0.0	0.0	-0.4	0.0	0.0	0.0
Change in reserves	-2.4	0.4	1.1	-1.6	-0.5	-0.4
Gross external financing requirement	**2.5**	**2.8**	**2.0**	**2.5**	**2.4**	**2.5**
Stock of international reserves, incl. gold	**16.0**	**15.6**	**14.5**	**16.3**	**16.7**	**17.1**

Source: Fitch Ratings estimates and forecasts and IMF

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