MOODY'S
INVESTORS SERVICE

CREDIT OPINION
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Update

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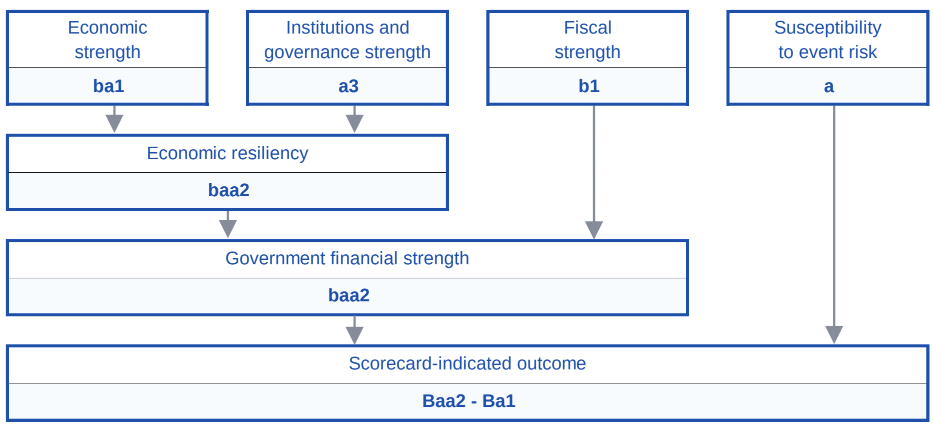
Government of Uruguay – Baa2 stable

Regular update

Summary

The credit profile of Uruguay is supported by its high institutional strength. While Uruguay has relatively high income levels, growth was already weak in the years preceding the pandemic-induced recession in 2020. Consequently, debt metrics deteriorated in recent years. In the context of the pandemic, the government is implementing a reform agenda to address structural challenges including relatively low levels of investment and spending rigidities. Fiscal consolidation plans beyond 2021 remain key to 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

» Robust government liquidity buffers

» Strong institutional framework

Credit challenges

» Structural rigidities in government spending

» Relatively high share of foreign-currency-denominated government debt

» Modest medium-term growth prospects

Rating outlook

The stable outlook balances the underlying fiscal and economic pressures that preceded the pandemic and the government's actions to address these underlying credit challenges.

Factors that could lead to an upgrade

Upward credit pressure could result from (1) continued progress on the government's reform agenda, in particular vis-à-vis compliance with the new fiscal rule and monetary policy framework that result in improving macroeconomic outcomes; (2) a material strengthening in the government's balance sheet, for example, through a reduction in the sovereign's debt and interest burdens and continued improvements in the debt structure; and, (3) a reduction in structural rigidities of Uruguay's credit profile such as those associated with low and declining productivity, which affects potential growth, as well as the relatively rigid government spending structure.

Factors that could lead to a downgrade

Downward credit pressure would emerge if we were to conclude that structural fiscal and economic challenges were unlikely to be addressed, denoting a weakening in policy responsiveness, and likely leading to economic growth underperforming and fiscal strength deteriorating further in the medium term, with a continued increase in debt ratios and/or a sustained, material erosion in external and financial buffers.

Key indicators

Uruguay	2016	2017	2018	2019	2020	2021E	2022F	2023F
Real GDP (% change)	1.7	1.6	0.5	0.4	-5.9	4.5	4.0	3.0
Inflation (CPI, % change, Dec/Dec)	8.1	6.6	8.0	8.8	9.4	7.7	7.0	6.6
Gen. gov. financial balance/GDP (%)[1]	-3.2	-2.7	-3.1	-4.0	-5.8	-4.3	-3.6	-3.3
Gen. gov. primary balance/GDP (%)	-0.7	-0.2	-0.5	-1.5	-3.0	-2.0	-1.1	-0.7
Gen. gov. debt/GDP (%)	44.2	44.8	48.0	51.6	61.8	61.2	60.3	60.5
Gen. gov. debt/revenues (%)	172.6	167.5	177.5	195.4	233.5	229.9	225.3	226.7
Gen. gov. interest payment/revenues (%)	9.6	9.3	9.7	9.5	10.5	8.8	9.3	9.6
Current account balance/GDP (%)	0.8	0.0	-0.4	1.6	-0.6	-0.5	-0.7	-0.5
External debt/CA receipts (%)[2]	242.5	224.8	223.7	234.3	316.9	230.5	221.7	207.2
External vulnerability indicator (EVI) [3]	108.3	108.6	78.8	87.0	93.2	84.7	87.2	85.5

[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 "ba1" **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 an estimated $58 billion in 2021 was smaller than the "Baa" median of around $270 billion. In 2021, we estimate the economy expanded by around 4.5% in real terms, partially recovering from a pandemic-induced contraction of 5.9%. We expect that the economy will expand by an average of 3.5% per year in 2022 and 2023. Work on the UPM-Kymmene (Baa1 stable) pulp mill plant has lifted investment levels from the low levels registered in 2019 and preceding years, and we expect investment levels to hold at current levels thanks to the government's pro-investment agenda. However, even with this sanguine view of investment, potential growth is likely to remain low.

Our final score for Uruguay's **institutions and governance strength** is "a3." 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 and frequent revisions to fiscal targets. In 2020, the central bank relaunched its inflation targeting strategy. Meanwhile, the executive secured legislation introducing a new fiscal policy framework that features a fiscal rule with structural balance targets, restraints on current expenditure growth and debt ceilings. The government met all of its fiscal rule targets in both 2020 and 2021. Building a track record of compliance under this new framework would support the reduction in fiscal imbalances and bolster fiscal policy credibility and effectiveness.

Uruguay's "b1" **fiscal strength** assessment balances its moderately high government debt burden, very strong asset-liability management practices and fiscal reserve assets with lingering vulnerabilities from a high proportion of foreign-currency debt. The divergence with the initial score of "b2" stems from the negative debt trend adjustment (minus one notch), which we consider signals a deterioration that was already captured in the 2020 metrics – we forecasts the debt burden will remain broadly stable in 2021-23. Debt and interest, when measured as a share of GDP and revenue, respectively, are now higher than the "Baa" medians but are aligned with those of other Baa2-rated peers. Although the government managed to reduce the share of foreign-currency-denominated debt over the past two decades, it remains at a relatively high level of over 50%. This exposes the overall debt stock to fluctuations caused by exchange rate depreciation, which, in turn, can lead to a deterioration in the debt-to-GDP ratio. Exchange rate risk is mitigated by the government's financial assets, which are mostly denominated in foreign currency and provide around 12 months of debt-service coverage.

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 domestic bank assets equivalent to more than 75% of GDP in 2020, and a Baseline Credit Assessment of baa3 for rated banks, 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 exchange rate risks stemming from the country's still significant degree of financial dollarization. Since 2016, Uruguay's current account has registered either surpluses or moderate deficits, reflecting the decrease in investment levels and sluggish economic activity. In 2020, the sharp contraction of services exports (amid a collapse of tourism) led to a small current account deficit. Partial-year data for 2021 suggests the deficit narrowed in 2021 and we expect this to continue into 2022-23 as fiscal consolidation continues.

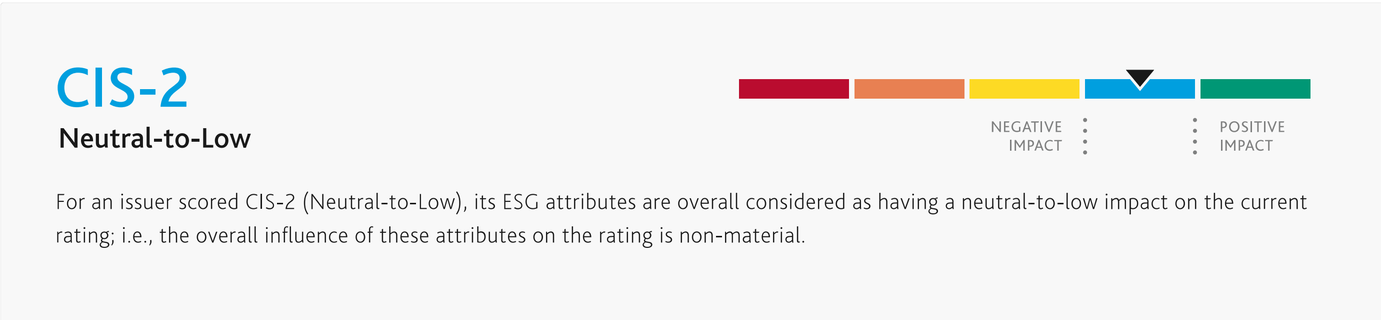
Uruguay's government liquidity risk assessment is "a," balancing the government's relatively low gross borrowing requirements – favored by a long maturity profile – against a relatively high share of external debt in total government debt.

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 to be very low.

ESG considerations

URUGUAY's ESG Credit Impact Score is Neutral-to-Low CIS-2

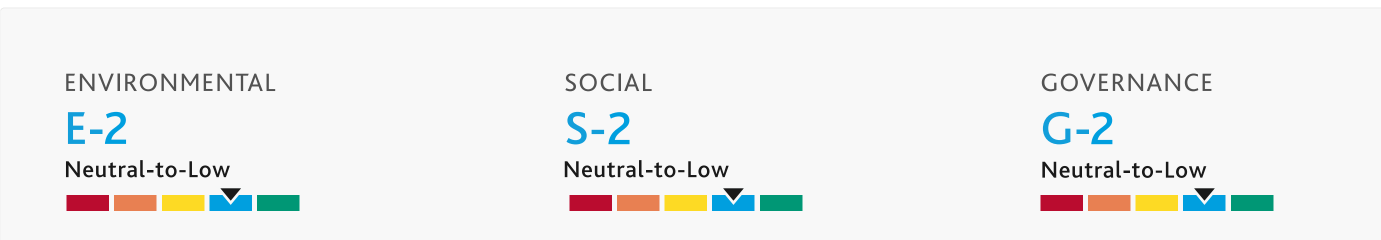
Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Uruguay's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting its exposure to social risks, exposure to environmental risks and broad societal consensus that supports its governance.

Exhibit 4
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

We assess Uruguay's exposure to environmental risks as neutral-to-low (**E-2** issuer profile score). 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

Exposure to social risks is neutral-to-low (**S-2** issuer profile score). The country's aging population, coupled with the population's predilection for social expenditure, will weigh on public finances in the coming years. A deterioration in the labor market, for the younger population in particular, also poses social risks. However, adequate provision of social services and a mature political system that develops policy on a consensus basis help mitigate social risks.

Governance

The influence of governance on Uruguay's credit profile is neutral-to-low (**G-2** issuer profile). The country has a long history of sustainable macroeconomic policies, strong institutions and a broad societal consensus on retaining the country's institutional arrangements.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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 the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

Stronger-than-expected fiscal consolidation in 2021

Data for 2021 showed the general government registered a deficit of UYU47 billion, a substantial narrowing from 2020's UYU60 billion.[1] Considering our estimate for 2021 GDP, this puts the deficit at 4.3% of GDP, a marked improvement from the 5.8% registered in 2020 (see Exhibit 5).

The 2021 fiscal result was aided by a strong increase in revenues, which benefited from the rebound in economic activity – we project 2021 GDP will report 4.5% annual growth. At the same time, in addition to benefiting from lower real borrowing costs, the government continued its determined commitment to controlling primary expenditures, which in real terms expanded by 1.6% relative to 2020.[2] This performance was achieved by tight control of personnel policy, as expenditure in salaries contracted by around 2% in real terms, the result of stable headcount and last year's wage negotiation. Other expenditure lines that are linked to wages, such as pensions and some transfers, were also contained (see Exhibit 6). The data indicates that the government met its spending cap on primary expenditure growth, set at 2.3% for 2021.

For 2022, the government announced that the coronavirus fund that has encompassed the pandemic-related spending since 2020 will be halved to about $400 million this year (although the amount could be modified depending on health and economic conditions). This will contribute to further fiscal consolidation in 2022. Moreover, renewed pressure from trade unions to raise wages, or the referendum on the Urgent Law (*Ley de Urgente Consideracion*, LUC) that was passed in 2020 and includes the government's fiscal rule, may put upward pressure on overall expenditures in the coming months. Regardless, we still expect the government to meet its fiscal rule targets. A continued narrowing of the fiscal deficit through 2024 to levels below 3% of GDP will support the stabilization of the debt burden, which we expect will remain around 60% of GDP.

Exhibit 5

2021 saw fiscal consolidation...

General government finances, % GDP

	2019	2020	2021
Total revenue	**26.4%**	**26.5%**	**27.1%**
Central government	**19.4%**	**19.8%**	**20.5%**
Taxes	17.2%	17.6%	18.5%
State-owned enterprises	0.9%	0.9%	0.7%
Rest	1.3%	1.3%	1.3%
Social security	**7.0%**	**6.7%**	**6.6%**
Total expenditure	**30.4%**	**32.3%**	**31.5%**
Current expenditure	**29.0%**	**31.0%**	**30.3%**
Salaries	5.1%	5.2%	5.0%
Pensions	9.5%	10.0%	9.8%
Transfers	8.3%	9.0%	8.6%
Interest expenditure	2.5%	2.8%	2.4%
Rest	3.6%	3.9%	4.6%
Capital expenditure	**1.4%**	**1.3%**	**1.2%**
Financial balance	**-4.0%**	**-5.8%**	**-4.4%**
Primary balance	**-1.5%**	**-3.0%**	**-2.0%**

Source: Ministry of Finance and Moody's Investors Service

Exhibit 6

...on the back of controlled expenditure and rebounding revenues

General government finances, real year-on-year variation

	2019	2020	2021
Total revenue	**-1.4%**	**-4.7%**	**5.3%**
Central government	**-2.2%**	**-2.9%**	**6.4%**
Taxes	-3.5%	-7.5%	28.4%
State-owned enterprises	15.9%	0.2%	-21.9%
Rest	-14.6%	4.4%	-0.1%
Social security	**0.7%**	**-9.6%**	**2.1%**
Total expenditure	**1.6%**	**1.0%**	**0.5%**
Current expenditure	**1.6%**	**1.4%**	**0.7%**
Salaries	3.8%	-1.8%	-1.8%
Pensions	2.1%	0.5%	0.0%
Transfers	0.7%	2.5%	-1.8%
Interest expenditure	-3.1%	5.0%	-11.4%
Rest	-1.9%	-4.7%	15.7%
Capital expenditure	**0.7%**	**-10.3%**	**-6.4%**

Source: Ministry of Finance and Moody's Investors Service

Inflation to remain above central bank target in 2022

Inflation ended 2021 at 7.96%, below the 9.4% level of 2020 but still above the central bank's (BCU) inflation target range (3-7%). Following an initial spike in inflation primarily caused by the exchange rate depreciation in early 2020, inflation had trended lower, as have inflation expectations. A factor that contributed to the moderation of inflation was a 2020 wage agreement between trade unions, business groups and the government that resulted in a 2% reduction in real wages, the first contraction since 2004. Moreover, wage policies remain a potential source of inflationary pressures – the government is balancing its goal of fostering job creation and its commitment to ensure an increase in real wages through 2024.

External pressures affect price dynamics in Uruguay given a still high degree of financial dollarization and its dependence on fuel imports. The latter has become an important source of inflationary pressures given the global rise in hydrocarbon prices. That said, the administration has aimed to reduce the pass-through to consumers by using ANCAP's (Ba1 stable) accumulated earnings, diverging from the new fuel price-setting mechanism included in the LUC.

The Monetary Policy Committee (COPOM) has continued to raise its monetary policy rate, which reached 6.5% in January 2022 – the tightening cycle began in August 2021, when the rate was 4.5% (the policy rate was reintroduced in September 2020 at 4.5% when the BCU revamped its policy framework). Despite this tightening, the COPOM still maintains an overall expansionary stance (i.e. negative level in real terms once inflation and inflation expectations are considered).

Building a track record of credibility will be important for monetary policymakers as past BCU leadership opted to retain economic dynamism at the expense of inflation targets. We expect the BCU will exhibit an increased commitment to inflation control than it has in the past, although meeting its targets over 2021-23 will be challenging. We expect inflation will trend down during the course of 2022 to levels closer to 7% by the end of the year, but remain above the inflation target band because this will narrow to a range of 3-6% in September 2022.

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

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor score	Final Factor score	Weights
Factor 1: Economic strength				ba1	ba1	50%
Growth dynamics	Average real GDP growth (%)	2016-2025F	1.5	b1		25%
	Volatility in real GDP growth (%)	2011-2020	3.1	b1		10%
Scale of the economy	Nominal GDP ($ billion)	2020	53.6	ba2		30%
National income	GDP per capita (PPP, Intl$)	2020	22,423	a3		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				a3	a3	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				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				baa2	baa2	
Factor 3: Fiscal strength				b2	b1	
Debt burden	General government debt/GDP (%)	2020	61.8	baa3		25%
	General government debt/revenue (%)	2020	233.5	baa3		25%
Debt affordability	General government interest payments/revenue (%)	2020	10.5	baa1		25%
	General government interest payments/GDP (%)	2020	2.8	baa2		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-6	-5	max ±6
	Debt trend	2016-2021F	17.0	-1	0	
	Foreign currency debt/general government debt	2020	54.5	-5	-5	
	Other non-financial public sector debt/GDP	2020	3.2	0	0	
	Public sector assets/general government debt	2020	0.0	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				baa3	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	baa3		
	Total domestic bank assets/GDP	2020	76.9	<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				Baa3 - Ba2	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

» **Outlook:** Sovereigns – Latin America & Caribbean: 2022 outlook stable as growth recovers and debt levels stabilize; political risks rising, 16 November 2021

» **Outlook:** Sovereigns - Global: Stable 2022 outlook as economic recovery eases credit pressures, but long-term costs of the pandemic weigh on sovereigns, 3 November 2021

» **Issuer In-Depth:** Government of Uruguay – Baa2 stable: Annual credit analysis 17 August 2021

» **Sector In-Depth:** Sovereigns – Global: Scarring from COVID-19 pandemic will increase fiscal risks and social pressures, 22 July 2021

» **Sector In-Depth:** Sovereigns – Latin America & Caribbean: Credit impact of ESG marginally lower in LatAm than in most other EM regions, 30 June 2021

» **Sector In-Depth:** Sovereigns – Emerging Markets: Social safety nets support credit quality by improving response to shocks, reducing social tensions, 10 June 2021

» **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 Our definition of general government excludes the effect of law 19,590, the so-called *cincuentones* law.

2 Data excludes the effect of the *cincuentones* law.

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