MOODY'S INVESTORS SERVICE

CREDIT OPINION
12 August 2022

Update

Send Your Feedback

Contacts

Renzo Merino +1.212.553.0330
VP-Senior Analyst
renzo.merino@moodys.com

Domenico Barbieri +1.212.553.9567
Associate Analyst
domenico.barbieri@moodys.com

Mauro Leos +1.212.553.1947
Associate Managing Director
mauro.leos@moodys.com

Alejandro Olivo +1.212.553.3837
MD-Sovereign/Sub Sovereign
alejandro.olivo@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Government of Uruguay – Baa2 stable

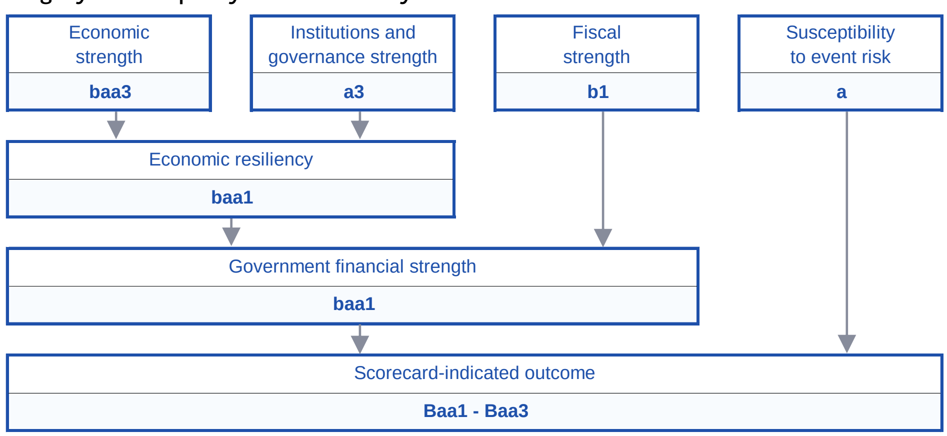
Regular update

Summary

The credit profile of Uruguay is supported by its robust institutional strength. Economic growth in 2021-22 will exceed the weak growth in the 2015-19, allowing GDP to return to pre-pandemic levels in 2022. Prudent fiscal management is supporting the strengthening fiscal policy credibility. During the pandemic the government moved ahead with its reform agenda to address its structural challenges, including relatively low levels of investment and spending rigidities. We expect compliance with the new fiscal rules will help reduce the government's debt burden in the near term.

Exhibit 1

Uruguay's credit quality is determined by four factors



Source: Moody's Investors Service

Credit strengths

» Strong institutional framework

» Favorable debt maturity profile and moderate government financing needs

» Robust government liquidity buffers

Credit challenges

» Structural rigidities in government spending

» Relatively high share of foreign currency-denominated government debt

» Low, albeit rising, levels of investment that can constrain economic growth prospects

Rating outlook

The stable outlook reflects a balance between the structural economic and fiscal challenges that Uruguay faced prior to the pandemic with our expectation that as the government implements its reform agenda and policies, it will effectively address these issues. In the years preceding the pandemic, Uruguay's economic performance lagged that of rating peers in part because of declining levels of investment and a significant loss of jobs. While the construction of the country's third largest pulp mill plant will change the trend in terms of investment, we expect that additional measures undertaken by the government to incentivize private investment and employment will support a broader recovery.

On the fiscal front, although government spending has a relatively rigid structure, the authorities identified savings and efficiency gains last year and we expect that the government will remain compliant with the spending limits set by the new fiscal rule. Over the long term, the pension reform will also help address some of these issues.

Factors that could lead to an upgrade

Upward rating pressure could result from a continued progress in the government's reform agenda, in particular related to the compliance with the new fiscal rule and monetary policy framework, which will drive improving macroeconomic outcomes; a significant 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 a reduction in the structural rigidities of the country's economy, such as those associated with low and declining productivity, which affects 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

Exhibit 2

Uruguay	2016	2017	2018	2019	2020E	2021E	2022F	2023F
Real GDP (% change)	1.7	1.6	0.5	0.4	-6.1	4.4	4.7	3.0
Inflation (CPI, % change, Dec/Dec)	8.1	6.6	8.0	8.8	9.4	8.0	8.8	7.0
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 (%)[1]	-0.7	-0.2	-0.5	-1.5	-3.0	-1.9	-1.1	-0.9
Gen. gov. debt/GDP (%)	44.2	44.8	48.0	51.6	61.9	61.4	56.6	56.5
Gen. gov. debt/revenues (%)	172.6	167.5	177.5	195.4	233.5	234.3	215.0	214.9
Gen. gov. interest payment/revenues (%)	9.6	9.3	9.7	9.5	10.5	8.8	9.3	9.1
Current account balance/GDP (%)	0.8	0.0	-0.4	1.6	-0.8	-1.7	-1.4	-1.3
External debt/CA receipts (%)[2]	240.3	225.5	224.2	234.9	320.9	233.6	206.9	194.8
External vulnerability indicator (EVI) [3]	108.3	94.0	80.8	77.3	99.1	91.5	99.6	103.2

[1] Excludes pension transfers and includes interest payments 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 quality incorporates our "baa3" **economic strength** assessment on a global basis, reflecting moderate growth potential and a relatively high income per capita, counterbalanced by the small size of the economy. At an estimated $59 billion in 2021, the Uruguayan economy was smaller than the Baa-rated peer median of around $250 billion. The economy expanded by around 4.4% in real terms in 2021, partially recovering from a pandemic-induced contraction of 6.1% in 2020. We expect that real GDP will continue growing by an average of 3.9% per year in 2022 and 2023. UPM-Kymmene's (Baa1 stable) pulp mill plant project 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.

Our assessment for Uruguay's **institutions and governance strength** is "a3," which balances the country's strong institutional framework, which reinforces policy predictability, with its still-evolving capabilities to effectively and credibly conduct such policies. The government introduced a new fiscal policy framework in 2020 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, establishing a limited but growing track record of strong fiscal management. Building a long track record of compliance under this new framework would help reduce fiscal imbalances, and bolster fiscal policy credibility and effectiveness. The authorities have also faced challenges in managing comparatively high inflation rates, which has historically been above the official target range. The central bank in 2020, revamped its monetary policy framework, including the reintroduction of a policy rate, that is more proactive, with the central bank being the first in the region to start tightening monetary policy in 2021.

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 government's 2021 debt burden of 61%, when measured as a share of GDP, is in line with the Baa-rated peer median. However, the government's interest burden of 8.8% of revenue remains above the Baa-rated peer median of 6.9%. Although the government managed to reduce the share of foreign currency-denominated debt over the past two decades, it remains relatively high at 47.1% as of June 2022 down from 52.7% in December 2021. 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. This 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 2021, and a Baseline Credit Assessment of baa3 for banks we rate, which informs the risk assessment of potential contingent liabilities on the government's balance sheet.

Uruguay's external vulnerability risk assessment is "a," reflecting its large external buffers that 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 lower investment levels and sluggish economic activity. The current account deficit expanded to 1.8% of GDP in 2021 from 0.8% in 2020 because of the pandemic's impact on the tourism sector, and growth in imports of metals and capital goods linked to major investment and infrastructure projects.

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 compromising the economic, institutional or fiscal features of Uruguay's credit profile as very low.

ESG considerations

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

Exhibit 3
ESG Credit Impact Score

CIS-2
Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

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

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-2	G-2
Neutral-to-Low	Neutral-to-Low	Neutral-to-Low

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 absent policies to address the challenges faced by the social security system. 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 policies based on consensus help mitigate social risks.

Governance

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

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on www.moodys.com. 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

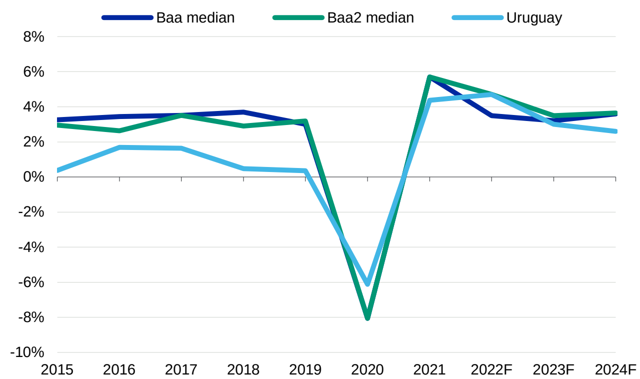
Economic growth to remain stronger in 2022 than pre-pandemic levels

We expect the economy to grow by 4.7% in 2022, before moderating to an average growth rate of 2.8% annually over 2023-25. Uruguay's growth rates will remain close to those of its peers rated Baa and Baa2 (see Exhibit 5). In addition, over 2022-25, the economy is likely to grow by 3.3% annually on average, much higher than the 0.9% annual average over 2015-19. Higher post-pandemic growth will cause real GDP levels to surpass 2015-19 trend levels by the end of this year (see Exhibit 6).

Exhibit 5

Growth levels will remain close to peer medians

Real GDP growth, annual change in percentage terms

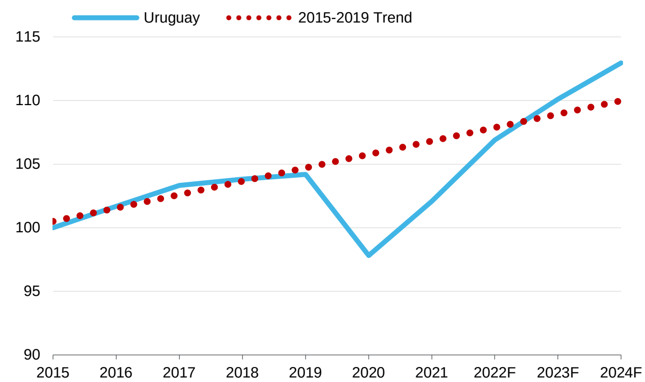


Source: Moody's Investors Service

Exhibit 6

An increase in private investments will help the economy surpass 2015-19 trend levels starting in 2022

Real GDP level, 2019 = 100



Source: Moody's Investors Service

Large-scale projects such as UPM's second pulp mill plant in the country and the railroad connecting it to the Montevideo port, and strong exports of key agricultural products such as soy, will drive economic growth in 2022. In the first quarter, gross fixed capital formation rose 13.7% year-on-year in real terms, while exports of goods and services expanded 23.5%. We expect this trend to moderate slightly in the second half of the year, but remain a key driver of economic growth in the short term.

Inflation will remain above the central bank's target range in 2022

Inflation reached 9.6% in July 2022, driven by rising tradable prices related to energy and food products. We expect inflation to moderate through the end of the year but end just below 9%. This would be above the 6% upper bound of the inflation target range – the range will narrow to 3-6% in September 2022 from 3-7% currently. While we expect inflation will decrease towards 7% in 2023, convergence with the inflation target range would likely take place in 2024.

The committee for monetary policy (COPOM) has raised the policy rate to 9.75% through July 2022 from a level of 4.50% in August 2021. This will shift monetary conditions to a more contractionary stance. Of note, since reintroducing the monetary policy interest rate as the main policy instrument in September 2020, there has been a material decrease in the volatility of the interbank interest rate.

The convergence of inflation with policy targets, as well as the continued anchoring of inflation expectations and progress in the de-dollarization of the domestic financial system will strengthen the credibility of monetary policy in Uruguay.

Fiscal performance continues to improve on lower expenditure

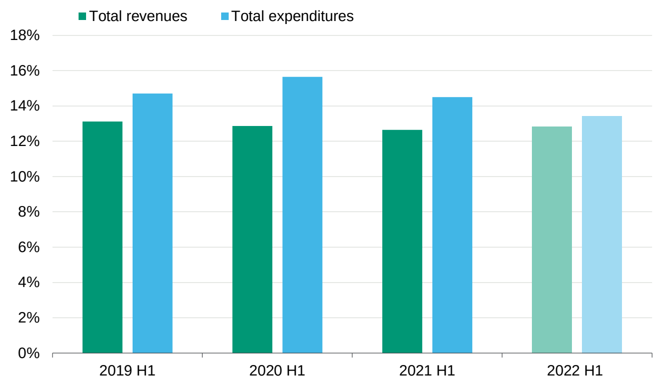
The government has started to reduce pandemic-related social spending, and has instead introduced a targeted subsidy system to incentivize employment while also continuing to provide support to lagging economic sectors. Ultimately, because of the government's prudent fiscal policies, expenditure represented 13% of GDP in H1 2022, less than the 15% of GDP in the H1 2019 (see Exhibit 7).

We expect lower expenditure to allow the government to reduce the fiscal deficit to -3.6% of GDP in 2022 from -4.3% in 2021 and -5.8% in 2020. As a result of the government's lower fiscal deficit, as well as continued robust growth of nominal GDP and broad stability of the exchange rate, we expect the debt burden to decrease to around 57% in 2022, which would be in line with the Baa-rated peer median (see Exhibit 8).

Exhibit 7

Strong budget controls have reduced the expenditure below pre-pandemic levels

Government revenues and expenditures, as a percentage of GDP

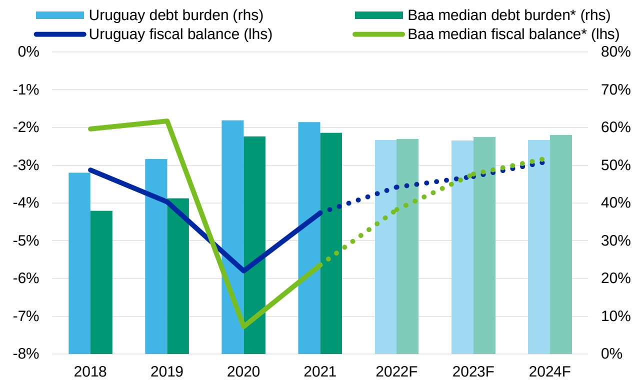


Sources: Uruguay Ministry of Economy and Finance, and Moody's Investors Service

Exhibit 8

The government's fiscal performance has continued to improve through the pandemic

Financial balance and debt burden, as a percentage of GDP



* Does not include Uruguay.

Sources: Ministry of Economy and Finance, and Moody's Investors Service

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				baa3	baa3	50%
Growth dynamics	Average real GDP growth (%)	2017-2026F	1.7	ba3		25%
	Volatility in real GDP growth (%)	2012-2021	3.1	b1		10%
Scale of the economy	Nominal GDP ($ billion)	2021	59.3	ba2		30%
National income	GDP per capita (PPP, Intl$)	2021	24,233.2	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				baa1	baa1	
Factor 3: Fiscal strength				b1	b1	
Debt burden	General government debt/GDP (%)	2021	61.4	baa3		25%
	General government debt/revenue (%)	2021	234.3	baa3		25%
Debt affordability	General government interest payments/revenue (%)	2021	8.8	a2		25%
	General government interest payments/GDP (%)	2021	2.3	a3		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-6	-5	max ±6
	Debt trend	2017-2022F	11.8	-1	0	
	Foreign currency debt/general government debt	2021	52.7	-5	-5	
	Other non-financial public sector debt/GDP	2021	3.3	0	0	
	Public sector assets/general government debt	2021	0.0	0	0	
Other adjustment to factor 3	*# notches*				-1	max ±3
F1 x F2 x F3: Government financial strength				baa1	baa1	
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	2021	76.8	<80		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				a	a	
	External vulnerability risk			a		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				Baa1 - Baa3	Baa1 - Baa3	

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

» **Sector In-Depth:** Financial Stability – Latin America & Caribbean: Frequently asked questions on inflation and interest rate rises in Latin America, 18 July 2022

» **Sector In-Depth:** Sovereigns – Global: Russia-Ukraine crisis dents but does not derail global economic recovery; impact on emerging markets most acute, 12 May 2022

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

REPORT NUMBER 1337303

MOODY'S
INVESTORS SERVICE