Moody's

Rating Action: Moody's upgrades Uruguay's ratings to Baa1; changes outlook to stable

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New York, March 15, 2024 -- Moody's Ratings ("Moody's") has today upgraded the Government of Uruguay's ("Uruguay") long-term issuer and senior unsecured bond ratings to Baa1 from Baa2. Moody's has also upgraded the senior unsecured shelf rating to (P)Baa1 from (P)Baa2 and changed the outlook to stable from positive.

The key drivers of the upgrade include strong institutions that support the implementation of structural reforms and continued compliance with fiscal and monetary policy frameworks, which in turn point to higher sustained growth rates than in the past, supported by strong investment. In particular, Moody's assesses that a set of reforms implemented in recent years strengthen the fiscal and monetary policy frameworks. A stronger investment trend will support growth performance, facilitating fiscal consolidation and stabilizing Uruguay's debt metrics over the coming years.

The Baa1 rating is also supported by strong institutions that reinforce political and social stability, attracting foreign direct investment (FDI). Comparatively large fiscal reserves and external buffers, and very strong asset-liability management practices, also support creditworthiness. These credit strengths are balanced against moderate level of public debt, structural rigidities in the government's expenditure and a relatively high, although declining, share of foreign-currency government debt.

The stable outlook balances prospects of sustained higher growth performance and improvement in fiscal policy implementation against Uruguay's exposure to weather-related shocks that weigh on growth and fiscal outcomes. Downside risks also relate to the possibility of growth returning to previous very low rates on a sustained basis, in particular if, despite the above-mentioned reforms, investment remains muted.

Uruguay's local and foreign-currency country ceilings were raised to Aa2 and Aa3 from A1 and A2, respectively. The five-notch gap between the local currency ceiling and the sovereign rating reflects low government intervention in the economy, strong institutions and predictable policies, low political risk balanced against moderate external vulnerability risk. The one-notch gap between the foreign-currency ceiling and the local currency ceiling incorporates Uruguay's open capital account and moderate policy effectiveness, which limits potential risks stemming from relatively high financial dollarization in the economy.

RATINGS RATIONALE

STRONG INSTITUTIONS SUPPORT IMPLEMENTATION OF STRUCTURAL REFORMS AND CONTINUED COMPLIANCE WITH FISCAL AND MONETARY POLICY FRAMEWORKS

Reform of Uruguay's policy-making frameworks makes its institutional setting more robust and resilient to shocks, strengthening the sovereign's credit profile. The authorities have demonstrated an ability to enact credit positive reforms and to deliver effective policy responses to shocks in challenging economic circumstances, including through a severe drought last year and a sharp devaluation of the Argentinean peso which negatively impacted domestic consumption and tax collection in Uruguay. Approval of the fiscal framework and ratification through a referendum process supports the durability of this reform. Similarly, approval of the social security reform indicates the ability of Uruguay's institutions to reach consensus around politically difficult reforms that have long-term economic and social impact.

Uruguay's government has implemented reforms to the fiscal framework starting in 2020, introducing a structural deficit target, a limit on real spending growth, and a net debt ceiling. Since then, the government has broadly adhered to the targets and ended 2023 in compliance with its structural deficit target of 2.7% and an overall public sector fiscal deficit of 3.3%. Adhering to the parameters of the fiscal rule built a track-record and increased the credibility of fiscal policy. Over the past four years, Uruguay's debt burden declined from 61% of GDP in 2021 to around 57% in 2023, supported by compliance with spending limits as well as relatively robust growth. Moody's expects the debt-to-GDP ratio to remain around current levels, and in line with peers over the near to medium term. Effective liability management has improved the sovereign's debt profile reducing interest and refinancing risks through long average maturity of public debt and increasing the share of local currency fixed-rate debt.

The central bank has revamped the monetary policy framework, improved the effectiveness of monetary policy instruments and enhanced communication with the market. Inflation has been on a downward trajectory, falling into the central bank target range of 3-6%. Moody's expects inflation to remain within the central bank target range for the rest of the year, in part thanks to better anchored inflation expectations. The convergence of inflation rates with policy targets, reduced intervention in the foreign exchange market, as well as efforts to anchor inflation expectations all improve the credibility and effectiveness of monetary policy.

The rating upgrade incorporates Moody's view that these structural reforms will prove durable and that the government will continue to build a longer track-record of sound macroeconomic policies.

PROSPECTS OF HIGHER SUSTAINED GROWTH RATES SUPPORTED BY STRONG INVESMENT FLOWS

In turn, a track record of sound macroeconomic policies fosters more robust, sustained, GDP growth. Moody's expects a strong economic recovery with GDP increasing around 3.5% this year, after a severe drought and the negative impact of the Argentinian peso devaluation resulted in GDP growth at only 0.5% in 2023, and 2.6% in 2025. Over the medium-term, Moody's expects GDP growth around 2.2-2.5%, supported by sustained investment and steady foreign direct investment. This is a marked shift in growth performance compared to pre-pandemic average growth rate of just below 1%.

Investment made a strong contribution to growth in 2021-22 with the ratio of investment to GDP over 18% in 2022-23 from a low point of 14.6% in 2019. Higher investment, supported by Uruguay's stable policy environment and strong FDI inflows, will address a key weakness in Uruguay's growth dynamics that persisted for several years. Economic growth will be supported by some large projects, including the operation of a new pulp mill and a pipeline of investments in infrastructure projects. Uruguay is attracting significant new investment in green hydrogen and a number of businesses are exploring opportunities in this area, which would represent an additional growth opportunity.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook incorporates Moody's expectations that recent reforms to fiscal and monetary policy frameworks will be preserved, supporting a longer track record of compliance with fiscal targets and stable debt burden. Sustained higher growth rates and sound fiscal policy implementation balance the risks related to Uruguay's exposure to weather-related shocks that weigh on growth and fiscal outcomes. Downside risks also relate to the possibility of growth returning to previous very low rates on a sustained basis, in particular if, despite the above-mentioned reforms, investment remains muted.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Uruguay's ESG Credit Impact Score (CIS-2) reflects its exposure to social risks related to aging population and to physical climate risks, mitigated by strong governance, supported by strong rule of law and broad societal consensus around economic policies.

Uruguay's exposure to environmental risks (E-3 issuer profile score) reflects exposure to physical climate risk, specifically excessive rains or droughts, which affects the agricultural sector and water supply.

Exposure to social risks (S-3 issuer profile score) is related to the country's aging population and its potential impact on the country's welfare system and public finances, and potential growth, although the recent pension reforms mitigates these risks. 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.

The influence of governance on Uruguay's credit profile is positive (G-1 issuer profile score). The country has a long history of strong institutions and consensus-based policy-making tradition that leads to durable policy decisions and supports social cohesion.

GDP per capita (PPP basis, US$): 27,770 (2022) (also known as Per Capita Income)

Real GDP growth (% change): 4.9% (2022) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 8.3% (2022)

Gen. Gov. Financial Balance/GDP: -3.2% (2022) (also known as Fiscal Balance)

Current Account Balance/GDP: -3.9% (2022) (also known as External Balance)

External debt/GDP: 74.9% (2022)

Economic resiliency: baa1

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 12 March 2024, a rating committee was called to discuss the rating of the Uruguay, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have materially increased. The issuer's institutions and governance strength, has not materially changed. The issuer's governance and/or management, has not materially changed. The issuer's fiscal or financial strength, including its deb profile, has not materially changed.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Uruguay's sovereign credit rating could be upgraded if additional structural and fiscal reforms lead to a material drop in debt burden and lower interest burden. A significantly more pronounced improvement in growth performance than currently expected, supported by stronger private investment over an extended period of time, which lead to further economic diversification and economic resilience to shocks would also support an upgrade.

The sovereign credit rating could be downgraded if reforms to fiscal and monetary policy frameworks eroded, leading to the emergence of fiscal pressures and a rise in the debt burden. Prospects of a return of persistent low growth rates would also put downward pressure on Uruguay's rating.

The principal methodology used in these ratings was Sovereigns published in November 2022 and available at https://ratings.moodys.com/rmc-documents/395819. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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At least one ESG consideration was material to the credit rating action(s) announced and described above. Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1355824.

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