Uruguay

Full Rating Report

Ratings

Foreign Currency

Long-Term IDR	BB+
Short-Term Rating	B

Local Currency

Long-Term IDR	BBB−
Country Ceiling	BBB

Outlooks

Foreign-Currency Long-Term IDR	Stable
Local-Currency Long-Term IDR	Stable

Financial Data

Uruguay

(USDbn)	2010
GDP	40.3
GDP per head (USD 000)	12.0
Population (m)	3.4
International reserves	7.7
Net external debt (% GDP)	-18.1
Central government total debt (% GDP)	47.6
CG foreign-currency debt	12.6
CG domestically issued debt (UYUbn)	162.9

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Related Research

Global Economic Outlook (June 2011)
Uruguay and Argentina: Increasingly More than a River Apart (July 2009)

Key Rating Drivers

Upgrade: On 14 July 2011 Fitch Ratings upgraded Uruguay's Foreign-Currency IDR to 'BB+' from 'BB' and Local-Currency IDR to 'BBB−' from 'BB+'. The Outlook is Stable. At the same time, the agency affirmed Uruguay's Foreign-Currency Short-Term IDR at 'B', and upgraded the Country Ceiling to 'BBB' from 'BBB−'.

External and fiscal vulnerabilities have reduced due to improvements in external and fiscal solvency ratios and strengthened external liquidity, and the better currency composition and maturity structure of government debt. High GDP per capita income, strong social indicators, and a solid institutional framework underpin creditworthiness. As a result, policy continuity and political stability remain anchored by a strong institutional framework. Financial dollarisation has reduced but remains relatively high, exposing the economy to FX shocks.

Growth: Uruguay's growth performance and outlook remain quite favourable. Its five-year average growth increased to 6.2% in 2010, considerably higher than the median for the 'BB' category (sovereigns rated 'BB+', 'BB' and 'BB−'). Uruguay is likely to continue outperforming peers in terms of growth over the forecast period. Reduced trade and financial links with Argentina make Uruguay less vulnerable to economic developments in its neighbour.

Inflation: inflationary pressures have increased as a result of external price shocks, adverse weather conditions and the rapid pace of domestic demand. Inflation could average 7.5% in 2011, almost two full percentage points above the forecast for the 'BB' median (5.6%). Although the macroeconomic policy framework has strengthened, further improvement in monetary policy credibility, and moderate wage increases, would be essential to bringing inflation down closer to levels comparable to those of peers.

Public Debt: Favourable growth momentum, exchange rate appreciation and relatively moderate fiscal deficits have supported debt reduction in recent years; this is likely to continue. Fitch estimates that central government debt could fall to 44.1% of GDP in 2011 from 50.2% in 2008, albeit still above the 'BB' median. The Uruguayan authorities have carried out proactive debt management, reducing both foreign-currency and roll-over risks. The proportion of local currency-denominated debt has improved and could equal about 43% of total debt in 2011.

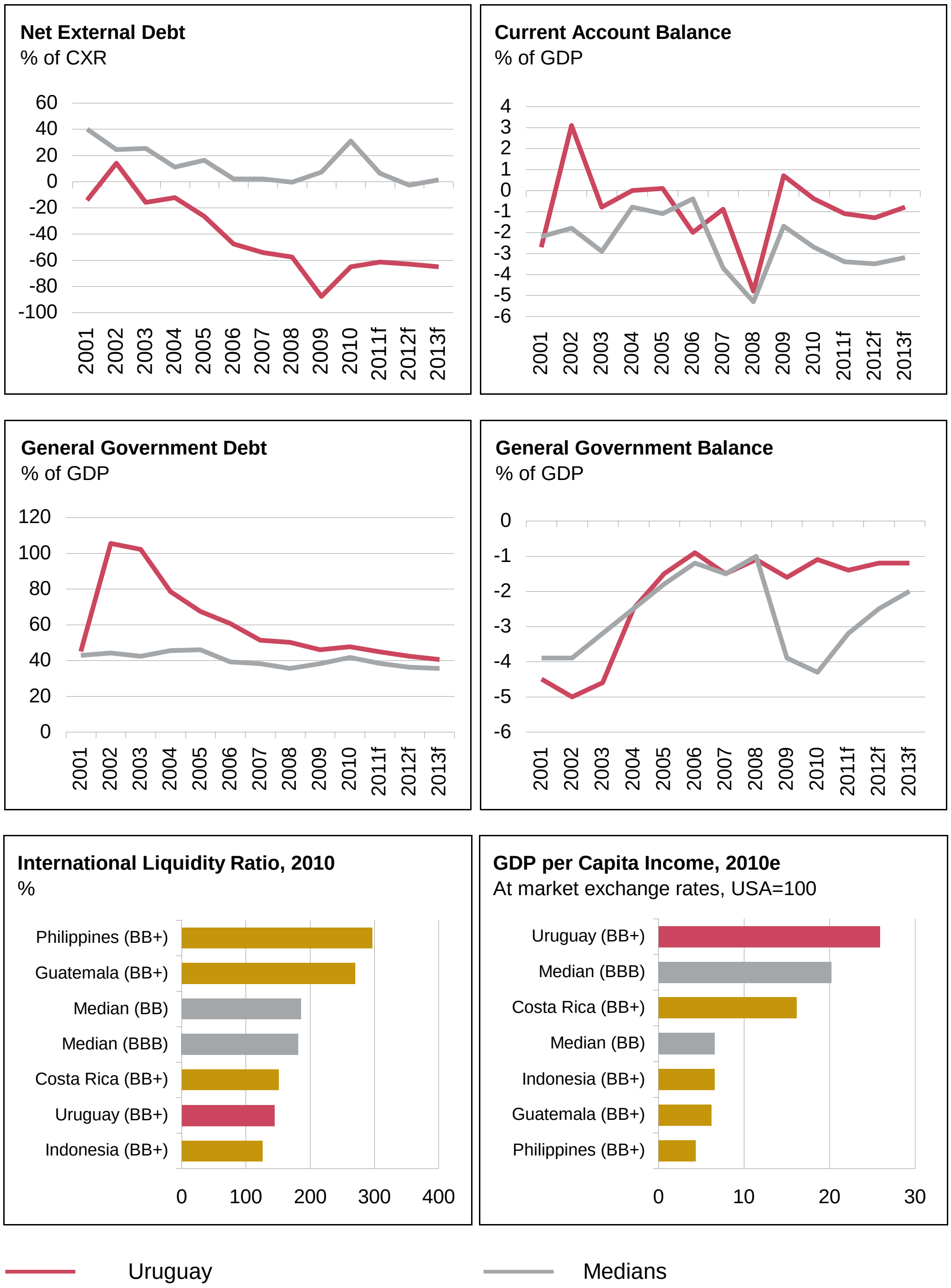
External Accounts: Uruguay's current account deficits are likely to remain moderate and over-financed by FDI inflows over the forecast period. Moreover, the increase in international reserves in 2011 could boost the external liquidity ratio to 168% in 2012, slightly below the 'BB' median of 176%. Nevertheless, in light of still high financial dollarisation and commodity dependence, higher external liquidity would further improve the economy's resilience to external shocks.

What Could Trigger a Rating Action

Positive: A sustained improvement in external and fiscal balance sheets and further consolidation of macroeconomic stability would be positive for creditworthiness.

Negative: A material deterioration in government debt burden and composition, or increased macroeconomic instability could weigh on Uruguay's credit profile.

Peer Comparison



Related Criteria

Sovereign Rating Methodology (August 2010)
Country Ceilings (September 2008)

Peer Group

Rating	Country
BB+	Costa Rica
	Guatemala
	Iceland
	Indonesia
	Macedonia
	Philippines
	Turkey
	Uruguay
BB	Egypt
	El Salvador
BB−	Angola
	Armenia
	Gabon
	Kingdom of Lesotho
	Nigeria
	Serbia

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
14 Jul 2011	BB+	BBB−
27 Jul 2010	BB	BB+
27 Jul 2007	BB−	BB
07 Mar 2005	B+	BB−
29 Mar 2004	B	B+
17 Jun 2003	B−	B
19 May 2003	D	B
10 Apr 2003	C	CCC−
12 Mar 2003	CCC−	CCC−
07 Jan 2003	B−	B
30 Jul 2002	B	B
28 May 2002	B+	BB−
13 Mar 2002	BB+	BBB−
19 May 2000	BBB−	BBB+
23 Jan 1997	BBB−	NR
26 Oct 1995	BB+	NR

Rating Factors

Summary: Strengths and Weaknesses

Rating Factor	Macroeconomic	Public Finances	External Finances	Structural Issues
Status	Neutral	Neutral	Neutral	Strength
Trend	Stable	Stable	Stable	Stable

Note: Relative to 'BB' category
Source: Fitch

Strengths

- Uruguay's strengthened policy framework has increased macroeconomic stability and supported high rates of growth.
- External financing needs are lower than for peers. Moreover, comparatively more robust FDI inflows provide financing for the country's current account deficit without increasing external indebtedness.
- Uruguay's creditworthiness is supported by comparatively high GDP per capita income, strong social indicators, and a relatively strong institutional framework, creating the conditions for policy continuity over the forecast period.
- Debt management initiatives have improved debt composition, reducing exchange rate and refinancing risks, with favourable debt dynamics.

Weaknesses

- Uruguay's general government debt burden remains above the median for the 'BB' rating category. Nevertheless, this level takes into account debt issued to the BCU (5.7% of GDP) for capitalisation purposes, which does not necessarily reflect fiscal dynamics.
- Financial dollarisation remains high compared with the median for the 'BB' rating category, although exchange rate risks are contained thanks to effective prudential regulation and improving external liquidity.
- External credit metrics are weaker than for peers and the sovereign remains a net external debtor. Although external liquidity is in line with that of peers, higher levels would be positive in light of the high financial dollarisation, the presence of non-resident deposits and high commodity dependence.

Local Currency Rating

Uruguay's Local-Currency Long-Term IDR is one notch above the Foreign-Currency Long-Term IDR due to: the comparatively low level of debt denominated in local currency; increased macroeconomic stability, allowing the government to extend maturities in local-currency-denominated debt; and the ability of the government to raise revenue in local currency through taxation.

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. In addition, the country's vulnerability to significant balance-of-payment pressures is reduced by the presence of an offshore banking system, greater exchange rate flexibility, historically high levels of international reserves, and improvements in the supervision and administration of non-resident deposits. Neither capital nor exchange controls were imposed during the severe crisis of 2002.

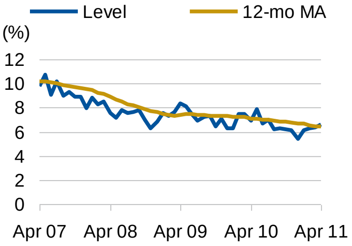
Outlook and Key Issues

Healthy Economic Growth Across Demand Components

The economic expansion of recent years has been supported by developments across all demand components. Such conditions have kept inflationary pressures well contained until recently. Household consumption posted a major 11.5% rebound in 2010. The role of private investment was remarkable (up 18.8% in 2010), partially due to the recovery from a low comparable base in 2009, and was well timed as the public sector started to withdraw its fiscal stimulus measures. The strong expansion in real exports during 2010 fell short compared with that of imports (9.1% compared with 16.5%), although thanks to favourable terms of trade there was no major impact on the balance of payments.

Figure 1

Unemployment Rate

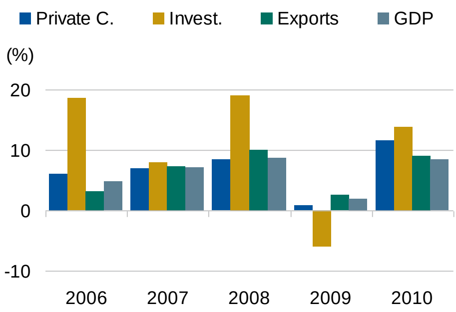


Source: BCU and Fitch

Fitch expects the Uruguayan economy to expand by 5.8% in 2011, with potential to exceed this, compared with the 'BB'-range median growth of 4.5%. It is likely to converge over the medium term to its potential rate, which the authorities estimate at 4.0%. Private consumption will remain strong thanks to record-low unemployment figures, good access to bank lending, and continued gains in real wages.

Figure 2

GDP Growth



Source: BCU and Fitch

The potential to exceed the forecast comes particularly from increases in private investment due to large initiatives in the pipeline. For example, a pulp manufacturing project valued at USD1.9bn (4.7% of Uruguay's GDP) is under construction. The developer expects it to start operations early in 2013. It will increase GDP growth by 0.8% during the construction period, and add up to 2.0% in its first production year.

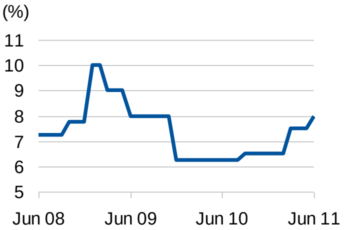
Investment projects in electricity and natural gas connectivity with neighbouring Argentina and Brazil could mitigate costs to the public accounts related to high oil prices and weather-related shocks like droughts. Moreover, Uruguay could have large hydrocarbon endowments after recent discoveries in the north-eastern territories, particularly of shale gas.

The government also wants to implement public-private partnerships, which would enable badly needed private investments in large public infrastructure projects, including highways, trains, prisons, and harbours, potentially improving competitiveness and growth prospects.

However, higher activity levels will be constrained by bottlenecks in the economy such as the labour market, with unemployment reaching record lows and putting pressure on certain industries, including construction. In such a scenario, and in light of Uruguay demographics, economic growth will be limited to productivity gains (2.0%-2.5% according to the BCU).

Figure 3

Monetary Policy Rate



Source: BCU and Fitch

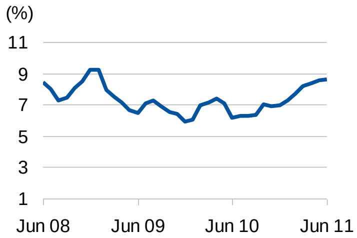
A New Round of Monetary Tightening

As in other emerging markets, high commodity prices and strengthening of domestic demand have resulted in consumer inflation accelerating consistently during the 12 months to June 2011 (8.6%, up from 6.9% at end-2010). This level, although still low compared with Uruguay's previous periods of high inflation and below the psychologically important 10% mark, remains above the upper inflation target, which could generate unwanted backward indexation.

In response to these developments, and to maintain its credibility, the BCU has moved aggressively to bring inflation back to the target range (4%-6%, effective since June 2011). Its

Figure 4

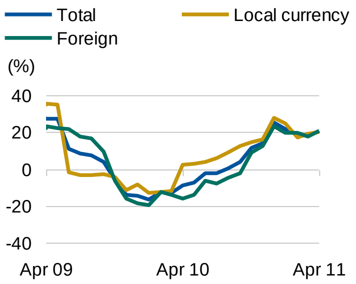
Consumer Inflation



Source: BCU and Fitch

Figure 5

Annual Credit Growth



Source: BCU and Fitch

intervention in the foreign exchange market to contain the appreciation of the peso has been decreasing as the exchange rate is no longer the main concern.

In March 2011 the monetary policy committee increased the monetary policy rate by 100bp to 7.5%. The increase, only the second in 12 months, was followed in May by a decision to increase reserve requirements on both local and foreign currency, and to impose an even higher reserve ratio on additional deposits. In June the policy rate was increased again by 50bp to 8.0%. Fitch expects these measures to be effective, with inflation decreasing in H211. The agency forecasts inflation to average 7.2% by year-end, very much in line with the 'BB'-range median. Surveys of private agents' expectations signal that convergence with the current inflation target will be slow (only by late 2012).

The more active use of reserve requirements, together with higher interest rates, would help to contain domestic credit growth, which jumped 26% in 2010. Despite its rapid pace, total credit/GDP is relatively low at 20.9% and has apparently not fuelled asset bubbles (measured in local currency).

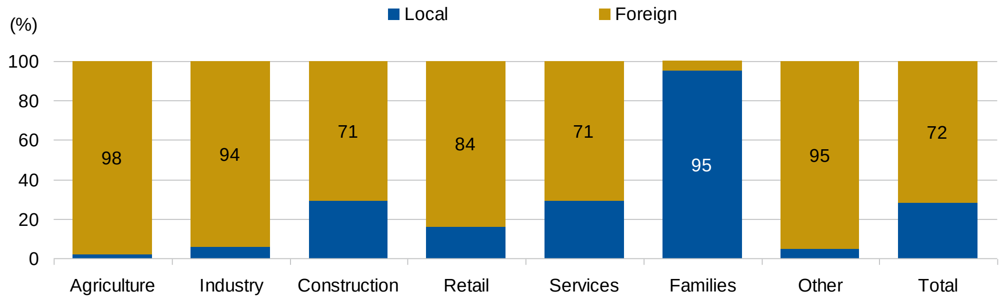
Reduced Risk from Financial Dollarisation

Dollarisation remains high in Uruguay, although risks have declined due to the effective financial system of prudential regulation, lower credit dollarisation and banks' increasingly peso-denominated deposits. The central government's debt-management strategy, and the BCU's monetary policy and prudential regulation, are combining efforts to continue de-dollarising the economy, although without an explicit target or timeline. The authorities aim at guiding the local market to adequately price foreign-exchange risks into interest rates.

Figure 6

Credit by Currency

Total



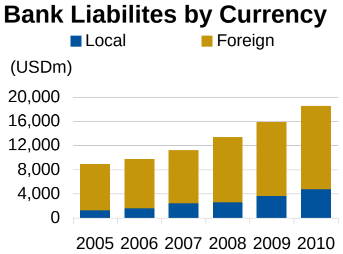
Source: BCU and Fitch

FX loans to sectors with income earned in local currency have decreased consistently, from 61.1% in 2006 to 45.9% in 2010. At the same time, these sectors' participation in total bank lending increased from 57.4% to 69.1%. The change has been more significant for families, reducing their debt in foreign currency from 9% of total debt at end-2009 to only 5% in 2010 (78% of total banking loans in local currency goes to this group). Tradable sectors such as manufacturing, agriculture and livestock continue to borrow mainly in foreign currency (98% and 94% of their total debt, respectively).

The exchange rate risk, measured by credit in foreign currency to earners in local currency with respect to total credit, declined from 37% in 2008 to 31.7% in 2010. This ratio varies with the exchange rate. According to the BCU, a 25% depreciation of the peso, an unlikely event without a major crisis, would move this ratio from 31.7% to 34.2%, the level in 2008, but still well below the 40% in December 2005.

Figure 7

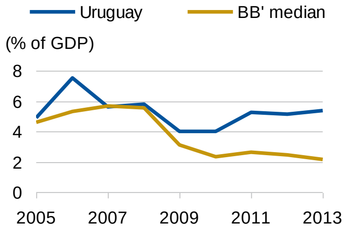
Bank Liabilites by Currency



Source: BCU and Fitch

Figure 8

Inward FDI



Source: BCU and Fitch

Total deposits increased by 17.0% during 2010, with most of this in local currency (32.1% compared with 13.1% in foreign currency). The increase puts deposits in local currency at 25.9% of total deposits, compared with 19.3% in 2008. Fitch expects further reductions to be slow, particularly as durable goods and real estate are still generally denominated in foreign currency. From companies' perspective, holding such a high level of assets and liabilities in foreign currency can be justified by their business lines, with any mismatches increasingly hedged through the financial market.

Non-resident deposits reached 16.4% of total private deposits in the banking system, down from19.6% in July 2009. However, Fitch does not expect this depositor base to represent a risk to financial stability due to improved regulation in terms of liquidity requirements and “firewalls” that prevent banks from lending domestically with non-resident deposits. In addition, non-resident deposits represented 30.8% of BCU's foreign reserves at end-March 2011, down from 45.6% in 2006 and close to 200% in 2001.

Current Account Deficits Return, But Are Well Financed

Fitch estimates that the current account deficit will increase in 2011 and 2012 as the trade deficit widens, before improving in 2013 as export revenue from investment projects under construction start to kick in. Higher current account deficits, as a result of the trade account's deterioration, will be easily financed by large inflows of FDI, allowing for moderate foreign reserves accumulation. FDI has apparently found an annual floor at 4% of GDP in recent years, even during the global downturn, well above the 'BB'-range median.

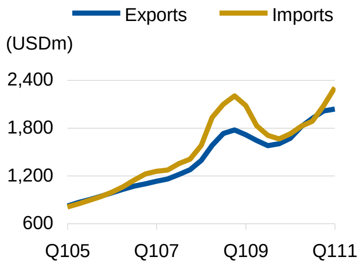
Export revenue increased by 18% on average during 2005-2010, and 26.2% in 2010 alone. The momentum continued early in 2011 (up 29.0% yoy in Q111) thanks to good performance in traditional and non-traditional goods, although Fitch expects some deceleration in the following quarters, leading to a 19% overall expansion over the year.

Although Brazil has consolidated its position as the main export destination, the exposure to European countries remains considerable (23.9% in 2010, up from 19.1% a year earlier). Exports to China represent less than 6% of the total. Deterioration in economic conditions in Europe or a major deceleration in Brazil could have significant consequences for Uruguayan exports, in terms of revenue and employment.

Figure 9

Foreign Trade

Q4-MA



Source: BCU and Fitch

Uruguay is less exposed to Argentina than in 2002-2003. The commercial link with that country remains but not worrisome at 7.5% of total exports. Non-resident deposits in Uruguayan banks, which Fitch believes are mostly from Argentines, remain relatively low at USD3.1bn, half the amount in early 2002. Although Argentine tourists represent over 50% of total visitors, this proportion has been falling consistently due to the arrival of more visitors from Brazil and Chile.

The real appreciation of the Uruguayan peso since 2006, together with major improvements in families' disposable income, has propelled demand for foreign goods. Imports of consumer goods jumped 32.7% yoy during Q111, but represented only 21.1% of total imports. The growth of intermediate goods (up 59.8% yoy) is compatible with current levels of economic activity, whereas larger imports of capital goods (up 28.5% yoy) respond to investments carried out by the private sector. Moreover, the announced large investment projects will require imported material and equipment in the coming quarters, further affecting the current account balance.

Figure 10

External Finances: Sources and Uses

(USDbn)	2010	2011f	2012f	2013f
Uses	1.2	1.7	1.5	1.7
Current account balance	0.2	0.5	0.6	0.4
MLT amortisation	1.0	1.2	0.9	1.3
Sovereign	1.0	1.2	0.9	0.9
Non-sovereign	0.0	0.0	0.0	0.4
Sources	1.2	1.7	1.5	1.7
Gross MLT borrowing	0.1	1.1	0.7	0.6
Sovereign	0.4	0.5	0.3	0.3
Non-sovereign	-0.3	0.6	0.4	0.3
Net FDI	1.3	2.4	2.6	2.9
Other credit flows net	-0.6	-0.1	-1.3	-0.9
Change in FX reserves (negative means increase)	0.4	-1.7	-0.5	-0.9

Source: Fitch

Another source of FX revenue is tourism. The number of tourists visiting Uruguay increased 6.6% yoy on average since 2005, and 14.7% in 2010 alone, with total revenue now representing close to 19% of export revenue. The outlook remains positive as official campaigns continue to position Uruguay as an attractive vacation destination, not only for its beaches — serving mainly Argentine and Brazilian visitors — but also for the adventurer and business-related segments. In Q111 Tourism revenue in increased 57.0% yoy.

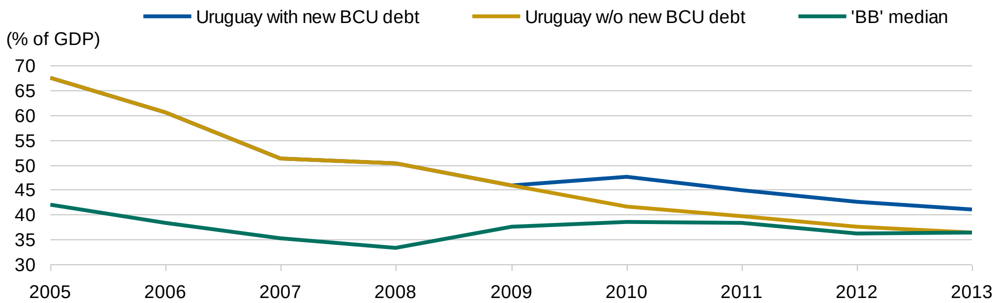
Foreign reserves fell by USD361m in 2010 due to lower deposits by financial institutions and the government's prepayment of multilateral external debt. Nevertheless, reserves increased by USD2.3bn to USD9.95bn in H111, signalling that the country's liquidity ratio could improve further to 168% in 2011 and 185% in 2012, respectively, more in line with the 'BB' median of 176% and 188%.

Public Finances: Approaching Medium-Term Goals

The general government deficit in 2010 was equivalent to 1.1% of GDP, a moderate improvement from 1.6% in the preceding year, and better than the 'BB' range median result of 3.6% of GDP. Tax revenue, which represents 63.2% of total revenue, increased 13.5% in nominal terms, and brought the tax burden to 17.0%, the second-highest level on record. Total expenditure followed the increase in revenue, with current and capital categories growing 13.8% and 20.7%, respectively.

Figure 11

General Government Debt



Source: BCU and Fitch

General gross government debt increased 18.5% in 2010, putting the debt to GDP ratio at 47.6% (up from 45.9% in 2009), reflecting the government's decision to capitalise the BCU[1]. Uruguayan debt ratios would look closer to those of peers if this operation were excluded (see Figure 11). Nevertheless, Fitch considers that the comfortable underlying fiscal position, continued economic growth and the appreciation of the Uruguayan peso are likely to positively influence government debt dynamics, further reducing the sovereign's debt burden.

In addition, the percentage of government debt denominated in local currency noticeably increased to 38.3% of total government debt at end-2010. New debt placements in that year were mainly in local currency, both nominal and indexed, as part of an overall initiative to reduce the foreign-exchange rate risk in public debt. Moreover, in January 2011 the government issued USD1.26bn in treasury notes with different maturities, from three to 13 years, both in local currency and inflation indexed. This was all purchased by local investors. Therefore, according to Fitch's estimates debt denominated in local currency could increase to 43% by end-2011.

Figure 12
Public Finances: Sources and Uses

(% GDP)	2010	2011f	2012f	2013f
Uses	2.8	3.5	2.5	2.0
Budget balance	1.1	1.4	1.2	1.2
Amortisation (by place of issue)	1.7	2.1	1.3	0.8
Domestic	1.0	0.9	0.8	0.3
Foreign	0.7	1.2	0.5	0.5
Sources	2.8	3.5	2.5	2.0
Gross borrowing (by place of issue)	3.7	3.5	2.4	2.9
Domestic	3.0	3.9	1.8	2.3
Foreign	0.7	-0.4	0.6	0.6
Use of treasury reserves (negative means accumulation)	-0.9	0	0.1	-0.9

[a] Adjusted for the debt placement to capitalize the BCU
Source: Fitch

Taking advantage of its strengthening liquidity position, the government prepaid multilateral debt of USD300m to the Inter American Development Bank in December 2010. In May 2011 it issued about USD491m in 10-year samurai bonds with payments almost fully guaranteed by the Japan Bank for International Cooperation. Nevertheless, Uruguay's strategy aims at placing net debt mostly in pesos to further improve its currency composition.

The government continues with its policy to maintain liquid assets to honour debt payments due in the following 12 months. The Treasury held over USD2.0bn in liquid assets at the BCU in June 2011. This further reduces refinancing risks, as debt amortisations average 1.4% of GDP during 2011-2013.

The modification of the consolidated public sector fiscal goal for 2011 (a deficit 0.5% larger than originally expected at 1.1% of GDP) reflects weaker results from public companies. Adverse weather conditions have forced public utilities to use thermal plants intensively, resulting in higher production costs that are not passed on to users.

The government remains committed to fiscal objectives at the consolidated level for 2011-2014, announcing that a lower surplus from public companies could be compensated for by lower deficits from the central government. Estimates for the general government deficit were cut to 0.7% of GDP in 2011 from 1.3% in the original budget, increasing moderately to 0.9% in the following two years. Energy costs represent a fiscal risk and explain why the government is

[1] The government issued USD1.9bn perpetual bonds and USD486m 30-year bonds, which are now part of BCU's equity position, to compensate for the losses stemming from its open market operations and sterilisation efforts.

aggressively trying to improve Uruguay's energy generation capacity through agreements with neighbouring countries and alternative sources.

Not the Same Frente Amplio

The administration of President José Mujica has guaranteed the continuity of the economic policy mix that has resulted in high growth, improved macroeconomic stability and increased foreign investment in the country. At the same time, the second government of the Frente Amplio continues to focus on social areas such as education, health and security.

Nevertheless, president Mujica may be losing reform momentum, as his government is struggling with maintaining party discipline due to the wide ideological differences within the coalition. At the same time, workers' unions have regained some strength, repeatedly taking their demands to the streets and paralysing urban centres.

Important legislation has been shelved due to the loss of political momentum, including a much heralded state reform. President Mujica's proposal to tax land ownership ignited a new political battle, both within this party and with the opposition. Lack of consultation inside his cabinet, together with allegations about changing the rules of the game, have already clouded an otherwise fair initiative. Even Vice-President Danilo Astori presented an alternative project.

Despite the noise, a strong institutional framework continues to be Uruguay's most valuable asset. Attitudes towards foreign investment remain generally positive. Nevertheless, a large open-pit mining project that would put Uruguay on the global mining map has received strong public opposition. In order to limit the political cost, the government might call for a referendum in the short term.

Forecast Summary

	2007	2008	2009	2010	2011f	2012f	2013f
Macroeconomic indicators and policy							
Real GDP growth (%)	7.2	8.7	2.0	8.4	5.8	4.3	5.4
Unemployment (%)	9.2	7.6	7.3	6.8	6.1	5.9	5.8
Consumer prices (annual average % change)	8.1	7.9	7.1	6.7	7.5	6.8	6.0
Short-term interest rate (%)[a]	4.1	9.8	8.6	6.3	7.8	8.4	7.6
General government balance (% of GDP)	-1.5	-1.1	-1.6	-1.1	-1.4	-1.2	-1.2
General government debt (% of GDP)	51.3	50.2	45.9	47.6	44.8	42.3	40.5
UYU per USD (annual average)	23.5	20.9	22.6	20.1	20.0	20.7	21.7
Real effective exchange rate (2,000 = 100)	104.0	115.8	121.0	137.2	138.4	145.7	153.7
External finance							
Current account balance (USDbn)	-0.2	-1.5	0.2	-0.2	-0.5	-0.6	-0.4
Current account balance (% of GDP)	-0.9	-4.8	0.7	-0.4	-1.1	-1.3	-0.8
Current account balance plus net FDI (% of GDP)	4.3	1.1	4.7	3.7	4.2	3.9	4.6
Net external debt (USDbn)	-4.3	-6.0	-8.1	-7.3	-8.2	-9.5	-11.2
Net external debt (% of GDP)	-18.1	-19.1	-25.9	-18.1	-17.7	-18.7	-20.7
Net external debt (% of CXR)	-54.2	-57.7	-87.8	-65.1	-61.5	-63.0	-65.0
Official international reserves including gold (USDbn)	4.1	6.4	8.0	7.7	9.4	9.9	10.8
Official international reserves (months of CXP cover)	6.0	6.5	10.7	8.1	8.1	7.5	7.3
External interest service (% of CXR)	11.0	6.6	8.8	7.5	4.5	3.8	3.2
Gross external financing requirement (% int. reserves)	64.8	87.1	28.5	23.0	28.5	22.8	23.4
Memo: Global forecast summary							
Real GDP growth (%)							
US	1.9	0.0	-2.6	2.9	2.6	2.8	2.9
Japan	2.4	-1.2	-6.3	4.0	0.5	2.7	1.3
Euro area	2.7	0.4	-4.1	0.9	1.7	1.8	2.1
World	3.7	1.4	-2.5	3.1	3.1	3.4	3.4
Commodities							
Oil (USD/barrel)	72.7	97.7	61.9	79.6	110.0	100.0	100.0

[a] Short term deposit rate (annual average)
Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

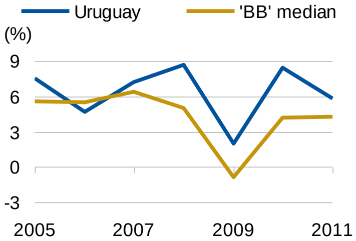
Uruguay

	2010						
	Costa Rica 'BB+'	Turkey 'BB+'	Indonesia 'BB+'	Philippines 'BB+'	Uruguay 'BB+'	'BB' median	'BBB' median
Real GDP (5yr average % change)	4.5	3.3	5.7	4.9	6.2	3.7	3.6
Volatility of GDP (10yr rolling SD)	3.1	5.5	0.9	2.1	5.5	3.2	3.4
Consumer prices (5yr average)	9.6	8.7	8.2	5.1	7.2	7.2	4.7
Volatility of CPI (10yr rolling SD)	2.6	17.5	3.4	2.3	4.6	3.4	2.4
Years since double-digit inflation	2.0	2.0	2.0	19.0	6.0	n.a.	n.a.
Unemployment rate	7.3	11.9	7.1	7.3	6.8	7.9	10.0
Type of exchange rate regime	Crawling band	Free Float	Managed float	Free float	Managed float	n.a.	n.a.
Dollarisation ratio	48.8	27.6	14.5	22.5	74.3	53.1	35.0
REER volatility (10yr rolling SD)	5.1	9.1	9.9	6.0	11.1	7.8	5.3

Source: Fitch

Figure 13

GDP Growth



Source: BCU and Fitch

Strengths

- Uruguay's five-year growth has outperformed that of peers. The country has shown improved resilience against external shocks, and is now posting faster GDP growth rates than the 'BB'-range median.
- Despite repeated increases in international commodity prices and weather-related shocks, the monetary authorities have managed to keep inflation in single digits and comparable with that of peers.
- Unemployment figures have reached historical lows thanks to economic dynamism across most industries, including labour-intensive sectors. Further advances in household consumption and tax collection are likely. The unemployment rate in Uruguay remains below those of other countries in its rating category.

Weaknesses

- As a small and open economy, growth remains more volatile in Uruguay than in peers. Inflation and GDP growth volatility remain above the 'BB'-range median, both dragged down by the impact of the 2002-2003 crisis.
- Dollarisation remains high compared with peers despite substantial progress in lowering credit dollarisation for sectors with income earned in local currency.
- Volatility in the nominal and real exchange rate remains high relative to the country's peers. This is the result of the 2002-2003 overshooting, which was followed by a consistent appreciation of the local peso in recent years.

Commentary

Monetary policy is likely to continue facing the challenges of high dollarisation, a small domestic capital market and limited financial intermediation. These factors partially constrain policy effectiveness due to a weak interest rate transmission channel.

Comparative Analysis: Structural Features

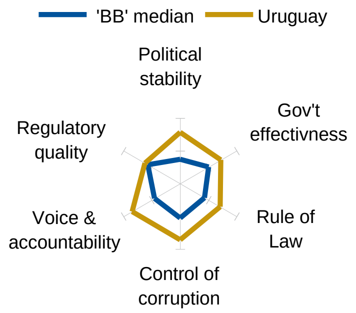
Uruguay

	2010						
	Costa Rica 'BB+'	Turkey 'BB+'	Indonesia 'BB+'	Philippines 'BB+'	Uruguay 'BB+'	'BB' median	'BBB' median
GNI per capita PPP (USD, latest)	10,930	13,710	3,720	4,060	12,900	6,420	11,250
GDP per capita (USD, mkt exchange rates)	7,471	10,106	3,036	2,015	11,954	4,439	9,329
Human Development Index (percentile, latest)	63.6	51.1	36.3	42.8	69.6	47.0	62.5
Ease of Doing Business (percentile, latest)	31.9	64.9	34.1	19.3	32.5	45.1	74.0
Trade openness (CXR and CXP % GDP)	43.9	25.1	25.6	44.1	28.0	45.2	46.7
Gross domestic savings (% GDP)	18.3	14.6	34.2	16.9	18.7	14.6	24.0
Gross national savings (% GNP)	19.6	13.7	34.4	20.1	17.9	17.7	24.9
Gross domestic investment (% GDP)	22.9	20.1	32.5	15.6	17.9	21.5	24.9
Private credit (% GDP)	46.2	45.8	26.2	34.4	20.9	33.7	68.3
BSR indicators	D1	C2	D2	D1	D1	n.a.	n.a.
Bank system CAR	14.0	19.0	16.3	17.3	15.2	16.5	15.0
Foreign bank ownership (% assets)	30.5	16.0	43.0	11.8	48.5	47.6	39.9
Public bank ownership (% assets)	66.4	32.0	46.0	12.5	45.6	18.6	15.6
Default record (year cured)[a]	1990	1982		1992	2003	n.a.	n.a.

[a] Distressed debt exchange in 2003. Capital losses in 1991 Brady exchange. Commercial bank loan rescheduling in 1983, 1986, 1988 and 1991
Source: Fitch and World Bank

Figure 14

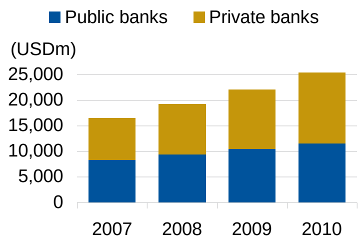
Governance Indicators



Source: World Bank, Fitch

Figure 15

Bank's Total Assets



Source: BCU

Strengths

- Uruguay's institutional strength stands out among rating and regional peers, reducing the risk of social and political instability. In addition, institutions are generally regarded as transparent and relatively free of corruption.
- Social risks are reduced thanks to the country's: high GDP per capita; superior social indicators, as measured by the United Nations' Human Development Index; declining poverty and unemployment; and relatively low income inequality. Further improvements may well materialise as the current government prioritises housing, education, security, infrastructure, and safety net enhancements.

Weaknesses

- Domestic savings remain low compared with peers, explaining Uruguay's low investment ratios and the need for foreign investment flows. Higher investment ratios are required to maintain high growth rates.
- Uruguay is 124th (out of 183 economies) in the 2011 Ease of Doing Business survey published by the World Bank. Although the country scores relatively well on businesses' access to credit, it underperforms on bureaucratic difficulties faced by entrepreneurs to start a business, obtain licences, register property, and pay taxes. Reforms are needed for Uruguay to take advantage of its highly educated population, low corruption perception, and political stability.

Commentary

The banking sector is classified 'D' or “Low Quality,” according to Fitch's Banking System Indicator (BSI). The system's Macro Prudential Indicator (MPI), however, is '1', which indicates that it has a “low” potential vulnerability to systemic stress. The Uruguayan financial system is highly liquid and well capitalised. Asset quality remains strong, with non-performing loans representing only 1.0% of credit portfolios, which are highly provisioned for losses. The system is not dependent on foreign capital, and loan exposure to non-residents is very low. However, public banks continue to dominate the scene with two institutions accounting for almost half the assets. The local securities market is small and almost entirely confined to public debt.

Comparative Analysis: External Finances

Uruguay

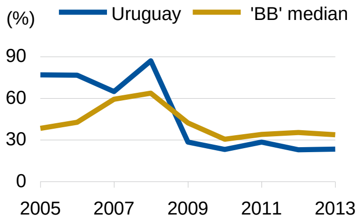
	2010					Last 10 years	
	Costa Rica 'BB+'	Turkey 'BB+'	Indonesia 'BB+'	Philippines 'BB+'	Uruguay 'BB+'	'BB' median	'BBB' median
GXD (% CXR)	59.6	190.0	103.6	86.1	165.2	101.2	95.8
GXD (% GDP)	25.0	41.5	27.0	39.9	46.0	38.8	45.9
NXD (% CXR)	-22.2	89.0	35.4	-19.6	-65.1	15.0	17.9
NXD (% GDP)	-9.3	19.4	9.2	-9.1	-18.1	7.4	7.9
GSXD (% GXD)	27.8	36.5	63.7	55.2	72.4	52.8	33.3
NSXD (% CXR)	-21.9	15.7	13.3	-23.8	45.6	7.3	-9.7
NSXD (% GDP)	-9.2	3.4	3.5	-11.0	12.7	2.9	-5.9
SNFA (USDbn)	3.2	-25.2	-11.0	20.8	-5.1	-1.1	4.3
SNFA (% GDP)	9.2	-3.4	-1.6	11.0	-12.7	-3.3	6.3
Ext. debt service ratio (% CXR)	10.5	38.2	18.8	10.5	22.6	14.9	14.3
Ext. interest service ratio (% CXR)	2.3	5.4	7.0	4.0	7.5	4.2	3.9
Liquidity ratio (latest)	150.9	91.6	126.0	296.2	144.7	151.8	137.0
Current account balance (% GDP)	-3.7	-6.6	0.9	4.5	-0.4	-2.0	-2.5
CAB plus net FDI (% GDP)	0.3	-5.6	2.2	5.1	3.7	1.5	0.7
Commodity dependence (% CXR, latest)	35.3	14.4	49.8	7.5	51.4	28.9	20.6
Sovereign net FX debt (% GDP)	-6.4	2.6	-0.5	-7.0	10.3	3.1	-4.4

Source: Fitch

Figure 16

Gross Financing Requirement

(Official reserves)



Source: BCU and Fitch

Strengths

- Current account deficits are substantially lower than those among its peers, and are adequately financed by increasing FDI inflows.
- Gross financing requirement as percentage of official reserves has been falling consistently, and since 2009 has been below the 'BB'-range median. External debt service measured in terms of current external receipts (CXR) has decreased substantially in recent years, but remains above that of its peers.
- Uruguay's net external creditor position is robust, as local banks (all private banks are foreign owned) and the non-bank private sector have accumulated a large amount of FX assets.

Weaknesses

- Uruguay's gross external debt remains considerably higher than that of peers in both GDP and CXR terms. However, 17.3% of gross external debt consists of foreign-currency deposits by non-residents in the local financial system.
- Net sovereign external debt was 45% of CXR, among the highest in the 'BB' rating category.
- Although Uruguay's external liquidity is broadly in line with that of peers, higher external liquidity levels are desirable due to the high dollarisation compared with peers and commodity dependence.

Commentary

High dependence on the cattle and agriculture industries (30% and 22% of the country's total exports, respectively) exposes Uruguay to price fluctuations in the commodity markets. However, any correction would be compensated for by an opposite move for oil and energy imports, partially mitigating any negative impact.

Comparative Analysis: Public Finances

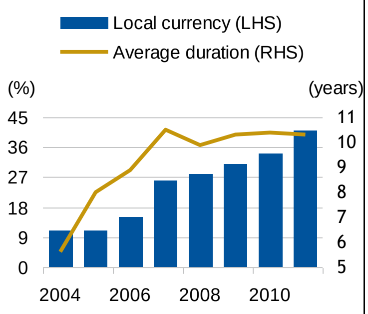
Uruguay

	2010					Last 10 years	
	Costa Rica 'BB+'	Turkey 'BB+'	Indonesia 'BB+'	Philippines 'BB+'	Uruguay 'BB+'	'BB' median	'BBB' median
Budget balance (% GDP)	-5.3	-3.3	-0.6	-3.7	-1.1	-2.5	-2.5
Primary balance (% GDP)	-2.9	0.1	0.8	-0.2	1.3	0.1	-0.2
Revenue and grants (% GDP)	13.6	35.0	15.8	14.2	26.9	25.2	32.5
Volatility of revenue/GDP ratio	1.0	4.6	8.5	4.5	0.7	6.2	6.8
Interest payments (% revenue)	17.6	12.8	8.7	24.4	8.8	11.3	7.2
Debt (% revenue)	217.9	118.7	162.8	390.9	177.0	164.7	114.0
Debt (% GDP)	29.7	41.6	25.7	55.4	47.6	40.5	35.6
Net debt (% GDP)	27.8	37.9	23.4	52.2	41.3	34.9	31.1
FC debt (% total debt)	23.4	34.5	51.5	46.9	61.6	60.1	32.4
CG debt maturities (% GDP)	5.3	13.5	1.9	12.0	2.8	4.8	5.9
Average duration of CG debt (years)	3.5	2.3	5.7	-	10.4	3.4	4.5

[a] GG if not otherwise specified
Source: Fitch

Figure 17

Central Government Debt



Source: BCU and Fitch

Strengths

- The central government's fiscal balances have outperformed those of peers in recent years even in the aftermath of the global financial crisis of 2008-2009. Government revenue has also shown greater resilience than that of peers, as reflected by low revenue volatility.
- Interest payments as a percentage of government revenue are lower than the 10-year 'BB' median.
- Even after including external debt prepayments in 2010, central government debt maturities remain below those of category peers and higher-rated sovereigns. In addition, the average duration of central government debt remains 10.4 years, substantially above the 'BB' and 'BBB'-range medians.

Weaknesses

- Uruguay's debt burden remains above the 10-year 'BB' median. General government debt excluding the BCU capitalisation (USD2.4bn) was 42% of GDP at end-2010.
- Despite the room for faster fiscal consolidation provided by strong economic growth, advances have been relatively slow. There are no domestically funded buffers to shield the economy against shocks.

Commentary

The currency composition of government debt has improved markedly as the proportion of debt denominated in local currency was in line with the 'BB' median at end-2010. Fitch expects further improvement in the short term due to the government's debt strategy, which prioritises issuance in pesos.

The favourable economic cycle could further support the strengthening of public finances if the government decided to generate financial surpluses at the central government level. This would not only lead to a faster reduction in the government's debt burden, but also to an increase in the flexibility of fiscal policy to deal with external shocks.

The government used part of its 2010 fiscal space to create an Electricity Stabilisation Fund, which is intended to meet the increased costs of electricity generation as a result of price or weather shocks. However, the fund remains underfunded, and the rules for its use and accounting are unclear.

Figure 19

Fiscal Accounts Summary

(% of GDP)	2008	2009	2010	2011f	2012f	2013f
General government						
Revenue	**25.3**	**26.6**	**26.9**	**27.2**	**27.0**	**27.2**
Expenditure	**26.4**	**28.1**	**28.0**	**28.6**	**28.2**	**28.3**
O/w interest payments	2.8	2.8	2.4	2.4	2.4	2.5
Primary balance	1.7	1.2	1.3	1.0	1.2	1.3
Overall balance	**-1.1**	**-1.6**	**-1.1**	**-1.4**	**-1.2**	**-1.2**
General government debt	**50.2**	**45.9**	**47.6**	**44.8**	**42.3**	**40.5**
% of general government revenue	198.0	172.8	177.0	164.4	156.5	149.2
General government deposits	7.0	9.1	4.8	5.6	5.3	5.2
Net general government debt	36.2	43.7	42.8	40.7	36.7	36.1
Central government						
Revenue	**20.0**	**20.5**	**20.7**	**21.0**	**20.8**	**21.0**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**21.1**	**22.0**	**21.9**	**22.0**	**21.8**	**21.8**
O/w current expenditure and transfers	16.5	17.6	17.8	18.1	17.9	18.0
- Interest	2.8	2.8	2.4	2.3	2.2	2.2
O/w capital expenditure	1.8	1.6	1.7	1.6	1.7	1.6
Current balance	0.7	0.1	0.5	0.7	0.7	0.8
Primary balance	3.5	2.9	2.9	2.9	2.9	2.9
Overall balance	**-1.1**	**-1.5**	**-1.1**	**-1.0**	**-0.9**	**-0.9**
Central government debt	50.2	45.9	47.6	44.8	42.3	40.5
% of central government revenues	250.7	224.0	229.5	213.3	203.0	193.5
Central government debt (UYUbn)	**327.8**	**324.6**	**384.6**	**418.0**	**442.9**	**476.3**
By residency of holder						
Domestic	-	-	-			
Foreign	-	-	-			
By place of issue						
Domestic	87.9	108.9	162.9			
Foreign	239.8	215.6	221.7			
By currency denomination						
Local currency	84.4	99.3	147.3			
Foreign currency	243.4	225.3	237.3			
In USD equivalent (eop exchange rate)	-	-	-			
By maturity						
Less than 12 months (residual maturity)	28.1	8.2	22.3			
Average maturity (years)	13.0	12.7	12.3	-	-	-
Average duration (years)	9.9	10.3	10.4	-	-	-
Memo						
Non-financial public-sector balance (% GDP)	-1.4	-1.7	-0.6	-	-	-
Net non-financial public-sector debt (% GDP)	-	-	-	-	-	-
Nominal GDP (UYUbn)	653.1	706.9	807.7	933.4	1,047.5	1,175.0

Source: Ministry of Finance and Fitch estimates and forecasts

Figure 20

External Debt and Assets

(USDbn)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Gross external debt	**16.4**	**10.7**	**13.7**	**14.8**	**15.6**	**13.8**	**16.0**	**16.7**	**18.8**	**18.5**
% of GDP	88.3	87.4	122.2	112.0	89.8	69.8	67.0	53.4	60.0	46.0
% of CXR	395.7	332.2	403.6	311.2	269.3	207.0	200.4	161.4	203.1	165.2
By maturity										
Medium- and long-term	**5.7**	**7.1**	**8.4**	**9.8**	**9.8**	**8.9**	**10.5**	**10.1**	**11.5**	**12.1**
Short -term	10.7	3.6	5.3	5.0	5.7	4.9	5.5	6.5	7.3	6.4
% of total debt	65.4	33.7	38.7	33.9	36.9	35.5	34.2	39.1	38.6	34.7
By debtor										
Monetary authorities	**0.6**	**2.6**	**3.0**	**3.2**	**2.5**	**0.1**	**0.3**	**0.3**	**0.6**	**0.7**
General government	**6.3**	**7.6**	**8.8**	**10.2**	**10.2**	**9.4**	**11.3**	**11.0**	**13.0**	**13.4**
O/w central government	-	-	-	-	-	-	-	-	-	-
Banks	**9.7**	**3.0**	**4.6**	**4.5**	**4.9**	**3.7**	**3.9**	**4.7**	**5.2**	**4.9**
Other sectors	**0.4**	**0.1**	**0.3**	**0.1**	**0.4**	**0.7**	**0.9**	**1.0**	**0.6**	**0.2**
Gross external assets (non-equity)	**17.0**	**10.3**	**14.2**	**15.4**	**17.1**	**17.0**	**20.3**	**22.6**	**26.9**	**25.8**
International reserves, incl. gold	3.1	0.8	2.1	2.5	3.1	3.1	4.1	6.4	8.0	7.7
Other sovereign assets nes	0.2	0.7	0.4	0.2	0.5	0.2	1.2	0.8	0.7	0.7
Deposit money banks' foreign assets	7.2	3.7	3.8	3.8	4.0	4.4	4.6	4.8	6.2	7.2
Other sector foreign assets	4.2	5.3	5.8	6.1	6.4	7.6	8.6	8.9	10.3	8.9
Net external debt	**-0.6**	**0.5**	**-0.5**	**-0.6**	**-1.5**	**-3.2**	**-4.3**	**-6.0**	**-8.1**	**-7.3**
% of GDP	-3.2	3.7	-4.9	-4.4	-8.9	-16.1	-18.1	-19.1	-25.9	-18.1
% of CXR	-14.3	14.1	-16.0	-12.2	-26.6	-47.7	-54.2	-57.7	-87.8	-65.1
Net sovereign external debt	2.9	6.1	6.4	7.5	6.7	6.2	6.0	3.8	4.3	5.1
% of GDP	15.8	50.1	56.9	56.4	38.3	31.1	25.0	12.3	13.8	12.7
Net bank external debt	0.3	-0.5	-1.4	-2.0	-2.2	-2.4	-2.5	-1.9	-2.7	-3.7
Net other external debt	-3.2	-4.7	-5.1	-5.6	-5.6	-6.5	-7.0	-7.1	-8.3	-7.2
Net international investment position	**0.6**	**-0.5**	**0.5**	**0.6**	**1.5**	**3.2**	**4.3**	**6.0**	**8.1**	**7.3**
% of GDP	3.2	-3.7	4.9	4.4	8.9	16.1	18.1	19.1	25.9	18.1
Sovereign net foreign assets	**-2.9**	**-6.1**	**-6.4**	**-7.5**	**-6.7**	**-6.2**	**-6.0**	**-3.8**	**-4.3**	**-5.1**
% of GDP	-15.8	-50.1	-56.9	-56.4	-38.3	-31.1	-25.0	-12.3	-13.8	-12.7
Debt service (principal & interest)	**1.8**	**1.8**	**2.0**	**2.4**	**2.8**	**2.9**	**2.7**	**2.8**	**2.8**	**2.5**
Debt service (% of CXR)	43.6	55.5	60.4	50.9	48.3	43.3	33.3	26.9	30.7	22.6
Interest (% of CXR)	18.8	20.4	18.3	15.6	14.5	13.8	11.0	6.6	8.8	7.5
Liquidity ratio (%)	88.7	82.1	78.1	75.5	80.8	82.1	98.1	105.4	118.0	144.7
Net sovereign FX debt (% of GDP)	16.0	72.8	71.8	57.0	48.3	35.9	26.2	11.7	11.0	10.3
Memo										
Nominal GDP	18.6	12.3	11.2	13.2	17.4	19.8	23.9	31.2	31.3	40.3
Gross sovereign external debt										
Inter-company loans	-	-	-	-	-	-	-	-	-	-

Sources: NBP, IMF, World Bank and Fitch estimates and forecasts

Figure 21

Debt Service Schedule on Medium- and Long-Term Debt at December 2010

(USDm)	2010	2011	2012	2013	2014	2015	2016+
Sovereign amortization	**1,055**	**992**	**637**	**418**	**335**	**677**	**13,327**
Multilateral	274	182	184	175	174	175	1,832
O/w IMF	0	0	0	0	0	0	0
Other	33	34	53	50	48	47	158
External bond debt	341	355	13	39	23	290	6,158
Domestic bond debt	407	421	387	154	90	165	5,179
Interest	**956**	**1,204**	**1,052**	**268**	**864**	**840**	**1,539**
Total sovereign debt service	**2,011**	**2,196**	**1,689**	**686**	**1,199**	**1,517**	**14,866**

Sources: Ministry of Finance, Central Bank and Fitch

Figure 22
Balance of Payments

(USDbn)	2008	2009	2010	2011f	2012f	2013f
Current account balance	**-1.5**	**0.2**	**-0.2**	**-0.5**	**-0.6**	**-0.4**
% of GDP	-4.8	0.7	-0.4	-1.1	-1.3	-0.8
% of CXR	-14.4	2.3	-1.4	-3.7	-4.3	-2.5
Trade balance	**-1.7**	**-0.3**	**-0.3**	**-1.2**	**-1.4**	**-1.1**
Exports, fob	7.1	6.4	8.1	9.5	10.8	12.9
Imports, fob	8.8	6.7	8.3	10.7	12.3	14.0
Services, net	**0.8**	**1.0**	**1.1**	**1.4**	**1.6**	**1.6**
Services, credit	2.3	2.2	2.5	3.0	3.3	3.5
Services, debit	1.5	1.1	1.4	1.6	1.7	1.9
Income, net	**-0.7**	**-0.7**	**-1.1**	**-0.9**	**-0.9**	**-1.1**
Income, credit	0.8	0.5	0.5	0.7	0.7	0.7
Income, debit	1.5	1.2	1.6	1.6	1.7	1.8
O/w: Interest payments	0.7	0.8	0.8	0.6	0.6	0.6
Current transfers, net	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**
Memo						
Non-debt-creating inflows (net)	2.0	1.3	1.6	2.4	2.6	2.9
O/w equity FDI	2.0	1.3	1.6	2.4	2.6	2.9
O/w portfolio equity	0.0	0.0	0.0	0.0	0.0	0.0
O/w other	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (- = increase)	-2.2	-1.6	0.4	-1.7	-0.5	-0.9
Gross external financing requirement	3.6	1.8	1.9	2.2	2.1	2.3
Stock of international reserves, incl. gold	6.4	8.0	7.7	9.4	9.9	10.8

Sources: IMF and Fitch estimates and forecasts