FitchRatings

FITCH UPGRADES URUGUAY'S IDR TO 'BBB-'; OUTLOOK REVISED TO STABLE

Fitch Ratings-New York-07 March 2013: Fitch Ratings has upgraded Uruguay's ratings as follows:

--Long-term foreign currency (FC) Issuer Default Rating (IDR) to 'BBB-' from 'BB+';
--Long-term local currency (LC) IDR to 'BBB' from 'BBB-';
--Short-term FC IDR to 'F3' from 'B'.
--Country Ceiling to 'BBB+' from 'BBB'.

The Rating Outlook is revised to Stable from Positive.

KEY RATING DRIVERS

The upgrade of Uruguay's sovereign ratings reflects the following:

--Uruguay's demonstrated economic resilience in recent years, most recently reflected by the country's healthy growth of 3.6% in 2012 despite the economic difficulties confronting its main trading partners. Uruguay's five-year average GDP growth at 5.6% is well above the 'BBB' median and its medium-term prospects remain favorable. Fitch forecasts a 4% average GDP growth for Uruguay in 2013 and 2014.

--Uruguay's social and political stability, strong institutions and relatively high per capita income are characteristics that are fully in line with investment- grade sovereigns. Policy continuity is likely after the 2014 presidential elections.

--Prudent fiscal management has led to a decline in government indebtedness and a significant improvement in debt composition in recent years. Financing flexibility has been enhanced with Uruguay having good access to international markets and multilaterals. Moreover, the steady development of the government's local securities market has broadened financing sources.

--Uruguay's public debt profile has improved thanks to well-timed liability management operations that have extended maturities, reduced dollarization, and deepened markets for Uruguayan debt. The foreign currency exposure of central government debt has fallen to 45% in 2012 from 74% in 2007.

--Uruguay's market-friendly policies have facilitated a strong flow of foreign direct investment, allowing for better financing of current account deficits and a steady diversification of the economy.

--Uruguay's external balance sheet has strengthened, increasing the country's shock-absorption capacity. International reserves have more than doubled between 2008 and 2012, reaching USD13.6 billion last year. Fitch estimates that Uruguay could become a net sovereign external creditor in 2013, which will be positive given its high commodity dependence and financial dollarization.

--Rating constraints include a relatively high government debt burden, high financial dollarization, and challenges posed by the sustained high inflation rate.

--Inflationary pressures remain high with inflation hovering close to the double-digit mark. A robust domestic demand, a still expansionary monetary stance, and limited effectiveness of monetary policy due to high financial dollarization and low financial intermediation mean that inflation will recede only gradually over the forecast period. Avoiding a wage-price spiral is important to maintaining inflation on a downward path and maintaining monetary policy credibility.

--Uruguay's fiscal deficits widened last year mainly due to 'one-off' factors. Fitch believes the country will continue to proceed gradually with fiscal consolidation, relying mainly on expenditure restraint in the next two years. This coupled with favourable growth should allow for a steady decline in government debt burden over the coming years, although it is unlikely to converge with the 'BBB' median.

RATING SENSITIVITIES

The Stable Outlook reflects Fitch's assessment that upside and downside risks to the rating are currently well balanced. Progress in reducing government indebtedness and improvement in the macroeconomic policy framework reflected in lower inflation and further strengthening of external credit metrics would improve Uruguay's creditworthiness. While not Fitch's base case, a material deterioration in the government debt burden and composition or increased macroeconomic instability could weigh on Uruguay's credit profile

KEY ASSUMPTIONS

Fitch assumes that Argentina's economic difficulties will have only a limited spillover in Uruguay due to Uruguay's strengthened external buffers and the reduced trade and financial links between the two countries in recent years. In addition, Fitch expects economic growth in Brazil, Uruguay's main trading partner, to recover in 2013.

Fitch expects some improvement in the policy mix, whereby a conservative fiscal policy and a prudent wage policy will be supportive of the monetary authorities' objective of reducing inflationary pressures.

Fitch expects that the conservative nature of Uruguay's policymakers will continue in the future, meaning that high fiscal deficits are unlikely unless there is a large economic shock. The authorities will continue to broadly adhere to their multi-annual budgetary targets.

Fitch assumes that China will avoid a hard landing and that commodity prices will remain at relatively high levels. Fitch also assumes that the eurozone remains intact and there is no materialisation of severe tail risks to global financial stability that could trigger a sudden stop to capital inflows to emerging markets and a sharp decline to commodity prices.

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Additional information is available on www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:
--'Sovereign Rating Methodology, Aug. 13, 2012.

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Sovereign Rating Methodology
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=685737