Fitch Upgrades Uruguay to 'BB'; Outlook Remains Positive

Fitch Ratings-New York-27 July 2010: Fitch Ratings today has upgraded Uruguay's long-term foreign currency Issuer Default Rating (IDR) to 'BB' from 'BB-' and the long-term local currency IDR to 'BB+' from 'BB'. The Outlook on both ratings remains Positive. Fitch has also affirmed Uruguay's short-term IDR at 'B' and raised the Country Ceiling to 'BBB-' from 'BB+'.

The upgrade reflects Uruguay's increased resilience to external shocks due to a strengthened macroeconomic policy framework, greater exchange rate flexibility, and a historically high level of international reserves. The Positive Outlook reflects the expectation that a continued good growth momentum supported by investment and external demand, as well as broad policy continuity under the new administration, could support further improvements in Uruguay's fiscal and external solvency and liquidity ratios over the forecast period.

In spite of the high level of financial dollarization, the country did not face balance of payment pressures or financial instability during the stress test of the global financial crisis. The current account registered a surplus of 0.8% of GDP and international reserves increased by 25% to USD8bn (25% of GDP). Moreover, in 2009, Uruguay's growth (2.9%) outperformed that of Latin America and peers in 2009. Low government revenue volatility and economic resilience resulted in a comparatively smaller fiscal deterioration (0.5% of GDP deficit increase in comparison to a 'BB' median increase of 3.1%).

High GDP per capita income, superior social indicators and broad institutional development are credit strengths that distinguish Uruguay in the 'BB' category. Moreover, the administration of President Jose Mujica has pledged policy continuity and has stated its commitment to increasing the country's competitiveness and growth potential through increased investment.

'Fitch expects Uruguay's growth recovery, at 5.5%, to continue outperforming rating peers in 2010 in the context of broad macroeconomic stability and this should favor the government debt dynamics,' said Erich Arispe Director in Fitch's Sovereign Group.

Uruguay's general government debt burden, estimated to reach 48.6% of GDP in 2010, remains above the 'BB' rating category. In addition, over 70% of the sovereign's debt is denominated in foreign currency exposing debt dynamics to currency risk. Partly balancing these credit weaknesses, astute and proactive liability management has reduced refinancing risks for the sovereign on the fiscal and external front. Government debt amortizations, at 1.7% and 2.4% of GDP in 2010 and 2011, respectively, are less than half the 'BB' median.

"A conservative fiscal stance going forward would not only support a faster reduction in government debt but also create space for counter-cyclical policy and assist monetary policy efforts in managing inflationary pressures,' added Arispe. Fitch notes that while Uruguay's five-year average inflation rate is in line with the 'BB' median, a further reduction in inflation would support the consolidation of macroeconomic stability and the overall policy framework.

The sovereign remains a large net external debtor, at 45% of CXR and the decline in this ratio in recent years was partly reversed in 2009 due to increased sovereign external borrowing and underperformance of exports. Moreover, in spite of the rapid pace of reserve accumulation, the country's external liquidity ratio of 179% remains relatively low given continued high levels of financial dollarization and commodity dependence.

On the other hand, Uruguay's low external financing needs, the prospects for continued FDI inflows and increased confidence in the financial system partly mitigate these risks. Finally, vulnerability to Argentina has diminished in recent years owing to lower trade and tourism exposure and more limited financial links.

A sustained reduction in the government's debt burden, improvements in government debt composition as well as further strengthening of Uruguay's external solvency and liquidity indicators would be positive for creditworthiness. Further consolidation of macroeconomic stability would also be viewed positively. On the other hand, a greater than anticipated deterioration in fiscal accounts resulting in negative debt dynamics would be viewed negatively, while a weakening in the macroeconomic policy framework leading to investor risk aversion or macroeconomic instability could also weigh on the Uruguay's credit profile.

Applicable criteria on Fitch's website at 'www.fitchratings.com'.

--'Sovereign Rating Methodology', dated Oct. 16, 2009;

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Additional information is available at 'www.fitchratings.com'.