Moody’s Upgrades Uruguay’s Sovereign Ratings

Moody's Investors Service has upgraded the government of Uruguay local- and foreign-currency bond ratings to Ba1 from Ba3. Both ratings have a stable outlook.

“Overall, progress observed in Uruguay’s debt and fiscal indicators, combined with an outlook for continued improvement, validate a high Ba rating,” said Mauro Leos, vice president and senior credit officer in Moody's Sovereign Risk Group.

Moody's decision to upgrade Uruguay’s sovereign ratings is supported by a strengthened credit profile that incorporates:

- **(i) a government debt structure characterized by moderate financing and rollover risks**
- **(ii) lower vulnerabilities to economic and financial shocks**
- **(iii) prospects for sustained economic growth in a context of macroeconomic stability**
- **(iv) declining government debt ratios coupled with policy continuity on the fiscal front**

A very favorable maturity profile coupled with modest gross financing needs and a strong liquidity reserves is associated with relatively moderate credit risks. Combined, these conditions mitigate the potential impact of exchange rate shocks, despite Uruguay’s relatively high share of foreign currency debt.

Uruguay’s average debt maturity exceeds 12 years, one of the longest in the sovereign universe. The government faces low refinancing risks, as less than 5% of the debt matures annually during 2011-2015. With 90% of the financial obligations carrying fixed interest rates, the government’s exposure to interest rate shocks is small.

Gross financing needs have been declining steadily, going from 10% of GDP at the beginning of the decade to some 3% of GDP at present. Furthermore, government cash reserves provide ample financial buffer as they are sufficient to cover more than 18 months of upcoming principal payments.

“Uruguay’s ratings are underpinned by lower susceptibility to event risk that reflects reduced economic and financial exposure to regional shocks, particularly those originating in Argentina,” said Leos.

Uruguay has diversified its export base as the share of exports going to Argentina has declined to 13% from 26% in 1996-2001. In addition, there has been a marked reduction in the share of non-resident Argentine deposits, which have declined to 21% of total deposits from a peak of 46% in 2001.

After reporting above-trend growth in recent years, the economy is expected to move toward steady, albeit lower, growth in the coming years. Favorable medium-term prospects are related to an upward trend in the Uruguay’s investment-to-GDP ratio, robust foreign direct investment inflows and positive spillover effects from Brazil

Based on a ranking of fiscal indicators, Uruguay's relative standing has been improving within the Ba peer group. Government debt ratios are at par with or below peer group medians. More importantly, official projections contemplate additional debt reductions in coming years, albeit at a moderate pace.

Policy continuity and predictability remain key elements of Uruguay's sovereign ratings.

"Strong consensus on the need to preserve conservative economic policies is present," said Leos. "During the administration of President Mujica, there have been virtually no deviations from policies that, for nearly a decade, have advocated macroeconomic stability and fiscal responsibility."

"Preserving current trends will be necessary, but not sufficient, to warrant additional upgrades," said Leos.

Increased diversification of Uruguay's economic base, continued reduction in foreign-currency denominated government debt, lower banking system dollarization, and confirmation of the authorities' ability to comply with targets incorporated in the multi-year fiscal framework are areas that will be monitored to determine if substantive progress is being made.

"Uruguay will have to demonstrate significant, additional improvements before any further upgrades will be considered, which we do not think is likely to occur in the near term," said Leos.

As part of the rating action, Uruguay's country ceilings for foreign currency bonds and for deposits were also upgraded going to Baa1 from Ba1 and to Ba2 from B1, respectively. Both ratings have a stable outlook. The country's ceiling for local currency bonds remains at A3, while the ceiling for local currency deposits was upgraded to A3 from Baa2.

The last rating action on the government of Uruguay was implemented on July 15, 2010 when Moody's placed Uruguay's sovereign ratings on review for possible upgrade.

The principal methodology used in rating the government of Uruguay is Moody's Sovereign Bond Methodology, published in 2008, which can be found at www.moodys.com in the Rating Methodologies sub-directory under the Research & Ratings tab. Other methodologies and factors that may have been considered in the process of rating this issuer can also be found in the Rating Methodologies sub-directory on Moody's webs.