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Supplementary Analysis:
Oriental Republic of Uruguay

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Supplementary Analysis:

Oriental Republic of Uruguay

This report supplements our research update "Uruguay Ratings Affirmed At 'BBB-/A-3'; Outlook Remains Stable," published on June 2, 2014. To provide the most current information, we may cite more recent data than that stated in the previous publication. These differences have been determined not to be sufficiently significant to affect the rating and our main conclusions.

Rationale

Sovereign Credit Rating
BBB-/Stable/A-3

The ratings on the Oriental Republic of Uruguay reflect its stable political system, predictable economic policies, robust medium-term growth prospects, and favorable government debt amortization profile. The ratings also incorporate Uruguay's limited fiscal and monetary flexibility, which a still highly dollarized economy exacerbates, and its vulnerability as a small, open economy in a region that is undergoing economic stress.

On a per capita basis, Uruguay's economy has grown 5.4% on average since 2006. Standard & Poor's Ratings Services expects GDP per capita to approach $17,000 in 2014 from just over $5,000 in 2005. The country's growing middle class, along with a stable political system, should sustain predictable economic policies, regardless of potential changes in government.

Uruguay's economy is likely to grow in a consistent manner, about 3.3% each year, in the next couple of years, with the exception of a persistently high inflation rate that will likely remain above the central bank's targeted level. At the same time, the central bank's real effective exchange rate has appreciated 21% from 2010 to March 2014, indicating a loss of competitiveness compared with its trade partners.

We project that GDP will grow about 3% in 2014. Continued efforts to diversify the economy, as well as attract large-scale investment projects, should sustain GDP growth at that rate or higher over the next three years. Foreign direct investment (FDI) is likely to largely fund the country's current account deficit, thereby containing external indebtedness. The National Industry Unit (Dirección Nacional de Industrias) projects total investment--both public and private--will reach up to $20 billion in 2013-2020 (a little over one-third of 2014 GDP), including the private sector's third pulp and paper mill (an investment of $2.5 billion). However, the current account remains vulnerable to the potential for oil imports to increase if a drought reduces the generation of electricity from hydropower plants. Still, policies such as the insurance agreement with the World Bank, the incorporation of new sources of wind energy, and the strengthening of the energy stabilization fund (Fondo de Estabilización Energética) reduce vulnerability.

The share of dollar-denominated assets and liabilities in the financial system remains about 80%, while inflation remains high; it has exceeded 9% (annualized rate) in recent months. Limited monetary flexibility, a rigid expenditure structure that limits fiscal flexibility, and vulnerability to adverse external developments also constrain the ratings.

The most visible risk of contagion emanates from Argentina (local currency: CCC+/Negative/C, foreign currency:

SD/NM/SD), with which Uruguay has trading and financial links. However, our ratings on Uruguay reflect our assessment that these links are not as strong as they were a decade ago when a sovereign payment default in Argentina contributed to Uruguay engaging in a distressed debt exchange to smooth out its debt profile. We believe that the Uruguayan authorities' efforts to lengthen the average maturity of government debt, to diversify the economy, to reorient exports away from the Mercosur trading block, and to strengthen the financial system will enable it to weather volatility in its bilateral exchange rate with Argentina or worsening economic conditions there.

Outlook

The stable outlook reflects our expectation for continuity and stability in macroeconomic policies following national elections later this year. We expect that Uruguay will maintain pro-investment policies to sustain GDP growth and diversify its productive base while pursuing cautious debt management policies to contain the risk of adverse external developments.

The government's ability to make timely adjustments in fiscal, monetary, and other policies in the event of an adverse external shock will influence the credit rating over the coming years. Continued GDP growth and economic diversification, along with a declining debt burden and improvement in monetary and fiscal flexibility, would provide Uruguay with greater capacity to withstand negative external shocks. A declining level of dollarization in the banking system (the proportion of loans and deposits denominated in dollars), along with lower inflation, would boost the effectiveness of monetary policy. The resulting improvement in economic resilience could lead to an upgrade.

Conversely, a weakening commitment to policies that sustain macroeconomic stability, or an inadequate response to adverse external developments that could reduce the country's external liquidity and raise its debt burden, could result in a downgrade.

Summary Statistics:

Table 1

Uruguay--Selected Indicators

	2007	2008	2009	2010	2011	2012	2013	2014e	2015f	2016f	2017f
Nominal GDP (bil. US$)	23.4	30.4	30.5	38.9	47.2	50.0	53.2	57.7	59.7	62.2	66.3
GDP per capita (US$)	7,011	9,075	9,073	11,542	13,976	14,880	15,830	17,175	17,754	18,506	19,721
Real GDP growth (%)	6.5	7.2	2.4	8.4	7.3	3.7	4.4	3.0	3.5	3.5	3.5
Real GDP per capita growth (%)	6.3	7.0	2.0	8.0	7.0	4.3	4.4	3.0	3.5	3.5	3.5
Change in general government debt/GDP (%)	2.4	8.2	2.0	4.0	5.1	5.8	9.1	4.0	4.2	3.0	2.9
General government balance/GDP (%)	(0.9)	(0.8)	(1.2)	(1.4)	(0.7)	(2.1)	(1.9)	(2.0)	(2.0)	(2.0)	(2.0)
General government debt/GDP (%)	63.1	62.7	60.1	57.0	53.8	54.1	57.2	55.0	53.3	51.2	49.1
Net general government debt/GDP (%)	48.1	51.3	50.0	50.3	45.5	46.1	50.2	48.5	47.4	45.5	44.1

Table 1

Uruguay--Selected Indicators (cont.)											
General government interest expenditure/revenues (%)	10.7	8.3	7.8	8.1	7.7	6.9	7.1	7.2	7.2	7.2	7.2
Other dc claims on resident nongovernment sector/GDP (%)	24.3	28.6	22.3	23.7	24.0	24.8	27.6	28.2	28.8	29.6	30.4
CPI growth (%)	8.1	7.9	7.1	6.9	8.6	7.5	8.5	9.0	8.0	7.0	7.0
Gross external financing needs/CARs plus usable res (%)	128.1	136.9	124.3	108.5	106.1	100.0	98.3	98.1	98.6	97.4	99.2
Current account balance/GDP (%)	(0.9)	(5.7)	(1.3)	(1.9)	(2.9)	(5.4)	(5.9)	(5.8)	(4.7)	(4.2)	(4.1)
Current account balance/CARs (%)	(2.7)	(16.8)	(4.1)	(6.6)	(10.1)	(19.4)	(22.1)	(23.5)	(17.7)	(15.0)	(14.7)
Narrow net external debt/CARs (%)	52.6	26.4	13.5	(3.7)	(11.7)	(13.1)	(28.3)	(20.8)	(15.9)	(13.9)	(12.2)
Net external liabilities/CARs (%)	24.1	18.3	20.3	18.7	32.4	39.3	43.3	70.8	84.2	95.1	106.3

Note: Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. CARs--Current account receipts. e--Economic. f--Forecast.

Institutional And Governance Effectiveness: The Government Likely Will Maintain Continuity In Economic Policies After The Upcoming National Elections

- We expect continuity in policies following national elections in October 2014.
- Election debate is likely to focus on issues such as crime and education, not on major differences in economic policies.
- An increasingly prosperous and middle-class society augurs well for long-term stability.

Uruguay's stable political system provides an anchor for economic stability, and we expect economic policy to remain stable and predictable after the next presidential and legislative elections scheduled for October 2014. Since 2004, Uruguay has been governed by the Frente Amplio (FA), a coalition of parties from the moderate to extreme left. The current president, Jose Mujica, is from the political left within the coalition. Mujica, like his FA predecessor, Tabare Vasquez, has pursued economic policies that have strengthened macroeconomic stability and avoided the type of populism seen in Argentina and Venezuela.

The Mujica Administration has maintained policies that have diversified the economy and reduced its vulnerability to external shocks. It has promoted investment, including large foreign investment projects, while boosting social spending, strengthening labor laws, and pursuing wage settlements that have been favorable to unions. It has also promoted the legalization of limited marijuana use, as well as other social policies such as legalizing abortion and gay marriage. The FA has managed to maintain its unity despite consistent internal tensions between different factions over economic and social policies. The opposition to the FA is divided largely between the two former dominant parties, the Colorados and the Blancos. Former president Tabare Vasquez, a moderate center-left leader who led the first FA administration elected in 2004, is currently favored in the polls to win the presidential election in October. The election debate largely centers on public security, quality of education, and inflation.

The policy differences between the main political parties have narrowed over the past decade. Opposition to some of the government's economic policies has sometimes been stronger within the FA than from the external opposition parties. The main political parties agree on the need to maintain macroeconomic stability and continue diversifying the economy, but they have differing opinions about the level of taxation and government spending, as well as the composition of spending. A new FA administration would maintain policy continuity, but its policies will depend, to some extent, on the internal dynamism of the coalition, where many elements are more radical than Tabare Vazquez. A potential Blanco or Colorado government would be more conservative than the FA and may differ more on microeconomic policies than on macroeconomic policies.

The next government will continue to place emphasis on containing inflation and external risks, mainly from Argentina. Uruguay's institutional strength sustains investor confidence in the country, despite adverse events in neighboring Argentina. Uruguay is a largely middle-class society with a relatively strong social contract that emphasizes consensus and social cohesion. The country ranks highly in international scores for governance and has the best ranking in Latin America in Transparency International's Corruption Perceptions Index. Most recently, Uruguay also was the best ranked country in Latin America in the Rule of Law Index, as published by The World Justice Report.

Uruguay is similar to Chile in terms of per capita income (projected to be about $17,000 in 2014), political stability, and level of development, but it has greater social cohesion and more even income distribution. For example, Uruguay's Gini coefficient (a measure of inequality, with zero being perfect equality and one being perfect inequality) fell to 0.38 in 2012 from 0.45 in 2004 and is the lowest in Latin America, and lower than Chile's 0.52. The middle class, using World Bank definitions, accounts for more than 72% of the population. The poverty rate is about 12%, and extreme poverty is less than 1%. In addition, about 95% of the population has access to health insurance, and the average life expectancy is nearly 80 years.

Uruguay faces no external or internal security threats. However, it has suffered from trade frictions caused by protectionist measures, as well as currency controls, imposed by Argentina. Such steps have hurt tourism from Argentina as well as trade, although the impact on the economy has been contained so far.

Economic Analysis: Benefits From Growing Prosperity And Economic Diversification

- Continued diversification of the economy should benefit long-term growth and stability.
- Uruguay's macroeconomy is stable, with the exception of a persistently high inflation rate.
- Progress in attracting more FDI into major projects, along with potential success in finding offshore oil, could have a major impact on GDP growth over the next five years.

A gradual transformation of the Uruguayan economy over the past decade underpins recent years of good GDP growth and augurs well for growth rates. Total investment has averaged 20% of GDP since 2005, compared with an average of just below 15% during the previous two decades. The higher investment levels have contributed to faster growth in output. GDP growth averaged 5.8% during 2005-2013, compared with less than 1% on average in the previous two decades. The growth reflects several large industrial projects, as well as a transformation of the country's agricultural sector. The introduction of new technology and management practices (often from Argentina) has led to impressive growth in soya and milk output (where productivity per hectare has nearly doubled in the past decade).

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Uruguay has had an average per capita growth rate of 5.4% since 2006, and we expect GDP per capita to approach $17,000 in 2014 from just over $5,000 in 2005. The economy has been operating at nearly full employment in the past three years, with the unemployment rate falling to 7% in early 2014 as the rate of employment rose. According to official calculations, increases in total factor productivity (the increase in output that is greater than the proportionate increase in inputs) account for just less than half of the output growth in recent years, followed by higher use of labor inputs and then capital.

The economy grew 4.4% in 2013, largely because of booming private consumption. Continued investment in large projects, along with a recent rise in real wages, sustained domestic demand. Total investment rose to nearly 23% of GDP, of which 18.3% came from the private sector and 4.6% from the public sector. Much of the growth in domestic demand in recent years has been funded by income growth, rather than lending. Overall credit to families (including consumer and mortgage) remains low at about 12.5% of GDP.

GDP may grow approximately 3% in 2014, below its trend rate of 3%-4%. Continued large-scale investment projects will sustain GDP growth over the medium term. Lower tourism earnings, due to economic problems in Argentina, will hurt growth in 2014. However, the recent construction of a large pulp and paper mill (Montes del Plata) will soon boost output and exports as well.

A potential real appreciation of the exchange rate, continued inflationary pressures, disruptions in trade with Argentina, and external shocks pose downside risk to our growth forecast. Moreover, unlike most Latin American countries, Uruguay will not enjoy a demographic dividend (a drop in fertility rates and an increase in the share of the working-age population) to boost labor supply (and GDP growth) in the coming years because its population is older and growing more slowly than most of them. Growth will depend heavily on total factor productivity growth (as well as more capital). In addition, the country's physical infrastructure constrains growth, along with human capital.

Uruguay's savings rate remains low, leading it to depend on external financing for a substantial share of its recently high level of investment. FDI remains key to further diversification of the economy over the medium term. The government recently signed an agreement for the construction of a third large pulp and paper plant. That, plus realization of proposed large projects to develop an iron mine and associated deep water port, would sustain good growth in the next few years, as well as further diversify the economy. According to the government, FDI of at least $20 billion is already committed for 2013-2020 in diverse sectors, such as logistics, renewable energy, mining, real estate, and other services.

Further development in the energy sector could make an important long-term contribution to GDP growth and external liquidity, helping reduce the country's dependence on high-cost fuel imports. (In particular, droughts can force the government to shift to costly oil-powered generation to compensate for the loss of hydro-power.) A new $1.1 billion floating liquefied natural gas regasification plant (by Gas de France-Suez and Marubeni Corp.) is likely to start operations in early 2015. Several companies have recently started oil and gas exploration offshore. The government has ambitious goals to generate more than half of the country's energy from renewable sources such as wind and solar by 2015, along with plans to boost use of natural gas.

Uruguay has been slower than many Latin American countries in advancing with public-private partnership projects. The first such project, a new prison, has just started. However, we expect that the pace of ambitious plans to build new highways, railways, and a massive new deep water port through such partnerships will likely be slow.

External Analysis: Uruguay Has Strengthened Its Resilience Against Shocks

- Ample foreign exchange reserves, plus the availability of funding from several contingency credit lines, should sustain external liquidity in the event of an external crisis.
- Uruguay's external liquidity position remains moderate, with gross external financing requirements projected to represent 58% of current account receipts on average through 2016.
- We expect FDI flows to continue to largely or fully fund current account deficits over the next three years.

A significant improvement in Uruguay's external position over the past decade sustains the country's stability. The country's external assets exceeded its external debt liabilities by about 100% of its current account receipts. FDI averaged 5.7% of GDP during 2005-2013, nearly double the average level of current account deficits (3% of GDP), containing the growth of external debt.

In 2013, Uruguay's current account deficit grew to $3.1 billion (5.6% of GDP) from $2.7 billion (5.4% of GDP) in 2012. Exports of goods rose 4%, while imports fell 6%, resulting in a smaller trade deficit of $1.3 billion, or 2.4% of GDP (down from 4.7% in 2012). However, the improving trade balance was offset by a deteriorating services balance, largely the result of higher public-sector interest payments abroad and private-sector dividend outflows. Overall, service exports declined 6% in 2013, hurt by falling tourist inflows from Argentina.

In the capital account, FDI increased 4% to $2.8 billion in 2013 (5.2% of GDP), compared with 5.4% in the previous year. The bulk of the FDI in the past decade consists of new flows, not reinvested earnings of existing foreign enterprises.

The current account deficit is likely to remain between 5% and 6% of GDP in 2014 and decline toward 4%-5% of GDP in the next two years. The trade deficit is likely to exceed 3% of GDP. Exports to South America (especially Argentina and Brazil) may decline in 2014, but exports to China may rise. FDI is likely to approach 5% of GDP in 2014 and in the coming two years, largely filling the current account deficit and, thereby, containing external indebtedness. The CAD remains vulnerable to large spikes in imports due to higher oil imports when drought reduces the generation of electricity from hydro-power plants. Still, policies such as the insurance agreement with the World Bank, the incorporation of new sources of wind energy, and a strengthening of the energy stabilization fund (Fondo de Estabilización Energética) reduce the level of vulnerability.

Continued success in diversifying the economy could improve Uruguay's balance of payments in the next three years. The composition of current account receipts has changed over the past decade. Earnings from tourism have increased in recent years, but non-tourism service exports (such as IT, design, pharmaceuticals, research and development, and other back-office and business processing operations) have grown much faster. Such service exports are approaching one-third of total service exports; more than one-third of them go to the U.S., and over 20% to the rest of Latin America.

Uruguay's recent economic growth reflects improvements in productivity and the creation of new productive capacity. The country's terms of trade (price of exports divided by price of imports) have barely improved in the past decade, unlike in most of South America. However, greater diversification of exports away from both Argentina and Brazil (thanks to rising exports of soya and pulp) has reduced the country's vulnerability to economic setbacks in those countries. Argentina accounted for less than 5% of total exports in 2013, down from more than 12% in 2005. China became the largest single export market, about 20% of total exports, overtaking Brazil (19%). A more diverse set of exports of both goods and services, along with less dependence on neighboring markets, could reduce the risk of a sudden loss of external liquidity.

The country's foreign exchange reserves grew $2.7 billion during the year, reaching a record $16.3 billion at the end of 2013, or 30% of GDP. In addition, the government has access to external funding of about 3.4% of projected 2014 GDP to reduce the country's vulnerability to external shocks. Moreover, we believe that Uruguay could quickly qualify for the International Monetary Fund's Flexible Credit Line facility. As a result, we expect Uruguay to have ample external liquidity to manage potential disruptions in global conditions as the U.S. Federal Reserve Bank withdraws its monetary stimulus.

Fiscal Analysis: Fiscal Deficits Are Manageable, And The Debt Profile Has Improved

- We expect public-sector deficits to remain moderate in the coming years, consistent with at least a stable burden of general government debt.
- A favorable debt maturity profile offsets the relatively high government debt and dollarization in the financial sector.
- Liability management aimed at reducing exposure to foreign-currency-denominated debt has reduced external vulnerability.

Fiscal

The consolidated public-sector deficit is likely to remain at 2.4% of GDP during 2014, an election year, based on slower-than-projected GDP growth. Persistently high inflation has led the government to desist from adjusting public-sector tariffs, contributing to revenue slippage. The general government deficit is likely to be about 2% of GDP, up slightly from 1.9% in 2013. Total public-sector spending rose by 1.6% of GDP in 2013, with nearly half the increase reflecting higher investment by public enterprises. Total interest spending rose by 0.2% of GDP to 2.8% of GDP. The increase reflects an equal increase in spending by both the central government and the central bank.

In general, public-sector enterprises do not depend on government financial support. However, the government typically incurs a large expense during years of drought because it has to fund the purchase of expensive oil imports to compensate for lost hydro-electric output. We estimate that public-sector enterprises pose a limited contingent liability for the sovereign.

We expect that the consolidated nonfinancial public-sector deficit is likely to remain close to 2% of GDP in the next three years, and the general government deficit slightly lower than that level. Some potential increase in government spending may be offset by lower losses at the central bank. The central bank's losses, due to open market operations in recent years to sterilize large capital inflows, have been about 1% of GDP.

About 2.5% of banking assets are to the central government, but that increases to almost 26% when including central bank exposure (most of it is reserves at the central bank and treasury notes). Contingent liabilities stemming from financial sector corporations are estimated at 1% of GDP.

Debt

We project that general government debt (including central bank debt issued for open market operations) is likely to be about 55% of GDP in 2014 and may decline modestly in the next three years. Net general government debt (Standard & Poor's includes liquid government assets in this calculation, but excludes the central bank's foreign exchange reserves) is likely to dip below 50% of GDP in 2014 and decline modestly in the next three years. The projections are subject to volatility as a result of sharp movements in the exchange rate because just less than half the central government's debt is denominated in foreign currency. We project that general government debt may rise by 3%-4% of GDP annually, on average, in the next four years while interest expenses remain below 10% of revenues.

Prudent debt management has significantly reduced the risks from a sudden disruption in external markets, or a spike in the exchange rate or interest rate. The government has undertaken liability management operations to improve the profile of sovereign debt, as well as to build reserves that provide cushion against external shocks. Last year, the government prefinanced all its amortization and interest payments for 2014. Total debt maturity is projected to be only 1.2% of GDP in 2014 and 2.2% in 2015. The strategy of prefunding future amortization payments and holding substantial levels of liquid assets provides insulation against Uruguay's external vulnerabilities but also imposes a fiscal cost.

More than 55% of the central government debt is in local currency as of March 31, 2014, compared with 11% in 2005. The average life of central government debt is 11.9 years. In 2014, the central government faces debt amortization for $350 million, equivalent to 0.6% of GDP. That increases to 2.1% in 2015 and 1.3% in 2016, though those levels are still low. Amortization in dollars accounts for an estimated 33% of total debt amortization, on average, for the next three years. More than 80% of the sovereign's external debt is commercial debt, and the rest is from multilaterals.

Central bank debt, much of it issued for open market operations, reached 17% of GDP in 2013 (all in local currency). The central bank could be in a position to pay down a substantial share of debt as it matures if the exchange rate depreciates or remains weak, accommodating an outflow of foreign exchange reserves as foreign investors repatriate their investments.

Total pension fund assets are just below 20% of GDP, providing a growing source of funding for the sovereign in case external markets are closed in the future. Most of the funds (about 80%) are invested in public debt. The government and central bank are working on a plan to set up an investment fund for retail investors who could directly purchase central bank debt, increasing the number of potential buyers.

Monetary Policy Analysis: Dollarization Is Falling Slightly, But Monetary Flexibility Remains Limited

- Uruguay's inflation rate will remain higher than that of much of Latin America, despite progress in strengthening macroeconomic stability in recent years.
- The inflation rate is likely to stay slightly above the bank's target range or gradually fall within the upper bound in the next couple of years.
- A high level of dollarization and indexation to inflation limit the effectiveness of monetary flexibility.

A persistently high inflation rate is the main macroeconomic weakness in Uruguay. Inflation ended 2013 at 8.5% and has been accelerating in early 2014, hovering at nearly 10% in recent months (annualized inflation rate of about 9.7% in first-quarter 2014).

A low level of domestic credit and dollarization limit the effectiveness of the transmission mechanism of monetary policy. Total credit from the financial system to the private sector and the nonfinancial public sector was less than 28% of GDP in 2013.

The shift in monetary policy toward inflation targeting has been common in many investment-grade sovereigns in Latin America, but Uruguay has not been as successful as most others. Its inflation rate has typically exceeded the central bank's target, weakening the credibility of its inflation targeting policy.

In June 2013, the central bank enlarged its inflation range to 3%-7% from 4%-6%, keeping the target at 5%. It also formally changed to using money supply growth instead of short-term interest rates as its primary policy tool. The new monetary policy has arguably become less transparent but perhaps more effective politically. Since the change last year to using money supply growth, the central bank has allowed short-term interest rates on its debt to rise substantially in order to contain inflation. Moreover, the recent sharp rise in interest rates also reflects external conditions, with the expectation of higher global interest rates.

The high inflation rate of recent times reflects various factors, including recent supply shocks, depreciation of the currency, many years of good GDP growth that has boosted demand, and rising public-sector tariffs. Prices in the non-tradable sector of the economy (such as health care, education, rents, and public transport) have risen faster than in the tradable sector. Booming personal income and a tight job market have boosted domestic demand and input costs for producers. In addition, a high level of salary indexation with inflation creates substantial inertia, making it harder for the central bank to reduce the inflation rate.

With inflation hovering just below 10% in early 2014, the government reduced some administered utility prices to keep it below the politically important threshold of 10%. It also eliminated the value-added tax on fruits, vegetables, utilities, and fuel, measures that may temporarily contain inflation but impose a fiscal cost. Early this year, the government also implemented a price freeze on basic goods in accordance with supermarkets and stores for three months. Uruguay no longer has automatic salary adjustments when inflation exceeds 10%, but such an inflation rate could raise political pressure to compensate workers in some manner, thereby potentially reinforcing second-round inflation pressures. Because 2014 is an election year, we do not expect the government to take steps that dramatically reduce the inflation rate to its target level. Instead, we expect that the authorities will take steps to gradually bring the inflation rate down to the high end of its target range in the next couple of years.

Uruguay's financial system has become less vulnerable to external shocks than it was in the past, but it's still relatively small in size. State-owned Banco de la Republica Oriental Uruguay (BROU) plays a predominant role in the financial system, accounting for nearly half of bank system assets, while the larger private sector banks are foreign-owned. The banks are generally well-capitalized, and bank supervision has improved in recent years as the country implements Basel II standards. Nonperforming loans (NPLs) in the private banking system are about 1% of total loans and are covered by loan loss provisions more than 3x, while public banks had a 2.8% NPL ratio. Total lending has remained below 65% of deposits in the past four years. Commercial credit has been growing faster than household credit in the last couple of years. Mortgages are less than 5% of GDP. The country's debt markets are generally weak, dominated by government and central bank paper, and the stock market is very small. The corporate bond market is also small, and there is little secondary trading of financial instruments.

Persistent dollarization remains a weakness in the financial system. Deposits in foreign currency accounted for 80% as of Dec. 31, 2013, for private banks, and 62% for public banks. Loans in foreign currency accounted for 71% for private banks and 49% for public banks. The banks invest their excess dollar deposits abroad and must fully match their dollar liabilities with dollar assets. Bank credit to households is denominated almost entirely in local currency, while all other types of lending are denominated mostly in dollars. Only about 20% of dollar deposits in Uruguay are owed to nonresidents. Nonresidents account for about 24% of total bank deposits, of which 9% is from Argentina (and much of the rest from Brazil). Credit to nonresidents is very low, less than 2% of total lending. Unlike in 2002, Uruguayan banks have next to no credit extended to Argentine residents, reducing their risks in the event of a sharp deterioration in that country.

Local currency depreciated 10% in 2013 and ended the year at Uruguayan peso (UYU) 21.389/per U.S. dollar. In the first months of 2014, the exchange rate ranged from UYU22.5-23/U.S. dollar. We expect the local currency to slightly depreciate to about UYU23/U.S. dollar at year-end 2014.

Local Currency Rating, T&C Assessment

Our local currency rating on Uruguay is the same as the foreign currency rating because dollarization continues to restrict monetary flexibility, and domestic capital markets remain modest in capacity.

The transfer and convertibility assessment is 'BBB+', two notches higher than the foreign currency rating, to reflect Standard & Poor's view that the likelihood of the sovereign restricting access to the foreign exchange that Uruguay-based non-sovereign issuers need for debt service is moderately lower than the likelihood of the sovereign defaulting on its foreign currency obligations. The foreign exchange regime in Uruguay remains fairly open. Uruguay's outward-oriented economic policies suggest a lower likelihood--than more interventionist sovereigns--that it would resort to such restrictions in a severe downside scenario.

Table 2

Uruguay--Selected Indicators											
	2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014e**	**2015f**	**2016f**	**2017f**
Economic indicators											
Nominal GDP (bil. LC)	549.5	636.2	687.5	779.9	912.3	1015.6	1141.0	1281.0	1431.9	1585.7	1756.1
Nominal GDP (bil. US$)	23.4	30.4	30.5	38.9	47.2	50.0	53.2	57.7	59.7	62.2	66.3
GDP per capita (US$)	7,011	9,075	9,073	11,542	13,976	14,880	15,830	17,175	17,754	18,506	19,721
Real GDP growth (%)	6.5	7.2	2.4	8.4	7.3	3.7	4.4	3.0	3.5	3.5	3.5
Real GDP per capita growth (%)	6.3	7.0	2.0	8.0	7.0	4.3	4.4	3.0	3.5	3.5	3.5
Real investment growth (%)	9.3	19.3	(4.7)	13.6	6.4	19.2	6.2	3.0	3.5	3.5	3.5
Gross domestic investment/GDP (%)	18.6	20.6	19.9	19.9	19.3	22.7	22.9	22.9	22.9	22.9	22.9
Gross domestic savings/GDP (%)	17.6	14.9	18.7	18.0	16.4	17.2	17.0	17.1	18.2	18.7	18.8
Real exports growth (%)	7.4	8.4	3.9	7.0	6.0	2.1	0.1	3.0	3.5	3.5	3.5
Unemployment rate (average %)	9.2	7.7	7.3	6.8	6.0	6.1	6.5	6.5	6.5	6.5	6.5
External indicators											
Narrow net external debt/CARs (%)	52.6	26.4	13.5	(3.7)	(11.7)	(13.1)	(28.3)	(20.8)	(15.9)	(13.9)	(12.2)
Gross external financing needs/CARs plus usable reserves (%)	128.1	136.9	124.3	108.5	106.1	100.0	98.3	98.1	98.6	97.4	99.2
Net external liabilities/CARs (%)	24.1	18.3	20.3	18.7	32.4	39.3	43.3	70.8	84.2	95.1	106.3
Current account balance/GDP (%)	(0.9)	(5.7)	(1.3)	(1.9)	(2.9)	(5.4)	(5.9)	(5.8)	(4.7)	(4.2)	(4.1)
Current account balance/CARs (%)	(2.7)	(16.8)	(4.1)	(6.6)	(10.1)	(19.4)	(22.1)	(23.5)	(17.7)	(15.0)	(14.7)
Trade balance/GDP (%)	(2.3)	(5.6)	(1.7)	(1.4)	(3.0)	(4.7)	(2.4)	(3.4)	(2.3)	(1.8)	(1.8)
Net FDI/GDP (%)	5.3	7.0	5.0	6.0	5.3	5.4	5.2	5.0	4.9	4.9	4.7
Net portfolio equity inflow/GDP (%)	0.0	(0.0)	(0.1)	(0.0)	(0.0)	0.0	0.0	0.1	0.1	0.1	0.1
Short-term external debt by remaining maturity/CARs (%)	47.9	44.7	54.8	49.1	40.8	34.1	39.1	45.0	39.6	33.1	32.0

Table 2

Uruguay--Selected Indicators (cont.)											
Reserves/CAPs (months)	2.1	1.8	3.2	4.9	4.6	5.4	6.3	7.0	6.1	5.4	5.0
Fiscal indicators											
Change in general government debt/GDP (%)	2.4	8.2	2.0	4.0	5.1	5.8	9.1	4.0	4.2	3.0	2.9
General government balance/GDP (%)	(0.9)	(0.8)	(1.2)	(1.4)	(0.7)	(2.1)	(1.9)	(2.0)	(2.0)	(2.0)	(2.0)
General government primary balance/GDP (%)	3.0	2.1	1.6	1.7	2.1	0.5	0.9	0.8	0.8	0.8	0.7
General government revenue/GDP (%)	36.6	35.4	37.2	37.9	37.3	37.5	39.3	38.8	38.6	38.6	38.7
General government expenditures/GDP (%)	37.5	36.2	38.4	39.3	38.1	39.6	41.1	40.9	40.6	40.7	40.8
General government interest expenditure/revenues (%)	10.7	8.3	7.8	8.1	7.7	6.9	7.1	7.2	7.2	7.2	7.2
General government debt/GDP (%)	63.1	62.7	60.1	57.0	53.8	54.1	57.2	55.0	53.3	51.2	49.1
Net general government debt/GDP (%)	48.1	51.3	50.0	50.3	45.5	46.1	50.2	48.5	47.4	45.5	44.1
General government liquid assets/GDP (%)	15.0	11.4	10.0	6.6	8.3	8.0	7.0	6.4	5.9	5.6	5.1
Monetary indicators											
CPI growth (%)	8.1	7.9	7.1	6.9	8.6	7.5	8.5	9.0	8.0	7.0	7.0
GDP deflator growth (%)	9.4	8.0	5.6	4.7	9.0	7.4	7.6	9.0	8.0	7.0	7.0
Other dc claims on resident nongovernment sector/GDP (%)	24.3	28.6	22.3	23.7	24.0	24.8	27.6	28.2	28.8	29.6	30.4
Foreign currency share of deposits in other dc (%)	105.6	108.8	102.5	95.3	86.0	86.4	88.1	88.1	88.1	88.1	88.1

Note: Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private-sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. The data and ratios above result from Standard & Poor's own calculations, drawing on national as well as international sources, reflecting Standard & Poor's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. CAPs--Current account payments. CARs--Current account receipts. FI--Financial Institutions. e--Estimate. f--Forecast.

Related Criteria And Research

Related Criteria

- Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers, May 7, 2013
- Sovereign Government Rating Methodology And Assumptions, June 30, 2011
- Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

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Related Research

- Uruguay Ratings Affirmed At 'BBB-/A-3'; Outlook Remains Stable, June 2, 2014
- Sovereign Defaults And Rating Transition Data, 2013 Update, April 18, 2014
- Oriental Republic of Uruguay, July 2, 2013

Chart 1

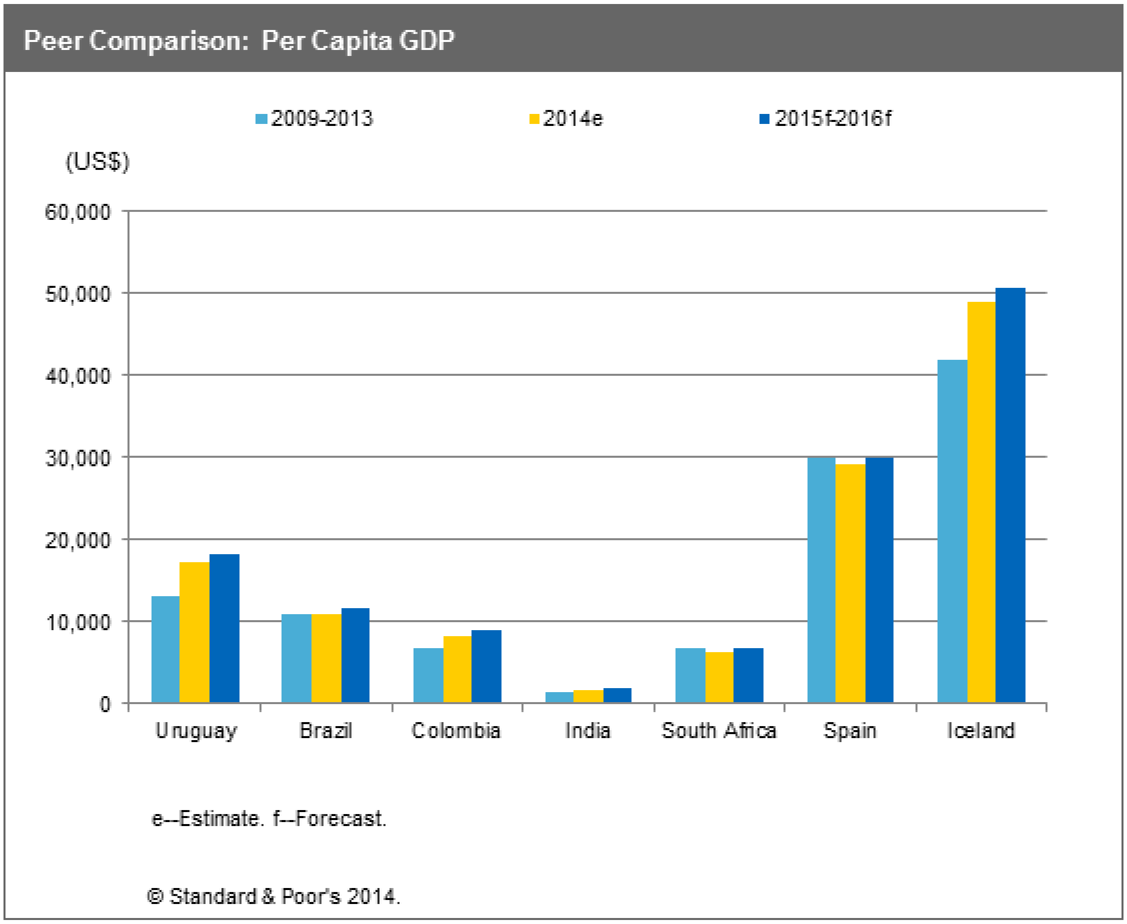

Chart 2

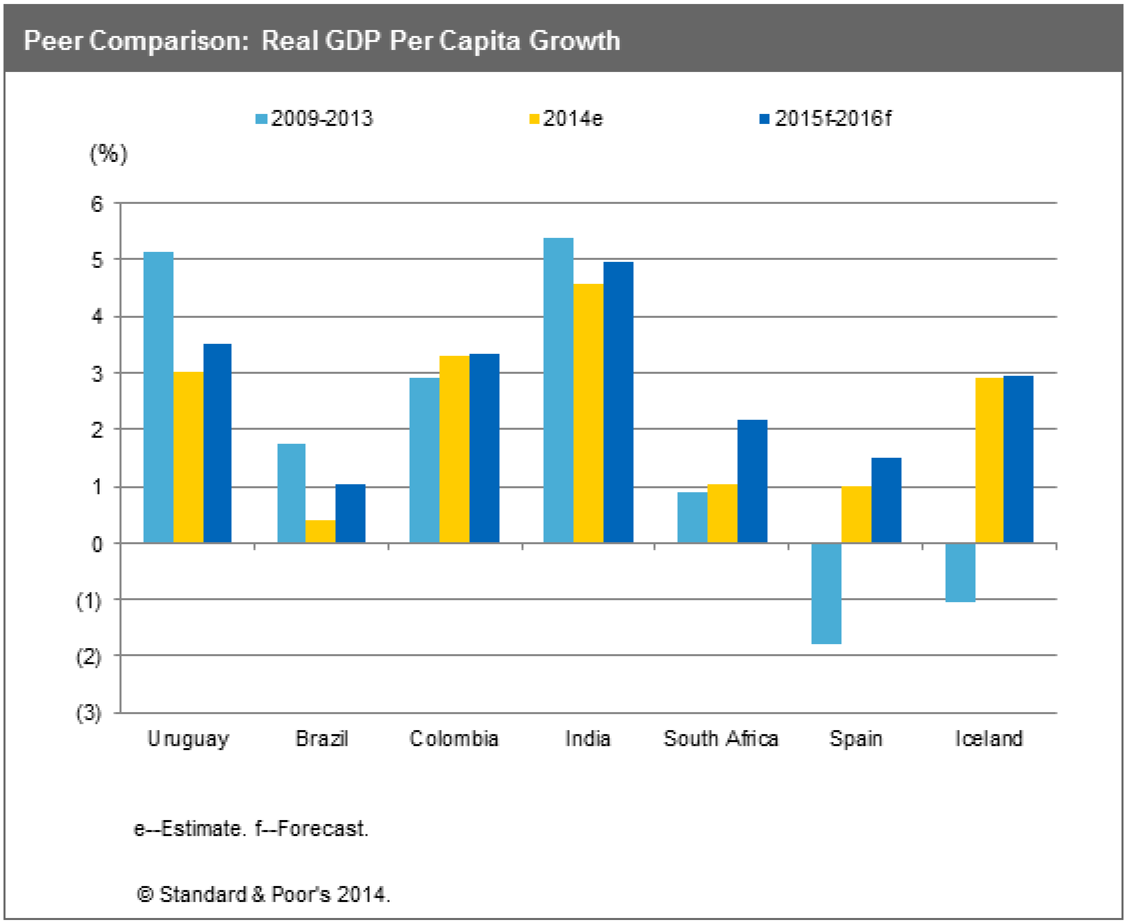
Peer Comparison: Real GDP Per Capita Growth
2009-2013
2014e
2015f-2016f
(%)
6
5
4
3
2
1
0
(1)
(2)
(3)
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 3

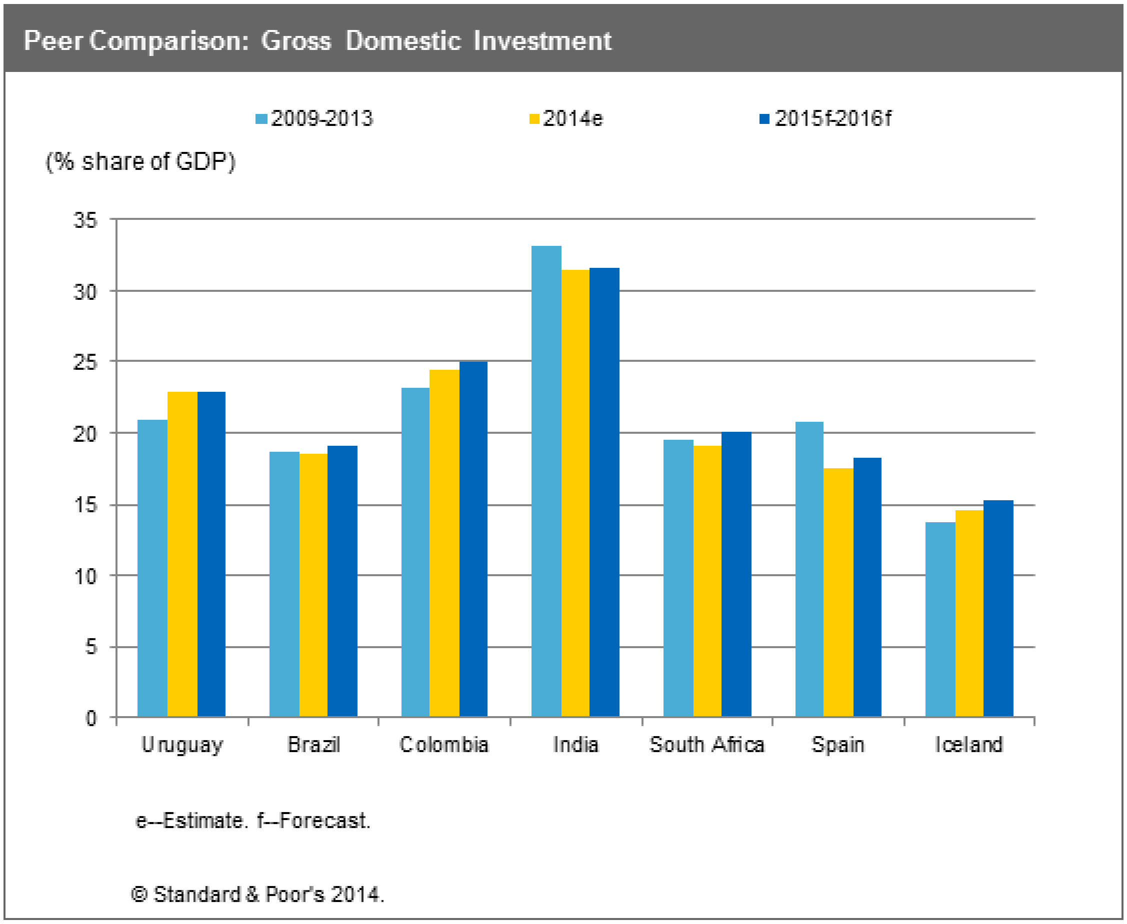
Peer Comparison: Gross Domestic Investment
2009-2013
2014e
2015f-2016f
(% share of GDP)
35
30
25
20
15
10
5
0
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 4

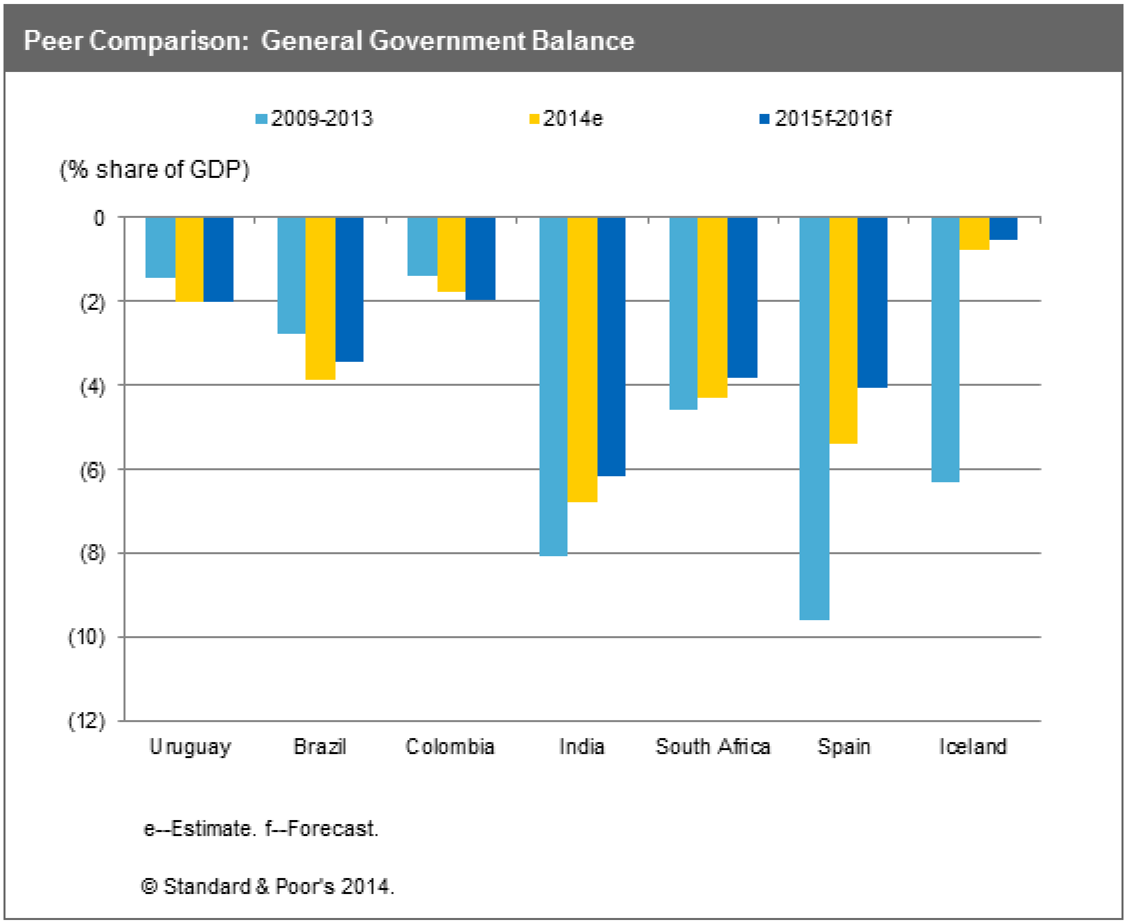
Peer Comparison: General Government Balance
2009-2013
2014e
2015f-2016f
(% share of GDP)
0
(2)
(4)
(6)
(8)
(10)
(12)
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 5

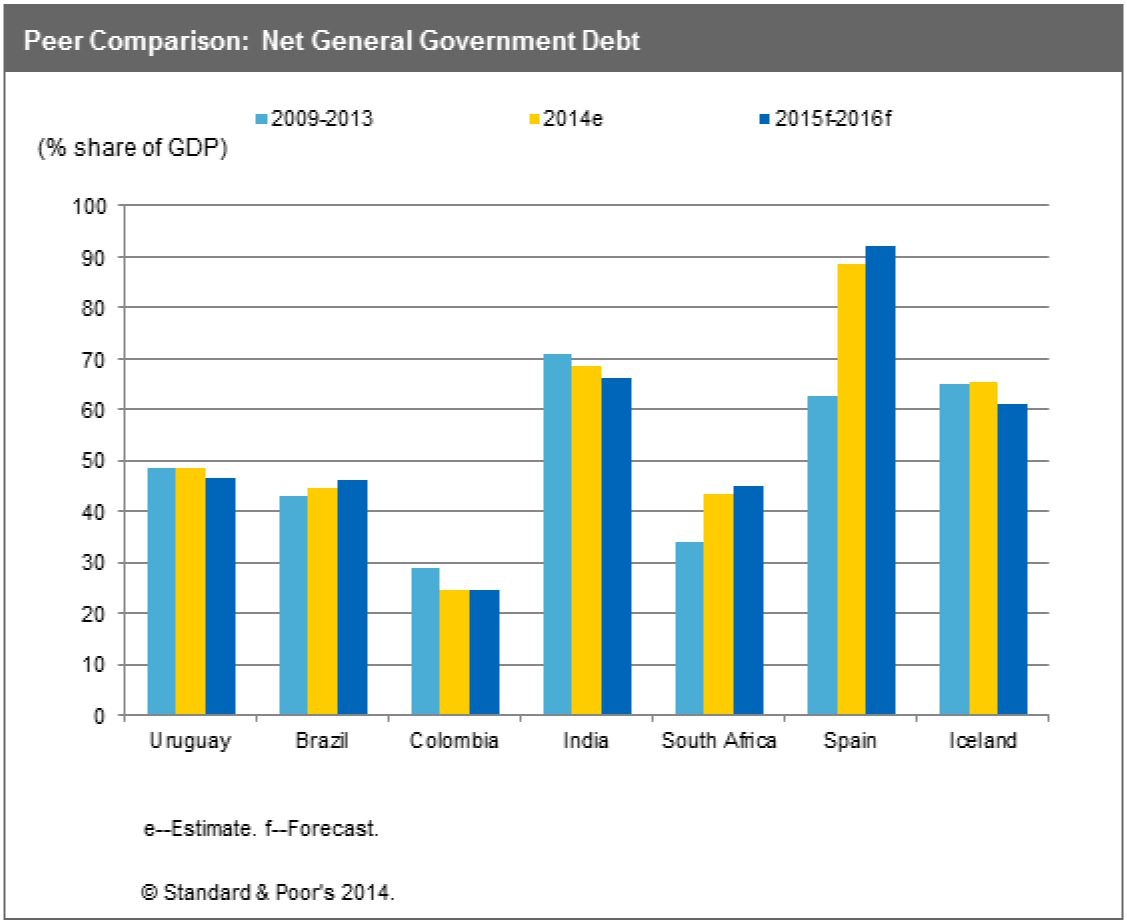
Peer Comparison: Net General Government Debt
2009-2013
2014e
2015f-2016f
(% share of GDP)
100
90
80
70
60
50
40
30
20
10
0
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 6

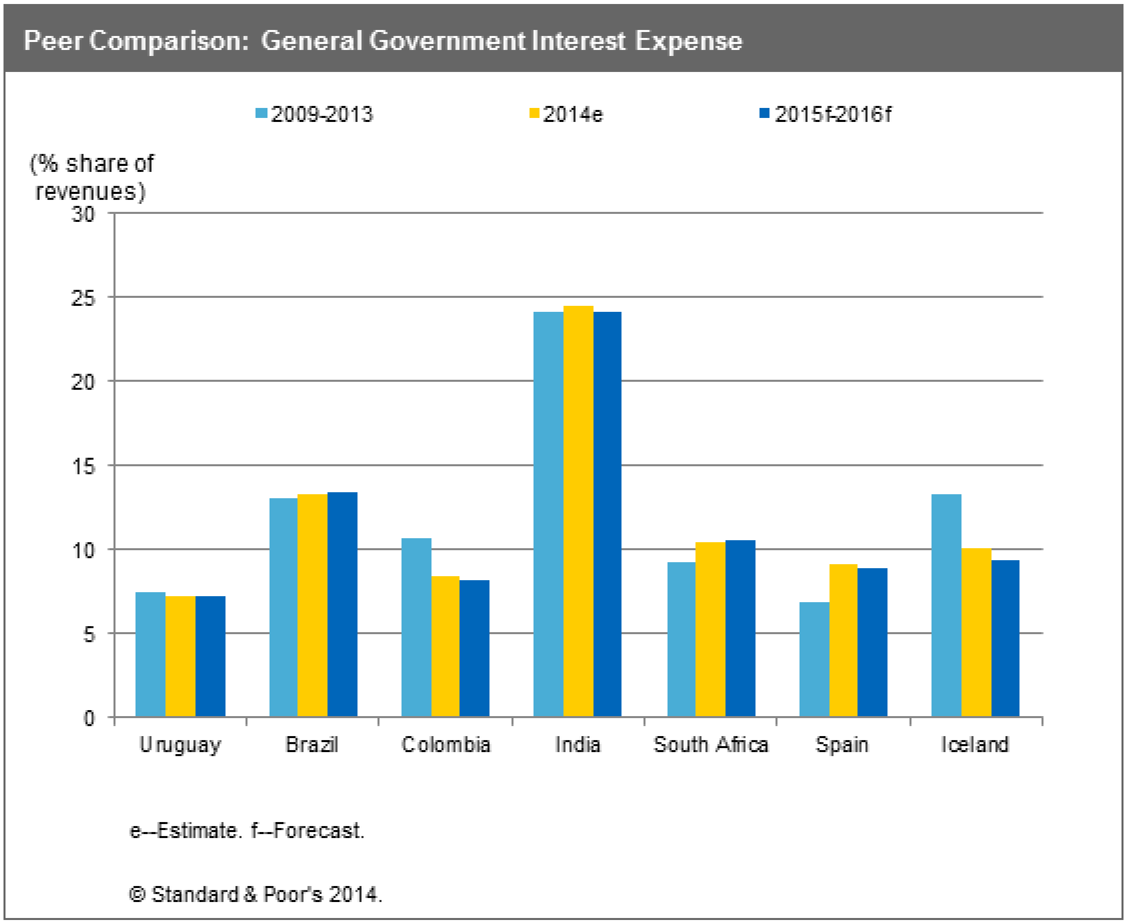
Peer Comparison: General Government Interest Expense
2009-2013
2014e
2015f-2016f
(% share of revenues)
30
25
20
15
10
5
0
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 7

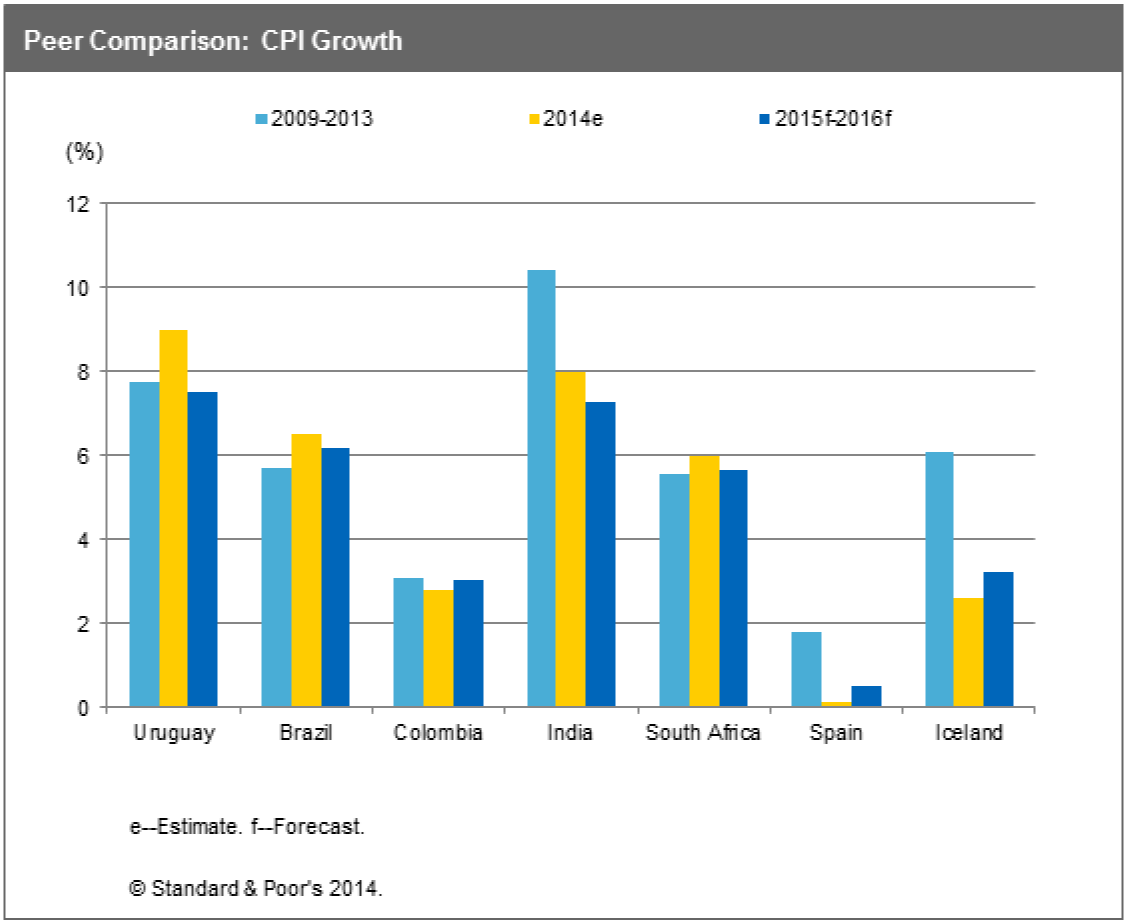
Peer Comparison: CPI Growth
2009-2013
2014e
2015f-2016f
(%)
12
10
8
6
4
2
0
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 8

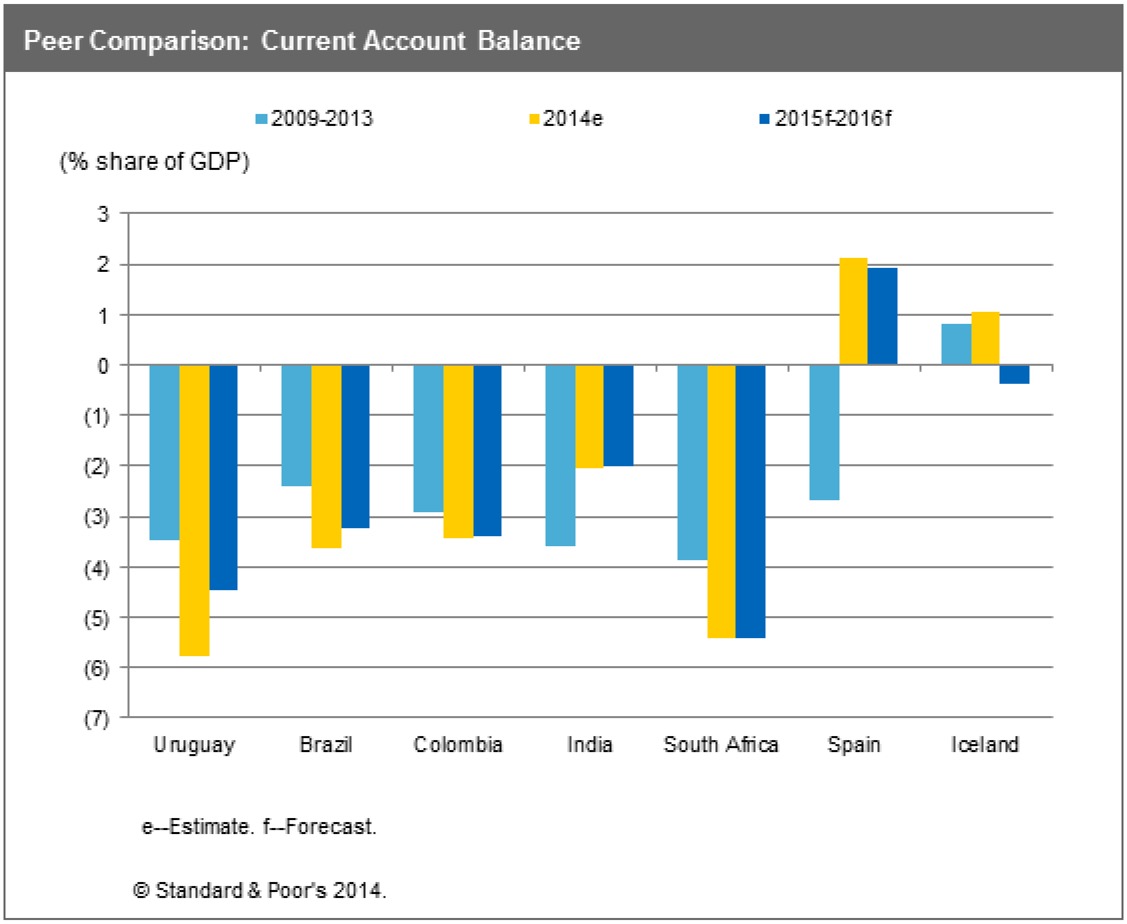
Peer Comparison: Current Account Balance
2009-2013
2014e
2015f-2016f
(% share of GDP)
3
2
1
0
(1)
(2)
(3)
(4)
(5)
(6)
(7)
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 9

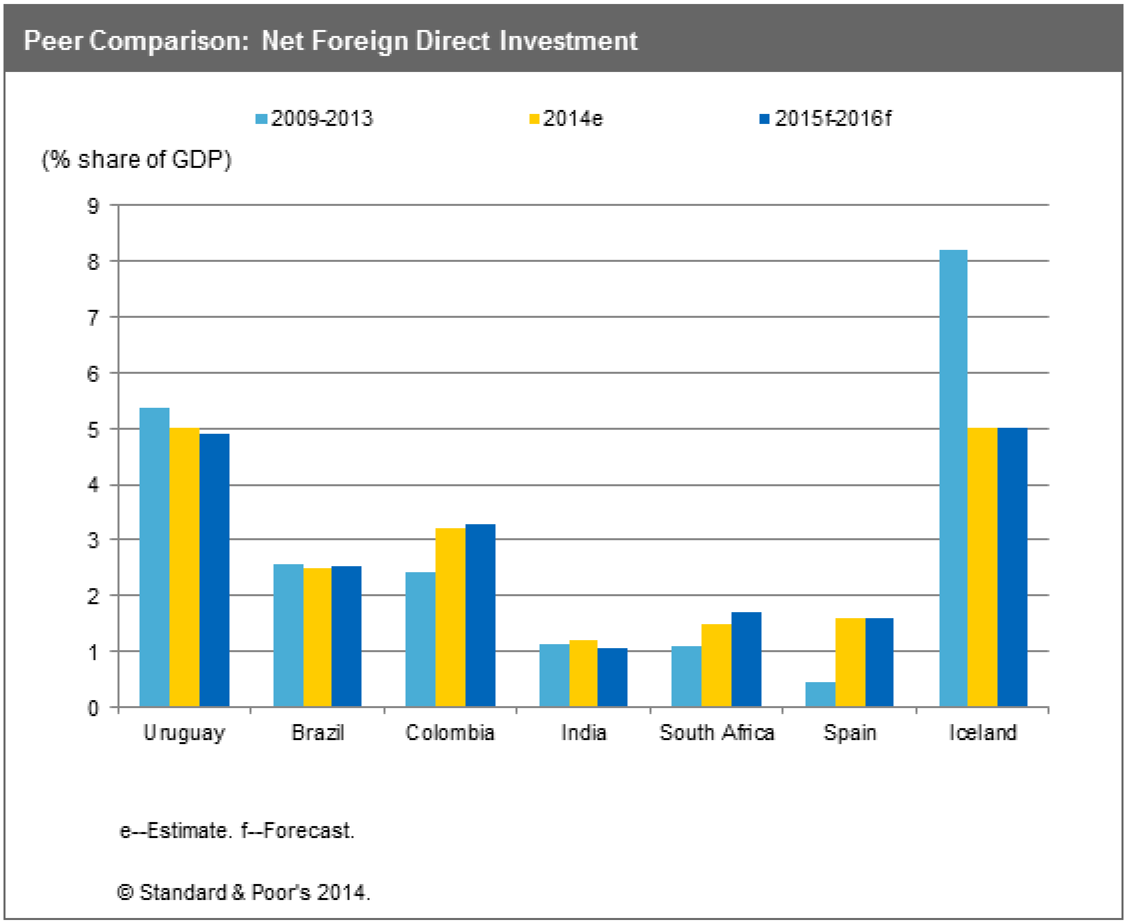
Peer Comparison: Net Foreign Direct Investment
2009-2013
2014e
2015f-2016f
(% share of GDP)
9
8
7
6
5
4
3
2
1
0
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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Chart 10

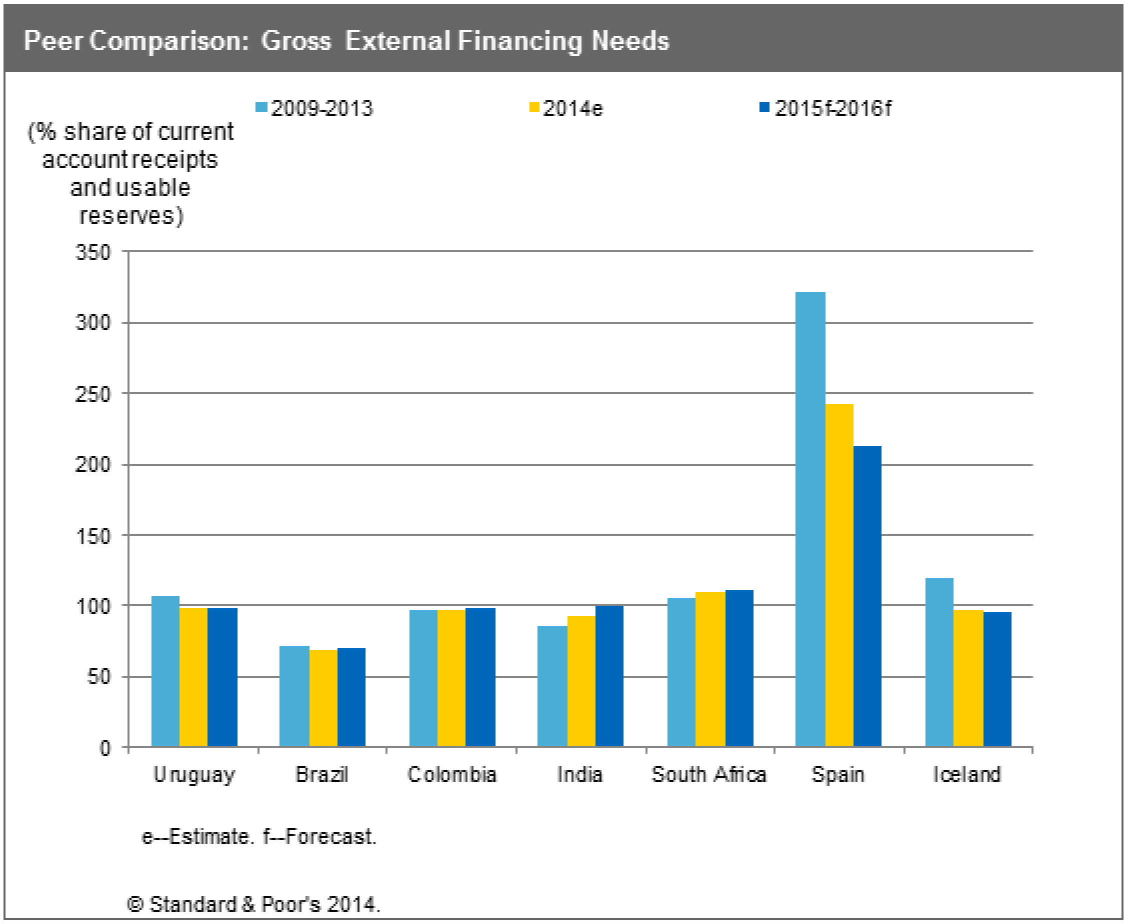
Peer Comparison: Gross External Financing Needs
2009-2013
2014e
2015f-2016f
(% share of current account receipts and usable reserves)
350
300
250
200
150
100
50
0
Uruguay
Brazil
Colombia
India
South Africa
Spain
Iceland
e--Estimate. f--Forecast.
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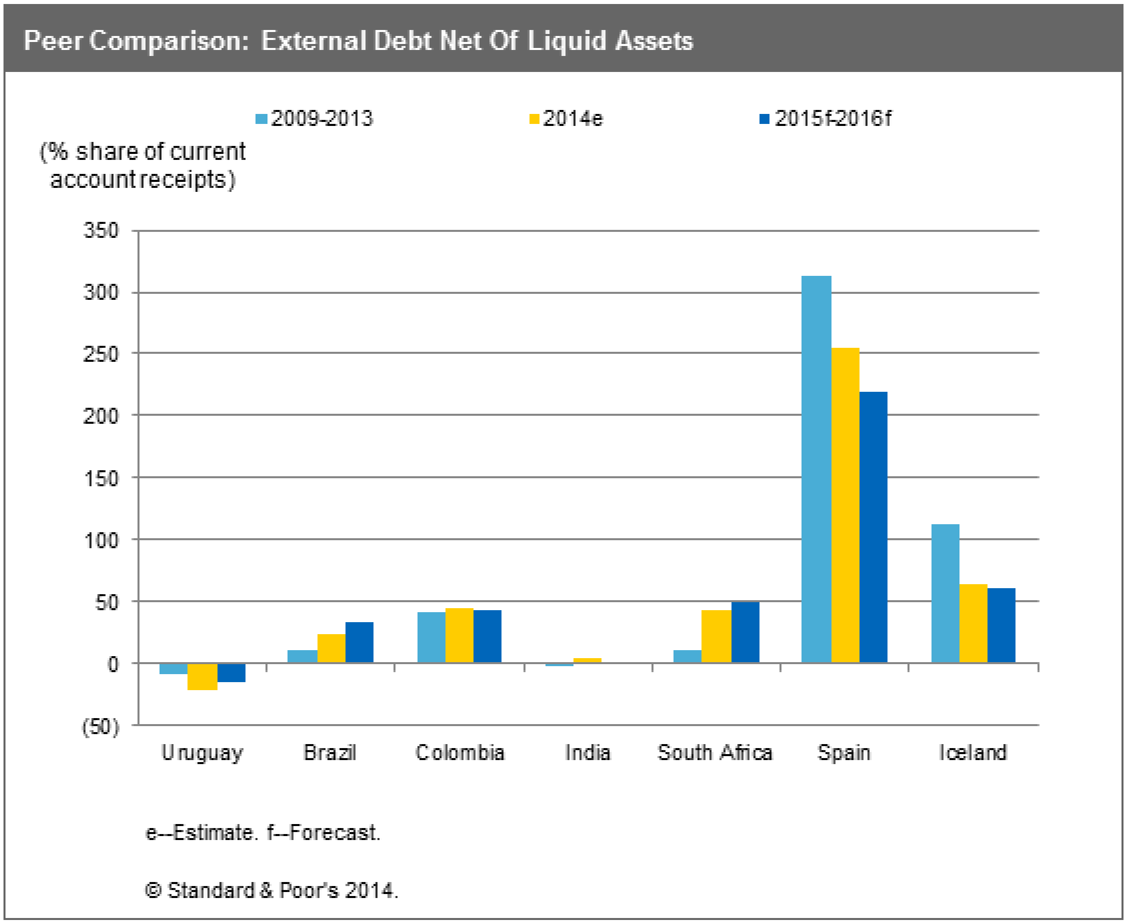
Chart 11



Ratings Detail (As Of August 1, 2014)	
Uruguay (Oriental Republic of)	
Sovereign Credit Rating	BBB-/Stable/A-3
Transfer & Convertibility Assessment	BBB+
Senior Unsecured	BBB-
Short-Term Debt	A-3
Sovereign Credit Ratings History	
03-Apr-2012	BBB-/Stable/A-3
25-Jul-2011	BB+/Stable/B
06-Sep-2010	BB/Stable/B

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.