FitchRatings

Uruguay

This report does not constitute a new rating action for this issuer. It provides more detailed credit analysis than the previously published Rating Action Commentary, which can be found on www.fitchratings.com.

Key Rating Drivers

Stable Outlook: The revision of Uruguay's Outlook to Stable from Negative reflects its fiscal resilience during the pandemic and further structural fiscal improvement. The rating is supported by high per capita GDP, strong governance scores and robust external liquidity. It is constrained by a record of weak economic growth and high inflation, high and heavily dollarised public debt, and policy flexibility weakened by dollarization, indexation and shallow financial depth.

Economic Recovery: Fitch Ratings forecasts the economy to grow 3.4% in 2021 and 2.7% in 2022 after falling 5.9% in 2020. This represents a slow recovery relative to peers given the importance of the lagging tourism sector and a small counter-cyclical policy effort, but is supported by the UPM pulp mill project, export dynamism and a particularly successful vaccination campaign.

Competitiveness Issues: We project growth to ease to a 2.0% pace as UPM finishes. Key issues – high fuel prices, slipping educational outcomes and labour rigidities – could persist in the absence of bold reforms to address them. Plans for a trade deal with China are a bright spot, however, and Uruguay's institutional strength and high agricultural prices could support investment.

Fiscal Improvement: Public finances are improving in cyclical and structural terms, after a fairly small deterioration in 2020-2021 due to prudent fiscal policy and resilient revenue. Fitch projects the central government deficit (net of 'cincuentones' pension effects) will fall to 4.5% of GDP in 2021 from 5.8% in 2020. The underlying fiscal position, net of pandemic spending and extraordinary revenue, has improved beyond its 2019 starting position.

Spending Austerity: Fitch's confidence in the authorities' spending-focused fiscal adjustment strategy has improved. The authorities are achieving savings by containing non-discretionary spending below high inflation, aided by real declines in wages (to which pensions are indexed). Real pensions and public salaries are on track to fall in 2022 for a third year. These savings could be difficult sustain for long, namely closer to 2024 elections, given a pledge for a real wage recovery.

Better Debt Dynamics: Fitch projects general government debt will decline to 65.0% of GDP at end-2021 from 66.2% in 2020 and rise gradually thereafter, diverging from the 'BBB' median projected to fall below 60%, but with a much smaller gap than pre-pandemic. Interest costs are being contained by favourable external market access supported by strong ESG credentials and a major reduction in peso borrowing costs that Fitch believes could be partly structural.

Uphill Disinflation Battle: Global pressures pushed inflation back above the target range (3%-7%) to 7.9% as of November, and expectations have drifted further above target. Guidelines for wage talks include conservative rises but also an ex-post inflation corrective in 2023 that could add inertia, as could higher rises and more frequent correctives being adopted in many sectors.

Important Referendum: The Lacalle Pou administration faces a test in March 2022 with a referendum of its 2020 'urgent consideration law' (LUC). Should the LUC be upheld, this could bolster the government's strong political standing and its ability to carry out reforms and sustain conservative policies, while a defeat could make this more difficult.

Rating Sensitivities

Fiscal Slippage, Weaker Growth: A substantial rise in government debt/GDP (e.g. due to failure to achieve fiscal consolidation) or a weak economic recovery or post-recovery trend growth, would be negative for creditworthiness.

Lower Debt, Higher Growth, Disinflation: Fiscal consolidation that puts debt/GDP on a downward path, stronger growth prospects, and progress in disinflation and financial de-dollarisation, would be positive for creditworthiness.

Ratings

Foreign Currency	
Long-Term IDR	BBB-
Short-Term IDR	F3
Local Currency	
Long-Term IDR	BBB-
Short-Term IDR	F3
Country Ceiling	BBB+

Outlooks

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

Rating Derivation

Component	Outcome
Sovereign Rating Model (SRM)	BBB
Qualitative Overlay (QO)	-1
Structural features	-
Macroeconomic	-1
Public finances	-
External finances	-
Long-Term Foreign-Currency IDR	BBB-

Source: Fitch Ratings

Applicable Criteria

Sovereign Rating Criteria (April 2021)

Country Ceilings Criteria (July 2020)

Related Research

Fitch Revises Uruguay's Outlook to Stable, Affirms IDRs at 'BBB-' (December 2021)

Latin American Sovereign Credit Overview 4Q21 (October 2021)

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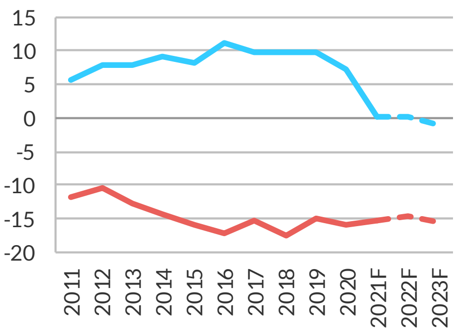
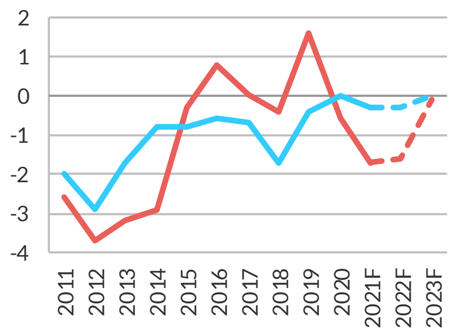
Peer Comparison

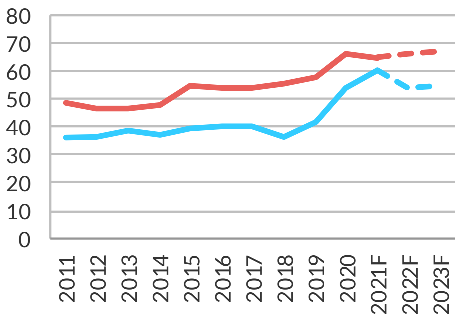
Net External Debt
% of GDP



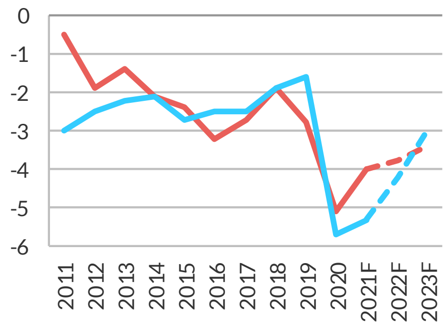
Current Account Balance
% of GDP



General Government Debt
% of GDP

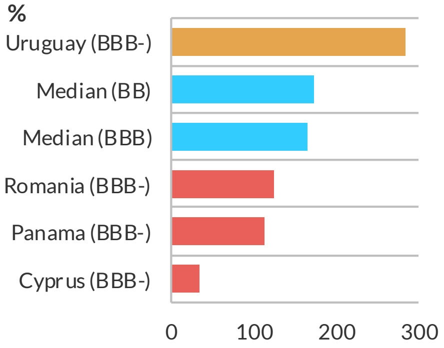


General Government Balance
% of GDP

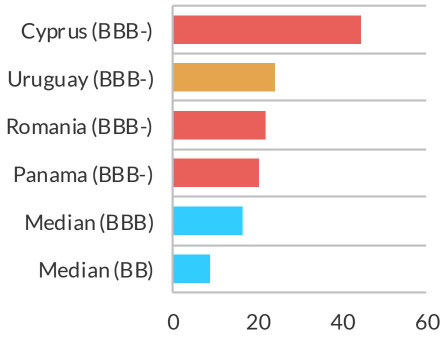


Uruguay — Median (BBB)

International Liquidity Ratio, 2021F
%



GDP Per Capita Income, 2021F
At market exchange rates, USA = 100



Note: Medians based on data for sovereigns in the respective rating category at the end of each year. Latest ratings are used for the current year and forecast period
Source: Fitch Ratings

Financial Data

Uruguay (USDbn)	2021
GDP	58.1
GDP per head (USD, 000)	16.7
Population (m)	3.5
International reserves	17.1
Net external debt (% GDP)	-15.4
Central government total debt (% GDP)	67.1
CG foreign-currency debt	19.0
CG domestically issued debt (UYUbn)	490.7

Source: Fitch Ratings

Rating Factors

Strengths

- Uruguay's governance scores are among the highest in the 'BBB' category and of all emerging markets, reflected in strong social and political stability and a particularly successful vaccination campaign.
- Per capita GDP and human development indicators are above the peer medians.
- High international reserves provide ample coverage of imports, broad money, and short-term external liabilities, buffering the small, open, commodity-dependent economy to shocks.
- A high net external creditor position estimated at 15% of GDP in 2021 reflects strong private-sector balance sheets offsetting a large sovereign external debtor position (16%).
- Strong global market access, precautionary credit lines, and long-dated debt support sovereign financing flexibility in the presence of a relatively shallow, but developing, local capital market.

Weaknesses

- Uruguay's real GDP growth was the lowest among 'BBB' peers in 2015-2019 before the pandemic, (0.8% on average), and its projected performance over the 2020-2022 pandemic shock is fairly weak relative to peers.
- The investment rate has been one of the lowest in the 'BBB' category, and this remains the case in 2020-2021 despite a large pulp project underway, highlighting competitiveness challenges that constrain potential growth.
- Inflation has been the highest in investment-grade space and has regularly exceeded the target range, although the central bank (BCU) aims to improve this.
- High dollarization (77% of deposits, the highest among 'BBB' peers with their own legal tender) and low financial penetration constrain policy flexibility, but macroeconomic risks are mitigated by a sound and highly liquidity banking sector.
- Government debt/GDP of 65% in 2021 is above the peer median and projected to diverge slowly. Interest/revenue is high – even more so considering official data do not capture capitalising interest on inflation-indexed debt paid at maturity – but stable.
- Foreign-currency debt estimated at 33% of GDP in 2021 (51% of the total) is one of the highest among 'BBB' peers, and the highest excluding peers that are dollarised or set to adopt the euro, rendering public finances highly sensitive to exchange-rate movements.

Local-Currency Rating

Uruguay's Long-Term Local-Currency Issuer Default Rating (IDR) is in line with its Long-Term Foreign-Currency IDR. Public finances do not represent a strength relative to external finances, and there is no record of preferential treatment of local-currency creditors.

Country Ceiling

Uruguay's Country Ceiling of 'BBB+' reflects the absence of capital controls or current account restrictions that could lead to transfer/convertibility risks. Vulnerability to external pressures is reduced by increased exchange-rate flexibility, strong bank supervision and high liquidity.

Peer Group

Rating	Country
BBB	Bulgaria
	Croatia
	Hungary
	Indonesia
	Italy
	Kazakhstan
	Peru
	Philippines
	Portugal
	Russia
BBB-	**Uruguay**
	Cyprus
	India
	Mexico
	Panama
	Romania
BB+	Azerbaijan
	Colombia
	Morocco
	North Macedonia
	Paraguay
	San Marino
	Serbia

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
22 Jul 16	BBB–	BBB–
7 Mar 13	BBB–	BBB
14 Jul 11	BB+	BBB–
27 Jul 10	BB	BB+
27 Jul 07	BB–	BB
07 Mar 05	B+	BB–
29 Mar 04	B	B+
17 Jun 03	B–	B
19 May 03	D	B
10 Apr 03	C	CCC–
12 Mar 03	CCC–	CCC–
07 Jan 03	B–	B
30 Jul 02	B	B
28 May 02	B+	BB–
13 Mar 02	BB+	BBB–
19 May 00	BBB–	BBB+
23 Jan 97	BBB–	NR
26 Oct 95	BB+	NR

Strengths and Weaknesses: Comparative Analysis

2021	Uruguay BBB-	BBB median[a]	BB median[a]	Cyprus BBB-	Panama BBB-	Romania BBB-
Structural features						
GDP per capita (USD, mkt exchange rates)	16,673	11,354	5,543	32,171	13,867	15,043
GNI per capita (PPP, USD, latest)	21,630	24,380	14,220	36,840	25,010	31,410
GDP (USDbn)	58.1			27.5	60.8	287.7
Human development index (percentile, latest)	71.2	68.0	52.4	82.9	70.2	74.4
Governance indicator (percentile, latest)[b]	82.1	58.0	44.0	71.0	53.1	59.2
Broad money (% GDP)	56.1	59.7	47.7	196.6	74.8	46.4
Default record (year cured)[c]	2003	-	-	2013	1996	1986
Ease of doing business (percentile, latest)	47.1	70.0	53.3	72.0	55.1	71.5
Trade openness (avg. of CXR + CXP % GDP)	30.3	46.3	46.5	144.4	39.6	42.4
Gross domestic savings (% GDP)	23.0	22.4	18.4	17.3	33.1	20.6
Gross domestic investment (% GDP)	18.3	23.6	22.0	19.5	28.8	26.4
Private credit (% GDP)	26.4	56.4	37.6	100.4	88.5	30.8
Bank systemic risk indicators[d]	bb/1			b/1	bb/1	bb/1
Bank system capital ratio (% assets)	17.0	15.3	16.2	16.5	16.3	23.9
Foreign bank ownership (% assets)	50.9	29.0	35.0	-	47.7	70.8
Public bank ownership (% assets)	49.1	13.5	16.8	-	16.3	10.9
Macroeconomic performance and policies						
Real GDP (5yr average % change)	0.0	3.5	4.0	3.4	1.3	3.7
Volatility of GDP (10yr rolling SD)	3.1	2.9	2.5	5.2	8.1	3.1
Consumer prices (5yr average)	7.8	3.9	5.4	0.6	0.4	3.1
Volatility of CPI (10yr rolling SD)	1.0	2.1	3.1	1.5	2.2	1.9
Unemployment rate (%)	0.0	3.5	4.0	3.4	1.3	3.7
Type of exchange-rate regime	Floating			Free floating (EMU)	No separate legal tender	Crawl-like arrangement
Dollarisation ratio (% of bank deposits)	76.7	17.1	40.4	18.0	100.0	39.0
REER volatility (10yr rolling SD)	3.8	4.9	6.1	2.2	3.9	3.1

Source: Fitch Ratings

Strengths and Weaknesses: Comparative Analysis (Cont.)

2021	Uruguay BBB-	BBB median[a]	BB median[a]	Cyprus BBB-	Panama BBB-	Romania BBB-
Public finances[e]						
Budget balance (% GDP)	-4.0	-2.3	-2.8	-5.0	-7.2	-8.0
Primary balance (% GDP)	-1.7	-0.3	-0.7	-2.7	-4.5	-6.5
Gross debt (% revenue)	240.7	140.2	158.4	263.4	321.0	151.3
Gross debt (% GDP)	65.0	36.1	39.1	104.0	61.9	51.0
Net debt (% GDP)	60.1	30.1	32.6	81.9	38.1	45.4
Foreign-currency debt (% total debt)	51.4	35.2	60.7	0.0	100.0	57.4
Interest payments (% revenue)	8.8	6.9	8.9	5.7	14.2	3.6
Revenues and grants (% GDP)	27.0	30.6	24.7	39.5	19.3	33.7
Volatility of revenue/GDP ratio	1.1	6.1	5.3	3.3	5.4	4.1
Central govt. debt maturities (% GDP)	3.7	4.3	4.9	6.0	2.3	5.9
External finances						
Current account balance + net FDI (% GDP)	2.6	0.6	0.8	7.5	0.4	-3.7
Current account balance (% GDP)	-1.7	-1.8	-2.6	-8.8	0.4	-6.3
Net external debt (% GDP)	-15.4	9.0	10.5	283.4	52.3	20.8
Gross external debt (% CXR)	319.8	116.3	117.2	602.3	450.1	146.4
Gross sovereign external debt (% GXD)	48.8	28.9	43.7	10.1	30.8	49.8
Sovereign net foreign assets (% GDP)	-16.2	2.7	-2.6	-12.7	-38.8	-7.8
Ext. interest service ratio (% CXR)	7.7	4.2	4.0	5.2	11.1	2.8
Ext. debt service ratio (% CXR)	19.3	15.9	15.1	7.6	30.1	18.1
Foreign-exchange reserves (months of CXP)	11.3	5.0	4.3	0.3	4.7	4.8
Liquidity ratio (latest)[f]	288.1	138.7	137.4	52.7	113.0	124.5
Share of currency in global reserves (%)	0	0	0	21	0	0
Commodity export dependence (% CXR, latest)	59.1	20.1	21.7	4.8	5.2	11.2
Sovereign net foreign-currency debt (% GDP)	3.7	-6.7	2.2	-3.4	35.7	14.4

[a] Medians based on actual data since 2000 (excl. forecasts) for all sovereign-year observations where the sovereign was in the respective rating category at year-end. Three-year centred averages are used for the more dynamic variables (e.g. current account and fiscal balance)
[b] Composite of six World Bank Governance Indicators used in the Sovereign Rating Model: Government Effectiveness; Rule of Law; Control of Corruption; Voice and Accountability; Regulatory Quality; and Political Stability and Absence of Violence
[c] Uruguay concluded an exchange offer for all foreign-currency bond debt on 22 May 2003.
[d] Bank systemic indicator, which equates to a weighted average Viability Rating; and macro prudential indicator, with 1 'low' systemic risk through to 3 'high'
[e] General government unless stated
[f] Ratio of liquid external assets, defined as the stock of official FX reserves including gold at the end of the previous calendar year plus banks' liquid external assets, to liquid external liabilities, defined as scheduled external debt service in the current year, plus the stock of short-term external debt and all non-resident holdings of marketable medium- and long-term local-currency debt at the end of the previous calendar year
Note: Acronyms used: Consumer Price Inflation (CPI), Gross Domestic Product (GDP), Current External Receipts (CXR), Current External Payments (CXP), Gross National Income (GNI), Purchasing Power Parity (PPP), Standard Deviation (SD), Foreign Direct Investment (FDI)
Source: Fitch Ratings

Key Credit Developments

Government Retains Strong Support, Faces Referendum Test

The political standing of the Lacalle Pou government remains strong going into 2022, supported by a strong vaccination campaign. As of 22 December 2021, 79% of the population was fully vaccinated, and 43% had received a booster shot, among the world's highest rates. Cases of the pandemic have fallen sharply after a severe outbreak in 2Q21 and remain at moderate levels.

The administration is likely to face greater political challenges and a busier legislative agenda from 2022. It has pledged to submit a social security reform following completion of an independent study commission, and may also take up reforms of labour laws (to address an ILO complaint), the civil service, and education. A major political test will come in March 2022 with a public referendum of the administration's 2020 "urgent consideration law" (LUC).

Derogation of the LUC would not prompt legal changes with major economic repercussions, in Fitch's view, given the law introduced small policy changes rather than major structural reforms. But the referendum is likely to be an important determinant of the administration's political standing for the rest of its term until March 2025. A favourable outcome for the administration could bolster its ability to advance reforms and continue with its conservative macroeconomic policymaking, while an adverse outcome could make this harder. Polling suggests more voters support upholding the LUC than overturning it, but the vote could go either way.

The authorities have sustained conservative policy settings in their budget and wage guidance, but fuel pricing has been an area of difficulty ahead of the referendum. They froze fuel prices in October for a second time in 2021 despite rising global prices, deviating from the rules-based framework based on import parity established in the LUC. The price freezes have weakened state oil refiner ANCAP's cash balance in 2021, but the authorities expect the current freeze to be funded by ANCAP's one-off profits from thermoelectricity sales to drought-stricken Brazil.

Slow but Firming Recovery in Economic Activity

Fitch forecasts Uruguay's economy to grow by 3.4% in 2021 after contracting 5.9% in 2020, better than previously expected given resilience at the height of the pandemic in 2Q21. A small counter-cyclical policy effort and the importance of the still-affected tourism sector have meant a slow recovery relative to peers, but this is firming, led by buoyant exports and investment. Consumption is recovering slowly, in part due to real wage declines, but these have supported the job recovery. Monthly data indicate employment has recovered its pre-crisis levels.

The bulk of the impact from the large UPM pulp mill and related railway project on headline real GDP growth was already felt in 2020 (1pp) when full-year construction began. This should be mildly positive again in 2021, negative in 2022 as construction winds down, and positive again in 2023-2024 as the ramp-up in production offsets the end of construction. Investment beyond the megaproject appears to be firming as well, supported by changes to a tax incentives regime.

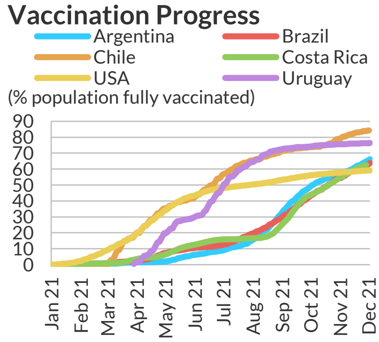
Fitch expects growth to moderate to 2.7% in 2022 and gradually to a 2% pace thereafter as the UPM project finishes, better than the pre-pandemic trend (0.8% on average in 2015-2019) but still low relative to peers. It remains unclear if the authorities can advance a bold reform agenda to tackle key competitiveness issues: slipping education outcomes, a rigid wage framework little reflective of sector- or firm-level productivity, and high fuel prices. Trade opening is a bright spot, on the other hand, as the authorities intend to pursue a trade agreement with top trading partner China. Uruguay's institutional stability in a volatile region could also support its attractiveness as an investment destination despite high production costs.

Cyclical and Structural Fiscal Improvement Underway

Fitch projects the central government deficit (excluding 'cincuentones' pension effects) will fall to 4.5% of GDP in 2021 from 5.8% in 2020, close to its pre-pandemic level of 4.0% in 2019. This reflects a meaningful improvement in the underlying fiscal position net of extraordinary factors: pandemic-related spending of 1.7pp of GDP, extraordinary revenues of 0.7pp (including special dividends of 0.4pp from the state bank and 0.2pp from the electricity company[1]), and capital gains from above-par proceeds of bond re-taps netted from the interest bill (0.3pp).

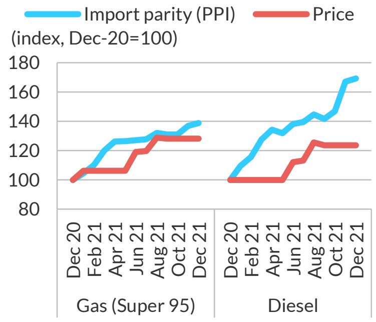
[1] Dividends from state-owned electricity utility UTE to the government are supported by exports to drought-stricken Brazil and liquidation of an energy stabilization fund (0.2% of GDP in 2019).

Vaccination Progress



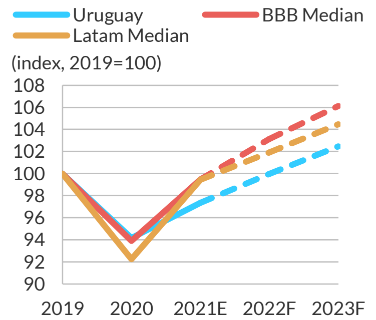
Source: Fitch Ratings, ourworldindata.org

Fuel Prices



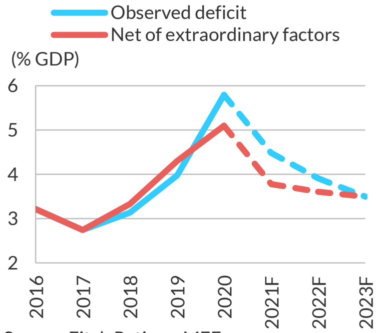
Source: Fitch Ratings, URSEA, ANCAP.

Real GDP Recoveries



Source: Fitch Ratings.

Central Government Deficit



Source: Fitch Ratings, MEF.

The fiscal improvement has been driven by strong revenue growth and well-contained spending growth. Tax collections have widely outperformed real GDP, in part due to booming demand for highly taxed imports. Non-pandemic spending has grown below high inflation, reflecting austerity efforts including a 5% real wage cut for public workers in January 2021.

The phasing-out of most pandemic spending in 2022 should reduce the deficit to 3.9% of GDP. The budget assumes no more pandemic spending (besides vaccination costs) after 2021, but some appears likely based on recent announcements. Permanent spending increases in the budget were kept modest and consisted mainly of higher benefits for early childhood (0.1% of GDP).

Fitch's improved fiscal projections reflect greater confidence in the authorities' spending-focused consolidation plan. High inflation has offered substantial fiscal relief by eroding spending in real terms, and the ex-post pressure it poses on spending via indexation is reduced by conservative wage increases (pension benefits are linked to the IMSN wage index). Private wage increases agreed to in ongoing talks are lagging inflation, and Fitch expects public wages will but cut again in real terms in January 2022. As a result, pensions (via the IMSN) and public wages should fall in real terms in 2022 for a third year. The authorities' efforts to achieve efficiency gains in operating expenditures are contributing some further fiscal savings, but less than expected. Cuts to investment have been deep, but with limited savings given its already low share in spending (4%).

Fiscal consolidation could become more challenging, particularly ahead of 2024 elections. Savings from wage containment could be difficult to sustain for long given the authorities' pledge for a real wage recovery, but this is intended to be very gradual. Tax collections have risen as a share of GDP during the pandemic, but the budget assumes a permanent 0.7pp increase that is uncertain given tax rates have not been raised. The pension system will remain a source of pressure. The social security study commission recommended parametric reforms with a transition period, which would provide fiscal relief on a long horizon, and greater basic pensions that could entail some costs on a shorter horizon. Fitch expects the authorities to submit a pension reform bill in 2022, but it could be difficult to advance if postponed much longer or if the LUC is overturned.

Fitch expects Uruguay to comply with its three new fiscal rules. The structural balance is falling, but subject to estimation difficulties given divergence in real GDP and tax collections (adjusting already strong taxes for a negative output gap could show a big rise in their structural level). A Fiscal Advisory Council was designated in 2021, which should offer greater scrutiny of the calculation. The cap on real primary spending growth of 2.3% will be easily met. A net borrowing cap is the most binding rule, but should be easily met in 2021 after a 30% let-out was invoked.

Improved Debt Dynamics

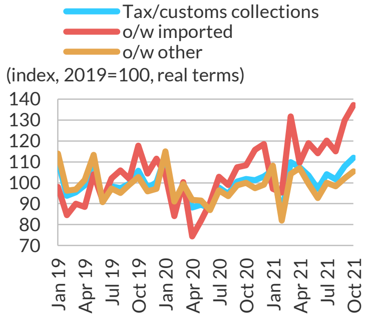
Fitch projects central government debt (the authorities' definition, excluding debt owed to the central bank) will reach 62.4% of GDP in 2021, broadly stable with 61.8% in 2020. Consolidated general government debt is projected to fall to 65.0% of GDP from 66.2%, as this metric also includes recapitalisation bonds issued to the BCU that were partially cancelled in December (1.2pp of the 6.0%-of-GDP total)[2]. A high GDP deflator helped debt dynamics in 2021, given this has been well above inflation and exchange-rate depreciation and therefore helps reduce the stocks of inflation-indexed peso debt and foreign-currency debt in terms of GDP.

General government debt is expected to rise slowly from 65% in the coming years, diverging from the 'BBB' median projected to fall from 60% of GDP. Fitch's projections assume a pace of peso depreciation in line with relative inflation, and they are highly sensitive to any divergence in these variables given the large stock of foreign-currency debt.

Strong access to global markets and multilaterals (including contingent credit lines) have enabled Uruguay to easily meet its higher financing needs during the pandemic. Global bond spreads have fallen below pre-pandemic levels, supported by strong ESG credentials. The local market remains relatively small, representing 24% of central government debt (excluding BCU capitalisation bonds) as of 3Q21, but it has been an increasingly important source of new borrowing, and at lower costs. The average real interest rate across the local curve (CUI index) stands at 1.3%, down from 3.0% pre-pandemic. Fitch expects a portion of this reduction is structural, meaning yields are likely to rise only partially back to their prior levels as monetary policy normalises.

[2] BCU capital of 15 billion UI (inflation-indexed pesos) is above its regulatory minimum of 5 billion UI, or 3.2% of GDP versus 1.0%. It did not improve in 2021 due to a wider quasi-fiscal deficit, so cancelation of the recapitalization bonds will reduce its capital position at end-2021 relative to end-2020.

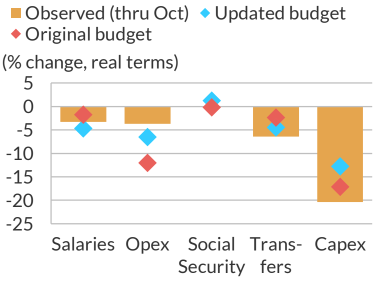
Tax and Customs Receipts



Source: Fitch Ratings, MEF.

Primary Spending Cuts

2021 vs. 2019, ex. COVID spending



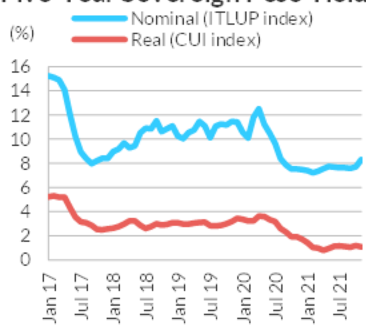
Source: Fitch Ratings, MEF.

Uruguay Debt Metrics (% GDP)

	2014	2019	2020	2021
CG debt (MEF)	37.5	51.6	61.8	62.4
+BCU bonds/loans	9.8	7.1	6.2	4.7
CG debt (Fitch)	**47.3**	**58.8**	**67.9**	**67.0**
+local gov/BPS debt	0.6	0.7	0.6	0.6
–BPS trust fund	-	1.8	2.4	2.6
GG debt (Fitch)	**47.8**	**57.6**	**66.2**	**65.0**
NFPS debt (BCU)	51.1	60.5	68.1	-
Public debt (BCU)	56.5	64.3	74.9	-

Source: Fitch Ratings, MEF, BCU.

Five-Year Sovereign Peso Yield



Source: Fitch Ratings, BEVSA

Lower real borrowing costs are supporting debt dynamics. The net interest burden reported in official data is projected to fall to 2.4% of GDP in 2021 from 2.7% in 2020 due to capital gains on above-par proceeds of bond re-taps. Gross interest (before capital gains) has been broadly stable with its pre-pandemic level of 2.7% of GDP, balancing higher debt and lower effective rates. It is considerably higher when considering interest on inflation-indexed bonds capitalising on principal but not captured in the cash-basis fiscal data (an additional 2pp of GDP at current inflation levels). The interest/revenue ratio of 8.8% in 2021 is above the 'BBB' median of 6.9%, and much more so (18.4%) adjusted for these accounting effects, but stable.

An Uphill Battle to Achieve Disinflation Goals

Consumer price inflation rose to 7.9% yoy in November, diverging from the official target range of 3%-7% after having fallen within the range briefly midyear. The increase in inflation has been driven by global price pressures that Fitch expects to ebb in 2022, but the inertial effects could be greater in Uruguay than elsewhere due to prevalent indexation. Inflation expectations according to analyst surveys and market breakevens have risen slightly farther above the target range, which falls to 3%-6% in September 2022. Fitch expects inflation to moderate from 8.0% at end-2021 to 7.1% by end-2022, and prospects for faster disinflation targeted by the authorities will hinge on global price trends, the exchange rate, and wage dynamics.

Official guidelines for ongoing private-sector wage talks call for conservative nominal increases in 2021-2023 based on ex ante inflation expectations, and include an ex post inflation corrective in June 2023. The government expects these guidelines will support a 1.0%-1.6% recovery of the 4% real wage loss during the pandemic, under its inflation assumptions. But real wage losses could grow further should higher market inflation expectations materialise, until inflation correctives kick in. As a result, many sectors have adopted higher increases and more frequent correctives. This could add inertia and make disinflation an uphill battle in coming years.

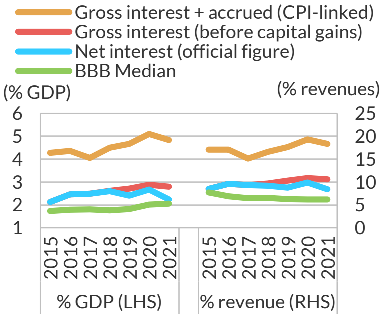
The BCU has lifted its policy rate a cumulative 125bp to 5.75% since August and accelerated the pace of monetary tightening in its most recent meeting. The current policy rate is negative at about -1.25% in ex ante real terms, still well below its estimated neutral real rate of 2%, but even gradual tightening could help contain inflationary pressures by strengthening the exchange rate (the key transmission channel in Uruguay, given high pass-through and shallow financial depth).

Robust External Accounts

Exports and imports have soared in 2021 on both price and volume effects, far surpassing their 2019 levels as of October, and keeping the trade surplus relatively stable. The pandemic and travel restrictions have had a substantial negative impact on net tourism inflows, which Fitch expects to erase the surplus in the services account this year. Fitch projects Uruguay's current account deficit will grow to 1.7% of GDP in 2021, from 0.6% in 2020 and a 1.6% surplus in 2019. The larger current account deficit partly reflects capital imports related to the UPM pulp mill project, and is thus more than fully funded by corresponding FDI inflows.

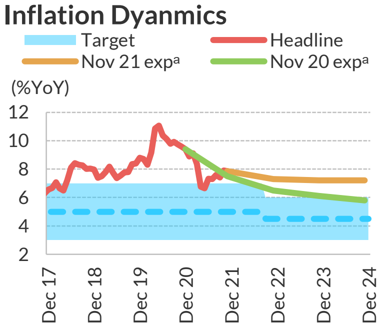
Positive combined current-account and FDI flows, sovereign external borrowing, and the IMF's global SDR issuance (the equivalent of USD590 million for Uruguay) lifted reserves to USD17.3 billion as of late December from USD16.2 billion at the end of 2020. Uruguay's reserves are high in terms of coverage of imports and the money supply, and along with the liquidity of the banking sector support one of the highest external liquidity ratios in the 'BBB' category (nearly 300%).

Government Interest Bill



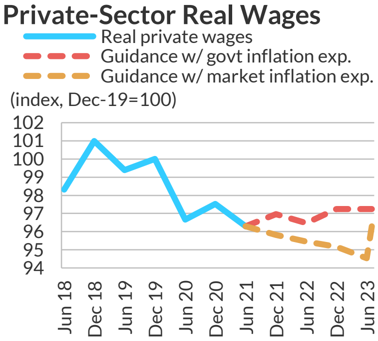
Source: Fitch Ratings, MEF.

Inflation Dynamics



[a] Breakeven expectation in local bond market
Source: Fitch Ratings, BCU, BEVSA.

Private-Sector Real Wages



Source: Fitch Ratings based on Labor Ministry.

Public Debt Dynamics

In Fitch's baseline scenario, gross general government debt (which consolidates bond holdings in the 'cincuentones' pension trust, and includes bonds issued to recapitalise the BCU) will fall to 65.0% of GDP in 2021 from 66.2% in 2020, and resume a slow upward path thereafter. This assumes a gradual economic recovery and improvement in the fiscal position beyond pre-crisis levels (after adjusted for the 'cincuentones' effect), as well as structurally lower peso borrowing costs. The main risks to debt dynamics include lower growth that hinders fiscal consolidation, or a large depreciation of the peso given the particularly large stock of foreign-currency debt.

Fitch uses stylised projections for a sovereign's gross general government debt/GDP ratio to illustrate the sustainability of its debt burden and its sensitivity to economic growth, the cost of borrowing, fiscal policy and the exchange rate.

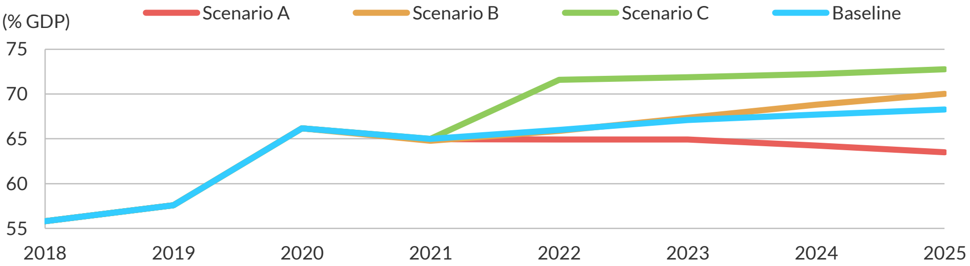
Debt Dynamics: Fitch's Baseline Assumptions

	2019	2020	2021	2022	2023	2024	2025
Gross general government debt (% of GDP)	57.6	66.2	65.0	66.0	67.1	67.7	68.3
Primary balance (% of GDP)	-0.4	-2.4	-1.7	-1.2	-0.8	-0.5	-0.5
Real GDP growth (%)	0.4	-5.9	3.4	2.7	2.5	2.0	2.0
Average nominal effective interest rate (%)[a]	8.0	8.5	7.7	7.0	6.9	6.8	6.7
UYU/USD (annual average)	35.3	42.0	43.8	45.2	47.3	49.4	51.4
GDP deflator (%)	8.5	10.9	9.3	7.2	6.9	7.0	7.0

[a] Includes capitalising interest on debt securities in inflation-indexed (UI) and wage-indexed (UP) peso units
Source: Fitch Ratings

Sensitivity Analysis

Gross general government debt



Source: Fitch Ratings, Fitch Debt Dynamics Model.

Debt Sensitivity Analysis: Fitch's Scenario Assumptions

Scenario A	Achieving of a primary fiscal balance by 2024 and the authorities' higher post-pandemic growth projections (3.1% on average in 2022-2025)
Scenario B	Failure to reduce the primary fiscal deficit below the pre-pandemic 2019 level of 1.5%-of-GDP, slowdown in growth back to pre-pandemic trend of about 1%.
Scenario C	One-off depreciation of the peso of 15% in 2022.

Source: Fitch Ratings

Forecast Summary

	2017	2018	2019	2020	2021F	2022F	2023F
Macroeconomic indicators and policy							
Real GDP growth (%)	1.6	0.5	0.4	-5.9	3.4	2.7	2.5
Unemployment (%)	7.9	8.3	8.9	10.3	9.7	8.5	8.5
Consumer prices (annual average % change)	6.2	7.6	7.9	9.8	7.8	7.7	7.1
Short-term interest rate (bank policy annual avg) (%)	7.4	6.8	8.0	5.1	6.0	8.0	9.0
General government balance (% of GDP)	-2.7	-1.9	-2.8	-5.1	-4.0	-3.8	-3.4
General government debt (% of GDP)	54.0	55.8	57.6	66.2	65.0	66.0	67.1
UYU per USD (annual average)	28.68	30.73	35.26	42.01	43.82	45.21	47.27
Real effective exchange rate (2000 = 100)	101.4	102.9	99.7	95.0	98.1	98.1	98.1
Real private sector credit growth (%)	-4.6	4.8	2.1	1.9	-1.7	-0.2	0.1
External finance							
Current account balance (% of GDP)	0.0	-0.4	1.6	-0.6	-1.7	-1.6	-0.1
Current account balance plus net FDI (% of GDP)	-3.1	-1.1	3.8	1.1	2.6	2.2	1.6
Net external debt (% of GDP)	-15.2	-17.5	-14.8	-15.8	-15.4	-14.6	-15.5
Net external debt (% of CXR)	-51.9	-58.9	-47.4	-57.8	-52.3	-48.5	-48.8
Official international reserves including gold (USDbn)	16.0	15.6	14.5	16.3	17.1	17.1	17.2
Official international reserves (months of CXP cover)	10.2	9.6	9.6	13.0	11.3	10.4	10.0
External interest service (% of CXR)	6.6	7.5	7.3	9.0	7.7	7.4	7.0
Gross external financing requirement (% int. reserves)	18.2	17.2	12.1	17.1	18.5	19.7	11.9
Real GDP growth (%)							
US	2.3	2.9	2.3	-3.4	5.7	3.7	1.9
China	6.9	6.7	6.0	2.3	8.0	4.8	5.3
Eurozone	2.4	1.9	1.3	-6.4	5.0	4.5	2.2
World	3.4	3.2	2.6	-3.3	5.7	4.2	3.0
Oil (USD/barrel)	54.8	71.5	64.1	43.3	71.0	70.0	60.0

Source: Fitch Ratings

Fiscal Accounts Summary

(% of GDP)	2018	2019	2020	2021F	2022F	2023F
General government						
Revenue	**28.2**	**27.5**	**27.0**	**27.0**	**25.9**	**26.0**
Expenditure	**30.2**	**30.3**	**32.1**	**31.0**	**29.7**	**29.4**
O/w interest payments	2.6	2.4	2.7	2.4	2.6	2.5
Primary balance	0.7	-0.4	-2.4	-1.7	-1.2	-0.8
Overall balance	**-1.9**	**-2.8**	**-5.1**	**-4.0**	**-3.8**	**-3.4**
General government debt[a]	**55.8**	**57.6**	**66.2**	**65.0**	**66.0**	**67.1**
% of general government revenue	197.5	209.8	244.7	240.7	254.5	258.1
Central government deposits	5.0	3.8	5.1	4.9	4.7	4.6
Net general government debt	50.7	53.8	61.1	60.1	61.3	62.5
Central government						
Revenue	**20.0**	**19.4**	**19.8**	**20.3**	**19.4**	**19.4**
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	**23.1**	**23.4**	**25.6**	**24.8**	**23.4**	**22.9**
O/w current expenditure and transfers	19.2	19.5	21.5	21.2	19.5	19.1
- Interest	2.6	2.5	2.8	2.5	2.7	2.7
O/w capital expenditure	1.4	1.4	1.3	1.1	1.1	1.1
Current balance	-1.8	-2.6	-4.5	-3.4	-2.8	-2.4
Primary balance	-0.5	-1.5	-3.0	-2.0	-1.2	-0.8
Overall balance	**-3.1**	**-4.0**	**-5.8**	**-4.5**	**-3.9**	**-3.5**
Central government debt	56.1	58.8	67.9	67.1	68.1	69.3
% of central government revenue	280.1	303.0	343.2	330.1	350.3	356.8
Central government debt (UYUbn)	**1,111.1**	**1,268.3**	**1,530.9**	**1,707.6**	**1,910.1**	**2,129.7**
By residency of holder						
Domestic	614.7	660.1	694.4	775.3	880.7	991.3
Foreign	496.4	608.2	836.5	932.3	1,029.4	1,138.4
By currency denomination						
Local currency	597.3	632.8	769.8	865.6	982.1	1,104.5
Foreign currency	513.8	635.5	761.1	842.0	928.0	1,025.1
In USD equivalent (eop exchange rate)	15.9	17.0	18.0	19.0	20.1	21.2
Average maturity (years)	13.8	14.0	13.5	-	-	-
Memo						
Nominal GDP (UYUbn)	1,982.2	2,158.7	2,253.1	2,546.7	2,804.4	3,073.8

Source: Fitch Ratings estimates and forecasts and Ministry of Finance

External Debt and Assets

(USDbn)	2016	2017	2018	2019	2020	2021F
Gross external debt	**41.6**	**44.7**	**44.0**	**48.1**	**52.0**	**54.8**
% of GDP	72.6	69.6	68.2	78.5	97.0	94.2
% of CXR	247.0	238.4	230.1	251.1	355.1	319.8
By maturity						
Medium- and long-term	34.1	37.3	37.1	41.3	45.3	47.9
Short-term	7.4	7.4	6.9	6.8	6.8	6.9
% of total debt	17.9	16.5	15.7	14.1	13.0	12.6
By debtor						
Sovereign	**16.2**	**18.5**	**17.7**	**20.6**	**25.1**	**26.7**
Monetary authorities	0.7	0.8	0.5	0.5	0.8	0.8
General government	15.4	17.6	17.2	20.1	24.3	25.9
O/w central government	13.8	14.5	15.3	16.3	19.8	21.0
Banks	**4.6**	**3.8**	**3.8**	**4.0**	**4.3**	**4.4**
Other sectors	**20.8**	**22.5**	**22.5**	**23.4**	**22.6**	**23.6**
Gross external assets (non-equity)	**51.4**	**54.5**	**55.3**	**57.1**	**60.5**	**63.7**
International reserves, incl. gold	13.5	16.0	15.6	14.5	16.3	17.1
Other sovereign assets nes	0.0	0.0	0.0	0.1	0.2	0.0
Deposit money banks' foreign assets	10.6	9.7	10.0	11.3	13.4	14.5
Other sector foreign assets	27.3	28.8	29.7	31.3	30.7	32.0
Net external debt	**-9.8**	**-9.7**	**-11.3**	**-9.1**	**-8.5**	**-9.0**
% of GDP	-17.2	-15.2	-17.5	-14.8	-15.8	-15.4
Net sovereign external debt	2.7	2.5	2.2	6.0	8.7	9.4
Net bank external debt	-6.1	-5.9	-6.2	-7.3	-9.1	-10.1
Net other external debt	-6.4	-6.4	-7.2	-7.8	-8.1	-8.3
Net international investment position	**-16.1**	**-17.1**	**-15.7**	**-15.9**	**-17.1**	**-16.6**
% of GDP	-28.2	-26.7	-24.4	-26.0	-31.9	-28.6
Sovereign net foreign assets	**-2.7**	**-2.5**	**-2.2**	**-6.0**	**-8.7**	**-9.4**
% of GDP	-4.7	-3.9	-3.4	-9.9	-16.2	-16.2
Debt service (principal & interest)	**2.4**	**3.7**	**3.9**	**4.3**	**3.5**	**3.3**
Debt service (% of CXR)	14.5	19.8	20.4	22.3	23.7	19.3
Interest (% of CXR)	7.4	6.6	7.5	7.3	9.0	7.7
Liquidity ratio (%)	193.6	203.6	221.6	225.3	251.0	288.1
Net sovereign FX debt (% of GDP)	2.5	-2.5	0.8	4.1	3.6	3.7
Memo						
Nominal GDP	57.2	64.2	64.5	61.2	53.6	58.1
Inter-company loans	13.5	14.3	14.5	15.9	15.7	16.7

Source: Fitch Ratings estimates and forecasts and Central Bank, IMF, World Bank

Debt Service Schedule on Medium- and Long-Term Debt at end-September 2021

(USDm)	2021	2022	2023	2024	2025	2026	2027+
Total Amortisation	652	1,922	1,718	1,750	2,315	1,890	25,112
External	134	1,038	657	750	1,174	1,717	21,411
Official multilateral/bilateral	25	215	262	355	368	411	2,465
Bonds	109	823	395	395	805	1,306	18,946
Domestic (bonds)	518	884	1,061	1,001	1,141	173	3,701

Source: Fitch Ratings, Ministry of Finance

Balance of Payments

(USDbn)	2018	2019	2020	2021F	2022F	2023F
Current account balance	**-0.3**	**1.0**	**-0.3**	**-1.0**	**-1.0**	**-0.1**
% of GDP	-0.4	1.6	-0.6	-1.7	-1.6	-0.1
% of CXR	-1.5	5.2	-2.2	-5.9	-5.4	-0.4
Trade balance	**2.3**	**3.1**	**2.0**	**2.1**	**2.1**	**3.2**
Exports, fob	11.6	11.7	9.9	12.5	13.0	14.3
Imports, fob	9.3	8.7	7.8	10.4	10.9	11.1
Services, net	**1.0**	**0.7**	**0.3**	**0.0**	**0.2**	**0.3**
Services, credit	5.5	5.3	3.7	3.4	4.4	5.0
Services, debit	4.5	4.7	3.4	3.4	4.2	4.8
Income, net	**-3.7**	**-3.0**	**-2.9**	**-3.4**	**-3.5**	**-3.8**
Income, credit	1.7	1.6	0.6	0.8	0.8	0.8
Income, debit	5.3	4.6	3.5	4.1	4.3	4.6
O/w: Interest payments	1.4	1.4	1.3	1.3	1.4	1.4
Current transfers, net	**0.1**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Capital and financial accounts						
Non-debt-creating inflows (net)	1.2	-0.9	0.5	1.5	1.1	1.1
O/w equity FDI	1.0	-0.7	0.8	1.5	1.1	1.1
O/w portfolio equity	0.2	-0.3	-0.3	0.0	0.0	0.0
O/w other flows	0.0	-0.4	0.1	0.0	0.0	0.0
Change in reserves	0.4	1.1	-1.6	-0.9	0.0	-0.1
Gross external financing requirement	**2.7**	**1.9**	**2.5**	**3.0**	**3.4**	**2.0**
Stock of international reserves, incl. gold	**15.6**	**14.5**	**16.3**	**17.1**	**17.1**	**17.2**

Source: Fitch Ratings estimates and forecasts and IMF

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