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CREDIT OPINION
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Update

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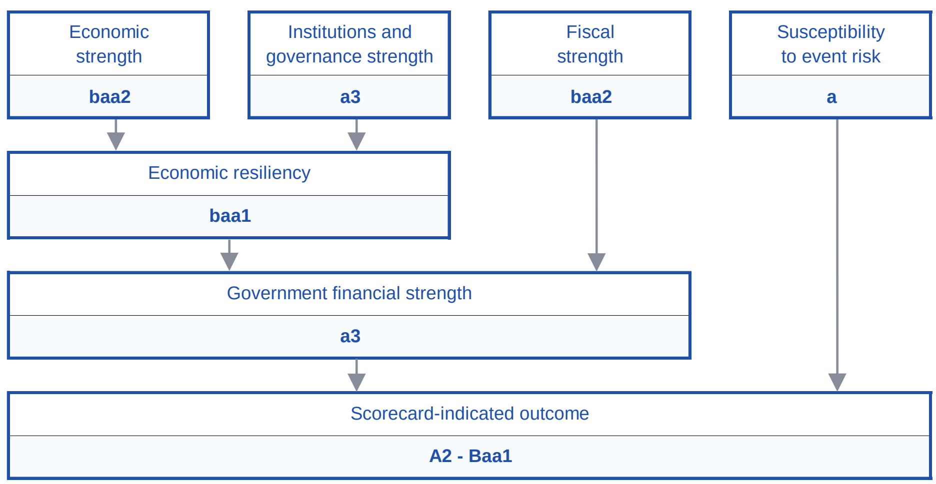
Government of Uruguay – Baa1 stable

Update following upgrade to Baa1, outlook changed to stable from positive

Summary

The credit profile of Uruguay is supported by its robust institutional strength and stronger growth prospects. Economic growth in 2022-24 will outpace the weak growth in 2015-19. Improved fiscal and monetary policy frameworks contribute to sound macroeconomic policies and support the sovereign credit profile. The government is progressing on its reform agenda to address its structural challenges, including relatively low levels of investment and spending rigidities. Compliance with the new fiscal rules will help stabilize the government's debt burden over the next three to five years.

Exhibit 1
Uruguay's credit profile is determined by four factors



Source: Moody's Ratings

Credit strengths

» Strong institutional framework

» Favorable debt maturity profile and moderate government financing needs

» Robust government liquidity buffers

Credit challenges

» Structural rigidities in government spending

» Relatively high, albeit declining, share of foreign-currency denominated debt

» Low investment levels

Rating outlook

The stable outlook incorporates Moody's expectations that recent reforms to fiscal and monetary policy frameworks will be preserved, supporting a longer track record of compliance with fiscal targets and stable debt burden. Sustained higher growth rates and sound fiscal policy implementation balance the risks related to Uruguay's exposure to weather-related shocks that weigh on growth and fiscal outcomes. Downside risks also relate to the possibility of growth returning to previous very low rates on a sustained basis, in particular if, despite recent reforms, investment remains muted.

Factors that could lead to an upgrade

Uruguay's sovereign credit rating could be upgraded if additional structural and fiscal reforms lead to a material drop in debt burden and lower interest burden. A significantly more pronounced improvement in growth performance than currently expected, supported by stronger private investment over an extended period of time, which lead to further economic diversification and economic resilience to shocks would also support an upgrade.

Factors that could lead to a downgrade

The sovereign credit rating could be downgraded if reforms to fiscal and monetary policy frameworks eroded, leading to the emergence of fiscal pressures and a rise in the debt burden. Prospects of a return of persistent low growth rates would also put downward pressure on Uruguay's rating.

Key indicators

Exhibit 2

Uruguay	2018	2019	2020	2021	2022	2023E	2024F	2025F
Real GDP (% change)	0.2	0.7	-6.3	5.3	4.7	0.4	3.5	2.6
Inflation rate (% change average)	7.6	7.9	9.8	7.7	9.1	5.9	5.3	5.8
Gen. gov. financial balance/GDP (%)[1]	-3.1	-3.9	-5.8	-4.1	-3.2	-3.3	-3.0	-2.8
Gen. gov. primary balance/GDP (%)[1]	-0.5	-1.4	-3.0	-1.9	-0.9	-0.8	-0.7	-0.7
Gen. gov. debt/GDP (%)	47.5	50.9	61.7	59.3	55.9	57.4	57.8	58.3
Gen. gov. debt/revenues (%)	177.5	195.4	233.5	234.2	214.9	221.1	229.5	231.5
Gen. gov. interest payment/revenues (%)	9.7	9.5	10.5	8.8	8.8	9.2	9.1	8.6
Current account balance/GDP (%)	-0.5	1.2	-0.8	-2.5	-4.0	-5.1	-4.5	-3.8
External debt/CA receipts (%)[2]	223.4	236.1	315.7	229.9	218.1	218.5	199.9	193.1
External vulnerability indicator (EVI) [3]	107.5	98.8	108.9	97.7	106.1	138.7	135.8	--

[1] Excludes pension transfers and includes interest payments related to the 'cincuentones' law starting in 2018.
[2] Current Account Receipts
[3] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves

Source: Moody's Ratings

Detailed credit considerations

Uruguay's credit quality incorporates our "baa2" **economic strength** assessment on a global basis, above the initial score of "baa3," reflecting its moderate growth potential and relatively high income per capita, counterbalanced by the small size of the economy. At $71 billion in 2022, the Uruguayan economy was smaller than the Baa-rated peer median of around $245 billion. The economy expanded by around 4.7% in real terms in 2022, and we expect real GDP to continue to grow by an average of 3.1% per year in 2024 and 2025. UPM-Kymmene's (Baa1 stable) pulp mill plant project has lifted investment levels from the lows registered in 2019 and earlier, and we expect the government's pro-investment agenda to help maintain the current investment levels.

Our “a3” assessment for Uruguay's **institutions and governance strength** balances the country’s strong institutional framework, which reinforces policy predictability, against its still-evolving capabilities to effectively and credibly implement such policies. The government introduced a new fiscal policy framework in 2020 that features a fiscal rule with structural balance target, limit on current expenditure growth and a ceiling on net debt. The government met all of its fiscal rule targets for four consecutive years (2020-23), establishing a limited but growing track record of strong fiscal management. Building a long track record of compliance under this new framework would help reduce fiscal imbalances, and bolster fiscal policy credibility and effectiveness. The central bank in 2020 revamped its monetary policy framework, including the reintroduction of interest rate as the main monetary policy instrument, and was among the first in the region to start tightening monetary policy in 2021.

Uruguay's “baa2” **fiscal strength** assessment balances its moderately high government debt burden, very strong asset-liability management practices and fiscal reserve assets with lingering vulnerabilities from a high, although improving, proportion of foreign-currency debt. The government's debt burden of 56% in 2022, when measured as a share of GDP, was in line with the Baa-rated peer median, while its interest burden of 8.8% of revenue was above the Baa-rated peer median of 6.6%. Although the government has managed to reduce the share of foreign-currency-denominated debt over the past decade, it remained relatively high at 45.7% as of year-end 2023, down from 52.7% in December 2021. This exposes the overall debt stock to fluctuations from an exchange-rate depreciation, which, in turn, can lead to a deterioration in the debt-to-GDP ratio. This exchange-rate risk is mitigated by the government's financial assets, which are mostly denominated in foreign currency and provide around 9 months of debt service coverage as of year-end 2023.

We assess Uruguay's **susceptibility to event risk** at “a,” driven by banking sector risk, government liquidity risk and external vulnerability risk. The banking sector risk assessment of “a” reflects the system’s relatively large size for a Latin American economy, with domestic bank assets equivalent to 79% of GDP in 2022, and a Baseline Credit Assessment of baa3 for the banks we rate, which informs the risk assessment of potential contingent liabilities on the government’s balance sheet.

Uruguay's external vulnerability risk assessment of “a” reflects its large external buffers that mitigate the exchange-rate risks stemming from the country's still-significant degree of financial dollarization. The current account deficit expanded to 4.0% of GDP in 2022 from 2.5% in 2021 because of growth in imports of metals and capital goods linked to major investment and infrastructure projects.

Uruguay's government liquidity risk assessment of “a” balances the government's relatively low gross borrowing requirements — favored by a long maturity profile — against a relatively high share of external debt in total government debt.

The country's political risk assessment is “aa.” The risk of political events compromising the economic, institutional or fiscal features of Uruguay's credit profile is very low.

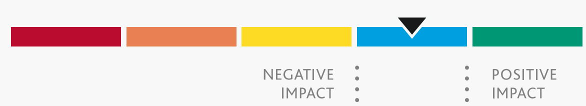
ESG considerations

Uruguay's ESG credit impact score is CIS-2

Exhibit 3

ESG credit impact score

CIS-2

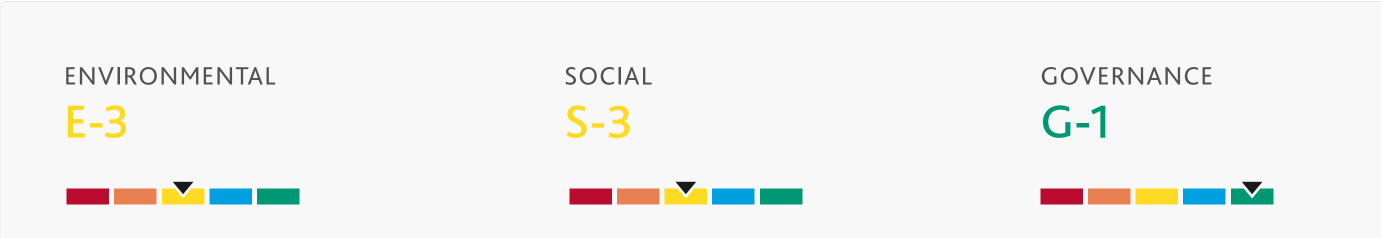


ESG considerations do not have a material impact on the current rating.

Source: Moody’s Ratings

Uruguay's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting its exposure to social risks, exposure to environmental risks and broad societal consensus that supports its governance.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Uruguay's exposure to environmental risks (**E-3** issuer profile score) reflects exposure to physical climate risk, specifically excessive rains or droughts, which affects the agricultural sector and water supply.

Social

Exposure to social risks (**S-3** issuer profile score) is related to the country's aging population and its potential impact on the country's welfare system and public finances, and potential growth, although the recent pension reforms mitigates these risks. A deterioration in the labor market, for the younger population in particular, also poses social risks. However, adequate provision of social services and a mature political system that develops policies based on consensus help mitigate social risks.

Governance

The influence of governance on Uruguay's credit profile is positive (**G-1** issuer profile score). The country has a long history of strong institutions and consensus-based policy-making tradition that leads to durable policy decisions and supports social cohesion.

All of these considerations are further discussed in the “Detailed credit considerations” section above. Our approach to ESG is explained in our report on how the scores depict varied and largely credit-negative impact of ESG factors and our cross-sector methodology General Principles for Assessing Environmental, Social and Governance Risks Methodology.

Recent developments

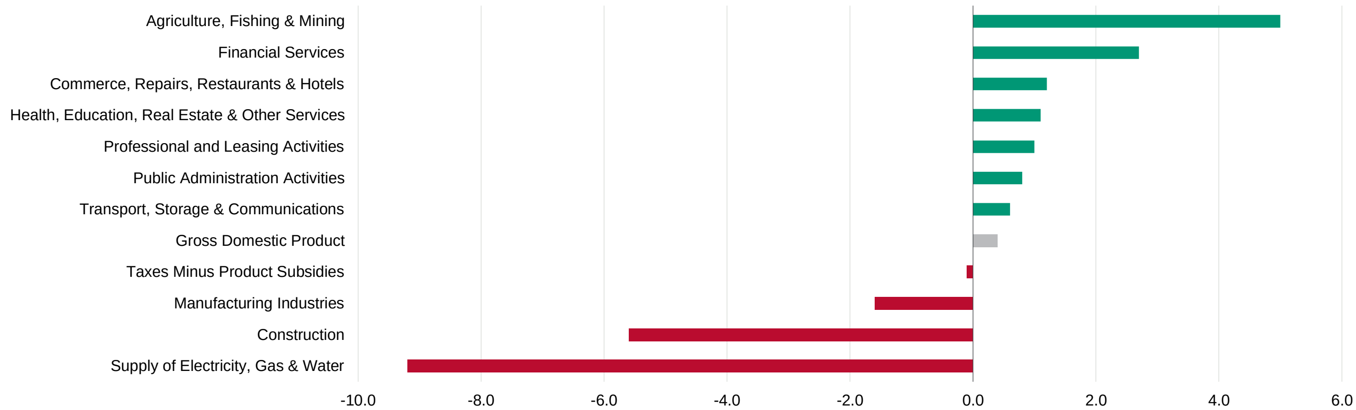
GDP results indicate economic growth slowed to 0.4% in 2023

GDP data for 2023 showed the slowdown of economic activity as growth increased 0.4%. The result was driven by growth from the summer 2023 tourism season, the start-up of the third pulp mill and improvement in agricultural yields after drought conditions subsided but was brought down by negative electricity generation and construction, as well as the closing of an oil refinery in September 2023. This is reflected in the central bank's GDP report that shows growth was impulsed by the agriculture, fishing and mining sector that expanded 5.0% year-on-year, followed by financial services at 2.7% and hindered by the supply of electricity, gas and water sector contracting year-on-year by 9.2% followed by the construction sector at 5.6% (see Exhibit 5).

Exhibit 5

The agriculture, fishing and mining sector recovered strongly after drought conditions subsided

Year-on-year change in economic activity by sector (in percentage terms)



Sources: Central Bank of Uruguay and Haver Analytics

We expect economic growth of around 3.5% for 2024 as the agricultural and tourism industries recover. There is also our expectation of strong investment moving forward as the Commission for the Application of the Investment Law (COMAP) provides tax incentives to investors. Furthermore, there could be another large investment project on the horizon as the Government of Uruguay signed a memorandum of understanding (MOU) with the company HIF. It is still early stages, but the proposed project is for the building of a green hydrogen plant in the department (province) of Paysandú, a potential investment of US$6 billion (about 1.5x the size of the previous largest investment in the country's history) and potential generation of as many as 3,000 jobs.

Uruguay meets its fiscal rule targets for fourth consecutive year

On 29 February, the independent Fiscal Advisory Council (FAC) in Uruguay, which provides methodological validation for the government's fiscal framework, verified compliance with the fiscal rule in 2023, marking the fourth consecutive year of meeting its fiscal targets.

The government met targets for all three pillars of the fiscal rule: the structural deficit was 2.7% of GDP, in line with the 2.7% target; real primary spending growth was -0.4%, below the 2.1% limit; and net indebtedness was $2.4 billion, below the $2.9 billion target. Due to drought conditions a national emergency was called by the Lacalle Pou administration, activating the legal escape clause and increasing the target in the third pillar to $2.9 billion from $2.2 billion originally laid out at the beginning of the year. Meeting the targets for the fourth consecutive year demonstrates the current administration's commitment to fiscal consolidation and building a track record of compliance with the new fiscal framework.

Additionally, the Ministry of Economy and Finance (MEF) reported the fiscal deficit remained broadly stable at 3.3% of GDP in 2023 (see Exhibit 6) despite the drought conditions that was deemed a national emergency. The level deficit in 2023 reflects government efforts to restrain expenditures in line with decreased revenues because of the drought, which both fell by 0.5% of GDP, respectively.

Exhibit 6

Breakdown of central government fiscal revenue and expenditure (2022-23)
(% of GDP)

	2022	2023	Difference 2023 vs 2022
Revenue	**26.1**	**25.6**	**-0.5**
Central Government	19.3	18.7	-0.6
Social Welfare Bank (BPS)	6.8	6.9	0.1
Expenditure	**26.9**	**26.4**	**-0.5**
Central Government	25.4	25.3	-0.1
Investments	1.6	1.1	-0.4
Primary Balance	**-0.8**	**-0.8**	**0.0**
Interest Payments	2.2	2.2	0.1
Fiscal Balance*	**-3.2**	**-3.2**	**0.1**

*Excluding income from the Social Security Trust (FSS)

Any discrepancies in the data is due to rounding
Source: Ministry of Economy and Finance

For 2024 the MEF set targets for a structural deficit of 2.9% of GDP; real primary spending limit of 2.8%; and maximum net indebtedness of $2.3 billion. These fiscal rule targets are stable compared to the 2023 results, with exception of the real increase in primary spending that was increased slightly given the robust growth forecast. We expect the current 2024 targets will lead to a slight decrease in the fiscal deficit and a slight increase in the debt-to-GDP in 2024, at around 2.8% of GDP and around 58%, respectively.

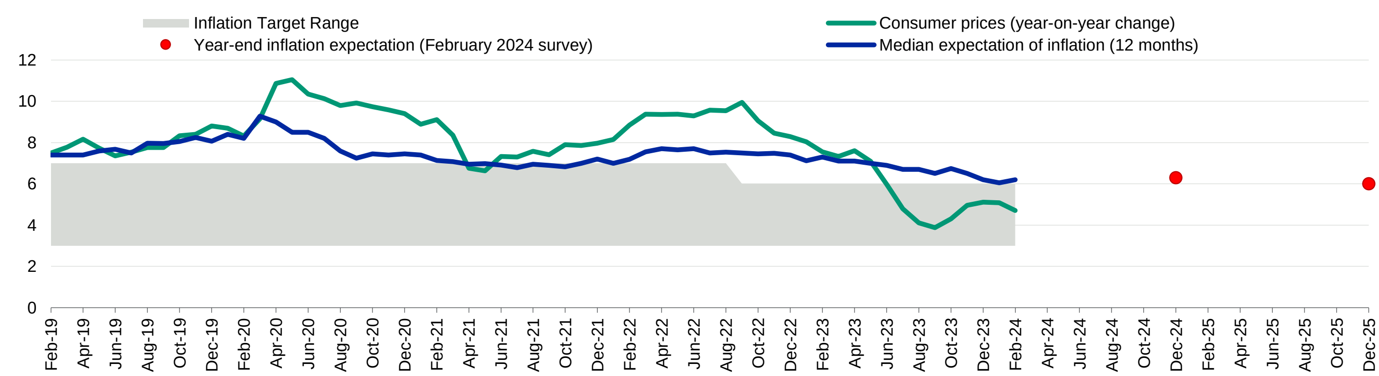
Still, there are risks to fiscal performance in the coming years, including a new administration that will take office next year. Despite the transition we expect the government to remain committed to fiscal consolidation and maintain broad compliance with the fiscal framework.

The central bank pauses its easing cycle in latest Monetary Policy Committee decision

The Monetary Policy Committee (COPOM) maintained its policy rate at 9% in February 2024, pausing its easing cycle that led to 250 basis points of cuts in 2023. As of February 2024, year-over-year inflation in Uruguay was 4.7%, down from 5.1% in January (see Exhibit 7). It also marked nine consecutive months of inflation remaining within the central bank's target range of 3%-6%. We expect inflation to end 2024 under 6%, slightly below inflation expectations in the central bank's survey that put it above the top of the target range at 6.3% for the 2024 calendar year.

Exhibit 7

Uruguay's policymakers are committed to keeping inflation within target range
In percentage terms



Sources: Central Bank of Uruguay, Ministry of Finance and Moody's Ratings

Moody's rating methodology and scorecard factors: Uruguay - Baa1 stable

Factor / Sub-Factor	Metric	Indicator Year	Indicator	Initial Factor Score	Final Factor Score	Weights
Factor 1: Economic strength				**baa3**	**baa2**	**50%**
Growth dynamics	Average real GDP growth (%)	2018-2027F	1.6	b1		25%
	MAD Volatility in Real GDP Growth (%)	2013-2022	1.7	ba2		10%
Scale of the economy	Nominal GDP ($ billion)	2022	71.2	ba1		30%
National income	GDP per capita (PPP, Intl$)	2022	27,769.8	a1		35%
Adjustment to factor 1	*# notches*				1	max ±9
Factor 2: Institutions and governance strength				**a3**	**a3**	**50%**
Quality of institutions	Quality of legislative and executive institutions			a		20%
	Strength of civil society and the judiciary			aa		20%
Policy effectiveness	Fiscal policy effectiveness			baa		30%
	Monetary and macroeconomic policy effectiveness			baa		30%
Specified adjustment	Government default history and track record of arrears				0	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				**baa1**	**baa1**	
Factor 3: Fiscal strength				**baa2**	**baa2**	
Debt burden	General government debt/GDP (%)	2022	55.9	baa2		25%
	General government debt/revenue (%)	2022	214.9	baa1		25%
Debt affordability	General government interest payments/revenue (%)	2022	8.8	a2		25%
	General government interest payments/GDP (%)	2022	2.3	a3		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-2	-2	max ±6
	Debt Trend - Historical Change in Debt Burden	2014-2022	19.2	0	0	
	Debt Trend - Expected Change in Debt Burden	2022-2024F	2.0	0	0	
	General Government Foreign Currency Debt/ GDP	2022	26.5	-2	-2	
	Other non-financial public sector debt/GDP	2022	2.5	0	0	
	Government Financial Assets including Sovereign Wealth Funds / GDP	2022	2.4	0	0	
Other adjustment to factor 3	*# notches*				0	max ±3
F1 x F2 x F3: Government financial strength				**a3**	**a3**	
Factor 4: Susceptibility to event risk				**a**	**a**	Min
Political risk				aa		
	Domestic political risk and geopolitical risk			aa		
Government liquidity risk				a	a	
	Ease of access to funding			a		
Specified adjustment	High refinancing risk				0	max -2
Banking sector risk				a	a	
	Risk of banking sector credit event (BSCE)	Latest available	baa3	baa3		
	Total domestic bank assets/GDP	2022	67.1	<80		
Adjustment to F4 BSR	*# notches*				0	max ±2
External vulnerability risk				a	a	
	External vulnerability risk			a		
Adjustment to F4 EVR	*# notches*				0	max ±2
Overall adjustment to F4	*# notches*				0	max -2
F1 x F2 x F3 x F4: Scorecard-indicated outcome				**A2 - Baa1**	**A2 - Baa1**	

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the scorecard-indicated outcome. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the scorecard-indicated outcome. For more information please see our Sovereign Ratings Methodology.

Footnotes: (1) Initial factor score: scorecard indicators combine with the automatic adjustments to produce an initial factor score for every rating factor, as detailed in Moody's Sovereign Ratings Methodology. **(2) Final factor score:** where additional analytical considerations exist, initial factor scores are augmented to produce a final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Ratings Methodology; details on country-specific considerations are provided in Moody's research. **(3) Scorecard-indicated outcome:** Factor 1: Economic Strength, and Factor 2: Institutions and Governance Strength, combine with equal weight into a construct we designate as Economic Resiliency (ER). An aggregation function then combines ER and Factor 3: Fiscal Strength, following a non-linear pattern where Fiscal Strength has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's Susceptibility to Event Risk, is a constraint which can only lower the government financial strength as given by combining the first three factors. **(4) There are 20 ranking categories for quantitative sub-factors:** aaa, aa1, aa2, aa3, a1, a2, a3, baa1, baa2, baa3, ba1, ba2, ba3, b1, b2, b3, caa1, caa2, caa3, ca and 8 ranking categories for qualitative sub-factors: aaa, aa, a, baa, ba, b, caa, ca **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

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