S&P Global
Ratings

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Research Update:

Uruguay Outlook Revised To Stable From Negative On More Balanced Economic Risks; 'BBB/A-2' Ratings Affirmed

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Overview

- Despite difficult economic conditions, Uruguay demonstrated resilience and real GDP expanded 1.5% in 2016. Economic prospects for 2017 and 2018 are favorable.
- Continuity of fiscal consolidation measures will pave the way for lowering the fiscal deficit gradually in line with the government's five-year budget.
- We are revising our outlook on Uruguay to stable from negative and affirming our 'BBB/A-2' foreign and local currency sovereign credit ratings.
- The stable outlook reflects our view that better economic prospects will balance the risks of adverse shocks and our expectation that the government will implement timely corrective policies to stay on the path of fiscal consolidation.

Rating Action

On May 30, 2017, S&P Global Ratings revised its outlook on the Oriental Republic of Uruguay to stable from negative. At the same time, we affirmed our 'BBB' long-term foreign and local currency sovereign credit ratings. In addition, we affirmed our 'A-2' short-term foreign and local currency ratings.

The transfer and convertibility assessment is unchanged at 'A-'.

Rationale

The stable outlook reflects our expectation of a gradual strengthening of the Uruguayan economy, which will support the country's income levels, revenue base, fiscal and monetary policy flexibility, and capacity to absorb debt. Since our last rating action on June 6, 2016, the economy has shown further resilience in the face of Argentina and Brazil's recession--with real GDP growth of 1.5% in 2016--while inflation has been contained after reaching double digits last year. The government has also shown commitment to achieving its fiscal deficit target by 2019, which will reduce the general government deficit and contain changes in general government debt. We believe that these developments have lessened the likelihood of a deterioration in Uruguay's creditworthiness over the next two years.

Uruguay has been growing consistently over the past 14 years. In 2016, GDP

grew 1.5%, following a deceleration to 0.4% in 2015; we estimate GDP per capita around US$19,300 between 2017-2020. The real GDP per capita growth rate should average 2% over the next three years.

Its relatively diverse structure has somewhat insulated Uruguay from the regional economic downturn and prevented contraction. The main sectors of the economy are the manufacturing sector (12.7% of GDP in 2016); the commerce, restaurants, and hotel sector (13%); the construction sector (9.5%); and the primary sector (6.5%). Transport and communications and energy propelled growth in 2016, led by the greater proportion of electricity generated from renewable resources. We expect real GDP growth to be 2% and 2.5% in 2017 and 2018, respectively, supported by the gradual recovery of neighboring sovereigns, lower inflation levels, and projected infrastructure projects estimated by the government at around US$12 billion.

We expect Uruguay's gradual fiscal strategy to bring the general government deficit to 4.8% of GDP in 2017 and 4% in 2018. The general government deficit increased to nearly 5.4% in 2016 because of one-off expenses to settle debts owed by public-sector companies (unlike the government's definition of the public sector, our definition of general government includes the central bank and excludes public-sector enterprises). In 2016, the government approved measures to raise revenues and cut spending, including increases on personal income tax from labor and capital gains; cut some central government expenses; restricted the hiring of new public servants; and postponed some spending projects. In addition, the government has imposed greater discipline on public-sector enterprises, leading to a surplus in public-sector enterprise balances in the year. We expect them to run small surpluses.

We expect the upcoming yearly budget revision this year to continue to apply constraints, given still uncertain macroeconomic conditions. We expect the public-sector deficit to converge toward the government's target of 2.5% of GDP by 2020.

In 2016, the change in general government debt was around 3% of GDP because of a more appreciated Uruguayan peso, since roughly 50% of Uruguay's debt is denominated in foreign currency. In 2017, we expect the change in general government debt to be around 5.3% of GDP as a result of an expected 4.8% general government deficit, moderate foreign currency depreciation, and relatively high inflation. As the government seeks to develop its still narrow and shallow domestic capital markets, we expect its exposure to foreign currency to gradually decline, though it should still remain over 40%. A steadily growing share of local currency-denominated debt would reduce the government's vulnerability to adverse exchange-rate movements. Changes in general government debt should be contained at levels close to 4% of GDP between 2018 and 2020 as the general government deficit gradually narrows.

Uruguay's debt burden remains moderate, and financing risks are low. We project that net general government debt over GDP (which includes central bank debt issued for open-market operations) will increase to 52% of GDP in 2017, from 50.3% in 2016. By 2020, we expect net general government debt to

stabilize at 50% of GDP because of a combination of moderate fiscal consolidation and GDP growth. We also expect general government interest payments to average 6% of general government revenues between 2017 and 2020. The projections are subject to volatility resulting from sharp movements in the exchange rate as about 55% of the central government's debt is denominated in foreign currency.

In our opinion, effective debt management has significantly reduced the risks of Uruguay's debt profile: The average maturity of the central government's debt has continued to increase and now reaches about 14 years, from eight years in 2005; about 94% of the debt is at a fixed rate, compared with 78% 11 years ago; and bonds compose 91% of central government debt, while 9% are loans. External market debt accounts for 74% of debt, while local market debt is about 26%. As of March 2017, the central government faces US$1.7 billion in debt service in 2017 (US$741 million in amortizations and US$1,022 million in interest payments), equivalent to about 3% of GDP, increasing to 5.2% of GDP in 2018.

Although in recent years Uruguay managed to diversify its economic partners and reduce its dependence on Brazil and Argentina, the latter still plays an important role when it comes to Uruguay's service exports. Expenditures made by Argentine visitors represent over 60% of total tourist expenditures in Uruguay in 2016, while foreign direct investment (FDI) flows from Argentina represent over 28% of total FDI. The tourism sector represented around 15% of current account receipts (CAR) in 2016. The current account deficit (CAD) narrowed to 0.2% of GDP because of a stronger services balance, including not only tourism but other types of global services, which have remained at around 7% of CAR in the past three years. The trade balance improved to a surplus of 0.7% of GDP in 2016, up from a deficit of 0.5% of GDP in 2015. Although export levels were lower in 2016 than in previous years, this was accompanied by declining volume of imports and lower oil prices.

Our base case assumes that the CAD will remain relatively stable in 2017, at 0.3% of GDP, and will decline to a deficit of 1.6% of GDP by 2020. Our scenario incorporates the likely pickup of FDI starting in 2019 because of large infrastructure projects that the government is pursuing. Gross external financial needs should remain at around 97% of CAR plus usable reserves in 2017 and continue to grow to roughly 100% over the next three years. We expect FDI to average 1.7% of GDP between 2017 and 2020, exceeding the projected CAD. We expect Uruguay to continue financing half of its central government deficit abroad, and thus narrow net external debt should be around 8% of CAR in 2017. Given Uruguay's narrow and shallow domestic capital markets, the sovereign depends on external debt.

At the same time, the central government's liquid external assets and contingent funding lines help to limit external liquidity risks. Liquidity buffers include the central government's liquid assets (estimated at around 5% of GDP in 2016) and the Energy Stabilization Fund (fund assets reached around US$300 million as of December 2016). Additionally, Uruguay continues to have contingent credit lines. These lines are worth close to 4% of GDP and include

lines from the Inter-American Development Bank (US$800 million), World Bank (US$520 million), Fondo Latinoamericano de Reservas (US$600 million), and Corporación Andina de Fomento (US$500 million). Moreover, we believe that Uruguay could quickly qualify for the International Monetary Fund's flexible credit line facility.

Uruguay's financial sector has shown resilience in 2016 along with the overall economy. The system remained healthy despite deposit withdrawals following the implementation of Argentina's Tax Amnesty, which concluded in March 2017; the approval of the fiscal transparency law in Uruguay in 2016; and the appreciation of the Uruguayan peso, as deposits fell 0.7% in 2016 and 0.9% as of April 2017. The Uruguayan banking system exposure to nonresident deposits has been constantly dropping and accounted for 11% of total deposits in 2016 and 15% in 2015, from 42% in 2002.

We believe that relatively high inflation and still high dollarization continue to limit Uruguay's monetary policy flexibility, since over 50% of resident loans are denominated in dollars, while more than 60% of resident deposits are denominated in dollars. In 2016, average yearly inflation was higher than in previous years, and it is still above the central bank's 3%-7% target, though year-end inflation was 8.1% in 2016--lower than 9.4% in 2015. The rise in inflation reflected a combination of the pass-through effect of significant currency depreciation and a hike in utility tariffs. Nevertheless, inflation in 2017 is likely to average close to the upper end of the central bank target.

We expect inflation to decline and remain within the central bank target range over the next three years. The recent wage agreements should reduce inflation inertia as they now stipulate nominal wage increases that vary with sectoral growth rather than inflation. The more dynamic sectors get higher nominal wage increases, versus less dynamic ones.

The broad political consensus on the need for fiscal consolidation reflects Uruguay's stable and well-established institutions that anchor economic stability. We expect that the Administration of President Tabaré Vazquez of the Frente Amplio, a coalition of parties from the moderate to the extreme left, will continue to implement policies to facilitate growth. The speed of this progress may be slower than we originally expected, in particular as the government no longer holds a majority at the Lower House, thus forcing the government to negotiate with opposition parties. Uruguay's political system is characterized by strong checks and balances, and continuity in key economic policies despite changes in government. Uruguay ranks low in perception of corruption and high with respect to the rule of law. Uruguay has greater social cohesion than most Latin American countries thanks to its large middle class and levels of social development.

Outlook

The stable outlook reflects our view of a strengthening economy, with a continued moderate level of growth, along with a gradual fiscal consolidation. We also expect continuity in key economic policies over the coming three to four years. We expect the government to continue developing local capital markets and gradually reduce its vulnerability to external shocks.

We could lower the ratings on Uruguay over the next two years if a combination of inadequate fiscal policy and lower-than-expected GDP growth results in a higher increase in general government debt annually than we currently envision. Failure to progress in developing domestic capital markets as well as contain inflation within the central bank target would make the government's debt vulnerable to large to movements in the exchange rate.

Conversely, we could raise the ratings in the coming two years if the government is able to increase the flexibility and effectiveness of monetary policy, combined with greater fiscal consolidation. Further reductions in inflation along with deeper local capital markets could decrease the level of dollarization and reduce the government's vulnerability to sudden changes.

Key Statistics

Table 1

Republic of Uruguay--Selected Indicators											
	2010	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017f**	**2018f**	**2019f**	**2020f**
ECONOMIC INDICATORS (%)											
Nominal GDP (bil. LC)	808.08	926.36	1,041.21	1,178.33	1,330.51	1,455.85	1,581.12	1,730.47	1,901.44	2,089.47	2,285.11
Nominal GDP (bil. $)	40.28	47.96	51.26	57.53	57.24	53.27	52.42	59.67	63.38	68.51	74.92
GDP per capita (000s $)	12.0	14.2	15.2	17.0	16.8	15.6	15.3	17.4	18.4	19.8	21.6
Real GDP growth	7.8	5.2	3.5	4.6	3.2	0.4	1.5	2.0	2.5	2.7	2.4
Real GDP per capita growth	7.4	4.8	3.2	4.3	2.9	0.0	1.1	1.7	2.2	2.4	2.1
Real investment growth	16.0	7.0	18.2	3.8	2.4	(9.2)	0.9	1.9	2.6	2.9	3.5
Investment/GDP	19.4	20.9	22.9	22.5	21.2	19.7	18.7	18.9	18.9	18.9	19.0
Savings/GDP	17.6	18.1	17.9	17.5	16.7	17.5	18.5	18.7	18.4	17.7	17.4
Exports/GDP	26.3	26.4	25.9	23.4	23.5	22.5	21.4	21.4	21.4	21.4	21.4
Real exports growth	7.2	5.8	3.6	(0.1)	3.5	(0.6)	(1.4)	2.0	2.5	3.0	3.0
Unemployment rate	7.2	6.3	6.5	6.5	6.6	7.5	8.1	7.5	7.2	7.0	6.8

Table 1

Republic of Uruguay--Selected Indicators (cont.)											
EXTERNAL INDICATORS (%)											
Current account balance/GDP	(1.8)	(2.7)	(5.1)	(5.0)	(4.5)	(2.2)	(0.2)	(0.3)	(0.6)	(1.2)	(1.6)
Current account balance/CARs	(6.4)	(9.6)	(18.4)	(20.2)	(18.2)	(9.1)	(1.0)	(1.2)	(2.7)	(5.6)	(7.2)
CARs/GDP	28.2	28.4	27.4	24.7	24.7	23.8	22.7	21.6	21.9	22.1	22.4
Trade balance/GDP	(1.3)	(3.0)	(4.6)	(2.4)	(1.6)	(0.5)	0.7	0.5	0.1	(0.6)	(1.1)
Net FDI/GDP	5.8	5.2	5.0	5.3	3.8	2.4	1.8	1.7	1.7	1.7	1.8
Net portfolio equity inflow/GDP	(0.0)	0.0	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Gross external financing needs/CARs plus usable reserves	108.4	105.8	99.4	98.4	96.6	93.4	98.4	97.4	98.2	99.2	100.3
Narrow net external debt/CARs	8.6	(2.8)	8.1	5.3	3.7	5.3	8.4	8.3	9.4	12.6	10.6
Net external liabilities/CARs	29.2	40.7	59.4	68.1	79.7	90.8	86.2	81.7	79.1	78.4	77.0
Short-term external debt by remaining maturity/CARs	49.0	40.6	33.8	41.0	47.9	56.3	59.6	48.0	44.9	41.5	37.7
Usable reserves/CAPs (months)	4.9	4.6	5.4	6.4	7.3	8.5	7.5	6.3	5.9	5.5	5.0
Usable reserves (mil. $)	5,722	7,469	9,060	10,172	9,756	7,508	6,852	6,988	7,322	7,473	7,534
FISCAL INDICATORS (%, General government)											
Balance/GDP	(1.3)	(0.7)	(2.1)	(1.8)	(3.0)	(4.2)	(5.4)	(4.8)	(4.0)	(3.6)	(3.2)
Change in debt/GDP	3.9	5.1	5.7	8.9	7.0	8.3	2.9	5.3	4.3	4.1	3.6
Primary balance/GDP	1.6	2.1	0.5	0.9	(0.2)	(0.7)	(2.1)	(2.7)	(1.2)	(1.3)	(1.2)
Revenue/GDP	36.6	36.8	36.6	38.0	37.5	37.0	38.0	38.1	38.2	38.3	38.1
Expenditures/GDP	37.9	37.5	38.6	39.8	40.5	41.2	43.4	42.9	42.3	41.9	41.3
Interest /revenues	8.1	7.7	6.9	7.1	7.6	9.6	8.7	5.5	7.3	6.2	5.4
Debt/GDP	55.4	53.5	53.3	56.0	56.6	60.0	58.2	58.4	57.5	56.4	55.2
Debt/Revenue	151.6	145.4	145.5	147.1	150.9	162.4	153.1	153.2	150.4	147.5	145.1
Net debt/GDP	49.5	45.3	45.6	49.7	49.0	50.5	50.3	52.1	51.5	50.7	49.9
Liquid assets/GDP	5.9	8.2	7.7	6.2	7.6	9.6	7.9	6.3	6.0	5.7	5.3
MONETARY INDICATORS (%)											
CPI growth	6.7	8.1	8.1	8.6	8.9	8.7	9.6	7.3	7.2	7.0	6.8
GDP deflator growth	4.9	9.0	8.6	8.2	9.4	9.0	7.0	7.3	7.2	7.0	6.8
Exchange rate, year-end (LC/$)	20.1	19.9	19.4	21.4	24.3	29.9	29.3	30.0	30.5	30.5	30.5
Banks' claims on resident non-gov't sector growth	20.8	18.9	15.0	24.9	18.0	22.4	1.2	11.5	9.3	7.2	7.2

Table 1

Republic of Uruguay--Selected Indicators (cont.)											
Banks' claims on resident non-gov't sector/GDP	22.8	23.6	24.2	26.7	27.9	31.2	29.1	29.6	29.5	28.7	28.2
Foreign currency share of residents' bank deposits	95.3	86.0	86.4	93.1	92.2	96.8	110.1	110.1	110.1	110.1	110.1
Real effective exchange rate growth	11.9	2.0	3.1	6.6	(1.7)	3.8	10.9	N/A	N/A	N/A	N/A

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. Banks are other depository 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. f--Forecast. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

Ratings Score Snapshot

Table 2

Republic of Uruguay--Ratings Score Snapshot	
Key rating factors	
Institutional assessment	Neutral
Economic assessment	Neutral
External assessment	Neutral
Fiscal assessment: flexibility and performance	Neutral
Fiscal assessment: debt burden	Neutral
Monetary assessment	Weakness

S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014 , summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments.

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 23, 2014
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Sovereign Ratings History, May 5, 2017
- Banking Industry Country Risk Assessment Update: May 2017, May 5, 2017
- 2016 Sovereign Ratings Update: Outlook and CreditWatch Resolutions, April 18, 2017
- Global Sovereign Rating Trends: First-Quarter 2017, April 10, 2017
- 2016 Annual Sovereign Default Study and Rating Transitions, April 3, 2017
- Sovereign Risk Indicators, found at www.spratings.com/sri
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion, Feb. 23, 2017
- Banking Industry Country Risk Assessment: Uruguay, July 19, 2016
- Research Update: Uruguay Outlook Revised To Negative On Risks Of A Weaker Economy; 'BBB/A-2' Ratings Affirmed, July 12, 2016

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that the key rating factors were unchanged.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Uruguay (Oriental Republic of)		
Sovereign Credit Rating	BBB/Stable/A-2	BBB/Negative/A-2

Ratings Affirmed

Uruguay (Oriental Republic of)	
Transfer & Convertibility Assessment	A-
Senior Unsecured	BBB
Short-Term Debt	A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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