R&I

NEWS RELEASE

Feb 14, 2018

R&I Upgrades to BBB, Stable: Oriental Republic of Uruguay

Rating and Investment Information, Inc. (R&I) has announced the following:

ISSUER: **Oriental Republic of Uruguay**

Foreign Currency Issuer Rating: BBB, Previously BBB-
Rating Outlook: Stable

RATIONALE:

Although growing somewhat slower than before, Uruguay's economy has increased its stability, driven primarily by domestic demand. This, coupled with the high likelihood of large foreign direct investments (FDI), has made the economic outlook brighter than previously expected. The current account balance, which turned into surplus, will likely be stable for the foreseeable future. Fiscal deficit reductions are also underway. Inflation was contained within the target range of Uruguay's central bank for the first time in several years mainly against the backdrop of lower food prices. Based on its view that the government's economic and fiscal management will be more solid in these circumstances, R&I has upgraded the Foreign Currency Issuer Rating to BBB. The Rating Outlook is Stable. While Uruguay, like other South American countries, has a traditional worker protection culture, it seems free of bad practices in other member countries of Mercosur, as evidenced by the fact that it ranks best in Latin America for degree of democratization, least corruption, adherence to the rule of law, etc. It is a safe, socially stable country.

Uruguay's economy has maintained positive growth, in contrast to its neighboring giant economies Brazil and Argentina, which were mired in serious recessions. This shows that its economic autonomy has increased significantly. UPM-Kymmene Corp. (UPM), a major paper manufacturer in Finland, signed a Memorandum of Understanding to execute an investment project to construct its second mill in Uruguay after a long period of negotiations with the government regarding, for example, related public investments in railway and port infrastructure and preferential tax treatment. The project is huge, worth US$4 billion, or over 7% of Uruguay's gross domestic product (GDP). In addition, the government will invest US$1 billion in logistics infrastructure, which was requested by UPM as part of the preconditions for its investments, principally through utilization of private capital. A near-term challenge for the government is to carry out such an epoch-making investment project steadily.

Following the revision of its balance of payment statistics method, Uruguay's current account balance turned into surplus in 2016. This is primarily attributable to the change of the coverage of intermediate trade, which is very common in free trade zones -- one of the strengths for the country. Once the government's infrastructure investment starts in earnest, an increase in imports of capital and intermediate goods is envisaged, suggesting that Uruguay is yet to become structurally a current account surplus country. Even if the current account balance moves back into deficit in the future, however, it will likely be stable on the whole, given that the deficit will be caused mainly by a surge in imports related to FDI. With no concern about foreign currency liquidity, the risk is low that economic trends will worsen due to insufficient external funding, in R&I's view.

Since 2012, the government has been taking a relatively expansionary fiscal stance. The Vazquez administration is focusing on fiscal consolidation, but struggling with spending cuts that are constrained by the provisions of the constitution, among others, partly because of pressure from his left-wing government. While the public sector fiscal deficit narrowed in 2017 and the deficit target toward 2019 is unchanged, continuous political efforts will likely be required. In R&I's view, a major focal point in evaluating the future creditworthiness of Uruguay will be whether the government is able to implement its fiscal consolidation plan steadily as the economic outlook grows brighter. Uruguay's outstanding public debt to GDP ratio of above 60% is high relative to other Latin American countries'. Nonetheless, the debt in the calculation includes short-term borrowings by the central bank for liquidity management purpose. Moreover, actual fiscal risk has been mitigated by ample liquid assets on hand, lines of credit from

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multilateral development banks and prudent debt management practices.

Containing inflation has been a significant challenge in the macroeconomic policy realm. In 2017, inflation was kept within the 3-7% target range of the central bank for the first time in several years against the backdrop of sharply lower food prices and a rebound in the peso's value. Even so, a more structural anchor is required. Because wage hikes have so far been linked to past inflation rates, inflationary pressures stemming from economic growth in excess of potential have been carried over. The government introduced new wage-setting guidelines that take into account economic growth and sector trends to a certain extent and call for wage increases set in nominal terms. R&I will keep an eye on whether such efforts help reduce inflation expectations gradually and rein in inflation structurally amid an actual fall in inflation.

The primary rating methodology applied to this rating is provided at "R&I's Analytical Approach to Sovereigns". The methodology is available at the web site listed below, together with other rating methodologies that are taken into consideration when assigning the rating.
https://www.r-i.co.jp/en/rating/about/rating_method.html

R&I RATINGS:

ISSUER:	**Oriental Republic of Uruguay**
	Foreign Currency Issuer Rating
RATING:	**BBB, Previously BBB-**
RATING OUTLOOK:	**Stable**

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