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DBRS Morningstar Confirms Uruguay at BBB, Stable Trend

Industry Group: Public Finance – Sovereigns

DBRS, Inc. (DBRS Morningstar) confirmed the Oriental Republic of Uruguay's (Uruguay) Long-Term Foreign and Local Currency – Issuer ratings at BBB. At the same time, DBRS Morningstar confirmed Uruguay's Short-Term Foreign and Local Currency – Issuer ratings at R-2 (high). The trend on all ratings is Stable.

KEY CREDIT RATING CONSIDERATIONS

The confirmation of the Stable trend reflects DBRS Morningstar's view that Uruguay has weathered several recent shocks to the economy relatively well. Between the last quarter of 2022 and the first half of 2023, the economy saw a contraction in agricultural output stemming from a severe drought, economic weakness in neighboring Argentina, and slowing external demand. However, the Uruguayan economy looks set to pick up, supported by a recovery in agricultural output and a strong labor market. The IMF expects GDP growth to come in at 1.0% for 2023 and 3.3% in 2024. Inflation has moderated from the peak, aided by the central bank's contractionary policy stance. Uruguay's external accounts do not present any clear imbalances. Additionally, ample foreign exchange reserves, conservative public debt management, and sound regulation of the banking system bolster the economy's defenses to further shocks.

The BBB credit ratings reflect DBRS Morningstar's view that Uruguay's predictable macroeconomic policymaking and strong governing institutions counterbalance the country's moderate levels of productivity, partially dollarized financial system and limited financial depth. Uruguay is a small, open economy reliant on agricultural commodity exports which leaves the country subject to external demand and global price shocks. Recent reforms, such as enhancements to the fiscal framework and the passage of pension reform, have strengthened the country's public finances, and the debt-to-GDP trajectory looks sustainable over the forecast horizon.

CREDIT RATING DRIVERS

The credit ratings could be upgraded if one or a combination of the following factors occurs: (1) continued fiscal consolidation, which places the public debt ratio on a firm downward trajectory over the medium term and provides greater fiscal space; or (2) increased levels of investment boost medium-term growth prospects.

The credit ratings could be downgraded if (1) there is a sustained deterioration in the fiscal trajectory, or (2) external buffers erode over time, thereby weakening Uruguay's resilience to adverse shocks.

CREDIT RATING RATIONALE

The Economy Has Been Hit By A Series Of External Shocks But Domestic Demand Has Been Resilient

The Uruguayan economy has slowed due to three external shocks. A severe drought, among the worst in Uruguay's history, adversely impacted the agricultural sector in the fourth quarter of 2022 and the first half of 2023, resulting in a sharp decline of beef, dairy, and soy exports. The hit to export volumes was compounded by the decline in global commodity prices, while economic weakness in neighboring Argentina led to a fall in inbound tourism and a loss of price competitiveness for some Uruguayan border communities. However, domestic demand has held up relatively well. In the first half of the year, private consumption continued to expand at a robust pace on the back of solid real wage gains and steady jobs growth.

From a structural perspective, the Uruguayan economy shows few signs of scarring from the pandemic. Output has largely returned to its pre-pandemic trend, the labor market does not show any signs of lingering stress, and the IMF estimate of potential growth at 2.2% is largely in line with pre-pandemic estimates. DBRS Morningstar expects growth to gradually accelerate in the second half of 2023 and into next year, supported by expectations of a better harvest and the scaling up of operations at the new UPM pulp mill. Volatility in Argentina could weigh on external demand, although the trade and financial links are relatively limited. The IMF expects GDP to grow by 1.0% for 2023 and 3.3% in 2024. Growth could outperform current expectations if large investment projects, such as the planned green hydrogen plant, are realized over the medium-term.

Uruguay’s external accounts do not pose any clear imbalances. The current account deficit increased from 0.8% of GDP in Q4 2020 (rolling 4 quarters) to 3.7% as of Q2 2023. The initial shift was due to the sharp decline in tourism exports, higher imports related to construction of the new pulp mill, and an increase in primary income outflows. More recently, the drought and the stronger currency relative to the Argentine peso have contributed to a falling goods exports and rising services imports. However, the current account deficit is largely funded by net inflows of foreign direct investment, and DBRS Morningstar expects the deficit to narrow as construction imports decline and exports of pulp products ramp up. In addition, exchange rate flexibility continues to help the economy adjust to evolving global conditions and USD 15 billion (20% of GDP) in reserves provides the central bank with substantial foreign exchange liquidity in the event of turbulence in global financial markets.

The Central Bank Continues To Maintain A Slightly Contractionary Stance Even As Inflation Reaches New Lows

Annual headline inflation declined from 9.9% in September 2022 to 3.9% in September 2023, the lowest rate in the last 18 years, before ticking up slightly to 4.3% in October. The disinflationary trend has been driven by lower international prices and a strong local currency. Non-tradables inflation is also moderating but remains above the central bank’s upper threshold for the target range. Tight monetary policy has helped guide inflation lower. With inflation falling, the central bank started to ease policy in April 2023; it has cut rates five times for a total of 225 basis points from the peak of 11.5% in March 2023. Nevertheless, the central bank remains cautious about the inflation outlook. Twelve-month inflation expectations have moderated over the last 12-18 months but are still above the central bank’s 3-6% target inflation range. Consequently, the central bank has kept monetary policy in a contractionary stance. The challenge of anchoring expectations for the central bank is complicated by the weak transmission of monetary policy amid high financial dollarization and low financial intermediation.

The banking system has weathered the COVID-19 shock and the global interest rate shock relatively well. The banking system is profitable, highly liquid, and well-capitalized. Risks to the banking system stemming from events in Argentina are also contained, with non-resident deposits accounting for less than 8% of total bank deposits and only 5% of loans directed to non-residents.

Fiscal Consolidation Slows After Substantial Progress

The pace of fiscal consolidation has slowed in Uruguay. After the deficit widened in the wake of the COVID-19 pandemic, the government tightened policy primarily by limiting public sector wage growth and controlling discretionary spending. The headline central government deficit (excluding the ‘cincuentones’ pension transfers) narrowed from 5.8% of GDP in 2020 to 3.2% in 2022. This year, the Lacalle Pou administration is aiming to keep the deficit stable at 3.2%. Positively, the budget estimate includes a significant boost in public investment. However, revenues are also coming in under budget due to lower-than-expected growth and inflation, which suggests that the fiscal deficit for the year could end up slightly above the budget estimate.

The IMF projects a gradual fiscal consolidation over the next five years. Two reforms – the introduction of the new fiscal framework and the overhaul of social security – should help foster prudent fiscal policymaking under the next administration regardless of who wins (see "Uruguay's Pension Reform Supports Long-Term Sustainability of Public Finances"). However, given rigidities in the spending profile we think it may difficult to achieve the projected fiscal consolidation. This view, combined with the statistical effect of the 'cincuentones' transfers, accounts for the one-notch adjustment to the Fiscal Management and Policy building block assessment.

Prudent Debt Management Reduces Risks To Debt Sustainability

The government debt-to-GDP ratio has returned to pre-pandemic levels and is stabilizing as the economy continues to grow at a moderate pace. According to the IMF, non-financial public sector debt increased from 60% of GDP in 2019 to 68% in 2020 due to the pandemic-related fiscal response and economic recession. The ratio has since returned to roughly its pre-pandemic level and is expected to stabilize around 62% of GDP over the forecast horizon. This represents an improvement on the expected debt trajectory relative to past expectations (for example, in October 2021 the IMF projected the debt ratio to stabilize around 71%). However, the currency composition presents some risk, as 45% of central government debt is denominated in foreign currency, thereby leaving public finances vulnerable to exchange rate shocks. To incorporate this risk, a negative adjustment is applied to the Debt and Liquidity building block assessment.

Conservative public debt management supports Uruguay's credit profile. Rollover and liquidity risks are minimal. Liquid assets held by the central government combined with loans and contingent credit lines from multilateral organizations largely cover 67% of debt servicing needs for the next 12 months. Exposure to interest rate risk is also limited due to the long average maturity of government debt (12.6 years) and the high share of debt that carry fixed rates (94%). The government continues to prioritize growing the share of local currency issuances in the domestic market, which should gradually reduce exchange rate risk.

Elections Next Year Are Not Expected To Change The Orientation Of Policymaking Regardless Of The Outcome

Uruguay's political environment is a key credit strength. Uruguay is a stable liberal democracy with an effective government and low levels of corruption. The country scores highly across a range of international governance measures. A centrist electorate facilitates political moderation and pragmatic policymaking. The basic pillars of macroeconomic policy are broadly supported across the political spectrum. The predictability of the policy framework through the electoral cycle fosters a favorable environment for economic growth.

The next general election is scheduled for late October 2024. Both houses of congress and the presidency will be up for grabs. If no presidential candidate secures a majority in the first round, a runoff election will be held for the top two contenders in the subsequent weeks. Visibility around each parties' electoral prospects will be greater following the parties' primaries in June 2024. DBRS Morningstar expects the next government to be committed to sound macroeconomic policymaking regardless of the outcome of the election.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

ESG Considerations had a significant effect on the credit analysis.

Environmental (E) Factors
The following Environmental factor had a relevant effect on the credit analysis: The Climate and Weather Risks environmental factor is relevant the credit ratings assigned to Uruguay. Uruguay faces occasional droughts which impact agriculture output and electricity generation. This factor has been taken into account in the Economic Structure and Performance building block.

Social (S) Factors
The following Social factor had a significant effect on the credit analysis: The Human Rights and Human Capital social factor affects the credit ratings assigned to Uruguay. Uruguay's per capita GDP is relatively low at USD 21,377 in 2023, reflecting a low level of labor productivity. This factor has been taken into account in the Economic Structure and Performance building block.

Governance (G) Factors
There were no Governance factor(s) that had a relevant or significant effect on the credit analysis.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (04 July 2023) https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria:-approach-to-environmental,-social,-and-governance-risk-factors-in-credit-ratings

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments.

Notes:
All figures are in US Dollars unless otherwise noted. Public finance statistics reported on a general government basis unless specified.

The principal methodology is the Global Methodology for Rating Sovereign Governments (06 October 2023) https://www.dbrsmorningstar.com/research/421590/global-methodology-for-rating-sovereign-governments . In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (04 July 2023) https://www.dbrsmorningstar.com/research/416784/dbrs-morningstar-criteria:-approach-to-environmental,-social,-and-governance-risk-factors-in-credit-ratings in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: https://www.dbrsmorningstar.com/about/methodologies.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and credit ratings are monitored.

The primary sources of information used for these credit ratings include Ministerio de Economía y Finanzas, Banco Central del Uruguay, Instituto Nacional de Estadística, Superintendencia de Servicios Financieros, the IMF, the World Bank, Bank for International Settlements, and Haver Analytics. DBRS Morningstar considers the information available to it for the purposes of providing these credit ratings was of satisfactory quality.

The credit rating was initiated at the request of the rated entity.

The rated entity or its related entities did participate in the credit rating process for this credit rating action.

DBRS Morningstar did not have access to the accounts, management and other relevant internal documents of the rated entity or its related entities in connection with this credit rating action.

This is a solicited credit rating.

The last credit rating action on this issuer took place on November 22, 2022.

Lead Analyst: Michael Heydt, Senior Vice President, Global Sovereign Ratings
Rating Committee Chair: Thomas Torgerson, Managing Director, Global Sovereign Ratings
Initial Rating Date: February 28, 2008

For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

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Issuer	Debt Rated	Credit Rating Action	Credit Rating	Trend
Uruguay, Oriental Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB	Stable
Uruguay, Oriental Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	BBB	Stable
Uruguay, Oriental Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (high)	Stable
Uruguay, Oriental Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (high)	Stable

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Uruguay

Scorecard Indicators

Fiscal Management and Policy	2017	2018	2019	2020	2021	2022	2023	2024	2025	Source	Current Scorecard Input	
Overall Fiscal Balance (% of GDP)	-2.5%	-1.9%	-2.6%	-4.7%	-2.6%	-2.5%	-3.2%	-2.6%	-2.5%	IMF WEO	13 year average	-2.6%
Government Effectiveness (Percentile Rank)	66.7	70.5	73.3	75.2	75.2	77.4	-	-	-	World Bank	5 year average	74.3
Debt and Liquidity	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**			
General Government Gross Debt (% of GDP)	55.8%	58.0%	59.8%	68.1%	63.4%	59.3%	61.6%	61.4%	61.7%	IMF WEO	5 year projection	61.6%
Interest Costs (% of GDP)	2.4%	2.4%	2.1%	2.6%	2.0%	2.0%	1.5%	1.5%	1.6%	IMF WEO	5 year average	1.9%
Economic Structure and Performance	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**			
GDP per Capita (USD thousands)	18.6	18.6	17.6	15.2	17.3	20.0	21.4	22.7	23.7	IMF WEO	10 year average	17.7
Output Volatility (%)	4.2%	4.3%	4.2%	4.1%	3.9%	3.1%	3.1%	3.1%	2.9%	IMF WEO	Latest	3.1%
Economic Size (USD billions)	65	65	62	54	61	71	76	81	85	IMF WEO	5 year average	63
Monetary Policy and Financial Stability	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**			
Rate of Inflation (%, EOP)	6.6%	8.0%	8.8%	9.4%	8.0%	8.3%	5.4%	5.7%	5.5%	IMF WEO	13 year average	7.7%
Main topics discussed in the Rating Committee include: t	12%	12%	12%	14%	13%	13%	-	-	-	BCU/IMF	Latest[1]	13%
Change in Domestic Credit (% of GDP)	-0.8%	1.2%	1.6%	1.0%	-1.0%	0.6%	-	-	-	IMF/IMF	7 year average[1]	0.2%
Net Non-Performing Loans (% of Capital)	-7.8%	-6.9%	-7.8%	-7.1%	-10.2%	-9.8%	-	-	-	IMF IFS	Latest[1]	-9.8%
Change in Property Price/GDP Index (%)	-	10.8%	4.7%	-3.4%	12.7%	-3.4%	-	-	-	INE/IMF	7 year average[1]	4.3%
Balance of Payments	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**			
Current Account Balance (% of GDP)	0.0%	-0.5%	1.2%	-0.8%	-2.5%	-3.5%	-3.7%	-3.3%	-2.9%	IMF WEO	8 year average	-2.0%
International Investment Position (% of GDP)	-25.8%	-23.8%	-25.3%	-29.9%	-24.3%	-22.3%	-	-	-	IMF	5 year average[1]	-25.1%
Share of Global Foreign Exchange Turnover (Ratio)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	-	-	-	BIS/IMF	Latest	0.0%
Exchange Rate Classification (see footnote)	3	3	3	3	3	3	-	-	-	IMF	Latest	3
Political Environment	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**			
Voice and Accountability (Percentile Rank)	86.7	89.3	88.9	93.7	92.3	91.8	-	-	-	World Bank	5 year average	91.2
Rule of Law (Percentile Rank)	70.0	71.4	73.3	72.9	73.8	75.9	-	-	-	World Bank	5 year average	73.5

See DBRS Morningstar's Global Methodology for Rating Sovereign Governments for additional details on the methodology behind the scorecard indicators and associated scoring thresholds. Exchange Rate Classifications: Freely floating exchange rate = 1; Float = 2; Crawls, banded pegs, and other managed = 3; Stabilized = 4; Pegs, currency unions and dollarized arrangements = 5.

[1] Scores for 2022 have been computed using the most recent data when year-end data is not available.

Rating Committee Date: 16-Nov-2023

Uruguay

Building Block Assessments and Rating Committee Summary

16-Nov-2023

Building Blocks	Scorecard Result	Quantitative Assessment	Net Impact of Qualitative Factors	Building Block Assessment
Fiscal Management and Policy	14.95	Good	- 1 Category	Good/Moderate
Debt and Liquidity	13.26	Good	- 1 Category	Good/Moderate
Economic Structure and Performance	6.05	Poor	N/A	Poor
Monetary Policy and Financial Stability	11.09	Good/Moderate	N/A	Good/Moderate
Balance of Payments	11.55	Good/Moderate	N/A	Good/Moderate
Political Environment	18.08	Strong	N/A	Strong

Overall Assessment	Composite Scorecard Result	Scorecard Rating Range	Composite Building Block Assessment	Indicative Rating Range
	62.5	A - BBB (high)	59.1	A (low) - BBB

Uruguay's Long-Term Foreign Currency - Issuer Rating BBB

Main topics discussed in the Rating Committee include: the fiscal position and outlook, risks to the debt trajectory, growth prospects, and inflation outlook. For additional details on DBRS Morningstar analysis and opinions, please see the accompanying rating report.

DBRS Morningstar Scorecard: Scoring Ranges and Associated Assessment Categories

Lower Bound	0.00	1.00	3.00	5.00	7.00	9.00	11.00	13.00	15.00	17.00	19.00
Upper Bound	0.99	2.99	4.99	6.99	8.99	10.99	12.99	14.99	16.99	18.99	20.00
Assessment Category	Very Weak	Weak	Weak/ Poor	Poor	Poor/ Moderate	Moderate	Good/ Moderate	Good	Strong/ Good	Strong	Very Strong

Uruguay, Oriental Republic of

ESG Checklist

ESG Factor		ESG Credit Consideration Applicable to the Credit Analysis: Y/N		Extent of the Effect on the ESG Factor on the Credit Analysis: Relevant (R) or Significant (S)*
Environmental		**Overall:**	**Y**	**R**
	Emissions, Effluents, and Waste	Do the costs or risks result in changes to a government's financial standing or relationship with other governments, and does this affect the assessment of credit risk?	N	N
	Carbon and GHG Costs	Does a government face coordinated pressure from a higher-tier government or from numerous foreign governments as a result of its GHG emissions policies, and does this affect the assessment of credit risk?	N	N
		Will recent regulatory changes have an impact on economic resilience or public finances?	N	N
		Carbon and GHG Costs	**N**	**N**
	Resource and Energy Management	Does the scarcity of key resources impose high costs on the public sector or make the private sector less competitive?	N	N
		Is the economy reliant on industries that are vulnerable to import or export price shocks?	N	N
		Resource and Energy Management	**N**	**N**
	Land Impact and Biodiversity	Is there a risk to a government's economic or tax base for failing to effectively regulate land impact and biodiversity activities?	N	N
	Climate and Weather Risks	Under key IPCC climate scenarios up to a 2°C rise in temperature by 2050, will climate change and adverse weather events potentially destroy a material portion of national wealth, weaken the financial system, or disrupt the economy?	Y	R
	Passed-through Environmental credit considerations	Does this rating depend to a large extent on the creditworthiness of another rated issuer which is impacted by environmental factors (see respective ESG checklist for such issuer)?	N	N
Social		**Overall:**	**Y**	**S**
	Human Capital and Human Rights	Compared with regional or global peers, is the domestic labour force more or less competitive, flexible, and productive?	Y	S
		Are labour or social conflicts a key source of economic volatility?	N	N
		Are individual and human rights insufficiently respected or failing to meet the population's expectations?	N	N
		Is the government exposed to heavy, coordinated international pressure as a result of its respect for fundamental human rights?	N	N
		Human Capital and Human Rights	**Y**	**S**
	Access to Basic Services	Does a failure to provide adequate basic services deter investment, migration, and income growth within the economy?	N	N
	Passed-through Social credit considerations	Does this rating depend to a large extent on the creditworthiness of another rated issuer which is impacted by social factors (see respective ESG checklist for such issuer)?	N	N
Governance		**Overall:**	**N**	**N**
	Bribery, Corruption, and Political Risks	Does widespread evidence of official corruption and other weaknesses in the rule of law deter investment and contribute to fiscal or financial challenges?	N	N
	Institutional Strength, Governance, and Transparency	Compared with other governments, do institutional arrangements provide a higher or lesser degree of accountability, transparency, and effectiveness?	N	N
		Are regulatory and oversight bodies insufficiently protected from inappropriate political influence?	N	N
		Are government officials insufficiently exposed to public scrutiny or held to insufficiently high ethical standards of conduct?	N	N
		Institutional Strength, Governance, and Transparency	**N**	**N**
	Peace and Security	Is the government likely to initiate or respond to hostilities with neighboring governments?	N	N
		Is the government's authority over certain regions contested by domestic or foreign militias?	N	N
		Is the risk of terrorism or violence sufficient to deter investment or to create contingent liabilities for the government?	N	N
		Peace and Security	**N**	**N**
	Passed-through Governance credit considerations	Does this rating depend to a large extent on the creditworthiness of another rated issuer which is impacted by governance factors (see respective ESG checklist for such issuer)?	N	N
		Consolidated ESG Criteria Output:	**Y**	**S**

* A Relevant Effect means that the impact of the applicable ESG risk factor has not changed the rating or rating trend on the issuer.
A Significant Effect means that the impact of the applicable ESG risk factor has changed the rating or trend on the issuer.

Oriental Republic of Uruguay: ESG Considerations

November 20, 2023

Environmental

The Climate and Weather Risks environmental factor is relevant to the credit ratings assigned to Uruguay. This primarily relates to weather-related risks that Uruguay faces in the form of occasional droughts which can impact agriculture output and electricity generation. Between the last quarter of 2022 and the first half of 2023, Uruguay experienced one of the most severe droughts in its history, which saw the agricultural sector contract by 27% YOY in Q2 2023. With regards to climate policy, Uruguay expects to be a net carbon sink in the forestry sector by 2030 through the expansion of tree plantations. Uruguay has also set targets to reduce the emissions intensity of the cattle industry. More than 90% of the electricity generated within the country comes from renewable sources such as wind, solar, hydropower, and biomass. Additionally, efforts are underway to transition to electric vehicles and to become a green hydrogen producer. In DBRS Morningstar's view, the fiscal, regulatory, and enforcement measures required to achieve the country's climate goals are unlikely to impact sovereign credit quality. In October 2022, the government issued a new sovereign sustainability-linked bond issuance, which includes coupon step-downs(step-ups) for meeting(missing) certain environmental sustainability metrics.

Social

The Human Rights and Human Capital social factor affects the credit ratings assigned to Uruguay. Uruguay's per capita GDP is relatively low at USD 21,377 in 2023, reflecting a low level of labor productivity. The Access to Basic Services factor does not affect the ratings. Uruguay has a robust social welfare system and the government provides for relatively high-quality healthcare, education, and social assistance.

Governance

No governance factors affect the credit ratings assigned to Uruguay. Uruguay has independent and transparent governing institutions, which provide a stable environment for investment relative to regional peers. Uruguay scores above the 70th percentile rank in all of the Worldwide Governance Indicators, and is a particularly strong performer in the Control of Corruption indicator and in the Voice and Accountability indicator (both ranking in the 92nd percentile).