MOODY'S
INVESTORS SERVICE

CREDIT OPINION
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Update

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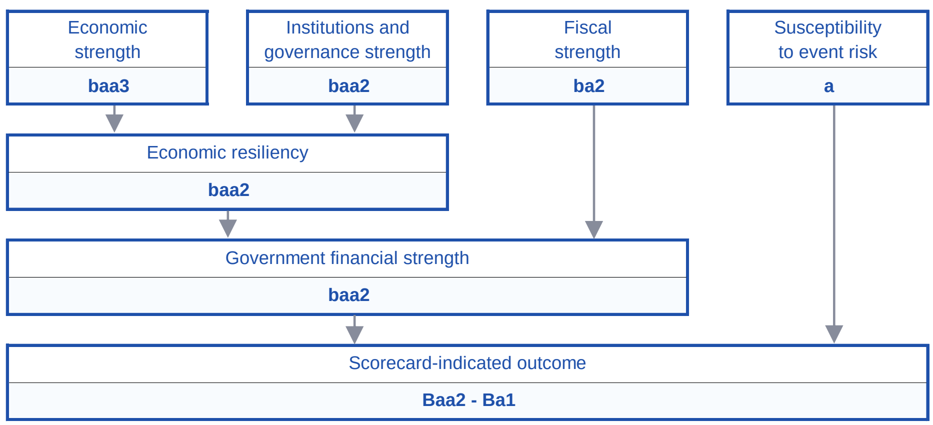
Government of Uruguay – Baa2 stable

Regular update

Summary

The credit profile of Uruguay is supported by its moderate economic and institutional strength. Uruguay has relatively high income levels and a growth potential of about 2.5%. Growth has been weak in recent years and we forecast a coronavirus-induced recession in 2020. Lower-than-potential growth and significant expenditure rigidity limit the authorities' ability to meet fiscal targets. Debt metrics have deteriorated in recent years, and fiscal consolidation plans beyond 2020 remain key in supporting the sovereign's credit profile.

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



Source: Moody's Investors Service

Credit strengths

» Favorable debt maturity profile and moderate government financing needs

» Large government financial buffers

» Strong institutional framework

Credit challenges

» Structural rigidities in the composition of government spending

» Still-significant share of foreign-currency-denominated government debt

» Modest medium-term growth prospects

Rating outlook

The stable outlook balances negative underlying fiscal and economic pressures against our assumption that the new administration will implement structural economic and fiscal reforms that will counter the ongoing erosion in Uruguay's economy and fiscal strength.

Factors that could lead to an upgrade

Upward credit pressure could result from (1) a reduction in structural rigidities in Uruguay's credit profile including those associated with low and declining productivity, which affect potential growth, as well as the relatively rigid government spending structure; (2) a significant strengthening of the government balance sheet through a reduction in the sovereign's debt and interest burdens; and (3) a reduction in vulnerability through a significant decrease in the share of foreign-currency-denominated government debt.

Factors that could lead to a downgrade

Downward credit pressure would emerge if we were to conclude that structural fiscal and economic challenges were not likely to be addressed, denoting a weakening in policy responsiveness and likely leading to economic growth underperformance and further deterioration in fiscal strength in the medium term, with a continued increase in debt ratios and a sustained, significant erosion in external and financial buffers.

Key indicators

Exhibit 2

Uruguay	2014	2015	2016	2017E	2018	2019	2020F	2021F
Real GDP (% change)	3.2	0.4	1.7	2.6	1.6	0.2	-3.3	4.0
Inflation (CPI, % change, Dec/Dec)	8.3	9.4	8.1	6.6	8.0	7.5	9.5	8.0
Gen. gov. financial balance/GDP (%)[1]	-2.3	-2.8	-3.7	-3.0	-3.4	-4.3	-7.1	-4.7
Gen. gov. primary balance/GDP (%)	0.0	-0.5	-1.0	-0.3	-0.6	-1.6	-4.0	-1.6
Gen. gov. debt/GDP (%)	40.9	48.4	48.0	48.3	52.0	56.4	65.0	64.7
Gen. gov. debt/revenues (%)	148.2	178.1	172.9	167.6	177.6	195.6	225.2	221.5
Gen. gov. interest payment/revenues (%)	8.3	8.5	9.6	9.3	9.6	9.3	10.8	10.6
Current account balance/GDP (%)	-3.2	-0.9	0.6	0.7	0.0	0.6	-2.4	-3.5
External debt/CA receipts (%)[2]	212.0	263.6	255.7	231.4	227.8	236.4	280.1	269.3
External vulnerability indicator (EVI) [3]	91.3	84.9	108.9	107.1	88.1	83.9	87.6	83.0

[1] Excludes pension transfers 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 Investors Service

Detailed credit considerations

Uruguay's credit profile incorporates our "baa3" **economic strength** assessment on a global basis, reflecting moderate potential growth and a relatively high income per capita, counterbalanced by the small size of the economy, which at $56 billion in 2019 was smaller than the "Baa" median of around $244 billion. In 2019, the economy grew 0.2% in real terms, and we expect a coronavirus-induced contraction of 3.3% in 2020, followed by a 3.5% annual average expansion in 2021-22. Investment levels have remained low over the past five years and while this rate is likely to rebound in 2020-22 because of the new UPM pulp mill plant, without a broader recovery, potential growth is likely to remain low.

Our final score for Uruguay's **institutions and governance strength**is"baa2." This assessment balances Uruguay's strong institutional framework, which reinforces policy predictability, with still-evolving capabilities to effectively and credibly conduct these policies. The authorities have faced challenges in meeting policy goals, as exemplified by the stubbornly high inflation rates that have often been above the official target range. Since January 2013, inflation has routinely exceeded the target's upper bound, including every month since February 2018. Current institutional arrangements guiding fiscal policy have not provided a strong anchor for the overall fiscal policy, which has led to a deterioration in the structural deficit and a procyclical policy stance. The new administration is currently developing a fiscal rule aimed at addressing these issues.

Uruguay's “ba2” **fiscal strength** assessment balances its moderate government debt burden, very strong asset-liability management practices and fiscal reserve assets, with lingering vulnerabilities from a high proportion of foreign-currency debt. Debt ratios are now higher than the “Baa” medians, including weaker-than-peer debt affordability, as measured by the interest payment-to-revenue ratio. Although the government managed to reduce the share of foreign-currency-denominated debt over the past two decades, this remains at a relatively high level at over 50%. This exposes the overall debt stock to fluctuations caused by exchange rate depreciation, which in turn can lead to a worsening of 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 12 months of debt service coverage. For this reason, we adjust the score up to “ba2” from the initial score of “b1.”

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 is “a,” which reflects the system’s relatively size for a Latin American economy, with domestic bank assets equivalent to 72% of GDP in 2019, and a Baseline Credit Assesment for rated banks of baa3, which informs the risk assessment of potential contingent liabilities materializing on the government’s balance sheet.

Uruguay's external vulnerability risk assessment is “a,” reflecting its large external buffers that partially mitigate the exchange-rate risks stemming from the country's still-significant degree of financial dollarization. Uruguay's current account has posted surpluses since 2016, although these have narrowed since 2017, with this trend reflecting the decrease in investment levels.

Uruguay's government liquidity risk assessment is “a,” balancing 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.” We consider the risk of political events developing in a manner that could compromise the economic, institutional or fiscal features of Uruguay's credit profile very low.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Uruguay

We take account of the impact of environmental (E), social (S) and governance (G) factors when assessing sovereign issuers’ economic, institutions and governance, and fiscal strength and their susceptibility to event risk. In the case of Uruguay, the materiality of the ESG factors to the credit profile is as follows:

Environmental factors affect Uruguay's credit profile in a limited manner. The country's large coastline is not susceptible to major flooding, and extreme weather events are rare in the region. The main risk is disruptive weather effects like excessive rains or droughts, which would affect the agricultural sector.

Social considerations, in particular an aging population, affect Uruguay's credit profile. The outbreak of the coronavirus will have an economic and fiscal impact on Uruguay, notwithstanding the government's efforts to keep the outbreak's impact to the minimum. The country's aging population, coupled with the population's predilection for social expenditure, will weigh on public finances in the coming years. A recent example of how this situation manifests is the so-called *cincuentones* law, which absorbed private fully funded would-be pensioners into the public system after their forecast pensions were deemed insufficient.

We do not consider governance risks material to Uruguay's credit profile. Uruguay has strong institutions and a broad societal consensus on retaining the country's institutional arrangements.

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 ESG risks influence sovereign credit profiles and our cross-sector methodology General Principles for Assessing ESG Risks.

Recent developments

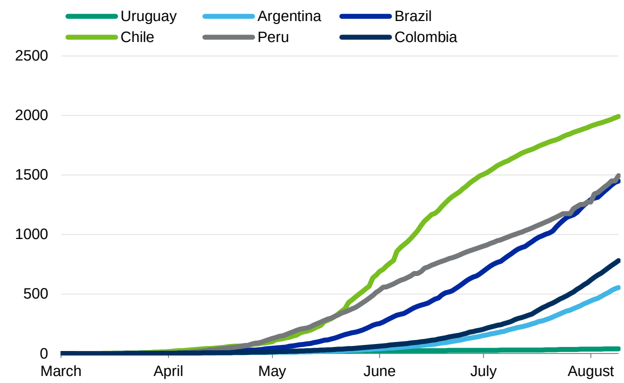
Uruguay's handling of the coronavirus outbreak has exceeded that of regional peers

Unlike other countries in the region, the level of spread of the coronavirus in Uruguay has been relatively modest despite some increased number of cases in July. As seen in Exhibit 3, as a share of the population there where 39 cases per 100,000 inhabitants as of 9 August. This compares to over 1000 cases per 100,000 inhabitants for countries like Brazil (Ba2 stable), Chile (A1 stable) and Peru (A3 stable). A factor that differentiates Uruguay is that the government did not declare a mandatory confinement as in other Latin American countries (see Exhibit 4), opting to allow individuals and businesses to decide on the measures they would pursue to limit spread. The low level of cases reflects Uruguay's strong institutions in relation to civil society. Additionally, this approach likely limited the negative effect of the outbreak on the economy, although before the outbreak the economy and fiscal accounts were already weak.

Exhibit 3

Uruguay has had very low number of coronavirus cases relative to regional peers

Cumulative cases per 100,000 inhabitants

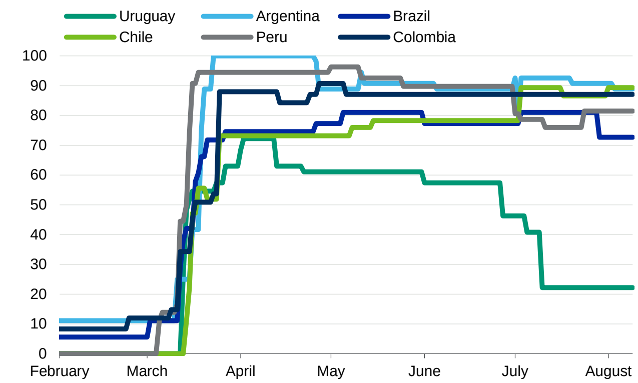


Sources: Johns Hopkins University, Moody's Investors Service

Exhibit 4

Despite having more relaxed mobility policies during the outbreak

Stringency index; 100 = more strict policies



Index measures strictness of 'lockdown style' policies that primarily restrict people's behavior

Sources: University of Oxford, Moody's Investors Service

Fiscal figures for the first half of the year show deterioration

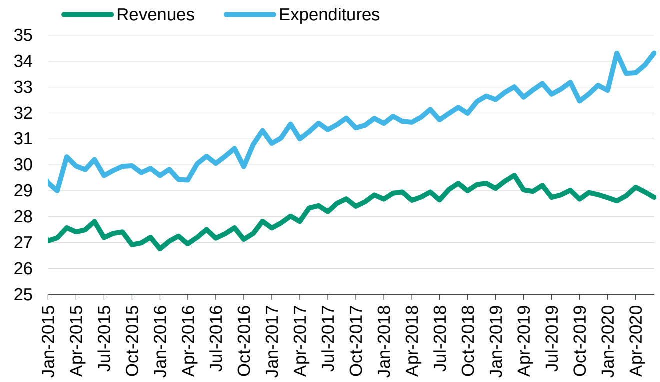
In the first six months of the year, the consolidated central government posted a deficit of UYU64 billion.[1]The figure represents a fiscal deficit of 5.7% of GDP on a 12-month rolling basis, a significant increase from the 4% registered by the same metric the year before.

Deficits widened markedly since April, a deterioration primarily attributable to the coronavirus pandemic. Revenue, having performed well during the first four months of the year, started registering sharp contractions in May and June, as falling economic activity hurt tax and social security revenues. Expenses, meanwhile, have been sharply increasing since April. The growth is in part the result of rising unemployment insurance payouts caused by increased claims in the context of the coronavirus pandemic. The increase in unemployment insurance was expected as not only due to the coronavirus pandemic but also because the government temporarily relaxed criteria to limit the social costs of the pandemic.

The coronavirus pandemic has deepened the already existing dynamic of rising expenditures and stagnant revenues that had been driving deficits wider since late 2018 (see Exhibits 5 and 6). While we expect economic activity to recover in the second half of 2020 the impact of the coronavirus pandemic will be significant. For the whole of 2020, we expect deficits to come over 7% of GDP.

Exhibit 5

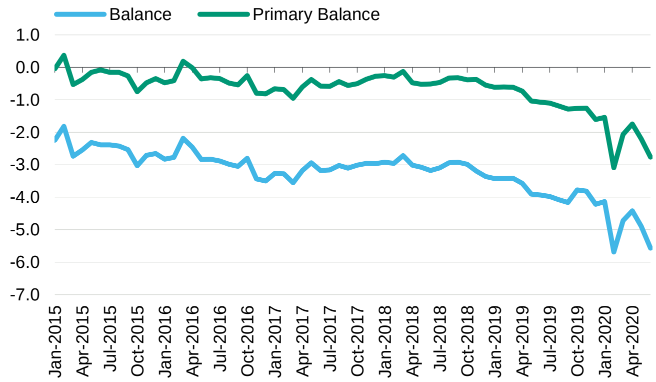
In the first half of the year revenues have stagnated as expenditure grows...
(12-month rolling, % of GDP)



Note: Data excludes the effect of law 19,590 (the *cincuentones* law)
Source: Moody's Investors Service

Exhibit 6

...further driving the already widening deficits
(12-month rolling, % of GDP)



Note: Data excludes the effect of law 19,590 (the *cincuentones* law)
Source: Moody's Investors Service

The administration saw the "Urgent Law" bill through Congress; our focus remains on the multiyear budget

The administration of president Lacalle Pou, which entered office on 1 March 2020, succeeded in passing its omnibus "Urgent Law" bill in early July. Although the administration had to water down parts of the bill to secure passage (such as labor market and public services liberalization), the bill still contained two major initiatives related to public finances. The first was the creation of the legal framework for a fiscal rule, which is now being developed by fiscal authorities. The second was the creation of an expert committee tasked with exploring pension reform alternatives.

When these two initiatives materialize, they may prove positive should they address the structural pressures of the inflexible spending composition in items that have driven up fiscal deficits over the past five years. However, at present our attention is focused on the upcoming five-year budget the administration is scheduled to present to Congress by August 31 at the latest. Authorities have publicly stated their intention of seeking fiscal consolidation and the targets, and compliance with the targets, will be a key factor in our analysis of Uruguay's creditworthiness.

Moody's rating methodology and scorecard factors: Uruguay - Baa2 stable

				Initial	Final	Weights
				Factor score		
Factor 1: Economic strength				**baa3**	**baa3**	**50%**
Growth dynamics	Average real GDP growth (%)	2015-2024F	1.5	b1		25%
	Volatility in real GDP growth (%)	2010-2019	2.3	baa3		10%
Scale of the economy	Nominal GDP ($ billion)	2019	56.0	ba2		30%
National income	GDP per capita (PPP, Intl$)	2019	23,581	a3		35%
Adjustment to factor 1	*# notches*				0	max ±9
Factor 2: Institutions and governance strength				**a3**	**baa2**	**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				-2	max -3
Other adjustment to factor 2	*# notches*				0	max ±3
F1 x F2: Economic resiliency				**baa1**	**baa2**	
Factor 3: Fiscal strength				**b1**	**ba2**	
Debt burden	General government debt/GDP (%)	2019	56.4	baa2		25%
	General government debt/revenue (%)	2019	195.6	a3		25%
Debt affordability	General government interest payments/revenue (%)	2019	9.3	a3		25%
	General government interest payments/GDP (%)	2019	2.7	baa1		25%
Specified adjustments	*Total of specified adjustment (# notches)*			-6	-5	max ±6
	Debt trend	2016-2021F	16.6	-1	0	
	Foreign currency debt/general government debt	2019	56.0	-5	-5	
	Other non-financial public sector debt/GDP	2019	3.4	0	0	
	Public sector assets/general government debt	2019	0.0	0	0	
Other adjustment to factor 3	*# notches*				1	max ±3
F1 x F2 x F3: Government financial strength				**baa1**	**baa2**	
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	ba1-ba2		
	Total domestic bank assets/GDP	2019	71.9	<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				**Baa1 - Baa3**	**Baa2 - Ba1**	

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.

Moody's related publications

» **Credit Analysis:** Government of Uruguay - Baa2 stable: Annual credit analysis, 12 August 2020

» **Issuer Comment:** Government of Uruguay: Consensus-building coalition will be key to passing reforms after elections, 28 October 2019

» **Rating Methodology**: Sovereign Ratings Methodology, 25 November 2019

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Official statistics report a deficit of UYU57 billion, which is flattered by the effect of law 19.590, the so-called cincuentones law. Our figures net out the effect of law 19.590.

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