MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Uruguay's Baa2 ratings, maintains stable outlook

10 Aug 2021

New York, August 10, 2021 -- Moody's Investors Service ("Moody's") has today affirmed the Government of Uruguay's long-term issuer and senior unsecured debt ratings at Baa2, and Uruguay's senior unsecured shelf ratings at (P)Baa2. Moody's also maintained the stable outlook.

The key drivers of the rating affirmation are (1) prudent fiscal management during the pandemic that has limited the rise in the debt burden and will lead to stabilization of debt ratios in the coming years; and (2) the ongoing reform process, which points to material changes in macroeconomic policymaking that should bolster fiscal and monetary policy effectiveness and credibility.

The stable outlook balances the underlying fiscal and economic pressures that preceded the pandemic and the government's actions to address these underlying credit challenges.

Uruguay's local and foreign-currency country ceilings remain unchanged at A1 and A2, respectively. The four-notch gap between the local currency ceiling and the sovereign rating reflects low government presence in the economy, strong predictability of institutions, low political risk and moderate external vulnerability risk. The one-notch gap between the foreign-currency ceiling and the local currency ceiling incorporates Uruguay's moderate policy effectiveness, which limits potential risks stemming from relatively high financial dollarization in the country, and an open capital account.

RATINGS RATIONALE

RATIONALE FOR AFFIRMATION AT Baa2

PRUDENT FISCAL MANAGEMENT DURING THE PANDEMIC LIMITED DETERIORATION IN THE GOVERNMENT'S DEBT METRICS

Moody's considers that in the context of the pandemic, the government's policy response has allowed it to provide support to the affected population and economy amid challenging health and economic conditions while also limiting the worsening of debt metrics. Thanks to a well-established social safety net with broad coverage, the Uruguayan government was able to provide relief to unemployed workers, in addition to other pre-existing programs. Additionally, the government established a "coronavirus fund" to encapsulate other pandemic-related social programs that amounted to 1.1% of GDP in 2020 and will amount to 1.7% of GDP in 2021. This strategy will allow the authorities to phase out the additional spending once the health emergency subsides. The government also managed to contain spending that was not related to the pandemic -- primary expenditures excluding the pandemic response declined 2.6% in real terms.

Overall, the fiscal response, along with a 5.9% contraction in real GDP last year, widened the fiscal deficit to 5.8% of GDP in 2020 from 4.0% in 2019, and contributed to an increase in the debt burden to 61.8% of GDP from 51.6% in 2019. The rise in the debt-to-GDP ratio was lower than that observed on average for Baa-rated peers (12 percentage-point increase), although this ratio is now higher than the current Baa median of 55% of GDP. In terms of debt affordability, because revenue was broadly resilient last year, the interest burden rose by a smaller margin to 10.4% of revenue in 2020 from 9.5% in 2019, and it is not materially higher than the Baa median of 8.3%.

Moody's expects that the Uruguayan economy will recover gradually in 2021-23, with average growth of 3%. Although Uruguay experienced its first wave of the pandemic in 2021, Moody's considers that the strong progress of the government's vaccination program -- as of 1 August, 64% of the population had received two doses -- will support the economic recovery this year. Meanwhile, Moody's expects the fiscal deficit to narrow in 2021 even as the government has increased its direct response to the pandemic through its "coronavirus fund." Consequently, Moody's forecasts that the debt-to-GDP ratio will peak in 2021 at 63% and will subsequently stabilize at this level as the government continues to pursue a fiscal consolidation strategy in the coming years.

ONGOING REFORM PROCESS, WHICH INCLUDES IMPORTANT CHANGES TO MACROECONOMIC POLICYMAKING

Even during the pandemic, the government made progress in passing legislation and advancing other measures that support its structural reform agenda. Many of these initiatives were included in the "Urgent Law" bill that was passed in mid-2020. Moody's considers that as these measures are implemented over the coming years, they will bolster fiscal and monetary policy effectiveness and credibility.

A key component of the reform package included modifications to the fiscal rule. In its new form, the fiscal rule incorporates three pillars: (i) a structural fiscal balance pillar, which accounts for business cycle fluctuations; (ii) a spending pillar that sets a cap on primary expenditure growth in real terms, set to match potential GDP growth; (iii) an annual net indebtedness limit set by the legislature in dollar terms. In 2020, the government complied with all three targets. Additional measures, including the setup of independent expert commissions to increase the transparency of the framework, will help strengthen fiscal policy credibility.

In line with Moody's expectation that Uruguay's history of policy-consensus building would support the adoption of measures to confront its structural economic and fiscal challenges in the coming years, important progress has been made in advancing a structural pension reform. Other key measures include (i) reform of the fuel market; (ii) improving the business environment to increase investment and employment levels; and (iii) deepening the domestic capital market to provide greater saving mechanisms and also increase available capital to support higher investment in the country.

On the monetary policy front, the central bank (BCU) made significant changes to its policy framework in September 2020 to address the country's relatively high inflation rate. The BCU relaunched its inflation targeting regime and sought to increase transparency in order to anchor inflation expectations. The authorities have also made explicit their effort to reduce financial dollarization as a condition to strengthen the monetary policy framework.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects a balance between the structural economic and fiscal challenges that Uruguay faced prior to the pandemic with Moody's expectation that as the government implements its reform agenda and policies, it will effectively address these issues. In the years preceding the pandemic, Uruguay's economic performance lagged that of rating peers in part because of declining levels of investment and a significant loss of jobs. While the construction of the country's third largest pulp mill plant by Finnish company UPM-Kymmene (Baa1 stable) will change the trend in terms of investment, Moody's expects that additional measures undertaken by the government to incentivize private investment and employment will support a broader recovery.

On the fiscal front, although government spending has a relatively rigid structure, the authorities identified savings and efficiency gains last year and Moody's expects that the government will remain compliant with the spending limits set by the new fiscal rule. Over the long term, the pension reform will also help address some of these issues.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Moody's assesses Uruguay's exposure to environmental risks as neutral-to-low (E-2 issuer profile score). 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.

Exposure to social risks is neutral-to-low (S-2 issuer profile score). The country's aging population, coupled with the population's predilection for social expenditure, will weigh on public finances in the coming years. A deterioration in the labor market, for the younger population, also poses social risks. However, an adequate provision of social services and a mature political system that develops policy on a consensus-basis help mitigate social risks.

The influence of governance on Uruguay's credit profile is also neutral-to-low (G-2 issuer profile). The country has a long history of sustainable macroeconomic policies, strong institutions and a broad societal consensus on retaining the country's institutional arrangements.

GDP per capita (PPP basis, US$): 22,459 (2020 Actual) (also known as Per Capita Income)

Real GDP growth (% change): -5.9% (2020 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 9.4% (2020 Actual)

Gen. Gov. Financial Balance/GDP: -5.8% (2020 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -0.7% (2020 Actual) (also known as External Balance)

External debt/GDP: 86.0% (2020 Actual)

Economic resiliency: baa2

Default history: At least one default event (on bonds and/or loans) has been recorded since 1983.

On 05 August 2021, a rating committee was called to discuss the rating of the Uruguay, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have decreased. The issuer's institutions and governance strength have materially increased. The issuer's fiscal or financial strength, including its debt profile, has decreased.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upward credit pressure could result from (1) continued progress on the government's reform agenda, in particular vis-à-vis compliance with the new fiscal rule and monetary policy framework that result in improving macroeconomic outcomes; (2) a material strengthening in the government's balance sheet, for example, through a reduction in the sovereign's debt and interest burdens and continued improvements in the debt structure; and, (3) a reduction in structural rigidities of Uruguay's credit profile such as those associated with low and declining productivity, which affects potential growth, as well as the relatively rigid government spending structure.

Downward credit pressure would emerge if Moody's were to conclude that structural fiscal and economic challenges were unlikely to be addressed, denoting a weakening in policy responsiveness, and likely leading to economic growth underperforming and fiscal strength deteriorating further in the medium term, with a continued increase in debt ratios and/or a sustained, material erosion in external and financial buffers.

The principal methodology used in these ratings was Sovereign Ratings Methodology published in November 2019 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1158631 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1288435 .

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Renzo Merino
Vice President - Senior Analyst
Sovereign Risk Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Alejandro Olivo
Associate Managing Director
Sovereign Risk Group
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 1 212 553 0376
Client Service: 1 212 553 1653

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