Research Update:

Uruguay Long-Term Ratings Raised To 'BBB+' On Stronger Fiscal Policy; Outlook Stable

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Overview

- Recent enhancements to Uruguay's fiscal policy framework, including the likely passage of social security reform, should contribute to stable public finances in coming years and limit rises in the debt burden.
- We expect these policies to support fiscal execution, alongside GDP growth backed by a pipeline of diversified investment projects after the completion of the UPM 2 plant and related infrastructure this year.
- As a result, we raised our long-term sovereign credit ratings on Uruguay to 'BBB+' from 'BBB'.
- The stable outlook indicates our expectation that continued economic growth and stable fiscal outcomes will contribute to a moderate fiscal deficit and a stabilization of debt levels.

Rating Action

On April 26, 2023, S&P Global Ratings raised the long-term foreign and local currency sovereign credit ratings on Uruguay to 'BBB+' from 'BBB'. The outlook is stable. In addition, we affirmed our 'A-2' short-term foreign and local currency ratings.

We revised up the transfer and convertibility assessment to 'A'.

Outlook

The stable outlook reflects our expectations for continued solid fiscal execution under an enhanced fiscal policy framework and for moderate economic growth that will limit increases in debt in 2023-2026. We expect investments in diverse sectors of the economy to support GDP growth of about 2.5% on average in 2024-2026.

Downside scenario

We could lower the ratings over the next two years if fiscal execution unexpectedly slips, weakening the government's commitment to contain fiscal deficits. In this scenario, we would expect the net general government debt burden to rise to well above 60% of GDP. A sustained weaker long-term GDP growth trajectory could weigh on economic resilience and lead to a lower rating.

Upside scenario

We could upgrade Uruguay in the next two years if we see a successful track record of lowering inflation from the 7% average of the past two decades and a sustained decline in inflation expectations, which could result in a more stable debt path, significantly reduce economic rigidities such as indexation, help expand private-sector credit, and deepen capital markets in local currency. Such developments could accelerate economic growth above our base case, and a deeper and well-capitalized financial system would strengthen Uruguay's monetary flexibility.

Rationale

The upgrade reflects recent enhancements to the fiscal policy framework, such as establishing an independent fiscal council and prudent fiscal execution during the COVID-19 pandemic. The likely approval of social security reform is another signal of fiscal commitment. We expect these measures to contain the annual rise in net general government debt, which excludes central bank debt, through next year's presidential election and over 2025-2026. We believe recent improvements to fiscal institutionality and the long-term benefits of structural reforms will contribute to anchoring expectations of public finances.

Our ratings on Uruguay are supported by its track record of stable and predictable economic policies and its well-established institutions, which have underpinned consistent economic growth. Uruguay also has a strong external position and the highest per capita GDP in the region.

Uruguay's relatively high inflation and still-high dollarization in the financial system constrain monetary policy flexibility and the ratings.

Institutional and economic profile: Growth will slow in 2023 but maintain support from macroeconomic and institutional stability

- Real GDP growth is set to slow to about 1% in 2023 following an average increase of 5.1% for 2021-2022.
- We expect 2% growth in 2025-2026, supported by a pipeline of smaller investment projects following the completion of the UPM 2 project.
- Uruguay's strong checks and balances and low perceived corruption, which sustain investor confidence, continue to support economic outcomes.

We estimate Uruguay's GDP per capita at US$21,700 in 2023, up from US$20,300 in 2022, which compares favorably with regional peers (and is similar to Chile's GDP per capita). Uruguay is a largely middle-class country with a strong social contract that emphasizes consensus and cohesion.

Real GDP growth is set to slow to about 1% in 2023 following an average of 5.1% for 2021-2022. Recent growth stemmed from the rebound from the 2020 contraction, the execution of large investments in the pulp and paper and logistical sector (almost 6% of GDP), and favorable export performance. A severe drought, lower investment levels, and a negative statistical carryover effect will contribute to the slower growth in 2023.

We expect growth to average 2.5% thereafter, thanks to higher exports (from the large pulp and paper project UPM 2) and a recovery in real wages, along with the execution of various investment projects in sectors such as real estate, commerce, transport, software, and agribusiness. Macroeconomic and institutional stability in Uruguay will continue to support private investments, despite high costs compared with the overall region.

Uruguay has well-established institutions and a cohesive political culture that we expect will continue to anchor economic policy. Economic policy differences across party lines are limited compared with most of the region. We believe there is broad consensus on key macroeconomic policies. Uruguay has a vibrant democracy and ranks high in global institutional quality rankings.

The Lacalle Pou administration took office in 2020 and was forced to refocus its priorities on the pandemic. However, it remained committed to addressing structural weaknesses in public finances through fiscal framework enhancements and transparency, as well as clear steps toward the social security reform. While the reform will not have an immediate financial impact, its approval supports our view of the country's institutional effectiveness and will contribute to the containment of budget pressures in the longer term.

Flexibility and performance profile: Expected moderate increases in the debt burden with support from enhancements in the fiscal policy framework

- We expect net general government debt will rise only moderately and reach 54% by 2026. We now exclude central bank debt from our general government metric.
- We expect current account deficits in 2023-2024 and slightly positive results starting in 2025, sustaining Uruguay's balanced external position.
- We assume inflation will remain above the central bank target range in the next couple of years.

We expect a general government (GG) deficit of 2.7% of GDP in 2023, slightly down from 2.8% in 2022, and we expect this metric to remain at about 2.5% in 2024-2026. Uruguay's budget will face pressure in 2023 from lower growth, tax breaks for 0.2% of GDP, and the government's promise to compensate for recent real wage losses, which will weigh on personnel and pension expenditure. The complete phasing out of COVID-19-related spending and capital expenditure adjustment should prevent fiscal slippage in 2023. Our definition of GG debt excludes the central bank and public-sector enterprises.

Corrective fiscal policy in recent years lowered the GG fiscal deficit, excluding extraordinary factors, by 1.3 percentage points in 2022 compared with 2019. Extraordinary factors include COVID-19 spending and inflows from the "cincuentones" ring-fenced trust (from changes to the social security system that enabled certain groups of future retirees in private pension plans to return to the public-sector pension system). This decrease reflects the administration's strong commitment to structurally improving the fiscal stance and reducing cyclical spending. We believe the fiscal framework will remain in place after the elections in 2024, anchoring the predictability and sustainability of fiscal outcomes.

Our key measure of a government's fiscal performance is the change in net GG debt stock, expressed as a percentage of GDP, which captures more than headline deficits and indicates debt trends. We estimate an increase in net GG debt of 5.5% of GDP on average over 2023-2026. In Uruguay, changes in net debt reflect headline deficits, along with the impact from exchange rate movements and inflation, due to its debt composition. Given the still-limited capacity of the government to issue in nominal domestic currency, debt levels will remain influenced by inflation and currency movements.

Accounting for projected deficits, inflation, and likely depreciation trends, our base case assumes net GG debt will trend toward 54% by 2026, from 48% in 2022. We also expect GG interest payments to average 6% of GG revenue between 2023 and 2026. We have excluded central bank debt (12% of GDP on average in the past 20 years) from our debt metrics. Central bank debt is a key asset for pension funds that would not be easily replaced. However, we have observed over a decade of cyclical movements in central bank debt levels and the economic cycle, supporting our view that such instruments largely serve monetary policy purposes and operations.

The government is likely to continue meeting its financing needs mainly through local and international bond issuance. Its main source of funding in 2022 was bond issuance in local and international debt markets, of which 87% was denominated in local currency. Foreign currency borrowing in 2022 included a global sustainability-linked bond issuance for US$1.5 billion maturing in 2034, which linked the bond's coupon interest rate to the achievement of climate and nature conservation performance targets aligned with Uruguay's Paris Agreement commitments.

Uruguay has ample external liquidity to manage potential financing disruptions. Liquidity buffers as of year-end 2022 included contingent credit lines for a total of US$1.5 billion (2.1% of GDP) with multilateral institutions, as well as government liquid assets at about 4% of GDP.

Inflation in Uruguay has been 7%-8% for almost two decades. The central bank has focused on anchoring expectations through increased communication and transparency with the market and especially with business chambers. Aside from external factors, local tariff and wage adjustments, inflation inertia, and the closing of the GDP gap will produce strains. We expect inflation will gradually decline to 6.2% in 2026, which is close to the upper bound of the central bank target (3%-6%).

High inflation and still-high dollarization continue to limit Uruguay's monetary policy flexibility. They also pose risks to the financial sector, in the case of potential sudden spikes in the exchange rate. Over 50% of resident loans and more than 70% of resident deposits are denominated in dollars.

Despite the high dollarization, the Uruguayan banking system has remained relatively healthy and resilient thanks to financial institutions' strong liquidity and capital. Credit to the private sector, however, remains relatively low at just under 30% of GDP. Asset quality metrics have remained stable. We classify Uruguay in group '5' of our Banking Industry Country Risk Assessment, or BICRA (see "Banking Industry Country Risk Assessment: Uruguay," published Nov. 8, 2022). BICRAs are grouped on a scale from '1' to '10', ranging from what we view as the lowest-risk banking systems, or group '1', to the highest risk, or group '10'.

Uruguay's external sector has remained balanced despite unfavorable regional and mixed global conditions. We expect deficits in the current account in 2023 and 2024 of 2.9% and 1.0% of GDP, respectively, and slightly positive results thereafter. The severe drought will have an estimated negative impact of 2% of GDP over 2022-2024. At the same time, exports will have support from the production of cellulose plant UPM 2 starting in the second half of 2023 (per estimates from the company, it will add US$1.1 billion in exports annually), a recovery of tourism services, and a potential increase in the exchange rate. On the imports side, lower capital imports and a gradual correction in international prices could contribute to external accounts.

Gross external financial needs should gradually return to just below 100% of current account receipts (CAR) plus usable reserves by 2025. We expect narrow net external debt to hover around 30% of CAR in 2023-2026. We expect the government to continue to finance part of the fiscal deficit with external sources through bond issuance and multilateral institution loans.

Key Statistics

Table 1

Uruguay--selected indicators

	2017	2018	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Economic indicators (%)										
Nominal GDP (bil. LC)	1,864.14	2,003.38	2,187.55	2,254.72	2,674.70	2,930.19	3,178.50	3,486.65	3,784.29	4,107.33
Nominal GDP (bil. $)	65.01	65.20	62.05	53.67	61.41	71.17	76.27	77.84	78.96	80.29
GDP per capita (000s $)	18.8	18.8	17.9	15.4	17.6	20.3	21.7	22.0	22.3	22.6
Real GDP growth	1.7	0.2	0.7	(6.3)	5.3	4.9	1.0	3.0	2.2	2.2
Real GDP per capita growth	1.4	0.0	0.7	(6.6)	4.8	4.5	0.6	2.6	1.8	1.8
Real investment growth	0.9	(10.5)	(2.0)	1.2	16.5	9.5	(2.0)	(1.0)	1.8	1.8
Investment/GDP	16.0	15.0	14.4	16.4	18.1	18.5	18.0	17.3	17.2	17.1
Savings/GDP	16.0	14.5	15.6	15.6	15.6	15.4	15.1	16.3	17.6	18.4
Exports/GDP	25.9	26.5	27.8	25.2	30.5	31.3	30.4	32.0	32.4	32.4
Real exports growth	5.3	(1.1)	4.6	(16.3)	11.7	11.1	5.3	15.5	9.9	8.5
Unemployment rate	7.9	8.3	8.9	10.4	9.3	7.9	7.2	7.2	7.2	7.2
External indicators (%)										
Current account balance/GDP	0.0	(0.5)	1.2	(0.8)	(2.5)	(3.2)	(2.9)	(1.0)	0.4	1.3
Current account balance/CARs	0.0	(1.6)	3.9	(3.0)	(7.4)	(9.2)	(8.7)	(2.9)	1.0	3.6
CARs/GDP	28.9	29.5	30.8	27.6	34.0	34.5	33.0	34.6	35.0	35.0
Trade balance/GDP	3.0	3.7	5.0	4.0	7.3	5.0	5.2	8.5	10.5	12.5
Net FDI/GDP	(3.1)	(1.1)	2.2	1.9	2.9	4.6	1.6	1.6	1.6	1.5
Net portfolio equity inflow/GDP	3.3	1.9	(1.7)	(2.8)	(1.4)	(2.2)	0.0	0.0	0.0	0.0
Gross external financing needs/CARs plus usable reserves	101.1	90.7	86.6	98.9	98.5	100.4	105.3	102.5	98.8	94.6
Narrow net external debt/CARs	26.3	27.8	31.5	26.7	21.3	29.9	37.6	37.9	31.9	23.9
Narrow net external debt/CAPs	26.3	27.4	32.8	25.9	19.8	27.4	34.6	36.8	32.2	24.8

Table 1

Uruguay--selected indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Net external liabilities/CARs	89.9	86.5	78.3	92.2	66.7	76.1	97.2	98.1	95.0	90.4
Net external liabilities/CAPs	89.9	85.2	81.5	89.6	62.1	69.7	89.4	95.4	96.0	93.8
Short-term external debt by remaining maturity/CARs	38.0	37.0	33.4	43.6	33.0	29.5	30.5	28.5	27.8	27.3
Usable reserves/CAPs (months)	4.4	6.2	6.2	5.6	4.8	4.2	3.6	3.3	3.4	3.8
Usable reserves (mil. $)	10,183	9,465	7,150	8,882	9,388	8,116	7,599	7,845	8,661	9,866
Fiscal indicators (general government; %)										
Balance/GDP	(2.7)	(3.4)	(4.2)	(5.0)	(3.6)	(2.8)	(2.7)	(2.5)	(2.5)	(2.5)
Change in net debt/GDP	3.9	5.7	7.2	9.1	6.3	1.4	5.9	5.5	5.5	5.4
Primary balance/GDP	(0.5)	(1.2)	(2.1)	(2.6)	(1.8)	(0.9)	(0.7)	(0.5)	(0.4)	(0.3)
Revenue/GDP	34.9	36.2	35.1	35.0	33.2	33.8	33.5	33.5	33.5	33.5
Expenditures/GDP	37.5	39.7	39.3	40.0	36.8	36.6	36.1	36.0	36.0	35.9
Interest/revenues	6.4	6.2	5.9	6.9	5.6	5.6	5.9	6.0	6.2	6.3
Debt/GDP	43.7	46.4	48.9	58.3	55.6	51.9	54.1	55.0	56.4	57.6
Debt/revenues	125.3	128.2	139.2	166.4	167.4	153.4	161.6	164.3	168.5	172.1
Net debt/GDP	38.4	41.5	45.1	52.9	50.9	47.9	50.1	51.1	52.6	53.9
Liquid assets/GDP	5.2	5.0	3.8	5.3	4.7	4.0	4.0	3.9	3.8	3.7
Monetary indicators (%)										
CPI growth	6.6	8.0	8.8	9.4	8.0	8.3	7.4	6.5	6.2	6.2
GDP deflator growth	5.7	7.3	8.4	10.0	12.7	4.4	7.4	6.5	6.2	6.2
Exchange rate, year-end (LC/$)	28.76	32.39	37.34	42.34	44.70	40.07	43.28	46.31	49.55	52.77
Banks' claims on resident non-gov't sector growth	0.5	11.6	10.7	12.3	12.4	9.6	9.0	9.0	9.0	9.0
Banks' claims on resident non-gov't sector/GDP	24.8	25.7	26.1	28.4	26.9	26.9	27.0	26.9	27.0	27.1
Foreign currency share of claims by banks on residents	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Foreign currency share of residents' bank deposits	73.3	73.6	76.2	77.4	77.2	75.0	75.0	75.0	75.0	75.0

Table 1

Uruguay--selected indicators (cont.)

	2017	2018	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Real effective exchange rate growth	6.1	1.5	(3.2)	(4.0)	(2.2)	11.0	N/A	N/A	N/A	N/A

Definitions: 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 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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. f--Forecast. 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

Uruguay--ratings score snapshot

Key rating factors	Score	Rationale
Institutional assessment	3	Stable democracy, predictable policies, free press, and peaceful changes of government. No external threats. Largely middle-class society with consensus on key economic policies. Policymaking during the past 15 years has remained generally effective. Strong institutional checks and balances, low perception of corruption, and respect for the rule of law.
Economic assessment	3	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1. We estimate GDP per capita growth over our forecast period will be in line with that of countries with similar levels of development.
External assessment	2	Based on narrow net external debt and gross external financing needs/(CAR plus usable reserves) as per Selected Indicators in table 1.
Fiscal assessment: flexibility and performance	5	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	3	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in table 1.
		Over 40% of gross government debt is denominated in foreign currency.
Monetary assessment	5	The Uruguayan peso is a free-floating currency with central bank intervention in foreign exchange markets. CPI as per Selected Indicators in table 1. The central bank has a track record of independence and has the ability to act as lender of last resort for the financial system.
		Resident deposits/loans in foreign currency account for more than 50% of the total.
Indicative rating	bbb+	As per table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BBB+	
Notches of uplift	0	

Table 2

Uruguay--ratings score snapshot (cont.)

Key rating factors	Score	Rationale
Local currency	BBB+	Default risks do not apply differently to foreign currency and local currency debt.

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). S&P Global Ratings' "Sovereign Rating Methodology," published Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating, the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Global Sovereign Rating Trends: First-Quarter 2023, April 17, 2023
- Sovereign Ratings History, April 11, 2023
- Banking Industry Country Risk Assessment Update: March 2023, March 30, 2023
- Sovereign Debt 2023: Commercial Borrowing In The Americas Stabilizing At Higher Levels Than Pre-Pandemic Years, March 9, 2023
- Banking Industry Country Risk Assessment: Uruguay, November 8, 2022
- Uruguay 'BBB/A-2' Ratings Affirmed; Outlook Remains Stable, April 21, 2022

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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		
Uruguay		
Short-Term Debt	A-2	
Upgraded		
	To	**From**
Uruguay		
Transfer & Convertibility Assessment	**A**	**A-**
Uruguay		
Senior Unsecured	BBB+	BBB
Uruguay		
Sovereign Credit Rating	BBB+/Stable/A-2	BBB/Stable/A-2