# Uruguay

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First Citizens
Research & Analytics

| COUNTRY | | CREDIT RATING | | | |
|---|---|---|---|---|---|
| Real GDP growth (%) 2016 | 0.90% | S&P Foreign Currency | BBB(N) | Major Trade Partners | China 15%, Brazil 14.4%, US 6.5%, Argentina 4.9% |
| Next General Election | 2019 | Fitch Foreign Currency | BBB-(S) | Major Exports | beef, soybeans, cellulose, rice, wheat, wood, dairy products; wool |
| Exchange Rate | UYU 29.915 | Moody's Foreign Currency | Baa2 (N) | GDP Composition | Agriculture: 7.5%, industry: 20.6%, services: 71.9% |
| | Price of 1 USD in UYU | | | | |

## RECENT ECONOMIC DEVELOPMENTS

**ECONOMIC OUTLOOK** — **STABLE**

Real GDP growth in Uruguay is projected to remain tepid in 2016 in light of economic weakness in key regional trading partners and elevated inflation. Growth in 2015 came at a paltry 1.0%, well below BMI's 4.8% estimate, due to weaker private consumption and sharper contractions in investment and real export growth than were anticipated. In 2016, growth is forecasted around of 0.9% and by 2017, economic activity should accelerate, expanding by 2.0% in real terms, as the economies of Brazil and Argentina rebound and demand for key agricultural exports improves.

The economies of two of Uruguay's main trading partners and sources of foreign direct investment (FDI)--Brazil and Argentina--are set to contract by 3.6% and 1%, respectively, in 2016, with growth in Brazil only expected to rebound slowly in the next two years. Although the Uruguayan economy's links with these countries are weaker than in the past, it will still suffer from the regional recession. In addition, lower trend growth in China (which buys 23% of Uruguay's exports) and weak global commodity prices also weigh on Uruguay's growth prospects. At the same time, inflation dynamics have worsened amid depreciation of the Uruguayan peso; we expect consumer confidence to remain weak in a context of inflation that remains close to 10%. Growth for 2016 -2017 is hinged on government's countercyclical and expansionary policies as well as FDI inflows from regional economies. Already, the Finance Ministry reports that the value of proposed FDI projects in the first four months of 2016 hit a three-year high, underscoring the country's continued investor appeal. Despite a fall in expected GDP per capita in U.S. dollar terms to around USD15,442 in 2016, Uruguay's income level still anchors the country as the wealthiest economy in the region in per capita terms and we believe that unlike regional neighbors, still-substantial investment, predictable policies, and a diverse structure will prevent the economy from contracting.

**LABOUR, INFLATION AND THE FINANCIAL SYSTEM** — **STABLE**

As at June 2016, the 12-month accumulated inflation rate reached just above 10% for the first time in over a decade. This peak in inflation was primarily caused by a combination of the pass-through effect of significant depreciation of the Uruguayan peso as well as an increase in utility tariffs. Despite low global oil prices, the transmission of these prices has been restrained as the government has prioritized improving the finances of ANCAP (State Owned Petrochemical/ Manufacturing company). By the end of 2016, S&P projects that inflation will remain close to 10%, as the impact of continued currency depreciation is counterbalanced by contractionary monetary policy, a decelerating economy, and new wage-indexation guidelines. Monetary policy has continued to tighten since 2013. Most recently, the central bank's monetary policy committee lowered its monetary aggregate growth target to 1%-3% and noted that the monetary aggregate remained flat in the second quarter of 2016. The central bank also raised reserve requirements to 28% from 23% for local currency deposits and to 28% from 26% for foreign currency deposits as of April 1, 2016. The tightening output gap should also prevent an inflationary spiral, while new wage-setting guidelines will limit the impact of wage indexation. Additionally, greater coordination between fiscal and monetary policy should benefit the effectiveness of each. Along those lines, in April 2016, the central bank and the Ministry of Finance established the Public Debt Coordination Committee to coordinate debt management strategies in the local market based on consistent monetary and fiscal policy goals. This coordination between fiscal and monetary authorities follows best practices established by the World Bank.

**EXTERNAL ACCOUNTS** — **STABLE**

The Uruguayan peso depreciated by nearly 23% in 2015 following portfolio outflows, supporting the country's external competitiveness amid regional and global volatility. Nevertheless, although slowing in the latter part of the year, central bank intervention in foreign exchange markets to help smooth this depreciation partly led to the fall in international reserves, which reached USD13.97 billion by April 2016 (excluding gold holdings), from USD17.5 billion at the end of 2014. Yet, on the other hand, the improvement in the CAD prevented deterioration in the country's external liquidity. Despite Uruguay's main trade partners' economic slowdown in 2015, coupled with the fall in global commodity prices, the majority of the country's commodity exports are agricultural goods, while Uruguay is also an oil importer. Over 60% of the country's commodity exports are related to agriculture, which we expect to be more resilient than other commodities in the face of global economic slowdown, particularly from China, while agricultural and oil prices tend to move in conjunction, limiting the risks of significantly higher current account imbalances. In 2015, Uruguay's CAD improved to 3.6% of GDP from 4.6% a year earlier, which was mostly caused by an improvement in the trade deficit to 0.5% of GDP from 1.6% in 2014. In 2016, S&P expects the current deficit to continue to shrink and reach 3.3% of GDP as energy prices remain low and economic slowdown will help shrink the external imbalance. FDI inflows are expected to remain above 3% of GDP over the next three years, gradually recovering as growth returns to some of Uruguay's main source markets, and contribute as a source of growth for the country. We expect FDI to once again fully fund the country's CAD beginning in 2017, which should contribute to a recovery in the country's international reserves to USD15.8 billion (not including gold holdings) by 2019.

**FISCAL PROFILE** — **NEGATIVE**

Weak revenues and elevated expenditures will drive Uruguay's fiscal deficit modestly wider in 2016. We expect the deficit to come in at 3.6% of GDP in 2016, from 3.2% in 2015, as the government pursues countercyclical fiscal policy in light of slower economic growth. However, the government's drive to increase tax rates in the coming months will support stronger revenue collections in 2017, helping to gradually narrow the deficit over the coming years. We forecast a 3.2% deficit in 2017, which will narrow to 2.5% by 2019, in line with the government's target. With its history of prudent fiscal policy and gradually narrowing deficits, Uruguay will maintain its sovereign credentials in the coming years, supporting favorable interest rates on its debt. S&P project that net general government debt over GDP (which includes central bank debt issued for open-market operations) will increase to 53.8% in 2016, from 50.3% in 2015, given the expected general government deficit of 4.5% of GDP and given expected further currency depreciation. By 2019, we expect net general government debt to reach 50.6% of GDP as deficits consolidate, currency depreciation moderates, and growth begins to recover. The projections are subject to volatility due to sharp movements in the exchange rate as about 56% of the central government's debt is denominated in foreign currency.

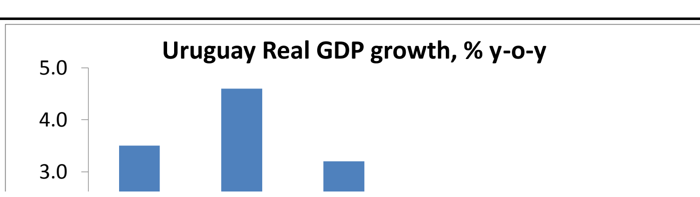
**CREDIT RATING** — **NEGATIVE**

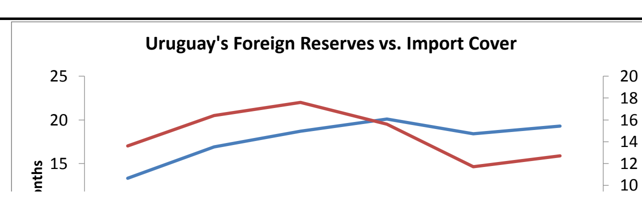
In June 2016 S&P held Uruguay's rating at BBB, however due to external weakness, the credit rating agency placed the country on negative outlook.
The negative outlook reflected the following factors:
1. Weak revenue expectations as well as policy inflexibility.
2. Difficulty Central Government may face in implementing timely reforms leading to widening of deficit .
3. Weakness in major trading partners.

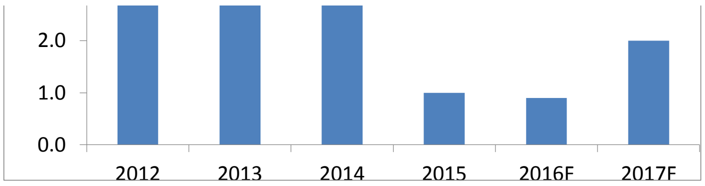
Additionally in June 2016, Moody's also placed Uruguay on a negative outlook with a credit rating of Baa2, in line with S&P's rating.

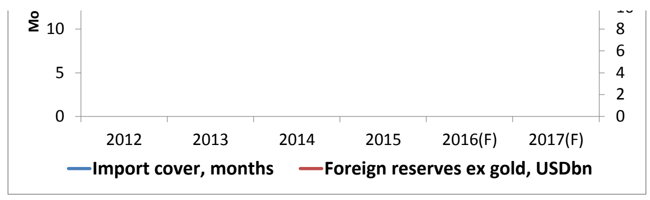
**OUTLOOK**

There is notable potential in Uruguay. Despite its exposure to agricultural shocks and slippage in fiscal policy, the country has demonstrated a willingness to develop the country and implement the changes that need to be made. Uruguay's main trade partners are China, Brazil and U.S; all of these countries are expected to face challenging economic condition in 2016-2017. The economy is highly dependent on exports to these countries as well as investment into its agricultural and manufacturing industries, its main exports. Investments are expected to face headwinds as Argentina becomes a more attractive prospect due to the removal of agricultural export taxes in the Argentine farming sector and cheaper costs due to Argentina's currency devaluation. Capital outflows driven by Argentine repatriation could drive a sell-off, and unexpectedly weak economic data out of China could unwind commodity prices' nascent recovery. Fiscal consolidation attempts as well as external weakness should be closely monitored.



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