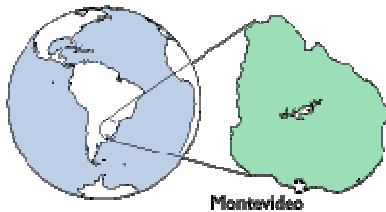


COUNTRY REVIEW

Uruguay



9 November 2009

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EULER HERMES COUNTRY RISK GRADE: B

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- Stable democratic framework.
- Good degree of social consensus.
- Recognition by left-of-centre government of need to prioritise macroeconomic stability (though a new administration takes office shortly).
- Sound Structural Business Environment.

Weaknesses

- Strong linkages with much larger neighbours Argentina and Brazil make the economy highly vulnerable to events in these economies.
- A highly dollarised banking system.
- Relatively high inflation.
- High public debt ratios.

Country Risk Assessment

Ratings	Uruguay		Median Grade B	Peers		
	Latest	Previous		Colombia	Costa Rica	Peru
Systemic Political Risk:	P2+	P2+	P2-	P3+	P2+	P3+
Systemic Economic Risk:	E4	E4	E4	E4	E4	E4
ME rating:	ME4	ME4	ME4	ME4	ME4	ME4
<i>Structure</i>	4.0	4.7	5.0	5.0	2.3	5.0
<i>Policy</i>	5.6	4.2	4.0	4.0	5.8	3.8
<i>Solvency</i>	3.8	4.3	2.5	3.8	1.3	2.8
<i>External Liquidity</i>	3.2	3.2	3.7	4.2	4.8	2.8
SBE rating:	SBE3	SBE3	SBE3	SBE3	SBE3	SBE3
COUNTRY GRADE:	B	B	B	B	B	B

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

ECONOMIC STRUCTURE

Country Profile

Capital city:	Montevideo
Population:	3.35 mn (2008)
GDP:	USD 31 136 mn (2008)
Currency:	Uruguayan peso (UYU)
Form of state:	Republic
Head of government:	President Tabare Vazquez
Next elections:	October/November 2009 (presidential & legislative)

Major Industries (% of GDP at market prices, 2007)		Global Assumptions	2009	2010
Agriculture	9.1%	Real GDP grth (% yr/yr) *	-3.9	0.9
Industry	32.3%	Inflation (% , av) *	-0.1	1.3
Mining	23.1%	Dated Brent (USD/b)	61	72
Services	58.6%	* Major economies		

Main Exports (% of total, 2008)		Main Imports (% of total, 2008)	
Live animals & animal products	35.5%	Consumption goods	18.0%
Chemicals & plastics	10.5%	Energy	26.5%
Cereals	9.8%	Raw materials & intermediate goods	38.2%
Hides & Skins & leather products	4.9%	Capital goods	15.5%
Textiles and clothing	4.9%		
Lead Export Markets (% of total exports, 2007)		Lead Import Markets (% of total imports, 2007)	
Brazil	15.1%	Brazil	19.1%
US	12.1%	Argentina	17.9%
Argentina	6.8%	US	9.5%
Mexico	6.4%	China	9.1%

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	19,310	23,135	31,136	30,460	31,711
Population (mn)	3.33	3.34	3.35	3.35	3.35
GDP per capita (USD)	5,799	6,927	9,294	9,093	9,466
Real GDP growth (% yr/yr)	4.6	7.6	8.9	0.5	2.8
Inflation (% , eop)	6.4	8.5	9.2	6.3	6.5
Fiscal balance (% of GDP)	-0.6	-0.2	-1.8	-3.3	-2.0
Current account balance (% of GDP)	-2.0	-0.9	-3.9	0.0	-0.7
External debt/GDP (%)	67	64	50	53	49
External debt/Exports of goods & services (%)	219	209	162	187	171
Interest payments/Exports of goods & services (%)	13	10	8	8	8
Foreign exchange reserves (USD mn)	3,085	4,114	6,353	8,100	8,500
Import cover (months)	6.3	5.5	4.9	9.8	10.9
Exchange rate assumption, UYU:USD (av)	24.07	23.47	20.94	22.86	23.50
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes Country Risk Unit

Political Stability

Uruguay has been stable within a democratic framework since returning to civilian rule in 1985, though the mixed economy/social welfare tradition and centrist, consensual politics has tended to slow the pace of economic reform. The traditional domination of two centrist political parties—the Colorados and the Blancos—was broken in October 2004 as the Frente Amplio (FA) a coalition of parties ranging from centre- to far-left won a majority in both houses of the legislature and the FA candidate, Tabare Vazquez, won a comfortable first-round victory in the presidential election. In the latest elections in October 2009 the FA retained a slim majority in both houses of congress and the FA's presidential candidate, Jose Mujica, won the presidential elections with a clear mandate, albeit after a second round run-off.

Despite his left-wing credentials—he had twice fought and lost elections on a more radical platform—President Tabare Vazquez prioritised orthodox stabilisation/reform policies and established himself as a member of the group of pragmatic left leaders in the region. Mujica (74) a former Tupamaros guerrilla and agriculture minister, is also from the Left. However, his running mate was Daniel Astori, a former finance minister in the Tabare Vazquez administration, who followed orthodox economic policies, and reportedly will oversee economic appointments in the Mujica administration. In any event the slim congressional majority of the FA means that major legislative changes will probably need a measure of cross-party support.

It is also likely that there will be a good measure of policy continuity. The outgoing Tabare Vazquez administration adopted a new IMF programme on taking office to run-on from that implemented by the previous administration, which had been central to stabilisation efforts after the economic crisis of the early 2000s. The programme was completed broadly successfully, but was not renewed. Nonetheless, the relationship with the Fund remains constructive. Reforms introduced under the outgoing government include a comprehensive tax reform and a five-year budget framework.

International relations are generally good. Uruguay is a member of the Mercosur custom union. Although there has been friction with Argentina over the construction of pulp mills on the Uruguayan side of the River Plate, this has not been allowed to spill over into other economic relations.

Economic Stability

The economy suffered badly in 1998-2002 with a 20% cumulative fall in real GDP, a severe banking and currency crisis and a quasi-voluntary public debt restructuring, as problems in neighbouring Brazil and Argentina (both much larger economies) hit exports and tourism and caused the repatriation of funds from Uruguay's banks (the traditional haven for Argentine capital flight). The economy remains highly vulnerable to developments in its larger neighbours, but, after recovering strongly from the earlier crisis with annual average growth of real GDP of 6.7% in 2004-08, has weathered the current global crisis relatively well, partly as a result of conservative policies and a stronger banking system, but also because Brazil and Argentina have avoided major banking and currency crises.

Growth returned in Q2 2009 as real GDP increased by 0.5% qtr/qtr (seasonally adjusted) after just one quarter of contraction—albeit a large -2.3% after only +0.3% in Q4 2008—helped by an increase in government consumption, marginally positive personal consumption and export growth and a sharp fall in imports, which offset a large fall in investment. In yr/yr terms the economy grew by 1.5% in H1 2009, which was relatively good in global terms. With lower interest rates and stronger external demand the recovery should continue, although fiscal support will lessen, with 0.5% growth in 2009 overall and 2.8% in 2010.

There were sustained primary fiscal surpluses in 2003-08 which limited the overall fiscal deficit (non-financial public sector, NFPS) to less than 1% of GDP until 2007 and allowed the gross public debt-GDP ratio to decline from 109% in 2003 to 53% at end-2008, though this was still relatively high. In 2009 a small primary deficit may emerge, as the downturn that set in late 2008 reduced revenues sharply (as a proportion of GDP) while non-interest expenditures were maintained. Moreover, based on data to September, the overall NFPS deficit could exceed government projections of 2.6% of GDP, widening to 3.3%. Consequently, the public debt-GDP ratio will start to rise again towards 60%. As the economy begins to recover, however, the fiscal deficit should narrow to around 2% in 2010.

Monetary policy is centred on achieving an inflation objective of 3-7%, which has been maintained for 2010-11. Inflation was within the top end of the range at 6.5% yr/yr in October 2009 for the first time since early 2007 and should remain within the upper bound through 2010, as commodity and energy

pressures along with spare capacity limit inflationary pressures. We expect inflation of 6.3% at end-2009 and 6.5% at end-2010, broadly in line with the Central Bank's latest expectations survey. With inflation still relatively high, the central bank's monetary policy committee is likely to remain cautious, having reduced interest rates twice in H1 2009 before leaving them on hold since. The exchange rate depreciated sharply during the worst of the global financial crisis, as did those of Brazil and Argentina and elsewhere in the region, but has since strengthened, pushing the real exchange rate into overvalued territory, and some depreciation is likely in 2010, though at a manageable pace.

The banking system is highly dollarized, which makes it vulnerable to exchange rate changes, but deposits have been maintained and NPLs are relatively low. Banks net foreign asset position is also strongly positive. Private sector credit growth was very rapid in 2007-08, but slowed sharply in H1.

The current account will narrow from a 3.9% of GDP deficit in 2008 to close to balance in 2009, as the fall in imports outpaces that of exports. As both recover in 2010 a small deficit of 0.5-1.0% of GDP is likely to return. Net FDI inflows, though well down on 2008, nonetheless should more than cover the current account deficit in 2010. Foreign exchange reserves have continued to increase and provide 9.5 months of import cover and 150% of external debt falling due in 2009 and in 2010. Total FX reserves also amount to 160% of the sum of our projected current account deficit for 2010 plus principal repayments on medium-term plus projected short term debt outstanding at end-2009.

External debt as a proportion of GDP declined from 107% in 2003 to 50% in 2008, but was still high, and is set rise again in 2008 to 53%. A similar pattern emerges for external debt relative to export earnings—421% in 2003 falling to 162% in 2007, before rising to 187% in 2009. Interest payments are around 8% of export earnings.

Structural Business Environment

The Structural Business Environment is generally sound, ranking above average in our overall assessment, but falling short of the strongest ratings.

The World Bank's 2009 Ease of Doing Business survey ranks Uruguay 114 of 181 surveyed. Based on data and definitions from the World Bank's 2009 Doing Business Survey, of ten areas surveyed, four—Starting a Business, Protecting Investors, Trading Across Borders and Enforcing Contracts—were below average and three—Dealing with Construction Permits, Registering property and Paying Taxes—were particularly weak and well below average. The World Bank Institute's Governance Research Indicator 2008 puts rule of law, control of corruption and regulatory quality all above average for the Latin American region, while the first two were above and the latter just below average for the lower middle income group of economies. Transparency International's Corruption Perception Index, 2008, assigns Uruguay a score of 6.9—on a scale of 1 (bad) to 10 (good)—and a ranking of 23= out of 180. As a broad measure of the pro-business environment The Heritage Foundation 2008 Index of Economic Freedom ranks Uruguay 38 out of 179.

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Charts

