Euler Hermes Economic Research

Country Report

Uruguay

Inflation and adverse external environment weigh on growth

General Information

GDP	USD49.06bn (World ranking 77, World Bank 2012)
Population	3.4 million (World ranking 133, World Bank 2012)
Form of state	Constitutional Republic
Head of government	Tabaré Vázquez
Next elections	2019, presidential and legislative

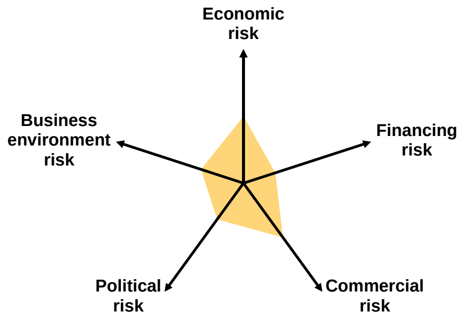
Strengths

- Durable, democratic political system with a good degree of social consensus
- High and inclusive growth
- High foreign reserves levels
- Relatively strong business environment in Latin America
- High levels of FDI inflows driven by ongoing investment plans, notably in infrastructure

Weaknesses

- Relatively high inflation and public debt-GDP ratio
- Banking system highly dollarized with large non-resident deposits
- Vulnerable to external shocks particularly via trade and financial links with low performing neighbours, Brazil and Argentina
- Strong appreciation of the Uruguayan peso against Brazil and Argentina currencies leading to a loss of exports competitiveness

Country Rating BB2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
Brazil	17%	1	17%	China
China	15%	2	15%	Brazil
Venezuela	5%	3	14%	Argentina
Argentina	5%	4	7%	United States
Russia	4%	5	6%	Venezuela

By product (% of total)

Exports		Rank		Imports
Other Edible Agricultural Prod	23%	1	13%	Crude Oil
Meat	15%	2	7%	Refined Petroleum Products
Cereals	13%	3	4%	Plastic Articles
Fats	8%	4	4%	Pharmaceuticals
Non-Edible Agricultural Prod.	7%	5	3%	Fertilizers

Source: Chelem (2012)

EULER HERMES
Our knowledge serving your success

Sharp slowdown in 2014 and 2015

Uruguayan activity accelerated to +4.4% in 2013 boosted by the openness of a new hydroelectric plant in Q2. On the expenditure approach, private consumption (which represents 75% of GDP) remained the main engine of growth (accounting for 4pp of total GDP growth). Household spending continued to benefit from very active social programs and wage increases. Public consumption also contributed positively to growth on the wake of the Presidential elections that were held in late-November 2014.

However available data for 2014 suggest a slowdown of the economy. On the domestic front, private consumption is being penalized by long-lasting elevated inflation. On the external side, the poor economic performance of Venezuela, Russia, Brazil and Argentina, as well as the slow-down of China, weigh on export performance. All in all, Euler Hermes expects Uruguay to grow by +2.7% in 2014 and by +2.9% in 2015.

Inflation remains elevated despite new tools for the Monetary policy

As of June 2013, the Central bank decided to alter the instruments of the monetary policy. The use of a single benchmark policy rate to ensure price stability was abandoned and replaced by Money supply variables targets. The expanded M1 (M1 and saving deposits) became the new variable of reference for the Monetary policy with the Central bank setting its indicative values every quarter.

Considering the continuous high inflation, the Central bank decided to lower its M1+ target to a range of 9-12% growth rate for Q2 and Q3 2014, against 13-15% in Q1. Despite the tightening of the monetary policy, consumer prices continued to evolve above the inflation target range set by the Central Bank for 2014 (5% +/-2pp), reaching +8.1% y/y in October. Euler Hermes expects inflation to reach +8.9% on average in 2014, and to remain elevated along 2015. The cycle of inflationary pressure will remain as long as wage increases are indexed in consumer prices growth.

Public finances are broadly under control

The fiscal deficit slightly narrowed from -2.8% in 2012 to -2.4% in 2013. However, given the sustained growth in expenditures driven by the electoral calendar, the fiscal balance can be expected to deteriorate in 2014. As of October 2014, Central government expenditure grew by +24% y/y, while fiscal revenues expanded by +13%. Euler Hermes expects the fiscal deficit to wide to -3.2% of GDP in 2014, and to remain at this level in 2015.

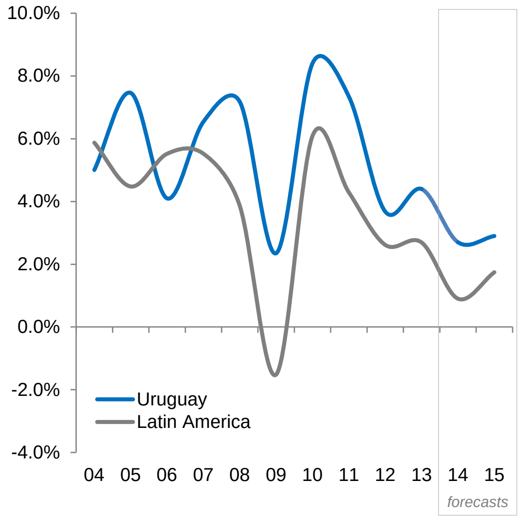
Public debt is showing an upward trend since 2012, after recording steady decrease from 2003 (111% of GDP) to 2011 (59%). It stood 62.1% of GDP in 2013 and should continue to rise in forthcoming quarters, going above 65% of GDP by 2015. For the moment, however, the financing of public debt does not raise concerns. Uruguay benefits from strong investor confidence and has easy access to international capital markets. Moreover, the debt profile has improved significantly over past years with lengthening maturity and 60% of public debt denominated in local currency. Large reserves and other liquid assets held by the Central bank could serve as a financial cushion in case of urgent need for funding. Net debt is indeed on a continuous decreasing trend and now accounts for 24.5% of GDP (against 75% in 2002).

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	3.7	4.4	2.7	2.9
Inflation (%, yearly average)	8.1	8.6	8.9	7.3
Fiscal balance (% of GDP)	-2.8	-2.4	-3.2	-3.2
Public debt (% of GDP)	59.5	62.1	65.1	66.7
Current account (% of GDP)	-5.6	-5.5	-6.0	-6.0
External debt (% of GDP)	42.2	41.0	45.5	47.8

Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

M1 growth rate (y/y, %)

Sources: National sources, IHS, Euler Hermes

Adverse external environment

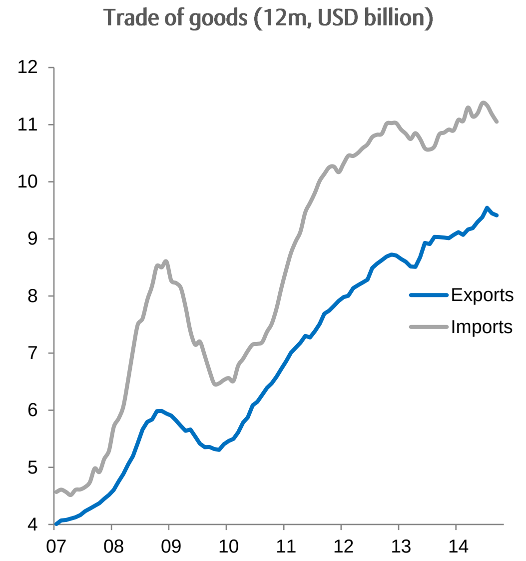
The current account deteriorated in recent years, mostly due to higher import than export growth (respectively +9.7% and +2.8% in average between 2011 and 2014). This pattern saw the current account deficit widen from -1.9% of GDP in 2010 to -5.5% in 2013.

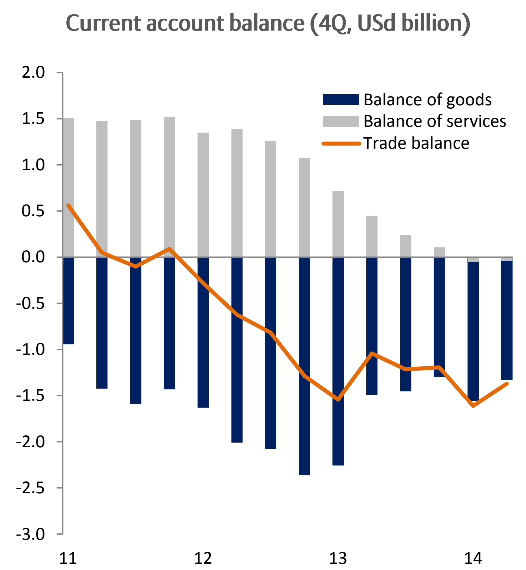
The economy is highly vulnerable to external shocks. The poor economic performance of Uruguay's top trade partners (Brazil, Venezuela, Argentina and Russia), as well as the downside pressures on commodity prices, are weighing on exports (-10% y/y in August, -4.5% y/y in September). However, as imports show a sharper drop, the trade deficit has slightly narrowed in latest months. Along with slowing domestic demand, the fall in oil prices also explains the recent fall imports (crude oil and petroleum product accounts for 20% of total imports). Moreover, the balance of services has been deteriorating since late-2012, largely due to a fall in tourism revenues (mainly from Argentinean and Brazilian), and switched in 2014 for the first time into a deficit. As this trend is expected to continue in forthcoming months, Euler Hermes expects the Uruguayan current deficit to widen to 6% of GDP in 2014 and in 2015.

The external deficit is easily financed. Indeed, Uruguay benefits from strong capital inflows (FDI and portfolio investment), thanks to the relatively strong business environment (*Doing Business* figures ranks Uruguay 84 out of 189 economies), the low level of corruption and good rule of law. More than 90% of the current account deficit is covered by FDI inflows. Moreover, FX reserves have continuously risen since the 2002 crisis thanks to the very active policy followed by the government aiming to reduce the external vulnerability of the country. As of September 2014, FX reserves (minus gold) stood at USD17.7 bn in, covering over 15 months of imports.

Continuity of social and economic policies with the new government

Repeating 2004's election results, former President Tabaré Vázquez (2004-2009) was announced the winner of the Uruguay's runoff presidential election with 53% of the vote. The Frente Amplio (FA) leftist party retains power. The new President committed to pursue the economic and social policies put in place by the very popular outgoing President José Mujica. Over past years, Uruguay social indicators have significantly improved: a large share of the population escaped poverty (37% of the population lived below the poverty line in 2005 against 13% in 2012), while investment, which was once Uruguay's Achilles' heel, has been exhibiting a remarkable performance over the past years, not only compared with the country's history, but also with regional developments. However, despite important investment plans ongoing, lack of infrastructure remains important.





Sources: National sources, IHS, Euler Hermes

Contact Euler Hermes Economic Research Team
research@eulerhermes.com

Last review: 2014-12-01
Country Risk Analyst:
Daniela Ordóñez
daniela.ordonez@eulerhermes.com