Rating Action: Uruguay

Moody's upgrades Uruguay's bond ratings

New York, January 12, 2009 -- Moody's Investors Service has upgraded the foreign- and local-currency bond ratings of the government of Uruguay to Ba3 from B1 to reflect a steady improvement in the government's overall debt profile.

"This improvement has contributed to reduced credit risks stemming from declining debt ratios" said Moody's Vice President-Senior Credit Officer Mauro Leos. "The upgrade reflects reduced vulnerabilities associated with a somewhat lower degree of dollarization in government debt obligations and, at the margin, Uruguay's banking system."

Uruguay's foreign-currency country ceiling for bonds and notes was also upgraded to Ba1 from Ba2, and the country's ceiling for foreign-currency bank deposits were upgraded to B1 from B2. Uruguay's local-currency country ceilings for bonds and notes and deposits are unaffected by this rating action.

Leos noted that notwithstanding the uncertainties of the current global economic and financial environment, improvements in Uruguay's creditworthiness position Uruguay closer to countries in the low end of the Ba rating category than those in the B range.

To date, a conservative fiscal stance complemented by proactive debt management has helped increase government debt affordability as evidenced by lower ratios of debt-to-revenues and interest payment-to-revenues," noted Leos. "Though still somewhat high, government debt ratios have been trending downwards in a very significant way."

He said liability management operations have been effective in extending average debt maturities, reducing near-term refinancing needs, and increasing the share of local-currency-denominated debt. "Given an improved maturity profile," said Leos, "Uruguay faces moderate rollover risks during 2009-2010, which should mitigate potential credit risks derived from a global financial environment in which liquidity is expected to remain tight."

He also said the ratings continue to incorporate structural constraints owing to the small size of the economy, a condition that limits the country's ability to confront external shocks. Even though Uruguay has been able to diversify its export markets, thereby reducing its economic and financial exposure to Argentina, the country remains exposed to regional shocks.

The ratings are supported by a strong institutional framework that incorporates a solid track record of economic policy continuity and Moody's favorable assessment of Uruguay's willingness-to-pay its debt.

In this respect, "Moody's views are influenced by the outcome of the 2003 debt restructuring process in which Uruguay's positive attitude towards creditors led to a debt exchange that involved minimal loss severity for bondholders," said Leos. "As high willingness to pay is considered to be an integral part of the country's credit profile, this factor is implicitly incorporated into the current ratings partly compensating for somewhat weak quantitative factors relative to credit standing."

As a more resilient banking system has emerged, potential credit risks derived from contingent liabilities appear to have declined, said Leos, who explained that the financial fundamentals of the banking system have improved on the back of enhanced asset quality and provisioning regulations, lower non-resident deposits, high liquidity ratios, and strengthened capital ratios.

"However, Uruguayan banks continue to confront risks derived from potential balance sheet mismatches given the prevailing degree of financial dollarization which, while lower than in previous years, remains high in absolute and relative terms," said Leos -- dollar-denominated loans and deposits account for more than 70% of the total. Additionally, a less favorable operating environment will negatively impact asset quality while increased exchange rate volatility may place additional pressures on the bank's balance sheet.

Moody's stable outlook for Uruguay's ratings already incorporates scenarios that contemplate a deceleration in economic activity after an extended period of above-trend growth. Given an international environment characterized by less-favorable economic and financial conditions, GDP and export growth are expected to decline as Uruguay faces more challenging macroeconomic conditions in the near term.

"While current ratings can accommodate a transitory deterioration in Uruguay's fiscal and external indicators," said Leos, "medium-term credit prospects will ultimately depend on the effectiveness of government policies to restore favorable trends that were observed in previous years."

The current stable outlook includes the presumption of economic policy continuity, a particularly timely consideration as general elections will take place in October. Leos noted that "the resolve of the authorities will be tested throughout 2009 as they confront the need to adopt economic and fiscal policies that will have to balance a trade off between financial and political considerations as the electoral period approaches."

Subsequent rating upgrades will require preserving a fiscal stance that assures sustained medium-term reductions in the government debt ratios. "Equally significant in this respect will be further improvements in the currency composition of government debt that reduces the share of foreign currency-denominated debt," said Leos. "The latter is viewed by Moody's as a condition necessary to strengthen the government's balance sheet and reduce Uruguay's credit exposure to exchange rate shocks."

The last rating action for Uruguay was made on August 2008, when Moody's placed the foreign and local currency government bond ratings on review for a possible upgrade.

The principal methodology that Moody's uses in rating the Government of Uruguay is its Sovereign Bond Methodology, which can be found at www.moodys.com in the Credit

Policy & Methodologies directory. Other methodologies and factors that may have been

considered in the process of rating this issuer can also be found in the Credit Policy &

Methodologies directory on Moody's website.

Any impact on other issuers resulting from today's rating action will be announced

separately.

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