Uruguay-ding light in Sovereign SLBs

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Uruguay is one of the few sovereign issuers of Sustainability-Linked Bonds (SLBs), and the first to reach an observation date; the bond (URUGUA 5.75% 34s, ISIN: US760942BE11) will observe its Sustainability Performance Targets (SPTs) at the end of 2025.[1]

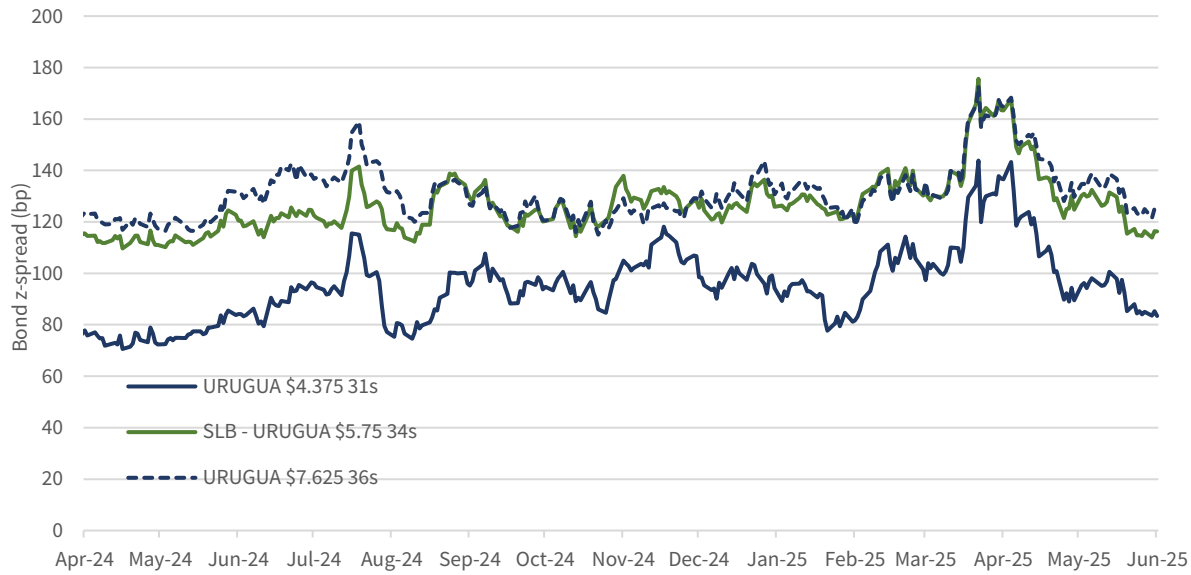
The most recent reporting, released on 31 May 2025, includes updated data, though with lags.[2] The first KPI, linked to emissions intensity, is reported annually but with a one-year delay. The second KPI, maintenance of native forest area, is reported only once every four years and with a year's delay, meaning the latest data is from 2021. The market will not receive an update until May 2027.

The newly reported data on emissions intensity shows improvements. While the country has more work to do to achieve its target, the new data moves in the right direction and so it seems more likely to be met. We reflect this in our pricing model, which adjusts the estimated option value from 7.9bps to 5.0bps. This could have driven a slight underperformance in the bond over the past year.

As shown in Figure 1 (and Figure 5, further on in the document) a market reaction to this new data is hard to observe, and the bond is trading in line with its peers. This may mean the market is balancing the chance of a step-up coupon with that of a step-down in this symmetric structure.

Delays in the reporting schedule may extend investor uncertainty and contribute to market volatility. However, the high materiality of the SLB option could offer meaningful opportunities.

Figure 1. Uruguay USD bond z-spreads since 25 Apr 2024. Source: Bloomberg, accessed 19 Jun 2025.



[1] For earlier analysis please see "Understanding dynamics between sustainable and traditional debt", AFII, 26 Jan 2023 and "Uruguay SLB: market update", accessed 06 Jun 2025.
[2] "SSLB Annual Report", Uruguay, 31 May 2025.

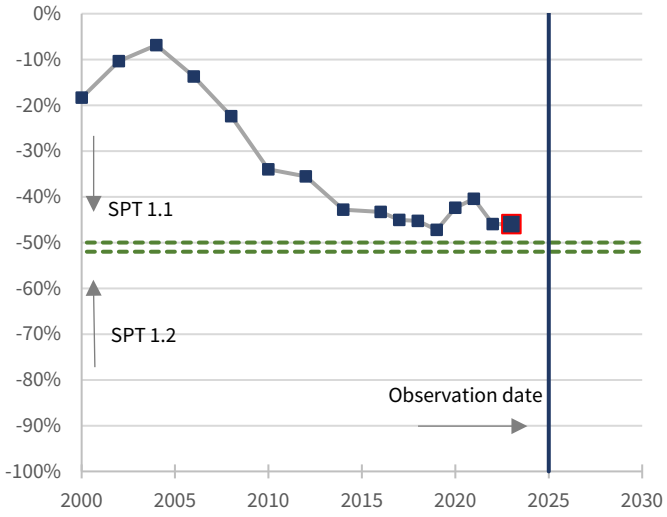
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KPI1

The first KPI is linked to a reduction in emissions intensity (emissions/GDP) compared to a 1990 baseline. There are two SPTs associated with this KPI; a less than 50% reduction results in a 15bps step-up, while a more than 52% reduction will result in a step-down of 15bps.

The most recent data point, reporting 2023 emissions, was flat on the year prior, showing a 46% reduction compared to the baseline (as shown in Figure 2).[2]

Figure 2. KPI1 aggregate GHG/Real GDP for Uruguay compared to 1990 baseline. Source: Ministry of Economy and Finance of Uruguay.



Given the reporting lag, year-end data is announced 17 months after the end of the year, meaning there are two years' worth of data before the observation date.

Table 1. Historical drift and volatility for emissions intensity. Source: Uruguay, AFII.

	Average annual drift	Annualised volatility
1990-2023	-1.69%	4.57%
2010-2023	-1.34%	5.15%
2016-2023	-0.42%	5.93%

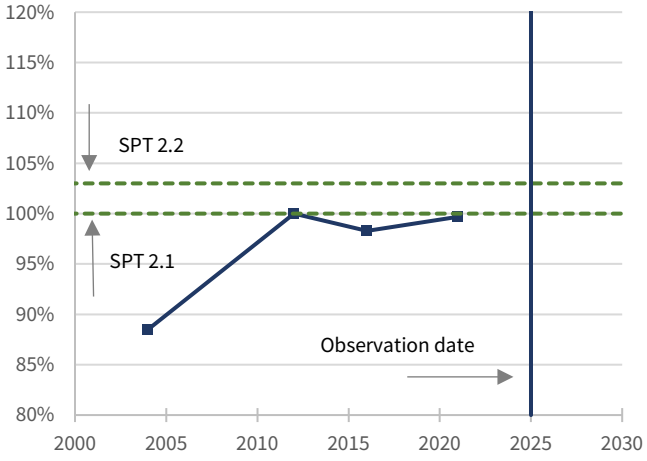
The time series shows there has been a slow down in the rate of reduction in recent years (see Table 1), albeit with largely constant volatility.[3] Over the next two years an average annual change of -2% is needed to meet the first target, or -3% to meet the stretch target.

KPI2

The second KPI measures native forest area compared to a 2012 baseline. Achieving the target of 100% will avoid a 15bps step-up, while achieving an increase to 104% will result in a 15bps step-down.

This data is only updated every four years, and a year in arrears, so there was no new reporting on KPI2 in the latest report. The final figure for 2025 is expected by 31 May 2027.

Figure 3. KPI2 Native forest area compared to a 2012 baseline. Source: Ministry of Economy and Finance of Uruguay.



[3] The data is not an annual series. It is reported every four years from 1990 to 1994, then biennially until 2016, and annually thereafter. For drift we have assumed interpolated interim data points, but for vol we have used the annualised volatility for each reported data point.

There are insufficient historical data points to infer any model dynamics. A qualitative assessment would suggest it's likely that at least the lower target will be achieved, but it's less likely that the higher target will be met since there has been no net improvement since 2013. As no new data has emerged since our Jun 2023 analysis, we maintain our prior probability estimates: a 25% chance of missing the lower target and a 40% chance of achieving the higher target.

Option Pricing

Bond structure

The final KPI figures for 2025 are due before 31 May 2027, because of the one-year lag. Our interpretation of the bond prospectus is that any change in coupon will begin to accrue from Oct 2027 and therefore impact seven years' worth of coupons. Considering just the step-up of 15bps per KPI, that means a maximum non-discounted cumulative increased coupon of 2.1%, although this is 1.63% on a discounted basis. This represents a relatively high degree of materiality compared to other structures, driven by the fact the observation date is set early in the life of the bond.

SPT probabilities

To price the step-up or step-down options, one must assess the probability of the issuer meeting each target.[4]

As both KPIs have two targets, there are three possible results at the observation date. If the lower target is missed the coupon will step-up, if the higher target is achieved the coupon will step-down, and if the result is in the middle there will be no change.

Figure 4. Illustrative probabilities used for SLB pricing. Source: AFII.

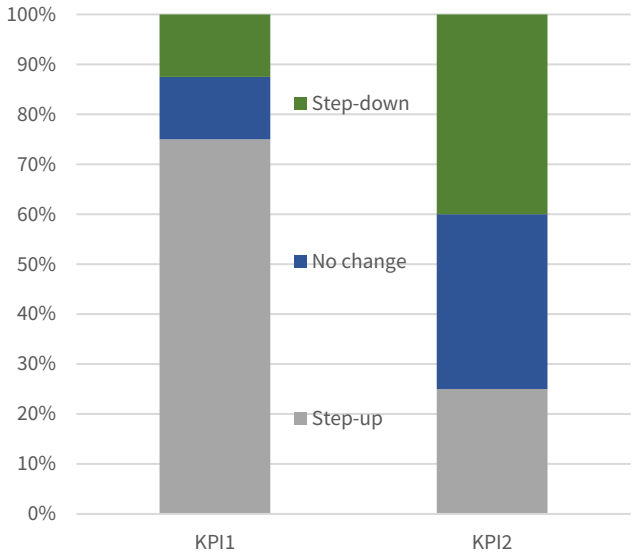


Figure 4 depicts the probabilities that we have used in our illustrative bond pricing. For KPI1, given the historical trend, we view it as more likely that neither target will be achieved. (For context a drift of -1.5% and a volatility of 5% will give a model probability of 74%). Because the targets are quite close together, it seems unlikely that no change in coupon will be achieved. For KPI2, in contrast, as the lower target is already achieved it seems likely this will remain the case, but in the context of recent volatility the range between the two targets seems wide. However, it also needs to be considered that there have been no other data published on this KPI since 2021.

Using the probabilities from Figure 4 gives a total option value of 0.39% or 5bps running. A breakdown for the individual targets is shown in Table 2 (overleaf). The values for KPI2 imply an

[4] For full details of the AFII option pricing approach please see "Sustainability Linked Bond Handbook", AFII, 12 May 2024.

Table 2. SLB option prices. Source: AFII.

	Upfront value	Running value
KPI1.1	0.61%	0.079%
KPI1.2	-0.10%	-0.013%
KPI2.1	0.20%	0.026%
KPI2.2	-0.33%	-0.042%
TOTAL	0.39%	0.050%

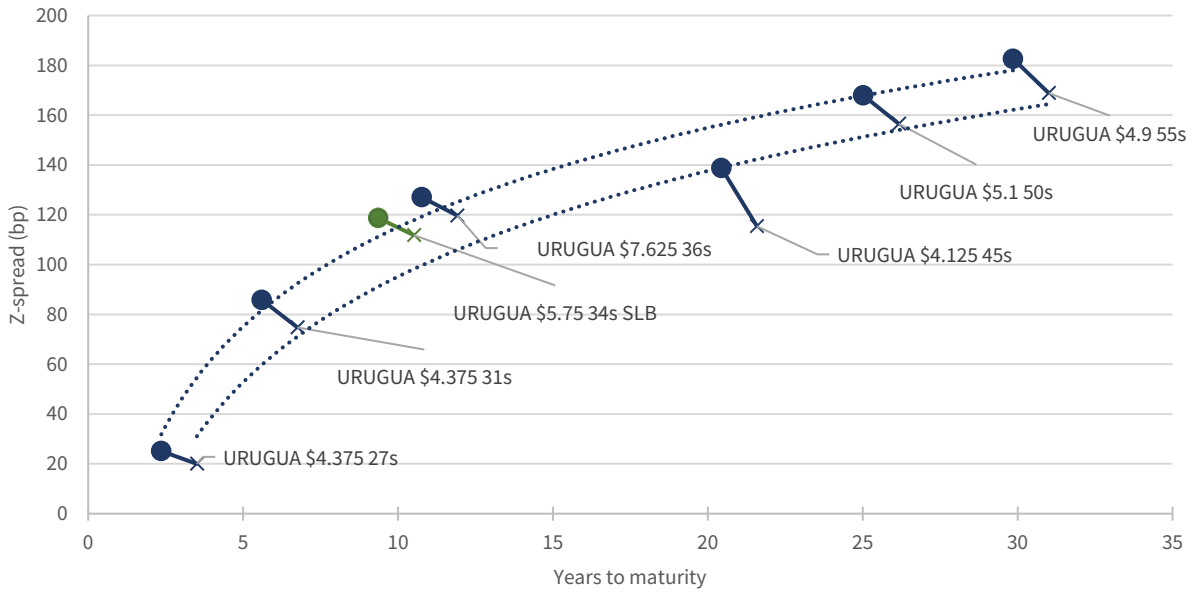
expectation of a step-down resulting in a negative option value. The value of the step-up in KPI1.1, however, is higher which is why the overall value is positive.

In earlier analyses we have estimated different option values, driven by the dynamics of Uruguay's emissions intensity. In Jan 23 when the bond was first issued, only data as of 2019 was available, which showed a reliable downward trend. We considered it likely the bond would result in a step-down, and estimated a value of -1.8bps.[5] In Jun 2023, once data points from 2020 to 2021 were available, it looked as though the KPI was heading off-track, and that either target would be hard to meet. This resulted in an estimated option price of 7.9bps,[6] which did appear to coincide with a period of outperformance. The additional two data points have shown emissions reductions from Uruguay, which means it now looks more likely to achieve the targets, which explains the reduction in option price.

Market Pricing

Figure 5 shows spread moves for USD Uruguay bonds that were issued longer than a year ago. We use these to see if there has been any reaction in the SLB since 25 Apr 2024, i.e. before the previous SLB report signalling the change in trend was released.

Figure 5. Uruguay USD bond spreads from 25 Apr 2024 (crosses) to 18 Jun 2025 (circles). Source: Bloomberg, accessed 18 Jun 2025.



If the option value has decreased from 7.9bps to 5.0bps we would expect to see an underperformance, but in fact the 34s have performed largely in line with the 31s and 36s.

It may be the market is implying no change in the probabilities of the target being achieved, or it may mean the data has not yet been digested.

[5] "Understanding dynamics between sustainable and traditional debt", AFII, 26 Jan 2023.
[6] "Uruguay SLB: market update", AFII, 5 Jun 2023.

Conclusions

Uruguay was the second sovereign issuer of SLBs, but will be the first to reach its observation date at the end of 2025. However, data reporting lags mean the market will not receive final results until Q2 2027.

Data from 2022 and 2023 shows some positive performance in reducing emissions intensity, which serves to increase, in our view, the likelihood of achieving the targets. This commensurately reduces the estimated option value from 7.9bps to 5.0bps.

We see no clear market reaction to this new data, and the SLB is pricing in line with peers. This suggests that the market may view the likelihood of a coupon step-up and step-down as evenly balanced.

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