Macro scenario - Uruguay

February 19, 2025

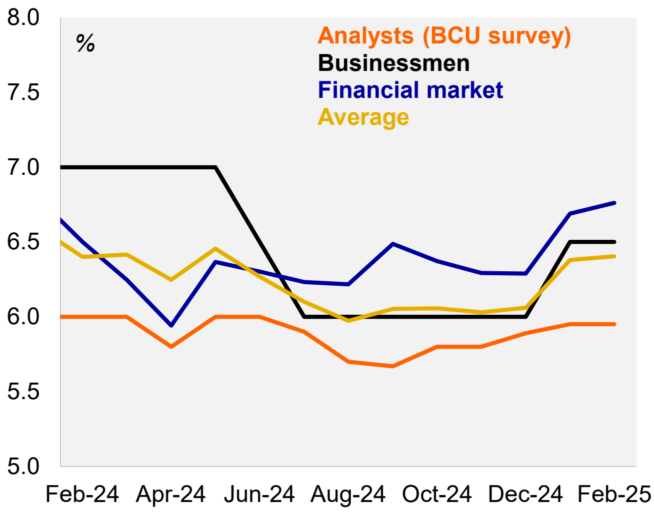
Higher rates, reacting to the rise in inflation expectations

- The central bank's monetary policy committee hiked the policy rate by 25 bps to 9.0% in February, for the second consecutive meeting. Given the recent deterioration of inflation expectations, we now expect a terminal rate of 9.50% for YE25, up from 9.0% in our previous scenario.
- Our call for higher rates will provide more incentives for the carry trade, leading to a slightly stronger currency. Thus, we now foresee the exchange rate at UYU 45.3/USD, from UYU 46 in our previous scenario. We forecast YE25 inflation at 5.5%, down from 6.0%.
- The incoming administration, to take office on March 1, has stated its commitment to fiscal responsibility and to maintaining the policy rate as the main instrument of monetary policy. Additional details on fiscal policy and plans to continue reducing inflation expectations should be announced in the near term.

Another rate hike amid deteriorating inflation expectations

In the February monetary policy meeting, the central bank's monetary policy committee unanimously hiked the policy rate by 25 bps for the second consecutive meeting, to 9.0%. According to the statement, the hike is intended to consolidate the continuing decline in inflation, bringing it to the 4.5% target in the Monetary Policy Horizon (MPH). The rebound in inflation expectations in recent months led to a less contractionary monetary policy stance. The press release states that inflation expectations rose to 6.12% in January, according to the BCU's survey of analysts. Following the February decision, we estimate the ex-ante real policy rate at 2.7% (using expectations for the policy horizon), above the BCU's estimate of the neutral real rate at 2.5% and back in (slightly) contractionary territory.

24-month inflation expectations

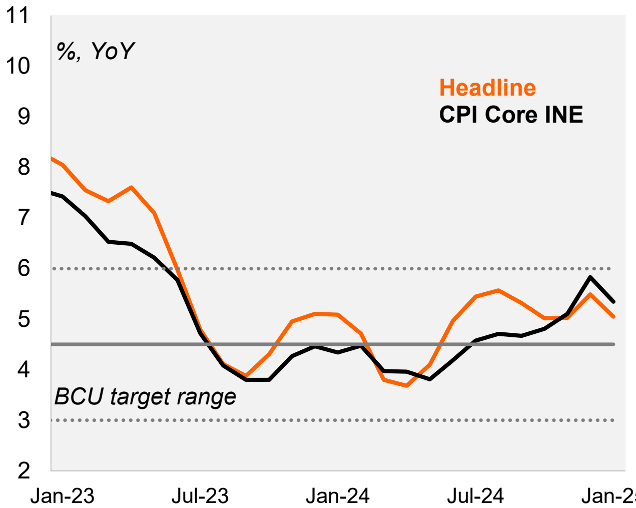


Source: BCU, INE, Bevsa

Annual inflation decelerated in January

Headline inflation rose by 1.1% MoM in January (from 1.5% a year ago and a five-year median figure of 1.7%). The main monthly impacts came from food and non-alcoholic beverages, driven by higher meat prices. In addition, housing, electricity, and water rose by 1.25% MoM, mainly explained by the positive effect of the second part of the "UTE rewards" program on electricity (electricity supply fell by 1.38% MoM). It is important to note that this discount ends in February. Core inflation (excluding fruits & vegetables and fuel prices) increased by 0.98% mom, from 1.45% mom in January 2024. On an annual basis, headline inflation fell to 5.05% in January (from 5.49% in December), while core inflation fell to 5.35% from 5.83% in the previous month. We note that both readings remain within the Central Bank's inflation target of 4.5% +/- 1.5%.

Annual inflation

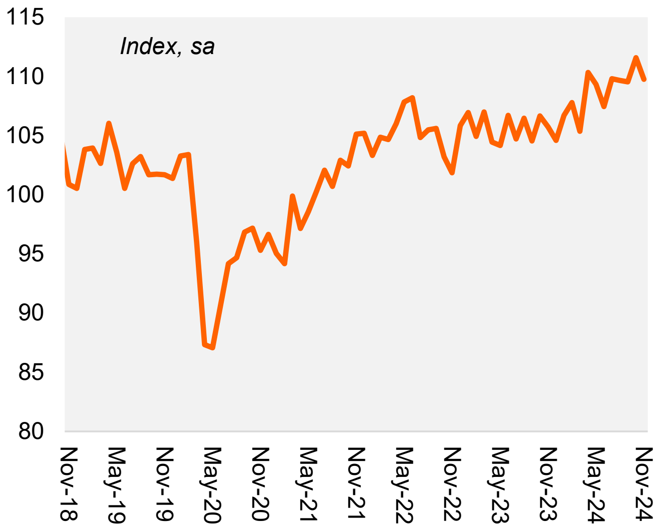


Source: INE

Activity expanded in 4Q24 through November

The monthly GDP proxy increased in November. The central bank's monthly GDP proxy (IMAE) expanded by 3.3% yoy in November, leading to an expansion of 4.0% in the quarter ended this month (4.1% yoy in 3Q24). The figures likely reflect base effects from the normalization of the agricultural sector after 2023's severe drought. On a sequential basis, the index contracted 1.6% mom/sa in November after expanding by 1.9% mom/sa in the previous months. Thus, the IMAE expanded by 1.2% qoq/sa in the quarter ending in November, up from 0.6% qoq/sa in 3Q24. The statistical carryover for 2024 stood at 3.2%.

Activity Index



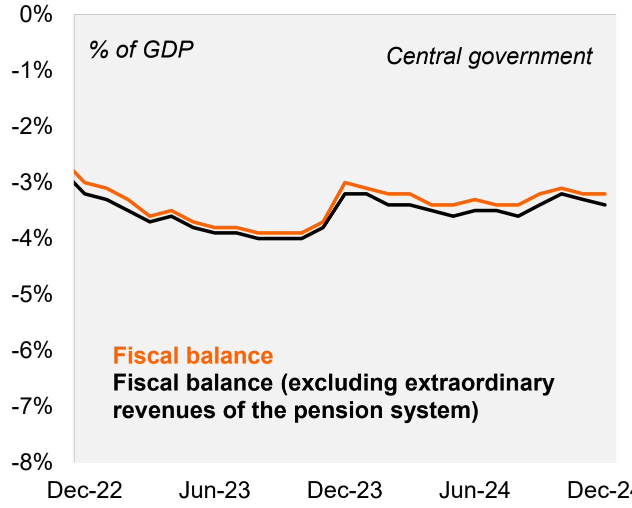
Source: BCU

Meanwhile, the latest economic indicator from the think tank Ceres shows that the level of economic activity continued to rise in January, increasing by 0.1% mom. This is the sixth consecutive month of growth, maintaining the positive trend. However, the diffusion index (the number of sectors performing favorably) fell to 60% in January from 80% in December.

Fiscal consolidation was postponed in 2024

The central government's 12-month nominal fiscal deficit rose slightly to 3.4% of GDP in December, from 3.3% in 2023. This fiscal-balance measure excludes extraordinary income from the social security agency (asset transfers from individuals switching from the private pension system to the public pension system). Total real revenues increased by 5.0% yoy in 4Q24, down from 7.7% in 3Q24. Total expenditures expanded by 4.8% yoy in 4Q24 led by pension and wage payments. The fiscal deficit was somewhat above the 3.1% of GDP official deficit forecast.

Fiscal balance



Source: Ministry of Economy and Finance

Higher rates

We forecast GDP growth of 2.3% in 2025, after an expected expansion of 3.0% in 2024 (with upside risks). On the demand side, private consumption will continue to support growth, along with spillovers from the macro adjustment in Argentina that we expect will continue this year. In particular, the tourism season is expected to be positive, providing a boost to growth in 1Q25. On the supply side, the risk of a drought in the agricultural sector could pose headwinds to activity.

We now see inflation at 5.5% in YE25. A lower-than-expected reading in January, combined with our expectation of a higher terminal rate (9.50% vs. 9.0% previously) and a stronger currency (UYU 45.3/USD against UYU 46/USD before), would keep inflation below the upper bound of the target range (6%). Nevertheless, the outcome of wage negotiations is likely to be key for inflation and inflation expectations.

Our forecast for the nominal fiscal balance in 2025 stands at -2.9% of GDP. However, our expectation of weaker growth limits the scope for improving the fiscal outlook this year. The incoming administration will present the new budget for the next five years by mid-year.

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Uruguay | Forecasts and Data

	2020	2021	2022	2023	2024F		2025F		2026F	
					Current	Previous	Current	Previous	Current	Previous
Economic Activity										
Real GDP growth - %	-6.3	5.3	4.9	0.4	**3.0**	3.0	**2.3**	2.3	**2.5**	2.5
Nominal GDP - USD bn	53.7	61.4	71.3	77.3	**80.5**	80.5	**77.9**	77.9	**76.9**	76.9
Population (millions)	3.5	3.5	3.5	3.5	**3.5**	3.5	**3.5**	3.5	**3.5**	3.5
Per Capita GDP - USD	15,461	17,616	20,418	21,665	**22,962**	22,962	**22,158**	22,158	**21,813**	21,813
Unemployment Rate - year avg	10.4	9.3	7.9	8.3	**8.0**	8.0	**7.8**	7.8	**7.6**	7.6
Inflation										
CPI - %	9.4	8.0	8.3	5.1	5.5	-	**5.5**	6.0	**5.2**	5.5
Interest Rate										
Reference rate - eop - %	4.50	5.75	11.50	9.00	8.75	-	**9.50**	9.00	**9.50**	8.75
Balance of Payments										
UYU / USD - eop	42.35	44.69	39.9	38.9	44.1	-	**45.3**	46.0	**46.8**	47.5
Trade Balance - USD bn	-0.2	0.0	-0.8	-2.5	**-1.0**	-1.0	**-1.0**	-1.0	**-1.0**	-1.0
Current Account - % GDP	-0.8	-2.5	-3.9	-3.6	**-2.0**	-2.0	**-2.0**	-2.0	**-2.0**	-2.0
Foreign Direct Investment - % GDP	1.9	2.4	4.5	5.5	**2.0**	2.0	**1.5**	1.5	**1.5**	1.5
International Reserves - USD bn	16.2	17.0	15.1	16.2	17.4	-	**18.5**	18.5	**18.5**	18.5
Public Finances										
Nominal Balance Central Gov. (*) - % GDP	-5.8	-4.2	-3.0	-3.3	**-3.4**	-3.1	**-2.9**	-2.9	**-2.5**	-2.5
Gross Public Debt Central Gov. - % GDP	48.0	61.2	58.5	58.3	**57.4**	57.4	**60.9**	60.9	**62.7**	62.7

Source: FMI, Haver, Bloomberg, BCU, Itaú.
(*) Excludes extraordinary inflows to the Social Security Trust Fund.

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