Macro scenario - Uruguay

May 15, 2024

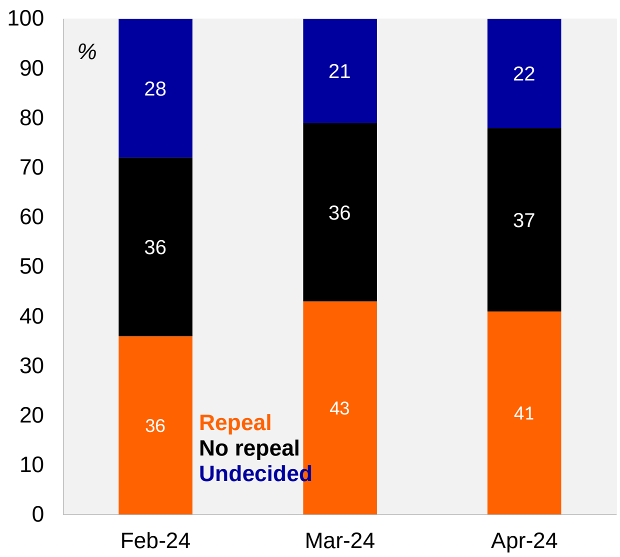
Activity recovery continues as elections loom

- As this year's general elections take shape, a plebiscite on social security matters could, if unexpectedly approved, significantly increase pressure on the fiscal accounts and hinder business confidence. Our base scenario assumes that the plebiscite is not approved, so we do not expect any impact on the economy due to this subject.
- In the meantime, inflation remains well-behaved despite an upside surprise in April. We still envisage 5.50% inflation for 2024, despite potential inflationary pressures from excess rainfall. We do not expect further rate cuts this year.
- We maintained our 2024 GDP growth forecast at 3.5%. While we still foresee a normalization of agricultural activity after the severe drought of 2023, higher-than- anticipated rainfall in 2Q24 may also have a negative transitory impact on output.

On the road to elections

The presidential race begins as risks from a plebiscite loom. Primary elections will be held on June 30 to determine the candidates for the general elections on October 27. A runoff would take place on November 24 if none of the candidates gets 50% + 1 of the votes, which is the likeliest scenario according to polls. Together with the general elections, Uruguayans will also vote in a plebiscite that aims to overturn the social security reform enacted in 2023. It should be noted that both the financial market and the economy have not yet been affected because most of the candidates and most of the business community and investors do not support this proposal. On the contrary, if approved, the plebiscite would lower the retirement age back to 60 years (from 65 years), make the minimum retirement pension equal with the minimum wage and abolish the private retirement savings (AFAPs). In our view, the fiscal cost of lowering the retirement age would lead to pension spending that is unsustainable in the long term, while making the minimum pension equal with the minimum wage would have a fiscal cost of around 1.5% of GDP per year. That said, the available surveys are not conclusive. According to a survey published by the consulting firm Cifra, 41% of respondents support the repeal of the reform, 37% do not support it and 22% remain undecided. It is important to note that the plebiscite requires 50% +1 of the votes to repeal the reform. Our base scenario assumes that the repeal of the social security reform is not approved, so we do not expect any impact on the economy due to this subject.

Voting intention to repeal the social security reform

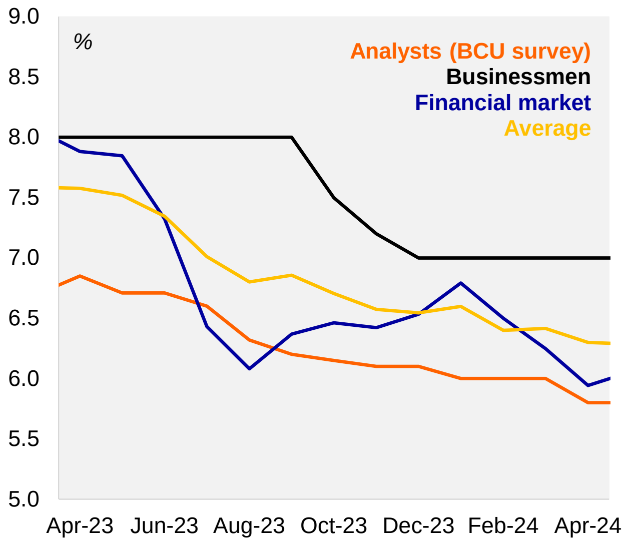


Source: Cifra

Annual inflation fell further in April, while inflation expectations recede

Headline inflation stood at 0.63% MoM in April (from 0.75% a year ago and a five-year median figure of 0.4%). The headline figure reflected the increase in food prices (incidence of 0.4 pp), in particular volatile prices (vegetables and legumes at 11.6% MoM). Core inflation (excluding fruits & vegetables and fuel prices) increased 0.52% MoM, unchanged from April 2023. On an annual basis, headline inflation decelerated to 3.7% from 3.8% in March, while core inflation remained virtually unchanged at 4.00%, both within the Central Bank's inflation target range (3%-6%). On the other hand, inflation expectations for the next 24 months (as per the central bank's survey) fell for the first time in 2024, to 5.80% yoy from 6.00% previously.

24-months inflation expectations



Source: BCU, INE, Bevsa

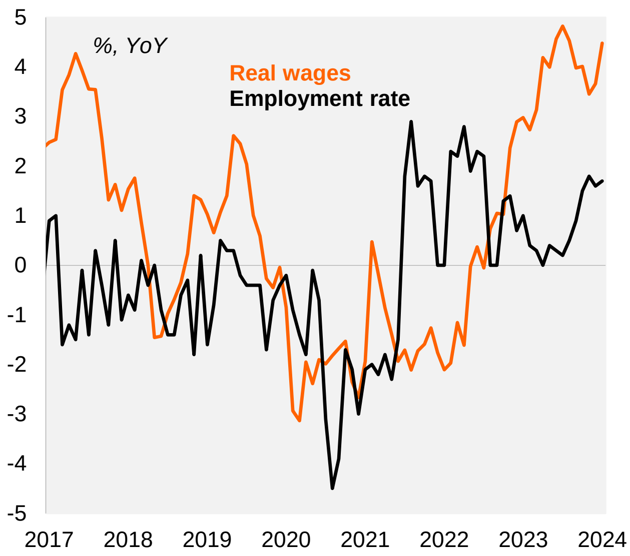
No more rate cuts in sight

In the run-up to the third monetary policy meeting of the year, we do not expect further rate cuts. In the previous meeting, held in April, the central bank's monetary policy committee unexpectedly cut the policy rate by 50 bps, to 8.50%, accumulating a total of 300 bps in the cycle. We currently estimate that the real ex-ante policy rate stands at 2.1% (using expectations for the monetary policy horizon), below the BCU's neutral real rate estimate of 2.4%, shifting monetary policy slightly toward expansionary territory even as inflation expectations remain above the BCU's 3%-6% inflation target.

Leading indicators point to growth in 2Q24

Activity to continue growing in 2Q24. The leading activity indicator published by think tank Ceres rose by 0.3% mom/sa in April, the seventh consecutive monthly sequential expansion. The diffusion index (the number of sectors that evolved favorably) rose to 72% in April, up from 62.5% in March. In our view, the solid labor market (employment rose by 1.3 pp yoy and real wages expanded 3.9% yoy in 1Q24) and greater domestic tourism expenditures, in turn mainly reflecting spillovers from the appreciation of the parallel exchange rate in Argentina, are the primary drivers of the favorable activity performance.

Labor market



Source: INE

Appetite for Uruguayan debt

The government issued a total of USD 1.8 billion of debt in global markets, split between CPI-linkers and local-currency bonds. Approximately USD 1.5 billion were new funds, while USD 250 million were liability management. The pricing was in line with the secondary market, refinancing and partly covering the sovereign's 2024 financing needs. In our view, the positive results reflect investor confidence in Uruguay.

The central government's 12-month nominal fiscal deficit increased slightly to 3.4% of GDP in 1Q24, compared to 3.3% at the end of 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).

Who'll stop the rain?

We maintained our 2024 GDP growth forecast at 3.5%, in light of positive figures for 1Q24. While we still foresee a normalization of agricultural activity after the severe drought of 2023, unexpected rainfalls in April may affect the soybean harvest in 2024.

We kept our inflation forecast for December 2024 at 5.50%. However, excessive rainfall may affect inflation in the near term, especially in volatile items such as fruits and legumes, likely due to supply issues.

We also maintained our monetary policy rate forecast of 8.50% for YE24. While we do not expect further cuts in 2024, the BCU could cut further if inflation remains well-behaved or if inflation expectations continue to correct toward the BCU's inflation target.

We have maintained our nominal 2024 fiscal balance forecast at -3.0% of GDP, in line with the MoF's projections. The government's discipline in fiscal management over the years supports our call.

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Uruguay | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	0.9	-7.4	5.6	4.7	0.4	**3.5**	3.5	**3.0**	3.0
Nominal GDP - USD bn	62.1	53.7	61.4	71.3	77.3	**84.4**	84.4	**91.7**	91.7
Population (millions)	3.5	3.5	3.5	3.6	3.6	**3.6**	3.6	**3.6**	3.6
Per Capita GDP - USD	17,650	15,221	17,324	20,058	21,665	**23,589**	23,589	**25,550**	25,550
Unemployment Rate - year avg	8.9	10.4	9.3	7.9	8.3	**8.0**	8.0	**7.8**	7.8
Inflation									
CPI - %	8.8	9.4	8.0	8.3	5.1	**5.5**	5.5	**5.5**	5.5
Interest Rate									
Reference rate - eop - %	8.57	4.50	5.75	11.50	9.00	**8.50**	8.50	**8.00**	8.00
Balance of Payments									
UGY / USD - eop	37.35	42.35	44.69	39.9	38.9	**39.5**	39.5	**41.5**	41.5
Trade Balance - USD bn	-0.1	-0.2	0.0	-0.8	-2.5	**1.0**	1.0	**1.0**	1.0
Current Account - % GDP	1.2	-0.8	-2.5	-3.7	-3.6	**-1.0**	-1.0	**-1.0**	-1.0
Foreign Direct Investment - % GDP	2.2	1.9	2.4	4.5	5.5	**2.0**	2.0	**1.5**	1.5
International Reserves - USD bn	14.5	16.2	17.0	15.1	16.2	**18.0**	18.0	**18.5**	18.5
Public Finances									
Nominal Balance Central Gov. (*) - % GDP	-4.0	-5.8	-4.2	-3.0	-3.3	**-3.0**	-3.0	**-2.7**	-2.7
Gross Public Debt Central Gov. - % GDP	48.0	61.2	57.8	57.4	57.2	**55.2**	55.0	**53.4**	52.0

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

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