Macro scenario - Uruguay

September 17, 2024

Consolidating the disinflation process

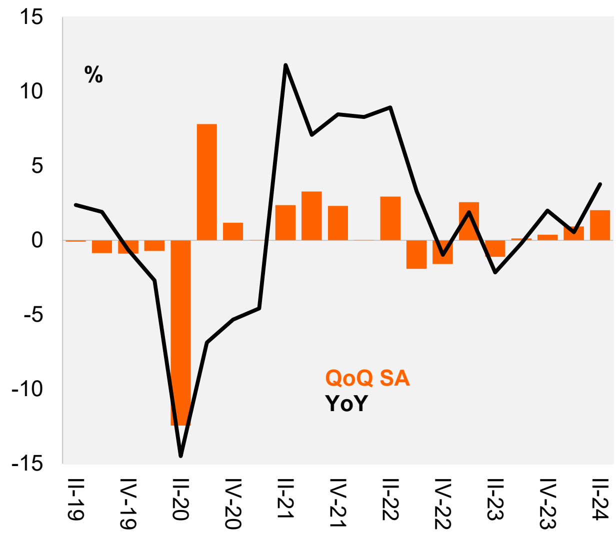
- Even after base effects contributed to an upside surprise in 2Q24 GDP, a weaker start to 3Q24 has prompted us to revise our GDP growth forecasts to 3.0% for 2024 and 2.5% for 2025.
- Our 2024 year-end inflation forecast has been lowered to 5.3% (from 5.5% in our previous scenario), mainly reflecting two consecutive lower-than-expected prints. With the monetary policy rate at neutral levels and the BCU focused on further strengthening the credibility of the inflation target, we do not expect additional cuts this year.
- All eyes are on the plebiscite and first-round presidential elections, scheduled for October 27, as polls point to a rejection of the plebiscite and a runoff election (which would be held on November 24).

Base effects supported a strong GDP expansion in 2Q24, as 3Q24 growth appears slower

GDP rose by 3.8% YoY in 2Q24 (above the 3.4% growth based on the monthly GDP proxy), up from the 0.6% growth posted in 1Q24, mainly reflecting the normalization of the agricultural sector after last year's severe drought. At the margin, using the central bank's seasonally adjusted series, GDP grew by 2.0% QoQ/SA in 2Q24, expanding sequentially for the fourth consecutive quarter. Thus, this year's statistical carryover had reached 2.6% by the end of 2Q24. On the supply side, the annual print was mainly driven by agriculture (+22.6% YoY, incidence of 1.3 pp) and the energy sector (+30.4% YoY, incidence of 0.7 pp), with the annual spikes reflecting base effects.

However, the leading economic indicator published by the think tank Ceres rose by 0.1% MoM/SA in August after being flat in July. The diffusion index (the number of sectors performing favorably) fell to 55% in August from an average of 72% in 2Q24.

GDP Growth

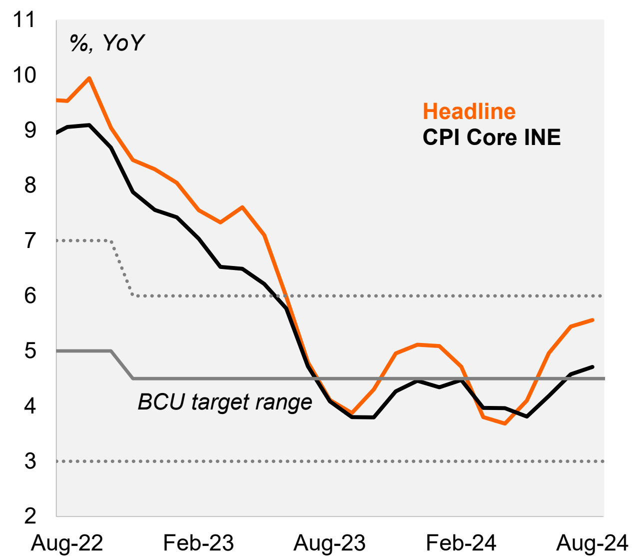


Source: BCU

Another lower-than-expected inflation print in August

Headline inflation rose by 0.29% MoM in August (from 0.17% a year ago and a five-year median of 0.66%). The print was below market expectations according to the BCU's survey (at 0.4%). The monthly headline rise was driven by price increases for food and non-alcoholic beverages (0.31% MoM), insurance and financial services (0.79% MoM) and healthcare services (1.05% MoM), partly offset by seasonal price decreases, particularly for clothing and footwear (-1.85% MoM). Core inflation (excluding fruits and vegetables and fuels) increased by 0.39% MoM, from 0.26% MoM in August 2023. On an annual basis, headline inflation rose to 5.57% in August from 5.45% in July, while core inflation accelerated to 4.71% from 4.58%. We note that both readings remain within the central bank's inflation target range (4.5% ± 1.5%).

Annual inflation



Source: INE

Waiting for the BCU's next move

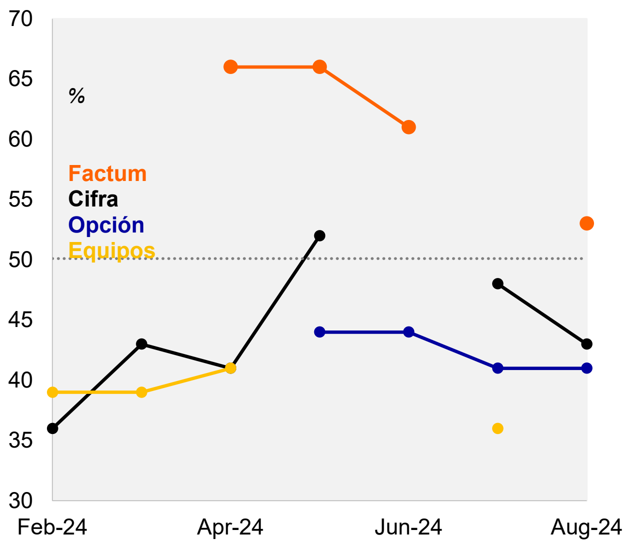
The central bank kept the policy rate at 8.5% in August, with the objective of consolidating the disinflation process and strengthening the credibility of the BCU's 4.5% inflation target. The central bank stated that the average of inflation expectations stood at 5.94%, lower than the previous meeting (6.10%), falling to the range of the inflation target range. We estimate that the real ex-ante policy rate stands at 2.4%, slightly below the BCU's neutral real rate estimate of 2.5% (recently updated from 2.4%), keeping the monetary policy rate around neutral levels. The Monetary Policy Committee highlighted the persistence of inflation around the middle of the target range, as well as the gradual convergence of its expectations.

Countdown to the first-round presidential election and plebiscite

All eyes are on the plebiscite and first-round presidential elections, scheduled for October 27. Polls are pointing to a rejection of the plebiscite and a runoff election, with no candidate winning a simple majority in the first round.

Polls show declining support for the plebiscite on social security issues. Early this year, polls suggested that support for approval was high (even reaching 66%, depending on the poll), but more recent surveys have shown only 46%, on average, intending to vote yes (a simple majority is needed for an approval). This shift in preferences likely reflects the increasing uncertainty about, and opposition to, the potential effects of the plebiscite being approved. In July, parties from the governing coalition signed a commitment to oppose the plebiscite, and recently a group of economists and experts from the opposition Frente Amplio party signed a similar commitment, reflecting a broad-based technical consensus on the negative effects of an approval.

Voting intention to repeal the social security reform



Source: Several consulting firms

Lower growth and inflation

Despite the higher-than-expected growth in 2Q24, we have lowered our 2024 GDP growth forecast to 3.0% from 3.5%, reflecting the weaker start to 3Q24. Our 2025 GDP growth forecast has also been lowered, to 2.5% from 3.0%, to reflect a lower statistical carryover.

We have revised our YE24 inflation forecast to 5.3% (from 5.5% in our previous scenario) following two consecutive lower-than-expected prints. The recent depreciation of the UYU leads us to be moderate with our downside revision.

Even with lower inflation likely in the near term, we do not expect changes in the monetary policy rate for the rest of the year, as it has reached neutral levels. The next monetary policy meeting is scheduled for October 8.

Our YE24 exchange rate forecast remains unchanged at 40.5 UYU/USD. In our view, the recent depreciation of the currency likely reflects election-related uncertainty, specifically about the outcome of the plebiscite on social security matters. Our base case assumes a rejection of the plebiscite. Besides this, the prospect of a stronger BRL and a widening of the interest rate differential as the Federal Reserve begins its easing cycle should favor the UYU in 4Q24.

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Uruguay | Forecasts and Data

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	0.7	-6.3	5.3	4.9	0.4	**3.0**	3.5	**2.5**	3.0
Nominal GDP - USD bn	62.1	53.7	61.4	71.3	77.3	**82.6**	82.6	**85.8**	85.8
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	**23,076**	23,076	**23,907**	23,907
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	**5.3**	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									
UYU / USD - eop	37.35	42.35	44.69	39.9	38.9	**40.5**	40.5	**42.5**	42.5
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	-3.9	-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	**-3.1**	-3.1	**-2.9**	-2.9
Gross Public Debt Central Gov. - % GDP	45.1	48.0	61.2	58.5	58.3	**56.0**	56.0	**55.0**	55.0

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

Macro Research – Itaú

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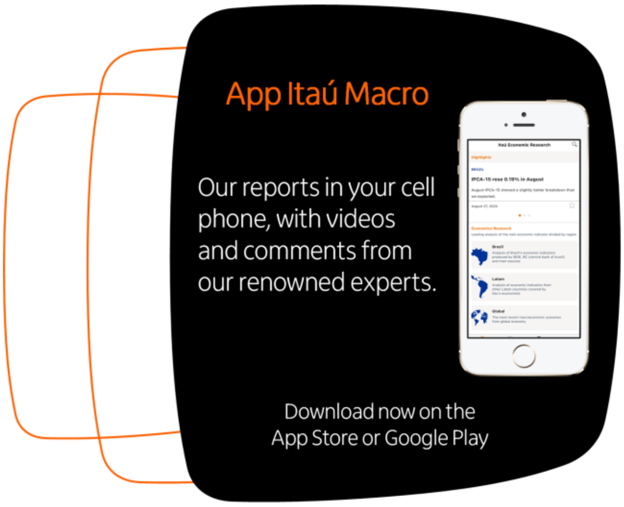

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