Research

Creating Opportunities

Uruguay Economic Outlook

2024

A Good Time to Implement Necessary Reforms

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Globally, a very soft landing that reduces the scope for interest rate cuts

Global growth is expected to moderate in the coming quarters and recover in 2025. In the U.S., growth is projected at 2.2% for 2024 and 2.3% for 2025. The Eurozone will experience cyclical recovery, with growth expected to be 0.7% this year and 1.6% in 2025. China's growth will slow down to 4.6% this year from 5.2% in 2023 despite increased stimulus, and further down to 4.2% in 2025.

In this context, the ECB has begun to lower interest rates. However, the Fed is waiting longer than anticipated to start its easing cycle, as the economic activity and labor market still show robustness, while inflation remains resilient at around 3% annually, above the 2% target.

Inflation is a key risk, as robust activity may endanger the convergence to 2%. Additionally, geopolitical contexts could generate new supply shocks that would hinder inflation moderation, thus reducing the scope for interest rate cuts.

Political Scenario in Uruguay: No Significant Policy Changes Expected

Unlike other countries in the region, Uruguay has low political polarization. The current social mood does not favor significant political change. Despite high confidence in the economy and positive government evaluations, the president is not eligible for re-election.

Regardless of the October election results, and despite early polling data, our base scenario includes the continuation (and commitment to compliance) of the fiscal rule, pension system reform with minor adjustments, and continuity of international policy.

Two key issues to monitor are party leaderships—all current leaders are new and have not led their parties before—and the social security reform referendum, which has a low (though not null) probability of approval and is not yet on market radars.

Uruguay's strong political culture suggests it can maintain balance and address significant challenges.

External sector

Our scenario of commodity price correction, greater global uncertainty and lower global growth, will affect Uruguay's exports. The prices of the key commodities for Uruguay reached highs in 2022 and are proving to be persistent, although this year they will correct downward (but will remain high in historical terms). Hence, we expect a 10% y/y drop in the exports of goods. This will be partially offset by higher pulp exports as the new mill starts up.

The current account had a deficit of 3.2% of GDP in 2022 due to the impact of the drought and a lackluster tourism season. This year the tourism season was better than expected, but imports will have the impact of the higher energy purchases required due to the low rainfall. Hence, we expect a current account deficit of 3.3% of GDP this year, improving slightly to -2.9% of GDP in 2024 once the drought fully dissipate.

Economic Activity: Despite Growth in 2024, Reforms Are Necessary for Further Expansion

Economic activity has been virtually stagnant in recent years, with significant rebounds only after strong shocks like the pandemic and recent drought.

In 2023, the meager 0.4% growth was due to several events affecting various sectors. The severe drought impacted agricultural production, costing about USD 1.88 billion (3% of GDP), and hydroelectric generation, leading to more costly thermal generation and higher imports. Another growth deterrent was the technical shutdown of the ANCAP refinery for maintenance.

The first quarter of 2024 saw economic performance slightly below expectations, with GDP up 0.6% year-on-year, while the agricultural and electric energy sectors recovered, industry remained sluggish due to the continued ANCAP refinery closure, as did construction due to the completion of UPM2. Tourism-related sectors also showed no significant improvement.

For the rest of the year, we expect the economy to gain momentum, driven by the recovery in agriculture and energy, which should see significant growth compared to the heavily impacted second quarter of 2023. We anticipate a rebound in activity levels to 3.2% for the whole year.

From a demand perspective, we expect a decrease in investment following the completion of UPM and FFCC projects, which will be more than offset by strong export growth (soybeans, pulp, meat) and private consumption driven by income recovery.

For 2025, we estimate a 2.7% expansion in activity, driven by a private consumption rebound, though still below Uruguay's potential GDP of 2.8%, highlighting the need for reforms to achieve sustainable growth.

Despite deviations in 2024 figures, public debt levels remain sustainable, and borrowing costs are low. Rating agencies maintain Uruguay's credit rating above the minimum investment grade, recently achieving the lowest sovereign risk level in its history. As of the end of 2023, Uruguay's gross public debt stands at 69% of GDP, still above pre-pandemic levels but continuing to decline since 2020.

Employment Stagnates in 2024

A greater decline in the employment rate than in the activity rate led to an unemployment rate rise to 9% in April 2024. Looking ahead, we foresee a slight improvement in labor market indicators as activity levels increase, needing more jobs. We target an 8.5% unemployment rate by year-end, with real wages expected to grow around 1.5% this year.

Better foreign trade performance expected

In 2023 Uruguay faced a drop in external demand (with China as its main trading partner) and falls in commodity prices, a situation which, added to the supply restriction imposed by the drought, caused exports to fall by 13% with respect to 2022 and totaled USD 11,518 million. Imports of goods, on the other hand, did not show a good performance either, falling by 3.8% in the year and reaching USD 10,614 million, reflecting the lower activity and the end of the UPM2 construction work, which significantly reduced imports of capital goods required for its construction.

While soybeans, one of the main export products, and the rest of the summer crops (corn, sorghum, sunflower) are expected to recover this year, 2024 will mark the milestone that cellulose will overtake meat as the main export product for the first time.

By 2024 we expect export growth of around 15% compared to 2023 and a slight decline in imports, mainly energy-related imports once local generation normalizes. By 2024 expected export growth will be lower as we will not have a new pulp-like boost once UPM2 exports at full capacity. Imports will continue to grow slightly as the level of activity permits.

It is worth highlighting the growing importance of service exports, which according to Uruguay XXI reports represented 30% of total exports in 2023. Within traditional services, tourism stands out, which showed an unprecedented situation in recent years, since the record of outbound tourism resulted in a deficit balance of about USD 187 million thanks to a very favorable bilateral real exchange rate for Uruguay, particularly due to the devaluation in Argentina in Dec23. This result began to reverse during 1Q24, with the "appreciation" of Argentina, and we expect this trend to continue during the rest of the year, eventually reversing the negative balance in tourism.

The current account will see an improvement in 2024 with a deficit of around 2.1% of GDP (from 3.6% in 2023) and a further improvement to -1.7% of GDP in 2025.

Continued Fiscal Institutional Compliance in 2023, but Some Caution for 2024

Authorities announced compliance with the fiscal rule in 2023 despite increased spending and reduced taxes, achieving this for the fourth consecutive year and improving Uruguay's sovereign debt rating to its highest historical level, above the investment grade requirement.

In 2023, the central administration's result was -3.3% of GDP. After correcting for extraordinary factors and considering GDP was impacted by drought (below potential), the MEF reported a structural deficit of 2.7% of GDP, precisely meeting the fiscal rule target in the latest accountability report for 2023. Central administration spending fell 0.4% in real terms (with a 2.1% cap), and borrowing was USD 2.424 billion, below the new limit considering the emergency water clause extension.

For 2024, the MEF revised the structural deficit target from 2.6% of GDP in the 2022 Accountability Report to 2.9% of GDP, justifying this change due to lower expected inflation and its impact on nominal revenue. Additionally, a primary real spending growth limit of 2.8% (new potential GDP, up from 2.1%) and a central government net borrowing cap of USD 2.300 million were established.

In early 2024, there is a deterioration in public accounts for both the central government and consolidated. In April, the central government +BPS recorded a 12-month deficit of 3.5% of GDP (compared to -3.2% in December 2023), while the consolidated government had a 4.2% deficit, 0.5 percentage points higher than the end of 2023. It is important to note that 2024 is an electoral year, historically more fiscally expansive.

Moreover, the government revised the central government+BPS deficit forecast from 2.7% to 3% of GDP, citing lower inflation levels than previous forecasts. Lower inflation negatively impacts nominal revenue but may also lead to real spending increases. Our consolidated global result forecast is a 3.6% deficit (excluding FSS) by year-end, an improvement of 0.2 percentage points from December, with further improvements in 2025. These results, without changes to the fiscal rule parameters in the next accountability report, will make compliance challenging in 2024.

Inflation and Monetary Policy: Prices Within Target Range, but Expectations Still Not Validating Sustainable Decline

The central bank's commitment to bringing inflation to the target range center is showing results. Since mid-2023, inflation, measured in year-over-year changes, has been within the target range, reaching a minimum of 3.7%, the lowest since August 2005. We expect acceleration, resulting in accumulated inflation of 5.5% this year and 5% in 2025, within the 3%/6% target range.

Expectations, which have been highly rigid in recent years, are starting to show an incipient convergence towards the target range center but still hover at the 6% ceiling for the 24-month monetary policy horizon.

In this scenario, the central bank will maintain a contractionary stance but is expected to pause until Q4 2024, resuming rate cuts and leaving the policy rate at 8.25% by year-end.

Exchange Rate: How Much Delay and How Much Fundamentals?

The peso's stability stands out among regional currencies, registering the lowest variation against the dollar over the past 12 months. This characteristic will persist at least this year, despite an expected slight acceleration in the peso depreciation rate to UYU/USD 40 by December 2024. This exchange rate acceleration is driven by a lower positive real interest rate, below the first-half average, and the Fed's postponed rate cut start.

As previously noted, the peso's strength is partly due to monetary policy, maintaining a substantial interest rate differential with international reference rates and a non-interventionist exchange rate policy, except during high volatility episodes. Additionally, a significant component is sustained by macroeconomic fundamentals, as evidenced by the investment grade and historically low sovereign risk levels.

Conclusions

We expect Uruguay's economy to resume growth in 2024 and 2025, with the recovery of the agricultural sector and private consumption as real wages recover amid slowing inflation.

This year is notable, with much of the global population voting, including Uruguay. Unlike other regions experiencing strong polarization, we do not expect significant political or economic changes in Uruguay due to its institutional strength, macroeconomic stability, and mature, consensus-driven political culture. These conditions provide a great opportunity to implement necessary reforms to increase productivity and achieve sustainable growth.

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Table 1. **URUGUAY: MACROECONOMIC FORECASTS**

	2021	2022	2023	2024f	2025f
GDP (% YoY)	5.6	4.7	0.4	**3.2**	**2.7**
Inflation (% YoY eop)	8.0	8.3	5.1	**5.5**	**5.0**
Inflation (% YoY ave)	7.7	9.1	5.9	**5.1**	**4.8**
Exchange rate (vs USD eop)	44.3	38.9	39.3	**40.0**	**42.2**
Exchange rate (vs USD ave)	43.6	41.2	38.8	**39.1**	**41.2**
Private Consumption (% YoY)	3.2	5.7	3.6	**2.5**	**2.9**
Public Consumption (% YoY)	5.2	2.5	-0.2	**-2.2**	**1.2**
Investment (% YoY)	19.3	5.7	-2.7	**-19.2**	**3.0**
Unenployment rate (%, eop)	7.0	7.9	7.8	**8.5**	**8.2**
Fiscal Balance (% GDP)	-4.0	-3.4	-3.8	**-3.6**	**-2.9**
Current Accoun (BoP, % GDP)	-2.4	-3.9	-3.6	**-2.1**	**-1.7**

Source: BBVA Resarch

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