BBVA Research

Uruguay Economic Outlook

2024

Creating Opportunities

Main messages. Global

Recent developments	A very soft landing so far. Growth has surprised upwards and inflation has halted its downward trend, mostly due to the service sector dynamism. With fiscal policy to some extent offsetting the contractionary impact of monetary tightening, the room for central banks cutting interest rates has declined. Still, financial volatility remains low.
Growth outlook	Growth will weaken in the next few quarters and recover somewhat in 2025. In the US, 2024 growth was revised up, but a soft-landing, with weaker demand and labor markets, is still expected. In the Eurozone, a cyclical recovery is expected to gain momentum ahead. In China, despite positive incoming data and increasing stimuli, structural challenges will eventually drive growth down.
Inflation and rates outlook	The ECB has started cutting interest rates, but the Fed will wait more than anticipated to launch its easing cycle. Domestic demand will eventually weaken, paving the way for further disinflation and rate cuts. However, inflation concerns will not fully subside and, therefore, interest rates are likely to remain at contractionary levels.
Risks	If activity doesn't weaken due to the dynamism of the services sector and/or a manufacturing recovery occurs, inflation converging to 2% would be at risk. In the current geopolitical context, new supply shocks could also prevent inflation from slowing. All this would leave little room for lower interest rates.

Key points. Uruguay

Political scenario

Uruguay has a society with political maturity that seeks consensus, so we do not expect significant policy changes regardless of the outcome of the October elections: we anticipate the continuity of the tax rule and the latest changes in the pension system.

Economic activity

After a weak GDP growth of 0.4% in 2023, activity will grow 3.2% in 2024 as a result of the recovery of the agricultural and energy sectors and private consumption. Despite this expansion, it is necessary to face the necessary reforms to gain competitiveness and maintain a path of sustainable growth.

Fiscal deficit

After complying with the tax rule for the fourth consecutive year in 2023, this year it will be more difficult to achieve it unless the expenses that are growing above the stipulated limit are managed. The government revised the expected deficit to 3% of GDP for the GC-BPS.

Exchange rate

The exchange rate will reach UYU/USD 40 in December 2024. The strength of the peso is due to both its solid foundations and a boost from the attractive yield of assets in domestic currency. We do not expect a correction of magnitude for the next two years despite further monetary easing.

Inflation

Inflation will end this year at 5.5% and will end 2025 at 5.0%. The Central Bank's efforts and improved communication are beginning to show early results in terms of expectations, increasing the strength of monetary policy.

BBVA Research

01

Global economic outlook

BBVA Research baseline scenario: inflation and interest rates are likely to decline, but will remain relatively high, favoring subdued activity growth

Scenario drivers

Interest rates to gradually fall, also in the US, where cuts were postponed amid large uncertainty, but will remain at contractionary levels

Fiscal policy will scarcely contribute to ease inflation pressures, mainly in the US; some consolidation is likely in Europe from 2025, given new fiscal rules

Supply conditions: geopolitical context makes negative shocks more likely than in the past, but no particular shock is assumed in baseline scenario

Macro trends: prospects

Global growth to be weak in 2H24 and recover somewhat in 2025; China's structural deceleration will weigh down

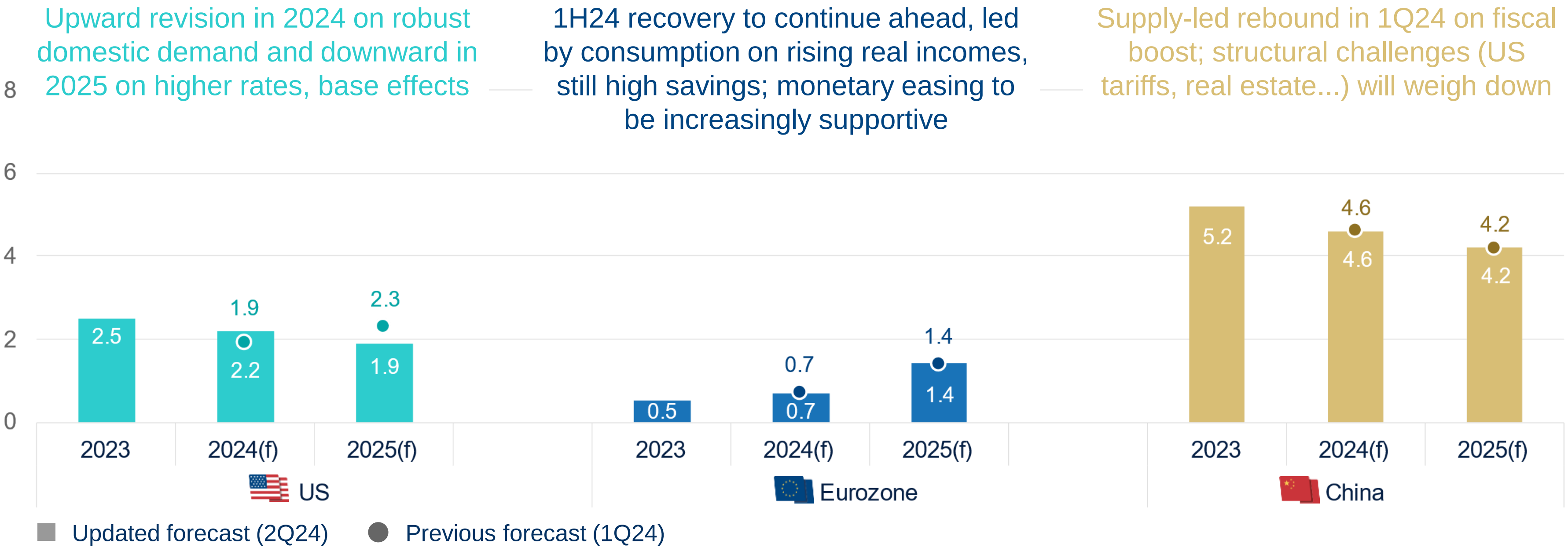
Inflation will ease further, but is set to remain higher than in recent decades on demand (fiscal policy, etc.) and supply (geopolitics, protectionism, etc.) issues

Volatility on geopolitics and US elections, likely offsetting the positive effects triggered by lower Fed rates

GDP growth prospects: a softer landing in the US, a cyclical recovery in the Eurozone and a structural deceleration in China

GDP GROWTH (*)

(%)



(f): forecast.

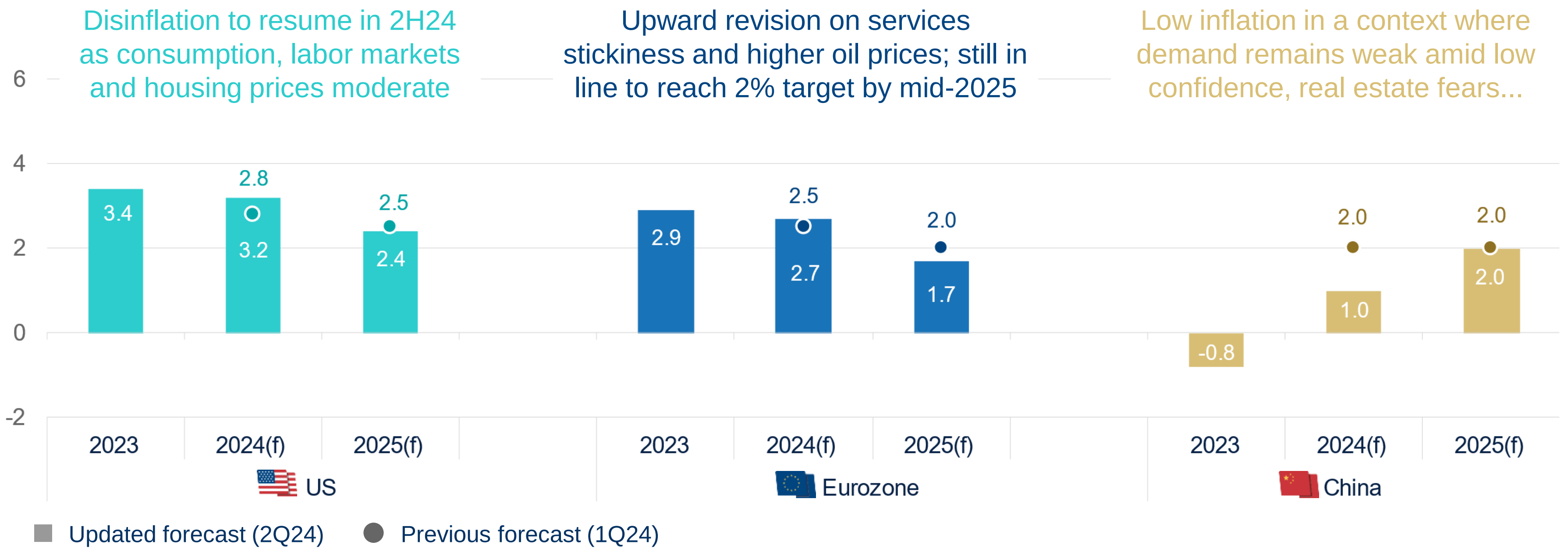
(*) Global GDP growth: 3.2% in 2023, 3.1% (+0.0 pp in comparison to previous forecast) in 2024 and 3.3% (+0.0 pp) in 2025.

Source: BBVA Research.

Inflation forecasts revised upwards in the US and Eurozone, mostly on service stickiness, and downwards in China, amid deflation concerns

HEADLINE INFLATION: CPI

(YOY %, END OF PERIOD)



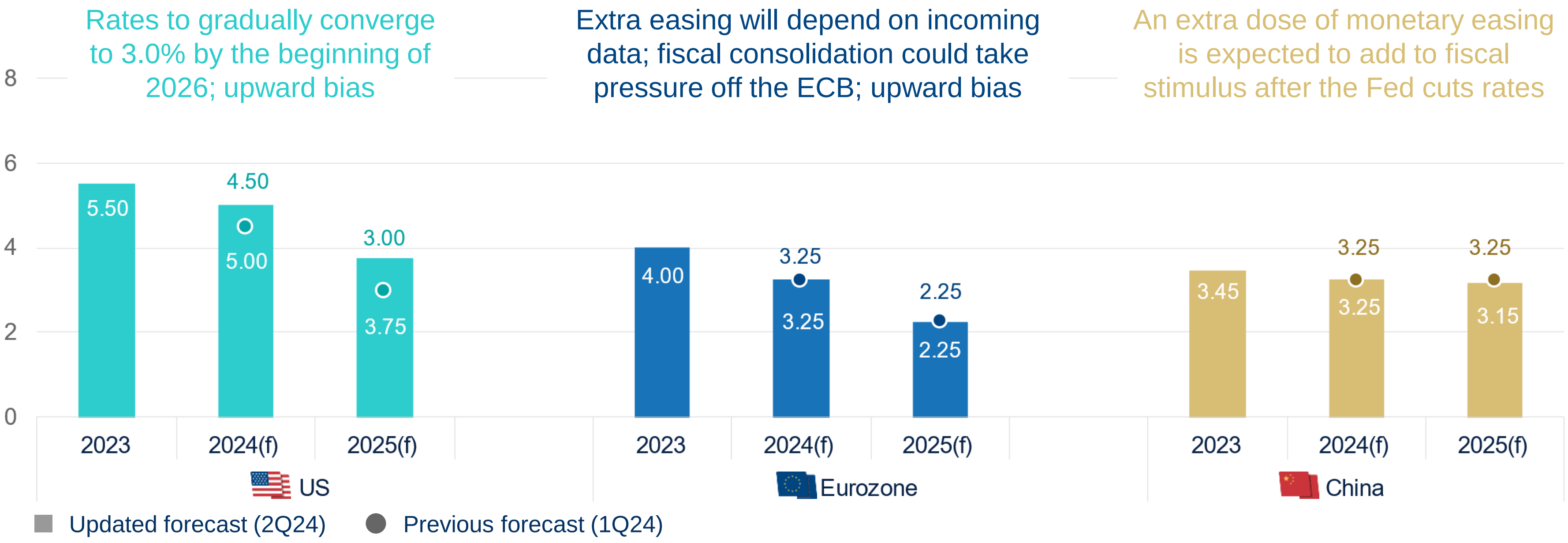
(f): forecast.

Source: BBVA Research.

The ECB has started cutting rates; the Fed will wait at least until Sep/24 to launch its easing cycle amid still uncertain growth and inflation moderation

POLICY INTEREST RATES (*)

(%, END OF PERIOD)

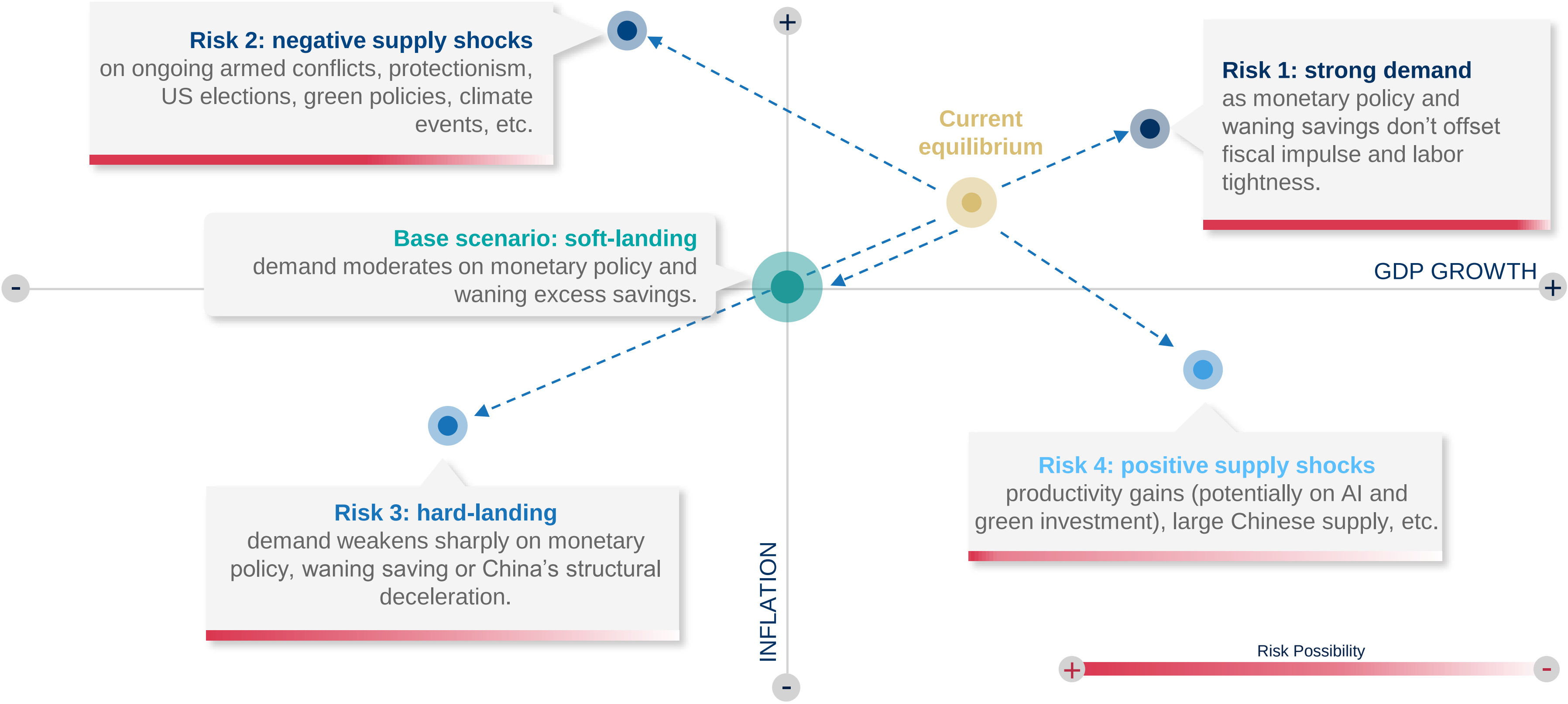


(f): forecast.

(*) In the case of the Eurozone, interest rates of the deposit facility.

Source: BBVA Research.

Risks: demand strength, protectionism, geopolitics, among other factors, could prevent inflation and interest rates from declining ahead



Research

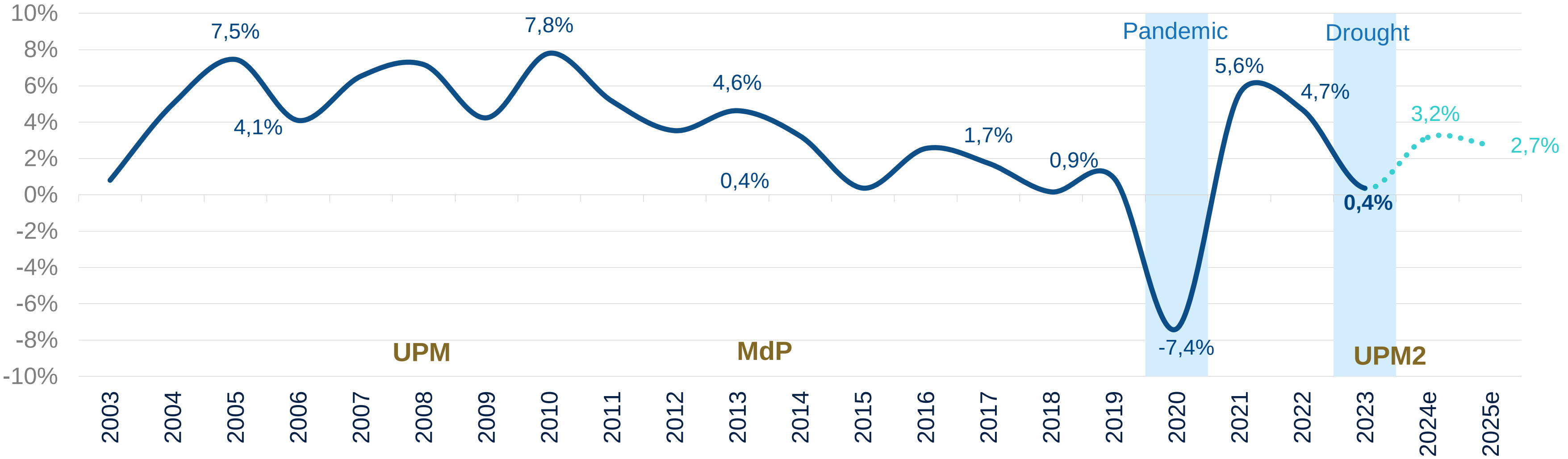
02

Uruguay economic outlook

Economic activity has remained virtually stagnant in recent years, rebounding only after particular recessionary shocks ...

GDP TRENDS AND FORECASTS

CHANGE %

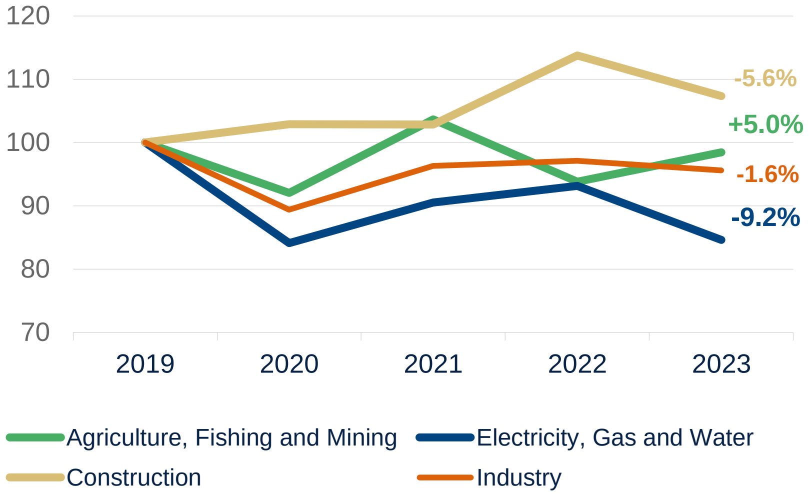


Source: BBVA Research and BCU.

In recent years, the country has made progress in many key institutional aspects to give stability and predictability to the private sector and to boost private sector investment. However, it is necessary to advance in structural reforms in order to gain competitiveness, boost the economy and consolidate a growing trend in the level of economic activity.

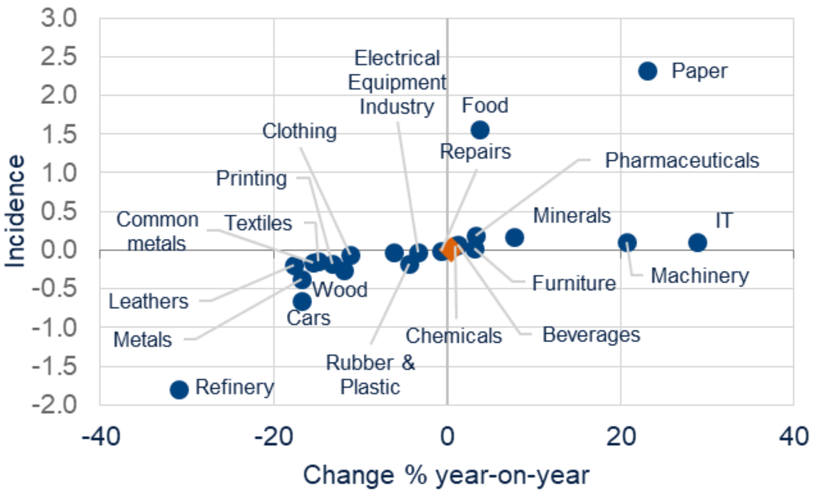
The drought impacted the agricultural sector and electricity generation but it was not the only thing that determined the meager growth in 2023 (+0.4%)

MOST AFFECTED SECTORS IN 2023
(% Y/Y CHANGE)



Source: BBVA Research and BCU.

MANUFACTURING INDUSTRY 2023
(INCIDENCE AND Y/Y % CHANGE)

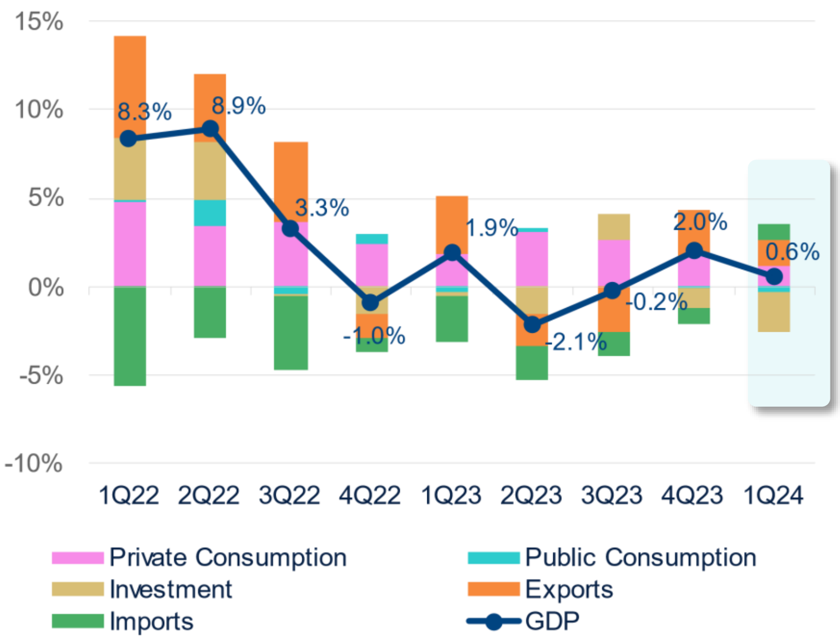


Source: BBVA Research and INE.

Official sources estimated the impact of the drought on agricultural activities between 2022 and 2023 at about USD 1.88 billion (3% of GDP). The maintenance shutdown of the ANCAP refinery offset the boost from output at UPM2, the completion of which also affected the Construction sector. Finally, low hydroelectric generation forced the importation of electricity and the use of other alternative sources.

Lower than expected growth in 1Q24: GDP rose 0.6% year-on-year (BBVAe= 0.9% y/y) and 0.9% quarter-on-quarter, seasonally adjusted (BBVAe= 1.2%)

GDP AND COMPONENTS (DEMAND)
(INCIDENCE AND Y/Y % CHANGE)



Source: BBVA Research and BCU.

DEMAND

- Investment fell due to the completion of UPM2
- Imports fell due to lower activity
- Private consumption and exports slowed.

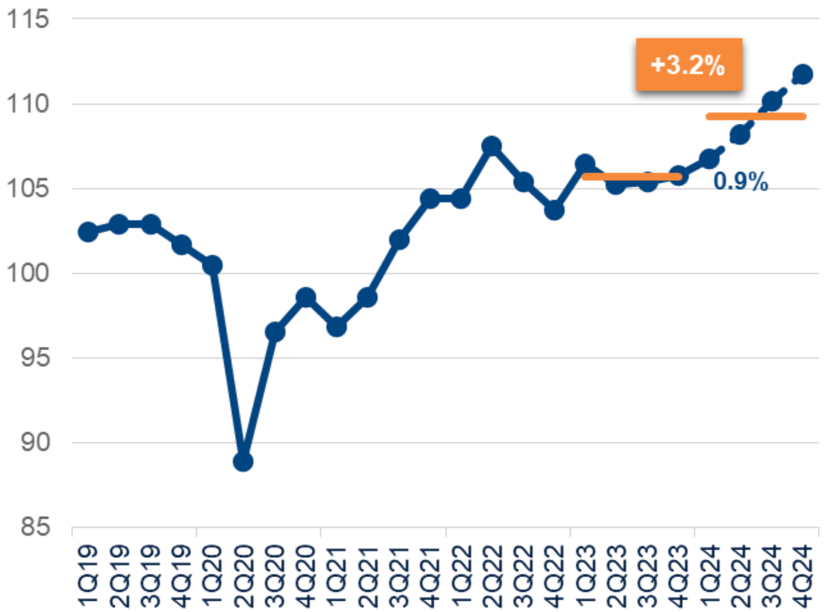
SUPPLY

- The Agricultural Sector and Electric Power showed positive performances by reversing the effect of the drought that hit them a year ago.
- There were also declines in the construction sector (reflecting the end of the UPM2 project) and in the manufacturing industry, which was affected mainly by the longer-than-expected maintenance shutdown of the ANCAP refinery.

We expect growth to recover by 2024 and 2025 after overcoming one-time factors that affected recent economic performance.

SEASONALLY ADJUSTED QUARTERLY GDP

(% CHG. Q/Q)

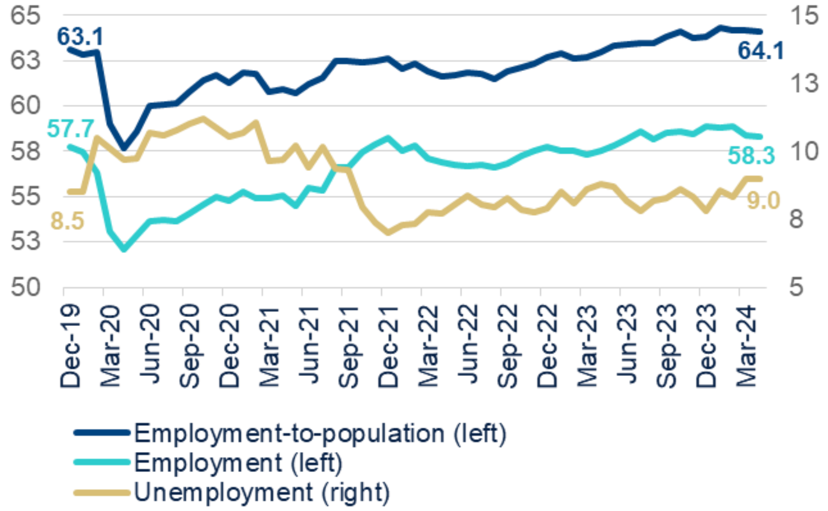


Source: BBVA Research and BCU.

- We expect growth of 3.2% in 2024 with a figure close to potential in 2025 (2.7%).
- The reversal of the effect of the drought will boost growth in the most affected sectors in 2023, mainly agriculture and energy, and will boost the exports of these sectors.
- The manufacturing industry will regain dynamism with the ANCAP´s reopening, which, together with the cellulose and food sector, will lead industrial growth.
- We anticipate a rebound in private consumption in the second half of the year to the extent that real wages continue to recover and the labor market does not deteriorate further.

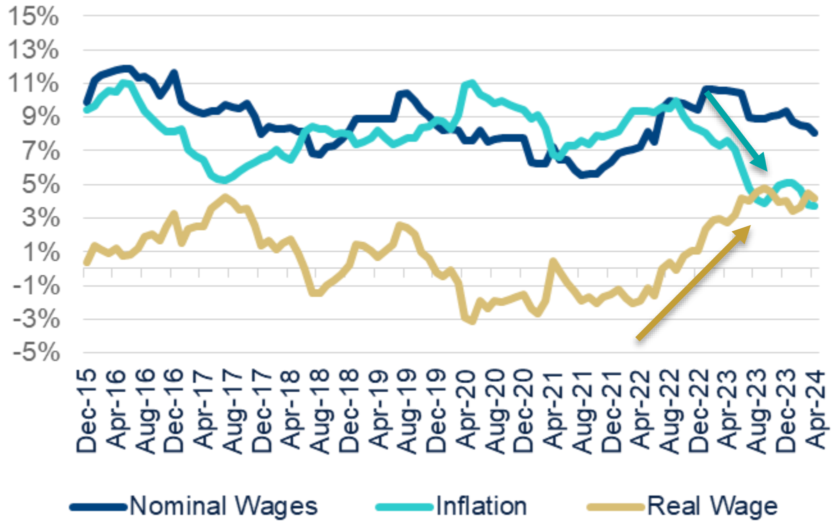
The significant job creation seen in 2023 (+37 thousand people) seems to have stagnated during the first few months of this year

EMPLOYMENT-TO-POPULATION, EMPLOYMENT AND UNEMPLOYMENT RATES
(AS % OF WAP AND EAP)



Source: BBVA Research and INE.

WAGES RECOVER IN THE FACE OF INFLATION
(% Y/Y CHG.)

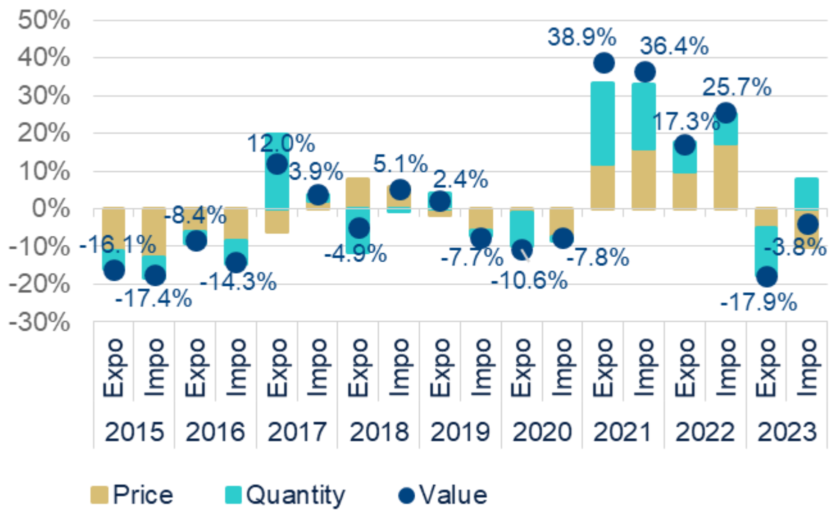


Source: BBVA Research and INE.

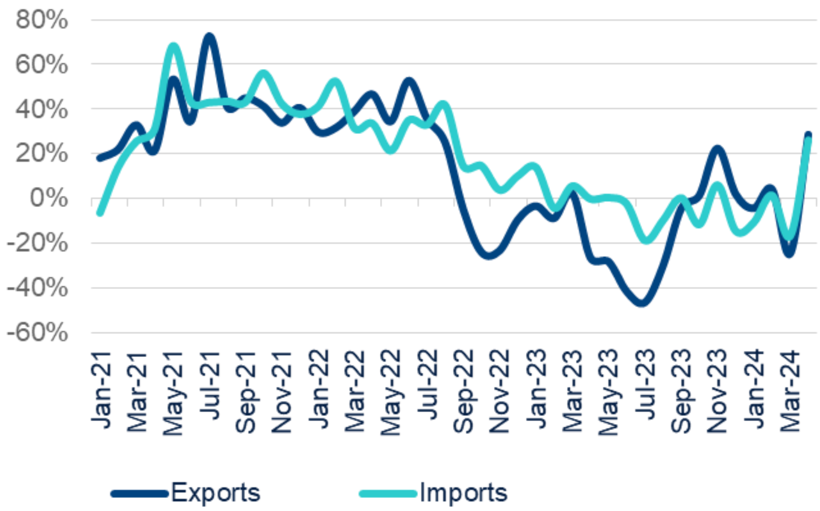
In April, the unemployment rate stood at 9% of the EAP. This rate was achieved by a greater drop in the employment rate than in the employment-to-population ratio. This dynamic was influenced by the drop in Construction and a tourist season that was not as good as expected. Real wages improve thanks to lower inflation. We expect unemployment to stand at 8.5% by the end of the year.

We expect foreign trade to overcome the adverse effects of 2023 and the reversal of these effects to have a positive impact in 2024

PRICES AND QUANTITIES OF FOREIGN TRADE
(% Y/Y CHG.)



MONTHLY EXPORTS AND IMPORTS
(% Y/Y CHG.)



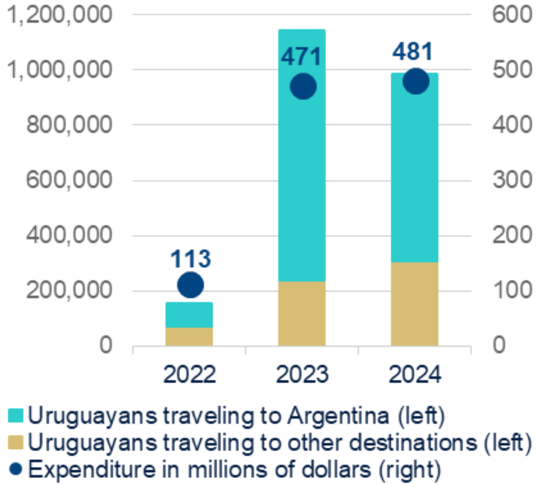
Source: BBVA Research and BCU.

The combination of a reduced external demand (mainly from China), lower commodity prices and the restriction of supply due to the drought caused a 13% drop in exports of goods if sales from free trade zones are also taken into account. Imports fell 3.8%, mainly driven by lower prices.

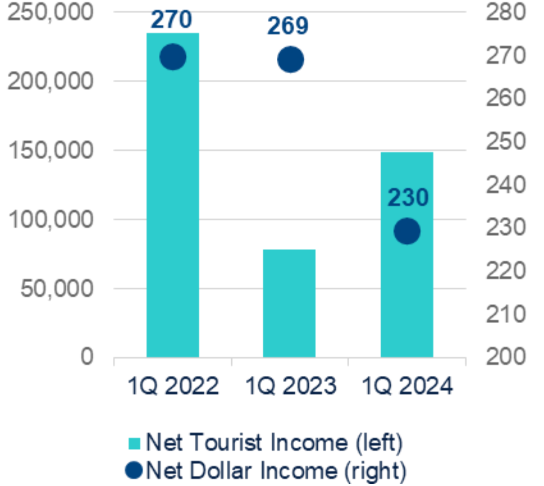
Tourism flow eased during the first quarter of the year: arrival of visitors fell 6.9% y/y while Uruguayans traveling abroad fell 13.6% y/y

VISITORS AND EXPENDITURE (FIRST QUARTER) (THOUSANDS OF PEOPLE AND THOUSANDS OF DOLLARS)

OUTBOUND TOURISM (FIRST QUARTER) (THOUSANDS OF PEOPLE AND THOUSANDS OF DOLLARS)



NET TOURISM (FIRST QUARTER) (PEOPLE AND THOUSANDS OF DOLLARS)



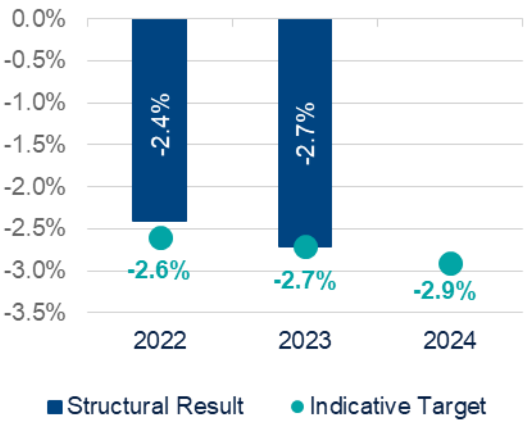
Source: BBVA Research and the Ministry of Tourism of Uruguay.

The change in relative prices in Argentina explains a lower flow of Uruguayans, as well as a lower expenditure in dollars in that destination. However, part of outbound tourism and spending was redirected to other destinations.

The three pillars of the tax rule were met in 2023 for the fourth consecutive year, underpinning tax credibility

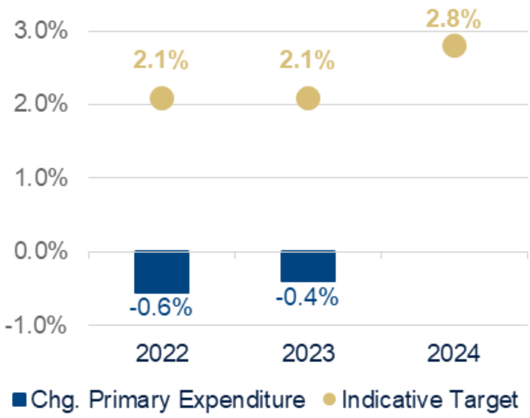
PILLAR 1

The indicative objective of the structural fiscal result, considering fluctuations in the economic cycle and extraordinary/transitory expenses and revenues.



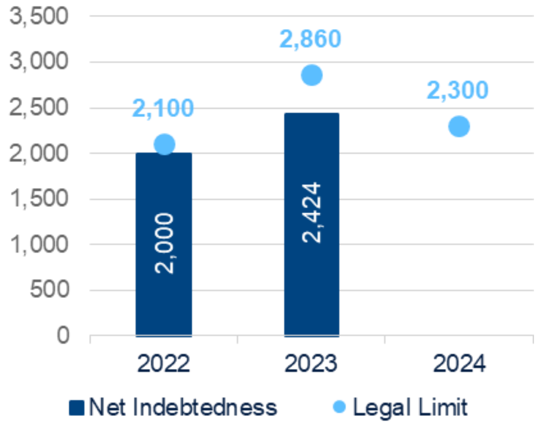
PILLAR 2

Indicative ceiling for real primary expenditure growth in line with estimated trend in real GDP growth.



PILLAR 3

Legal limit on annual net public debt in dollars.



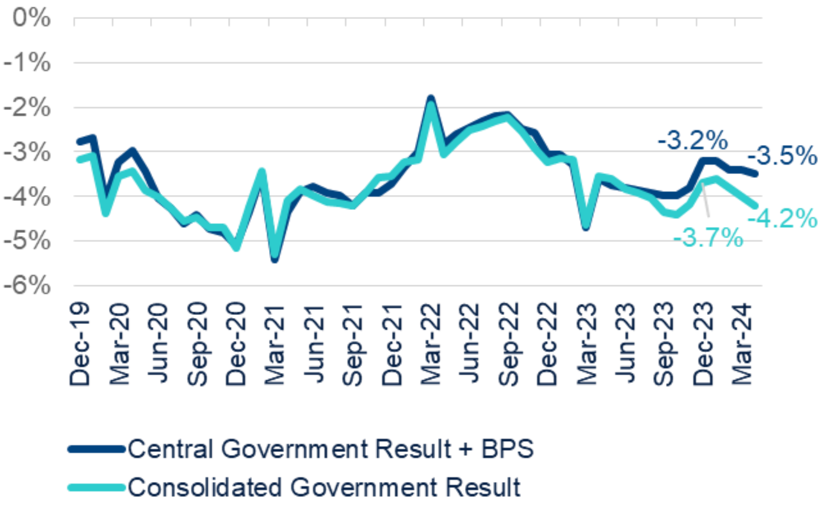
Source: xxxxxxxxxxxxxxx

We expect a global deficit of -3.6% of GDP for this year and -2.9% of GDP for 2025.

This would occur with the improvement planned for the second part of the year

FISCAL RESULT

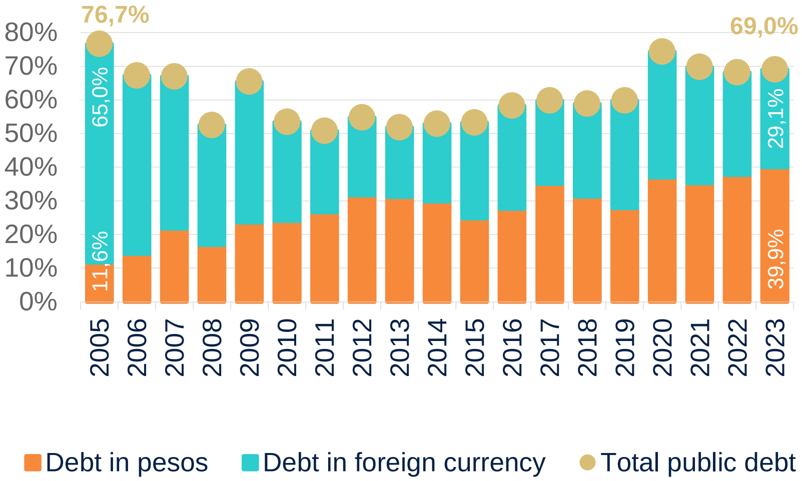
(AS % OF GDP, LAST 12 MONTHS)



Source: BBVA Research and MEF.

GROSS GOVERNMENT DEBT

(% GDP)

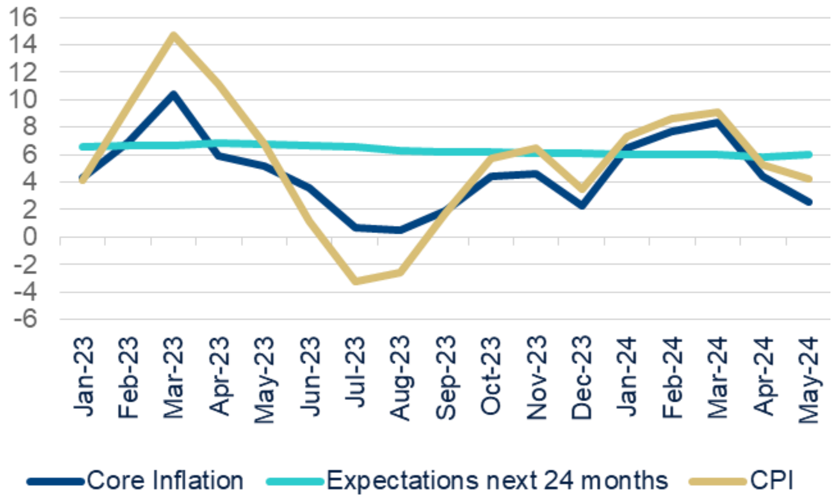


Source: BBVA Research and BCU.

The expected improvement in activity will bring relief in tax collection (which has been hit by the drought) while spending is expected to moderate in line with what the tax rule allows. This will make it possible to ensure that the debt remains within sustainable parameters.

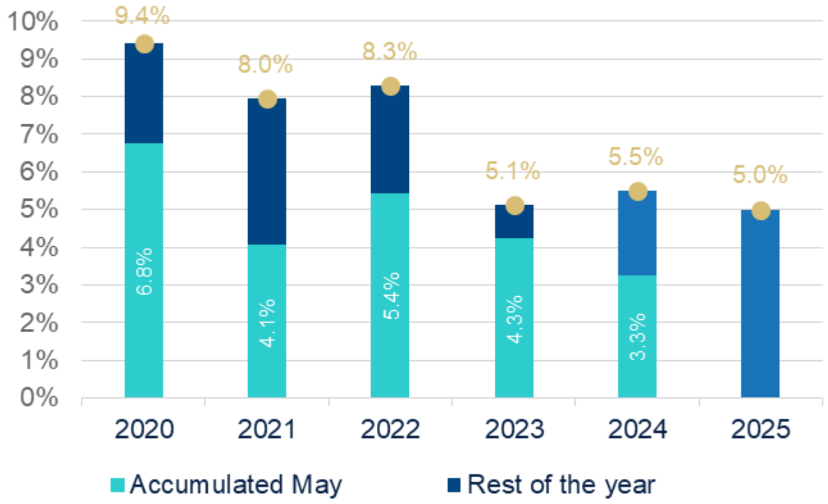
Inflation is on track to remain within target range, but expectations remain firm at the target ceiling

INFLATION AND EXPECTATIONS
(CORE INFL AND CPI IN ANNUALIZED 3M MOVING AVG., %)



Source: BBVA Research and BCU.

ACCUMULATED INFLATION
(%)



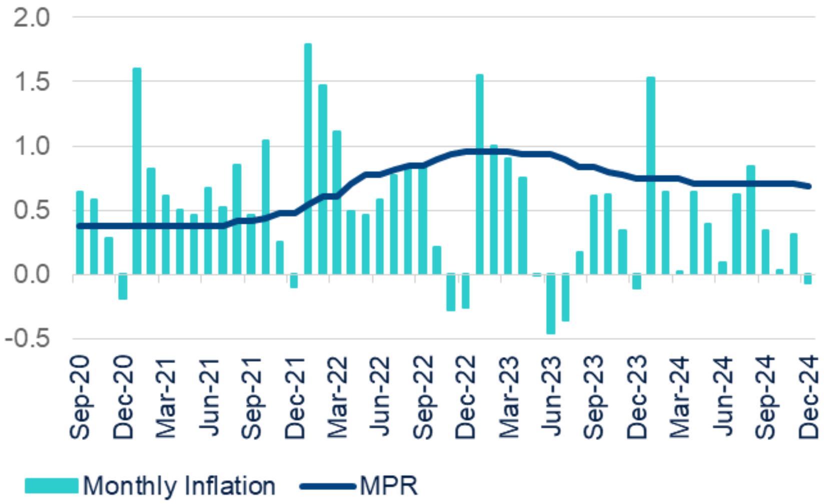
Source: BBVA Research and INE.

As of Q3 2023, core inflation has been below the general level. In recent months, an incipient decline in expectations has begun to take place.

We expect a slight increase in prices in 2H24, accumulating an increase of 5.5% this year and 5.0% in 2025.

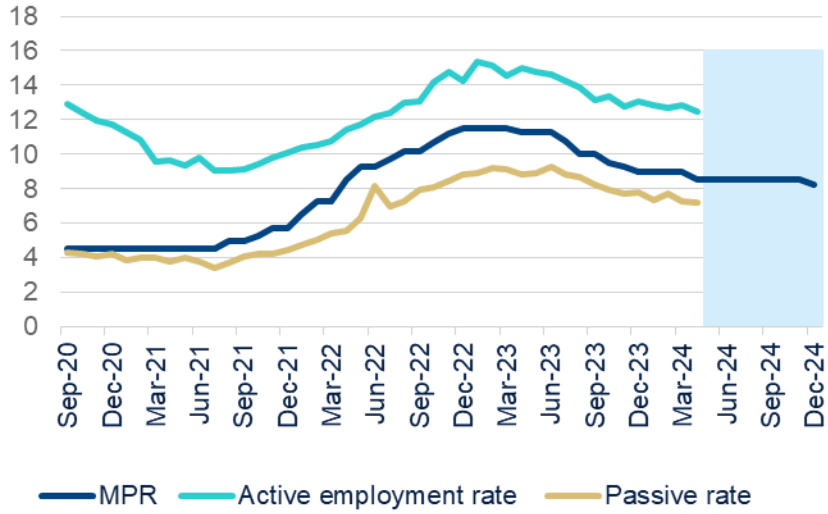
The BCU remains committed to fighting inflation and the market accompanies monetary policy decisions

INFLATION AND MONETARY POLICY RATE
(% MONTHLY CHANGE, MER)



Source: BBVA Research, INE and BCU.

MONETARY POLICY RATE, TRADE RATES
(% Y/Y CHG.)

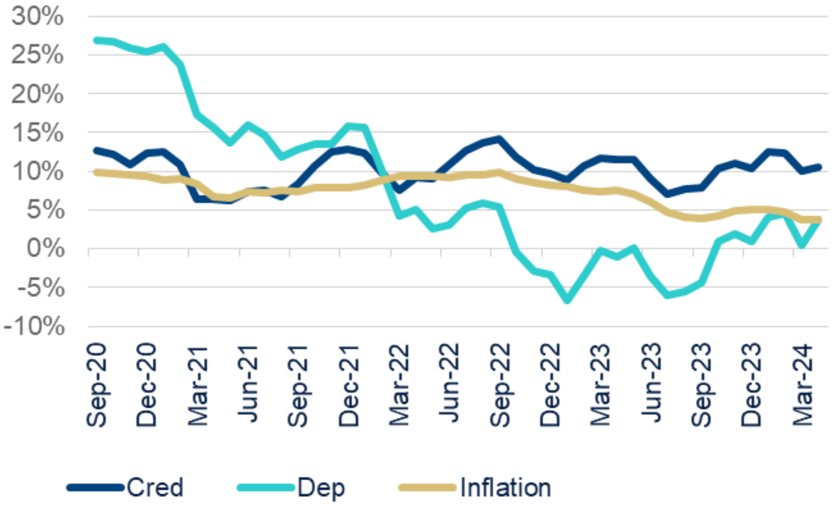


Source: BBVA Research and BCU.

The monetary policy committee will resume cuts toward the end of the year; the reference rate will reach 8.25% at the end of the year.

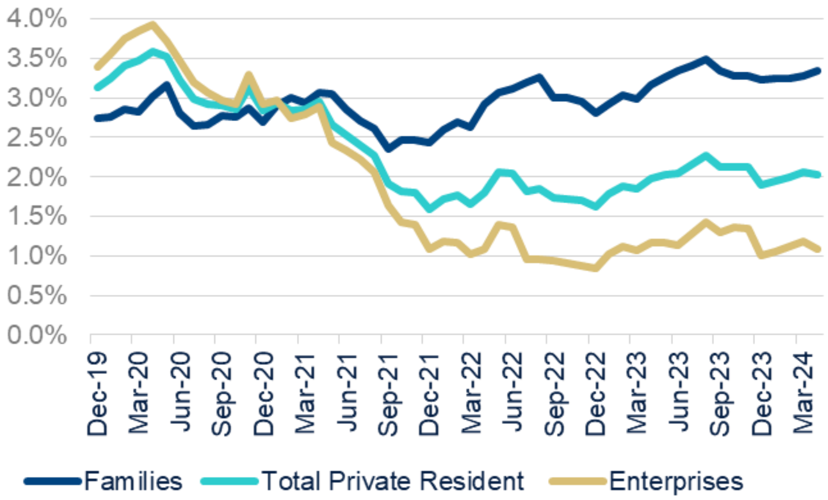
The financial system shows quality growth; the challenge is to increase penetration and reduce the use of foreign currency

CREDITS, DEPOSITS AND INFLATION
(% Y/Y CHG., CRED. & DEP. EXPRESSED IN PESOS)



Source: BBVA Research, INE and BCU.

FINANCIAL SYSTEM DELINQUENCE
(% DELINQUENT PORTFOLIO / TOTAL PORTFOLIO)

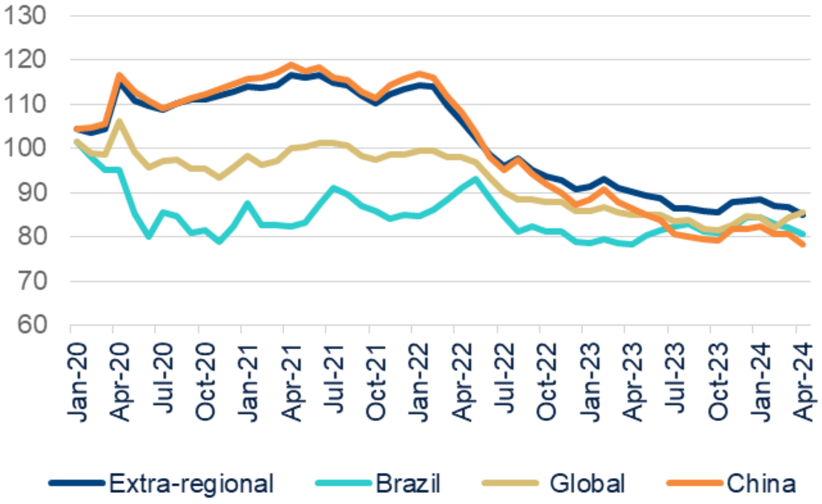


Source: BBVA Research and BCU.

Credit continues to grow at rates that exceed inflation, with a good quality portfolio. The negative variations in deposits are due to the periods of strengthening of the peso given the high share of deposits In foreign currency

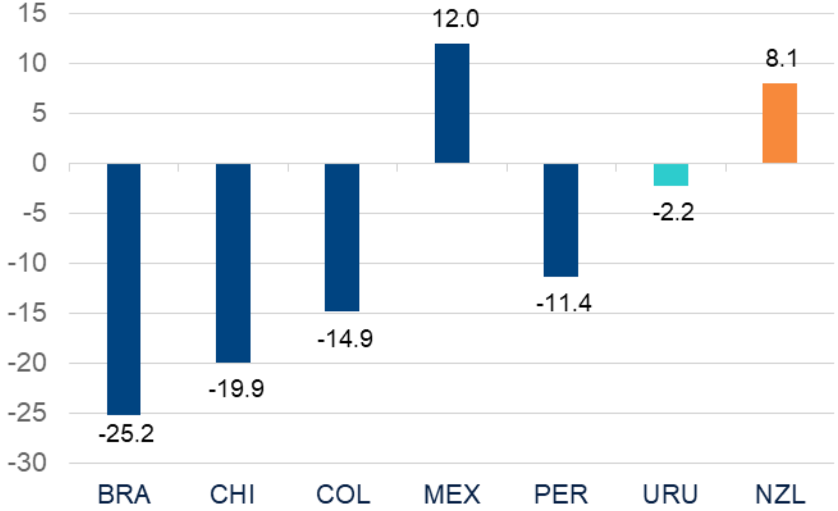
The peso, a stable currency with solid fundamentals (and steroids)

REAL EXCHANGE RATE
(AVG.-2019 = 100)



Source: BBVA Research and BCU.

EXCHANGE RATE VARIATIONS
(VAR% BETWEEN DEC19 AND MAY23)

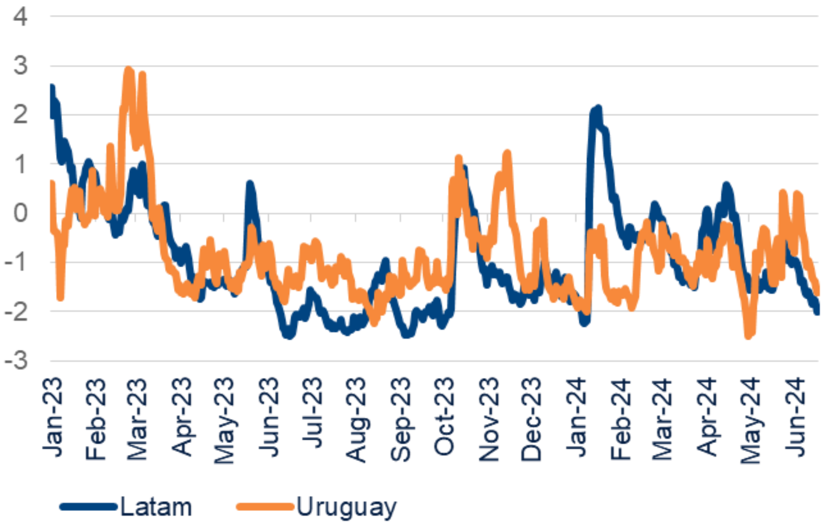


(-) implies depreciation against the USD
Source: BBVA Research and HAVER.

The exchange rate will reach UYU/USD 40 by the end of the year, speeding up the depreciation due to the Fed postponing its rate cut. We do not expect an increase in the exchange rate over the next 2 years that would bring the real exchange rate to pre-pandemic levels.

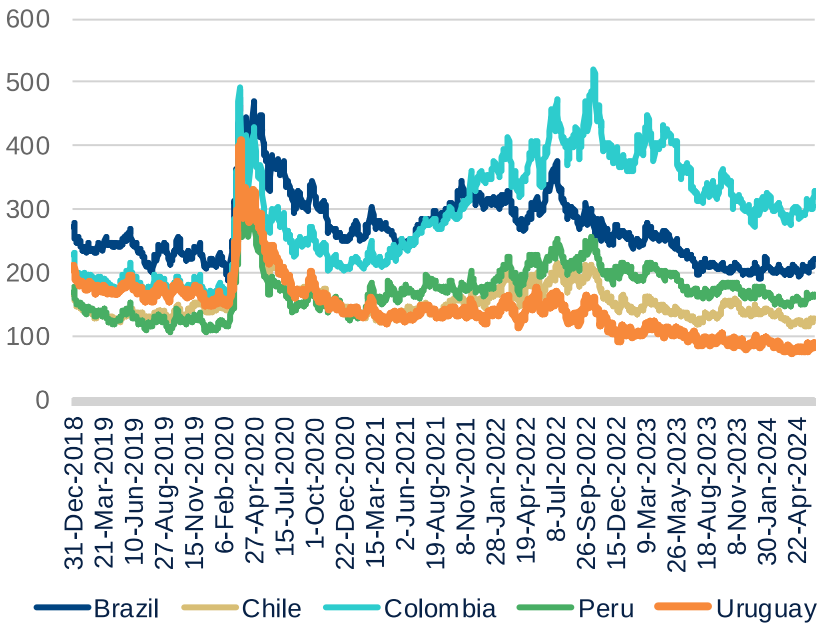
The low perception of political and economic Risks would allow the necessary reforms to be addressed in an orderly manner to boost the economy

INDEX OF POLITICAL TENSIONS*
(% OF GDP)



*Index originally constructed by BBVA Research based on the tone and coverage associated with the GDELT search of the intersection of two sets of keywords, according to the methodology of Caldara, Dario and Matteo Iacoviello (2022). This index is a weighted product made up of GDELT's tone (i.e., associated sentiment) and relative coverage (i.e., the number of news items that match the two sets of keywords/total number of news published).
Source: BBVA Research.

COUNTRY RISK
(EMBI)



Source: BBVA Research and JP Morgan.

Forecasts

	2021	2022	2023	2024p	2025p
GDP (% y/y)	5.6	4.7	0.4	3.2	2.7
Inflation (% y/y, EOP)	8.0	8.3	5.1	5.5	5.0
Inflation (% y/y, average)	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, average)	43.6	41.2	38.8	39.1	41.2
Private consumption (% y/y)	3.2	5.7	3.6	2,5	2.9
Government expenditure (% y/y)	5,2	2.5	-0.2	-2.2	1.2
Investment (% y/y)	19.3	5.7	-2.7	-19.2	3.0
Unemployment rate (% EOP end)	7.0	7.9	7.8	8.5	8.2
Overall fiscal balance (% GDP)	-4.0	-3.4	-3.8	-3.6	-2.9
Current account (% GDP)	-2.4	-3.9	-3.6	-2.1	-1.7

Source: BBVA Research.

Disclaimer

BBVA Research

Uruguay Economic Outlook

2024

Creating Opportunities