Research

Uruguay Economic Outlook

2023

Creating Opportunities

Main messages. Global

Recent developments

A combination of easing supply shocks (due to lower commodity prices and normalized supply bottlenecks) and resilient demand (on tight labor markets and lingering post-covid reopening effects) has continued to support growth. While, in general, headline inflation has peaked, core inflation has yet to decline more significantly. In this context, the central bank's focus on inflation has been reaffirmed, which has helped to create tensions in US regional banks.

Growth outlook

2023 growth will be higher than previously forecast, mostly due to positive incoming data, but 2024 growth will be weaker than anticipated, thanks to the lagged impact of tighter monetary and credit conditions. Global growth will slow from 3.4% in 2022 to 2.9% (+0.2pp higher than the previous forecast) in 2023 and 2.9% (-0.3pp) in 2024.

Inflation and rates outlook

Central banks will keep rates at restrictive levels for some time, probably for longer than markets are expecting. Liquidity withdrawal programs, credit tightening boosted by the US banking turmoil and, eventually, less expansive fiscal policies will also favor a gradual easing of demand and prices. Still, some second round effects will contribute to keep inflation above the targets for a long period. Against this backdrop, the main risk is that high inflation and tight monetary conditions triggers a sharp recession or new financial instability episodes.

Key messages. Uruguay

Activity

Uruguay's economy managed to emerge from the recession at the end of 2022, growing 0.9% y/y in 1Q23 (+1.2% y/y). We expect growth of around 2% in 2023, driven mainly by private consumption due to the recovery of real wages. For 2024, there will be a slight rebound in activity to 2.3% once the adverse effects of the drought have been overcome.

External sector

After two years of strong foreign trade growth, 2023 will show a drop in the export of goods (-10% y/y), partially offset by the dynamism of export of services. Meanwhile, imports will be sustained by energy imports, which are necessary due to the low generation of hydroelectric power. The current account deficit will remain at 3.3% in 2023.

Fiscal Deficit

The deterioration observed in the public accounts in recent months is the result of a drop in revenues and an increase in spending (in real terms). The performance of public enterprises was affected by the drought and renders compliance with the fiscal target very challenging. We estimate consolidated deficits of 3.1% of GDP and 2.9% of GDP for 2023 and 2024.

Exchange rate

Sustained by macroeconomic fundamentals and the contractionary monetary policy cycle, the peso has strengthened in line with most currencies in the region. We expect it to maintain this dynamic and reach UYU/USD 39.7 in Dec-23.

Inflation

Inflation is expected to reach 7.5% this year and 6.2% in 2024. Prices show signs of subdued slowdown. The central bank of Uruguay (BCU) has paused the interest rate cutting cycle until the downward trend in inflation is confirmed.

BBVA Research

01

Global Economic Outlook

Reinforced prospects for growth and inflation easing despite recent resilience: credit tightening amid banking stress likely to add to monetary tightening

BBVA RESEARCH BASELINE SCENARIO

High-for-long interest rates

Restrictive monetary stance, also on credit tightening and liquidity withdrawal; cautious policy reversal from 1Q24 (or later).

Growth slowdown

Labor markets and demand will eventually ease, driving growth down despite supply normalization.

Gradual disinflation

Contained commodity prices and limited second round effects, but inflation above targets for some time.

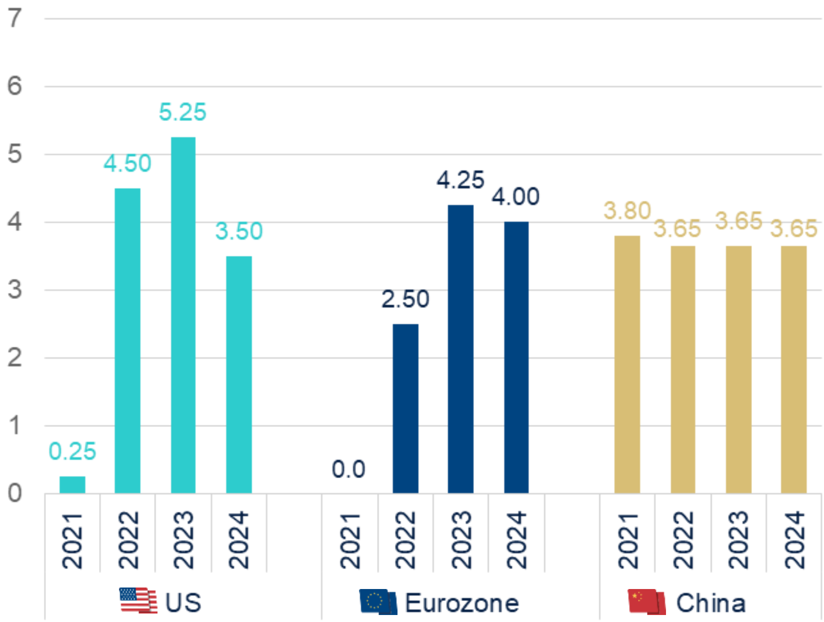
Financial volatility

Relatively high volatility and limited flows to riskier assets; US banks stress, with no contagion to large banks or abroad.

Central banks will remain focused on inflation despite banking stress: after reaching restrictive levels, rates will likely remain unchanged for a long period

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)

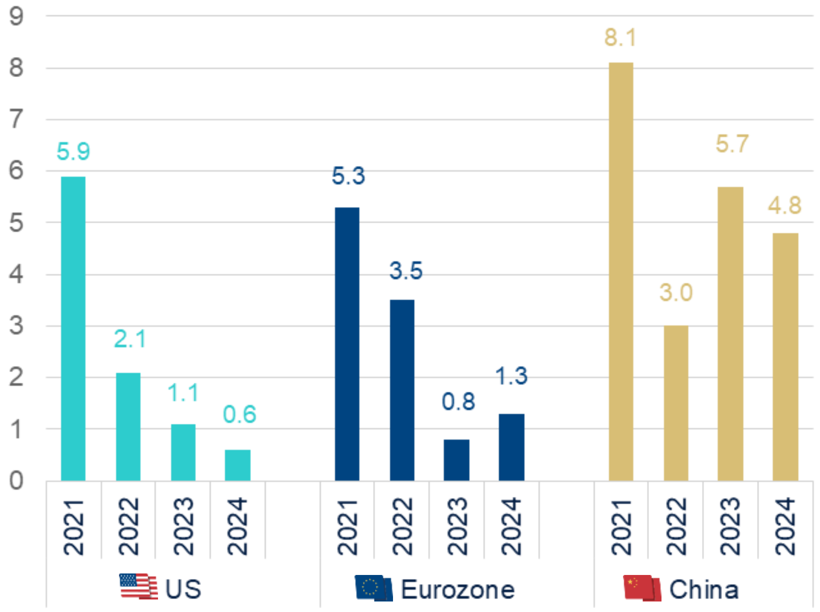


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- Central banks are likely to use policy rates to fight inflation and liquidity tools to address bank stress; financial dominance is not expected, but is a risk.
- The rate hiking cycle is presumably over in the US (but one more hike is possible) and closer to its end in the EZ, where at least two more hikes are likely.
- Easing cycles are not likely before 1Q24 in the US and 4Q24 in the EZ.
- Still, Fed and ECB will maintain quantitative tightening programs in place, with a gradual and predictable liquidity withdrawal pace.
- Credit tightening and, eventually, fiscal policy are likely to help monetary policy to reign in on inflation.

GDP forecasts: up in 2023 on robust demand and easing supply shocks, but down in 2024 on the lagged impact of tighter monetary and credit conditions

GDP: ANNUAL GROWTH IN REAL TERMS (*)
(%)



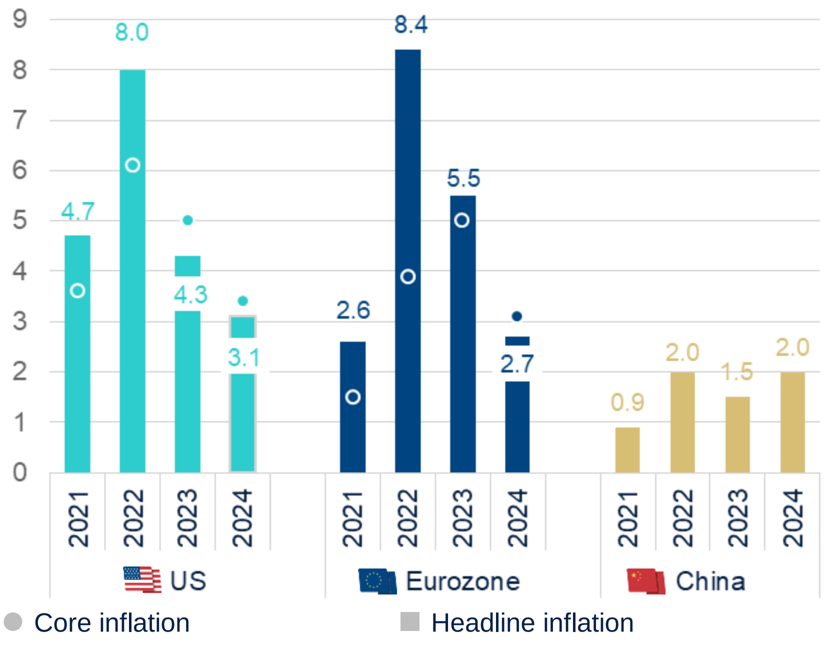
(*) Previous forecasts: 0.8% in 2023 and 1.8% in 2024 in the US, 0.6% in 2023 and 1.6% in 2024 in the Eurozone, 5.2% en 2023 and 5.0% in 2024 in China.
Source: BBVA Research.

- 2023 upward revisions (US: 0.3pp, EZ: 0.2pp, CHN: 0.5pp) on supportive incoming data reflecting strong private consumption (mainly in the US and China) and lower energy prices (mainly in the EZ).
- 2024 downward revisions (US: -1.2pp, EZ: -0.3pp, CHN: -0.2pp) on effects of tighter monetary policy and less supportive credit conditions, to which the recent banking stress is likely to contribute.
- Vanishing reopening effects, easing fiscal support and financial volatility are also likely to hit growth.
- Global growth to slow from 3.4% in 2022 to 2.9% (+0.2pp) in 2023 and 2.9% (-0.3pp) in 2024.

Inflation will continue to ease, but will be more persistent than previously expected; it will be over the targets for long in the US and EZ

INFLATION:CPI

(Y/Y %, PERIOD AVERAGE)

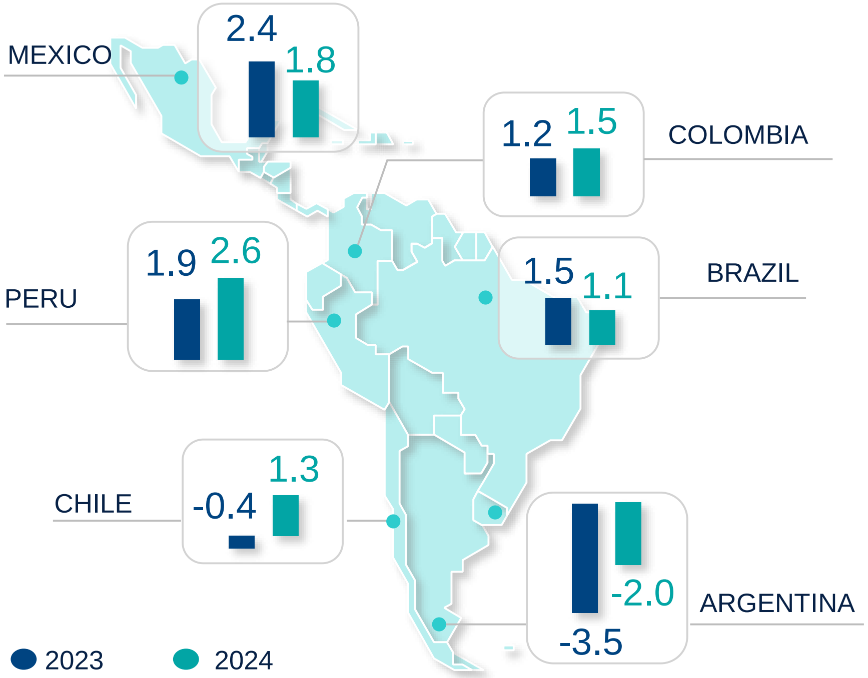


Source: BBVA Research.

- Supply improvement (lower commodity prices, bottleneck normalization) and monetary tightening will pave the way for a further decline in inflation: headline inflation has peaked; core inflation is set to soon ease more significantly.
- Still, the dynamism of private consumption amid tight labor markets will favor (contained) increases in wages and profit margins, slowing inflation's downward trend.
- In China, price pressures remain under control despite the post-covid recovery due to favorable commodity prices, supply recovery and private sector "balance sheet recession".

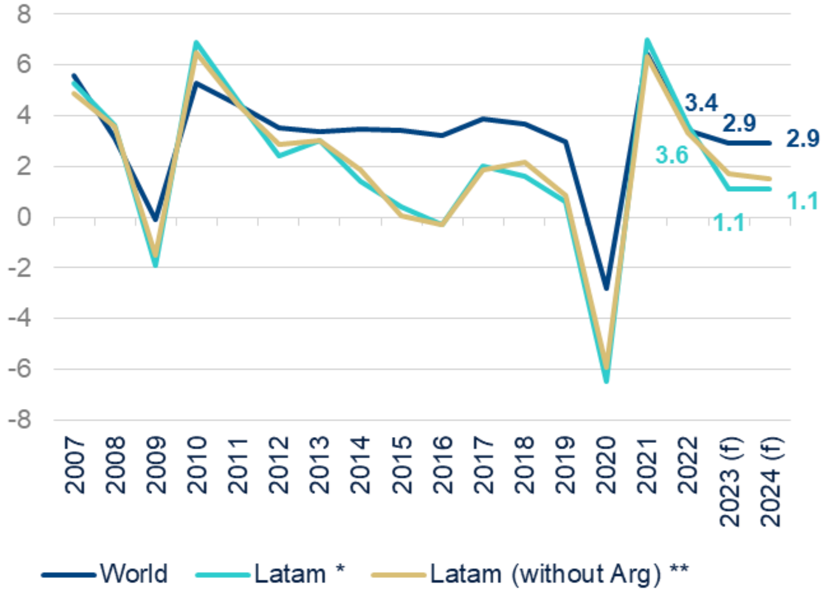
Latam will experience a significant growth moderation in 2023, greater than the world average, and will maintain a weak performance in 2024

GDP GROWTH
(ANNUAL CHANGE, %)



Source: BBVA Reseach.

WORLD AND LATAM GDP
(ANNUAL CHANGE %)



(f): BBVA Research projections.
(*): Includes Brazil, Chile, Colombia, Mexico, Peru, Paraguay and Uruguay.
(**): Includes Argentina, Brazil, Chile, Colombia, Mexico, Paraguay, Peru y Uruguay.

In an uncertain context, the risk that high inflation and tight monetary conditions triggers a recession or financial instability has increased lately

MAIN RISKS

PERSISTENT INFLATION AND TIGHT MONETARY POLICY:

- strong demand
- tight labor markets
- China recovery
- higher commodity prices
- wage-price spirals
- not fully anchored expectations

→

FINANCIAL INSTABILITY
(contagion from US banking stress, vulnerabilities in real estate and leverage markets, non-banking sector, etc.)

GLOBAL RECESSION

MAIN UNCERTAINTIES

GEOPOLITICAL TENSIONS

US-CHINA RIVALRY (DEGLOBALIZATION, ETC)

ENERGY TRANSITION AND CLIMATE CHANGE

SOCIAL TENSIONS AND POPULISM

BBVA Research

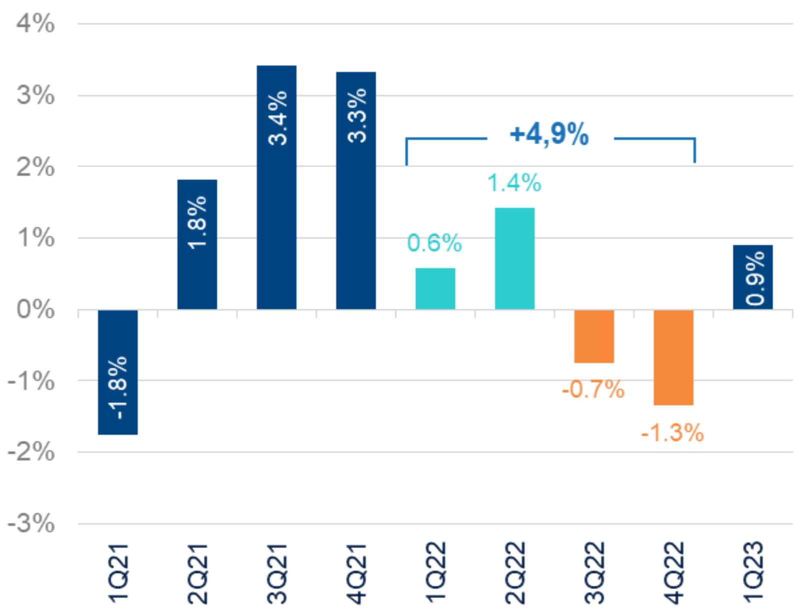
03

Uruguay Economic Outlook

Uruguay's economic activity expanded by 4.9% in 2022 and started off 2023 with 1.2% y/y growth

SEASONALLY ADJUSTED QUARTERLY GDP

QoQ % CHANGE

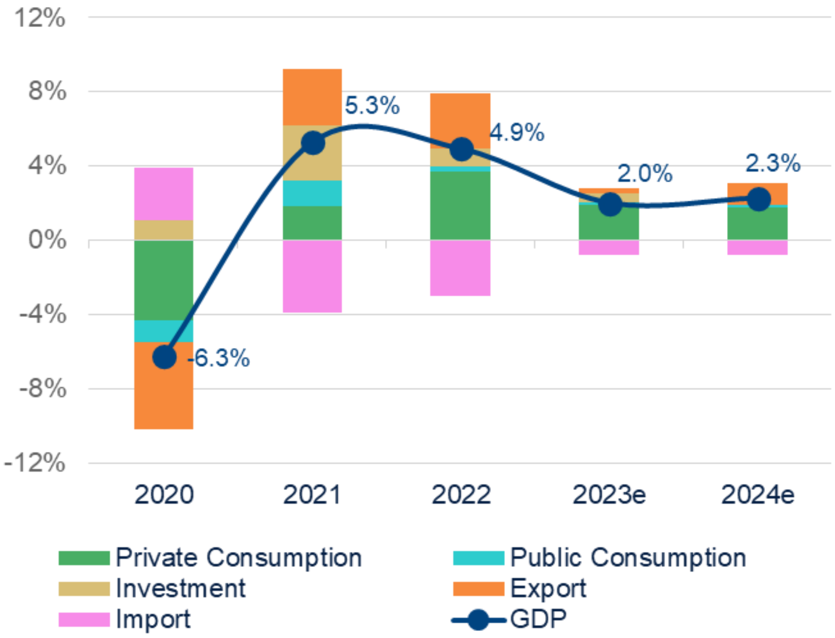


Source: BBVA Research and BCU.

- In 1Q23, Uruguay moved out of recession thanks to a seasonally adjusted GDP growth of 0.9%, which was above expectations and was seen practically across the board, except for in sectors that continue to be affected by the drought.
- The consequences of the water deficit are evident mainly in the agriculture and livestock sectors, but the situation also affects electricity generation.
- In recent months, it was necessary to import energy from Brazil, in contrast to 2021, when energy was exported to Brazil.
- The good performance of construction, both residential and in the energy and services sectors, offset the drop in activities in the UPM2 project.

We expect a slowdown in economic activity in 2023 to 2%, and a slight rebound in 2024 to 2.3%

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



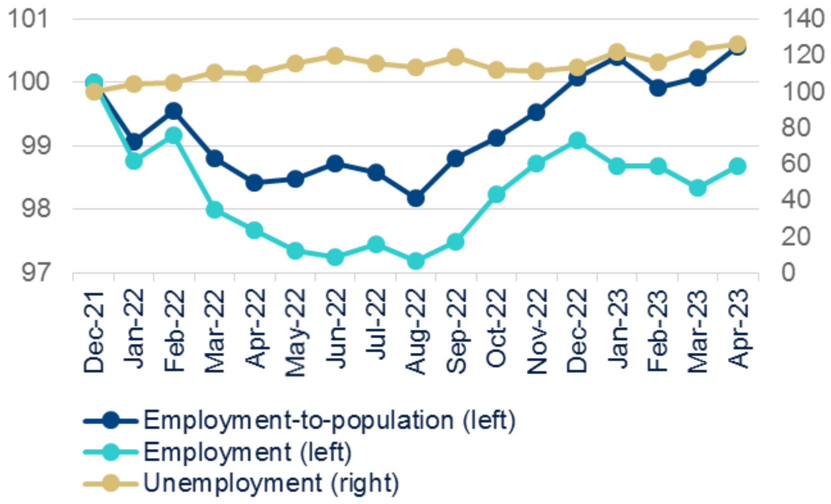
Source: BBVA Research and BCU.

- Growth in 2023 will be driven by private consumption thanks to an improvement in real wages, after three years of wage purchasing power loss.
- The completion of UPM2 will detract from investment, which could be partially offset by the emergence of other infrastructure-related projects (energy sector) that could boost it in the medium term.
- We expect a low contribution from exports of goods, while imports slow down in growth, which will only be sustained by increases in energy purchases and tourism spending abroad.
- We expect the adverse factors holding back growth in 2023 to dissipate by 2024.

After the post-pandemic recovery, employment-to-population ratios showed a slight deterioration that will continue this year

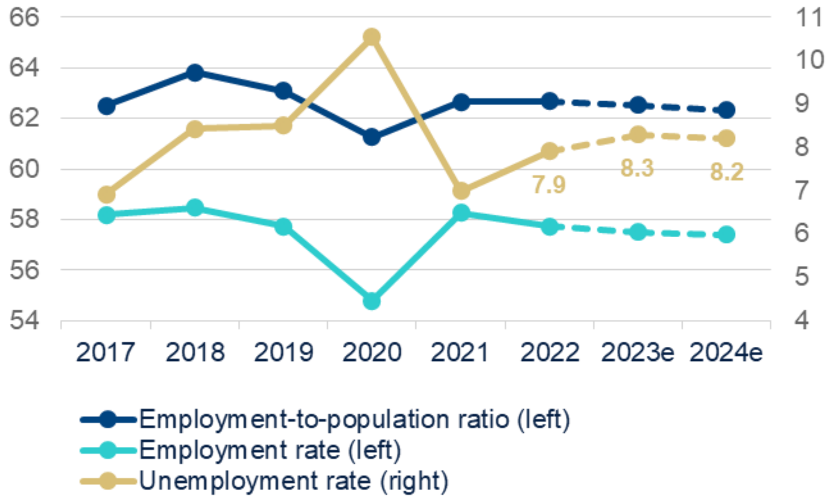
EMPLOYMENT-TO-POPULATION, EMPLOYMENT AND UNEMPLOYMENT: EVOLUTION

(BASE 100= Dec-21)



EMPLOYMENT-TO-POPULATION, EMPLOYMENT AND UNEMPLOYMENT RATES

(AS % OF WAP AND EAP)

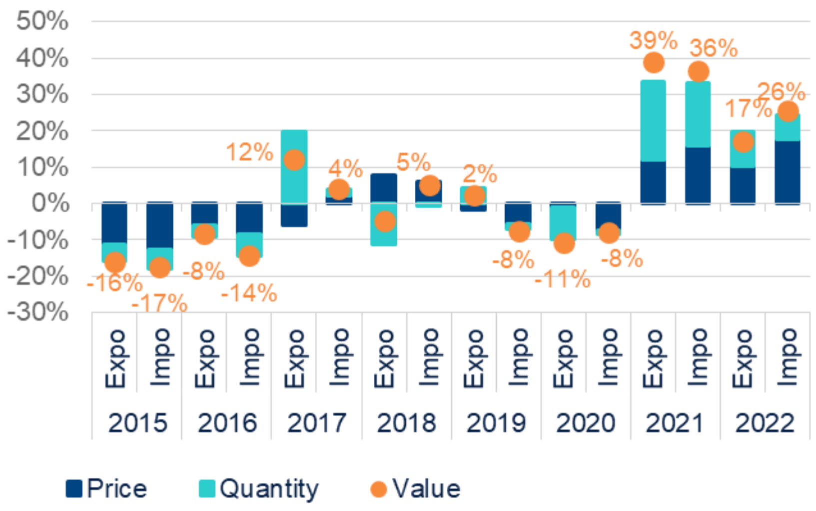


Source: BBVA Research and INE.

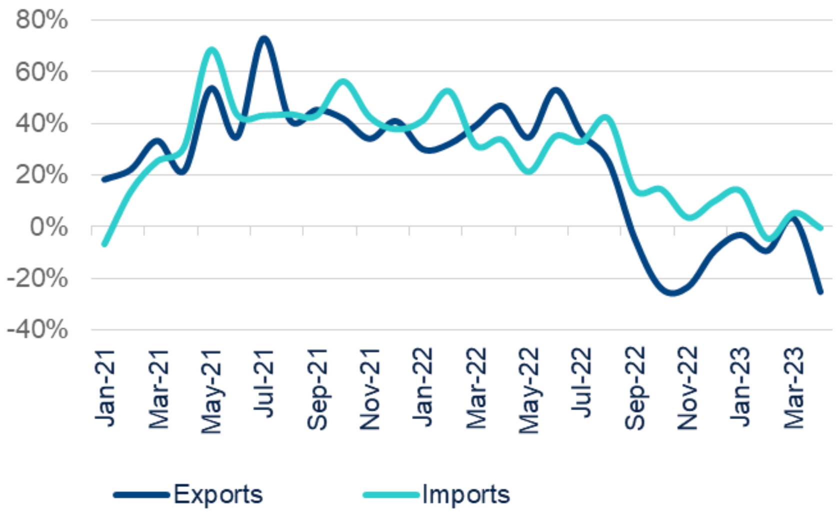
The average unemployment rate for 2022 was 7.9%, leaving 144.5 thousand people unemployed at the end of the year. We expect the deterioration in the labor market observed until April to continue and close the year with an unemployment rate of 8.3% of the EAP.

After two exceptional years, the external sector suffers the consequences of the drought in 2023 in an increasingly adverse global context

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



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

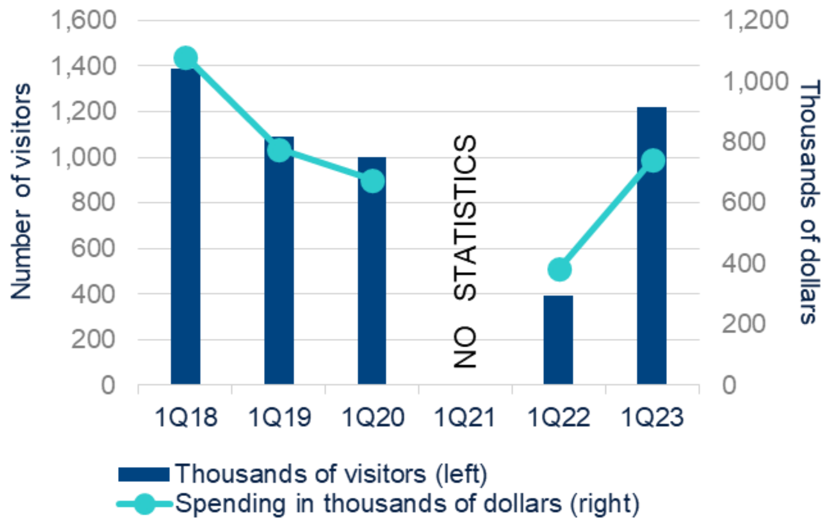


Source: BBVA Research and BCU.

We expect a drop in goods exports in the order of 10% for this year, with pronounced declines in soybeans and beef. For 2H23 we expect the start of UPM2 exports. Imports remain more stable: the end of the UPM2 construction work and lower activity are compensated by energy purchases from Brazil.

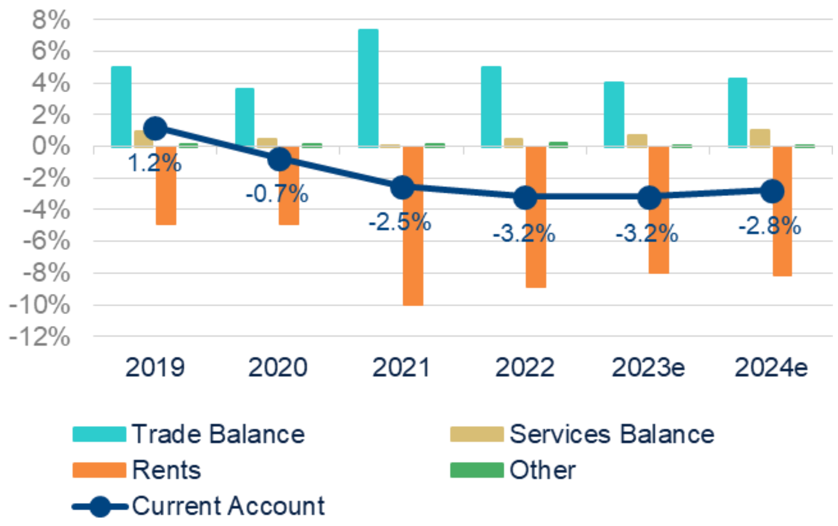
Tourism recovers and compensates part of the decline in the result of trade in goods, although the income deficit continues to weigh on the current account

TOURISM: VISITORS AND SPENDING IN DOLLARS
(THOUSANDS OF PEOPLE AND THOUSANDS OF DOLLARS)



Source: BBVA Research and Uruguay Ministry of Tourism.

CURRENT ACCOUNT & COMPONENTS
(% of GDP)



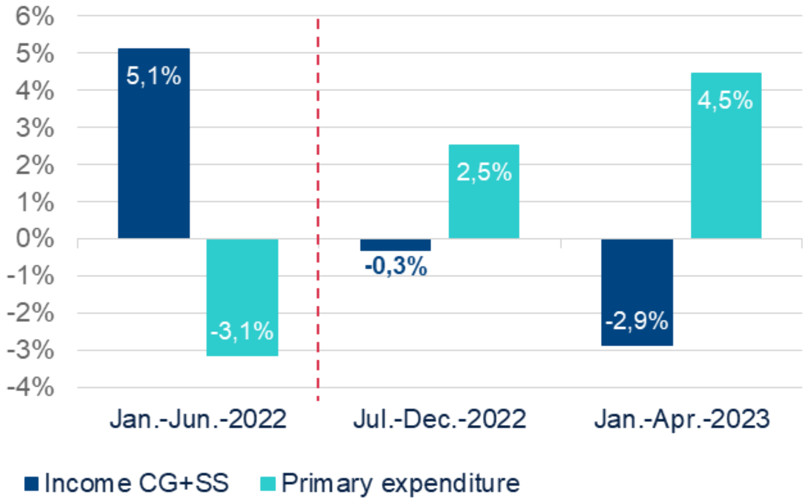
Source: BBVA Research and BCU.

The number of visitors rebounded in 1Q23, even surpassing 1Q19 (pre-pandemic) levels by 11.6%, which generated an income of only USD 741 million, 4.5% below 1Q19. We estimate that the current account deficit will close the year at -3.2% of GDP and improve slightly to -2.8% of GDP in 2024.

The public accounts had a break in the trend in mid-2022, which became more pronounced in the first months of 2023

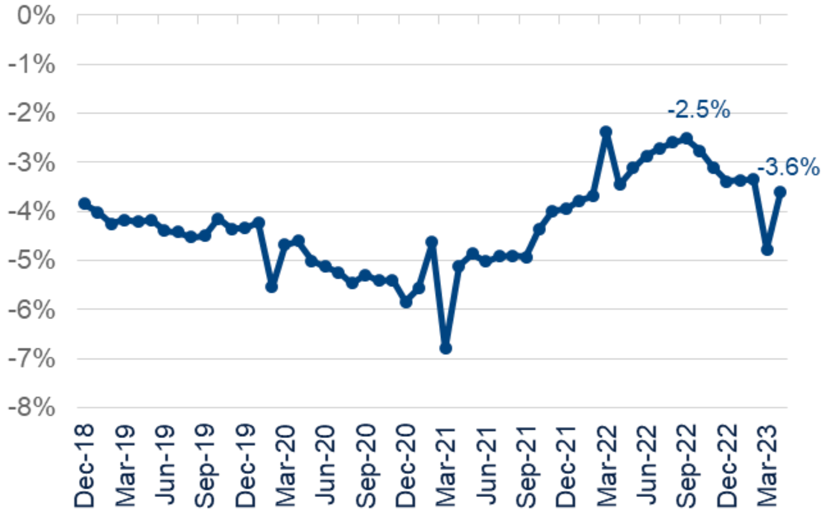
PRIMARY INCOME AND EXPENDITURE

CG + SOCIAL SECURITY (% Y/Y CHG. IN REAL TERMS)



CONSOLIDATED FISCAL RESULT

(% GDP, LAST 12 MONTHS)

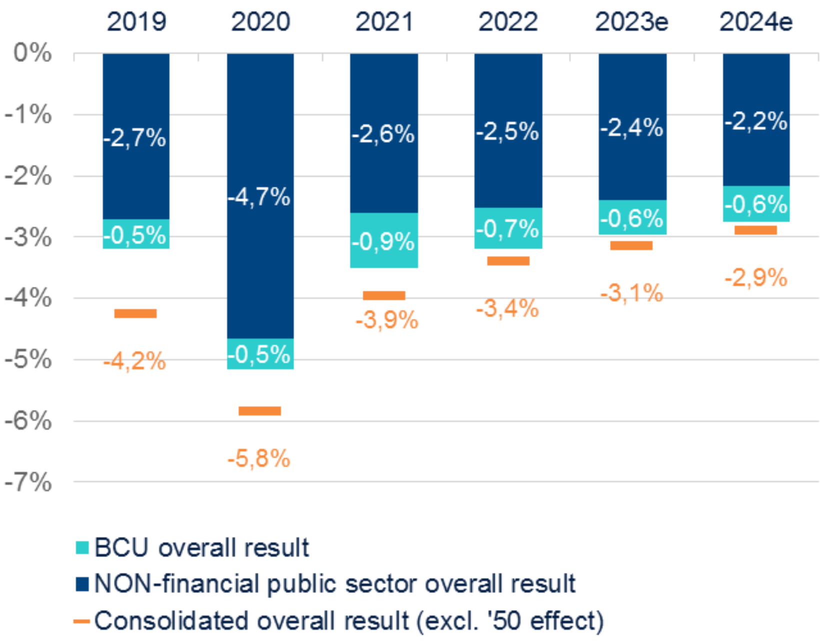


Source: BBVA Research and MEF.

The slowdown in tax revenues continues, although more subdued than in the latter part of 2022, while expenditures continue to increase in real terms, leading to a deterioration in the consolidated fiscal result since September 2022, when it achieved its best result to date.

... affecting the consolidated result

CONSOLIDATED FISCAL RESULT
(% GDP)

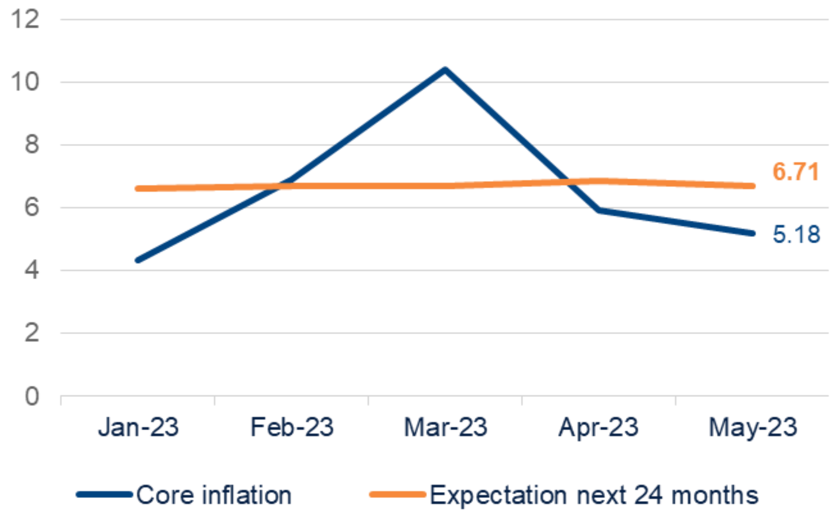


Source: BBVA Research and BCU.

- Growth in terms of real wages (+1.3%), Pensions (+2.5%), Transfers (+5.5%) and Investment (+22.1%) were recorded in the first four months of the year, deteriorating the result.
- Several factors are turning yellow lights on the fulfillment of the fiscal target for this year: the drought, which affects not only the agricultural sector but also electricity generation, and this may have an impact on the results of public companies.
- Our forecast points to an overall fiscal result of -3.1% of GDP for this year, improving to -2.9% of GDP by 2024.

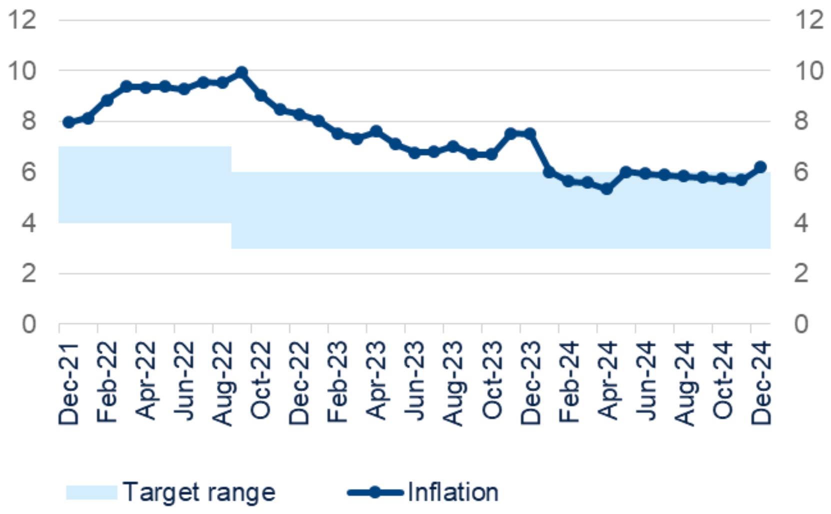
Inflation to reach 7.5% in dec23 and will reach 6.2% by the end of 2024

FORECASTS AND CORE INFLATION
(CORE INFLATION IN ANNUALIZED 3M MOVING AVERAGE, %)



Source: BBVA Research, INE and BCU.

INFLATION AND TARGET RANGE
(% Y/Y CHG.)



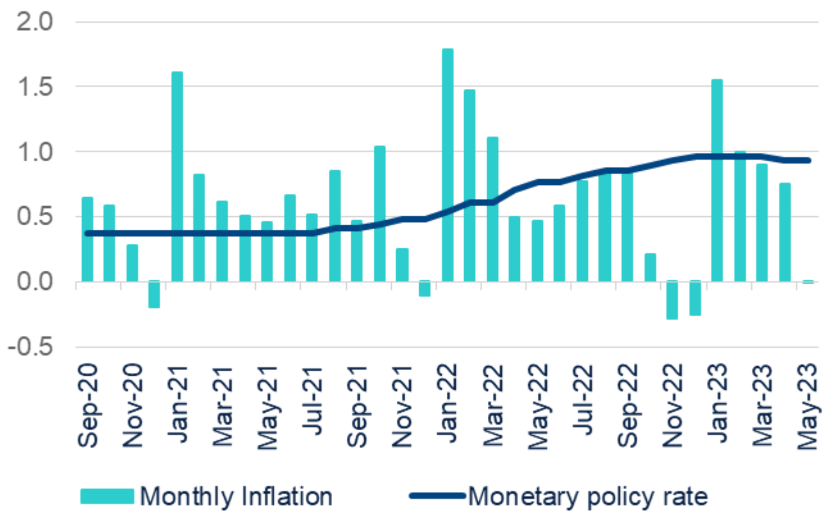
Source: BBVA Research and BCU.

In May, core inflation cuts at the margin and expectations remain tight above target range.

Prices decelerating slowly and pose a dilemma for wage negotiations.

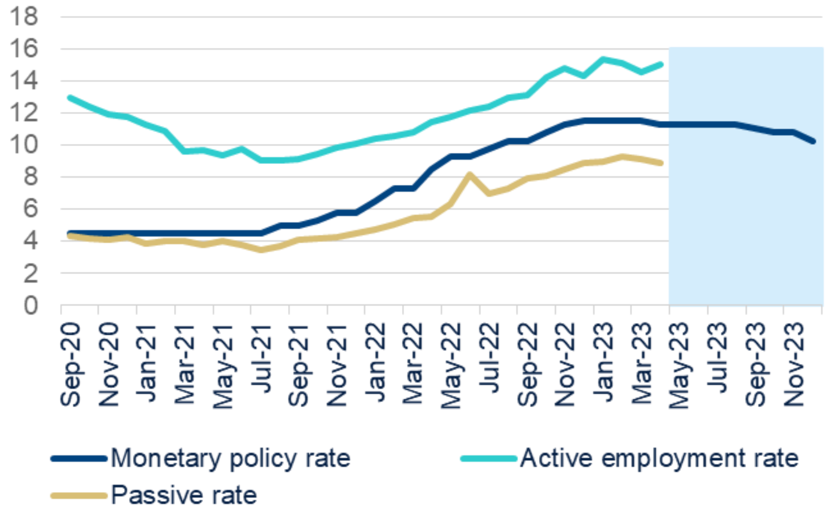
BCU initiated downward rate cycle in the region and paused, but will continue to cut rates while maintaining the contractionary stance

INFLATION AND MONETARY POLICY RATE
(% MONTHLY CHG., MONTHLY EFFECTIVE RATE)



Source: BBVA Research, INE and BCU.

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

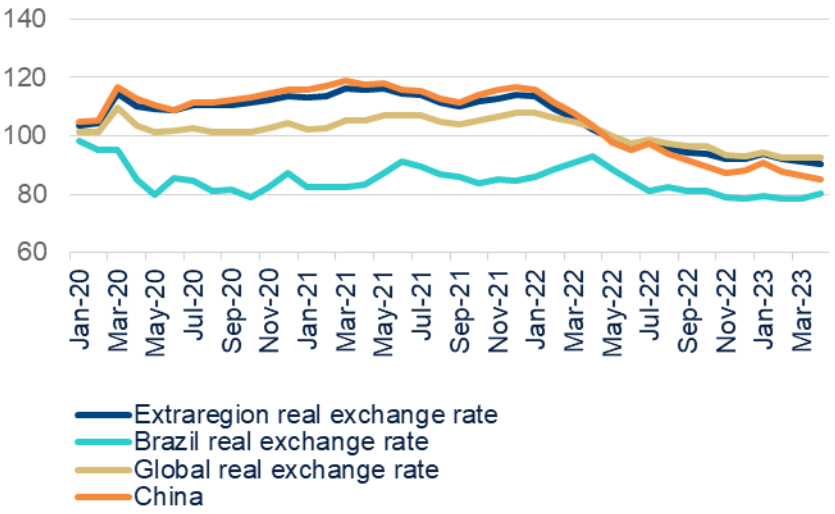


Source: BBVA Research and BCU.

The BCU will continue to cut interest rates as expectations point to consolidation in the slowdown of inflation. We expect the monetary policy rate to stand at 10.25% by the end of this year.

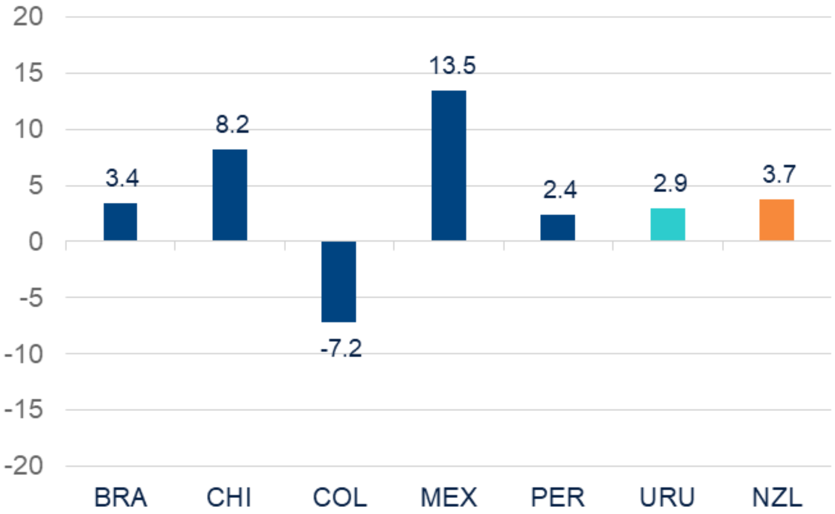
With strong support from macroeconomic fundamentals, the exchange rate will reach UYU/USD 39.7 in Dec-23

REAL EXCHANGE RATE
(AVG. 2019 = 100)



Source: BBVA Research and BCU.

CHANGE IN EXCHANGE RATES
(% CHG. BETWEEN JUN-22 AND JUN-23)

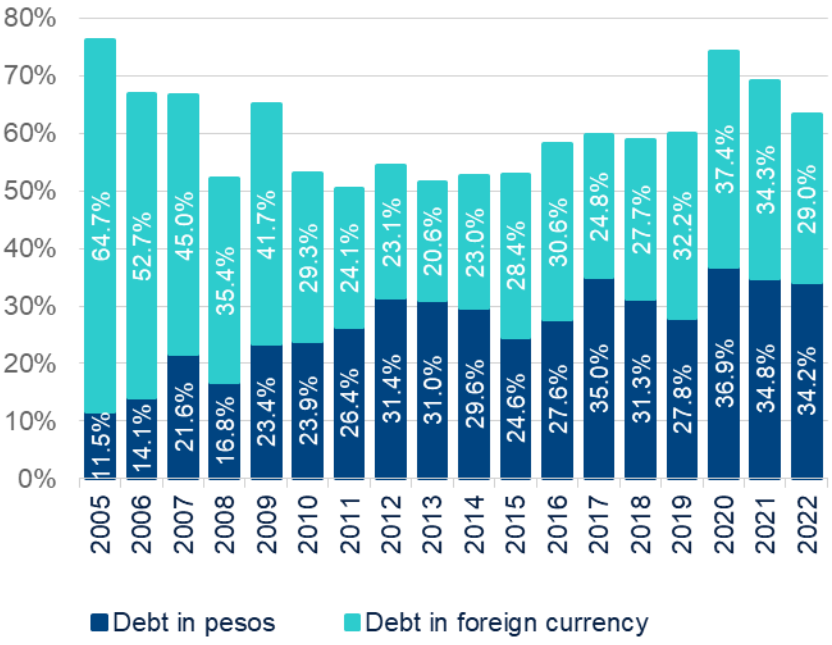


Source: BBVA Research and HAVER.

The average real exchange rate in Jan-Apr is 12% behind the same period last year. Expectations of the end of the Fed rate hike cycle and reduced pressure on risk premiums support the strengthening of regional currencies, except Colombia and Argentina due to domestic issues.

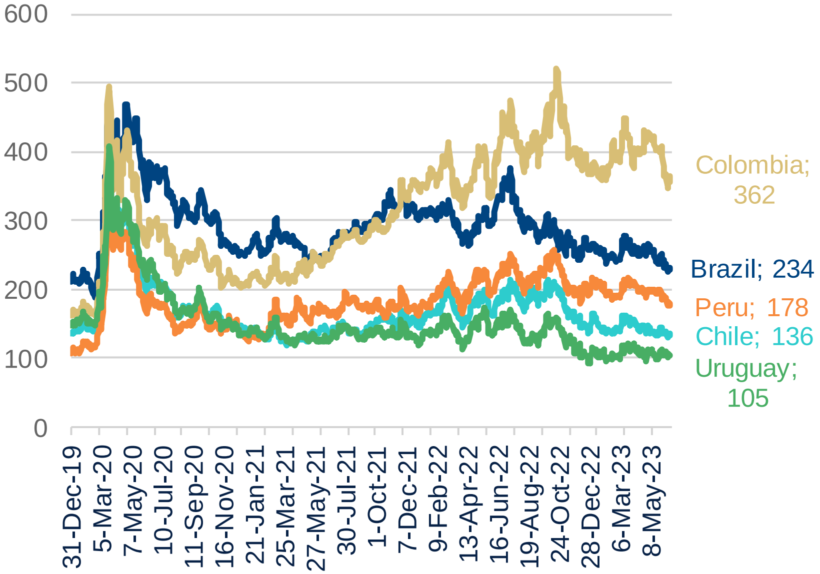
Institutional strength and sustainable macroeconomy put Uruguay high on the radar of international investors

PUBLIC DEBT IN URUGUAYAN PESOS AND DOLLARS (% GDP)



Source: BBVA Research and BCU.

COUNTRY RISK (EMBI)



Source: BBVA Research and JP Morgan.

Forecasts

Uruguay

	2020	2021	2022	2023f	2024f
GDP (% y/y)	-6.3	5.3	4.9	**2.0**	**2.3**
Inflation (% y/y, EOP)	9.4	8.0	8.3	**7.5**	**6.2**
Inflation (% y/y, average)	9.8	7.7	9.1	**7.2**	**5.8**
Exchange rate (vs. USD, EOP)	42.4	44.3	38.9	**39.7**	**42.3**
Exchange rate (vs. USD, average)	42.0	43.6	41.2	**39.1**	**41.1**
Private consumption (% y/y)	-6.8	2.9	6.0	**3.0**	**2.8**
Public consumption (% y/y)	-7.1	8.4	1.6	**1.0**	**1.0**
Investment (% y/y)	7.7	18.3	5.2	**2.5**	**0.0**
Unemployment rate (% EOP end)	10.6	7.0	7.9	**8.3**	**8.2**
Overall fiscal balance (% GDP)	-5.8	-3.9	-3.4	**-3.1**	**-3.0**
Current account (% GDP)	-0.7	-2.5	-3.2	**-3.2**	**-2.8**

Source: BBVA Research.

Disclaimer

Uruguay Economic Outlook

2023

Research

Creating Opportunities