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Uruguay Strategy View

The fiscal balance clocks in at -4.0% of GDP in August

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Uruguay's fiscal position worsened in August, with increasing income sources being outpaced by the rise in expenditures. The Government's policy agenda continues to concentrate on bolstering disposable income and real wages after the high inflation in 2022 put a strain on salaries. The administration still strives to consolidate the fiscal position, conveying a strong commitment to balancing government accounts in the medium term. However, its recent policy response to the drought has halted fiscal consolidation for the time being, with the climatic conditions being especially hard on revenue streams. In August, non-financial public sector income printed 27.5pp of GDP (+0.1pp relative to July). The increase came mainly from a recovery in the Other Income segment, which drove the hike. On the spending side, expenditures came at 28.8pp of GDP (+0.1pp relative to July), with increasing Soc. Sec. outlays. Personnel Expenditure and Transfers. In this context, the primary fiscal deficit excl. cincuentones came at -1.3pp of GDP, improving by +0.1pp relative to July, and accumulating a 0.5pp deterioration YTD. In this context, the +0.1pp variation in the primary position in August was accounted for by a 0.1pp hike in NFPS income, and a 0.1pp increase in NFPS outlays. Inversely, the consolidated public sector deficit excl. cincuentones worsened due to an increase in interest payments. In this context, the headline deficit stood over the 3pp of GDP mark for the tenth month running. August's print came in at -4.0% of GDP— up from -3.9% of GDP in July, and June, and -3.7% in May—.

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In August, non-financial public sector income printed 27.5pp of GDP (+0.1pp relative to July). The increase came solely from an increase in Other Income, which singlehandedly explained the rise. Central Govt & SocSec income clocked in at 27.5pp of GDP in August (+0.1pp relative to July). The Tax revenue segment did not experience a positive change this month, showcasing no variation relative to July. Neither did the Soc. Sec. contributions segment. However, Other Income rose by 0.1pp, accounting for the whole monthly increase. The rest of the sectors showcased no variation relative to July's figures. The SOEs' primary balance, one of the main drivers of 2022's fiscal overperformance, came in at +1.1pp, worsening marginally relative to July's figures. Finally, the primary balance of Munis & BSE continues to stand at the +0.1% of GDP mark. All in all, non-financial public sector income in August rose by 0.1pp relative to July.

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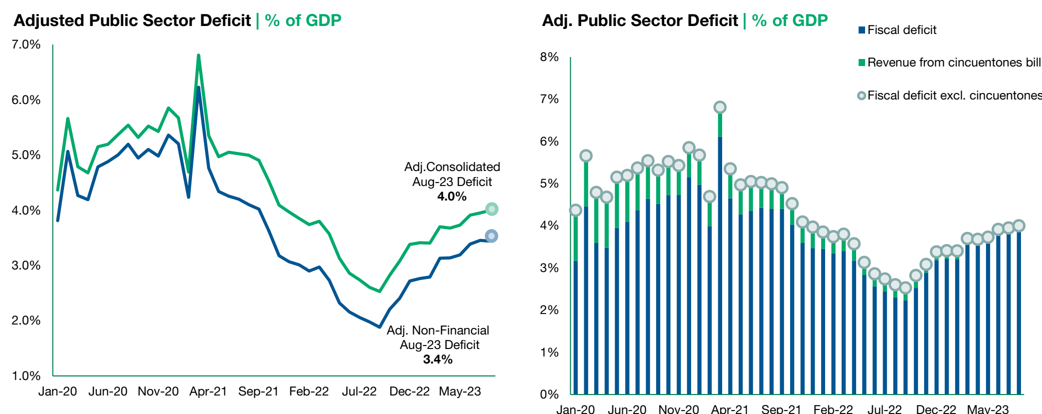
Figure 1: August's fiscal figures



12m rolling - as % of GDP	Dec-21	Dec-22	Jul-23	Aug-23	Dec-23*	Dec-24*
NFPS Income	**26.7%**	**27.1%**	**27.4%**	**27.5%**	**25.8%**	**26.0%**
Central Government	**18.9%**	**19.3%**	**19.2%**	**19.3%**	**18.9%**	**19.0%**
Tax Revenues	*15.9%*	*16.5%*	*16.5%*	*16.5%*	*16.1%*	*16.2%*
International Trade	*1.1%*	*1.1%*	*1.1%*	*1.1%*	*1.1%*	*1.1%*
Others	*1.8%*	*1.7%*	*1.6%*	*1.7%*	*1.7%*	*1.8%*
Soc.Sec contributions	6.4%	6.8%	7.0%	7.0%	6.9%	7.0%
SOE primary balance	1.4%	1.0%	1.2%	1.1%	0.1%	0.3%
BSE &Munis primary balance	0.2%	0.1%	0.1%	0.1%	0.1%	0.1%
BCU primary balance	0.0%	-0.1%	0.0%	0.0%	-0.1%	-0.1%
NFPS Outlays	**27.5%**	**27.8%**	**28.7%**	**28.8%**	**26.6%**	**26.3%**
Central Govt. Primary Outlays	25.8%	25.4%	26.0%	26.2%	25.3%	25.2%
Personnel spending	*4.6%*	*4.6%*	*4.8%*	*4.8%*	*4.6%*	*4.6%*
Non-Personnel spending	*4.3%*	*3.9%*	*3.7%*	*3.8%*	*3.5%*	*3.5%*
Pensions	*9.0%*	*8.9%*	*9.2%*	*9.2%*	*9.1%*	*9.1%*
Transfers	*7.9%*	*8.0%*	*8.3%*	*8.4%*	*8.1%*	*8.0%*
Public investment	1.8%	2.4%	2.7%	2.5%	*1.2%*	*1.1%*
Public Sector Primary Balance	-0.7%	-0.6%	-1.3%	-1.2%	-0.8%	-0.3%
Interest payments	2.8%	2.6%	2.6%	2.7%	2.4%	2.3%
Consolidated Public Sector Deficit	-3.5%	-3.2%	-3.8%	-3.9%	-3.2%	-2.5%
Cincuentones revenues	-0.5%	-0.2%	-0.1%	-0.1%	0.0%	0.0%
Adjusted Consolidated Public Sector Deficit	**-4.0%**	**-3.4%**	**-3.9%**	**-4.0%**	**-3.3%**	**-2.6%**

Source: TPCG Research based on MEF

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We continue to believe the slow but steady deterioration of the fiscal position is credit negative, even if we don't expect it to affect valuations in the short run, with the widening fiscal deficit starting to threaten compliance with the fiscal rule this year. The administration has made a significant effort to cleanse public finances since the start of its tenure, and the major effect of the drought on the economy has generated a slowdown in revenue streams and forced the administration to deploy some fiscal stimuli. However, the administration is carrying a significant deviation from this year's fiscal targets, which already proposed no additional fiscal consolidation, leaving the fiscal position flat relative to 2022. In this context, the government envisages the fiscal deficit to total -3.3pp of GDP, now carrying nearly a 0.7pp deviation from year-end targets. In this context, after complying with all three pillars of the fiscal rule since its creation, it seems these are increasingly becoming under threat. While the government should be able to meet both the requirements regarding the cap to the increase in primary expenditure and the net indebtedness cap, the first pillar, the binding structural balance, does seem under threat. The budget law establishes a -2.7% structural deficit for 2023. With the headline figures exhibiting a -4.0% deficit, it is difficult to envisage a convergence to the target by year-end. Still, after an expenditure-heavy 4Q22 that collected significant one-off outlays, the rolling 12m figures should showcase an improvement as the year advances. We expect the fiscal deficit to close near the -3.5% mark in 2023. Even if the administration has some leeway this year due to the drought, if it misses the 2023 targets, the chances of fulfilling the planned consolidation for 2024 (which would

drive the deficit back to -2.6% of GDP in 2024), would deteriorate considerably. This could be concerning given the chances of the administration executing a considerable fiscal consolidation in an electoral year are already low, especially as the govt. coalition does not part as the top dog in the race, trailing the FA in voting intention. We believe that, under severe political strain, for 2024 we expect the need to win back voters should prime over any consolidation effort the administration is prepared to execute, a problem which could compound with the possibility of a bloated 2023 deficit.

BoP flows weakened in 2Q23, in line with expectations

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In other news, 2Q23 BoP flows came roughly in line with expectations, as Uruguay's current account deficit clocked in at USD0.81bn vs. USD0.66bn in 1Q23, with the worsening responding to the unfavorable climatic conditions. Dissecting the widening, the main driver behind the worsening came on the back of significantly weaker exports, as the latter underperformed 2Q22 figures by -USD806mn, singlehandedly explaining the current account's quarterly variation. The underperformance of exports during 2Q23 was mostly expected, as the drought experienced during the last months of 2022 and early 2023 hampered both the soybean and maize campaigns. Most of the agriflows coming from these usually materialize during the second quarter of the year, generating the expectations of a very weak 2Q23 in Exports, due to the severity of the drought. On positive news, Imports lost some steam during this quarter, weakening by -USD117mn relative to 2Q22. This put the change in the Goods balance at -USD688mn. Another positive contribution to the print came in the shape of the Services Balance. Even if Imports rose by +USD142mn, Exports were able to outpace the segment, clocking in with a +USD202mn rise relative to 2Q22, therefore putting the net variation of the Services balance at +USD60mn. All in all, the trade balance managed to post a +USD660mn surplus, albeit nearly halving relative to 2Q22, where the extremely good agricultural campaign bolstered BoP flows significantly. Primary income allowed for another +USD234mn in the CA deficit's compression, while Secondary income was mostly irrelevant for this quarter's BoP print. All in all, the Current Account balance experienced a -USD388mn worsening, with the main driver being the weak agricultural export flows caused by the impact of the dry climatic condition on crops. In 12m-rolling terms, the current account deficit came in at -3.7% of GDP (-USD2.8bn), roughly level with the end of 2022 (-3.7% of GDP; -USD2.6bn).

Figure 2: 2Q23 BoP figures

USDmn	2021	2022	2Q22	2Q23	Δ	1H22	1H23	Δ
Current account	-1,555	-2,620	-424	-812	-388	-1,311	-1,474	-164
Goods & Services	4,402	3,670	1,288	660	-628	2,059	1,755	-304
Goods	4,616	3,501	1,453	765	-688	2,029	1,368	-661
Exports	15,827	17,062	4,808	4,002	-806	8,461	7,790	-670
Imports	11,211	13,561	3,355	3,238	-117	6,432	6,423	-9
Services	-214	169	-165	-105	60	30	387	357
Exports	3,700	5,503	1,234	1,436	202	2,550	3,345	795
Imports	3,914	5,334	1,399	1,541	142	2,520	2,957	437
Primary Income	-6,035	-6,421	-1,741	-1,507	234	-3,438	-3,315	123
Secondary Income	78	130	29	35	7	68	85	17
Capital account	-30	3	2	1	-1	4	1	-3
Financial Account	-183	-2,319	-511	-395	115	4	-281	-284
Direct Investment	-1,493	-3,175	-781	-1,632	-851	-1,153	-2,763	-1,610
Portfolio Investment	1,084	1,877	1,773	1,268	-505	1,884	1,728	-156
Derivatives	435	378	14	216	201	268	236	-33
Other Investment	-1,053	180	-795	172	966	-89	619	708
Errors & Ommisions	1,402	299	-88	416	504	1,310	1,193	-118
Reserve Assets	843	-1,578	-722	-418	304	-907	-101	806
12m-rolling GDP (USDmn)	**61,422**	**71,199**	**66,676**	**75,752**	**9,076**	**66,676**	**75,752**	**9,076**
Balance as % of GDP (12m)	-2.5%	-3.7%	-2.9%	-3.7%	-	-2.9%	-3.7%	-

Source: TPCG Research based on BCU

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We find the 2Q23 BoP flows credit positive, with the 1H23 showcasing little difference relative to the very strong 1H22, this being consistent with the strong performance of the FX during 2023. The current account balance came in better than expected during the first quarter of the year, with good exports not suffering any negative variations, but also with the services balance shoring up international accounts massively, on the back of a strong tourism campaign. In addition, even with a strong real appreciation, imports did not experience large corrections to the upside. During the 2Q23, exports did plummet, but the rest of the segments remained supportive, with both a reduction in good imports and a stronger services balance and primary income, which managed to limit the damage generated by the drought. In this context, the Current account deficit clocked in at -USD1474mn in 1H23, just widening by USD164mn relative to 1H22, when it clocked in at -USD1311mn. All of this was also consistent with the performance of the USDUYU, which refused to depreciate during the first months of the year. With the effect of the drought fading away beyond 2Q23, we expect the last half of 2023 to show even more encouraging BoP flows.

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