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Uruguay Strategy Flash

BCU hikes policy rate 25bp to +11.5%

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In December's COPOM meeting, board members decided to increase the key rate by 25bp to +11.5%, with the hike coming in below expectations. The BCU deepened its adjustment cycle by increasing the policy rate by 25bp to +11.5%, with the previously provided forward guidance pointing at a 50bp hike. With this, the CenBank consolidated real rates firmly in positive territory and has now conveyed that the tightening cycle has come to an end, as it does not expect to increase the policy rate any further in future meetings. The BCU press release did indicate the COPOM will continue assessing the local and international context to eye out possible increases in the policy rate, given inflation prints and expectations do not progress as expected, with both currently evolving to the Cenbank's satisfaction. According to the BCU, the decision to hike the policy rate by 25bp instead of 50bp comes on the back of the positive trend portrayed by headline inflation, which is deaccelerating during 4Q22, following two surprisingly low prints in October and especially November, where the price gauge presented a negative variation, coming in 50bp below expectations. Still, the headline index continues to run far over the BCU's target range, which stands at 6%-3% since September. While inflation prints seem to have peaked and are now starting to deaccelerate, levels are still running high, and are likely to continue to do so.

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In its announcement, the COPOM signaled it does not expect to increase the policy rate any further moving into 2023. In turn, the Monetary Policy Committee assessed the local and international contexts and their effect in the policy bias. On the external side, the COPOM is wary of the complex global scenario, albeit now presenting improved prospects for 2023, and reducing the pressure on commodity prices, presenting less of a threat to the local inflationary process. On the local side, the strong growth exhibited by the economy allowed the BCU to persist with its tightening monetary policy bias, even as economic activity is slowing slightly during 2H22 relative to the first half of the year. Still, the BCU´s tighter hike comes mostly on the back of the positive evolution of the inflationary process which is starting to converge to the CenBank's target range. With November's print, the index dropped by nearly 60bp under October's +9.05%yoy figure, now standing at +8.46%yoy, receding for the dangerously close two-digit mark. Monthly gauges seem to be relenting relative to the high 1H22 prints, especially after November's slowdown. However, the latter was marked by a drop in the more volatile subsections of the index. Besides, the yoy index has exceeded the BCU's target range for eighteen months in a row.

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Expectations portray a similar scenario, currently evolving to the BCU's satisfaction, albeit still proving inflexible on the downside. Real economy agents now expect a 12m-running inflation of +9% in November (+0.0pp relative to October), while market forecasts stand at +7.40% in December, dropping by 0.1pp relative to November. Still, in a context where the BCU's target range has tightened from 7%-3% to 6%-3% in September, both estimations end with inflation very much outside the eop upper bound. Real economy agents see inflation closing the year at +9% while market analysts forecast a +8.4% inflation by end-2022.

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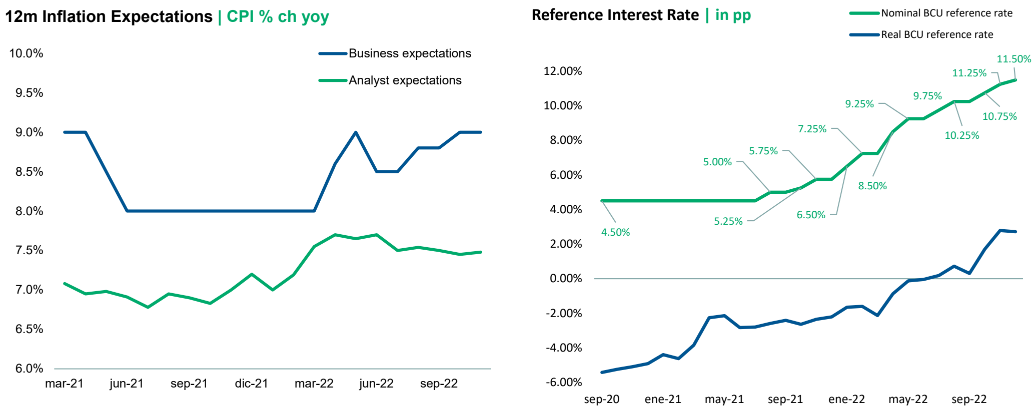
In this context, the BCU halting its tightening bias going into 2023, we expect the Cenbank to shift its policy bias gradually during the year, as inflation recedes and expectations align with the BCU's target range. With the policy rate standing at 11.5%, the real rate now stands close to the 2.5%-3% mark, firmly in positive territory. In a scenario where inflationary pressures start to dilute during 2023, the CenBank has little incentive to push real rates beyond that mark, which should in turn cause a shift in the BCU's policy bias. Since January, the CenBank increased the policy rate by 625bp, finally bringing real rates to fringe positive territory by mid-2Q22. Inflation prints are likely to continue deaccelerating, but expectations point at a persistent inflationary aftermath, and the perspective of no more policy rate hikes could render the real rate in linkers attractive.

Figure 1: The BCU announced the end of the tightening cycle



Source: TPCG Research based on INE & BCU

The fiscal balance clocks in at -3.2% of GDP in November

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Uruguay's fiscal position worsened in November, with increasing expenditures driving the widening, as public sector income increased marginally. The Government's policy agenda has shifted slightly, concentrating on bolstering disposable income and real wages, which suffered on the back of the high 1Q22 inflation prints. Still the administration continues to consolidate the fiscal position, conveying a strong commitment to balancing government accounts in the medium-term. In November, non-financial public sector income printed 28.2pp of GDP (+0.1pp relative to October), as mild increases in Tax revenues and Soc.Sec collection compensated for a tightening in the SOEs primary surplus. On the spending side, expenditures came at 28.5pp of GDP (+0.5pp relative to October). Central Government primary outlays increased in November, with the widening coming on the back of Transfers, Non-Personnel outlays and Public Investment. In this context, the primary fiscal deficit excl. cincuentones came at -0.4pp of GDP worsening for two consecutive months, with the fiscal balance suffering substantially during 4Q22. November's figure followed prints of -0.1pp in October — +0.1pp in September and —0.0pp in August—. The widening returned the primary deficit to May levels, on the back of a marginal 0.1pp increase in NFPS income, and a 0.5pp increase in NFPS outlays. Consistently, the consolidated public sector deficit excl. cincuentones punched through the 3pp of GDP mark, after remaining below that threshold since May. November's print came in at -3.2% of GDP— up from -2.9% in October, -2.7% in September and -2.7% in August—.

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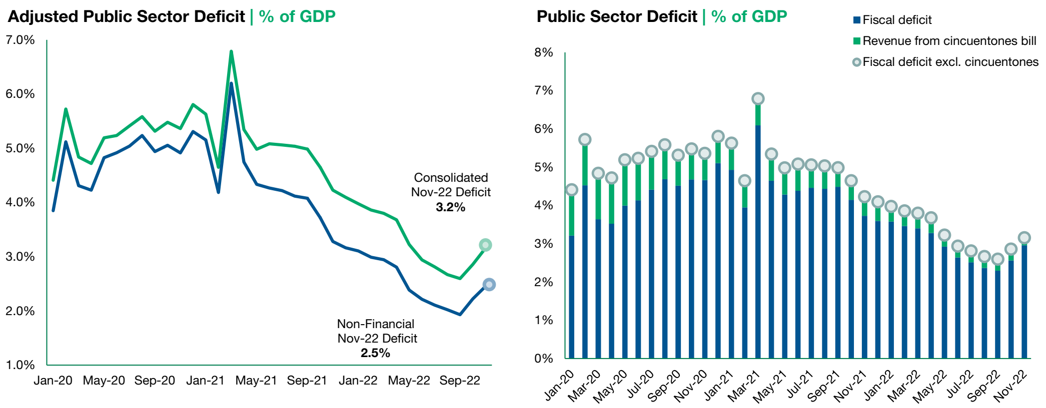
Figure 2: November's fiscal figures



12m rolling - as % of GDP	Dec-20	Dec-21	Oct-22	Nov-22	Dec-22*
NFPS Income	**28.0%**	**27.7%**	**28.1%**	**28.2%**	**26.3%**
Central Government	**19.8%**	**19.6%**	**20.0%**	**20.1%**	**19.2%**
Tax Revenues	*16.6%*	*16.5%*	*17.0%*	*17.1%*	*16.4%*
International Trade	*1.0%*	*1.1%*	*1.2%*	*1.2%*	*1.1%*
Others	*2.2%*	*1.9%*	*1.8%*	*1.8%*	*1.7%*
Soc.Sec contributions	7.2%	6.6%	7.0%	7.0%	6.5%
SOE primary balance	1.0%	1.5%	1.1%	1.1%	0.4%
BSE &Munis primary balance	0.1%	0.2%	0.2%	0.2%	0.3%
BCU primary balance	0.0%	0.0%	-0.1%	-0.1%	-0.1%
NFPS Outlays	**30.2%**	**28.5%**	**28.0%**	**28.5%**	**26.5%**
Central Govt. Primary Outlays	28.2%	26.7%	25.8%	26.1%	25.3%
Personnel spending	*5.2%*	*4.8%*	*4.7%*	*4.7%*	*4.6%*
Non-Personnel spending	*4.0%*	*4.4%*	*3.8%*	*3.9%*	*4.0%*
Pensions	*10.0%*	*9.3%*	*9.2%*	*9.3%*	*9.0%*
Transfers	*9.0%*	*8.2%*	*8.1%*	*8.2%*	*7.7%*
Public investment	2.0%	1.8%	2.2%	2.4%	1.2%
Public Sector Primary Balance	-2.1%	-0.7%	0.2%	-0.2%	-0.2%
Interest payments	3.0%	2.9%	2.7%	2.8%	3.1%
Consolidated Public Sector Deficit	-5.1%	-3.6%	-2.6%	-3.0%	-3.3%
Cincuentones revenues	-0.7%	-0.5%	-0.3%	-0.2%	0.2%
Adjusted Consolidated Public Sector Deficit	**-5.8%**	**-4.1%**	**-2.9%**	**-3.2%**	**-3.5%**

Source: TPCG Research based on MEF

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