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Uruguay Strategy Flash

BCU ratifies the policy rate at +11.5%

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In February's COPOM meeting, board members decided to maintain the policy rate at +11.5%. The BCU acted in accordance with the forward guidance provided in December's meeting, maintaining the key rate at +11.5%. This is the first time the monetary policy committee does not increase the policy rate in one of its meetings since Jul-21, marking the end of a protracted hiking cycle. Even as nominal rates seem to have peaked, the Cenbank is expected to maintain a hawkish stance throughout the year, keeping the policy rate plateaued at a high level. The BCU press release did indicate the COPOM will continue assessing the local and international context with both inflation prints and expectations evolving to the Cenbank's satisfaction. According to the BCU, the decision to maintain the policy rate at +11.5% comes on the back of the positive trend portrayed by headline inflation, which continues to decelerate. 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. In addition, the BCU also pointed out the drought should affect food prices on the upside, putting some additional strain into the inflationary process and maintaining it at higher levels for some time.

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In its announcement, the COPOM continues to signal 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 drought also affecting neighboring peers did raise some alarms in the BCU, both due to the inflationary and economic implications the natural phenomenon should have on Uruguay. Still, the BCU´s stance 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 January's print at +8.05%yoy, the index marked its fourth consecutive decrease in a row, following prints of +8.29%yoy in December, +8.46%yoy in November and +9.05%yoy in October.

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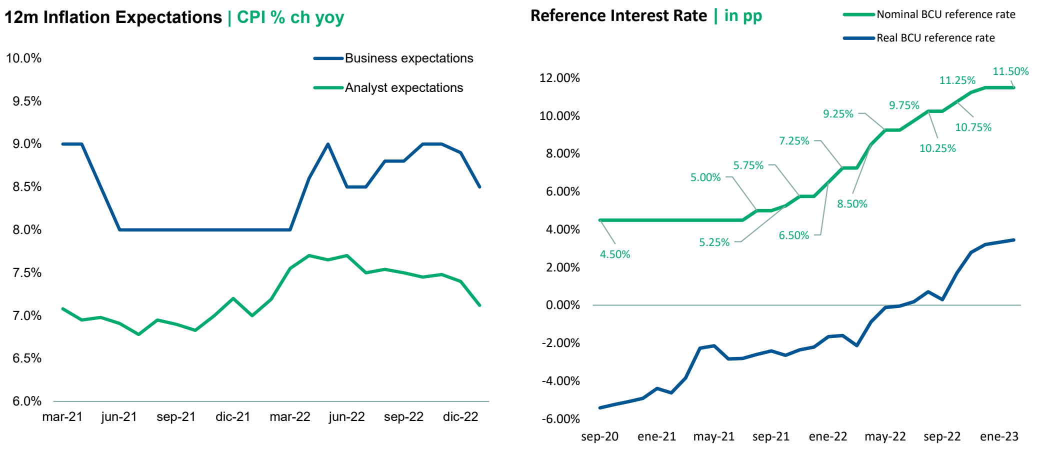
Expectations portray a similar scenario, currently evolving to the BCU's satisfaction, albeit still proving more inflexible on the downside. Real economy agents now expect a 12m-running inflation of +8.5% in January's poll (-0.4pp relative to December), while market forecasts stand at +7.12%, dropping by -0.3pp relative to December. 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. Consistently, real economy agents see inflation closing the year at +8.5% while market analysts forecast a +7.1% inflation by end-2023. This contrasts with the government's forecast, as Mrs. Arbeleche announced the administration expects yealy inflation to close at +6.7%. With the real rate firmly in positive territory, we expect the BCU to maintain its hawkish bias throughout 1H23, mostly on the back of flat nominal rates and converging expectations.

Figure 1: The BCU maintained the policy rate at +11.5%



Source: TPCG Research based on INE & BCU

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