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Uruguay Strategy Flash

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Yesterday in his state of the union address in Congress, Mr. Lacalle Pou announced tax cuts and other measures to support small businesses, roughly costing USD150mn. In his speech, the President highlighted the strong points of the administration's tenure, pointing out Uruguay's strong recovery and growth, the drop in unemployment, and the solid management of the COVID crisis and public finances, in addition to other topics. As expected, the President announced cuts to the Personal Income Tax (IRPF) and the Social Security Assistance Tax (IASS), which requires retirees with high pensions to pay a percentage to the state. The proposed measures included increasing the deduction rate for the IRPF from 10% to 14% for citizens with low income, increasing the annual deduction rate for having children from 13bpc to 20bpc (one bpc is equivalent to 5660 UYU, or 135USD), and maintaining the doubling of said deduction in the case of disability. In addition, the ceiling on the cost of properties to access the mortgage credit deduction will be increased to UI1mn (USD137.000), and the credit for leases increased to 8%. These measures should impact around 75% of the taxed individuals, while 14% (nearly 60 thousand Uruguayans) should not pay the IRPF anymore. The total cost of the reductions related to the IRPF is budgeted at USD80mn, the largest of the three. In the case of the IASS, the administration will increase the minimum non-taxable pension, from 8bpc to 9bc (from UYU 45.280 to UYU 50.940), and credit leases also increase to 8%. In this case, the cuts should affect the entire tax base, and nearly 20.000 Uruguayans are expected to stop paying the IASS, with the estimated cost hovering around the USD30mn mark. Finally, in the business department, the government announced the regime for the Income tax for economic activities (IRAE) would shift from a fixed-rate scheme, based on the income level, to a progressive model more similar to the IRPF, benefiting 26.600 small businesses. In addition, small businesses whose income surpasses 310.000UI in a year will not have to forcibly remain as IRAE contributors for the next two years. Finally, the administration raised the floor to pay for the IMEBA, to UI2.5mn, and is prepared to condone some credits to independent workers, with the barrage of business-related policies costing around USD40mn.

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Mr. Lacalle Pou also pointed out that the tax reductions should boost economic activity and consumption, while also declaring that the cuts have a progressive element, targeting some weaker sections of the Uruguayan workforce. These sayings come on the back of the controversy that the news generated, as the administration received critics from both sides of the political spectrum. Some analysts pointed out that tax reductions could be dangerous, and could threaten fiscal consolidation if growth perspectives were stumped, or if outlays were not trimmed accordingly. On the other hand, some political actors chose instead to criticize the taxes chosen to be cut, as they argued that the reduction would increase inequality, leaving more resources to the wealthier part of the Uruguayan society, while taking away government resources to tend to the more vulnerable sections of the population. Amidst these critics, Mr. Lacalle Pou pointed out that the ones to benefit from the tax cuts the most would be middle class citizens, and that he expected the boost in disposable income to bolster consumption.

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In our view, these measures fit well in the overarching government strategy ahead of the 2024 elections, even as they present a mild threat to fiscal consolidation. Taking a look at 2022 figures, we notice the IRPF and the IASS jointly collected USD2.4bn, roughly amounting to 18% of the total tax revenues. Most of this comes from the IRPF, as it represents 15.3% of the total collection, vs. the IASS 2.6%. So, in this context, the IASS collection would suffer a USD30mn drop this year, that against a 2022 figure of 362mn would mean an 8% decrease. Besides the IRPF category affected by the measures corresponds to the one taxing salary income, which in 2022 harvested USD1.66bn. The USD80mn decrease would represent a -5% decrease in the collection. Overall, the income measures would result in a -0.18% of GDP drop in tax revenues next year, and in addition to the business aid, the number would total 0.25% of GDP. To put the number in context, the administration this year managed to surpass its structural fiscal target by 0.2% of GDP. So, these measures mostly compensate for last year's overperformance, and should not be a major threat to fiscal figures, leaving the administration still in a solid position to comply with this year's target. In addition, economic growth could help to further offset these decreases. However, we do believe the announcements are in line with the administration's strategy of bolstering real wages in the medium run, especially in the context of a sharp popularity drop in Mr. Lacalle Pou's image during recent months, which came on the back of the Astesiano scandal. We believe the government will try to shore up voter support with a stronger policy bias regarding income, with the recent announcements coming in that line.

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