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April 27, 2023

Uruguay Strategy Flash

The president of the BCU, Mr. Labat gave a press conference addressing the state of the Monetary Policy in Uruguay.

The president of the BCU, Mr. Labat gave a press conference addressing the state of the Monetary Policy in Uruguay. Regarding inflation, the president highlighted the drop in the headline index in the last months, albeit pointing out that the effect of the drought was felt heavily throughout 1Q23, especially in the ever-volatile segments of Fruits and Vegetables, which accumulated a 31% and 40% variation in the first 3 months of the year, respectively. The BCU expects the effect of the drought to continue going forward but highlights its transitory nature. When questioned on the effects of the salary negotiations on inflation, the president replied that the Central Government's mandate of increasing real wages was included in the forecasts. Therefore, even if said negotiations could reduce inflation compression prospects, the BCU did take into consideration the government's comments to model the behavior of the inflationary process going forward. In this context, the BCU's forecasts see inflation standing near the 5% mark by the end of its Monetary Policy Horizon (ie. 24 months, or end-2024).

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In terms of growth, Mr. Labat pointed out the drought will hit GDP metrics for the 1Q and 2Q of 2023. Still, the BCU expects seasonally adjusted growth to be positive for both 1Q23 (+0.8%qoq) and 2Q23 (+0.5%qoq). However, on the annual gauge, the 1Q23 is expected to edge 1Q22 marginally, posting a 0.1%yoy rise. This should come on the back of a solid tourism campaign, which saw incoming tourism surpass the levels seen in 2019. However, for 2Q the effect of the drought should prevail, causing a -0.8%yoy drop.

Regarding the economic agent expectations, the president pointed out they are evolving to the BCU's satisfaction, albeit at a slower pace than expected.

Regarding the economic agent expectations, the president pointed out they are evolving to the BCU's satisfaction, albeit at a slower pace than expected. They are presenting a relatively flat trajectory lately, outside of the BCU's target range. When questioned on the inflexibility to the downside of inflation expectations, the president responded that the former tend to be backward-looking, and with Uruguay's history with inflation it is foreseeable for them to be more inflexible in the medium term. However, he still stated that they would continue to monitor the evolution of expectations.

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Mr. Labat addressed the COPOM's decision to lower the policy rate by 25bp to 11.25%, reaffirming the BCU's will to maintain the policy rate contractive. He alleged that, with the headline index and expectations receding during 1Q22, the current policy rate continues to be hawkish, maintaining real rates well inside positive territory. He also pointed out that the flexibilization of the monetary policy stance will be very gradual, and that the BCU is prepared to prolong the hawkish stance for as long as needed to ensure the convergence with the updated target (3%-6%).

When questioned regarding the overperformance of the FX rate, Mr. Labat pointed out that the BCU will continue its non-intervention strategy.

When questioned regarding the overperformance of the FX rate, Mr. Labat pointed out that the BCU will continue its non-intervention strategy. He also stated that even as the FX is a key variable that the BCU constantly monitors, the exchange rate policy does not have a fixed target. Rather, it consists of allowing the FX rate to float as freely and transparently as possible, limiting BCU interventions to the minimum. Even as he commented on the strengthening of the FX, Mr Labat highlighted the fact that said overperformance came on the back of capital inflows and favorable BoP flows, rather than BCU intervention.

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