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Uruguay Strategy View

The fiscal balance clocks in at -3.8% of GDP in May

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Uruguay's fiscal position worsened slightly in May, with stable income sources being outpaced by a marginal increase in expenditures. The Government's policy agenda continues to concentrate on bolstering disposable income and real wages, after the high inflation during 2022 put a strain on salaries, recently announcing a tax cut of 0.25pp of GDP. 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. In May, non-financial public sector income printed 27.3pp of GDP (+0.0pp relative to April). Even if the segment did not experience an aggregate variation, there were some minor shifts in its composition. On the spending side, expenditures came at 28.4pp of GDP (+0.1pp relative to April), with increasing Soc. Sec. outlays and Transfers. In this context, the primary fiscal deficit excl. cincuentones came at -1.2pp of GDP, worsening by -0.1pp relative to April, and by -0.4pp since December after a quiet January and February. In this context, the -0.1pp variation in the primary position in May was accounted for by a flat NFPS income, and a 0.1pp increase in NFPS outlays. Consistently, the consolidated public sector deficit excl. cincuentones stood over the 3pp of GDP mark for the seventh month running. May's print came in at -3.8% of GDP— flat from -3.8% in April, but up from -3.7 % in March and -3.4% in January, February, and December—.

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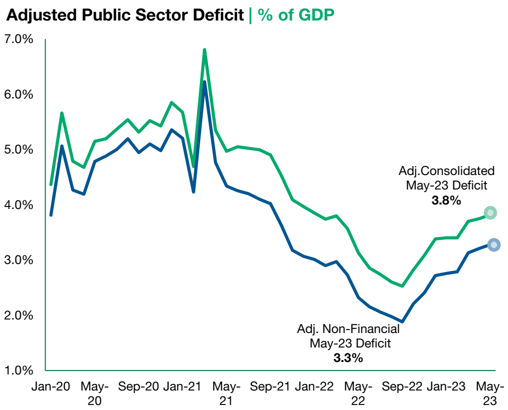
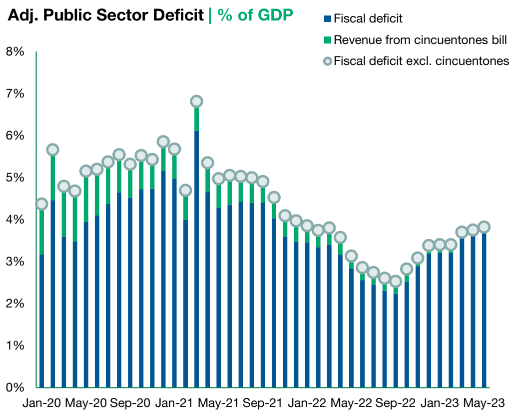
On the spending side, expenditures came at 28.4pp of GDP (+0.1pp relative to April), with increasing Soc. Sec. outlays and Transfers. In May, the COVID Fund balance totaled -0.3pp of GDP— dropping by -0.1pp relative to April and reducing its size by 0.3pp YTD. In this context, Central Govt & Soc. Sec. expenditures totaled 25.9pp (+0.2pp relative to April) increasing on the back of twin increases. A 0.1pp increase in Soc. Sec. outlays was matched by a 0.1pp rise in Transfers. Public investment lost some momentum relative to April, experiencing a marginal drop that drove the segment to the 2.5pp of GDP mark, partly offsetting the increase in expenditures. With non-financial public sector income showing no variation, non-financial public sector outlays increasing by +0.1pp, and cincuentones revenues standing at 0.1pp of GDP, the primary deficit excl. cincuentones stood at -1.2pp in May—over April and March's 1.1pp mark and up from -0.8pp in February and -0.8pp in January—.

Figure 1: May's fiscal figures





12m rolling - as % of GDP	Dec-21	Dec-22	Apr-23	May-23
NFPS Income	**26.7%**	**27.1%**	**27.3%**	**27.3%**
Central Government	**18.9%**	**19.3%**	**19.2%**	**19.2%**
Tax Revenues	*15.9%*	*16.5%*	*16.5%*	*16.6%*
International Trade	*1.1%*	*1.1%*	*1.1%*	*1.1%*
Others	*1.8%*	*1.7%*	*1.6%*	*1.5%*
Soc.Sec contributions	6.4%	6.8%	6.9%	6.9%
SOE primary balance	1.4%	1.0%	1.2%	1.3%
BSE &Munis primary balance	0.2%	0.1%	0.0%	0.0%
BCU primary balance	0.0%	-0.1%	0.0%	0.0%
NFPS Outlays	**27.5%**	**27.8%**	**28.3%**	**28.4%**
Central Govt. Primary Outlays	25.8%	25.4%	25.7%	25.9%
Personnel spending	*4.6%*	*4.6%*	*4.6%*	*4.7%*
Non-Personnel spending	*4.3%*	*3.9%*	*3.8%*	*3.8%*
Pensions	*9.0%*	*8.9%*	*9.0%*	*9.1%*
Transfers	*7.9%*	*8.0%*	*8.2%*	*8.2%*
Public investment	1.8%	2.4%	2.6%	2.5%
Public Sector Primary Balance	-0.7%	-0.6%	-1.0%	-1.1%
Interest payments	2.8%	2.6%	2.6%	2.7%
Consolidated Public Sector Deficit	-3.5%	-3.2%	-3.7%	-3.7%
Cincuentones revenues	-0.5%	-0.2%	-0.1%	-0.1%
Adjusted Consolidated Public Sector Deficit	**-4.0%**	**-3.4%**	**-3.8%**	**-3.8%**

Source: TPCG Research based on MEF

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In addition to the monthly fiscal print, the administration presented its 2022 Budget review, updating its macro assumptions for inflation, growth and the FX, also correcting fiscal targets to the upside, as expected. The government presented the 2022 Budget review and updated its macro forecasts for the coming years. GDP growth is expected to clock in at +1.3% in 2023, and at +3.7% in 2024. Inflation expectations remain unchanged, standing at +6.7% for the eop yoy gauge for 2023, and +5.8% for the following three years. Looking at the FX, the administration expects the USDUYU for 2023 to stand near the 40.1 mark, while, for 2024, its forecast stands at 42.8, marking a +7% depreciation for next year. Regarding fiscal projections, the administration halted its consolidation mode to attend to the crisis caused by the drought. This resulted in a perceptible widening of the deficit in the first months of 2023, which put the government in a difficult position to comply with the established targets. In this context, the administration triggered the escape clauses in the Budget Law, allowing it to correct some of the 2023 targets to the upside. Regarding the structural deficit target, the administration presented an updated target at a -2.7% deficit for 2023, 0.2pp over the -2.5% target established in last year's budget, but consistent with the original budget law presented in 2020. This, however, means that the administration is expecting to lose most of the accumulated overperformance from 2021 this year. Regarding the change in real expenditures, the administration still expects to comply with this target, updating its objective to a -0.6% reduction in said items, from a +1% increase in last year's budget review. Finally, the government raised the debt ceiling exceptionally from USD2.2bn to USD2.9bn for 2023. In this context, the administration pretends to end the year with a deficit of -3.3% of GDP ex. cincuentones, practically unchanged from 2022 figures. Currently, said figure stands near the -3.8% mark, which means the administration must consolidate nearly 0.5pp of GDP up until the end of the year to comply with the set objective.

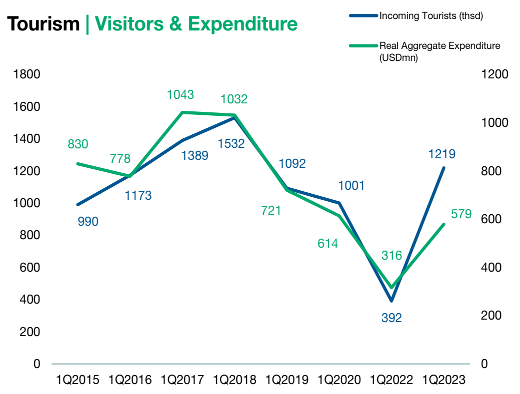
BoP flows turned supportive during 1Q23

In other news, BoP flows posted a very solid 1Q23, as Uruguay's current account deficit clocked in at USD0.44bn vs USD0.86bn in 4Q22, mostly on the back of the robust tourism campaign.

In other news, BoP flows posted a very solid 1Q23, as Uruguay's current account deficit clocked in at USD0.44bn vs USD0.86bn in 4Q22, mostly on the back of the robust tourism campaign. Dissecting the widening, the services balance was the segment with the largest impact, as the latter overperformed 1Q22 figures by USD0.4bn. This can be explained mostly by the very good tourism campaign, which saw the number of visiting tourists return to pre-pandemic levels (+21.8% over 1Q20 figures). However, budget constraints from neighboring Argentinian tourists did water down the impact of a sizable increase in visitors, as real expenditure in USD weakened by -5.7% relative to 1Q20 figures. In this context, incoming tourism generated an additional USD591mn in service exports. On the other hand, FX conditions also presented a good scenario for Uruguayans to travel abroad, and so during 1Q23, outgoing tourism increased service imports by nearly USD260mn, partially offsetting the very solid summer campaign. The trade balance put on a flat performance, with Exports just increasing by USD6mn. Imports on the other hand benefited from the FX trend and PCE dynamics, rising by USD108mn. Still, the trade balance marginally improved to a USD611mn surplus (+USD43mn relative to 1Q22), subverting expectations, as the impact of the drought was expected to hamper international accounts further, especially on the export side. Primary income contributed very marginally to the deficit widening, as its deficit increased by USD37mn. All in all, the Current Account balance experienced a USD422mn improvement, with the robust tourism campaign being the main driver. In 12m-rolling terms, the current account deficit came in at -2.8% of GDP (-USD2.07bn), improving by 0.7pp relative to the end of 2022 (-3.5% of GDP; -USD2.5bn).

Figure 2: 1Q23 BoP figures

USDmn	2021	2022	1Q22	1Q23	Δ
Current account	-1,551	-2,500	-863	-440	422
Goods & Services	4,486	3,784	779	1,229	450
Goods	4,473	3,452	568	611	43
Exports	15,684	17,065	3,661	3,812	150
Imports	11,211	13,613	3,093	3,201	108
Services	13	332	211	618	407
Exports	3,713	5,430	1,281	1,957	676
Imports	3,700	5,097	1,070	1,339	268
Primary Income	-6,114	-6,420	-1,683	-1,720	-37
Secondary Income	78	135	41	51	9
Capital account	-30	1	0	0	0
Financial Account	-543	-2,143	925	69	-856
Direct Investment	-1,756	-3,336	-410	-1,058	-648
Portfolio Investment	1,042	1,629	144	508	364
Derivatives	466	833	399	83	-316
Other Investment	-1,138	308	977	219	-758
Errors & Ommisions	1,038	357	1,788	509	-1,279
Reserve Assets	843	-1,578	-185	318	503
12m-rolling GDP (USDmn)	**61,422**	**71,199**	**63,629**	**74,355**	**10,726**
Balance as % of GDP (12m)	-2.5%	-3.5%	-2.9%	-2.8%	-



Source: TPCG Research based on BCU & Tourism Ministry

Even as BoP flows surprised on the upside during 1Q23, they were consistent with the performance of the FX during the first half of 2023.

Even as BoP flows surprised on the upside during 1Q23, they were consistent with the performance of the FX during the first half of 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. All of this was also consistent with the performance of the USDUYU, which refused to depreciate during the first months of the year. Even if the drought should be somewhat harsher with exports during 2Q23, we do believe that the performance of the FX during this quarter should provide some evidence in favor of relatively sound BoP flows.

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All in all, we find the BoP print to be supportive of our position in local currency and nominals, even if, in our view, the fiscal position and recent corrections in targets are slightly credit negative. Starting with BoP flows, the solid 1Q23 print, compounded with the FX dynamics during 1H23 suggests the macro scenario is bound to favor nominals on the local currency side. (For a more in-depth view click here). Regarding the fiscal print and the updated fiscal targets, we find them to be slightly credit negative, albeit they respond to the complex climatic dynamics present during the 1Q23, which forced the government's hand into shoring up the economy and activity levels. Even if we believe the fiscal stimulus was justifiably deployed, the abrupt stop in fiscal consolidation does partly offset the very solid track record the administration has been building since the start of its tenure. In addition, this means the administration will enter an election year with a weaker fiscal balance than expected which in practice could mean no fiscal consolidation in over two years. While the administration's track record and acumen do point to a very responsible management of public finances, the government's decision to deploy fiscal stimuli this year is not compatible with doing an expansive fiscal policy during 2024, both institutionally (due to the Budget Law), and from a practical standpoint.

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