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Uruguay – Strategy
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’22 Budget Review: Fiscal Consolidation halted

- **IN THIS PIECE.** The administration recently presented its budget review for the 2022 period, updating the base scenario for the next five years. We take an in-depth look at the reviewed macroeconomic forecasts, focusing on the fiscal path going forward, attempting to determine how viable the administration’s consolidation is proposing.

- **OUR KEY TAKEAWAYS**. We find the administration’s macro forecasts are mostly consistent with our house view. Government estimates expect growth to slump in 2023 due to the crisis, posting a 1.3% yoy increase relative to 2022, to then rebound more strongly in 2024 (+3.7%yoy). In terms of prices, the administration forecasts yearly inflation at +6.7% by end-2023, converging to the BCU’s target by 2024 (+5.8%). In addition, the government expects the REER to appreciate further in the medium term, accounting for slight nominal depreciations offset by higher inflation prints.

  However, we find that important political constraints could roadblock the execution of the updated consolidation path. The government experienced significant success in its consolidation efforts up to this point in its tenure, complying with all three pillars of the fiscal rule for several consecutive periods. However, the administration plans to halt the fiscal consolidation this year, with 2023’s consolidated deficit expected to clock in aligned with 2022’s figures, at -3.2% of GDP. This comes from supporting the economy during the severe climatic crisis suffered during the final months of 2022 and 1Q23. The issue comes in the shape of the 0.7pp consolidation planned for 2024, which is an electoral year. This plan envisages the administration compressing the deficit to 2.6% of GDP by end-2024. With the administration currently trailing the FA in popularity metrics by 5pp and carrying a 0.5pp deviation from the 2023 fiscal target, we believe the execution risks of the consolidation plan are significant.

- **STRATEGY IMPLICATIONS.** In our view, the risks of a deviation from the projected fiscal path and, therefore, a more supportive stance in 2024 are substantial. Still, we do not expect this to impact valuations in the short run, as the administration’s track record on the fiscal front and the correct deployment of stimuli to shore up a weakened economy should justify any deviation in 2023. However, if said trend continues in 2024, some questions may arise.

TPCG LATAM
URUGUAY STRATEGY VIEW

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Authorities presented the official base scenario for the 2023-27 period before Congress. Official forecasts put GDP growth at +1.3% in 2023 and +3.7% in 2024, after a twin solid increase in 2021 (+5.3%) and 2022 (+4.9%). Beyond 2024, the Government expects GDP growth to stabilize near the +2.9% mark. While this year’s estimates reflect the strong impact that the drought is expected to have on activity figures for 1H23, GDP growth prospects, going forward, look feasible, with the terminal growth rate standing at a reasonable level. The terminal growth rate was derived from a new estimate of Uruguay’s potential growth, which the MEF needed to establish the cap for increases in primary expenditure within the fiscal rule. We currently find that drought’s impact on activity levels during the first quarter of the year has been milder than expected. In fact, it has been mostly offset by a very solid tourism campaign, which saw the number of visitors exceed pre-pandemic levels by nearly +21.8%. 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. On the external side, export numbers for the 1Q23 have been solid enough (+7.5%yoy for goods) and do not denote a harsh impact from the dry climatic conditions. Still, we expect the drought to heavily weigh activity and export figures during 2Q23, where the brunt of the soybean campaign is harvested and sold. Our estimates indicate the drought should cause a -USD1.6bn loss in this year’s harvest, of which nearly 1.3bn would come due to the poor soy campaign. We expect this loss to hamper the 2Q23 export and activity figures. External conditions for 2023 are also less auspicious than last year, as commodity prices dipped, affecting meat and agricultural exports, which also face quantity constraints due to the drought. In addition, growth prospects do not seem extremely flattering amongst relevant trading partners – including China (+5.2% real GDP growth), the US (+1.6%), Argentina (-3%), Brazil (+1.8%), and the Euro Zone (+0.8%)— Still, we expect the recently installed UPM II to become fully operational during 2H23, partially offsetting the effect of the drought in both the external and activity segments. In this context, we consider official GDP growth prospects for the 2023-27 period feasible, with 2023 riddled with idiosyncratic convulsions followed by a stronger 2024 as the affected sectors recover. The Government expects the nominal GDP to total USD78.6bn in 2023.

Figure 1: Official macroeconomic assumptions 2023-27

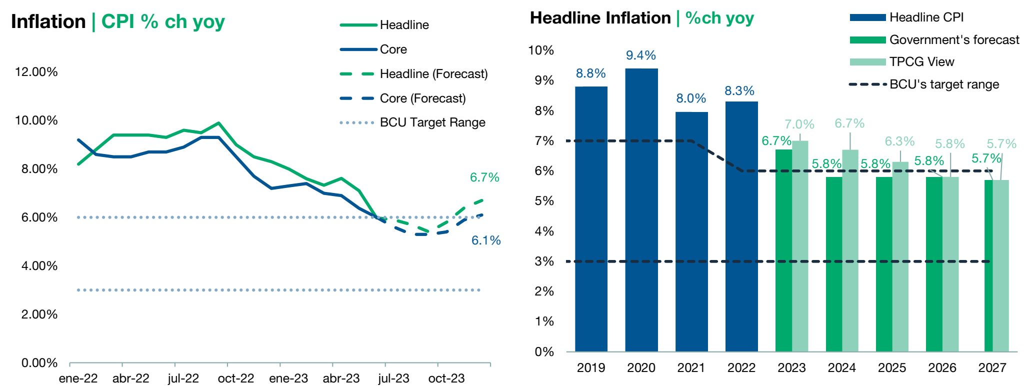
	2020	2021	2022	2023	2024	2025	2026	2027
GDP								
GDP Growth	-6.3%	5.3%	4.9%	1.3%	3.7%	2.9%	2.9%	2.9%
Consumption expenses	-6.9%	4.0%	5.0%	2.0%	3.2%	2.4%	2.7%	2.7%
Gross capital formation	7.7%	18.3%	5.2%	1.6%	-5.5%	4.7%	2.7%	3.6%
Gross fixed capital formation	1.2%	16.5%	9.5%	-4.0%	1.4%	2.9%	3.6%	3.0%
Net exports								
Exports	-16.3%	11.7%	11.1%	1.2%	10.6%	3.2%	3.|%	2.4%
Imports	-12.2%	18.2%	12.5%	3.7%	3.3%	2.7%	2.4%	2,0%
Nominal GDP (bn UYU)	2,254,723	2,674,701	2,930,192	3,152,695	3,470,468	3,777,112	4,105,434	4,460,930
Nominal GDP Growth		*18.6%*	*9.6%*	*7.6%*	*10.1%*	*8.8%*	*8.7%*	*8.7%*
Nominal GDP (bn USD)	53,667	61,412	71,177	78,566	81,030	84,016	87,172	90,584
Nominal GDP Growth (USD)		*14.4%*	*15.9%*	*10.4%*	*3.1%*	*3.7%*	*3.8%*	*3.9%*
Inflation & FX								
Year-end								
Inflation	9.4%	8.0%	8.3%	6.7%	5.8%	5.8%	5.8%	5.7%
UYU/USD	42.2	44.6	39.9	42.5	44.5	46.8	49.0	51.2
Depreciation rate	*12.8%*	*4.5%*	*-11.8%*	*6.5%*	*4.9%*	*5.1%*	*4.7%*	*4.4%*
Average								
Inflation	9.8%	7.7%	9.1%	6.7%	6.4%	5.7%	5.7%	5.6%
UYU/USD	42.0	43.6	41.1	40.1	42.8	44.9	47.1	49.3
Depreciation rate	*19.2%*	*3.7%*	*-5.5%*	*-2.5%*	*6.7%*	*5.0%*	*4.8%*	*4.6%*
Emplyoment								
Population employed (mn)	1.57	1.62	1.66	1.68	1.70	1.71	1.73	1.74
Population employed (%ch yoy)	-3.7%	3.7%	2.5%	0.9%	1.0%	0.9%	0.9%	0.7%
Employment rate	54.3%	56.0%	57.1%	57.3%	57.6%	57.9%	58.1%	58.3%

Source: TPCG Research based on MEF Uruguay

On the prices side, the Government continues to forecast non-compliance with the BCU's 3-6% target range for 2023, with estimates converging to the target range by 2024.

On the prices side, the Government continues to forecast non-compliance with the BCU's 3-6% target range for 2023, with estimates converging to the target range by 2024. In a context where the BCU's target range compressed from 7%-3% to 6%-3% in Sept-22, compliance with the goal this year looks unlikely (albeit not far-fetched) in the short term. Though the CPI dropped into the target range in June, the government expects inflation re-accelerate in the coming months, ending 2023 at +6.7% by the end of 2023 (our House estimate is consistent, coming at +6.7%yoy Dec/Dec) and finally fall inside the BCU's target by 2024, with the yearly print standing at +5.8%, which is the government's forecast for 2025-27 as well. In this context, market expectations present a similar scenario for the CPI path. For 2023, the BCU's expectations survey presents an eop rate of +6.95%, marginally over the government forecasts. For 2024, analysts are less optimistic than the administration, expecting a slower convergence to the BCU's target range, with inflation ending the year at +6.74%, 94 bp over official forecasts. Therefore, contrary to government forecasts, the market is still not expecting inflation to converge to the BCU's target by 2024. Furthermore, market expectations do not indicate inflation should comply with the BCU's target range by 2025 either, as forecasts stand 50 bp above the Cenbank's upper limit of 6%. Our estimations for 2023 stand slightly above both the official forecasts and market expectations, hovering around the +7% mark. We expect the public policy mix to become increasingly supportive as the year advances. On the one hand, we expect the BCU to loosen its Monetary policy stance, dropping rates as inflation converges and as a proxy to take some pressure off the continuously appreciating FX. On the other hand, this year's salary negotiations will include some adjustment components in some sectors, allowing real wages to recover to pre-pandemic levels. These clauses should add extra persistence to the inflationary process in the medium run. Still, with a strong tailwind provided by a robust baseline effect, the yoy gauge should tend to continue its downside trend up until 4Q23.

Figure 2: Forecasted disinflation path



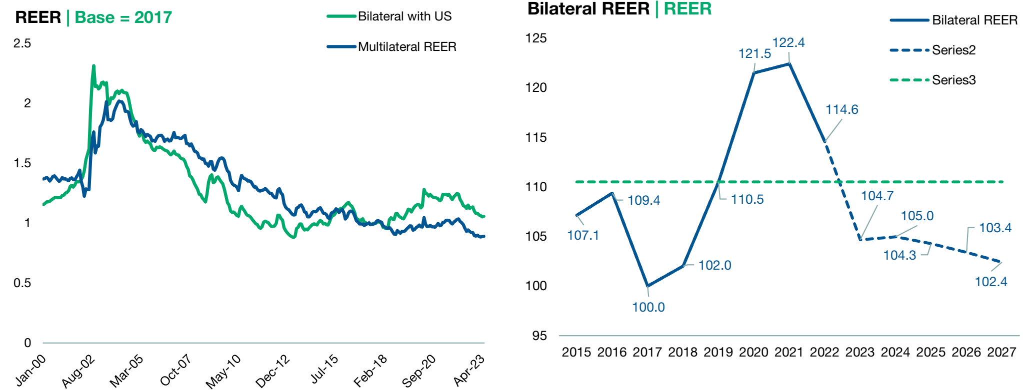
Source: TPCG Research based on INE and CINVE

Looking at the path for the REER, we find the administration expects it to continue its appreciation, which is consistent with the recent performance of the Uruguayan economy.

Looking at the path for the REER, we find the administration expects it to continue its appreciation, which is consistent with the recent performance of the Uruguayan economy. Currently, the bilateral REER with the US stands at 105.2, and the government scenario sees it dropping to 104.7 by end-2023. This comes on the back of a combination of relatively high inflation (+6.7%yoy for 2023) and an appreciation of the nominal FX rate (-2.5%yoy). We believe the base scenario looks feasible, as the USDUYU accumulates a -7.3% average appreciation YTD. The government expects the real appreciation to continue throughout the 2024-27 period, with a slight hiccup in 2024, where the administration expects a slight correction of the REER to the upside, from 104.7 to 105, coming on the back of a +6.7% depreciation of the USDUYU and 6.4% inflation. Beyond 2024, the forecasted depreciation rate converges gradually to 4.5% by 2027. With a solid UYU, the government expects the depreciation rate to slow down significantly relative to 2019 and 2022. As inflation expectations slow down, the implicit REER by the end of the 2023-27 period should stand at 102.4 (100=2017), well below 2021's recent peak (122.4) and even 2019's 110.5. Furthermore, the average REER between 2010-20 stood at 104.7, so the official scenario puts the real exchange rate with the US 2018 levels by 2027. We believe the risks to the baseline scenarios are slightly tilted to the downside. The idiosyncratic factors surrounding Uruguay's REER have evolved significantly. With the incorporation of UPM II into the export circuit, in addition to the growth of the consulting and software industries, we believe

the REER could appreciate further in the coming years. Beyond 2024, however, an administration change could see a different set of policies regarding the FX. Still, under the current BCU regime, with the USDUYU floating freely, we believe the REER could appreciate more aggressively in the medium run.

Figure 3: REER appreciation



Source: TPCG Research based on BCU

The drought forced a politically inconsistent fiscal consolidation plan on the administration.

The fiscal deficit excl. cincuentones compressed by 0.5pp in 2022—from 3.9pp in 2021 to 3.4pp in 2022, on the back of a very strong improvement in Income sources and a trim in discretionary spending, as the need to support disposable income dissolved.

The fiscal deficit excl. cincuentones compressed by 0.5pp in 2022—from 3.9pp in 2021 to 3.4pp in 2022, on the back of a very strong improvement in Income sources and a trim in discretionary spending, as the need to support disposable income dissolved. Revenues exhibited solid growth in yoy terms, and even in a context of a strong GDP rebound, Total income managed to offset the improvement in activity levels. Total income soared by 0.5pp of GDP, catapulted by a solid rise in Tax revenues (+0.3pp) due to higher VAT and IRAE (corporate income tax) collections and robust improvements in Soc. Sec. contributions (+0.3pp). However, other Income sources did suffer a dip, slashing 0.2pp from Total Income's growth. On the spending side, the Government maintained its consolidation mode, seeking to restore balance to the fiscal accounts. However, the magnitude of the cuts was significantly smaller than in 2021. Spending dropped -0.3pp in 2022—on the back of a -0.4pp fall in non-personnel expenditure, accompanied by a -0.2pp drop in Soc. Sec. outlays and a -0.1pp reduction in Wages. However, the compression was offset by a substantial +0.5pp increase in Capex, as the government put the pedal to the metal regarding capex in the later stages of the year, as it was clear it would comply with the established fiscal targets. In this context, the non-financial primary balance excl. cincuentones printed -0.8pp, down from -1.2pp in 2021.

Between 2023-27, the Government expects the non-financial public sector primary balance to improve by 0.8pp of GDP.

Between 2023-27, the Government expects the non-financial public sector primary balance to improve by 0.8pp of GDP. The target implies consolidating the primary position from a -0.8% of GDP deficit to a neutral position by the end of 2027. With the improvement in the primary balance, the overall deficit would drop to 1.9pp by 2027, down from 3.4pp in 2022. To meet this target, the consolidation plan trims non-financial public sector spending by 0.7pp of GDP—from 26.9pp in 2022 to 26.2pp in 2027—on account of lower non-personnel spending (-0.8pp), lower personnel spending (-0.4pp), flat Soc. Sec. expenditure, lower transfers (-0.2pp), slightly lower interest payments (-0.1pp), and a strong increase in capex (+0.6pp). Besides lower central Government & social security outlays, the consolidation plan foresees an improvement in the SOE's primary position (0.3pp) and a reduction in both BCU interest expenses (-0.2pp) and cincuentones revenues (-0.1pp). At the same time, the Munis & BSE balance is expected to remain unchanged. On the revenues side, the Government expects a 0.1pp of GDP improvement in Central Government & social security income—from 26.1 in 2022 to 26.2pp in 2027—completing the consolidation efforts. In this case, the rise results from a mixed behavior of the segment. Tax revenues (+0.1pp) and Social Security Income (+0.1pp) are expected to increase marginally. However, International Trade is expected to drop by -0.1pp of GDP. Altogether, the

budget expects the consolidated public sector balance to improve by 1.5pp between 2023-27, from -3.4pp in 2022 to -1.9pp in 2027.

Figure 4: Consolidation efforts for the 2023-27 period

% of GDP annualized	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27
Central Government & Social Security	-3.7	-3.0	-3.1	-2.6	-2.3	-2.1	-2.1
Primary balance incl. cincuentones	-1.6	-0.8	-0.7	-0.3	0.0	0.1	0.0
Central Govt & Soc. Sec. income	25.6	26.1	25.8	26.0	26.3	26.3	26.2
Central Government	*19.1*	*19.3*	*18.9*	*19.0*	*19.3*	*19.3*	*19.3*
Tax revenues	*16.2*	*16.5*	*16.1*	*16.2*	*16.5*	*16.6*	*16.6*
International trade	*1.1*	*1.1*	*1.1*	*1.1*	*1.1*	*1.0*	*1.0*
Others	*1.9*	*1.7*	*1.7*	*1.8*	*1.7*	*1.7*	*1.7*
Social security	*6.5*	*6.8*	*6.9*	*7.0*	*7.0*	*7.0*	*6.9*
Central Govt & Soc. Sec. Spending	27.2	26.9	26.6	26.3	26.3	26.3	26.2
Personnel spending	*4.7*	*4.6*	*4.6*	*4.6*	*4.5*	*4.3*	*4.2*
Non-Personnel spending	*4.3*	*3.9*	*3.5*	*3.5*	*3.3*	*3.2*	*3.1*
Pensions	*9.1*	*8.9*	*9.1*	*9.1*	*9.1*	*9.1*	*8.9*
Transfers	*8.0*	*8.0*	*8.1*	*8.0*	*8.0*	*7.9*	*7.8*
Public investment	*1.1*	*1.6*	*1.2*	*1.1*	*1.4*	*1.8*	*2.2*
Interest payments	2.1	2.2	2.4	2.3	2.3	2.2	2.1
State Owned Enterprises							
Primary balance	0.7	0.2	0.1	0.3	0.1	0.4	0.5
Interest payments	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Munis & BSE							
Primary balance	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Interest payments	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
BCU							
Primary balance	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Interest payments	0.9	0.6	0.5	0.4	0.5	0.5	0.4
Cincuentones	0.3	0.1	0.0	0.0	0.0	0.0	0.0
Consolidated public sector balance	**-3.5**	**-3.2**	**-3.2**	**-2.5**	**-2.5**	**-2.0**	**-1.8**
w/o Cincuentones	*-3.9*	*-3.4*	*-3.3*	*-2.6*	*-2.6*	*-2.1*	*-1.9*

Source: TPCG Research based on MEF Uruguay

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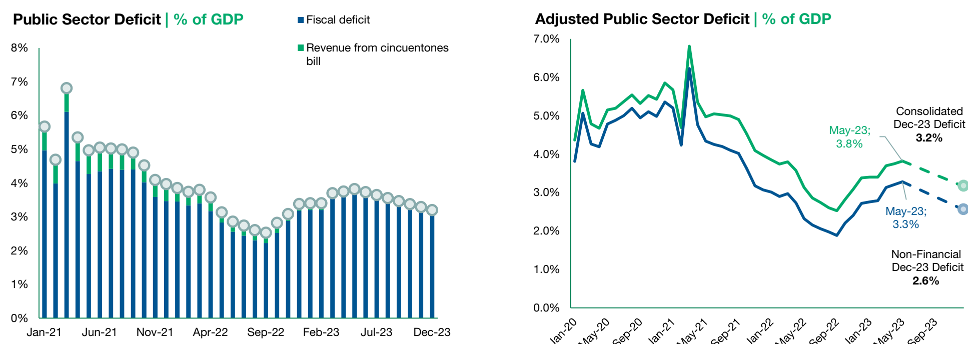
The Government now expects a 3.2pp of GDP consolidated deficit in 2023, unchanged from 3.2pp in 2022, showcasing no improvements, stopping fiscal consolidation on its tracks. The administration's focus has shifted significantly, now concentrating on a more supportive income policy, which is compounded by some tax relief measures announced in March, which, even if mostly insubstantial, point in the direction of the administration's policy mix. With this, the administration plans no further improvements in fiscal metrics this year. Still, that means that the government is deviated from its end-2023 targets. May's fiscal figures printed a -3.7% consolidated deficit, meaning the administration is currently 0.5pp deviated from the eop estimates. In addition, the fiscal balance has worsened significantly since the start of the year. Income sources increased by 0.2pp YTD, mostly accounted for by an overperformance of the SOE balance, which widened its surplus by 0.3pp of GDP. In addition, twin 0.1pp improvements in Tax revenues and social security collections aided Income figures. Still, a 0.2pp drop in Other income and marginal reductions in other segments shaved away some overperformance. The real problem came on the Outlays side, as they rose by 0.6pp YTD, coming on the back of three 0.2pp rises in Transfers, Soc. Sec. Outlays, and Capex. A timid -0.1pp reduction in non-personnel expenditure was offset by an increase of the same magnitude in Wages. The administration's targets see both the primary deficit and the consolidated figures to match those posted in 2022. In this context, the government expects the Central Government & Social Security total balance to improve by +0.5pp throughout the rest of the year, which looks feasible, albeit not easy, as it requires the administration to withdraw the currently deployed fiscal stimulus.

Figure 5: Fiscal deficit path for 2023

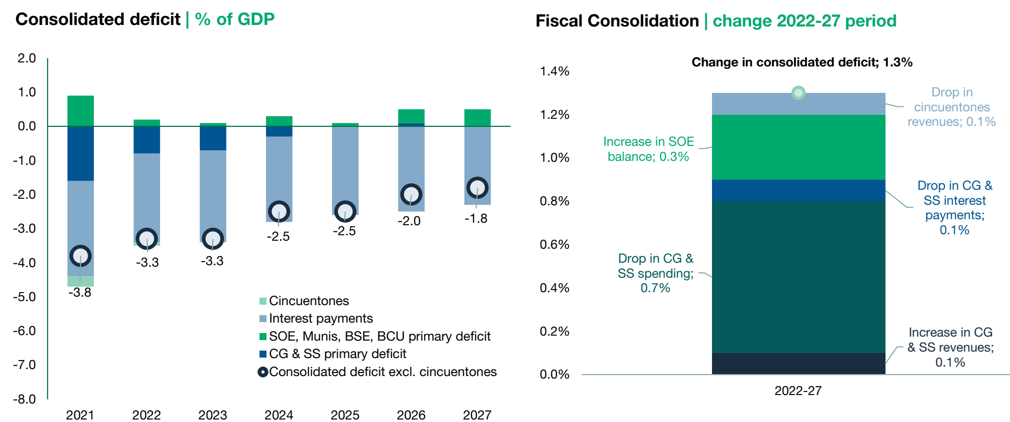


Source: TPCG Research based on MEF Uruguay

After 2023, the consolidation plan proposes a 0.7pp deficit compression during 2023 to smoothen substantially throughout the 2024-26 period.

After 2023, the consolidation plan proposes a 0.7pp deficit compression during 2023 to smoothen substantially throughout the 2024-26 period. If the government hits this year's 3.2pp deficit target for the consolidated public sector balance, the 2024 target forces the administration to a 0.7pp of GDP compression to put the total deficit at 2.5pp by year-end, a large compression compared to this year's expected figures. However, the government counts on phasing out the stimuli deployed to combat the drought during the next year, allowing it to compress outlays with less political cost. The negative fiscal impulse then eases towards a more gradual consolidation between 2025-27, from -2.5pp in 2024 to -1.8pp in 2027. With cyclical factors on the rise due to the weakened economy, the Government expects a stable balance relative to last year, albeit with a significant reshuffle inside fiscal accounts' composition. The administration expects income sources to fall due to the slowdown in economic activity and the slight tax reliefs offered by the administration. Tax Revenues are poised to fall by -0.4pp, being slightly offset by a +0.1pp rise in Social Security income, putting the net reduction in Income sources at -0.3pp. On the expenditure side, the administration expects a -0.3pp compression, mostly based on the phasing out of Non-Personnel outlays (-0.4pp) and Capex (-0.4pp), which would then be offset by rises in Soc. Sec. expenditures (+0.2pp), Interest Payments (+0.2pp), and Transfers (+0.1pp), effectively reshuffling the composition of govt. expenditure in the foreseeable future. Beyond 2023, the Government plans a more gradual consolidation, pushing the non-financial public sector primary deficit excl. cincuentones from -0.3pp in 2024 to +0.0pp in 2027. Between 2024-27, the budget foresees a higher SOE primary result (+0.2pp), increased central Government income (+0.2pp), and a reduction in personnel spending (-0.4pp), Non-personnel spending (-0.4pp), Soc. Sec. expenditures (-0.2pp), Transfers (-0.2pp), and Interest Payments (-0.2pp), these being slightly offset by a massive +1.1pp rise in Public Investment.

Figure 6: Updated fiscal consolidation plan



Source: TPCG Research based on MEF Uruguay

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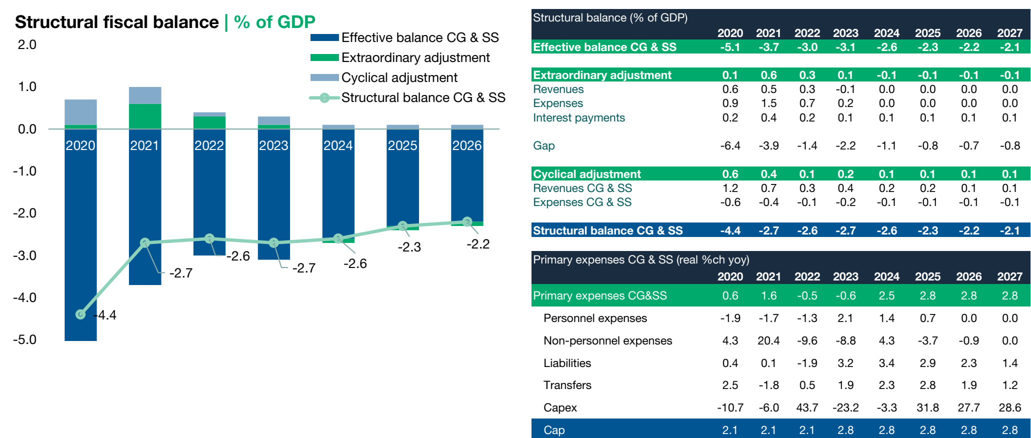
Still, the core of the fiscal strategy lies in the fiscal rule introduced in 2020, which establishes (i) a structural balance, (ii) a spending cap, and (iii) a net borrowing cap. For the third year straight, the government was compliant with all three pillars, albeit by a slimmer margin this time around. Regarding the structural result, the 2021 Budget Review determined an improvement of +0.1% of GDP for 2022. The Government complied with the target, posting a 2.6% structural deficit (0.1pp under 2022 data). Still, this was the first time since 2020 that the administration did not post an overperformance, narrowly fitting the target. On the spending side, the Government managed to compress real primary spending—including Public-Private Participation (PPP) Contracts—by -0.5pp relative to 2021, overperforming in this department, as the maximum threshold predetermined in the fiscal rule based on the Government's estimate of the potential growth rate allows for an annual +2.8pp increase. Lastly, the third pillar of the fiscal rule consisted of a USD2.1bn net borrowing cap. The Central Government's net borrowing needs totaled USD1.86bn in 2022—0.24bn below the net borrowing cap—with gross borrowing needs totaling USD5.1bn and principal payments and financial asset variation totaling USD2.6bn and USD147mn, respectively. In this context, the effective Central Government & Social Security balance printed -3.2pp of GDP in 2022, slightly missing the proposed -3.1pp deficit in the budget. It is important to add that the only binding targets refer to the three pillars of the fiscal rule, while the effective fiscal balance is only an indicative target.

Looking at the expected figures for 2023, the three pillars showcase the administration's intent to deploy fiscal stimuli to aid the stumbling economy.

Looking at the expected figures for 2023, the three pillars showcase the administration's intent to deploy fiscal stimuli to aid the stumbling economy. Regarding the structural deficit, the updated targets put 2023 metrics at -2.7pp of GDP. This rubricates a 0.1pp widening relative to 2022 and showcases the administration corrected last year's estimate for 2023 (-2.5pp) upwards, allowing for a 0.2pp wider structural position. Regarding the spending cap, the administration expects a reduction in primary outlays. In particular, forecasts put outlay variation at -0.6pp, compressing relative to 2022's expectations (+1pp). This would come way below the allowed 2.8% yoy variation. The reduction mostly accounts for the administration's slower-than-envisaged phasing out of the COVID fund, which amounted to 0.6pp of GDP by end-2022. Finally, the administration solicited authorization to raise the net debt ceiling from the allowed USD2.2bn to USD2.9bn (+660mn), citing the escape clause of the fiscal responsibility law due to the hydric deficit and its impact on the economy. In this context, we find that the recent budget review suggests the administration's focus has shifted from consolidating the fiscal position, at least in the short term.

Figure 7: Fiscal rule period 2023-27



Structural balance (% of GDP)	2020	2021	2022	2023	2024	2025	2026	2027
Effective balance CG & SS	**-5.1**	**-3.7**	**-3.0**	**-3.1**	**-2.6**	**-2.3**	**-2.2**	**-2.1**
Extraordinary adjustment	**0.1**	**0.6**	**0.3**	**0.1**	**-0.1**	**-0.1**	**-0.1**	**-0.1**
Revenues	0.6	0.5	0.3	-0.1	0.0	0.0	0.0	0.0
Expenses	0.9	1.5	0.7	0.2	0.0	0.0	0.0	0.0
Interest payments	0.2	0.4	0.2	0.1	0.1	0.1	0.1	0.1
Gap	-6.4	-3.9	-1.4	-2.2	-1.1	-0.8	-0.7	-0.8
Cyclical adjustment	**0.6**	**0.4**	**0.1**	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**
Revenues CG & SS	1.2	0.7	0.3	0.4	0.2	0.2	0.1	0.1
Expenses CG & SS	-0.6	-0.4	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1
Structural balance CG & SS	**-4.4**	**-2.7**	**-2.6**	**-2.7**	**-2.6**	**-2.3**	**-2.2**	**-2.1**

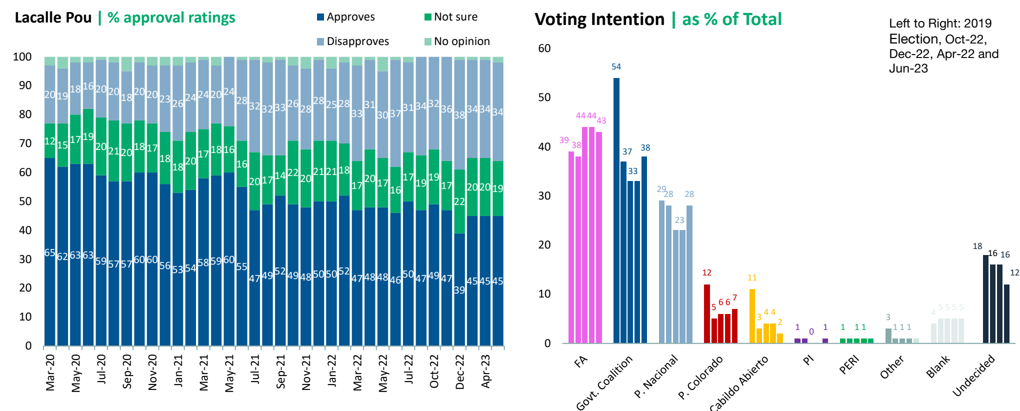
Primary expenses CG & SS (real %ch yoy)	2020	2021	2022	2023	2024	2025	2026	2027
Primary expenses CG&SS	0.6	1.6	-0.5	-0.6	2.5	2.8	2.8	2.8
Personnel expenses	-1.9	-1.7	-1.3	2.1	1.4	0.7	0.0	0.0
Non-personnel expenses	4.3	20.4	-9.6	-8.8	4.3	-3.7	-0.9	0.0
Liabilities	0.4	0.1	-1.9	3.2	3.4	2.9	2.3	1.4
Transfers	2.5	-1.8	0.5	1.9	2.3	2.8	1.9	1.2
Capex	-10.7	-6.0	43.7	-23.2	-3.3	31.8	27.7	28.6
Cap	2.1	2.1	2.1	2.8	2.8	2.8	2.8	2.8

Source: TPCG Research based on MEF Uruguay

While deploying fiscal stimuli to combat the economic crisis seems adequate, the administration's consolidation plan for 2024 becomes an open question, as it requires a major fiscal consolidation in an electoral year.

While deploying fiscal stimuli to combat the economic crisis seems adequate, the administration's consolidation plan for 2024 becomes an open question, as it requires a major fiscal consolidation in an electoral year. We believe the administration's efforts to consolidate fiscal position up until this year have been commendable from a practical and institutional standpoint. In addition, with the drought causing major damage to the Uruguayan economy, the deployment of fiscal stimuli does seem correct from a macro standpoint. However, the timing of the crisis does seem unfortunate for the administration. A bloated fiscal position this year means (as drawn up in the Budget review), a major consolidation in 2024, which is an electoral year. And here is where we identify the major uncertainty in the administration's fiscal strategy, as the political incentives are not adequately lined up to perform such a fiscal effort. On paper, the administration expects the fiscal deficit to compress from 3.2pp of GDP to 2.6pp by end-2024. And this is considering the administration hits this year's targets, from which current figures deviated. A 0.7pp of GDP consolidation in a key electoral year presents considerable execution risks. While accelerating fiscal expenditure just to improve its electoral chances seems slightly out of character for the administration, the polls suggest an upscale battle, which could result in some fiscal slack. The administration does not start as a frontrunner for the next election. The ruling coalition's internal rifts have compounded with a relatively strong FA, which, according to the latest polls by Equipos Consultores, edges the former by nearly 5pp (43pp vs. 38pp) in voting intention, with another 12% of voters remaining undecided. If the administration enters 2024 trailing the FA in voting intention and accumulating some additional deviations in 2023, we expect substantial deviation risks. On the other hand, we believe an overperformance in fiscal metrics this year or a substantial improvement in the ruling coalition's popularity metrics could dilute the execution risks of the fiscal consolidation plan.

Figure 8: The FA stands as the top dog entering the 2024 election



Source: TPCG Research based on Equipos Consultores

GFNs to slowly drop in the coming years. Still, the debt trajectory points downwards.

The Govt forecasts USD20.1bn in gross bond sales between 2023-2027, including USD4.3bn in 2023 and USD34bn in 2024.

The Govt forecasts USD20.1bn in gross bond sales between 2023-2027, including USD4.3bn in 2023 and USD34bn in 2024. The Government's 2023 Gross Financing Needs (GFN) forecast totals USD4.9bn, accounting for a USD0.59bn primary fiscal deficit, which now triples the initial estimate for the year that stood at USD0.2bn. Interest payments and amortizations complete the picture totaling USD1.95bn and USD2.3bn, respectively. On the sources side, the Government is counting on USD0.45bn from IFIs and USD4.3bn from market issuances. With the final numbers of the recent global issuance in hand, we believe the administration still has room to tap international markets once more during 2H23 to cover its GFNs. With the new global issuance, the administration's total tap adds up to USD2.7bn, leaving nearly USD1.6bn in issuances until the end of the year. We expect local treasury auctions to raise USD1.9bn in 2023 (USD0.9bn from the 1Q23 extraordinary auction plus USD1bn from scheduled auctions). In addition, the recent global tap, that leaves the administration with a USD1.2bn gap. With this in mind, we believe the administration could try to issue another international bond before the end of the year. Having exhausted the appetite for nominal securities, we believe a new issuance could come in the shape of an UI-linked global bond, or a hard currency USD issuance.

Looking at 2024, official forecasts put GFNs at USD4.36bn—down from the USD4.9bn in 2023, albeit revised upwards relative to the 2022 estimates

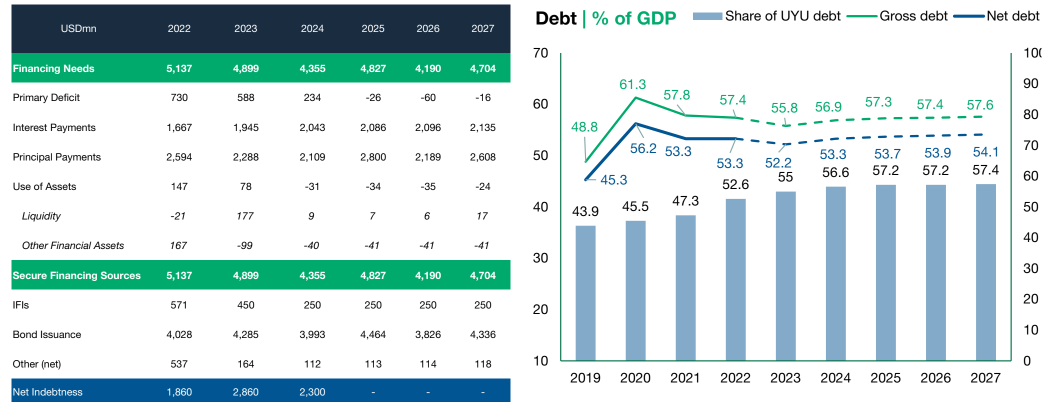
Looking at 2024, official forecasts put GFNs at USD4.36bn—down from the USD4.9bn in 2023, albeit revised upwards relative to the 2022 estimates. These pointed at GFN's totaling USD3.9bn in 2024, accounting for a slower fiscal consolidation path, resulting in more borrowing needs. 2024's primary deficit should come in at USD250mn, significantly wider than 2022's estimate (-USD50mn). Interests and amortizations are expected to total USD2bn and USD2.1bn respectively, with interest payments being corrected upwards since the last review, but with amortizations being forecasted at lower levels. In 2024, the Government expects to collect USD4bn from debt markets— marginally below 2023's figures— but USD0.5bn above last year's estimates. Beyond 2024, GFNs spike in 2025 before bottoming in 2026, although remaining roughly stable in the USD4-5bn range.

The administration expects gross debt to continue its downward trajectory in 2023, to then stabilize around the 57% of GDP mark, as net debt follows suit, stabilizing roughly at 54% of GDP.

The administration expects gross debt to continue its downward trajectory in 2023, to then stabilize around the 57% of GDP mark, as net debt follows suit, stabilizing roughly at 54% of GDP. After 2020's spike, gross debt dropped nearly 1.5pp in 2021, as fiscal compression reduced financing needs. The downward trajectory continued in 2022, albeit at a slower pace, as gross debt decreased by 0.4pp of GDP. The Government expects debt to trough in 2023, with gross debt falling to 55.8pp (-1.6pp vs. 2022), before stabilizing around that level, as official projections put gross debt at 57.6% by 2027, increasing slowly but steadily during the 2023-27 period. In turn, net debt should follow suit, dropping by 1.1pp relative to 2022, as to stand at 52.2% of GDP by end-2023. However, the net debt ratio should continue to increase very gradually over time, ending 2027 at 54.1%. The debt trajectory is consistent with a reduction in financing needs, driven mainly by a plausible fiscal trajectory, an aggressive bilateral REER appreciation, and solid enough GDP growth prospects. In the past decade, the Government has

made remarkable efforts to reduce the share of foreign FX-denominated debt, smooth the debt maturity profile, and optimize the precautionary debt management policy to buffer the economy from external shocks. In our view, potential deviations from the planned fiscal consolidation in the context of declining approval ratings could boost GFNs in the coming years, posing additional risk to the official debt baseline scenario.

Figure 9: Gross debt stabilizing near 57.6pp of GDP by the end of 2027



USDmn	2022	2023	2024	2025	2026	2027
Financing Needs	**5,137**	**4,899**	**4,355**	**4,827**	**4,190**	**4,704**
Primary Deficit	730	588	234	-26	-60	-16
Interest Payments	1,667	1,945	2,043	2,086	2,096	2,135
Principal Payments	2,594	2,288	2,109	2,800	2,189	2,608
Use of Assets	147	78	-31	-34	-35	-24
Liquidity	*-21*	*177*	*9*	*7*	*6*	*17*
Other Financial Assets	*167*	*-99*	*-40*	*-41*	*-41*	*-41*
Secure Financing Sources	**5,137**	**4,899**	**4,355**	**4,827**	**4,190**	**4,704**
IFIs	571	450	250	250	250	250
Bond Issuance	4,028	4,285	3,993	4,464	3,826	4,336
Other (net)	537	164	112	113	114	118
Net Indebtness	1,860	2,860	2,300	-	-	-

Source: TPCG Research based on MEF Uruguay

Strategy Implications: The principal hurdle against the consolidation plan is political feasibility.

We believe the proposed consolidation plan is credit negative, even if we don't expect it to affect valuations in the short or medium run. The administration has done a significant effort to cleanse public finances since the start of its tenure, and the deployment of fiscal stimuli this year, with the economy heavily affected by the drought, does seem appropriate. However, we also find that, in the current political landscape, with the government coalition trailing the FA by a significant margin, the chances of consolidating the deficit next year are slim. The political destiny of the administration for the next five years is at play, which means, it will probably shift its policy bias to a more supportive stance, to regain the lost ground. While we do not believe these policies should have any impact on valuations in the short run, given the administration's track record, next year when the government starts deviating from its fiscal target more significantly, some questions may start to arise. This could be especially worrisome if the administration deploys more fiscal stimuli in 2024, and loses anyways against the FA, as it would leave an increasingly leftist FA in a more delicate fiscal position, that, with widening premiums due to a change in regime, could somewhat strain Uruguayan finances in the medium run. However, in a scenario where the current administration secures a second tenure, we believe most worries should be undone, as their track record suggests further consolidation to be in order. The problem? Under severe political strain, for 2024 we expect the need to win back voters should prime over any consolidation effort the administration is prepared to execute.

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