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September 15, 2023

Uruguay Strategy Flash

Uruguay's growth clocked in at -2.5%yoy in 2Q23

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GDP fell by -2.5%yoy in 2Q23—-1.4%qoq seasonally adjusted—suffering the brunt of the effect of the drought after a better-than-expected 1Q23. During the second quarter of the year, Uruguay's economy contracted after experiencing a +1.5%yoy rebound during 1Q23. Both year-on-year and quarter-on-quarter growth showed signs of deacceleration, albeit printing a mixed performance in terms of sectors. The quarterly decrease was mainly driven by a very poor performance from the agricultural sector. We expected the brunt of the effect of the drought to be reflected in the 2Q23 GDP print, and the harsh climatic conditions took a significant toll on the segment. In this context, the sectors which were mainly responsible for the fall in GDP were Agriculture Fishing, and Mining (-27.4%yoy), Power Generation (-11.8%yoy), and Construction (-6.6%yoy). The segments contributed -2.1pp, -0.3pp, and -0.3pp to the quarterly GDP print, respectively, clearly showcasing that the brunt of the drop came on the back of the effect of the drought on the agricultural sector. In addition, Commerce, Hotels & Restaurants (-1.8%yoy), and Manufacturing (-1.5%yoy) posted timid negative variations, contributing another -0.3pp and -0.1pp to the quarterly drop, respectively. Even if the primary and secondary sectors had a difficult quarter, being mainly responsible for the economic contraction, the Services sector continues to enjoy positive dynamics and managed to cushion economic activity, offsetting part of the decrease. In particular, Public Services (+3.6%yoy), Professional Activities (+3.5%yoy), and Transport, Storage, Information & Communication Services (+2.5%yoy) managed to post quarterly increases amidst a complex scenario, each offsetting the GDP drop by +0.2pp. In addition, Financial Services (+0.9%yoy) and Health, Education, and Other Services (+0.6%yoy) timidly contributed some additional growth to the quarterly print, with each adding +0.1pp to the general figure. In this context, the general performance of the economy was conditioned by a drought-struck primary sector (contributing-2.1pp), compounded with a weak performance from the secondary sector (-0.8pp), which was partially offset by the improving dynamism of the Services sector, which carried the economy, adding +0.6pp to the quarterly print.

Figure 1: The economy underperformed in 2Q23

%yoy	3Q22	4Q22	2022	1Q23	2Q23	1H23
GDP	**3.4%**	**-0.1%**	**4.9%**	**1.5%**	**-2.5%**	**-0.5%**
Final Consumption	5.0%	3.4%	5.0%	2.3%	3.9%	3.1%
PCE	7.3%	4.5%	6.0%	3.6%	4.8%	4.2%
Govt. Expenditure	-3.0%	-0.2%	1.6%	-2.9%	0.7%	-1.0%
Investment	-2.1%	-1.2%	5.2%	-5.4%	-8.7%	-7.2%
Exports	13.6%	-5.6%	11.1%	13.7%	-6.3%	3.0%
Imports	16.8%	3.7%	12.5%	13.3%	7.5%	10.3%

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GDP	**3.4%**	**-0.1%**	**4.9%**	**1.5%**	**-2.5%**	**-0.5%**
Agriculture	-6.5%	-21.5%	-2.9%	-6.2%	-27.4%	-18.4%
Manufacturing	-3.2%	-4.3%	0.1%	1.2%	-1.5%	-0.2%
Power & Water	1.2%	-5.7%	0.4%	-0.4%	-11.8%	-6.3%
Construction	8.4%	1.5%	7.0%	2.5%	-6.6%	-2.3%
Commerce	11.2%	5.6%	10.4%	5.5%	-1.8%	1.6%
Transport	7.6%	6.8%	9.7%	7.7%	2.5%	4.9%
Financial Services	1.2%	2.7%	2.7%	1.0%	0.9%	0.9%
Professional Activites	5.0%	3.8%	6.2%	3.1%	3.5%	3.3%
Public Administration	-1.9%	0.3%	-1.1%	-2.9%	3.6%	0.4%
Other Services	1.9%	1.1%	5.6%	1.8%	0.6%	1.2%

Source: TPCG Research based on BCU

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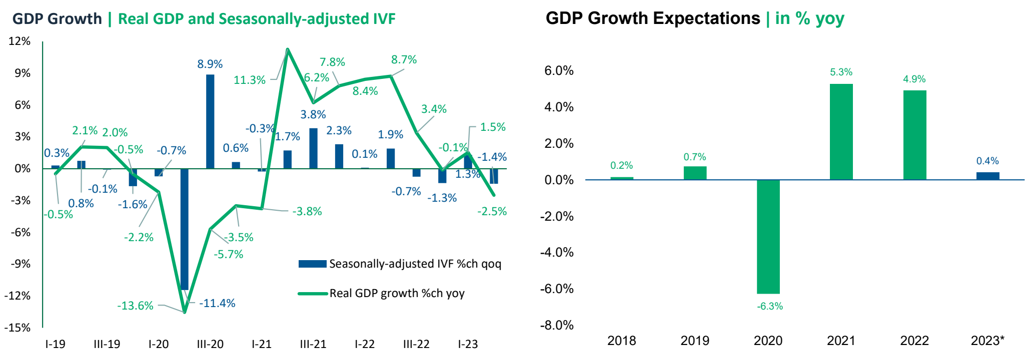
Under the expenditure approach, consumption continued to present encouraging dynamics, while the external sector hammered down on economic activity, with the GDP print presenting very mixed figures. Regarding our first point, Final Consumption performed very well, accelerating relative to 1Q23, posting a +3.9%yoy rise. This made the segment responsible for a positive +3pp contribution to the GDP print. The solid performance came mostly on the back of PCE (+4.8%yoy), while Govt. Expenditure also proved supportive, especially as the administration's fiscal bias became temporarily dovish during 2Q23, making the segment rise moderately, exhibiting a +0.7%yoy variation. In this context, the former pitched in +2.8pp to growth, while the latter's contribution was positive, albeit marginal, at +0.1pp. However, Investment figures suffered, dropping by -8.7%yoy, explained by both a drop in Inventories (-22.5%yoy) and in Fixed Capital Formation (-7.6%yoy). The former contributed -0.3pp to the fall in GDP, while the latter caused a -1.4pp contraction in activity metrics in 2Q23. Finally, the external sector became aggressively unsupportive during 2Q23. After posting a relatively good 1Q23, the trend reversed in the second quarter of the year. Exports were hammered down by the effect of the drought, suffering a -6.3%yoy contraction. This slashed quarterly growth by -1.9pp. In addition, Imports continued to exhibit positive dynamics, favored by solid consumption figures and a strong UYU in this period. Therefore, the segment rose by +7.5%yoy in 2Q23, presenting a negative contribution of -1.9pp to the general activity figure. All in all, the net contribution of the external sector was deeply negative, offsetting growth by nearly -3.8pp.

Figure 2: Growth forecasts hover around the +1% mark



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In this context, we find the GDP print slightly credit negative, as the magnitude of the contraction surprised on the upside.

In this context, we find the GDP print slightly credit negative, as the magnitude of the contraction surprised on the upside. Analyst expectations predicted a -1.6%yoy print, while the government's (-1.2%yoy) and BCU's (-0.8%yoy-0.9%yoy) estimates were even more positive. Still, expectations had zeroed in on the likely probability of a weak 2Q23 GDP print, and after a better-than-expected 1Q23 figure, 1H23 growth stands at the -0.5%yoy mark, showcasing a moderate contraction relative to 1H23. In this regard, the worst-performing sectors, Agriculture and Power generation, responded to very harsh climatic conditions, even as if consumption dynamics and the services segment continue to perform positively. This highlights the fact that the Uruguayan economy is suffering a transitory supply shock, caused by the drought, that should wane as the year advances. In this context, the latest BCU survey conveys analyst expectations for GDP growth this year stand at +1.13%yoy, while the MEF's budget review estimates suggest a +1.3%yoy GDP increase for 2023. Still, we expect these figures to be revised to the downside, as the former is only consistent with a +2.5%qoq increase in both remaining quarters of the year, while the latter is consistent with two quarterly increases of +2.7%qoq. With statistical carry presenting a scenario where the economy contracts by -0.8%yoy, we expect positive dynamics to continue during the 2H23 in the services sector, while the primary and secondary sectors recover. Still, we expect the economy to grow at a +1.5%qoq growth rate during the second half of the year, making our estimates consistent with a timid +0.4%yoy growth for the year. In addition, we find that the reduced levels of economic activity do increase the likelihood of a more aggressive BCU going forward, possibly cutting rates at a faster pace to support the economy.

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