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January 4, 2024

Uruguay Strategy Flash

Uruguay's Monthly Inflation Prints -0.11%mom

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December CPI prints -0.11%mom, coming 10bp over the -0.2%mom expectations portrayed in the BCU's survey. Monthly inflation printed -0.11 %mom, —decelerating relative to the recent prints, which saw twin +0.6%mom prints in September and October followed by a +0.34%mom gauge in November. Food prices, which had remained relatively anchored in recent months, did a U turn, spiking by +0.98%mom in December. In this context, the inflationary process continues to gain momentum in yoy terms. The monthly deflation was explained singlehandedly by the UTE rewards program. Instead, the Food & Drink index had a very volatile behavior throughout the year. After posting an average +1.9% monthly print in the first four months of the year, the next four months printed back-to-back negative variations, which were followed by neutral prints since, coming in at +0.01%mom in October and +0.07%mom in November. Now, the index once again reaccelerated, partially offsetting the deflationary print of the headline index in December. Therefore, the segments that drove the monthly drop in the headline gauge were Housing (-2.95%mom) and Transport (-0.98%mom), with the Food & Drink index (+0.98%mom) partially offseting the negative variations. On the yearly gauge, consumer prices ended 2023 increasing by +5.11%, increasing by 0.15pp relative to November's +4.96%yoy, as the baseline effect continues to reverse, as Dec-22's print clocked in at -0.26%mom, leaving September's print as the trough in the headline index evolution. In this context, the yoy variation still sits comfortably inside of the BCU's target, coming under the +6%yoy upper bound for the seventh month running after standing over the mark for two full years.

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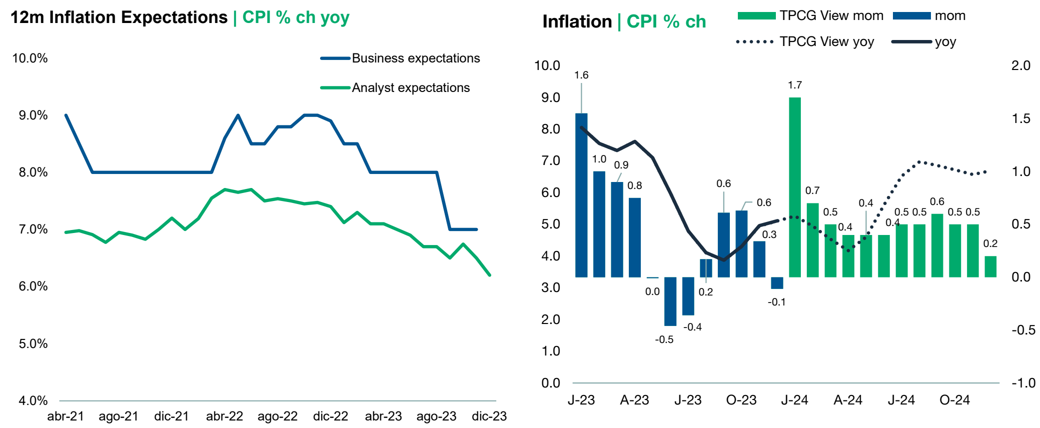
December's CPI print was largely explained by the drop in Housing prices, influenced by the seasonal UTE Rewards program, which compounded with falls in Transport prices, while the Food & Drink index partly offset the negative variation. The main contributor to the monthly drop was the Housing segment, which decreased by -2.95%mom. This reduction came mostly on the back of the UTE rewards program, which caused a -9.31%mom to drop in Electric Energy prices, as the program heavily subsidizes the December electric bill to households which made timely payments of their monthly bills during 2023. This one-off seasonal effect will disappear in January, which will mean a strong surge in inflation during said month. However, for the time being this reduction contributed 39bp to the monthly drop of the headline index, making the segment the largest determinant of the fall in the index. Transport (-0.98%mom) also provided a negative contribution to the monthly print, adding another 11bp to the decrease. The segment was influenced by the drops in Gasoil (-3.37%mom) and Gas (-2.57%mom) prices. On the other side of the spectrum, the Food & Non-Alcoholic Beverages index surged again by +0.98%mom, after a year of significant volatility due to the drought affecting the supply of fresh fruit and vegetables. Its monthly print was explained due to the increase in prices in several subsections. The always volatile Fruits segment experienced a +6.9%mom rise, while Vegetables suffered a similar variation, albeit more moderate, at +2.28%mom. Also, Meat and Dairy prices increased, fueling the sub-index, printing variations of +0.39%mom and +0.43%mom, respectively. In this context, Food & Non-Alcoholic Beverages' contribution was substantial offsetting the drop in the monthly gauge by 25bp. The rest of the sectors experienced increases mostly in the -0.2%mom — +0.7%mom range, contributing the remainder of the December print.

Figure 1: December's inflation came in slightly over expectations



Source: TPCG Research based on INE & CINVE

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For 2024, we expect inflation to continue accelerating throughout the year, possibly breaching the BCU's upper range by end-2024. The BCU's battle to reign in the inflationary process has been mostly successful. However, the CenBank had the help of favorable BoP flows, which enabled the FX anchor to reinforce the monetary program and benefitted from heavily depressed 2H23 prints and a strong baseline effect, which favored the collapse of the headline index. Having endured high monthly prints during 1Q23, this means that for 2024, we expect the baseline effect to play heavily in favor of the BCU, which should be consistent with headline inflation remaining inside the target range of the BCU throughout the 1H24. So, while the current context presents a favorable scenario for early 2024 in terms of the yoy prints, we believe the BCU is becoming increasingly isolated in its fight against inflation. The general policy bias of economic policy is pivoting to dovish, especially in the income and fiscal departments. Fiscal figures convey that the Administration has lost part of the fiscal discipline it exhibited during the 2021-22 period. This compounds with the guidelines it provided for the salary negotiations in 2H23, which suggest real wage increases for workers, in addition to the customary inflation adjustments, to compensate for the weakening of real wages during the pandemic, responding to its campaign promises. Both biases should put upward pressure on non-tradeable prices. Given the electoral calendar, we do not expect the government to change its income or fiscal policy bias during 2024 significantly. In addition, tradeable prices exhibited a strong deacceleration, with the USDUYU holding fast during 2023. If the FX weakens nominally in 2H24, tradeable prices should also accelerate, adding extra pressure to the headline index. All this compounds with a BCU, which currently holds a neutral monetary bias, which is unlikely to tighten in a context where the CPI sits comfortably within the target range, and the rest of economic policy remains dovish. All in all, we expect a relatively quiet 1H24, with the acceleration in monthly inflation being offset by the baseline effect. For 2H24, with an increasingly strained non-tradeable index and a waning baseline effect, we expect inflation to slip out of the CenBank's target range, ending Dec-24 near the +6.6%yoy mark.

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