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Uruguay Strategy Flash

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In February's COPOM meeting, board members decided to maintain the policy rate at +9%. The BCU's decision came in line with expectations and was also consistent with the forward guidance provided in December's meeting, which suggested further cuts would likely depend on the evolution of inflation expectations, which failed to budge further in recent months. The decision was also justified by the favorable CPI prints of the last months, which, even if still within the BCU's target range, accumulated some momentum relative to September's trough. With this, the BCU maintained its neutral bias, leaving behind its cutting cycle, which started in April. With the strong slowdown in inflation experienced since May, the general direction of the monetary policy now oscillates between a neutral and slightly supportive bias. In this context, we find that the BCU's COPOM prefers to err on the side of caution, so as to not undo its previous efforts to tame inflationary pressures. The BCU press release did give some forward guidance regarding further rate cuts. It indicates the COPOM will maintain its current stance, as expectations continue to align to the center of the target range, and the credibility of inflation remaining inside the BCU's target range grows. In that sense, the press release suggests that policy rates are close to target levels. The press release highlighted the convergence of both headline and core inflation to the BCU's target, which stands at 6%-3% since Sept-22. The abrupt descent in the yoy index responded to both a normalization of Food prices after the drought, and a significant tailwind provided by the baseline effect.

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In its announcement, the COPOM continues to signal the path of the key rate will be conditioned by the evolution of the economic agent's inflation expectations. In turn, the Monetary Policy Committee assessed the local and international contexts and their effect on policy bias. On the external side, the COPOM is wary of the complex global scenario. Global inflation halted the reduction it had shown in recent months, particularly in its core component. In this context, the Federal Reserve decided to maintain its reference rate and the probability of a cut in policy rates dropped. In the region, activity in Brazil showed less deceleration than anticipated, while in Argentina, a high level of uncertainty remains while the new government makes macroeconomic corrections. Looking at Uruguay, activity showed an increase in the last quarter due to the rebound in agriculture after overcoming the effects of the drought. The CenBank's short-term projections suggest that the economy will continue growing in the next two quarters.

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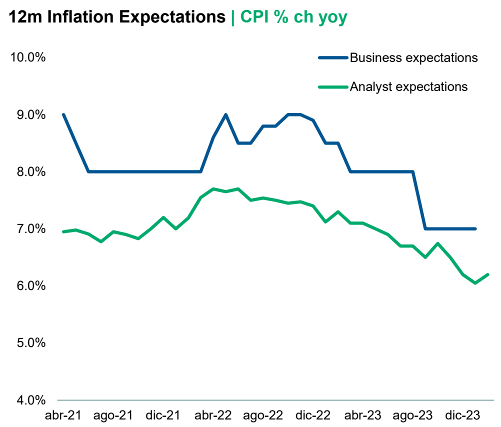
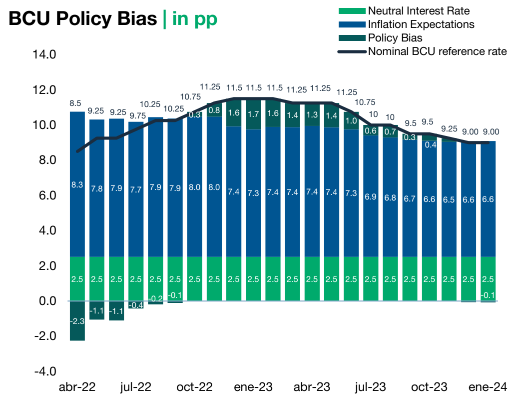
Expectations continue to evolve to the BCU's satisfaction, albeit remaining stubbornly over the CenBank's target. Real economy agents now expect a 12m-running inflation of +7% in January's poll (+0.0pp relative to December), while February's market forecasts rose to +6.20%, showcasing a 15bp rise relative to January's estimates. Still, in a context where the BCU's target range has tightened from 7%-3% to 6%-3% in Sept-22, both estimations end with inflation slightly outside the eop upper bound. Consistently, real economy agents see inflation closing the year at +7% (0.0pp vs. December) while market analysts forecast a +6.3% inflation by end-2023 (+0.25pp vs. January). The official forecasts for 2023 see inflation closing the year at +5.8%. Market analyst estimates project a slightly higher inflation for the year, as they expect the yoy index to exit the BCU's target range by the end of 2024, as do real economy agents which still expect a stubbornly high inflation for the year. In a context where economic agents are starting to become more skeptical of the BCU's ability to maintain the CPI index within the target range in 2024, we expect the BCU to continue to err on the side of caution, maintaining a neutral to hawkish monetary bias, especially as economic activity continues to pick up momentum, requiring less support and as inflation slowly creeps up.

Figure 1: The BCU held the policy rate at +9%





Source: TPCG Research based on INE & BCU

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