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Uruguay Strategy Flash

Uruguay's Monthly Inflation Prints +0.64%mom

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February CPI prints +0.64%mom, coming in line with the +0.7%mom expectations portrayed in the BCU's survey. Monthly inflation printed +0.64 %mom, —decelerating relative to January's print, which saw a +1.53%mom gauge preceded by a -0.11%mom December print and a +0.34%mom print in November. Food prices continue showing momentum, and after increasing by +0.98%mom in December and +1.75%mom in January, the subsection was the key driver behind the monthly rise, clocking at +0.65%mom. In this context, the inflationary process started to decelerate in yoy terms, entering a period with a very favorable baseline effect, which we expect will continue up until Apr-24. The food and Drink index had a very volatile behavior throughout the last 12 months. After relatively neutral prints in late 2023, coming in at +0.01%mom in October and +0.07%mom in November the index once again reaccelerated, partially offsetting the deflationary print of the headline index in December, and contributing significantly to January's and February's increases. However, there were other components affecting the headline index in February. These were, Home Equipment (+2.02%mom), Transport (+1.02%mom), and Education (+1.79%mom) while the negative variation in Clothing (-1.85%mom) partially offset the price increases. On the yearly gauge, consumer prices in February increased by +4.71%yoy dropping by nearly 40bp relative to January's +5.09%yoy. This mostly responded to a favorable baseline effect as, during 1Q23, the supply shock caused by the drought spiked the headline index, meaning current monthly figures should come well below the bloated 1Q23 gauges. In this context, the yoy variation still sits comfortably inside of the BCU's target, coming under the +6%yoy upper bound for the ninth month running after standing over the mark for two full years. In this context, YTD inflation stands at +2.18%.

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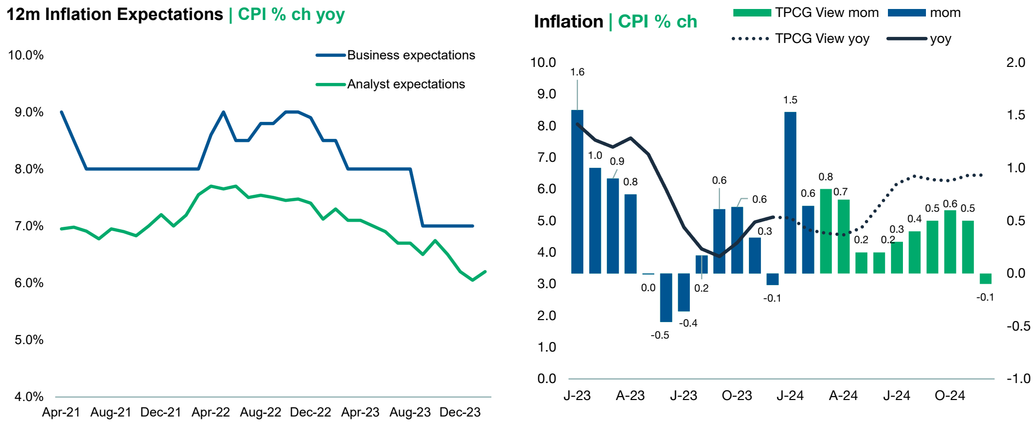
February's CPI print was largely explained by rising Food and Drink Prices, which compounded with increases in the Home Equipment, Transport, and Education subsections. These were partly compensated by decreases in the Clothing segment. The main contributor to the monthly increase was the Food & Non-Alcoholic Beverages index, which surged again, increasing by +0.65%mom, albeit decelerating relative to January's +1.75%mom print. Its monthly print was explained due to the increase in prices in several subsections. The always volatile Fruits segment experienced a +8.26%mom rise, while Vegetables went in the other direction, dropping by -1.49%mom. Meat prices also exhibited a slight variation, rising by +0.18%mom. In this context, Food & Non-Alcoholic Beverages' contribution was substantial, adding 17bp to the monthly gauge, nearly a third of the print. In addition, Home Equipment rose by +2.02%mom, fueled by the +4.40%mom salary increase in Domestic Service personnel, causing an 11bp increase in the monthly CPI print. Furthermore, the Transport segment experienced a +1.02%mom hike, on behalf of increases in Plane ticket prices (+20.66%mom), which were tempered by a reduction in Gasoil prices (-2.71%mom), putting the net contribution of the segment to the CPI print at 11bp. Finally, Education prices spiked by +1.79%mom, responding to seasonal increases in private education prices, at all levels. This contributed 6bp to the increase in headline prices. On the other hand, sales affected the Clothing segment, causing a -1.85%mom reduction in prices, which offset the monthly increase by 5bp. The rest of the sectors experienced increases mostly in the +0.0%mom — +0.8%mom range, contributing the remainder of the February print.

Figure 1: February's inflation came in line with expectations



Source: TPCG Research based on INE & CINVE

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In the short run, we expect the headline index to temper on behalf of a favorable baseline effect, before creeping up during 2H24, 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. All this compounds with a BCU, which even if ever vigilant, and likely to err on the side of prudence, currently holds a neutral monetary policy stance, and is likely to be more passive throughout 2024. 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 +6.3%yoy mark.

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