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Uruguay Strategy Flash

Uruguay's Monthly Inflation Prints +0.02%mom

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March CPI prints +0.02%mom, coming significantly below the +0.5%mom expectations portrayed in the BCU's survey, surprising on the downside. Monthly inflation printed +0.02%mom, —decelerating massively relative to both January and February's prints, which came in at +0.64%mom and +1.53%mom respectively. The main driver behind the depressed print comes on the back of a strong decrease in Food prices (-0.56%mom) which reverted the momentum exhibited in the last couple of months, as the segment clocked in at +0.65%mom in February, +1.75%mom in January and +0.98%mom in December with the subsection being the key driver behind the recent prints. In this context, the inflationary process continued its deacceleration in yoy terms, entering a period with a very favorable baseline effect, which we expect will continue up until Apr-24, and compounded with a very low print. The food and Drink index had a very volatile behavior throughout recent 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 in the next three months, posting prints of +0.98%mom in December, +1.75%mom in January and +0.65%mom in February, before once again slumping into negative territory in March. This decrease was partially offset by the remainder of the segments, which posted moderate variations that drove back the index to a neutral print. Notably, both Housing (+0.47%mom) and Education (+1.99%mom) were the segments responsible for bringing the general index back to neutral. On the yearly gauge, consumer prices in March increased by +3.8%yoy, dropping by nearly 90bp relative to February's +4.71%yoy. This responded both to the very depressed print and 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 tenth month running after standing over the mark for two full years. In this context, YTD inflation stands at +2.20%.

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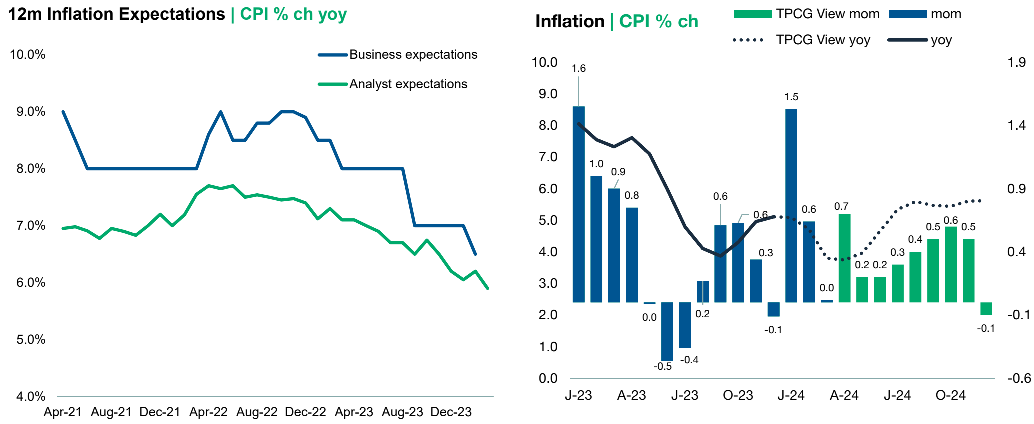
March's CPI print was largely explained by the fall in Food and Drink Prices, which were offset by the rises in the Housing and Education subsections. The main contributor to the monthly print was the Food & Non-Alcoholic Beverages index, which reversed its recent trend, falling by -0.56%mom. Its monthly gauge was explained due to the decrease in prices in several subsections. The always volatile Fruits segment experienced a -3.18%mom fall, while Vegetables went in the other direction, albeit marginally, rising by +0.65%mom. Meat prices also exhibited a major decrease, falling by +1.70%mom. In this context, Food & Non-Alcoholic Beverages' contribution was substantial, subtracting 15bp from the monthly gauge. On the other side, Education prices spiked by +1.99%mom, responding to seasonal increases in private education prices, at all levels. This contributed 7bp to the rise in headline prices. Also, Housing increased by +0.47%mom, fueled by the +5.21%mom increase in siphoned gas prices, causing a 6bp increase in the monthly CPI print. The rest of the sectors experienced increases mostly in the -0.4%mom — +0.6%mom range, contributing the remainder of the March print.

Figure 1: March's inflation came significantly below expectations



Source: TPCG Research based on INE & CINVE

We believe the effect of the USDUYU appreciation in the print was noticeable, but March's gauge also suggests a weak inflationary process for non-tradeable goods. Therefore, the print significantly increased the likelihood of both inflation ending 2024 inside the target range and of the BCU lowering the policy rate in the coming meetings. Monthly inflation clocked in way below expectations in March, with CPI showcasing practically no variation. The Core indicator also followed suit, dropping by -0.04%mom. In this context, the weak performance of tradeable goods was based on the FX appreciation, as the USDUYU experienced a very strong month, strengthening by 2.1% in March. However, non-tradeable prices, which tend to be stickier, also had a weak showing, as they were unable to significantly compensate for the drop in the tradeable segment. While we initially expected reinflationary pressures to start to mount after the first half of 2024, which would still enjoy a favorable baseline effect, the latest print suggests that inflation is bound to remain more depressed than initially envisaged. In that context, we expect the BCU to have additional room to lower the policy rate going forward. As we expected, the CenBank maintained a prudent stance throughout the start of 2024, preferring to err on the side of caution. However, with inflation dropping, and expectations converging to the target range, the BCU has now some space to cut the policy rate in coming meetings. Even with March being a complex month for inflation, as it generally counts with a large seasonal effect, the performance of both tradeables and non-tradeables suggests that the real policy rate is somewhat hawkish, depressing prints via both the usual transmission mechanisms of the monetary policy and the FX. While it continues to be true that both the income and fiscal bias of the administration stand between neutral and dovish, the FX appreciation looks to be priming over said effects. And while the FX was a key anchor throughout the disinflationary process in recent years, the performance of non-tradeables suggests there is significant wiggle room for the BCU to shift to a softer stance. In addition, the very depressed print is also consistent with inflation remaining inside the BCU's target range throughout 2024. All in all, we find this news is credit positive for the nominal space, as a robust FX, high rates, and the prospect of near-term BCU policy rate cuts make them look increasingly attractive.

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