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Uruguay Strategy View

The fiscal balance clocks in at -4.2% of GDP in November

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Uruguay's fiscal position improved in November, with a slight drop in income sources being outweighed by a significant reduction in expenditures. During the first months of the year, the administration looked to bolster disposable income and combat the economic slowdown caused by the drought. The climatic phenomenon hit consolidation efforts hard, straining income sources, and causing the fiscal deficit to bloat significantly. However, as we expected, with the one-off expenditures made by the govt. in Nov-22 and Dic-22 coming out of the 12m rolling figure, fiscal figures are now improving. In November, non-financial public sector income printed 27.1pp of GDP (-0.1pp relative to October). On the spending side, expenditures came at 28.5pp of GDP (-0.3pp relative to October), with a minor reshuffle inside the segment. In this context, the primary fiscal deficit excl. cincuentones came at -1.6pp of GDP, tightening by 0.2pp relative to October, albeit still accumulating a 0.9pp deterioration YTD. The consolidated public sector deficit excl. cincuentones followed suit, improving relative to October. In this context, the headline deficit stood over the 3pp of GDP mark for thirteen months in a row. November's print came in at -4.2% of GDP— down from from -4.5% of GDP in October, -4.4% of GDP in September but up from -4.1% in August—.

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In November, non-financial public sector income printed 27.1pp of GDP (-0.1pp relative to October). Central Govt & SocSec income clocked in at 27.1pp of GDP in November (-0.1pp relative to October). Even if the variation was minor, there were compensating changes in both directions inside the segments. The Tax revenue segment experienced a negative change this month, worsening timidly (-0.1pp) relative to October. However, the fall was offset by a +0.1pp rise in other income sources. Soc. Sec. contributions remained stable relative to October, which was mostly the case for the rest of the sectors. On the other hand, the SOEs' primary balance, one of the main drivers of 2022's fiscal overperformance, came in at +0.8pp, worsening by -0.1pp relative to October's figures. Finally, the primary balance of Munis & BSE continues to stand at the +0.1% of GDP mark. All in all, non-financial public sector income in November worsened by -0.1pp relative to October.

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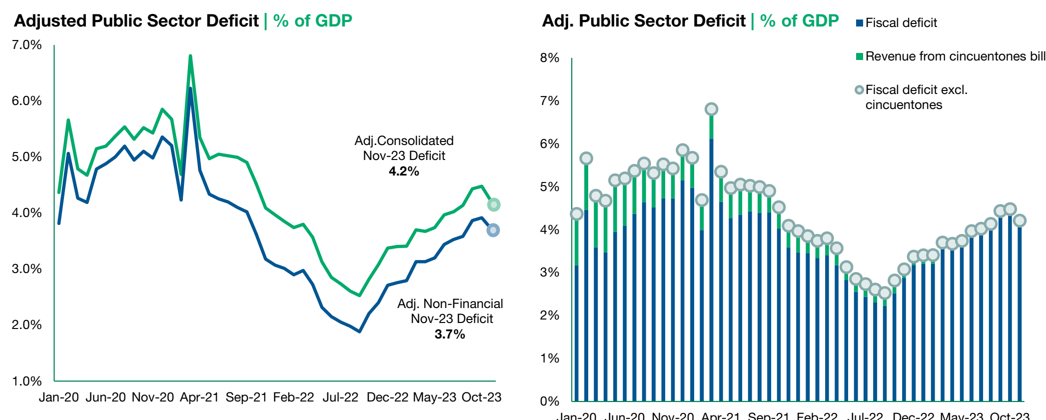
On the spending side, expenditures came at 28.5pp of GDP (-0.3pp relative to October), with a minor reshuffle inside the segment. In November, the COVID Fund balance finally came down to 0.0pp of GDP— tightening by -0.1pp relative to October and reducing its size by 0.5pp YTD. In this context, Central Govt & Soc. Sec. expenditures totaled 26.3pp (-0.1pp relative to October), mainly as Non-personnel expenditure dropped by -0.1pp, as the rest of the segments stood flat relative to October, completing the picture. The main savings, as we expected came on the capex front. Public investment dropped by -0.2pp relative to October, with the segment standing at 2.2pp of GDP mark, adding to the drop in Central Govt. Outlays. With non-financial public sector income dropping by -0.1pp, non-financial public sector outlays falling by -0.3pp, and cincuentones revenues standing at 0.1pp of GDP, the primary deficit excl. cincuentones stood at -1.6pp in November— tightening by 0.2pp relative to October and September, while showcasing increases relative to August's (-1.5pp) figure—.

Figure 1: November's fiscal figures



12m rolling - as % of GDP	Dec-21	Dec-22	Oct-23	Nov-23	Dec-23*	Dec-24*
NFPS Income	**26.7%**	**27.1%**	**27.2%**	**27.1%**	**25.8%**	**26.0%**
Central Government	**18.9%**	**19.3%**	**19.2%**	**19.2%**	**18.9%**	**19.0%**
Tax Revenues	*15.9%*	*16.5%*	*16.5%*	*16.4%*	*16.1%*	*16.2%*
International Trade	*1.1%*	*1.1%*	*1.0%*	*1.0%*	*1.1%*	*1.1%*
Others	*1.8%*	*1.7%*	*1.7%*	*1.7%*	*1.7%*	*1.8%*
Soc.Sec contributions	6.4%	6.8%	7.1%	7.1%	6.9%	7.0%
SOE primary balance	1.4%	1.0%	0.9%	0.8%	0.1%	0.3%
BSE &Munis primary balance	0.2%	0.1%	-0.1%	-0.1%	0.1%	0.1%
BCU primary balance	0.0%	-0.1%	0.0%	0.0%	-0.1%	-0.1%
NFPS Outlays	**27.5%**	**27.8%**	**28.8%**	**28.5%**	**26.6%**	**26.3%**
Central Govt. Primary Outlays	25.8%	25.4%	26.3%	26.3%	25.3%	25.2%
Personnel spending	*4.6%*	*4.6%*	*4.8%*	*4.8%*	*4.6%*	*4.6%*
Non-Personnel spending	*4.3%*	*3.9%*	*3.8%*	*3.7%*	*3.5%*	*3.5%*
Pensions	*9.0%*	*8.9%*	*9.3%*	*9.4%*	*9.1%*	*9.1%*
Transfers	*7.9%*	*8.0%*	*8.3%*	*8.3%*	*8.1%*	*8.0%*
Public investment	1.8%	2.4%	2.4%	2.2%	*1.2%*	*1.1%*
Public Sector Primary Balance	-0.7%	-0.6%	-1.7%	-1.5%	-0.8%	-0.3%
Interest payments	2.8%	2.6%	2.7%	2.6%	2.4%	2.3%
Consolidated Public Sector Deficit	-3.5%	-3.2%	-4.4%	-4.1%	-3.2%	-2.5%
Cincuentones revenues	-0.5%	-0.2%	-0.1%	-0.1%	0.0%	0.0%
Adjusted Consolidated Public Sector Deficit	**-4.0%**	**-3.4%**	**-4.5%**	**-4.2%**	**-3.3%**	**-2.6%**

Source: TPCG Research based on MEF

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With only one month remaining, the substantial deviation from fiscal targets suggests the administration will have trouble complying with the first pillar of the fiscal rule for the first time in its tenure. The administration has made a significant effort to cleanse public finances since the start of its tenure, and the major effect of the drought on the economy has generated a slowdown in revenue streams and forced the administration to deploy some fiscal stimuli. However, the administration is carrying a significant deviation from this year's fiscal targets, which already proposed no additional fiscal consolidation, leaving the fiscal position flat relative to 2022. In this context, the government envisages the fiscal deficit to total -3.3pp of GDP, now carrying nearly a 0.9pp deviation from year-end targets. In this context, after complying with all three pillars of the fiscal rule since its creation, it seems these are increasingly becoming under threat. While the government should be able to meet both the requirements regarding the cap to the increase in primary expenditure and the net indebtedness cap, the first pillar, the binding structural balance, does seem more difficult to accommodate. The budget law establishes a -2.7% structural deficit for 2023. With the headline figures exhibiting a -4.2% deficit, it is difficult to envisage a convergence to the target by year-end. Still, November's figure confirms our view that, for December, the reduction in one-off outlays made by the administration by this time last year should allow headline figures to creep closer to the target. Even if the administration has some leeway this year due to the drought, if it misses the 2023 targets, the chances of fulfilling the planned consolidation for 2024 (which would drive the deficit back to -2.6% of GDP in 2024),

would deteriorate considerably. This could be concerning given the chances of the administration executing a considerable fiscal consolidation in an electoral year are already low, especially as the govt. coalition does not part as the top dog in the race, trailing the FA in voting intention. We believe that, under severe political strain, for 2024 we expect the need to win back voters should prime over any consolidation effort the administration is prepared to execute, a problem which could compound with the possibility of a bloated 2023 deficit. In this scenario, we continue to believe the slow but steady deterioration of the fiscal position is credit negative, even if we don't expect it to affect valuations in the short run, with the widening fiscal deficit threatening compliance with the fiscal rule this year. (For more information, please see our YA for Uruguay here).

CA flows weakened in 3Q23, with spiking FDI supporting the BoP

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In other news, 3Q23 BoP flows worsened, as Uruguay's current account deficit clocked in at USD1bn vs. USD0.8bn in 2Q23, with the widening responding mainly to a weak performance in the exports department. Dissecting the widening, the main driver behind the worsening came on the back of significantly weaker exports, as the latter underperformed 3Q22 figures by -USD1272mn, singlehandedly explaining the current account's quarterly yoy variation. The underperformance of exports during 3Q23 was mostly expected, as the drought experienced during the last months of 2022 and early 2023 hampered both the soybean and maize campaigns. Most of the agriflows coming from these usually come during the second and third quarter of the year, generating the expectations of a very weak 2Q23 in Exports, followed by an also weak 3Q23 due to the severity of the drought. However, during 3Q23, international prices were not as favorable for Uruguayan exports, hampering their development. On positive news, Imports lost some steam during 3Q23, weakening by -USD275mn relative to 3Q22. This put the change in the Goods balance at -USD998mn. The Services Balance also clocked in the red, but its deficit was much tighter. Service Imports rose by +USD45mn, while Exports dropped by -USD52mn rise relative to 3Q22, therefore putting the net variation of the Services balance at -USD97mn. All in all, the trade balance posted a +USD116mn surplus, weakening massively relative to 3Q22, as that year was a record for Uruguayan exports. Primary income allowed for +USD228mn in the CA deficit's compression, while Secondary income was mostly irrelevant for this quarter's BoP print. All in all, the Current Account balance experienced a -USD860mn worsening, with the main driver being the weak export flows caused by the impact of the dry climatic condition on agricultural products and unflattering prices. In 12m-rolling terms, the current account deficit came in at -4.7% of GDP (-USD3.66bn), significantly over the end of 2022 mark (-3.9% of GDP; -USD2.8bn).

Figure 2: 3Q23 BoP figures

USDmn	2021	2022	3Q22	3Q23	Δ	9M22	9M23	Δ
Current account	-1,519	-2,794	-183	-1,043	-860	-1,669	-2,533	-863
Goods & Services	4,460	3,520	1,211	116	-1,095	3,120	1,706	-1,414
Goods	4,637	3,499	1,372	375	-998	3,324	1,682	-1,642
Exports	15,848	17,040	4,929	3,657	-1,272	13,393	11,407	-1,986
Imports	11,211	13,541	3,557	3,282	-275	10,069	9,725	-344
Services	-177	22	-161	-258	-97	-204	24	229
Exports	3,746	5,473	1,304	1,252	-52	3,841	4,442	601
Imports	3,923	5,451	1,465	1,510	45	4,046	4,417	372
Primary Income	-6,057	-6,456	-1,429	-1,201	228	-4,897	-4,366	532
Secondary Income	78	142	34	41	7	108	127	19
Capital account	-30	3	2	0	-2	6	1	-5
Financial Account	-184	-2,193	-181	-958	-777	-325	-1,408	-1,083
Direct Investment	-1,507	-2,956	-714	-1,670	-956	-1,870	-4,145	-2,275
Portfolio Investment	1,084	1,882	321	-112	-433	2,210	1,524	-685
Derivatives	443	374	50	-5	-55	317	219	-99
Other Investment	-1,048	86	480	600	120	244	866	622
Errors & Ommisions	1,364	598	0	85	85	1,339	1,124	-215
Reserve Assets	843	-1,578	-319	229	548	-1,226	128	1,354
12m-rolling GDP (USDmn)	**61,422**	**71,199**	**68,746**	**77,396**	**8,650**	**68,746**	**77,396**	**8,650**
Balance as % of GDP (12m)	-2.5%	-3.9%	-3.1%	-4.7%	-	-3.1%	-4.7%	-

Source: TPCG Research based on BCU

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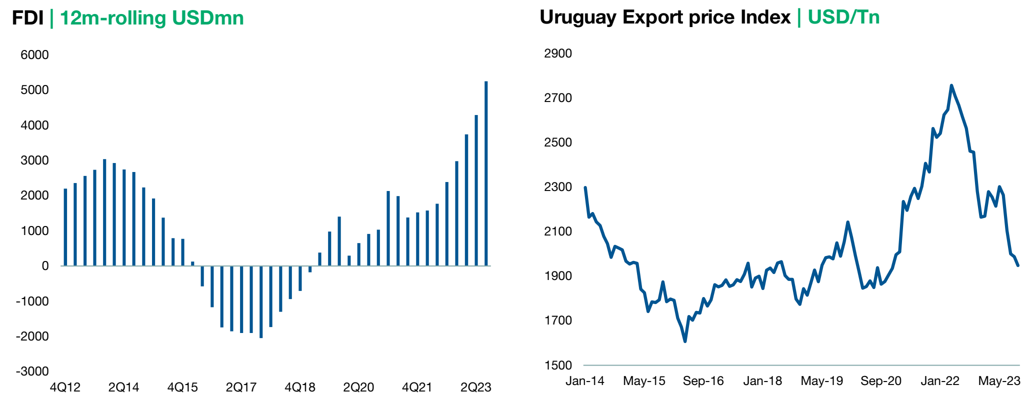
With a widening CA deficit, the relatively flat performance of the FX was explained by the financial account, as FDI flows massively supported the economy, peaking in 3Q23. The performance of the current account during the first nine months of the year was foreseeable, as exports were hit very hard by climatic factors and prices, plummeting by nearly USD2bn YTD. While import dynamics, the services balance, and primary income partially offset this drop, the current account balance still worsened by - USD863mn in the first nine months of the year. During this period, the FX was able to remain relatively flat, even appreciating in nominal terms during 1H23. Its performance was in turn supported by massive FDI inflows, which continued to increase well into 3Q23. Specifically, direct investment rose by USD2.3bn relative to 9M22. This caused the financial account to overperform by USD1bn, compensating for the weakening CA. In our view, 4Q23 should see a reversal of this dynamic, as last year's CA deficit was very wide due to the drought, while this year's good climatic conditions should support a tighter deficit, which should in turn compress the 2023 final figures. In turn, FDI flows should also weaken entering 4Q23, with little juice left in the UPM II project, which was finalized in late 2Q23. We expect such a dynamic to seep into 2024, with recovering exports allowing to tighten a CA deficit which will compensate for the drop in FDI left by UPM II. (For more information, please see our YA for Uruguay here).

Figure 3: FDI supported a weakening CA on behalf of the drought and weaker international prices.



Source: TPCG Research based on BCU

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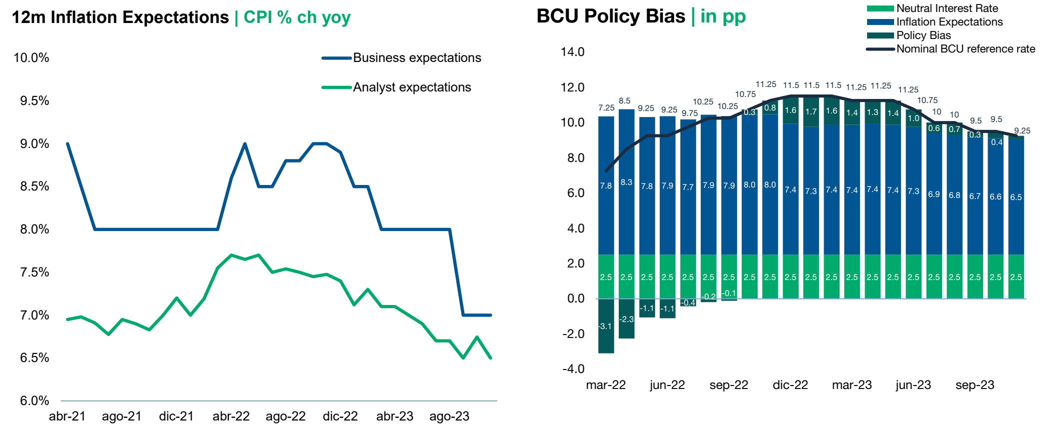
Finally, the BCU, in the last COPOM meeting of 2023, decided to lower the policy rate by 25bp to +9%. The BCU's decision came in line with expectations and was also consistent with the forward guidance provided in November's meeting, which suggested the cutting cycle was coming to an end. Still, the 25bp slash was justified by the favorable CPI prints of the last months, and the compression of inflation expectations, which are slowly converging to the BCU's target range. With this, the BCU deepened its cutting cycle, which started in April. The move is consistent with the BCU's policy bias, which was expected to hold a contractive stance, as the drop in inflationary pressures and expectations was forecasted to edge the drop in the nominal policy rate. Under our calculations, the policy bias of the BCU is very close to the neutral interest rate, which conveys its contractive stance is coming to an end, with any more rate cuts starting to move the policy bias into more dovish territory. 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, and the credibility of inflation remaining inside the BCU's target range grows. 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, which is now starting to wane. (For more information, please see our YA for Uruguay here).

Figure 4: The BCU policy bias is turning neutral



Source: TPCG Research based on BCU, INE & BEVSA

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Expectations continue to evolve to the BCU's satisfaction, with most estimates slowly converging toward the CenBank's target. Real economy agents now expect a 12m-running inflation of +7% in November's poll (+0.0pp relative to October), while December's market forecasts dropped to +6.20%, showcasing a 30bp reduction relative to November'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 +6.5% (-0.5pp vs. October) while market analysts forecast a +5.2% inflation by end-2023 (+0.0pp vs. November). The official forecasts for 2023 see inflation closing the year at 6.7%. Market analyst estimates already project a lower inflation for the year, given the surprising deacceleration experienced in the last months by the CPI index. However, real economy agents still expect a stubbornly high inflation for the year. We believe the expectations of economic agents should continue to converge to the BCU's target range, albeit at a slower pace now that inflation is poised to reaccelerate.

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