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Uruguay Strategy Flash

Uruguay's Monthly Inflation Prints -0.46%mom

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June CPI prints -0.46%mom, coming in 74bp under the +0.28%mom expectations portrayed in the BCU's survey. Monthly inflation printed -0.46%mom, — continuing the deaccelerating trend exhibited in May's -0.01%mom print, April's+0.75%mom, March's +0.9%mom, and February's +1%mom. The collapse of the monthly index comes mostly as a consequence of the end of the drought, which continues to pressure food prices to the downside, allowing them to normalize. In this context, the inflationary process presented an abrupt stop in June, which is consistent with the normalization of agricultural prices. After posting an average +1.9% monthly print in the first four months of the year, the Food & Non-Alcoholic Beverages segment presented a negative monthly variation for the second month in a row, coming in at -1.31%mom, after May's -0.54%mom. The subsection had printed +1.93%mom in April, +2.24%mom in March, +1.84%mom in February, and +1.85%mom in January, accumulating a +8.1% rise in the first four months of the year. The segment nearly singlehandedly spearheaded the decreases, with Transport (-1.60%mom) also deepening the negative trend, while very timid increases in Housing (+0.37%mom), and Restaurants&Hotels (+0.49%mom) partially offset the drop in food and fuel prices. The rest of the segments had little to no influence on the monthly print. On the yearly gauge, consumer prices rose by +5.98%yoy, decreasing relative to May's +7.10%yoy print, and clocking in at the lowest mark in 2023. The yearly index in June was aided by the tailwind provided by the baseline effect, as June-22's print came in at nearly 0.6%mom, nudging the headline trend down. In this context, the yoy variation now finally managed to just scrape inside of the BCU's target, coming under the +6%yoy upper bound after standing over the mark for two full years. With June's inflation clocking in at -0.46%mom, YTD inflation currently stands at +3.78%, dropping relative to May.

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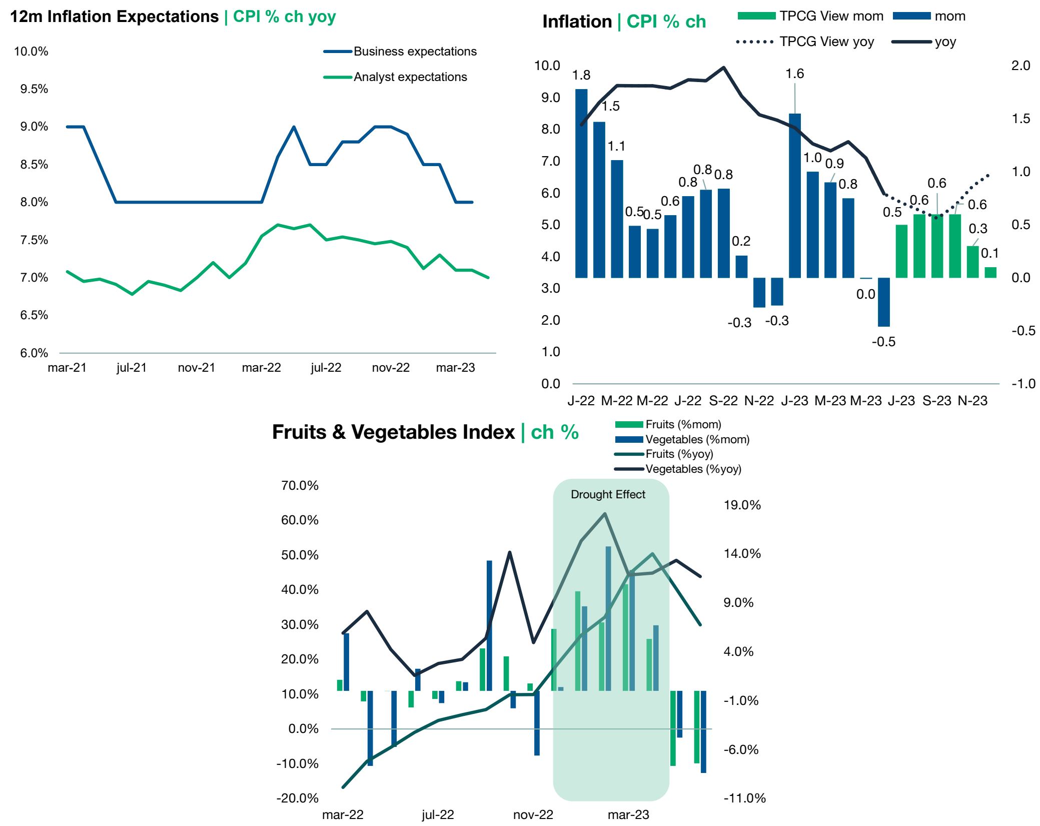
June's CPI print came mostly on the back of the Food & Non-Alcoholic Beverages segment, as the end of the drought marked a normalization of food prices, while a drop in fuel prices deepened the deflationary trend. The Food & Non-Alcoholic Beverages continued its current trend, deepening the reversion of the 1Q23 prints, posting a -1.31%mom drop following another negative print in May (-0.54%mom). In June, subsection performance was also marked by volatility, with several sub-indexes experiencing large decreases, deepening most trends relative to May. The always volatile Fruits segment experienced a -7.40%mom drop, as did Vegetables, which fell by -8.38%mom, as the effect of the drought continues to subside. Meat prices also experienced a decrease after rising in June, with the subsection printing a -0.24%mom drop. Dairy products saw their prices increase, by +0.25%mom. In this context, Food & Non-Alcoholic Beverages' contribution singlehandedly contributed 35bp to the monthly print. The only other three subsections that affected prices significantly were Transport (-1.60%mom), Housing (+0.37%mom), and Restaurants&Hotels (+0.49%mom). The first dropped mainly due to decreases in Gasoil (-7.02%mom), Gas (-2.77%mom), and Airplane Ticket prices (-7.61%mom), contributing 18bp to the monthly fall of the general index. The second was affected by increases in Rent (+0.52%mom) and Waste management services (4.01%mom), offsetting the monthly fall by 5bp. Finally, Restaurants and Hotels rose driven by Restaurant Services (+0.63%mom), contributing an extra 4bp to the monthly gauge. Finally, the rest of the sectors experienced increases mostly in the -0.3%mom — +0.3%mom range, contributing the remainder of the June print.

Figure 1: June's inflation came way under expectations



Source: TPCG Research based on INE & CINVE

We find the print to be credit positive, and heavily supportive of our position in nominals in the local currency side.

We find the print to be credit positive, and heavily supportive of our position in nominals in the local currency side. As we expected, the end of the drought marked an abrupt correction in Food prices, which tilted the general index strongly to the downside, after being the major cause of the strong increases in monthly inflation at the start of the year. In this context, the drought added volatility to an inflationary process that was not reflecting a strong acceleration in the core index, which averaged a +0.36% mom print from February to June. However, it is also important to note that the current deflationary process is also transitory, and we expect this trend to continue in the short run, as prints converge to core inflation, near the 0.4%-0.5% level. In addition, a high baseline will probably push the headline yoy index to the downside up until 4Q23. However, the weak prints of the last quarter of 2022 should probably force the yoy gauge upwards, ending the year slightly over the BCU's target range. Looking at tomorrow's COPOM, we expect the monetary policy committee to aggressively lower the policy rate. This should respond to both the slowdown of inflation and the BCU's intent of reducing the pressures on the FX, without direct interventions in the spot market. In this context, our baseline scenario sees the CenBank lowering the policy rate by 75bp tomorrow. However, risks are tilted to the upside, as we assign more probability to a more aggressive cut from the BCU than to a more hawkish correction in the policy rate.

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