

# Uruguay

# Economic Outlook

Second half 2019

November 2019

## Key messages



The global setting, marked by a slowdown in growth and a high degree of uncertainty, will further complicate recovery of economic activity in Uruguay, which is slowing while waiting for UPM2 investment.



Uruguay returns to the polls on November 24 to decide who the next president will be. Regardless of who wins, reforms will be necessary to achieve fiscal consolidation and maintain the IG.



The CB is maintaining its policy to intervene each time volatility increases.



Inflation is expected to increase and will once again breach targets in 2020.

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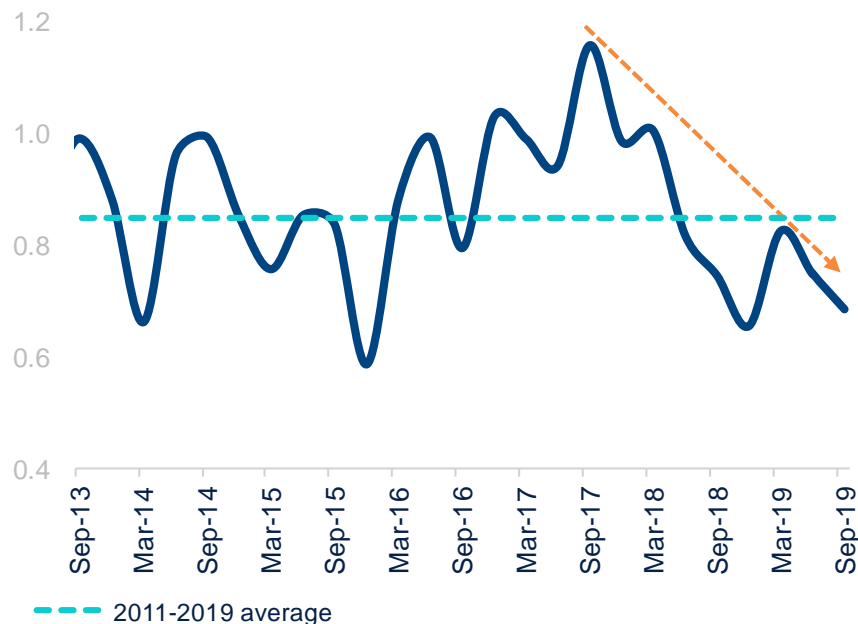
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# Global setting: slowdown and uncertainty

# Global growth continues to weaken

## WORLD GDP GROWTH

(FORECASTS BASED ON BBVA-GAIN MODEL; % QoQ)



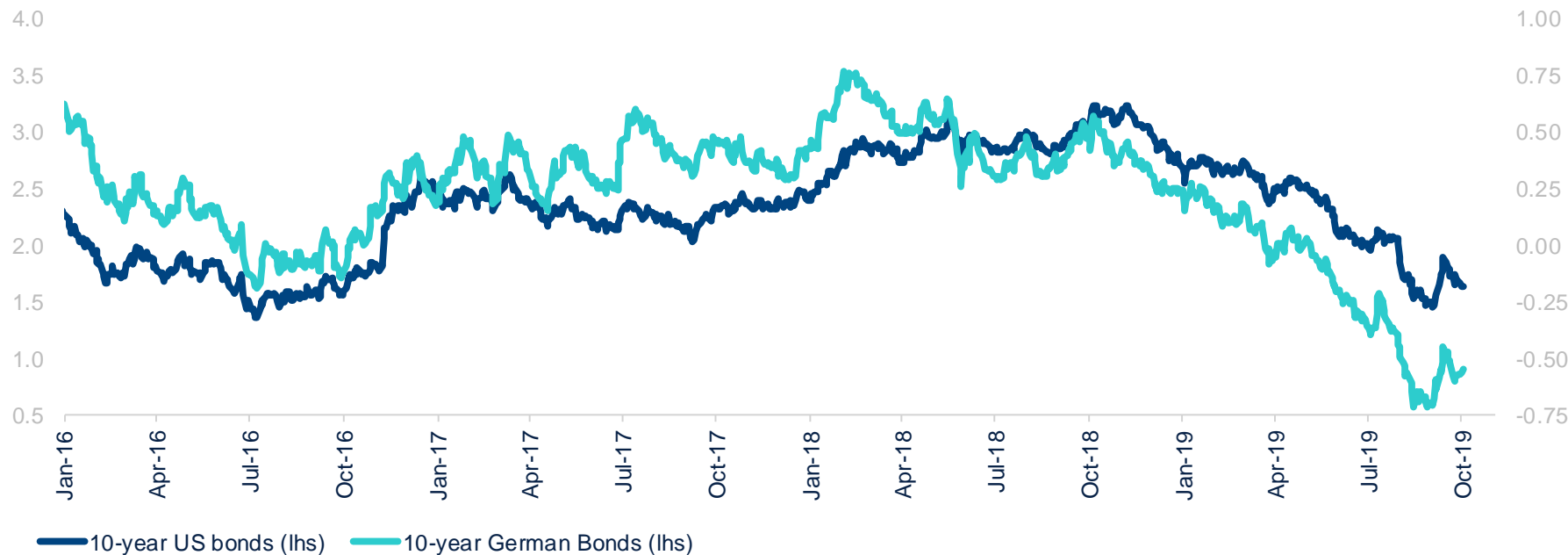
Source:: BBVA Research

- Recent evidence confirms that **uncertainty and protectionism are negatively affecting growth.**
- The recent **slowdown in growth** was higher than expected, especially in China and Europe.
- Performance of exports and manufacturing remains particularly weak...
- ... and there are already indications that this weakness is starting to spread to the services sector.

# There is a movement toward safe haven investments in financial markets

## SOVEREIGN DEBT YIELDS

(%)



# Counter-cyclical policies will help to control financial stress, but will not prevent global slowdown



## COUNTER-CYCLICAL POLICIES

### Monetary policy:

- Counter-cyclical forces will stay center stage ...
- ...despite their limited effectiveness in the current setting.
- Additional adjustments in the coming months.

### Fiscal policy:

- Should play a greater role...
- ... but the political climate and high level of debt restrict its use.
- Measures in China and to a lesser extent in Europe.

Coordination of policies between countries is now less likely.

## GLOBAL UNCERTAINTY

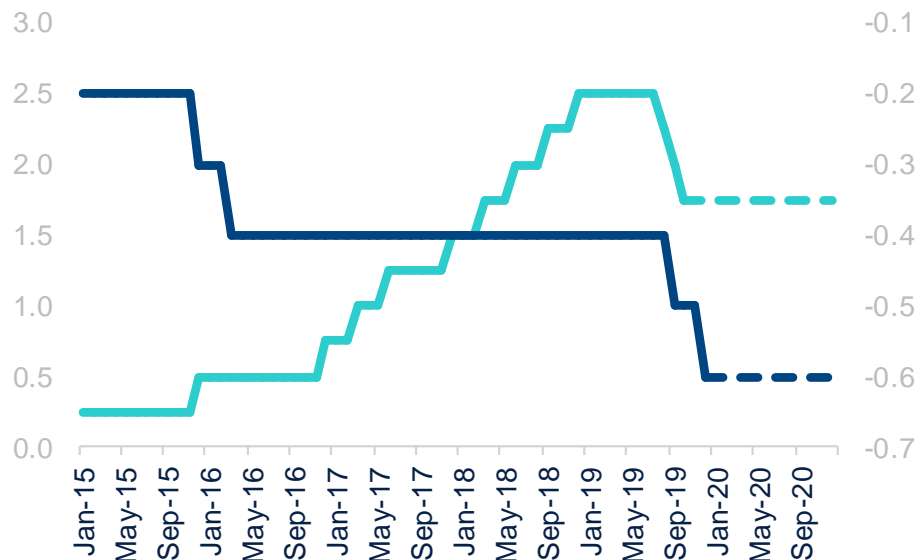
Tensions between the US and China will persist:

- A partial trade deal between the two countries is likely.
- It is unlikely that tariffs will return to their levels of a few months ago.
- Structural and technological issues will continue to cause turbulence.

Brexit, as well as political and geopolitical tensions in certain regions will cause further uncertainty.

# The central banks are again adopting monetary stimulus measures

## FED & BCE: INTEREST RATES (\*) (%, END OF PERIOD)



■ **Fed:** 75 bps reduction in interest rates in recent months.

■ **BCE:** an aggressive monetary package

- 10 bps cut from deposit rates
- tiered deposit rate system
- quantitative expansion
- liquidity auction with more favorable conditions

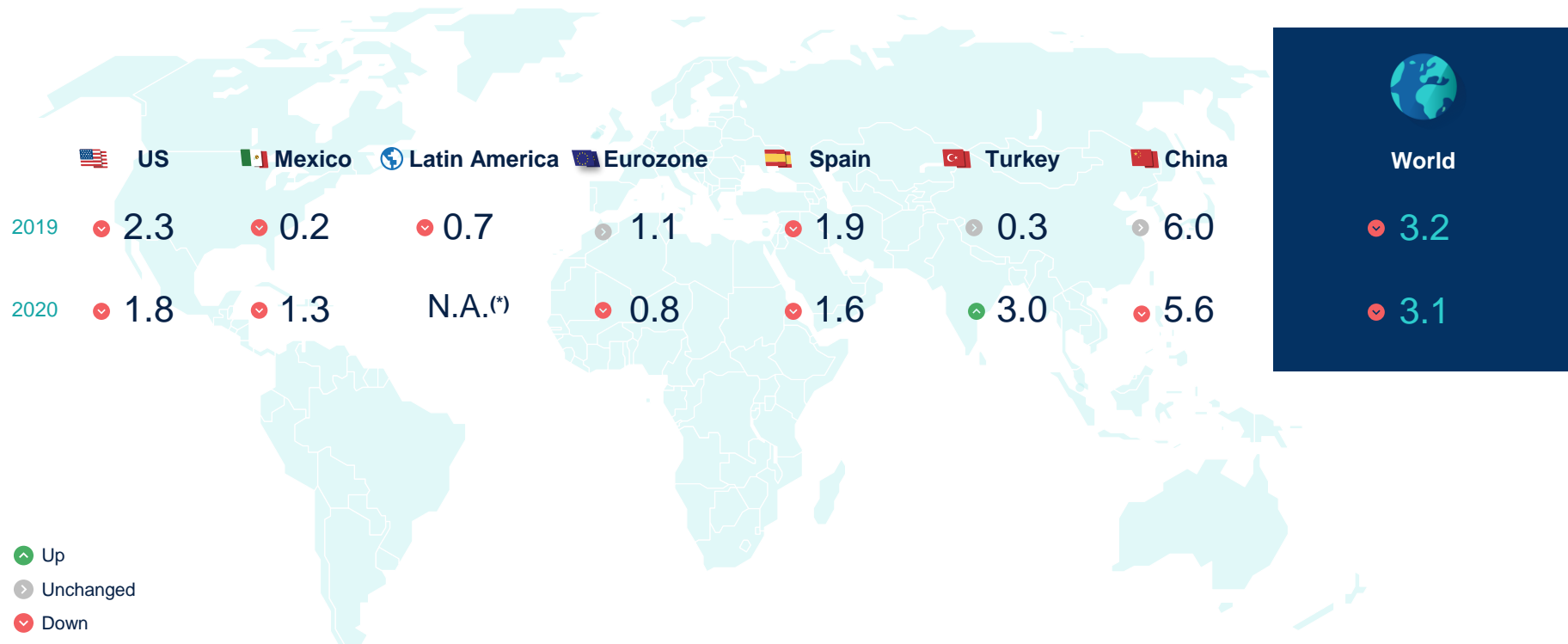
■ In Europe, an additional reduction to the 10 bps deposit rates is likely.

■ **China and other emerging countries:** more aggressive rate cuts.

(\*) Deposit interest rates in the case of the ECB. Forecast from Oct/19.  
Source: BBVA Research



# The global economy slows more markedly

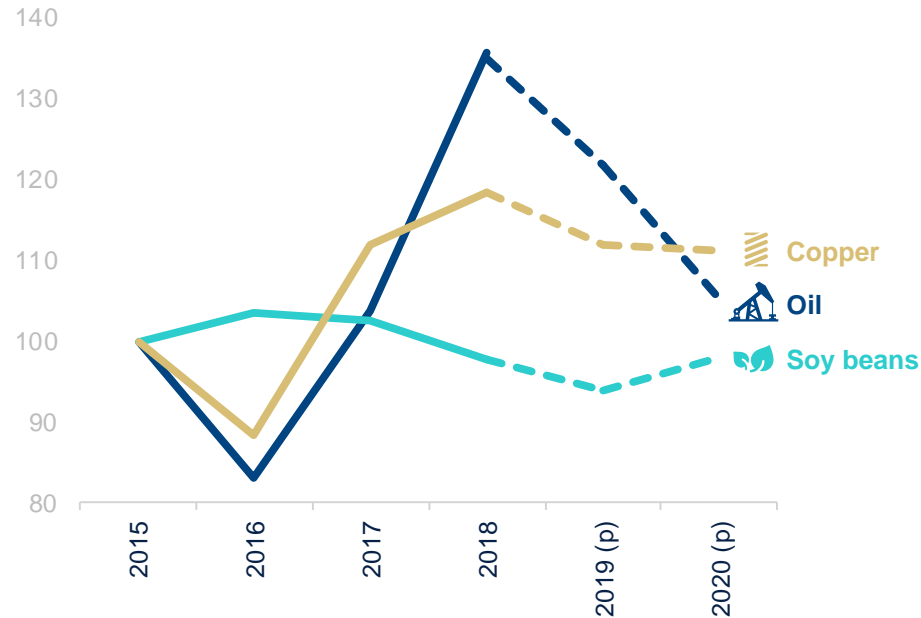


(\*) Aggregate forecast for Latin America not available due to lack of definitive forecast for Argentina.  
Source: BBVA Research

# The worse growth prospects undercut prices for raw materials

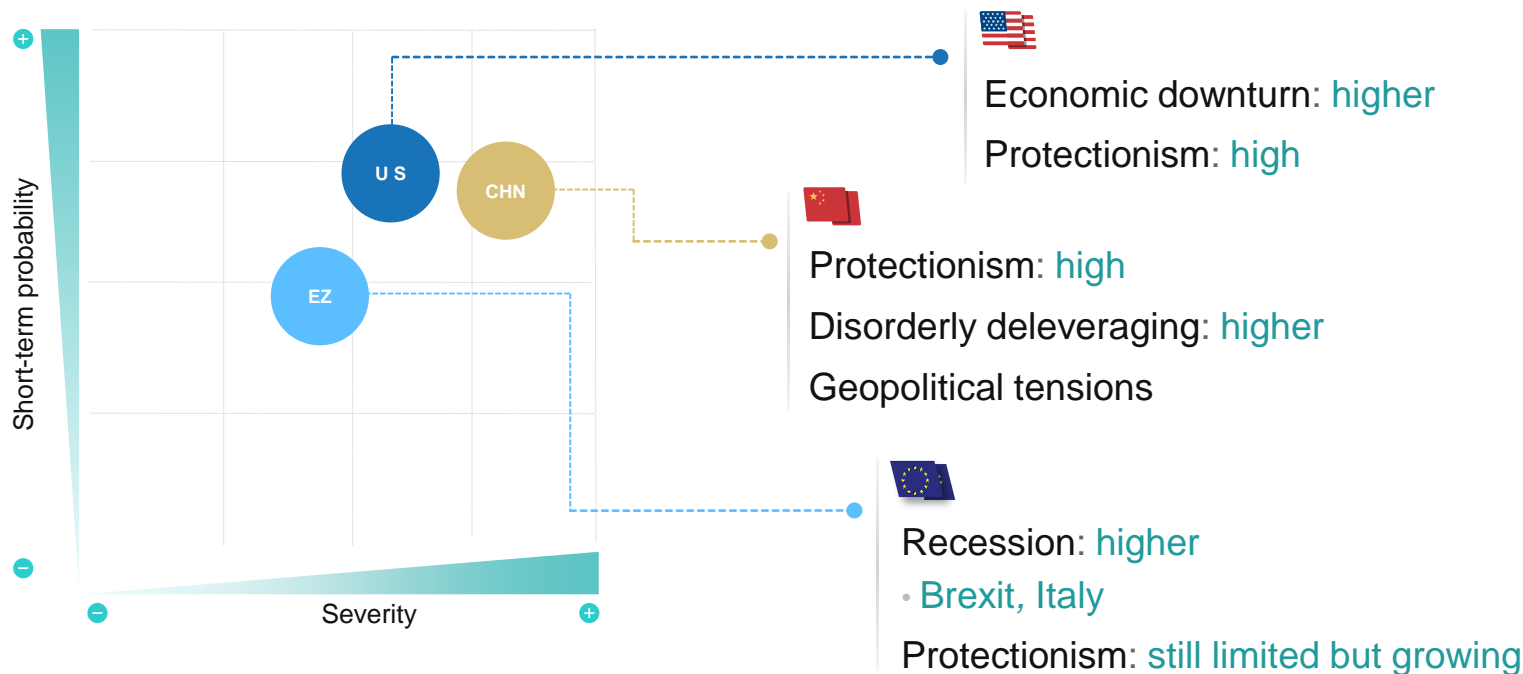
## RAW MATERIALS: AVERAGE ANNUAL PRICES

(AVERAGE 2015 INDEX = 100)



- **Oil:** slight upward short-term revision of forecast and risk that an escalation of tensions in the Middle East could push prices up.
- In any event oil prices are still **expected to level off over the medium term** given the relative robustness of supply at a time of reduced demand.
- **Soy and copper:** forecasts revised downward.

# Global risk continues to increase, primarily due to tensions between China and the US

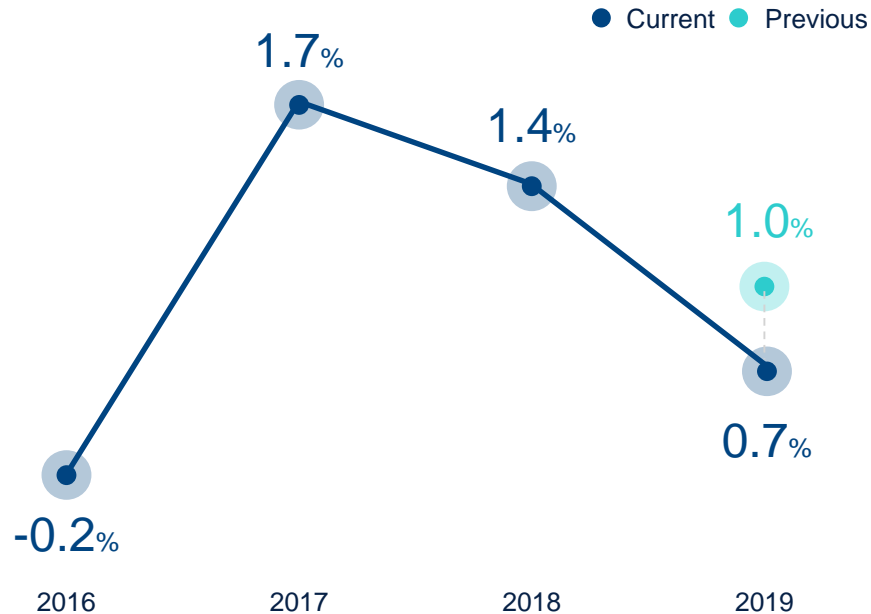


Source: BBVA Research

The risk of geopolitical upheaval in the Middle East has also increased.  
Financial vulnerabilities may increase risk severity.

# Latin America will grow 0.7% in 2019, less than expected and recorded in the two previous years

## GDP GROWTH IN LATIN AMERICA (\*) (% YoY)

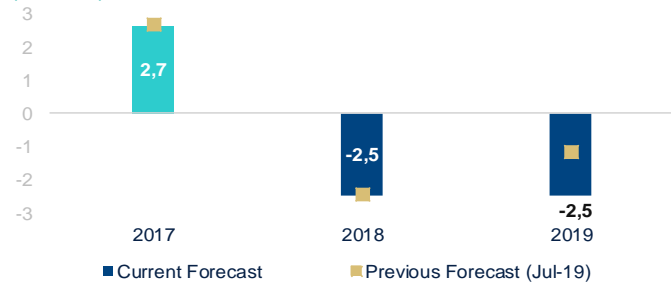


- GDP growth forecast in 2019 is revised 0.3 pp down from 1.0%.
- Economic growth will be weak, lower than that of 2017-18 and the growth potential rate.
- Regional growth will pick up moderately in 2020, but is expected to remain relatively weak, below growth potential.

# Argentina: economic policy uncertainty causes market volatility and deepens the downturn

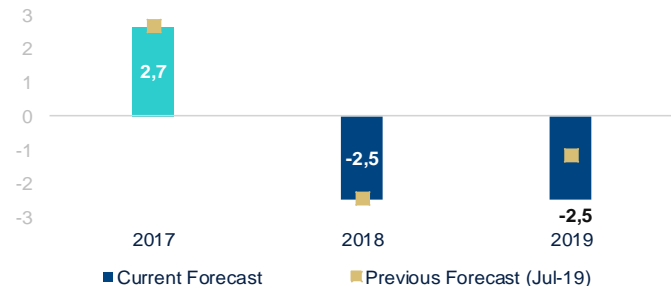
## ARGENTINA: GDP GROWTH

(% YoY)



## ARGENTINA: INFLATION AND EXCHANGE RATE

(%, END OF PERIOD)



- The market reacted very negatively to the primary elections in August due to the greater uncertainty regarding the future course of economic policy, and the situation has not improved since then.
- The closure of the local sovereign debt market, the dollarization of portfolios and the outflow of banks dollar deposits drove exchange control measures and rescheduling of public debt.
- In this context, the GDP will fall further than expected this year and inflation will accelerate.

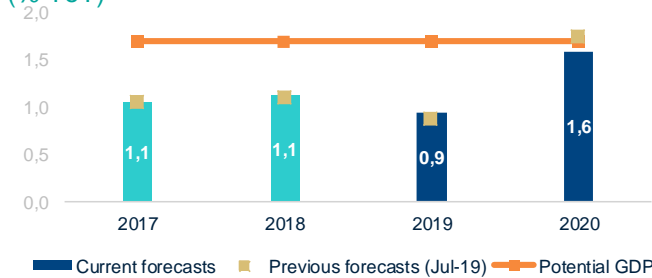
(\*) No 2020 forecast for Argentina, awaiting further information.

Source: BBVA Research

# Brazil: recent data supports the 2019 growth forecast, but the global setting negatively impacts expectations for 2020

## BRAZIL: GDP GROWTH AND POTENTIAL

(% YoY)



- The 2Q19 GDP upward growth surprised and the more recent data are relatively positive.

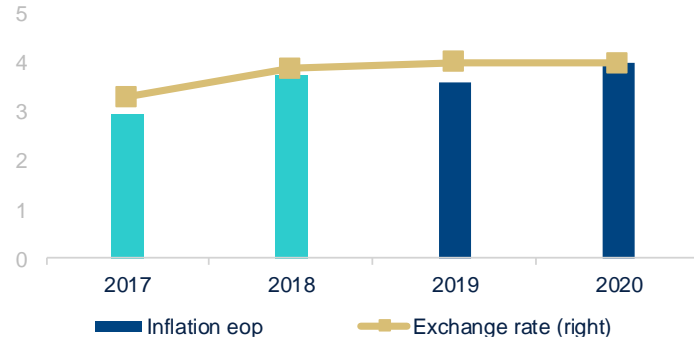
- Adoption of the social security reform and advances in other structural issues favor growth prospects.

- However, the worsening global setting will weigh heavily.

- We expect the GDP to grow 0.9% in 2019 and 1.6% in 2020, with lower interest rates and inflation under control.

## BRAZIL: INFLATION AND EXCHANGE RATE

(%, END OF PERIOD)



Source: BBVA Research

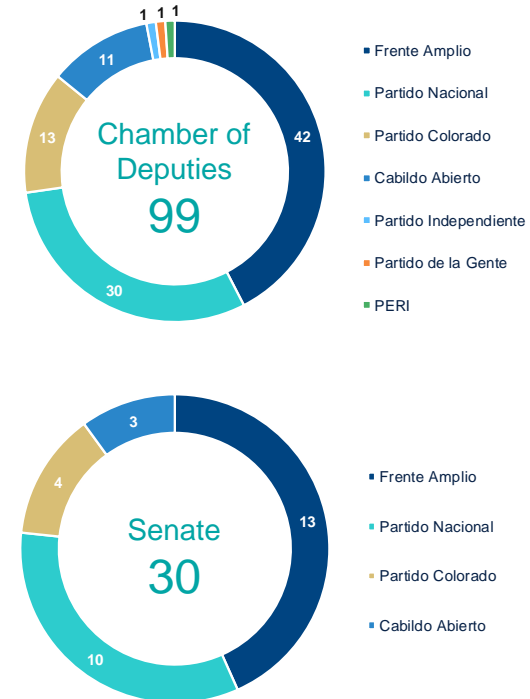
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Uruguay: the new  
authorities must focus  
on the structural  
reforms needed

## Martinez and Lacalle Pou will be assessed in the second round

- With broad participation of the population (88.9% of those registered in the census) Uruguayans went to the polls.
- The candidate Daniel Martinez (FA) won the highest number of votes (39.2%), however, it was not enough to win in the first round and he had to enter a second with the candidate Luis Lacalle Pou (PN) who won (28.6%).
- No one party will have a majority in the Congress.

### NEW COMPOSITION OF CONGRESS

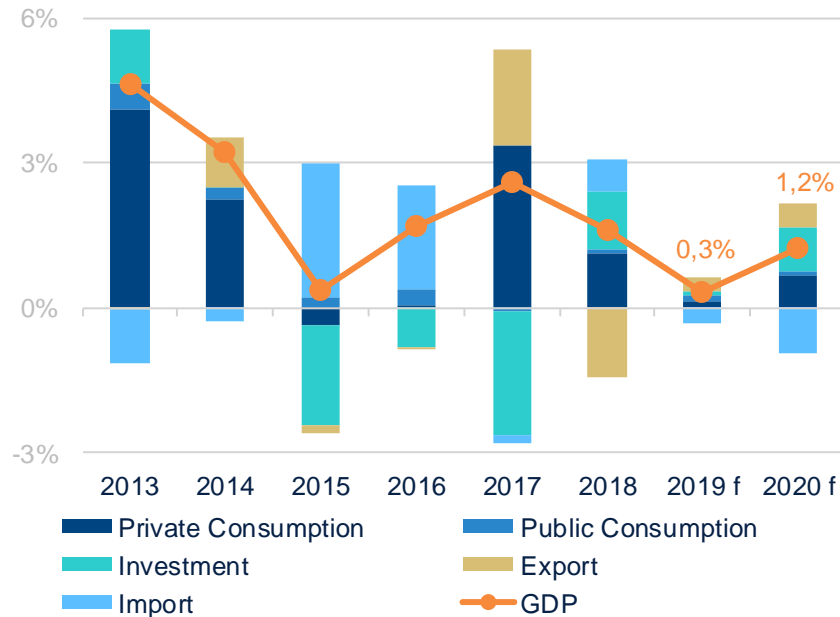




# We revised GDP downward to 0.3% (previously 0.8%) for 2019 and from 1.7% to 1.2% for 2020

## CONTRIBUTIONS TO ECONOMIC GROWTH

(%)



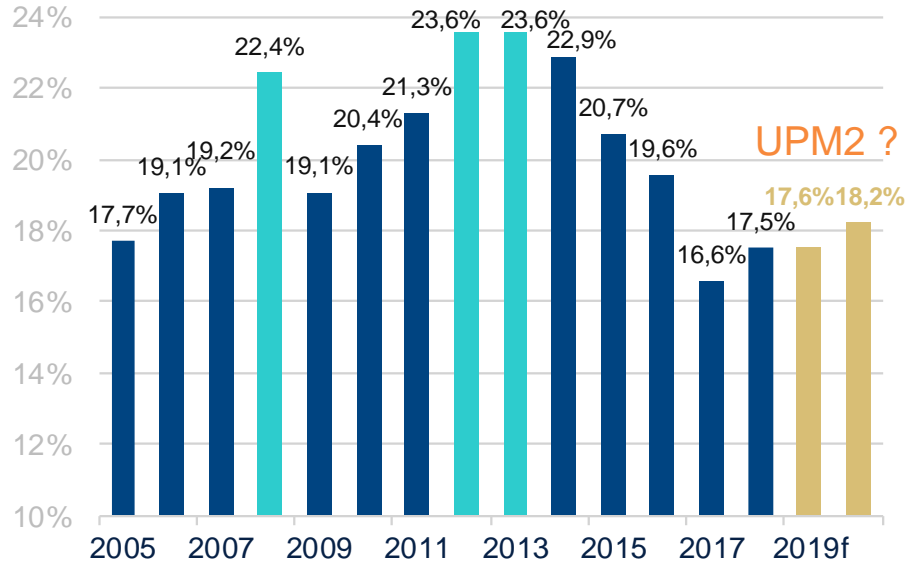
Source: BBVA Research & BCU

- The data for 2Q19 confirm the **stagnation** of internal demand. On the one hand **private consumption fell 0.1% y/y**, while investment **fell 4.1% y/y** pulled down by public investment.
- **External demand** made a positive contribution to 2Q19 GDP thanks to the improvement in the export market, mainly **soybean**.
- For the second part of the year, we estimate **a mild recovery in investments** to the extent that the railway works associated with UPM will continue but will not greatly energize activity in 2019, which will barely grow 0.3% on average for the year.
- Deterioration of the regional setting also leads us to revise **2020 GDP downward** as the Argentina affect will not only be felt by tourism but also in other activity sectors affecting external demand.
- On the other hand **nor do we forecast significant growth in private consumption** in that the increase in real wages is limited by a labor market with high unemployment and very restricted growth in real wages.

# We expect greater dynamism in investments in 2020, not so for private consumption

## EVOLUTION OF LEVELS OF INVESTMENT

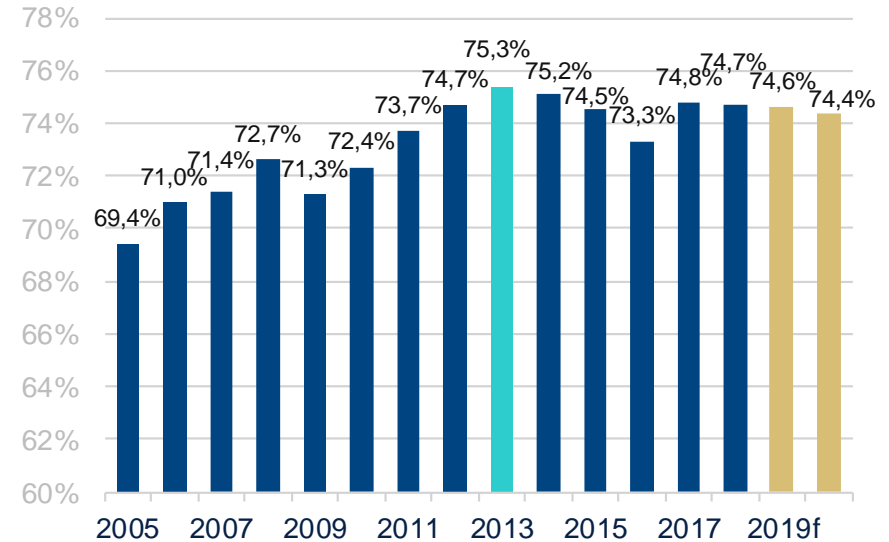
(% OF GDP)



Source: BBVA Research & BCU

## PRIVATE CONSUMPTION

(% OF GDP)



Source: BBVA Research & BCU

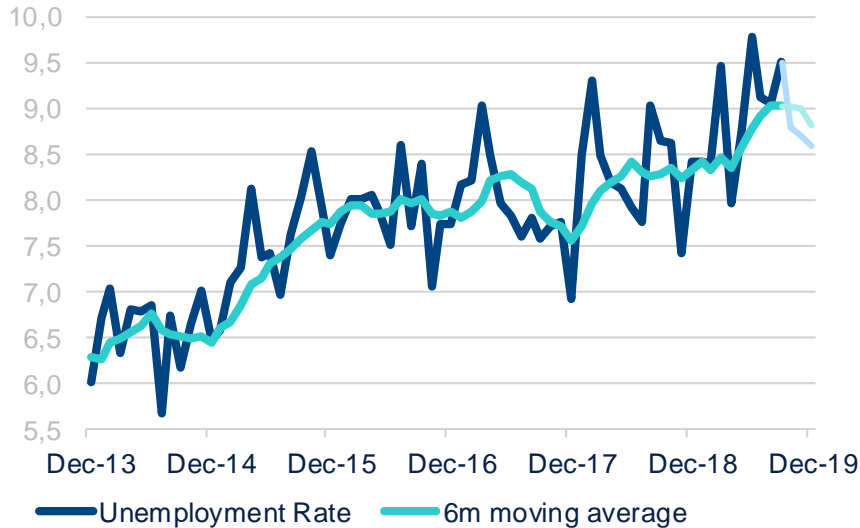
With the construction of UPM2 we expect greater dynamism in investments, not only in the private sector but also in the public, concerning the infrastructure the Government committed to with the pulp mill.

There will be minimal variation in private consumption in 2020 but not enough to earn a share of GDP.

# Deterioration in the Uruguayan labor market persists: more unemployment and lower growth in real wages

## UNEMPLOYMENT RATE

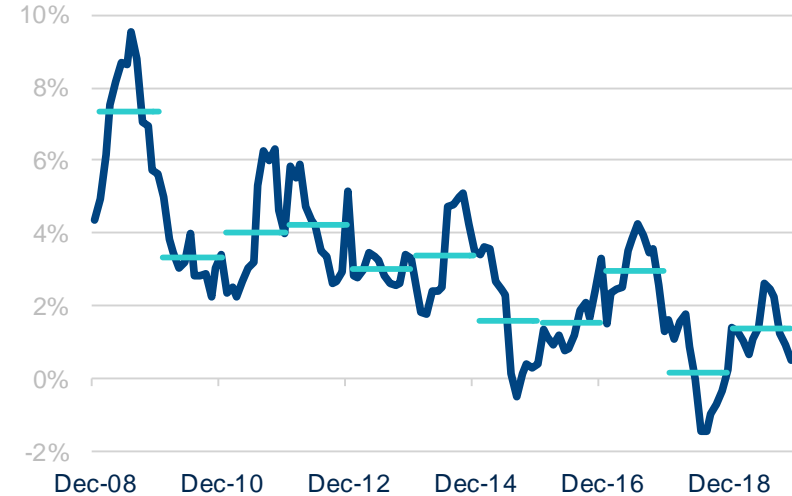
(% OF THE ECONOMICALLY ACTIVE POPULATION)



Source: BBVA Research and INE (Instituto Nacional de Estadística — Spanish National Statistics Institute)

## REAL WAGES

(% CHANGE Y/Y AND ANNUAL AVERAGES)



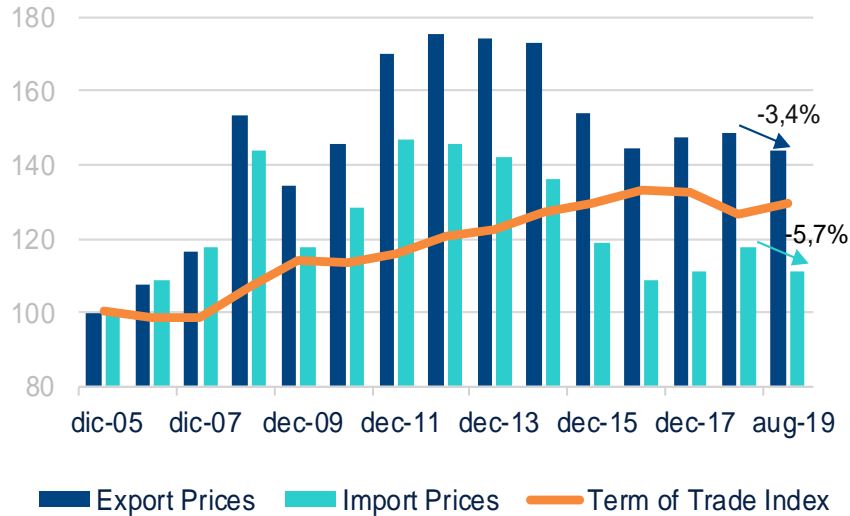
Source: BBVA Research & INE

The unemployment rate remains relatively high (September 9.5% of the PEA). Despite the recent increase, the activity rate is below that recorded for 2018. The employment rate continues to decline indicating lower employment demand linked to lower economic activity. Real wages will not grow in 2020.

# The trade balance improvement is driven by the recovery of the agricultural sector

## TERMS OF TRADE

(BASE INDEX 100 = 2005)

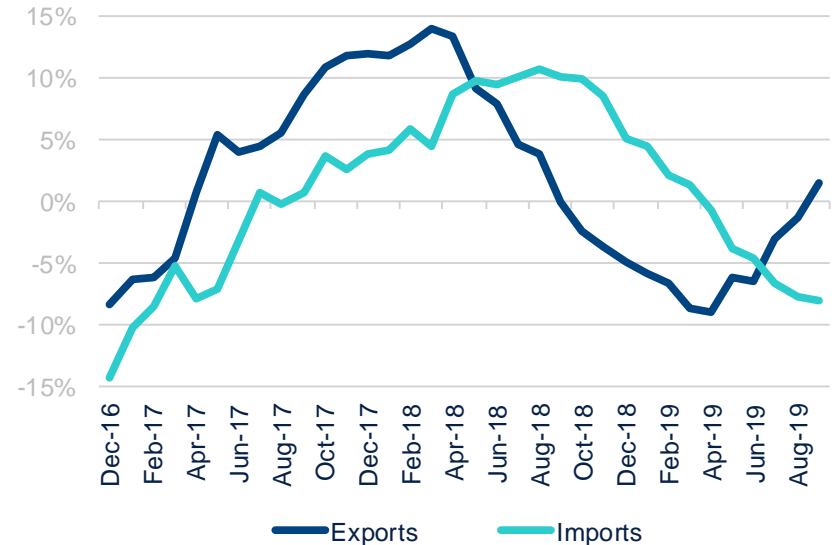


Source: BBVA Research & BCU

The higher drop in import prices relative to export prices shows a 2.5% improvement in the terms of trade for 2019.

## EXPORTS AND IMPORTS

(% CHANGE Y/Y, LAST 12 MONTHS)

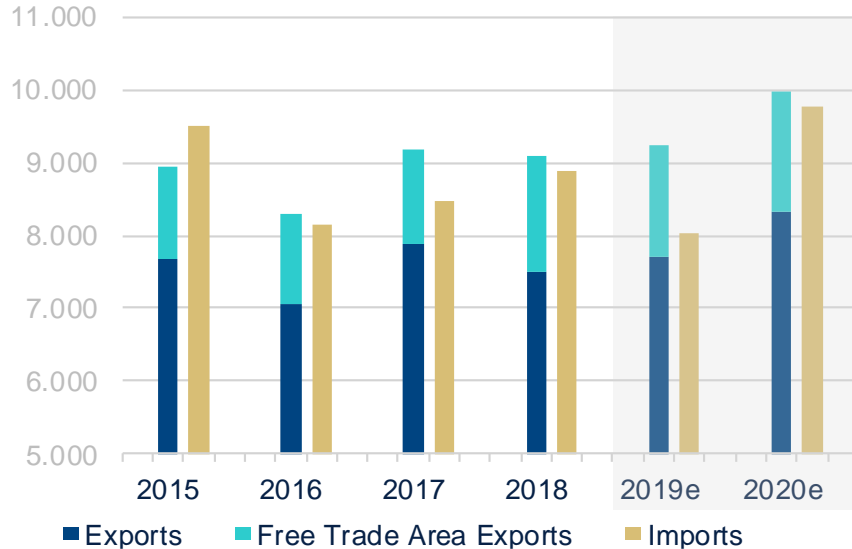


Source: BBVA Research & BCU

The recovery of the amounts exported (+7.6% y/y through August) were driven by primary goods (+25.5% y/y) due to improvements from soybean and meat products, reversing the fall in exports in 2019.

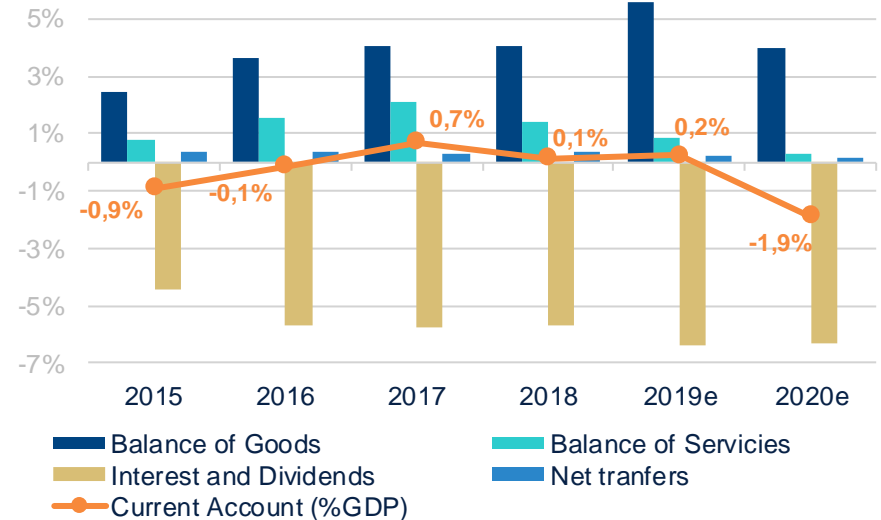
## The contribution of foreign trade facilitated a small surplus in 2019. However, the anticipated fall for 2020 has to do with the construction of UPM2

### TRADE BALANCE (INCLUDES ZZFF) (IN MILLIONS OF USD)



Source: BBVA Research Uruguay XXI and BCU

### CURRENT ACCOUNT AND COMPONENTS (AS A % OF GDP)

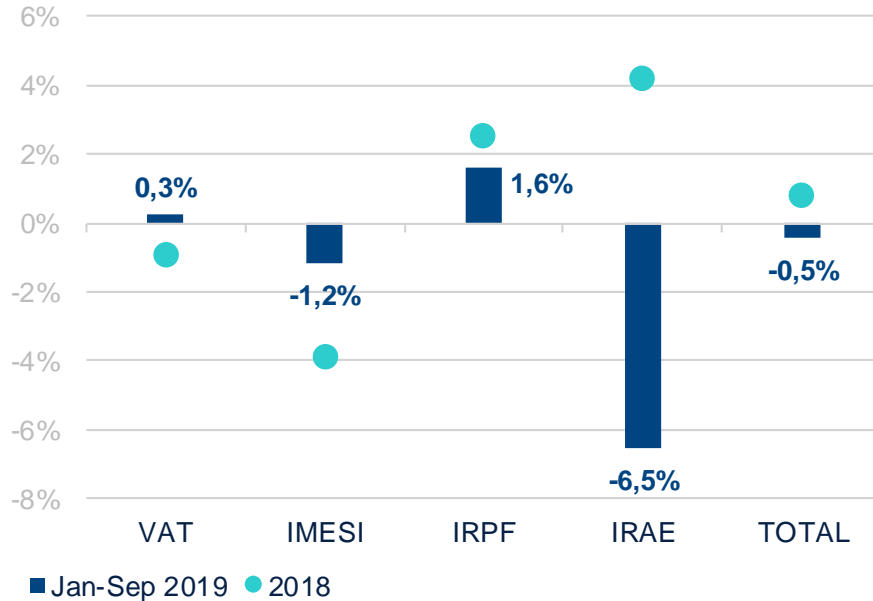


Source: BBVA Research & BCU

The contribution of foreign trade is essential to counteract the fall in real services (tourism) and the deterioration of the primary income account which is income, interest and dividends. The 2020 current account fall forecast is related to the increase in imports that will be needed for construction of the pulp mill.

# The drop in tax revenues in real terms distances the possibility of fiscal consolidation

## TAX COLLECTION IN REAL TERMS (% CHANGE YOY)

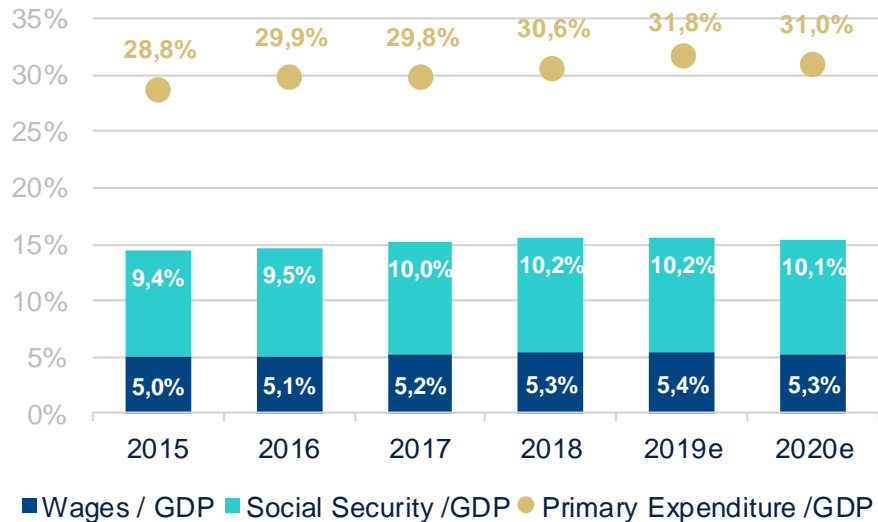


VAT = Value Added Tax; IMESI = Impuesto Específico Interno (Specific Internal Tax);  
 IRPF= Impuesto a la Renta de Personas Físicas (Personal Income Tax); IRAE = Impuesto a la Renta de  
 Actividades Económicas (Corporate Income Tax).  
 Source: BBVA Research & MEF

- Approximately 70% of Government revenue comes from tax collection.
- Tax collection in the first 9 months of the year fell – in real terms – 0.5% compared with the previous period.
- From a few months ago tax collection has reflected sluggish economic activity: in consumption, domestic VAT is stagnant while VAT from imports has fallen.
- IMESI has shown a continuous decrease over the year while the IRAE – which is levied on corporate income – reverses the performance of 2018 dropping significantly in real terms, indicating that corporate margins are decreasing.
- The only one that remains slightly positive (+1.6% y/y) is IRPF, though it has reflected real falls for several months.

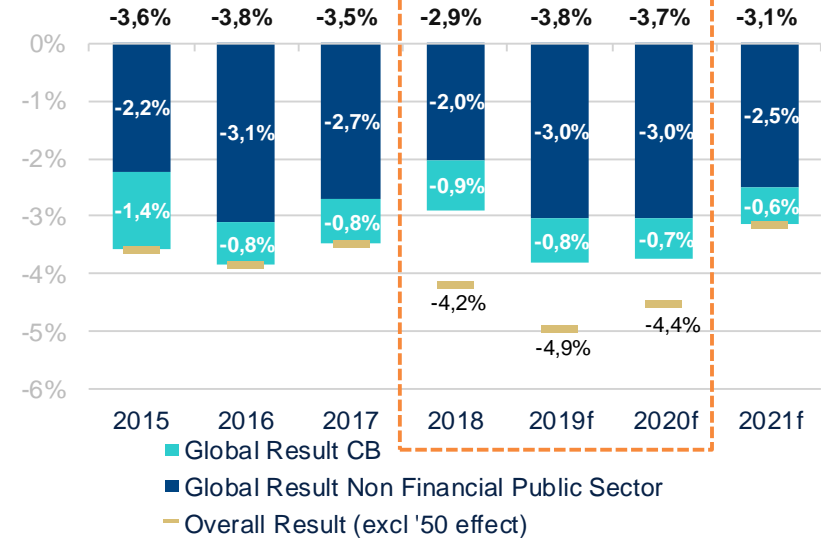
## The electoral year determined the possibility of cutting public spending and delayed essential reforms that will remain for the next administration

### CURRENT EXPENDITURE OF THE CENTRAL GOVERNMENT (% OF GDP)



Source: BBVA Research & MEF

### PUBLIC SECTOR RESULT (% OF GDP)

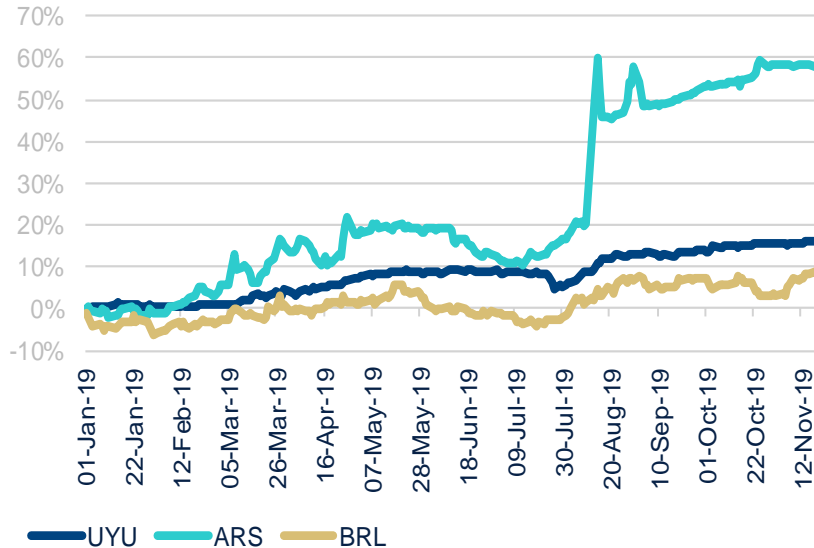


Source: BBVA Research & MEF

Spending continues to weigh on the public accounts: only a part of this has been contained, but because more than 50% of the primary expenditure is used to pay salaries and liabilities – which cannot be lowered – only structural reform can change this and achieve a degree of fiscal consolidation in the context of low economic growth. The only factor that is making a difference in the fiscal result is the extra income from the '50 Trust, but this effect will reverse in a couple of years.

# The CB maintains its policy to contain volatility

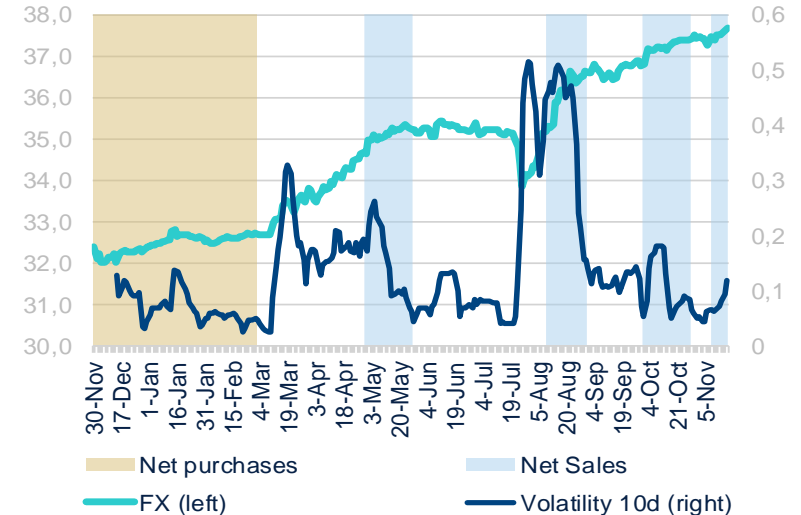
## BILATERAL EXCHANGE RATE VS USD (% ANNUAL ACCUMULATED CHANGE)



Source: BBVA Research and Haver

## VOLATILITY AND INTERVENTION

(VOL: STANDARD DEVIATION OF EXCHANGE RATE 10D, FX: UYU/USD)



Source: BCU and BBVA Research

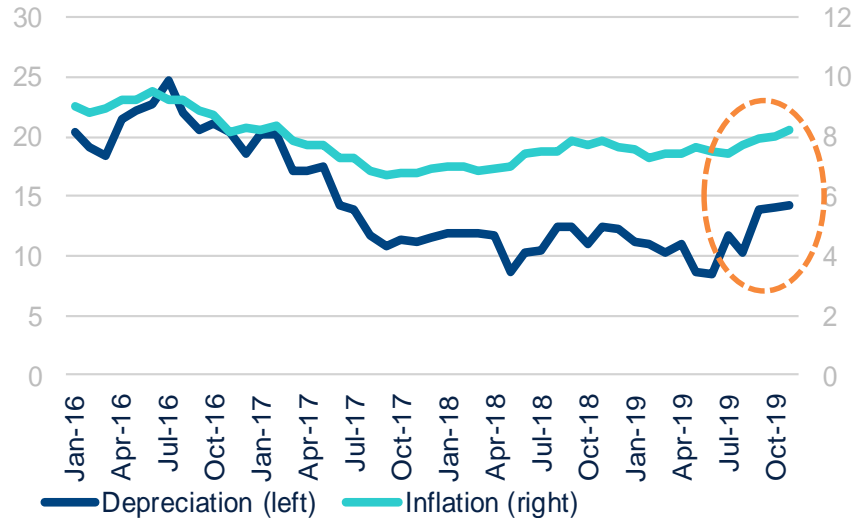
In recent months there has been a global strengthening of the dollar and this affects practically all currencies in the region. In addition, the Uruguayan peso was impacted by the depreciation of Argentina.



# Inflation will remain outside the target range

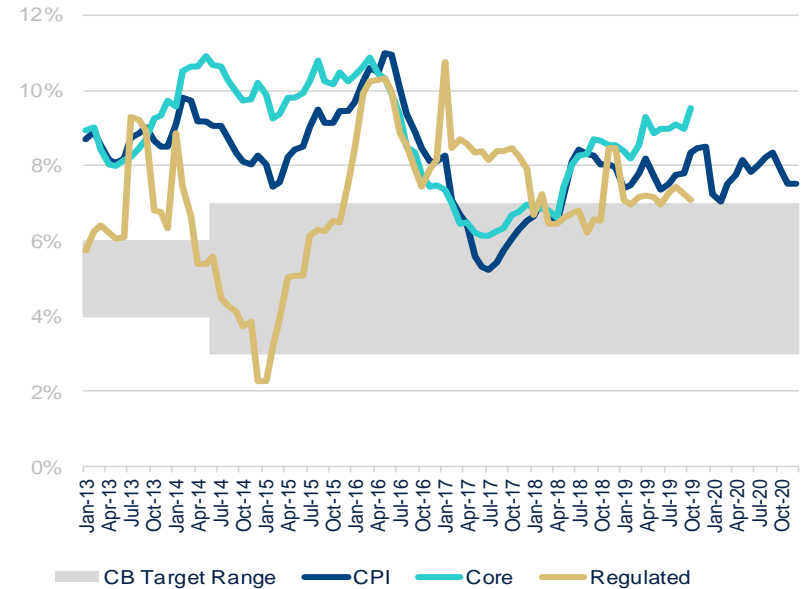
## EXPECTATIONS TO 18 MONTHS

(%)



Source: BCU and BBVA Research

## INFLATION, GENERAL LEVEL, UNDERLYING AND ADMINISTRATED (% CHANGE YY)



Source: BBVA Research, INE and BCU

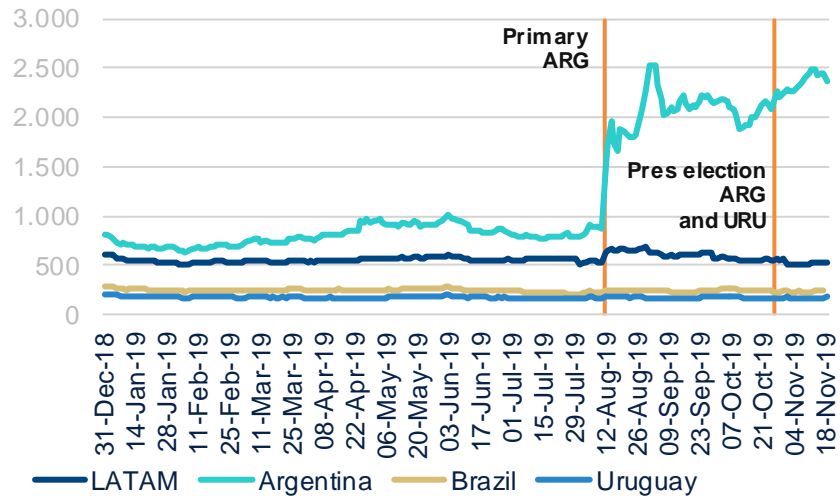
Despite the increased expectations of devaluation, expectations for inflation barely increased; though core inflation shows an increase from the acceleration of the exchange rate in recent months.

We raised the inflation forecast for 2019 to 8.5% and 7.5% for 2020 assuming the continuity of moderately contracting domestic policies and the stabilization of international volatility.

# These factors should not be neglected

## RISK INDICATORS

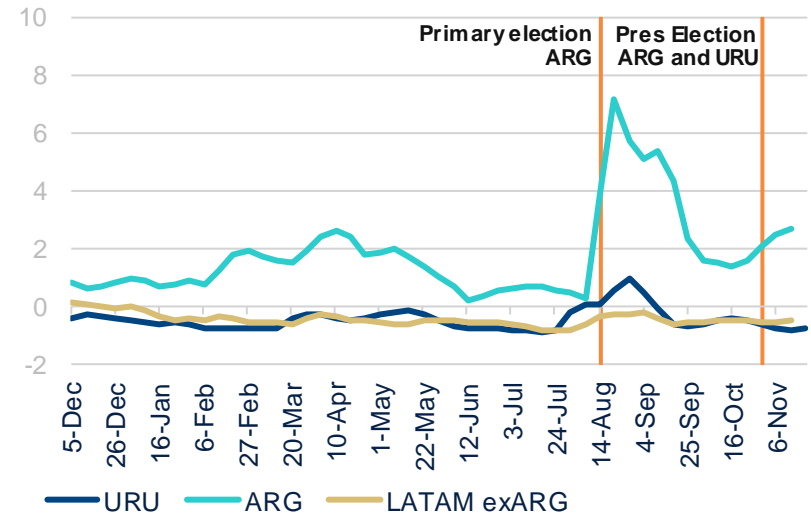
(EMBI)



Source: Haver & BBVA Research

The election process did not impact on sovereign risk. No contagion from Argentina.

## FINANCIAL STRESS INDEX



Source: BBVA Research & BCU

The Financial Stress Index also confirms decoupling.

03

# Uruguay: Forecast Table

# Uruguay Table

	2017	2018	2019 (f)	2020 (f)
<b>GDP (% YoY)</b>	2.6	1.6	0.3	1.2
<b>Inflation (YoY %, eop)</b>	6.6	8.0	8.5	7.5
<b>Inflation (% YoY, average)</b>	6.2	7.6	7.9	7.8
<b>Exchange rate (vs. USD, EOP)</b>	28.9	32.2	38.0	41.0
<b>Exchange rate (vs. USD, average)</b>	28.6	30.7	35.2	39.6
<b>Asset interest rates (% , average)</b>	21.2	19.9	19.4	19.8
<b>Private consumption (% YoY)</b>	4.6	1.5	0.2	0.9
<b>Public consumption (% YoY)</b>	-0.7	0.8	1.0	1.0
<b>Investment (% YoY)</b>	-13.0	7.3	0.5	5.0
<b>Consolidated Fiscal balance (% GDP)</b>	-3.5	-2.9	-3.8	-3.7
<b>Current account (% GDP)</b>	0.7	0.1	0.2	-1.9