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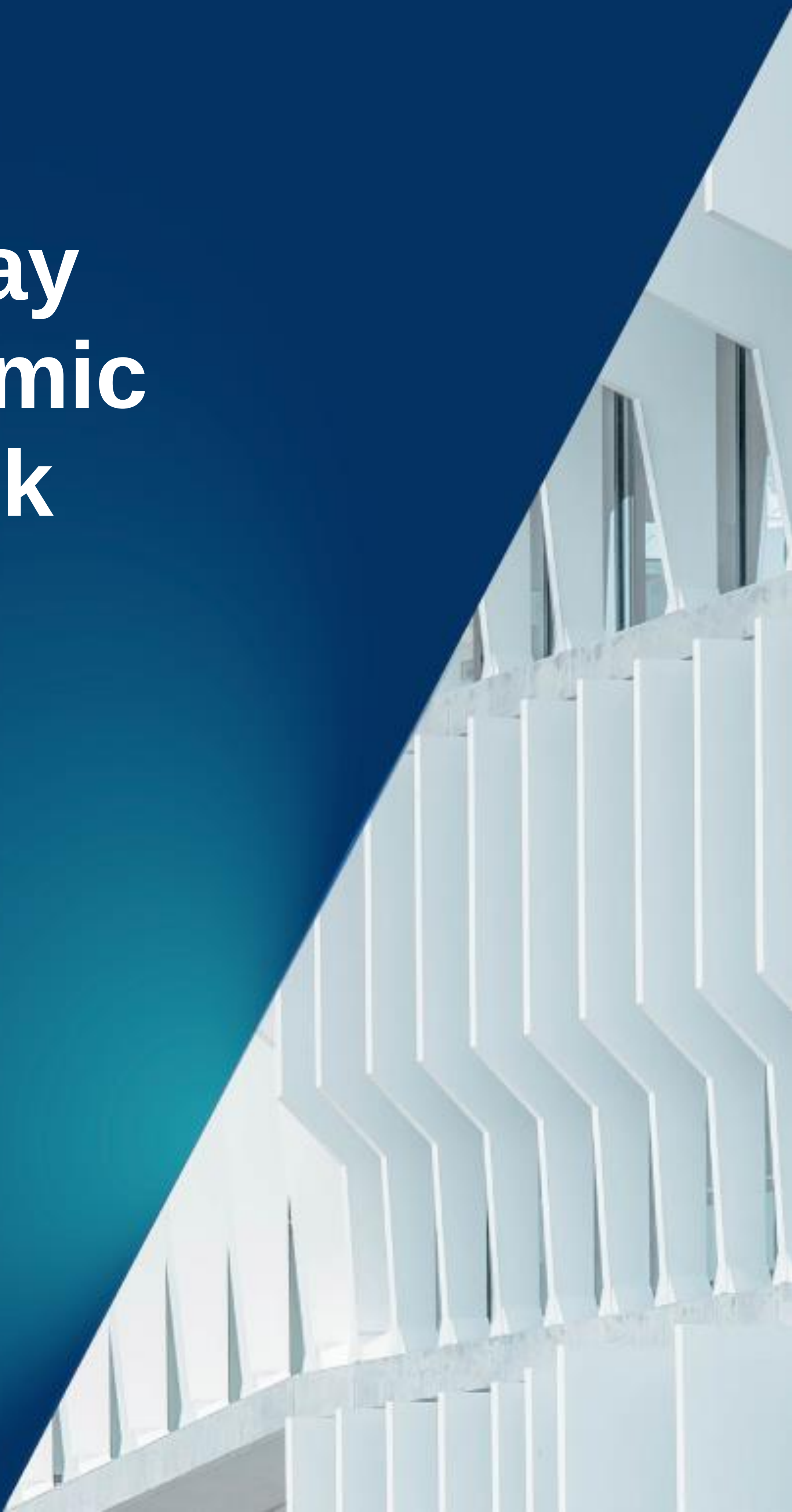
Uruguay Economic Outlook

First half 2021



Uruguay Economic Outlook. First half 2021

We adjusted Uruguay's growth downwards as uncertainty around COVID-19 remains at a very high level

Despite the persistent high levels of global uncertainty about the pandemic evolution, with only a few countries rolling out vaccines quickly, the global economic rebound has been stronger than expected. Following a decline of 3.3% in 2020, **world GDP is expected to grow 5.9% this year**, mainly driven by China (+7.5%) and the USA (+6.2%). High global liquidity is keeping commodity prices high, and we believe that they will remain at current levels until US monetary stimulus begins to be withdrawn, which is expected to be no earlier than 2022.

Uruguay's economic activity fell 5.9% in 2020, ending a streak of 17 consecutive years of growth. Given the lower statistical carry-over resulting from the slowdown in the last quarter of 2020 and the continuation of the health crisis, we have adjusted our growth forecast to 2.7% **(down from 4%)**. Meanwhile, the trajectory in our baseline scenario has been confirmed by certain mixed signals from the partial indicators relating to activity in 1Q21. Growth will be driven by investment (11.7%), bolstered by the UPM2 project and the Central Railroad, and a moderate increase in consumption (+1.6%). With the health crisis under control, we expect a greater activity growth in 2022, 3.5%.

The **labor market** continues to be severely hit by the pandemic, and while increases in the employment-to-population ratio and employment rate have been observed, the scale of these improvements is not enough to positively impact the unemployment rate, which we estimate will sit around 10% by the end of 2021.

The exacerbation of the health crisis led to an increase in the estimated expenditure needed to compensate for the impact of COVID, which rose from USD 540 million to USD 900 million. Regarding the revenue, improvements will be moderate due to the fact that a large proportion of tax revenue is linked to activities that will be less dynamic than previously expected in 2021. Thus, **there will be an annual deficit of 5.4% of GDP in the fiscal balance** (-5.7% of GDP excl. over-50s). In 2022, without pandemic-related spending, we assume that fiscal consolidation will resume and that the deficit will be brought to 3% of GDP.

The pandemic has also left a scar in the monetary sector. The Central Bank will maintain the expansionary trend in its monetary policy until at least 3Q21. The market has noticed the pragmatism and commitment of the monetary authority in its fight against inflation. Consequently, despite the accommodative stance of the BCU (*Banco Central del Uruguay* — Central Bank of Uruguay), inflation expectations and CPI records indicate a sharp slowdown in the next 24 months. The delicate situation in the labor market, the wage agreement for this year and the weakness of the dollar have lifted the pressure on prices, which will lead to **inflation of 7.2% in 2021**. The slowdown in 2022 will be less pronounced due to improved economic activity and inflation will hit 6.8%.

The Uruguayan peso was not immune to international market movements. The exchange rate was testament to the strengthening of the US dollar in March, when markets anticipated that the Fed would move ahead with rate increases given the signs of recovery shown by the US economy. The exchange rate subsequently re-stabilized and was at its least volatile level since the beginning of 2020, when compared to currencies of other economies in the region or of a similar commercial profile. Given the BCU's stance and the expected weakness of the dollar, we expect **the exchange rate to reach 46 UYU/USD by Dec-21**.

The improvement in the exchange rate and commodity prices, which will remain high for the rest of the year, will boost exports while imports will be increased by the purchases needed to complete ongoing investment projects. It is worth noting the poor performance we expect from the Tourism sector as a result of health restrictions. **We estimate a current account deficit of 2.3% of GDP in 2021** (following a 0.5% deficit in 2020). This deficit may be halved in 2022 once imports for projects begin to ease and exports are able to grow due to an increased external demand.

Regarding the environment, Uruguay continues to reduce its CO2 emissions faster than most of its neighbors and is one of the countries with lower per capita emissions in South America. We believe that a sustainability agenda that attracts investments in areas such as clean transport, agriculture and sustainable construction will further boost the very good performance seen in recent years.

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