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URUGUAY STRATEGY

October witnessed an acceleration in inflation, aligned with earlier projections. Following a decline in 11 out of the last 12 months, y/y inflation for October surged from 3.9% to 4.3%. Anticipating the continuation of this trend into 2024, especially as the tailwinds supporting disinflation and monetary policy constraints diminish, it is expected that inflationary pressures will persist. However, it is foreseen that inflation will remain within the target range for the subsequent year. In a positive economic development, exports experienced growth in October. This growth was facilitated by both a recovery in the absolute number of exports and the advantageous backdrop of a very low comparative basis, attributed to the onset of the drought in late 2022. The introduction of the new Monthly Economic Activity Indicator (IMAE) in August signaled an upswing in economic activity. This aligns with the projections indicating that by late Q3, the economy should commence its recovery from the setbacks endured since the previous year. Following the depreciation experienced between August and October, the local Uruguayan Peso has now stabilized around $40. This stabilization is attributed to the fact that the "higher for longer" thesis in US rates has already been factored into the currency's valuation.

October's inflation rose to 0.63%, the highest reading since April. The increase was in line with analysts' expectations (0.6%) with prices rising in all the different categories. The highest contributor to the monthly inflation was the transport division, as fuels rose 4.67% in average and representing almost half of the rise of the index. The CPI index has risen by 4.9% during the year and 4.3% in the last 12 months. Up until last month, inflation had been falling almost uninterruptedly after peaking at 10% in September 2022. The survey conducted by the Central Bank of Uruguay (CBU) in November showed that analysts expect inflation to finish the year at 5.2% but accelerate in the following years with expectations for the next 12 months at 6.5% and 6.1% in the next 24 months. We are confident

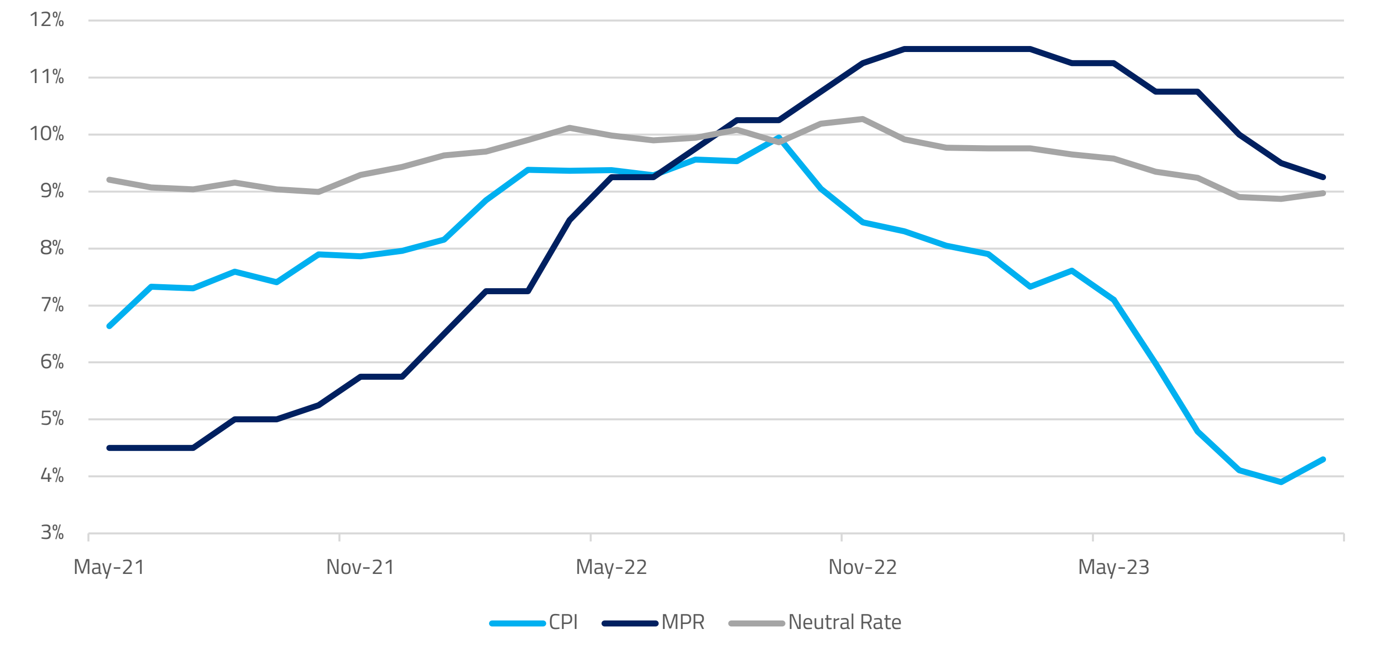
Exhibit 1. Inflation approached its target in October.
y/y Inflation and CBU's target

Source: INE

that inflation will remain within the target range at least for the next 12 months but will slowly approach to its ceiling. As we have mentioned before, the current rise in the fiscal deficit will act as an inflationary force. The loosening of the monetary policy will start to push inflation higher next year as the 12 to 18 month delay in the monetary policy lag will start running in April, and central banks globally will continue or start their loosening process. Agent's confidence in the long-term sustainability of the monetary policy results is still low, even more so considering the uncertainty of a possible government change in the relevant period. With current inflation trending to the upside, it would not come as a surprise that expectations climb higher than current levels.

The central bank cut its Monetary Policy Rate (MPR) by 25bp. After a 50bp reduction of the MPR in October, the CBU decided to continue its loosening process cutting by an additional 25bp in November, reaching 225bp since April. According to the minutes of the last meeting, there is conformity with the results achieved so far, and further action will be data dependent. The latest cut was unexpected, in its October meeting the Monetary Policy Committee (MPC) had hinted that a pause was expected as disinflationary forces were receding and expectations remained above the ceiling of the target range. In its latest monetary policy report, the CBU updated its neutral rate from 2% to 2.4% above inflation expectations for the Monetary Policy Horizon (MPH, 24 months). Inflation expectations after the latest update fell from 6.87% to 6.57%, signaling a similar movement between expectations and the MPR. Now, the difference between the MPR and the neutral rate is less than 30bp, leaving close to no room for further rate cuts. Given the inability of the CBU to anchor inflation expectations and the rigidity mainly of business owners, if expectations increase in the upcoming months, this will force the CBU either to increase once again its MPR, which is highly unlikely, or to break its word to keep monetary policy on restrictive ground.

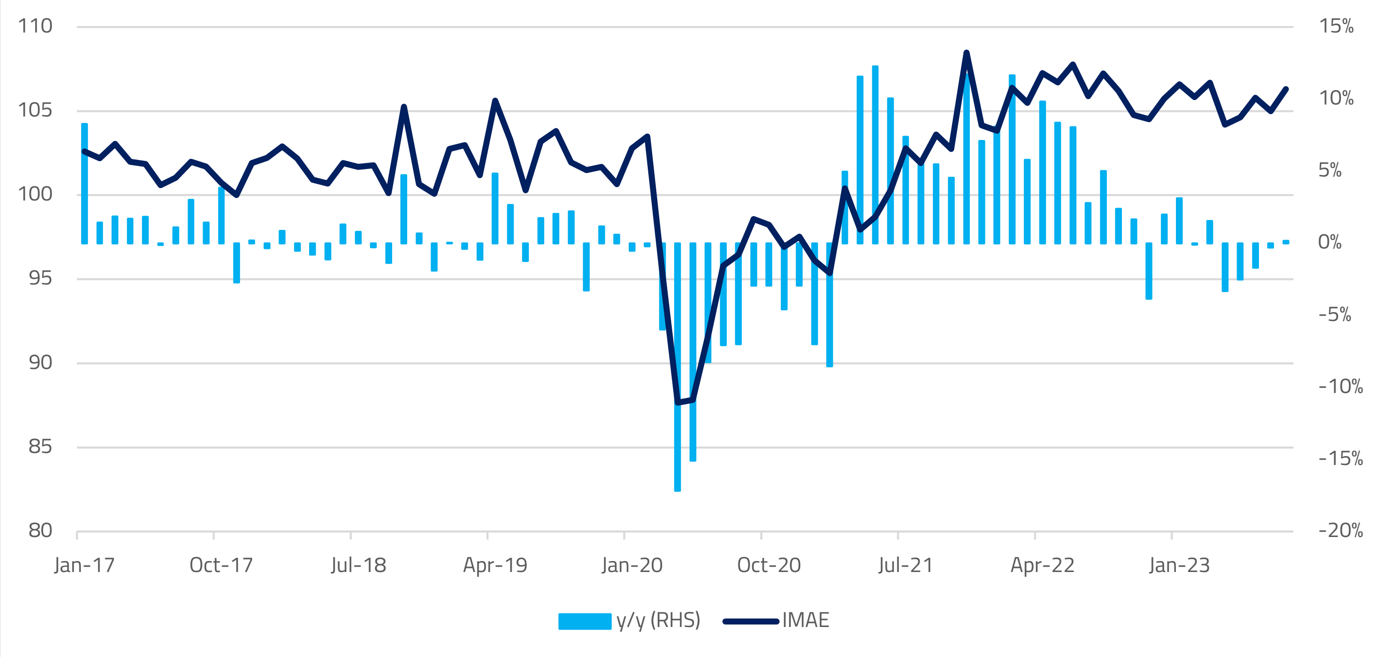
Exhibit 2. The MPR is approaching its neutral level.
CPI, MPR and Central bank's neutral rate



Source: INE; CBU

Higher inflation would help adjust the fiscal imbalance. The recent uptick in inflation is not an isolated incident; rather, it signifies a shift from the conditions that led to the lowest inflationary reading in 18 years. Various factors that previously contributed to this minimal inflation are now transforming into challenges. Notably, the fiscal deficit has risen to levels akin to those observed in December 2019. The Frente Amplio (FA) concluded 2019 with a fiscal deficit of 4.4% of GDP and bequeathed the government, in February 2020, with a deficit of -4.3% of GDP. Throughout the electoral campaign and its tenure in opposition, the current government vehemently criticized the management of public accounts. Historical data reveals a consistent growth in public spending by an average of 1.2% of GDP during electoral years. The government is now confronted with the task of reducing the fiscal deficit without resorting to unpopular measures that might jeopardize its chances of reelection. While the government had successfully diminished the fiscal deficit to 2.5% of GDP in September 2022, a robust economic performance was disrupted by the Q4 2022 drought. Subsequently, the fiscal deficit experienced a steady increase, driven by a rise in public spending as a percentage of GDP—from 26.3% to 27.4%—accompanied by a decline in income from approximately 26.5% to 25.9%. Despite adhering to fiscal rules, that include unobservable variables such as potential GDP, the success in managing the fiscal account was contingent on temporary circumstances rather than structural changes. Although economic activity is anticipated to continue improving throughout the remainder of the current mandate, aiding in fiscal balance enhancement, the present deficit remains significantly distant from the government's -2.5% objective. Therefore, a higher inflation rate could serve to mitigate the current spending levels and contribute to a more sustainable fiscal outlook, increasing the incentive to aim for the ceiling rather than the floor of the target range.

Exhibit 3. Activity rose in August.
IMAE and y/y change (RHS)



Source: CBU

Activity is showing signs of a potential recovery. So far, data is showing that the economy is in route to revert the negative tendency shown since Q4 from last year. The recently published Monthly Economic Activity Indicator (IMAE for its Spanish acronym) showed that activity increased in August y/y after falling uninterruptedly since April. The IMAE rose by 0.2% y/y and by 1.2% m/m on a seasonally adjusted basis. The IMAE will be published monthly with a 60-day lag, acting as a proxy for the GDP number which is published with a 90-day lag. Moreover, export data continue to show an improvement. In October total exports grew by 14% y/y and 2.3% m/m, whilst advanced November data show an even stronger y/y growth at 20% for the first half of the month. Despite prices having suffered a strong setback since last year, winter crops promise a solid performance for exports. After the drought, rains have been abundant and export levels should surpass last year's. Moreover, there is a promising performance for summer crops as well, which should boost activity during the beginning of the year. Regarding the upcoming summer season, the unpredictability after the Argentinian elections has grown. The uncertainty regarding the recent regime change is as high as it can be, but the ability to reinvent itself of the Argentinian consumer is amusing. When everything pointed for a slow 2024 season, demand for high-end properties is at very high levels and operators are anticipating a season at least as good as 2023. Last season surprised positively and led activity to positive growth during Q1 despite the slowdown in export activity and the impact of the drought. The combination of a solid tourist season and the improving exporting industry should lead to a solid start of the year.

Lacalle Pou concluded a satisfactory trip to China. While the prospect of a Free Trade Agreement (FTA) between Uruguay and China waned considerably following the election of President Lula in Brazil and the resurgence of Brazil's protectionist policies, the Uruguayan government persisted in efforts to secure preferential terms for its local products. A recent development unfolded as President Lacalle Pou, accompanied by a diverse team representing various government sectors, concluded a diplomatic mission to China. During this visit, a comprehensive strategic partnership was forged, encompassing 24 different facets ranging from commerce and investment to science, technology, education, and sports. As reported by the Chinese network CCTV, President Xi Jinping expressed a welcome for an increased influx of high-quality agricultural products from Uruguay and pledged to promote additional investments by Chinese companies in the country. Despite mentions of advancing FTA negotiations, the realization of such an agreement still appears distant. Chinese authorities have already initiated discussions regarding the potential importation of carbon-neutral meat from Uruguayan producers. Notably, this meat is currently predominantly exported to Europe and South Korea. Anticipation is growing that Argentina, with its newly elected government, will break away from decades of excessive protectionism. This shift in policy could catalyze a transformation within Mercosur, potentially evolving it into a modernized customs union. It is noteworthy that this transformation may occur despite Brazil's historical stance on the matter. The geopolitical landscape is undergoing notable shifts, and Uruguay is strategically positioning itself within this evolving framework to foster economic partnerships and trade relations.

In conclusion, as we approach the end of the year, we remain confident that our initial projections will continue to be confirmed. We have observed an increase in economic activity during the second half of the year, which we have already begun to witness, and we anticipate that this trend will persist into the first half of 2024. Furthermore, it is important to note that we have reached the lowest point in the disinflationary cycle, and in the coming months, we expect a moderate acceleration in inflation, always within the target range. Given the performance of nominal peso bonds over the last 18 months, we recommend gradually reducing exposure to these bonds in favor of inflation-indexed bonds (UI). It is worth mentioning that the potential implications of a change in government in the upcoming elections, coupled with the previously mentioned increase in inflation, could contribute to higher inflation levels in the short term. At the same time, it is likely that the cycle of reducing reference interest rates by the central bank is coming to an end. Regarding the local currency, we foresee a scenario of stability. The outlook is based on a greater supply of dollars through increased exports and limited external upward pressure on the dollar. In summary, we consider the risk of depreciation of the local currency to be low in this context.

Exhibit 4. Projections

Inflation	2021	2022	2023	2024
MEF	8.0%	8.1%	6.7%	5.8%
BCU	8.0%	8.1%	5.7%	5.3%
Mkt Consensus	8.0%	8.1%	5.2%	6.5%
Latin Securities	**8.0%**	**8.1%**	**4.7%**	**5.4%**

GDP growth	2021	2022	2023	2024
MEF	4.4%	4.9%	1.3%	3.7%
BCU	4.4%	4.9%	1.0%	4.0%
Mkt Consensus	4.4%	4.9%	0.8%	3.1%
Latin Securities	**4.4%**	**4.9%**	**1.0%**	**3.0%**

Exchange Rate	2021	2022	2023	2024
MEF	44.7	40.1	41.9	44.5
Mkt Consensus	44.7	40.1	40.0	42.3
Latin Securities	**44.7**	**40.1**	**40.0**	**42.0**

Source: CBU, Latin Securities, MEF

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