MONTHLY REPORT

ECONVIEWS

ECONOMÍA Y FINANZAS

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THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- After tightening FX controls by mid-September, the spread between the official and the BCS rate climbed -with almost no pause- from 70% to 120%, despite government agencies' intervention selling bonds. The BCS jumped to 171 pesos per US Dollar, increasing 130% YTD. The Ministry of Economy announced on Oct 19th that those buying dollars through the BCS market will have a "parking" period of 3 days (prior 15).
- Net liquid reserves have fallen to extremely low levels (below USD 1 bn), while Central Bank still maintains official FX volatility reduced, despite the announcement on Oct 1st that it would increase it.
- On Oct 15th CB added severe restrictions to the access of dollars for imports. Amounts bigger than USD 50k (previously USD 500k) will now require authorization. Also, it increased 1-day reverse repo rate three times, starting from 19% to the actual 30%. Additionally, it will use again the 7-day reverse repo as a policy tool and set a 33% rate, while it lowered 28-day Leliqs rate from 38% to 36%. Retail time deposits rate will pay a 34% rate.
- Soybean export taxes were temporarily reduced from 33% to 30% in Oct, 31.5% in Nov, 32% in Dec, and will return to 33% in Jan-2021.
- Tax revenues went up 43% y/y in September, the first increase in real terms during 2020. Assistance to the Treasury accelerated and was ARS 193 bn.

FIGURE OF THE MONTH

FX spread between the official and BCS stands at

120%

the highest record since 1989

TO BE ALERT

A bitter performance for sovereign bonds: they fell more than

20%

since their debut on early September.

WHAT'S COMING NEXT?

- The Government aims to avoid a virtual devaluation at any cost, but each day the task is becoming more uphill. A significant FX spread, scarce net reserves, negative real interest rates, and very tight controls, are factors that add much pressure to the official FX market. Also, incentives are really distorted: exporters avoid selling dollars, while consumers and importers try to advance consumption/purchases.
- The IMF concluded its staff visit and stressed the complex economic and social difficulties Argentina is facing. The IMF team will return on the second/third week of November to start negotiations. The entity could be an ally to anchor expectations.
- According to preliminary data of September, economic activity improved in comparison to August, when the recovery had lost some dynamism. However, the recent tightening of FX controls for imports will certainly take a toll on the pace of recovery for the coming months.
- "Plan Gas 4" was released: it encourages companies to invest in production by guaranteeing demand for the next 3 years; the stimulus price will be USD 3.7 per MBTU.

SUMMARY OF MAIN INDICATORS

Economic activity

- Economic Activity ↑
- Consumer Confidence ↑
- Industrial activity ↑

External accounts

- Current account →
- Reserves BCRA ↓

Fiscal balance →

Financial variables

- Inflation ↓
- Real exchange rate ↓
- Country Risk →

External variables

- Soybean price →
- Brazilian GDP ↑

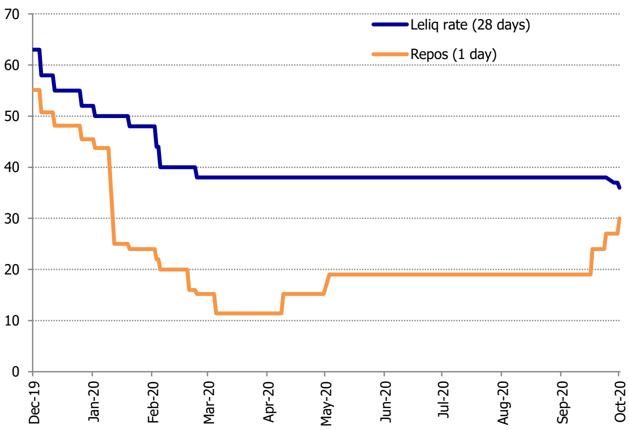
Confidence in the Government ↓

Up arrow indicates improvement, down arrow worsening and horizontal no changes

GRAPH OF THE MONTH:

The CB increased reverse repo rate from 19% to 30%

Interest rates, in %



Source: Econviews based on BCRA

RECENT ECONOMIC DEVELOPMENTS

Pressure in the FX market has increased substantially because of lack of confidence and the absence of a clear macroeconomic plan. After tightening FX controls in mid-September ("XXL *cepo*"), the spread between the official and BCS rate began to increase with almost no pause. At that time, CB had reduced the monthly quota of USD 200 for individuals and virtually forced companies to restructure dollar-denominated debt, by allowing them to pay only 40% of maturities, while the remainder would have to be re-scheduled with an average life of at least two years. In practice, the market response to these measures was very negative, and the FX spread, which at that time was close to 70%, increased to around 120% in only one month, the highest level since 1989. To add liquidity in the BCS market, the Ministry of Economy announced on Oct 19th that the National Securities Commission will reduce the "parking" period of those buying dollars through it to 3 days, from the previous 15. In addition, after reaching a successful debt agreement in early September, country risk began to deteriorate again from 1,100 bps to 1,432 bps currently, particularly hit after the Central Bank forced companies to restructure dollar debts. As a result, the performance of sovereign bonds was the worst in comparison to other recent debt exchanges, and bond prices collapsed more than 20%.

In early October, CB announced it would increase volatility in the exchange rate. Immediately, the currency depreciated 0.9% d/d but then CB began to contain depreciation again, reducing volatility. FX intervention amounted to USD 500 million up to Oct 9th, gross international reserves fell below USD 41 bn, and net liquid reserves stand below USD 1 bn.

Since mid-September, CB tried to improve short-end peso rates to increase appetite for these instruments, but the reaction was so mild that it had no success. Every Thursday CB' Committee holds a policy meeting, and on the last three weeks the 1-day reverse repo rate was increased, first from 19% to 24%, then to 27%, and now to the current 30%. Short-end peso rate has been lagging. At the beginning of October, a 30-day Treasury Bill in pesos yield was slightly above 30%, while nowadays it increased to 46%. The idea was to try to harmonize interest rates between the Treasury and CB without worsening the quasi fiscal deficit. In consequence, the 28-day Leliq rate was reduced from 38% to 37%, and nowadays to 36%. In the last policy meeting it was announced that 7-day reverse repo will be used again as a policy tool. This instrument had not been used since 2018, and the rate was set at 33%. Furthermore, the rate paid for retail time deposits was slightly increased from 33% to 34%. Given that expected inflation for the next 12 months stands around 50%, the implied real interest rate is negative (-11%).

As interest rates are clearly not being used to contain depreciation expectations, the Government made some changes for exporters to encourage FX proceeds. In consequence, soybean export taxes were temporarily cut from 33% to 30% in October, will increase to 31.5% in November, to 32% in December, and will return to 33% in Jan-21. However, this measure had no significant impact, as the FX spread is too big to lure exporters to sell dollars at 54 pesos (net of export taxes), while the free exchange rate is closer to 170. In the last policy meeting CB toughened controls for imports. Amounts above USD 50k will need authorization (previously USD 500k). This measure will certainly take a toll on the pace of recovery for the coming months.

Dollar deposits continued to drop at an average speed of USD 83 million per day (last 5 days, moving average), decelerating from the previous records (USD 170 million). They amount to USD 15.6 bn and had fallen USD 1.9 bn since the implementation of the "XXL *cepo*". At the same time, credit in dollars contracted by USD 290 million, and the current stock is USD 5.8 bn. Therefore, the dollar liquidity buffer has reduced from USD 11.3 to 9.7 bn. However, legal reserve requirement (% of deposits in CB) fell only USD 250 million and stands at USD 11.8 bn, which means that 75% of deposits are backed up with dollars in the CB.

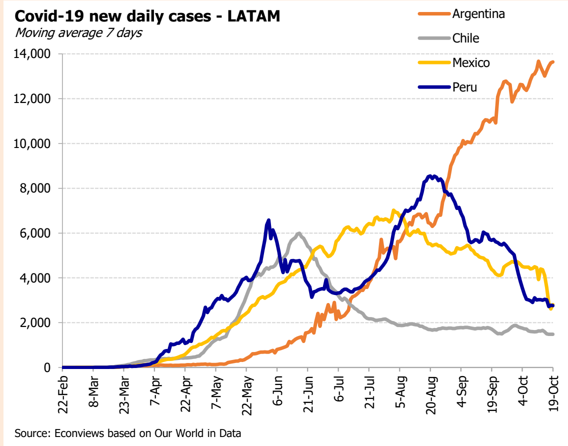
Economic activity went up 1.1% m/m in July, recording its third consecutive rebound since April's all-time low. According to preliminary data, in August activity lost some steam, but in September gained strength again. Leading indicators for construction are encouraging, especially considering that, measured in dollars, construction cost is cheap. As a matter of fact, in September cement production went up 16.2% m/m. Other leading indicators for activity also showed good signals: automobile production (32.6%), retail sales (12.6%), motorcycle licenses (7.4%) and VAT revenues (2.3%) recorded monthly increases (s.a. data).

Monthly inflation accelerated for the second time in a row, from 2.7% in August to 2.84% in September, driven by rises in food and beverages (3.0% m/m, contributing by 0.84 pp) and clothing (5.4% m/m, 0.52 pp). Core inflation decelerated from 3.0% to 2.3%. Thus, so far this year accumulated inflation rose to 22.3%, while annual inflation decelerated from 40.7% to 36.6% in September.

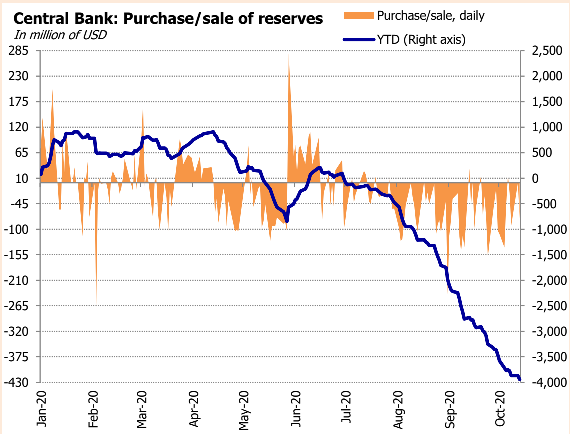
Volatility and emerging risk have increased. The noise is coming from the USA, as presidential elections will take place in November, and the debate on the optimal fiscal stimulus has not ended. In addition, Covid-19 cases began to increase again in Europe: France and the UK implemented restrictions to mobility. The IMF-WEO for October considered that although the global economy is recovering to pre-pandemic levels of activity, it remains prone to setbacks. Argentina will fare only better than Peru in the Latin American context when considering 2020 and 2021 together. According to the IMF the net loss in the two years among to 7.5% of GDP. In our numbers there is room to do slightly better than that. Chile, Brazil, Colombia and even Mexico are forecast to do better than that.

I. Time is running out

As time goes by the economy seems to be getting deeper into a hole. The government continues to be haunted by **the record levels of the alternative exchange rates, the persistent drop in international reserves and the increase in the country risk** as measured by the EMBI. In the meantime, the sanitary situation is deteriorating rapidly as the number of cases increases and there are no signs yet that they have peaked, while the government maintains a long lockdown that delays the economic recovery.



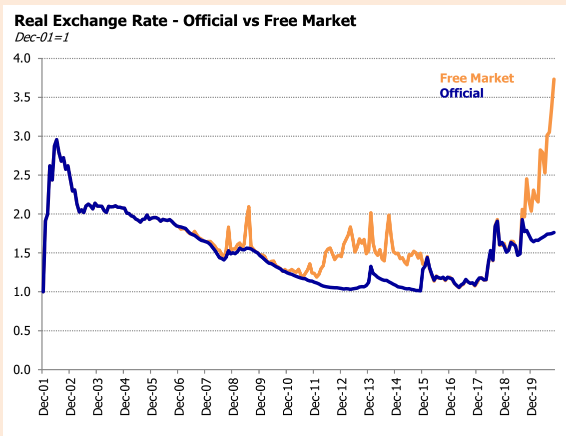
The most urgent challenges are on the external front, where the government continues to experience a drop in reserves at a time when they are already at critical levels. Net reserves, once one nets out short-term liabilities and accounting tricks, are only 6.4 billion dollars and still dropping, liquidity is extremely low (close to nil), and the Central Bank is facing difficulties to meet external payments. It can still repo part of the gold, but time is running out and the government is struggling to find an effective response to deal with the problem.



The shortage of international reserves has become a critical constraint for the functioning of the economy, and to the extent that the government does not find a way out, the pressures on the parallel exchange rates will continue, and there will be **increasing difficulties to import, which will create shortages and put additional pressures on domestic prices**, and complicate the economic recovery.

So far, the government has failed in its attempts to control the parallel exchange rates and **the spread has been spiraling and reaching record levels, that were not seen since the 1980s.** One of the problems is that **there is an erroneous diagnosis of the situation.** The government's basic assumption is that the peso is not overvalued, a view that is based on the fact that the real effective exchange rate does not seem to be low (appreciated) compared to recent historical levels.

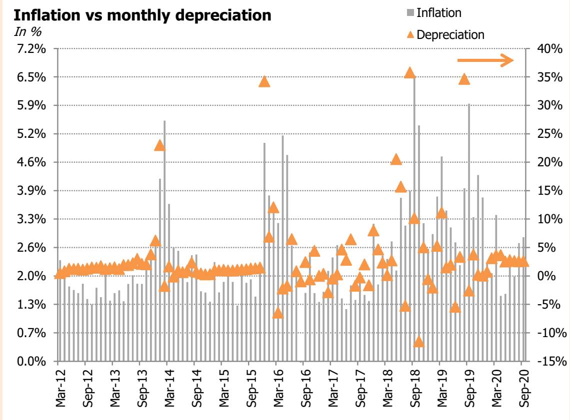
The main flaw in the government's analysis is that does not take into account the need to have a weak currency in the current situation in which the country does not have international reserves and needs to increase the stock, in which it does not have access to the international markets to borrow, in which companies cannot borrow abroad and bring dollars because there is uncertainty about whether they will be able to access the foreign exchange market to meet their obligations, in which individuals and firms are concerned about the respect of property rights and the extent of government intervention and hence the pressures are for capital outflows. **The economy today needs an undervalued currency.**



The equilibrium exchange rate is not the same in a sunny day than in the middle of the storm. And the uncertainty that Argentina faces today compounded with the need to increase reserves requires a weak currency relative to its long-term level.

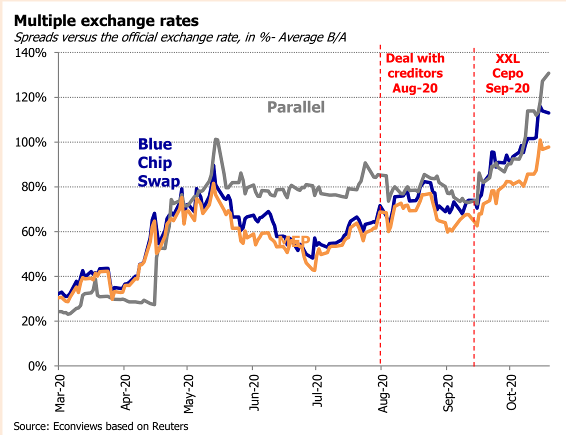
A long-term solution to this problem requires a comprehensive macroeconomic program, which is not on the table at the moment. The need for the program is clear. **The current level of the alternative exchange rates reflects numerous concerns**, some of them about the possible evolution and consistency of economic policies but also about the overall economic model that the government has in mind.

The questions abound about economic policies, such as whether there is financing for the fiscal deficit and what the government can do if it fails to find funding in the market: shall it print money and run the risk of a much higher inflation or will it reduce the deficit? Is the government willing to tighten monetary policy raising interest rates high enough to stabilize the parallel exchange rates? Will it be ready to remove or be more flexible in the use of price controls to favor private investment? Will the new conditions allow the Central Bank to eliminate the *cepo*? Will it continue to increase the tax pressure above the levels of other emerging markets that is leading many companies and individuals to leave the country?



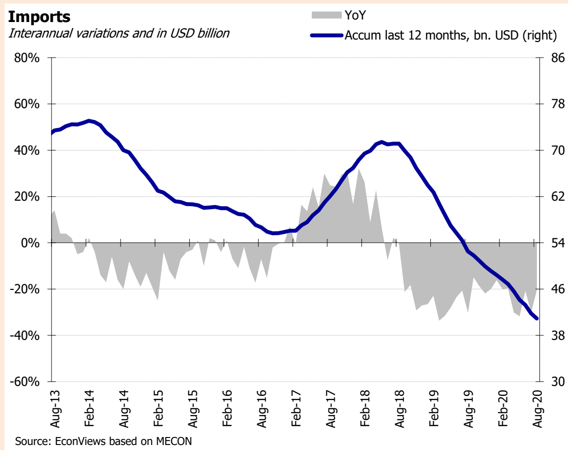
It is clear that all these policy measures cannot be adopted quickly, but **so far the government has not sent clear signals regarding in which direction it wants to move.** This view seems to be shared by the IMF mission that recently visited Argentina, as evidenced by some statements that the staff made and by recent remarks of its managing director.

In the meantime, **the government will need to make policy decisions, and all of them will have side effects. Doing nothing and waiting for a miraculous normalization of the situation is not an option.** Isolated policy measures in homeopathic doses have not worked so far and are unlikely to do the trick because they do not change expectations, which are at the heart of the exchange rate problem. **Devaluation by itself and without supporting measures runs the risk of rising inflation and end-up having little effect on the FX spread.**



What alternatives does the government have to alleviate the situation? Letting the exchange rate float, like in the 2001 crisis, is not an option today due to the lack of plan and the risk of spiraling inflation. It seems that it needs to move on a two-prong approach to reduce the FX spread. **First, and despite the clear reluctance to depreciate the official exchange rate, at some point it will be inevitable to devalue**, probably by around 25%. Perhaps it will be a remake of Fabrega's devaluation of January 2014, when all of sudden the Central Bank depreciated the peso because the Central Bank had run out of reserves. At that time, the pass-through to inflation was roughly 30%. Such a move will not close the gap, but it would be a move in that direction.

Second, it would need to deal with the parallel exchange rates (where the blue chip swap is the most important reference), which float and where the Central Bank does not intervene, namely because it does not have enough dollars. **In essence it requires reducing the overhang of pesos, the concerns about future inflation and restore confidence.** Not an easy combination. **A realistic objective would be to tighten monetary policy and announce a fiscal deficit consistent with the availability of financing.**



So far the response has been to tighten the FX and import restrictions, to send some mixed signals about hiking interest rates (in which the Central Bank increased the repo rate, but lowered the rates on Leliqs) **and measures to increase liquidity in the blue chip swap market, which have not worked.** They have been too little, and somewhat confusing. On the official exchange, rather than accelerating the rate of depreciation, it decided to maintain and only introduced some volatility in the day-to-day fixings. The answer should a more comprehensive program.

What are the most likely outcomes? First, **we do not expect that the pressures on reserves will loosen**, most likely they will continue, and the Central Bank is running out of reserves. The current strategy of further controls on imports could backfire as it will generate shortages and spur inflation.

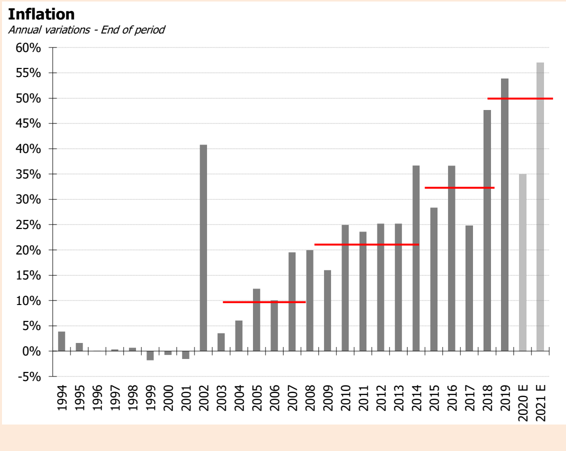
If the Central Bank in fact fails to reverse the situation it will be forced to devalue, though it is likely to split the foreign exchange market with a commercial exchange rate for imports and exports and financial exchange rate for other transactions. **With the right monetary policy, it might reduce the spread to more manageable levels** of around 25 to 30%, though it waits to be seen whether the Central Bank will be willing to tighten monetary policy.

Time is running short and there is no room to procrastinate policy decisions, as the peso is depreciating relentlessly in the alternative markets, the government's positive image is falling rapidly and the import and FX controls are bringing business decisions to halt, threatening the economic recovery.

The main hope is that the government finally realizes that it is rapidly advancing on a collision path and that the IMF program offers one of the few possibilities to put together a credible and consistent program that can turnaround the situation. True, the IMF does not have a very good track record in Argentina, but this time could be different. The IMF can wait, as the payments on the program only come due in the second half of next year, and most likely would avoid signing a program that is doomed to fail. Argentina does not have that luxury and needs to make progress as soon as possible.

The IMF mission will come to Argentina in November to start the negotiations and Guzmán has said that the negotiations will take a few months. As most IMF programs the negotiations are likely to center on the path of the fiscal deficit (and the need to reduce the primary deficit that is in the budget to less than 4.5% of GDP), on the exchange rate policy (that the IMF has already criticized), on monetary policy and, if in the end Argentina requests and Extended Fund Facility, some structural reforms.

An IMF program provides the best opportunity to revert the current situation, especially if the program includes additional funding to replenish reserves and a loosening of the *cepo.* If there is a will there is a chance. **It won't be easy, it will require some tough policy decisions, but Argentina still has a chance to turn around the situation.**

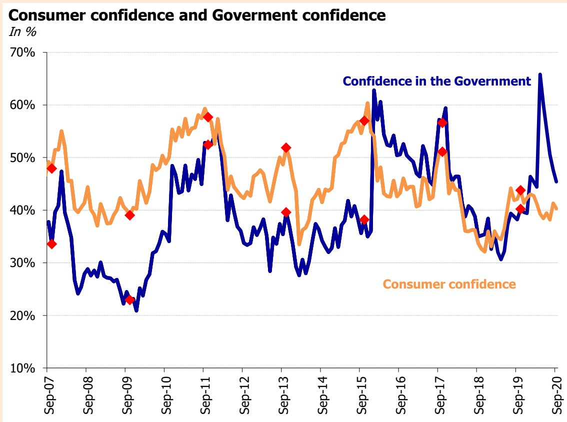


Gross versus net reserves

In billion of USD

Gross reserves (1)	**40.8**
Central Bank liabilities (2)	**34.4**
Reserve requirements in USD	11.9
Swap Central Bank of China	19.4
BIS	3.2
Net reserves (3) = (1) - (2)	**6.4**
SDRs and Gold (4)	4.2
Contributions to international organizations (5)	1.3
Liquid reserves (6) = (3) - (4) - (5)	**0.8**

Source: Econviews based on IMF, Ministry of Economy and own estimates



Source: Econviews based on UTDT

II. Social instability: a growing threat for the economy

The social situation in Argentina has become a key concern for the business community and the middle class. Not by chance poverty was one of the main themes at IDEA, the biggest business conference in Argentina. On top of the Covid-19-led shock to employment and poverty, there seems to be a more structural pattern in Argentina with ripple effects on human capital and security related issues, both topics that are key for business and development more broadly**.**

Poverty has surpassed the 40% barrier and will grow higher in 2H. Salaries will drop in real terms for the third year in a row and informality is rising. The only positive element to highlight is that in this crisis the state is somewhat better organized than in 2002. It runs a few flagship programs to assist people in the lower end, which meant that only a quarter of the poor are also in extreme poverty versus half of them in 2002. The short-term challenges for social policy are huge. Argentina will need to undergo a fiscal adjustment. Secondly, inflation is doomed to increase next year, hurting informal and poor people more than the rest. More insecurity and brain drain are part of the cocktail. The consensus is that it will get worse before it gets better, but sadly nobody guarantees the latter.

Poverty and unemployment

*Total 31 urban agglomerates - 1H 2020**

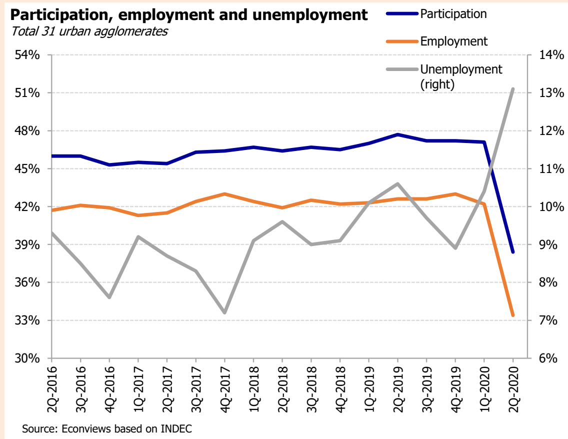
	%
Poverty	40.9%
Indigence	10.5%
Employment	33.4%
Unemployment	13.1%

*2Q for employment and unemployment

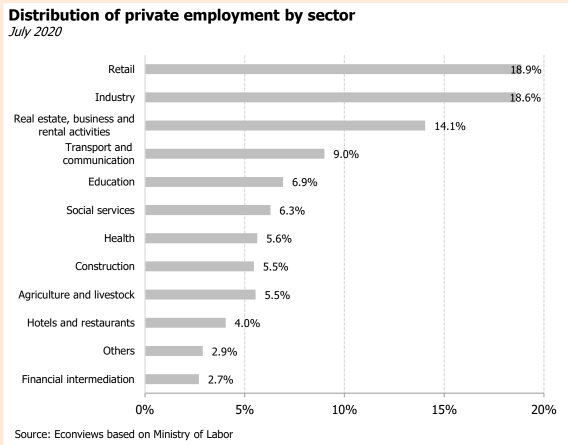
Source: Econviews based on INDEC

i. Chilly labor market

The unemployment rate hit 13.1% in the second quarter of 2020, the highest number since 2004. If we add 9.6% of under-employment, we find 22.7% of the population with job problems. But this is not the whole story in the labor market. These numbers are accurate, but unemployment has not climbed further for two important reasons: the labor force declined by 9 percentage points due to the lockdown and private sector was banned from laying off staff. Some people say that unemployment could have been 29% assuming similar employment numbers but a normal participation rate. This is somewhat misleading, as we need to assume that if people could seek a job (i.e. softer lockdown) some would have found it or not lost it. So, using more reasonable assumptions unemployment would have reached 18-20%, getting near the record of 2002 when it hit 21.5% by May.



The Argentine labor market counts 19.4 million people. Of those, there are 4.5 million informal workers and 3.7 million self-employed, of which 70% are considered low income people. Almost 9 million are formal employees, but only two thirds of them work in the private sector. Unemployed were 1.8 million people but after Covid-19 outbreak the number rose to 2.26 million denting mainly form the informal pool and low income self-employed. Using an 18% unemployment in a normalized participation rate we adjust the number of unemployed to 3.8 million people.



Comparing Q2 2020 with Q2 2019 we note that the employment rate fell by 21.7%, from 42.6% to 33.4%. This affected men more than women and low-skilled workers far more than skilled labor. This can also be seen with

informal workers that represented 10.9% of the labor force a year ago and just 6.1% now. Public workers now represent 22% of all employees back to 16.5% a year ago, as this group has been fully protected in the pandemic. The problem is that while labor participation and employment rate will gradually recover, nobody sees a full recovery of the employment rate for a while, as GDP would go back to 2019's level in 2023 at the earliest.

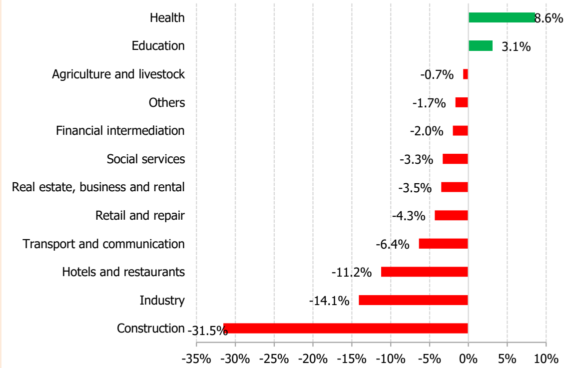
The private formal market has resisted reasonably well. Firstly, by definition, it is the more stable part of the labor market. But in this occasion, it was strengthened by two regulatory shocks that added to an already rigid marketplace. By December president Fernandez doubled the redundancy payment and then in April it prohibited layoffs, a measured that was rolled over at least until November. This means that companies that managed to reduce staff was either because they closed or they arranged voluntary payments to staff, which in most cases were in line with double redundancy scheme. This was the case, for instance, of the dozen or so multinational firms that left or shrunk its presence in the country. It is fair to say that the government has paid part of the salaries or provided soft loans through one of the ad-hoc programs called ATP. This program takes around ARS 35 billion per month on average. In April over 400,000 firms applied to it while in the latest version the number of applicants dropped to 274.000. In terms of workers the state helped to pay over 2 million wages back in April and 1.3 million in September.

All in, the private formal sector only shed 3% of its workforce compared to February or 180,000 people of which 67.800 were in the construction sector (17.4% of its workforce), which has a special regime with its own unemployment insurance. Hotels and restaurants also reduced over 10% of their staff. Some companies suspended staff temporarily paying 75% of the salary during the worst part of the lockdown, but it is believed that the proportion of suspended workers is around 5% by October.

The problems in the formal labor market are far more severe than those arising from the pandemic. In the last 5 years Argentina cut its formal headcount by 7%, a problem that also affects social security revenues and fiscal sustainability. In the last 5 years manufacturing shed 14% of its jobs. Construction 30%, retail 4% and hydrocarbons & mining 6.9%. Health, education, and utilities are net gainers. Looking at a 10-year spam, the number of formal jobs in the private sector only inched up by 1.3% when population growth is roughly 1% per year.

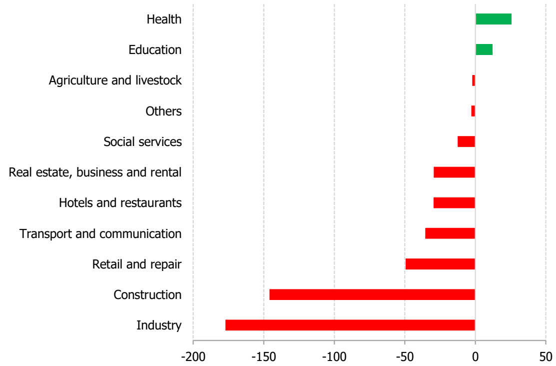
At a regional level, 22 out of 24 provinces lost jobs in the last 5 years. In 9 of them the decrease was over 10%. This mainly affected poorer districts on top of two provinces in Patagonia: Santa Cruz and Tierra del Fuego. Conflicts around the formal labor markets with courts siding with workers, often challenging common sense, have incentivized a de-facto flexibilization. While formal labor shrank, the number of independent workers increased by 5% in 5 years to bypass rigid legislation and often contingent liabilities, which may take small companies to bankruptcy.

Evolution of private employment by sector
July 2020 vs July 2015 - % change, seasonally adjusted



Source: Econviews based on Ministry of Labor

Evolution of private employment by sector
July 2020 vs July 2015 - Thousands of jobs, seasonally adjusted



Source: Econviews based on Ministry of Labor

Evolution of private employment per province
July 2020 vs July 2015 - % change, seasonally adjusted

Source: Econviews based on Ministry of Labor

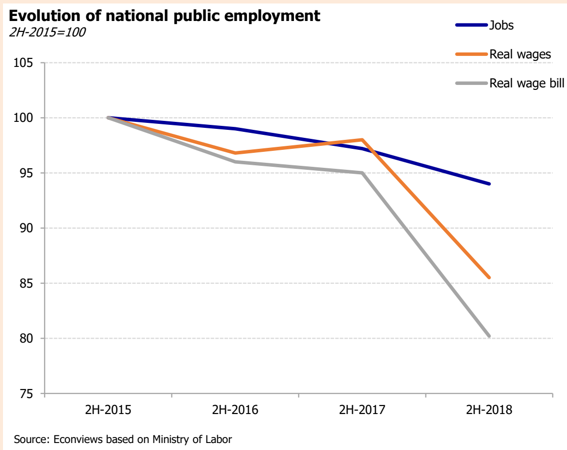
Salaries fall to 2009's tally

The average private formal salary is down by 4.6% in real terms as of July 2020. In our view, salaries will fall even more in the coming months as inflation will outpace salary increases being negotiated by unions. If we compare the average salary to 2 years ago the number goes down to -9% and to 14.7% if we compare to July 2017. If we want to find an average real salary lower than today, we need to go back to 2009. This in many ways makes sense since the current GDP is in 2007's level.

So, while salaries do not seem to be totally out of touch with an "equilibrium level", it is hard to foresee a big rebound. One of the features of the 2002 rebound was that salaries were very cheap, and this enabled to run a recovery without import restrictions and generating exports in labor intensive sectors where Argentina does not enjoy long-term competitiveness. Is this a viable or desirable solution? Probably not. But, as we see a real depreciation extremely likely, salaries are bound to fall further.

However, the big question is if a cheaper salary would help to reinvigorate the labor market. The answer is ambiguous for us. One the one hand the price signal is important, but on the other hand we are somewhat bearish about the recovery of investment aside some construction work. In other words, while the job-growth elasticity can be higher than in recent times if salaries continue declining, we do see much growth beyond a short-term recovery.

Labor training should be a critical part of the policy mix once Covid-19 is over. Argentina invest in labor training a third of the average OECD countries in terms of GDP, although it still does more than most countries in the region except for Chile. Argentina is famous in the Latin American context for the quality of its human capital and for a bunch of high-profile companies. This is well-deserved but not the full story. Firstly, the pool of talent that can excel in IT, health, engineering, agro-sciences, among others, is very important but it comprises only a small fraction of the population. Secondly, Argentina has an important stock of human capital, but the flow has been worsening over the years. Argentina has been putting emphasis on social protection but much less in retraining. And we do not see yet movements in that direction. Levy Yeyati, Montane and Sartorio proposed 4 policies: wage subsidies, support to micro-entrepreneurs, vocational training and to a lesser extent employment service. The problem is that all these features are not fiscally neutral and are difficult to implement in states with no not great implementation capabilities and more so with short term fiscal urgencies.



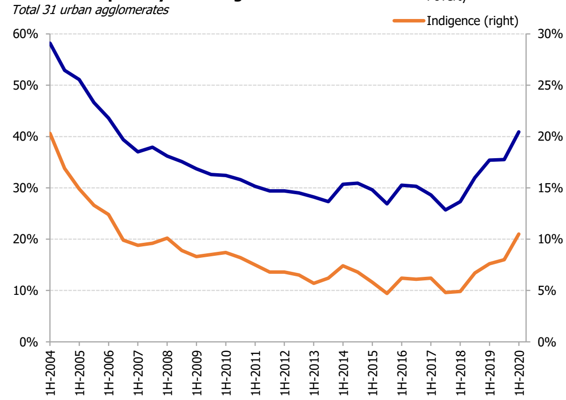
What are unions agreeing these days? Some 15 unions have agreed new terms for 2020. From 15% in the case of teachers to 37% for rubber workers there is a wide range of agreements. Others such as retail workers agreed on lump sum amounts. Most agreements last only a few months or have contingency clauses, as both parties see that inflation has more room to increase than decrease. The dynamic of these negotiations could be tricky. While the labor market is chilly and pressures are not there, the mid-term elections of October next year can be a catalyst for unions, with government support, to seek faster salary increases to boost consumption.

Wages may be the only tool available. This year the government has already forced banks to refinance twice credit card balances. It also lured banks to finance durable goods and some not so durables such as haircuts in 12 instalments at zero rate with the carrot of reducing reserve requirements. But if wages continue to fall, credit card limits will be stretched, and not even negative real rates could do the trick of waking consumption up.

ii. Poverty is becoming more structural and income more unequal

At 40.9% poverty hit a new high. This means that over 18.6 million Argentines are official poor. Only 2.5 years ago only 25.7% Argentines were poor. Now we estimate that when second half numbers become public easily 45% of the population may be below the poverty line. This takes Argentina back to 2004 when it was recovering from the worst crisis. This opens the pandora box for several other problems. Insecurity is increasing, different groups have occupied land in different parts of the country as part of a broader housing problem. Drug trafficking as an easy way of receiving an income is another concern. In all cases these are multi-causal problems, but poverty is a common factor, almost a necessary condition. So, beyond any moral concern, this is also a problem for business and investment, as social stability is as important as macro stability to think in long term investments. Sadly, Argentina can promise neither of them today.

Evolution of poverty and indigence
Total 31 urban agglomerates

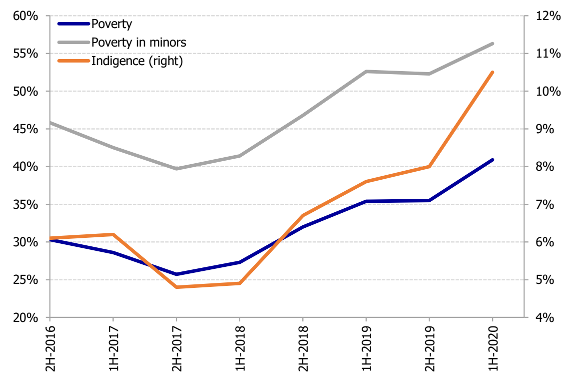


Source: Econviews based on INDEC and Schteingart et al.

The only positive element of this new jump in poverty is that indigence only affects a quarter of poor when in 2002/3 it was 50%. This is mainly the result of a handful of government programs that have been in place for years and a learning curve in government officials. This is one of the few areas in which there is no controversy in Argentina. Macri never tried to dismantle the flagship poverty alleviation programs and, if anything, it increased the funding for them.

Some stylized facts about poverty. If affects 30.4% of households and 40.9% of people with indigence reaching 8.1% of households and 10.5% of people. Poor households have on average 4.1 members. One of the most worrying elements is that poverty reaches 56.3% of children under 14. In this group 28% of the poor are in extreme poverty. Among the over 65s the poverty rate is just 11.4%. This says a lot about the good social security coverage in Argentina (and it also talks about the endemic fiscal deficit). Poverty is equally split between the Metropolitan Area of Buenos Aires and the interior, but with peaks in the outskirts of Buenos Aires (47%), Concordia (52%) and trough in the City of Buenos Aires where only 17% of the population is poor and the proportion of extreme poverty is just 21%, 4 points less than the national average.

Evolution of poverty and indigence
Total 31 urban agglomerates



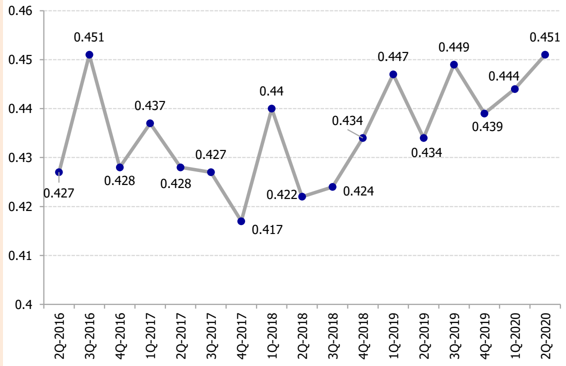
Source: Econviews based on INDEC

The gap between actual income earned by the poor and what they would need to emerge from poverty is at an all-time high: 41%. Every one of the 4.5 million poor households under the poverty line would need 18,000 pesos to cross the line or 81 billion pesos per month or 1 trillion pesos a year. This is roughly 3% of GDP. **The poverty problem in Argentina goes well beyond Covid and the last recession**. If Argentina could magically take it back to 30%. Then, it would still need 20 years growing at 3% to reduce poverty to 10%, according to a paper produced by CIPPEC (think tank). But Argentina's potential growth rate is below 3% and the starting point will not be 30% but 45%. In other words, Argentina could reduce somewhat the current poverty level, but going below 25-30% would require structural reforms and not just growth. According to a paper published by CEDLAS Argentina was one of the Latin American countries were poverty fell the least between 2006 and 2016.

Some features illustrate how structural poverty may be. Men have equal participation considering those in "chronic poverty" and "non-vulnerable" groups. But the former has 5.7 years of education while the latter surpass 15 years. The conditional cash transfer is alleviating this among the young cohorts, though. Among women, 90% of the non-vulnerable is active in the labor market while less than 50% among those in chronic poverty are. Access to sewage system is less than 30% among the chronic poor and over 90% in the non-vulnerable group as defined by Gasparinin-Tornarolli-Gluzman (Cedlas)

Inequality has also widened lately. The lockdown has hit people differently. The gini coefficient in Q2 rose to 0.451 from 0.434 the year earlier. The income of the richest decile was 25 times the poorest decile when a year ago was 20 times and 18 times in 2018. A recently released paper by CEDLAS showed that the lock down affected the income of the richest deciles only marginally, but over 25% in the bottom end. According to a simulation run in this paper decile 7,8,9 and 10 increased their share in the lockdown while bottom 6 deciles lost out. This also relates with the impossibility of remote working in the low-end in the income distribution.

Gini Index
0-1, 0 means perfect income equality

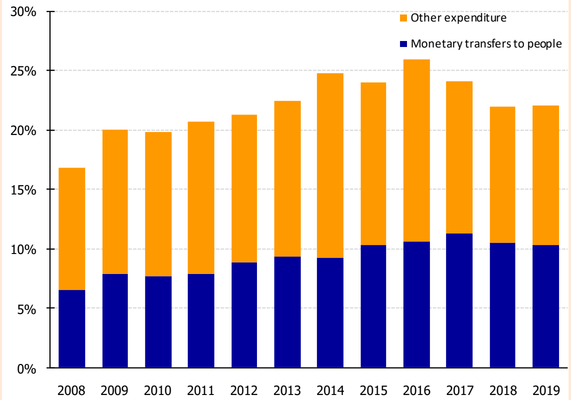


Source: Econviews based on INDEC

iii. Argentina's social programs and their cost

The end of convertibility and the rise of unemployment and poverty after the 2002 crisis were the triggers for many social programs that expanded the universe of beneficiaries. And since then, they continued to expand in line with the economy stagnation since 2011 and the strong deterioration due to the Coronavirus crisis.

Expenditure of the National Public Administration
Accrued basis - % of GDP



Source: Econviews based on the Congressional Budget Office

Social expenditure has been growing steadily in recent years. They took around **38% of expenditure in 2008 and 47% in 2019**. Today, **80% of social expenditure corresponds to social security,** its historical high since the early nineties. The rest corresponds, among others, to education, housing and health. Considering pensions and other transfers to families and social programs, in 2019 the National Public Administration paid 21.3 million social benefits, with an expense equivalent to 10.3% of GDP. **Between 2008 and 2019, the number of benefits increased by almost 10 million.** Of the total benefits that were paid last year, around 13% went to people of working age.

This year, due to the quarantine, more than 33 million benefits will be paid to 25 million people (60% of total population), mainly due to the implementation of the Emergency Family Income (IFE), which reached 9 million people, and the payment of part of the wages of private employees, in order to fulfill the monthly income of around 3 million

Expenditure of the National Public Administration
Accrued spending as a percentage of GDP - 2019

	Monetary transfers to people			Other expenditure	Total expenditure of the NPA
	Total	Retirements and pensions	Social programs		
2008	6.5%	5.6%	0.9%	10.3%	16.8%
2009	7.9%	6.8%	1.1%	12.1%	20.0%
2010	7.7%	6.5%	1.2%	12.1%	19.8%
2011	7.9%	6.7%	1.2%	12.8%	20.7%
2012	8.8%	7.7%	1.1%	12.5%	21.3%
2013	9.3%	8.1%	1.2%	13.1%	22.4%
2014	9.2%	8.0%	1.2%	15.6%	24.8%
2015	10.3%	8.9%	1.4%	13.7%	24.0%
2016	10.6%	9.0%	1.6%	15.3%	25.9%
2017	11.3%	9.6%	1.7%	12.8%	24.1%
2018	10.5%	8.9%	1.6%	11.4%	21.9%
2019	10.3%	8.7%	1.6%	11.7%	22.0%

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workers, within the framework of the Emergency Assistance Program for Work and Production (ATP). With data up to August, both programs have implied disbursements of AR$ 323,750 million, equivalent to around 8% of primary expenditure and 12.4% of social security spending.

Since the flagship child allowance program (AUH) was implemented, Argentina is one of the first countries in the region in terms of the share of GDP allocated to social security programs, along with Brazil. Due to the latest UN ECLAC data (for 2018), Argentina spent the equivalent of 10.9% of GDP on social benefits, slightly below Brazil (13%), but well above other neighbors such as Chile (5.7%), Colombia (5.5%) and Mexico (3.4%). Regarding coverage, the "Universal Child Allowance" (the largest program in Argentina) reaches 2.5 million families, that is, more than 13 million people, around a quarter of total population.This coverage is similar to that of the "Bolsa Familia" flagship program in Brazil that reaches about 50 million people (12 million families), whichalso represents approximately a quarter of the population of Brazil.

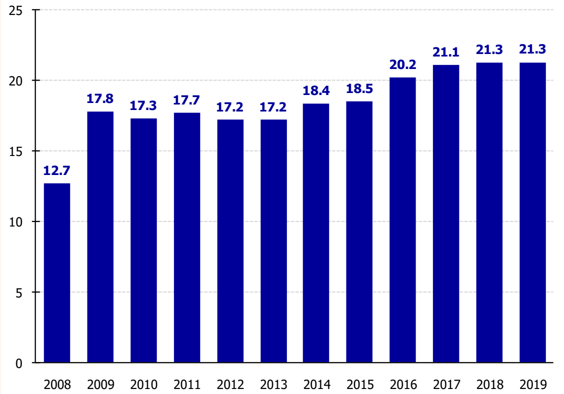
However, if we look at the potential for innovation, for example, the AUH loses against the "Brasil Sin Miseria" program implemented by the Dilma Rousseff government, which seeks to generate the necessary conditions for the genuine and long-term achievement of permanent income in families, not contingent ongovernment assistance. This program, in addition to ensuring a basic income, includes training and professionalization programs. In this respect, it is quite comparable with the "Progresar" program in Argentina, but the local program is a kind of scholarship for students between 18 and 24 years old and its coverage is much smaller than the one provided by the Brazilian one.

Benefits by age
In 2019

Age	# Benefits	Accrued spending	
		In million $	As a % of GDP
Minors (0-18)	9,047,473	253,612	1.2%
Working age population	2,707,450	242,254	1.1%
Seniors	7,622,669	1,663,301	7.7%
No specific age	1,908,951	61,858	0.3%
Total	**21,286,543**	**2,221,025**	**10.3%**

Source: Econviews based on the Congressional Budget Office

Social security coverage
In millions of benefits



Source: Econviews based on the Congressional Budget Office

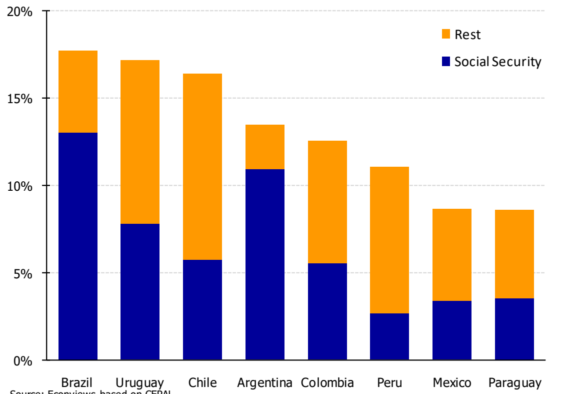
An ineffective medication for a serious illness

As we have previously analyzed, the coverage of social assistance has increased strongly in recent years. **Between 2008 and 2019, the households that received social plans increased by ten percentage points**, and if we eliminate "double benefits", total beneficiaries amounted to 20 million last year, more than 8 million above 2008's beneficiaries**.** However, **poverty averaged 35.7% in 2008 and 35.5% in 2019, while indigence went from 9.5% to 7.8%.**

The budget for food emergency in 2002 was just over 10,000 million pesos at today's prices, when indigence was increasing to more than 25% of the urban population. Today, with less than 10% indigence, the government allocates about 70,000 million to food cards.

Despite the scope and the budgetary magnitude of social programs, they have been showing the insurmountable limits of assistance policies. Beyond the current economic scenario, poverty seems to have a floor of 25% of total population (more than 10 million people) and **the policy of fiscal assistance without labor compensation has become an obstacle to overcoming this structural poverty.**

Social spending in Latin America
As a % of GDP, in 2018

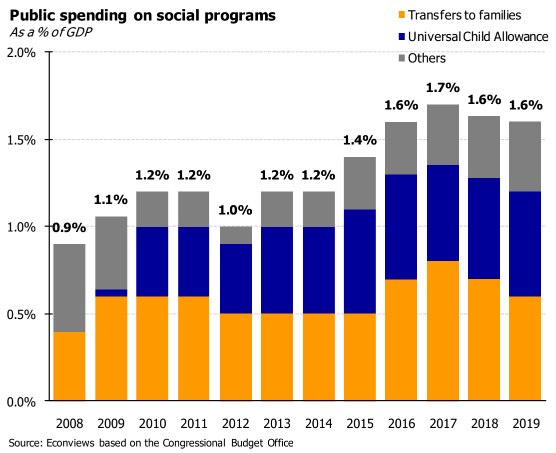


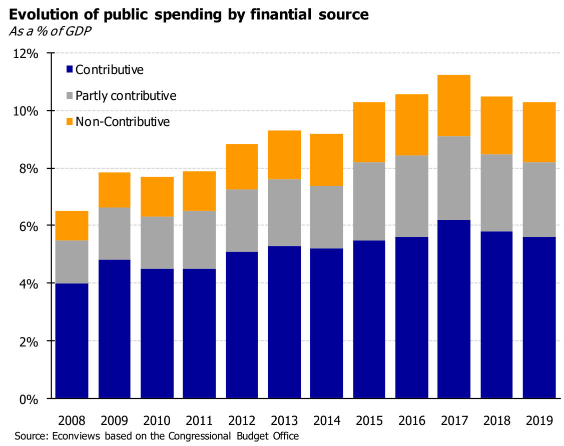
Source: Econviews based on CEPAL

The great problem of sustainability

The worrying counterpart of this greater social assistance is that, as the recession lengthens, unemployment increases and, in turn, the quality of employment deteriorates, **the deficit of the social security system also increases.** Partly-contributory and non-contributory benefits are growing much faster than contributory ones, and this year even at a faster rate because both the IFE and the ATP programs do not have a counterpart in previous or present contributions. **This undermines the sustainability of the pension system.**

In recent years, in which there was a large increase in benefits (due to social security contributions amnesties in 2005 and 2016) but the number of people contributing to the pension scheme was flat, **contributions had a participation of around 50% in the financing of the universe of benefits.** According to the Congressional Budget Office, **of the 21.4 million social benefits paid in 2019, only 7.7 million corresponded to retirements and contributory pensions.** This expense was equivalent to **5.6% of GDP.** The rest, around 13.7 million benefits, were non-contributory and represented an expense equivalent to 4.7% of GDP. According to ANSES (Social Security Agency), as of June 2020, **out of 6.8 million retirements and pensions, 3.6 million (52%) are benefits that were obtained thanks to tax amnesties.**





iv. Conclusion

Argentina faces a very difficult social environment. Over 10 years of stagnation, high inflation and COVID-19 have become a deadly cocktail for the social fabric. People have lost faith and patience. There is a huge problem with quality of public goods. There are over 1,000 shanty towns in the province of Buenos Aires alone. Public education quality has gone down and there is a huge housing deficit. Health care has a good coverage, but the quality is lousy except for the City of Buenos Aires and a couple of other provinces.

Paradoxically, Argentina runs large programs at the federal level on top of smaller provincial policies. This has prevented a worse crisis. But once Argentina emerges from recession it will probably need to reshuffle some of the programs. Years of handouts have worsened the working culture, and this is noteworthy in absenteeism rates that are way higher than in previous decades. The next generation of policies will need to provide training and pick the best of the many successful back to work programs around the world. Argentina had started to work on these programs some 15 years ago, but implementation mistakes and the lack of growth have conspired against the succ ess. Policy makers should start thinking now not just on the design but also on how to build the political consensus, so programs can be labeled as state po licy rather than opportunistic election gimmicks.

Social Benefits - 2019
National Public Administration

	# Benefits	% of GDP
Retirements	5,080,092	5.7%
Contributory Pensions	1,679,472	1.8%
Transfers to families	4,845,708	0.6%
Universal Child Allowance & Universal Pregnancy Allowance	4,201,765	0.6%
Non-contributory disability pension	1,034,599	0.6%
Disability pension	187,722	0.2%
Mothers of 7 children or more	297,875	0.2%
"PROGRESAR"	571,445	0.1%
Complementary social wage	320,581	0.1%
Non-contributory pensions (PUAM)	133,920	0.1%
"Hacemos Futuro"	236,327	0.1%
Spouse Allowance	727,553	0.1%
Ex-gratia pensions	60,881	0.04%
Jobless claims	114,545	0.03%
Food cards	1,345,653	0.03%
"Jóvenes con más y mejor trabajo"	121,667	0.01%
Temporary employment programs	55,330	0.01%
Non-contributory old-age pensions	1,632	0.01%
Maternity and marriage	102,565	0.01%
War veterans & political prisoners pensions	28,169	0.01%
Non-contributory pensions (Special Laws)	1,344	0.01%
Direct aid in emergency situations	72,464	0.01%
Other scholarships	3,464	0.003%
Productive Recovery Program (REPRO)	51,571	0.002%
Training and employment insurance	10,199	0.0002%
Total	**21,286,543**	**10.3%**

Source: Econviews based on the Congressional Budget Office

	2019	2020 E	2021 E	2022 E	2023 E
Inflation (eop)	53.8%	35.0%	57.0%	40.0%	35.0%
Exchange rate ARS/USD (eop)	59.9	85.0	132.0	181.0	230.0
Real exchange rate ARS/USD (eop, Dec-01=100)	151.6	162.5	164.0	163.9	157.3
Paralell exchange rate ARS/USD (eop)	76.8	191.2	231.0	307.7	368.0
Spread with official exchange rate (eop)	28.1%	125.0%	75.0%	70.0%	60.0%
Gross reserves (USD billion, eop)	44.8	41.5	41.5	45.0	50.0
Policy rate (eop)	55.0%	44.0%	46.3%	33.5%	28.0%
GDP (YoY)	-2.1%	-11.6%	6.0%	2.2%	3.0%
Private consumption (YoY)	-6.6%	-13.5%	6.8%	2.3%	3.0%
Primary surplus (% GDP)	-0.4%	-6.5%	-3.5%	-1.0%	-0.8%
EMBI Argentina (spread in bps, eop)	1,744	1,200	950	850	750
Public net debt (% GDP)	43.2%	49.9%	46.3%	46.2%	44.8%
Soybean price in USD per ton (annual average)	327	340	350	350	350
Exports of goods (USD billion)	65.1	55.4	59.4	65.0	70.0
Imports of goods (USD billion)	49.1	40.7	45.8	48.1	52.1
Trade balance (USD billion)	16.0	14.6	13.6	16.9	17.9
Current account (% GDP)	-0.8%	0.1%	-0.3%	0.5%	0.3%

Source: EconViews

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