THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

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Editorial: The Wrong Medicine Against Inflation

Controlling inflation has become a priority for the government on the road to elections. The high records of December and January, which are unlikely to recede much in February, have accelerated the search for recipes that help lower inflation.

Unfortunately, the bulk of the ammunition that is being used goes through increasing price controls, putting a ceiling on rate increases, delaying the depreciation of the exchange rate and pressures on companies, recipes that have failed in the past and that will hardly work this time. They are like a treatment that can alleviate the symptoms for a little while, but do not provide a real cure; at the same time that relative price imbalances increase, which means that the problems will surely be more acute in the future.

History records a few moments when the agreements worked, but only because there was a consistent plan behind it. There are examples such as the Krieger Vassena plan of 1967 or the Israel stabilization plan of 1985 in which price agreements contributed to lowering inflation. But in those cases, they were successful precisely because it was carried out within a program that contemplated monetary and fiscal policies that were consistent with the objectives and in which controls were a complementary element that helped to "coordinate" the drop in inflation.

In those plans, the agreements were a sort of dam until the economic program matured. Without a macro program that contemplates the consistency of the monetary and fiscal variables, the forced price agreements end in tears (*Rodrigazo* or spring plan) or at least they do not meet their objective.

Recently, Minister Guzmán and Cabinet Deputy Chief Cecilia Todesca correctly pointed out that the inflation problem is macro and not microeconomic, statements that are shared by the vast majority of economists and businessmen. However, these opinions that drew applause for the minister are not consistent with the economic policy measures. Little is said about how the government can finance a fiscal deficit of 6% of GDP, as is in the Budget, without resorting to a strong monetary issue that breaks the objective of lowering inflation, or how it will manage to increase reserves with a high FX spread and slowing down depreciation.

Also, there does not seem to be an awareness of the impact that pressure on companies can have on other central objectives such as growth, employment and poverty. Argentina desperately needs investments and businessmen who bet on the country. To the extent that they are persecuted and regarded as those responsible for an inflation that by its nature is macroeconomic, they will be hardly willing to invest; and without investment there will be no growth.

How could these measures impact the agreement with the IMF? The more technical sector understands that the agreement, although it generates political costs, will provide a plan on which the macro can be improved and even make price and wage agreements more viable. The sectors that are more political do not want to know anything about tying their hands during the electoral campaign. An extended facilities agreement looks not only at stability, but also at growth and Argentina's ability to increase reserves to repay debt. Price controls and the new exchange rate policy go in the opposite direction. The market has already voted, the country risk remains at 1,500 points and does not show signs that it may go down. This scenario does not seem conducive to reaching an agreement before the elections.

LAST WEEK IN REVIEW

- The **cost of the total basic basket rose 4.6% m/m** in January, reaching ARS 56,459 for a typical family of 4.
- In the first month of the year, the **cost of construction rose 3.1% m/m and wholesale prices soared 5.6%**, its highest monthly variation since August 2019.
- **Country risk reached 1,509 points**, its highest level since last year's restructuring.
- **Entre Ríos reached an agreement with the Ad Hoc group of bondholders** that owns 58% of its debt in USD. Last Friday closed the restructuring of the Salta bond to 2024

NEXT WEEK'S HIGHLIGHTS

- **Today**, the **fiscal accounts for January** could be published.
- **Tuesday 23** will be for retail. INDEC will publish December data for **supermarkets, wholesalers, shopping centers** and sales of household appliances.
- On **Wednesday 24**, the **EMAE for December** comes out and with that we will have a first approximation to 2020's GDP. We believe that December will not be as auspicious as the previous months.
- On **Wednesday 24** the Treasury will have its **second and last bond auction** of the month. There it must gather funds for the maturities of **ARS 142.4 MM of LECER** (X26F1) and **ARS 67.9 MM of LEDES** (S26F1) on Friday 26.
- On **Thursday 25** the numbers of **the commercial balance** of January come out. We expect the surplus to return, after the December deficit.
- On **Thursday 25** the **quarterly monetary policy report** will also be published.
- On **Friday 26**, the BCRA will give us the **FX market data** for January.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	89.4	0.6%	3.3%	44.6%	▲
Blue Chip Swap	142.9	-5.3%	-3.9%	77.6%	▼
CB reserves (USD million)	39,475	+74	-212	-5,251	▲
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	-6 p.p.	=
Badlar rate (private banks)	34.3%	+0.13 p.p.	+0.06 p.p.	+1.38 p.p.	▲
Merval (in ARS)	49,255	-4.3%	1.6%	27.6%	▼
Country Risk (spread in %)	1,509	0.8%	6.1%	-26.2%	▲
Official exchange rate BRL/USD	5.47	1.8%	0.0%	24.5%	▲
Soybean (USD/ton)	508.4	-0.1%	5.5%	55.4%	▼
Oil - Brent (USD/barrel)	64.5	-0.3%	16.6%	8.2%	▼

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

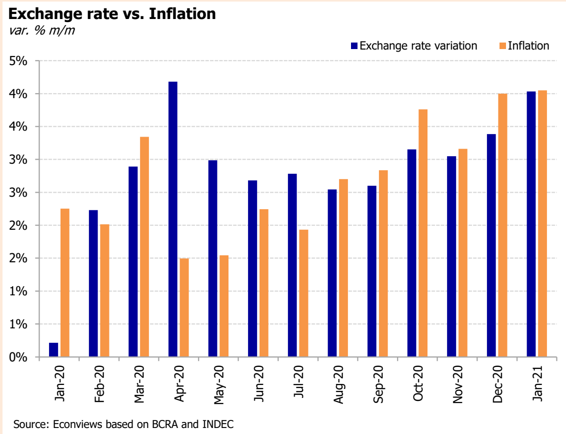
		m/m	q/q	LD vs previous Q
Industrial production	*Dec-20*	0.9%	4.9%	3.3%
Automobile production	*Jan-21*	11.2%	48.4%	38.1%
Steel production	*Jan-21*	-1.2%	18.8%	7.5%
Poultry production	*Dec-20*	1.9%	0.8%	0.2%
Dairy production	*Dec-20*	0.8%	1.1%	2.0%
Beef production	*Dec-20*	-3.8%	-2.1%	-3.3%
Real Estate transactions (CABA)	*Dec-20*	-5.4%	58.6%	-1.0%
Flour Production	*Dec-20*	-6.3%	-9.5%	-12.4%
Oil production	*Dec-20*	0.7%	0.0%	1.1%
Gas production	*Dec-20*	-3.0%	-2.0%	-2.6%
Cement production	*Jan-21*	-3.9%	14.8%	1.1%
Construction activity	*Dec-20*	4.3%	12.7%	10.1%
Retail sales	*Jan-21*	4.7%	10.9%	7.9%
Gas sales	*Dec-20*	13.8%	17.6%	20.7%
Motorcycle licenses	*Jan-21*	-15.7%	-9.7%	-18.6%
Use of electricity	*Jan-21*	3.2%	7.0%	5.0%
Subway rides (CABA)	*Dec-20*	36.0%	80.0%	66.8%
Imports CIF	*Dec-20*	-4.5%	23.3%	4.6%
Exports FOB	*Dec-20*	-20.3%	-6.0%	-18.4%
Loans in ARS to private sector	*Jan-21*	-1.0%	-0.7%	-1.4%
VAT-DGI Revenues	*Jan-21*	4.4%	7.1%	0.3%
Formal private jobs (SIPA)	*Nov-20*	0.1%	-0.1%	0.0%
Formal private jobs (EIL)	*Dec-20*	0.0%	-0.2%	0.0%
Consumer confidence	*Jan-21*	-2.8%	-1.7%	-3.7%
Government confidence	*Jan-21*	1.6%	-13.4%	-3.8%

Note: stoplight color depends on monthly variation

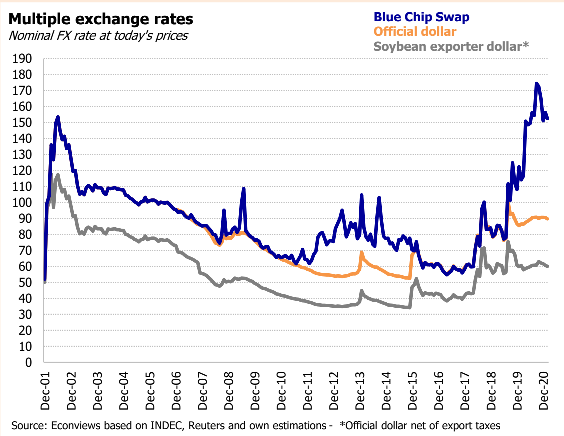
The New Exchange Rate Strategy and the Short Blanket Theory

The elections are approaching, **and the government has already made it clear that it is going to step on three relevant prices in the economy: the exchange rate, utilities rates and the interest rate.** Delaying the exchange rate will not be easy or free. A jump in inflation and a surge in the FX spread appear among the main risks. To what extent can the official exchange rate lag? Does the CB have enough gasoline to keep the dollar under control?

Although the exchange rate policy aimed to keep the exchange rate from lagging behind inflation, February brought a sharp turn of the wheel. In the average for January, the official dollar advanced 4%, in line with the inflation figure, moving at an annualized rate of 60%. But in the first half of February, it has already slowed to just over 40%. Guzmán announced that the government will seek the exchange rate to average around ARS 102 in December, which implies a rise of 25% throughout the year, or a monthly rise below 1.5%. Inflation would be at 29% according to the Budget. Until now, a real appreciation of less than 2% would not be so serious, if compared to the historical average.



If we look only at the real exchange rate, today there seems to be some room to appreciate. The exchange rate is at levels at the end of 2007, valued at today's prices, more than 10% above the average of ARS 80,35 of the last twenty years. But of course, at that time the financial dollar was trading in line with the official one, and even came to be below it, while gross reserves exceeded USD 45,000 million and liquid reserves were positive. The problem is that the market expects much higher inflation than the Budget, around 50**%. If the dollar moves to 25% and inflation is 50%, the real appreciation of the exchange rate would be around 18%**, even higher than in 2011, which was 11% and led to the implementation of exchange controls at the end October. Guzmán's hope is that the exchange rate anchor limits inflation and that this helps to negotiate nominally lower parities and thus reduce the entire nominality of the economy. But the amount of money to be issued by the Central Bank is not going to be adjusted t o a lower nominality. The blanket is short.



The recipe for the exchange rate delay in electoral years is well known. In 2015, the real appreciation reached 4% between January and October, and the Central had to sell reserves in the market for USD 4.4 billion so that the exchange rate did not escape. Throughout the year, it ended up giving up more than USD 8,000 million in this way. In 2013, meanwhile, the government reached October with a practically invariant real exchange rate, but the Central intervened in the market with USD 2.5 billion in the months prior to the elections, and with USD 5.4 billion throughout the year. The end result was the same in both cases: the year ended with a sharp, discrete jump in the exchange rate. In 2013, the official dollar jumped more than 10% in the last two months of the year, while in 2015 the lifting of the *cepo* demonstrated the strong delay in the exchange rate, as it posted a jump of more than 30%. **This time, the Central does not seem to have enough fuel to sustain such an exchange rate delay.** Foreign exchange interventions are limited by low levels of reserves, while it is difficult to continue turning off the tap at imports in an economy that aims to take off in the face of elections.

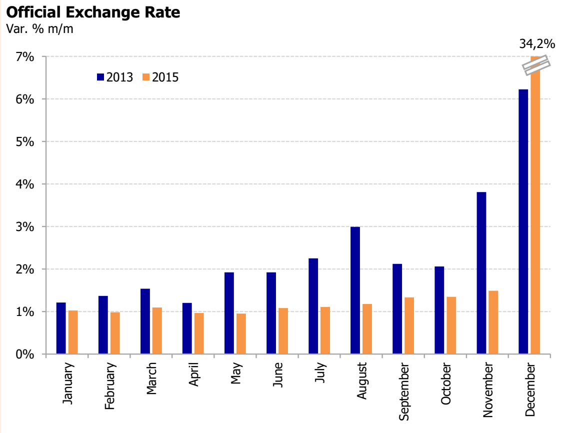
The shortage of foreign exchange is a strong limit for the official foreign exchange delay strategy. This is even more so because the ability to intervene in the market depends to a great extent on the higher expected income flows from the exporters, thanks to the increase in the price of commodities. But a **cheaper exchange rate implies fewer incentives to export and greater incentives to import.**

We do not rule out that the government manages to maintain a crawling-peg rate below inflation. But it will not be free, especially for the FX spread that appears to be the escape route by nature before the perception of a possible discrete exchange rate adjustment in the future. In 2011, for example, the spread increased from 3% in January to 19% in October, with annual inflation just above 23%. Today the situation is different and the room for maneuver has shrunk. For now, the spread remains stable, helped by a financial exchange rate that is, by far, at the highest levels in decades measured at today's prices.

The limitations of the new foreign exchange strategy are clear. But the advantages over inflation in a context in which the monetary issue can rise 60% and there are no dollars to increase imports and supply the market, are not so clear. The first quarter of the year will close with accumulated inflation above 12%, so it will be very difficult for the annual to end below last year's record. Although the exchange rate lag is usually effective to moderate inflation in the short term, this year there is a lot of inflationary inertia, with strong price adjustments of non-tradables, which were the ones that were most relegated in 2020.

Another issue to monitor is wages. If, despite setting a ceiling on parity, the objective is to "put money in people's pockets", that extra purchasing power will have two main destinations: inflation or FX spread. With the exception of 2019, since the second government of Cristina Kirchner, real wages have only increased in electoral years: 6.9% in 2011, 3.8% in 2013, 4% in 2015 and 3% in 2017.

Although we do not rule out that inflation will be below 50% in December with an exchange rate advancing several points below, it is not the scenario we are assuming as a base. Our premises assume inflation of 50%, with an exchange rate closing the year at ARS 121, that is, 43.5% above the end of 2019. There is a chance that the result will end up being "halfway" between what REM and EconViews expect, and what the Budget includes. But if this happens, we will have to revise the numbers for 2022, which will end with inflation higher than we expect and an official exchange rate that will surely adjust discreetly after the elections, as in 2013 and 2015.



Employment and Productivity After Covid

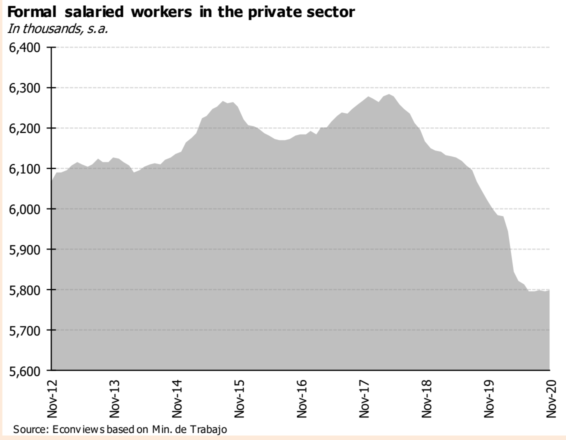
Since the pandemic began, 184,400 formal private jobs and 223,000 have been lost if we consider the last year. If the count is made by incorporating the public sector and workers from other regimes (self-employed, single-tax payers -*monotributistas*- domestic workers), the loss falls to 177,700 since February and 199,100 in the last year. In other words, in the last year the private sector got rid of 3.7% of its workforce and the market as a whole of 1.6%. These numbers are consistent with the disappearance of 22,000 companies in the last 12 months to October, according to data from AFIP.

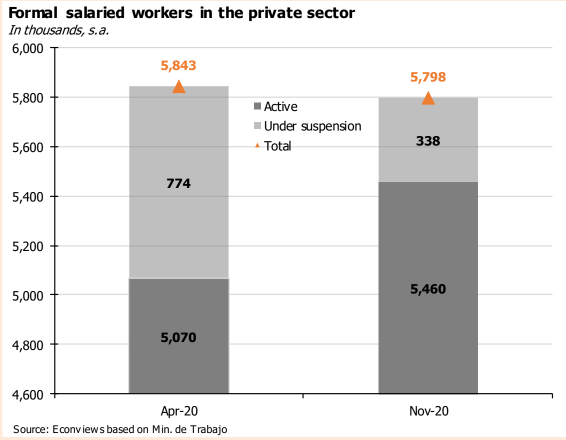
The good news comes from the suspension side. In April there were almost 780,000 suspended workers and by November there were almost 340,000 left. In other words, in the formal private sector in a dependency relationship, the number of people who actually work has increased by about 390,000 since April. The other good news is that the number of private jobs stopped falling in July. It is clear that the ban on layoffs distorts these numbers somewhat, but at least there is some stability that not even the ban stopped at the beginning of the pandemic.

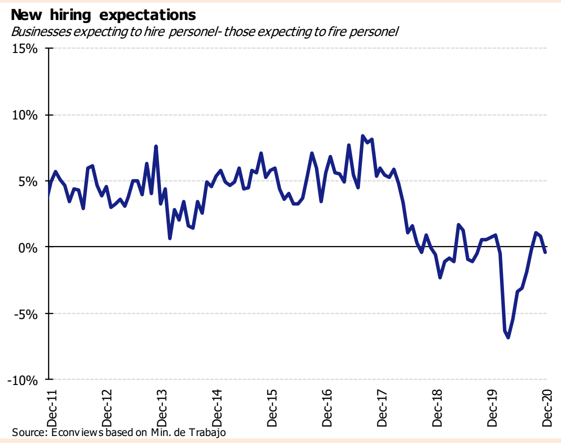
In perspective, the almost 5.8 million formal private employees registered in November 2020 are almost millimetrically equivalent to those in November 2010. The peak of the series was April 2018 (always in seasonally adjusted terms). It means that since the recession was declared in the Macri government, 7.7% of registered jobs in the private sector have been lost.

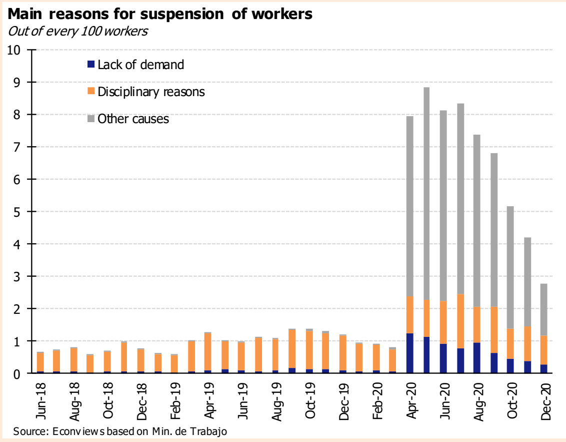
Although the situation stabilized, caution prevails among employers when hiring. In December, only 3.9% of those surveyed expected to increase their staffing in the coming months, while 4.3% were willing to reduce their staff. Thus, the balance of hiring expectations turned negative again after the moderate optimism in October and November. The vast majority of employers (91.8%) believe they will keep their current workforce. This number is not very different from the months of stringent quarantine (91.2% average in April-June). Between 2017 and 2019 it was lower, around 85%, due to the high expectations that employment would grow, first, and then layoffs. But since then, the percentage of businessmen who do not foresee changes in their staff has stabilized at around 90%. What is interesting is that the monthly survey carried out by the Ministry of Labor has an optimistic bias, either because employers want to give that impression or because of fear of statistical secrecy. But the positive balance of the EIL survey between 2011 and 2019 was not seen in net hires. Something like "bought in the survey, neutral in reality".

The suspensions acted as a cushion preventing further destruction of private employment during the quarantine. Almost a fifth of the companies surveyed by the EIL applied suspensions between April and June, against an average of 7% in 2019. Historically, the predominant reason for suspension was for disciplinary reasons, although since the end of 2018 the fall in demand gained space within of the causes reported by the companies. From April 2020 onwards, suspensions were inflated for “other reasons” (explaining 73.8% of the total for that month). By December, the percentage of companies applying suspensions has dropped to 12.3% as workers return to activity. In any case, **the suspension rate per 100 workers (2.5%) still triples**



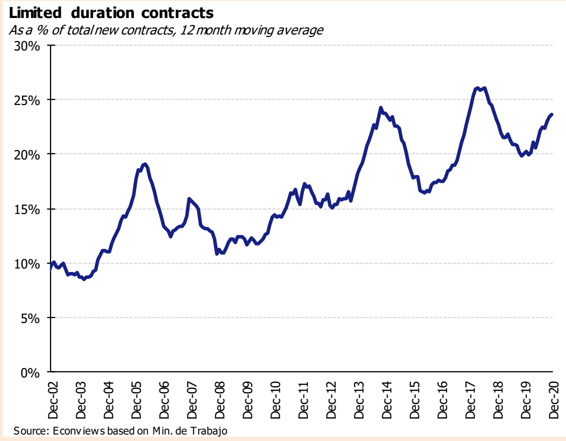




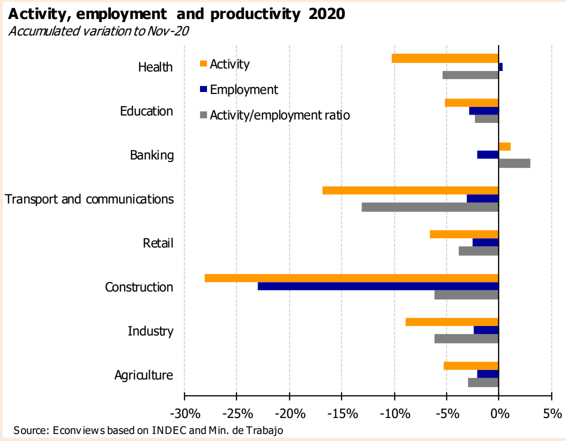


pre-pandemic levels, although it has decreased compared to the hardest months, when it reached almost 1 in 10.

One fact to pay attention to is the increase in contracts of limited duration. The number of new contracts signed under this modality rose 3.6 percentage points between 2019 and 2020, from 20.1 to 23.6% of the total. Correspondingly, most of the casualties come from workers with permanent contracts, a form of employment that is slowly losing place. But as the historical series shows, this change is not the effect of the Coronavirus, but rather reflects a long-term trend: at the beginning of the 2000s, only 10% of formal contracts were signed for a limited time. One of the reasons for this rise in fixed-term contracts is that many industries have to replace workers who do not attend because they are at-risk population, and it becomes an over-cost for the firm.

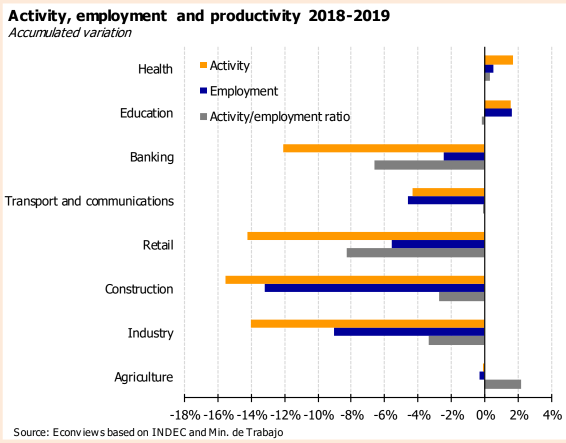


The picture of 2020, with double-digit drops in activity and employment figures, does not tell us much about sectoral productivity, or perhaps it would be unfair to measure it since employers cannot fire, but the pandemic restricts your activity. None of the main sectors created new jobs except Health, since the circuit of medical centers and laboratories was demanded by the pandemic, but in any case the growth was marginal (0.3% accumulated to November).



The financial sector was one of the few that avoided a contraction in activity, and as it reduced jobs, the relationship between activity and employment improved 1.2%, but it is difficult to speak of a real improvement in productivity. This does not change the fact that restrictions on mobility have encouraged the use of virtual financial tools by merchants and consumers. As a general rule, the strict quarantine plummeted activity levels, while the ban on layoffs and the widespread use of suspensions cushioned the fall in employment, so the activity / employment ratio plunged in almost all main sectors.

If we go back two years, we see that the economic impact of the exchange rate crisis that began in 2018 was not so distant from that of 2020, although it was more evenly distributed among the main sectors. The loss of private salaried jobs between February 2018 and the same month of 2020 (-282,000) exceeds that of the Coronavirus (-177,000). **However, the losers and winners (or least harmed) of each period are not the same.** While 103,000 industrial jobs were lost in the 2018-19 recession, the Manufacturing sector suffered far less from social distancing than services and even added 10,000 jobs since March. Construction had been in decline since before the pandemic (-96,800 jobs in 2018-19) and restrictions on mobility hit it even harder last year (-36,200 jobs). Something similar happened in Commerce, which had already slashed 67,000 jobs during the recession and destroyed another 18,600 in 2020.



Predictably, the item hardest hit by the Coronavirus was Hotels and Restaurants, which in 9 months lost triple the number of jobs (43,600) than in the previous two years (14,200). **Given that activity fell across the board in that period, we see a decline in the activity/employment ratio during the currency crisis.** The exceptions were, on the one hand, Agriculture, which with less employment (-0.3%) and a slight drop in activity (-0.1%), mainly due to the 2018 drought, managed to improve the relationship, and on the other, Health, whose activity level increased 1.7%, above a 0.5% rise in occupancy.

Finally, looking at the movie of the eventful decade of 2010, we can draw some conclusions. Despite the tailwind of commodity prices, especially in the first five years, activity in Agriculture advanced just 1.3% between 2011 and 2020. It achieved this rise along with a 6.2% contraction in employment, which distinguishes its product-worker ratio as the highest of the decade (8.0%). But the best sector performance corresponds to Transport and Communications companies, which before 2020 increased both their activity and hiring, but since the former grew faster, the ratio between the two was optimized by 4.9%. Since it was one of the sectors with the worst result in this indicator during the pandemic, including last year, the ratio worsened 8.9%.

Commerce, the main employer with more than 1 million registered workers is stagnant since 2011, fluctuating in line with real wages. But employment in the sector peaked in 2015 with almost 1.2 million, a level that it recovered around April 2018 and then lost again. In any case, the labor balance for the decade was barely positive (0.6%) before the pandemic, and counting 2020 it turns negative (-1.2%), while activity decreased 14.9% in these years. The decline of Industry was more pronounced in both aspects: it lost 164,000 jobs (-13.1%) and its production fell 17.9% between 2011 and 2020. Finally, Health and Education achieved an even increase in their workplaces and their level of Although its activity/employment ratio did not improve, it testifies to the good performance of both sectors during the 2010s.

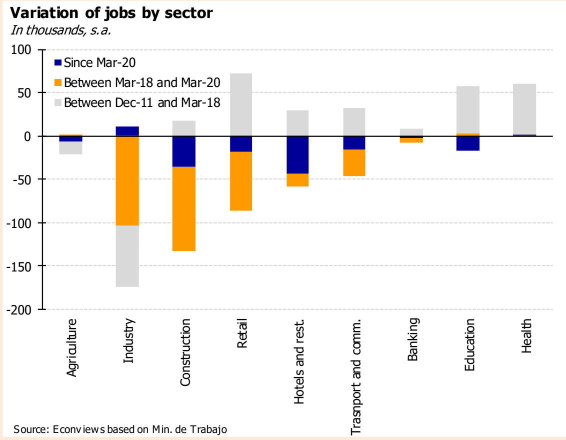
At the aggregate level, two trends overlap. On the one hand, there is a significant drop in labor productivity in almost all sectors. That is, there is less value added per worker. This is also verified in the macro: the productivity of the entire economy fell in the 8 years of Cristina and also in the 4 of Macri. In parallel, there is an increase in informal work or lower quality hiring. Beyond social charges, the labor conflict caused by the number of lawsuits makes many medium and small companies feel that they have many contingent liabilities when hiring.

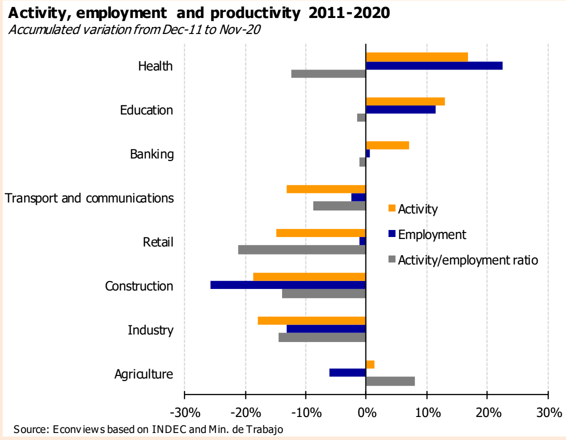
The other issue is the growing role of the public sector. In 2012, 23% of registered workers including all regimes were from the public sector. Today that number is 27%. In 20 years the provinces went from 1.3 to 2.3 million jobs. The number of taxpayers to the single-tax (*monotributo*) is also growing and the number of self-employed is stagnant, the most punished from the tax point of view.

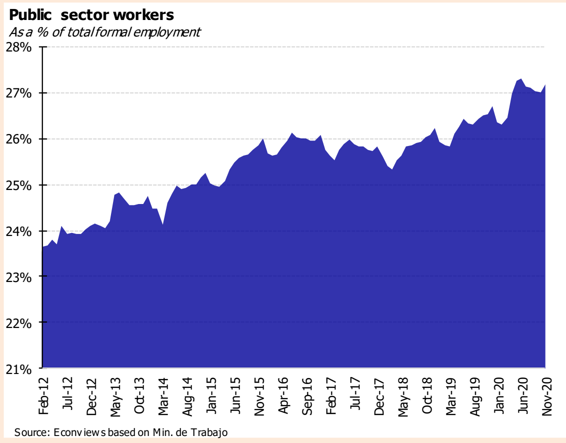
A regional look

In the breakdown of the provinces, the situation of employment is complicated in all cases. Currently the number of private formal jobs is more than 5% below their respective maximums in all districts (considering the period from January 2009 to November 2020). The largest decreases can be seen in San Juan with a drop of 22.1% vs April 2013 and in Catamarca which is currently 21.6% below the peak in April 2017. In this case there is a specific situation derived from the end of the useful life of a copper mine.

If we look at the largest provinces, we see smaller falls, but since they represent more than 75% of the total, the impact is much greater. Specifically,







the level of wage earners in Buenos Aires is 6.9% below its maximum (August 2015), in CABA 9.4% (December 2017), in Córdoba 9.1% (April 2018), in Santa Fe 6.5% (April 2018) and in Mendoza 9.4% (April 2013). In the country as a whole, the historical maximum of the series is in April 2018 when there were 6,286,700 employees. In November 2020 that figure reached 5,795,600, which shows a negative difference of 491,100 jobs.

Taking the interannual variation of registered private sector salaried workers, we see that the country as a whole has been registering falls for 27 consecutive months ago, and since April 2020, with greater intensity resulting from the impact of the pandemic and the quarantine. Looking more closely on each of the provinces we find cases such as San Luis and Catamarca that accumulate even more months of consecutive losses (59 and 34 respectively). The only province that does not follow this logic is Tierra del Fuego, which in the last three months with available data presented year-on-year increases.

Although the situation in each province responds, in part, to its own dynamics, in order to reverse the decline, conditions of macroeconomic stability must be achieved that favor investment and, therefore, promote hiring by companies.

Consecutive Months of Employment Decline

Private Sector Registered Employees - Var. % a/a s.a.