

MONTHLY REPORT

ECONVIEWS
ECONOMÍA Y FINANZAS

April 2021
Issue #202



Inflation rose in March, but the economy will still **muddle through** until the **elections**

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Special Analysis on **Recent IMF Programs**
and **What They Imply for Argentina**

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RECENT DEVELOPMENTS

- President Fernandez announced an 8pm curfew in the Buenos Aires Metropolitan Area for two weeks, starting April 16th, to curb the recent spike in cases. Other populous provinces, such as Santa Fe, are imposing similar measures.
- Minister Guzmán toured European countries to rally support for the negotiations with the IMF. On Friday 16th he met with the president of the Paris Club, with whom Argentina faces a USD 2.4 billion maturity in May. Official sources were optimistic about Argentina's chances to defer payment of the Paris Club debt until later in the year.
- After the previous two flopped, the Treasury raised ARS 123 billion at its latest auction on April 21st. Nearly half came from a CER-linked letter due for April 2022, showing the market keeps a healthy appetite for inflation-adjusted debt. The next auction is scheduled for April 28th, days before an ARS 63 bn maturity.
- The price of soybeans shot up to USD 550 per ton and is nearing an 8-year high. Higher export proceeds are contributing to keep the current calm in the FX market, despite a volume of harvest below 2020's levels.
- YPF hiked gas prices another 6% last Saturday. After a final rise programmed for May, prices should remain frozen until 2022.

FIGURE OF THE MONTH

In March, monthly inflation hit

4.8%

Its highest mark since the post-PASO devaluation

TO BE ALERT

The spread between the official FX and the Blue Chip Swap stands at

63.9%

and has grown steadily across April

WHAT'S COMING NEXT?

- Bad news from New York courts: Judge Loretta Preska ruled against Argentina on the mishandling of official GDP figures in 2014, to avoid paying a bonus on restructured bonds due to GDP growth above 3.25% the previous year. The settlement could cost Argentina around USD 0.5 billion, according to analysts.
- On 30th April the government will need to decide whether it tightens restrictions, as the health system is becoming overwhelmed by the rise in severe covid-19 cases.
- With a more orthodox Guzmán emptying his toolbox to control runaway inflation, the Government faces pressure from its left flank to tighten price controls and restrict grain and meat exports. Recently the Ministry of Production reached a deal with businessmen to freeze the price of electronics for 6 months. The Ministry is vying for a similar arrangement with food producers, one of the more sensible items in the CPI.
- A local pharmaceutical company will begin production of the Sputnik V vaccine starting in June: the initiative could help speed up Argentina's vaccination effort and restore normality sooner than expected.

SUMMARY OF MAIN INDICATORS

Economic activity

Economic Activity



Consumer Confidence



Industrial activity



External accounts

Current account



Reserves BCRA



Fiscal balance



Financial variables

Inflation



FX spread



Country Risk



External variables

Soybean price



Brazilian GDP



Financial conditions

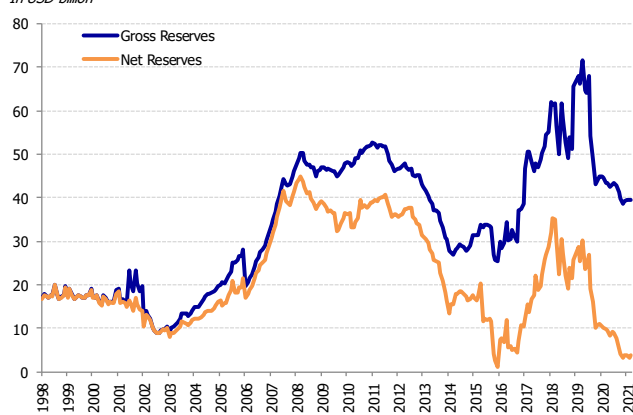


Up arrow indicates improvement, down arrow worsening and horizontal no changes

GRAPH OF THE MONTH:

Net international reserves are still at very low levels


In USD billion



Memo item: Net Reserves = Gross Reserves - USD reserve requirements - SDRs - China Swap - BIS & Repos
Source: Ecomviews based on BCRA

RECENT ECONOMIC DEVELOPMENTS



MAR	MAR	MAR	APR	APR	APR	APR
19 th	26 th	30 th	7 th	8 th	16 th	22 nd
Econviews Monthly #201: Postponing adjustments until the elections + analysis of FX controls	Fernandez clashes with Uruguay's Lacalle Pou over trade openness at Mercosur's 30th anniversary .	Government extends price caps on essential goods, mainly food and household items, until May 15th .	Authorities announce new restrictions on mobility from 23pm to 6am , to contain the rise in new Covid-19 cases.	Senate approves bill to raise minimum taxable income , exempting over 1 million individuals.	Buenos Aires Metropolitan Area enters an 8pm curfew until May 1 st , with schools closed and limits on retail.	Econviews Monthly #202 

POLITICS

Covid-19 is occupying the agenda again, although the climate of cooperation prevalent in March 2020 is long gone, with federal and local authorities clashing over the extent of restrictions. Government officials agreed with the opposition to postpone the primaries until September, and the general elections until November. Polls show a slight advantage for the governing coalition, but it all depends on how inflation, vaccination and reopening play out in the next months. In order to contain social discontent after the new sanitary measures, the Government will grant an ARS 15,000 bonus to beneficiaries of the universal child allowance (AUH) and some self-employed workers.

PANDEMIC

The second wave is hitting the region in full force and Argentina is no exception. Daily cases shot up to 24,000 and new deaths near 300, with confirmed presence of the more contagious Manaus and UK variants. The sanitary system in the Buenos Aires Metropolitan Area is already under stress. On April 7th authorities announced mobility restrictions between 23pm and 6am, only to double down a week later and enforce an 8pm curfew starting April 16th. Schools will be closed until May. So far around 13% of the population has been vaccinated. 75% of seniors above 70 have received at least one shot and other at-risk groups are being called up, but widespread immunity still appears far off.

ECONOMIC ACTIVITY

Economic activity shrank 1.0% monthly s.a. in February, according to the EMAE published by INDEC. Thus, economic activity was 2.6% below February 2020's level, before the quarantine. The monthly stumble was mostly due to drops in Construction and Industry; in fact, Construction's ISAC index fell 3.9% and the manufacturing IPI dropped 1.0%. Automotive production took a plunge in February, but according to ADEFA, in March production doubled. Other preliminary indicators yielded positive results for March: cement production grew 2.6% s.a. and the use of electricity by industries was up by 4.3%. However, the new restrictions could take a toll on activity, particularly in the services sector.

INFLATION

Guzmán heralded March's monthly inflation as the "year's worst": an unexpected 4.8%, the figure set off alarms in the Government and the markets. A whopping 28.5% monthly rise in education costs after schools reopened pushed the index higher, but after subtracting that item inflation remains above 4%. Clothing and apparel shot up 10.6% m/m, food and beverage prices grew 4.6% and core inflation accelerated from 4.1% in February to 4.5% last month. In y/y terms, headline inflation is up 42.6%. Some relief came from wholesale prices, which grew 3.9% in March, down from 6.1% in February. Utility rates remain frozen and some ruling coalition legislators are pushing a bill to limit hikes on SMEs and families.

MONETARY SECTOR

With proceeds from the harvest flowing in, the Central Bank built up USD 689 million in reserves between March and April. Without loosening currency controls and despite a slower pace of depreciation for the official FX rate (now at ARS 93), the monetary entity has managed to keep the parallel dollars contained. However, the spread with the BCS, which stands at ARS 152, has been rising steadily this month, going from 60.7 to 63.9%. While inflation rises, the Central Bank keeps its policy rate at 38%. With its liabilities at 11.5% of GDP, authorities are probably hesitant to bloat the quasi-fiscal debt even further and instead tackle inflation through RER appreciation, which we estimate at 3% in 2021.

FISCAL ACCOUNTS

At ARS 74 billion in the red in March, the Government closed Q1-2021 with a primary deficit at -0.1% of GDP. Revenues from the tax on wealth added up ARS 689 million, less than expected. Adjustment in pensions (28.9% y/y) and public sector wages (21.4%), which both grew below inflation, were offset by the jump in energy and transport subsidies, up 58.5% and 65% respectively. With utilities frozen, the latter have come to represent 11.5% of GDP. The second wave of the pandemic has forced the Government to roll out extra social expenditures. With some oxygen from the IMF's SDR allocation (around USD 4.3 billion), we expect the fiscal deficit to total 4.5% of GDP in 2021.

I. The economic scenario before and after the elections and the role of the IMF

It is increasingly clear that the government is taking every economic decision with an eye on the election and that the 4.8% March inflation rate was a disruptive figure and a potential threat. It was totally unexpected, much higher than anyone was projecting. This jeopardized the strategy of avoiding disruptions on the way to the elections. **The risks are clear. The parallel exchange rates, wage negotiations and expectations all add momentum to an inflation process that the government is finding difficult to maintain under control.**

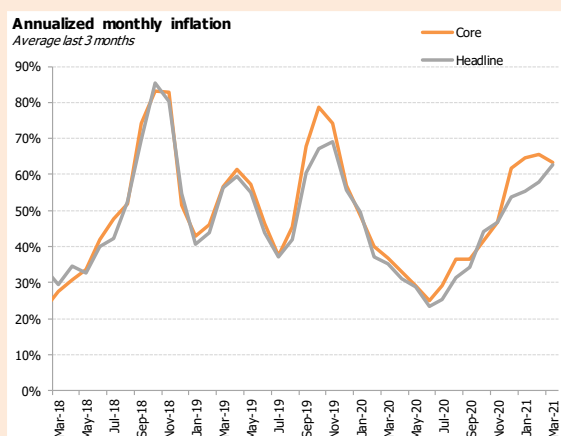
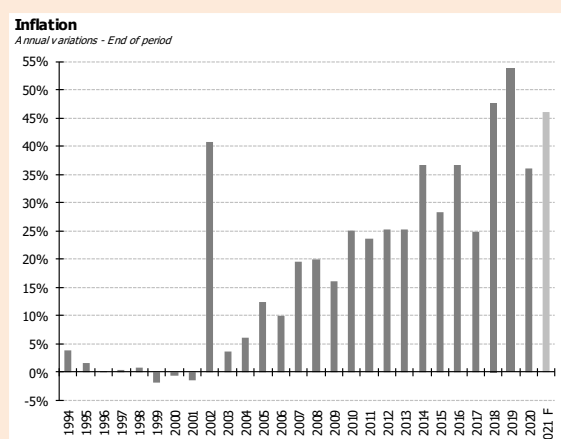
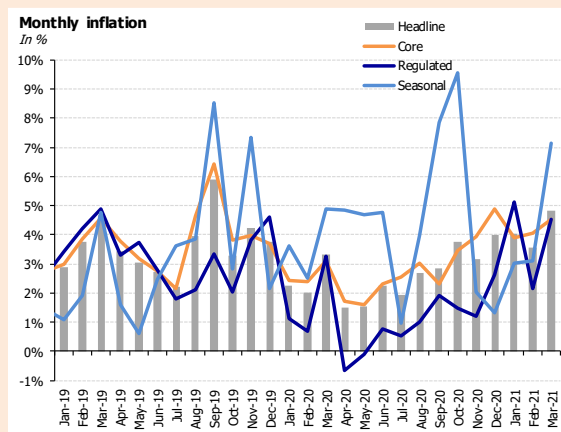
The government is trying to respond in a decisive way, but the policy measures so far have been largely ineffective. Inflation remained dormant though the lock down period last year in spite of large increases in the money supply, mainly because people reduced spending and increased their demand for money. However, once the government started to relax the quarantine, spending increased, and inflation gradually returned to its previous trend and remained in the 3.5 to 4.0 range since last October. The March 4.8% figure does appear as an outlier, but nevertheless generates concerns and a need to respond in a more energetic way.

The international experience shows that countries that have high and persistent rates of inflation have difficulties in bringing it down, especially if one wants rapid and significant reductions. So far, the government's strategy has been based primarily on microeconomic policies which included acting directly on prices through policy measures such as the imposition of price controls, limits on the increases in utility rates and on regulated prices (such as health insurance). The policy menu included slowing down the rate of depreciation of the currency. These measures will undoubtedly have some effect in the short run, though at the cost of creating imbalances in relative prices. This implies less inflation today at the cost of having more inflation in the future.

This emphasis in micro-policies indicates that there is some complacency regarding monetary policy and some contempt towards fiscal policy, which is worrisome in a country that does not have access to financing.

Minister Guzman's views appear to be more balanced, as he has publicly recognized that inflation is a macroeconomic phenomenon, though he also argues that it has multiple causes. But so far there has been more emphasis on price controls than in addressing the fundamentals, especially regarding monetary policy where interest rates have been maintained well below inflation.

The main weakness of the current approach is the lack of an integrated plan that combines orthodox and "heterodox" policy measures that can have a real chance of bringing down inflation in a sustained way. A case in point is the lower rate of depreciation. In a typical stabilization program, the Central Bank can use the exchange rate as a nominal anchor, but this requires a clear and credible announcement regarding the rate of depreciation of the exchange and the policy measures that can give credibility to the announcement. This is not case right now as the Central Bank simply reduces the rate of depreciation with no announcement, no



international reserves to defend the parity, with a spread of roughly 60% between the official and parallel exchange rates, and with the generalized perception that the Central Bank will have to depreciate the exchange rate after the elections.

In addition, the overall macroeconomic situation has been complicated by the second wave of the pandemic that threatens the fiscal balance. On the one hand the government will need to provide more subsidies to those who are losing income and suffer the effects of the loss of economic activity, while tax revenues will also be affected. Much will depend on the length and depth of the quarantine, but we are now leaning to think that the Central Bank will need to finance a primary deficit of around 4% of GDP, somewhat higher than we had in previous projections and one that creates an inconsistency with the efforts to bring down inflation.

True, the economy is likely to grow at least 7% this year, though this is mainly thanks to the statistical carry-over from last year. Most of the improvement has already taken place, and while we expect the economy will resume growth in the third quarter, it will fall short of a strong recovery.

Everything indicates that the economy will manage to get to the elections without facing an economic crisis. There are various threats, of course, namely inflation, a possible devaluation, a new escalation of the parallel rates, a recession driven by the lockdown or a severe rationing of international reserves. Nevertheless, the muddle through scenario appears as the most likely one.

An IMF agreement post-election. Will it happen? What can it entail?

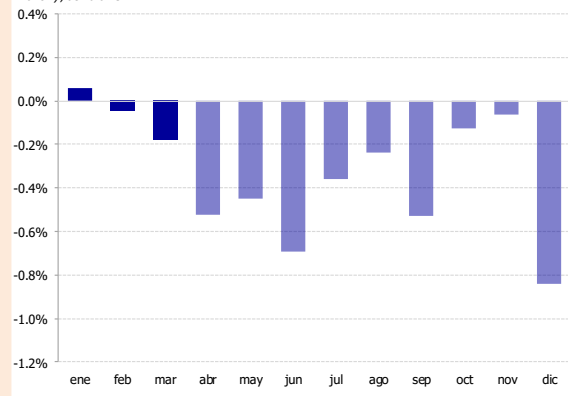
The big question is what happens after the election. At that point an adjustment in relative prices will be all but unavoidable, especially in utility rates and probably in the official exchange rate, with the risks of a spike in inflation. At that time, the negotiations with the IMF are likely to be at full speed and there are essentially two possible scenarios.

In the first one, there is an agreement in which both sides make important compromises in order to avoid a traumatic default. Argentina has to pay 18 billion dollars next year to the Fund and without an agreement to refinance them Argentina will face default. This would not be a good outcome for the Fund, because its major debtor would be in default, nor for Argentina, as it would be cut off from the World Bank, IDB and other multilateral financing and would become a pariah at the international level, and it could even be expelled from the G-20.

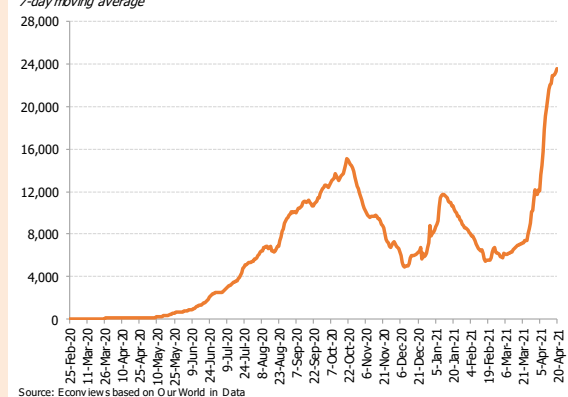
There is also a small probability that the government coalition eventually dismisses these concerns and adopts a more radical stance regarding its domestic policies and its international position, in effect becoming "Argenzuela". Unlikely but still a concern.

What would an IMF program entail? The Fund has one main objective, namely it wants to ensure that the macroeconomic situation allows Argentina to repay its debt over time. The IMF is in no rush to get the money, but it will seek a program that ensures that Argentina reduces the fiscal deficit or even generates a fiscal surplus in order to improve its

Primary Result - 2021 estimate
Monthly, as % of GDP

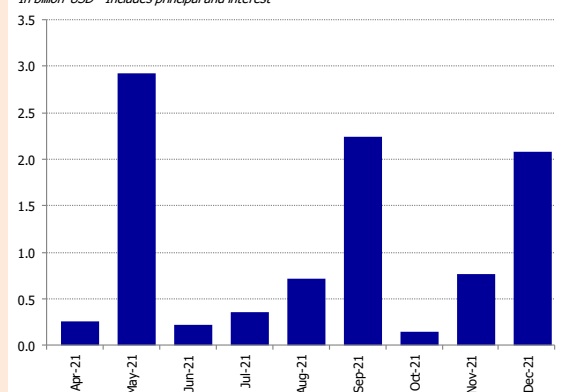


Covid-19 new daily cases - Argentina
7-day moving average



Source: Econviews based on Our World in Data

USD maturities with the private sector and multilateral organizations
In billion USD - Includes principal and interest



capacity to pay, that increases net international to reasonable levels, that generates the conditions for the country to regain access to the international capital markets and that that generates a policy environment that is conducive to long-term growth.

In practice, in the new program the negotiations will center on the fiscal deficit and the need to finance it through debt as opposed to borrowing from the Central Bank. Negotiations will also focus on the adoption of a more flexible exchange rate system that allows an increase in international reserves, in ensuring solvency and reducing Argentina's credit spreads, and in removing many of the controls and regulations that hamper private investment and growth.

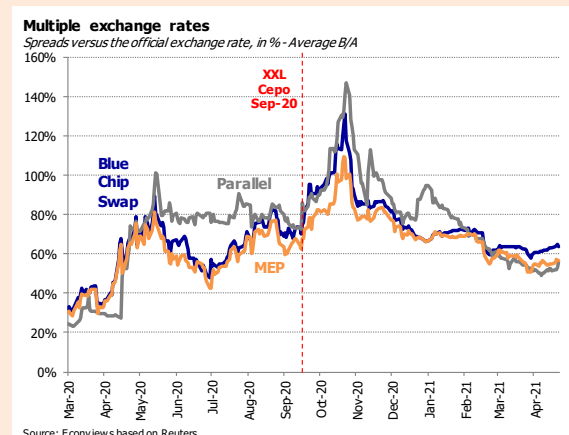
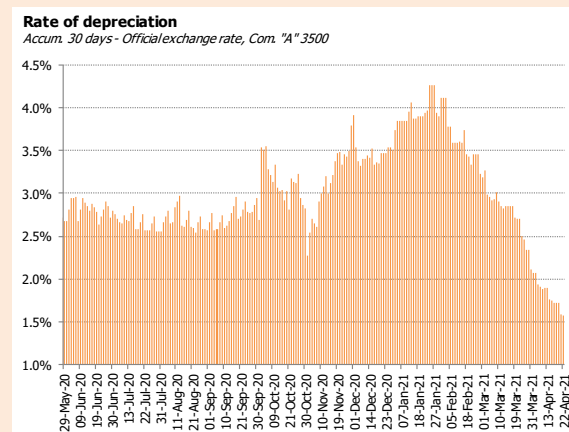
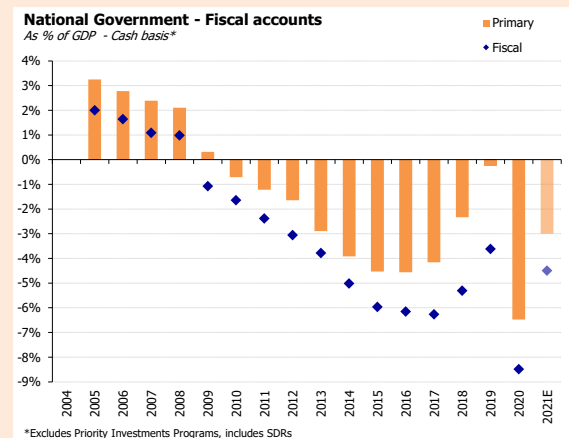
The program should lead to important changes in policies, some that will be more difficult to implement than others. Starting with the primary fiscal deficit, the agreement should allow a gradual reduction in the deficit, achieving a balanced budget in 2024. The Covid crisis provides an excuse for the gradual approach, and it would help the Fund to show that it is not as rigid as in the past regarding the fiscal stance and that is willing to give Argentina time given the large poverty levels that prevail. The government can strike a second victory, at least with its constituencies, regarding the time it negotiates to repay debt. It is unclear how long the IMF loan will be, but it will be easy to argue using some creativity that Argentina got much more time than in previous programs.

The other aspects will be more difficult to negotiate. Perhaps at the top of the list will be exchange rate policy, where the current regime in which the exchange rate is used to reduce inflation, in which there are widespread controls for current account transactions and in which there is a large spread between the official and the parallel exchanges is at best very controversial and most likely unacceptable to the Fund. The Fund will probably see a more flexible exchange rate as one of the main instruments to replenish the meager stock of reserves.

The IMF clearly prefers a floating exchange rate system, though the previous program indicates that in Argentina it is dangerous to have full flexibility and that some degree of intervention may be warranted. The discussions will center about how to reduce the spread between the official and the parallel rates, which in fact can only be done by effecting a devaluation of the official rate or an appreciation of the parallel rates. The latter typically requires tighter monetary policy (i.e. higher interest rates) or a sharp rise in confidence that induces capital inflows. We imagine that devaluation and/or increases interest rates are medicines that will be tough to swallow by the government.

The IMF is likely to accept some type of capital controls on inflows as well as on outflows (especially on short-term flows that are the most volatile), but it is also likely to negotiate a gradual elimination of the FX restrictions, especially those that affect trade and the payment of dividends.

There will also be discussions about interest rates monetary policy and on the overall approach to bring down inflation. The Fund does see monetary and fiscal as key elements in any stabilization program, in contrast to what many in the government think.





Last, but not least, there will be a discussion whether the overall policy environment is conducive to growth. This is part as what is generally knows as the structural reforms. Here the discussions will center around the price controls, and many regulations that are now in place.

In a nutshell, the negotiations with the IMF will not easy, but there are incentives for both sides to reach an agreement. We believe that most difficult discussions will be on exchange rate and monetary policy and on the removal of price controls.

II. What Is The IMF Program Going to Look Like?

In 2021 the economy is set to recover somewhere between 6 and 8% depending on the severity of the second wave of Covid and the speed of delivery of vaccination. With elections in October we allocate little chances, if any, to reaching an agreement with the IMF before then. The assumption is that a program with the Fund can pave the way for having a roadmap in terms of fiscal and monetary policies as well as some “structural reforms”.

History of IMF Programs with Argentina

Program	Date		Amount Agreed (in million USD)	% of Quota	% of GDP
	Start	Expiration			
SBA	20-Jun-18	24-Jul-20	57,320	1277%	11.1%
SBA	20-Sep-03	5-Jan-06	12,569	424%	9.8%
SBA	24-Jan-03	31-Aug-03	2,988	103%	2.3%
SBA	10-Mar-00	23-Jan-03	22,726	800%	6.5%
of which SRF	12-Jan-01	11-Jan-02	7,961	287%	2.5%
EFF	4-Feb-98	10-Mar-00	2,813	135%	0.5%
SBA	12-Apr-96	11-Jan-98	1,042	47%	0.2%
EFF	31-Mar-92	30-Mar-96	5,515	361%	1.5%
SBA	29-Jul-91	31-Mar-92	1,040	70%	0.3%
SBA	10-Nov-89	31-Mar-91	938	66%	0.7%
SBA	23-Jul-87	30-Sep-88	1,199	85%	0.7%
SBA	28-Dec-84	30-Jun-86	1,161	106%	0.7%
SBA	24-Jan-83	23-Jan-84	1,622	187%	1.0%
SBA	16-Sep-77	15-Sep-78	181	36%	0.2%
SBA	6-Aug-76	5-Aug-77	295	59%	0.3%
SBA	15-Apr-68	14-Apr-69	125	36%	0.3%
SBA	1-Mar-67	14-Apr-68	125	36%	0.4%
SBA	7-Jun-62	6-Oct-63	100	36%	0.4%
SBA	12-Dec-61	16-May-62	100	36%	0.3%
SBA	12-Dec-60	11-Dec-61	100	36%	0.4%
SBA	3-Dec-59	2-Dec-60	100	36%	0.5%
SBA	19-Dec-58	2-Dec-59	75	50%	0.2%

Source: Econviews based on IMF

So, in this note we described two possible scenarios. In the first one, the government makes its act together and signs a USD 40 billion-dollar loan with the IMF after the election and starts delivering on it in early 2022. Adjustment does happen in an orderly fashion, regaining gradually some credibility. Even if Argentina may not fulfil all the conditionality, it sets a trend for improvement in the long run. Still, our base case is that 2022 will be a year of meagre growth. With relative prices hugely distorted, a year without elections will become a good opportunity to work on regulated prices, FX rates and set the scene for some reforms.

In the second scenario the agreement takes longer, as the most radical sectors of the government take the reins of the economy and the adjustment is market driven rather than government-led. In this situation, things will get worse before they get better. If negotiations do not bear fruit quickly after the elections, credibility issues will put pressure on the FX and international reserves, which we expect to remain weak in such scenario.

As we assign more probabilities to the first scenario, we reviewed around 10 IMF programs of the last few years to get a better flavor of what the IMF requests under EFF programs and if Argentina receives similar

treatment, how can the Argentine macro perform under those conditionalities.

One alternative question to bear in mind is whether the result of the elections can change the probabilities. In principle we do not think so unless the outcome is either too good or too bad for the government. In those cases, there might be a pandora box in terms of radicalization, but again we do not see that as likely.

Scenario 1: Adjustment, IMF, and Argentina back to earth.

The situation we foresee for 2022 has the following parameters. The elections do not change dramatically the political situation. This means that the government controls the Senate and needs to seek allies to pass legislation in the House. It may lose or gain a few seats but would not control Congress entirely. Second parameter is that an agreement with the IMF does happen, as Argentina would not have the money to repay the USD 40 billion plus owed at the end of the year to the Fund, and the lack of agreement would also put pressure on other Washington based lenders.

The program to come.

We have investigated several recent IMF programs and, in more detail, the last 3 Extended Fund Facility Agreements with Pakistan, Ecuador and Angola, given the amounts committed. Taking the last 10 EFFs, the IMF requested a fiscal adjustment of 3 percentage points in the primary account and 3.8 points in the total balance. We exclude Angola from the sample, as this African country was not requested any consolidation.

IMF Extended Fund Facility Programs

	Date		Amount Committed (million of USD)	% of Quota	Primary Balance (% of GDP)			Fiscal Balance (% of GDP)		
	Start	Expiration			Initial	End	Difference	Initial	End	Difference
Angola	7-Dec-18	6-Dec-21	4,452	434%	5.4	4.7	-0.7	0.4	-0.6	-1
Barbados	1-Oct-18	30-Sep-22	449	341%	3.3	6	2.7	-1.3	2.5	3.8
Costa Rica	1-Mar-21	29-Feb-24	1,777	335%	-1.7	1.7	3.4	-7	-3.4	3.6
Ecuador	30-Sep-20	29-Dec-22	6,496	661%	-5.8	2.3	8.1	-8.9	0.6	9.5
Equatorial Guinea	18-Dec-19	17-Dec-22	283	130%	1.9	3.9	2	1.3	2.3	1
Ethiopia	20-Dec-19	19-Dec-22	1,036	250%	-2	-1.2	0.8	-2.5	-1.9	0.6
Georgia	12-Apr-17	11-Apr-21	656	230%	-2.7	-1.5	1.2	-4.1	-2.8	1.3
Jordan	25-Mar-20	24-Mar-24	1,253	270%	0.9	1.4	0.5	-3	-2.6	0.4
Kenya	2-Apr-21	1-Jun-24	1,770	230%	-4.6	0.2	4.8	-8.7	-4.3	4.4
Pakistan	3-Jul-19	2-Oct-22	5,914	210%	-0.4	2.7	3.1	-7.1	2.6	9.7

Source: Econviews based on IMF

This may look consistent with Argentina, which will sign with 4 points of primary deficit (before the SDR allocation) and may finish at 0%, so slightly more aggressive than its peers, but nothing to write home about. Where Argentina's program may look unambitious compared to its peers is with its final fiscal balance: the average EFF ends with a primary surplus of 2% or 1.7% excluding Angola. This level would be too much for the rigidities of the Argentine public spending and more so considering the high level of taxation.

On average countries going through EFF programs had to cut spending in 1.5 percentage points of GDP, something that would look unimpressive for Argentina. In the case of Ecuador, the requested

reduction reached 5 points. In a couple of countries such as Angola and Ethiopia, the IMF agreed to more spending, something that would look unthinkable in Argentina. Excluding those from the list, the average cut was 2.2 pp, a number that has a better flavor for the Argentine situation.

Going through the measures that were used to design a fiscal plan, there is a lot of tax increases, a prescription that Argentina is unlikely to go through considering that the current government has already increased tax pressure considerably, from 23.2% to over 26% at the Federal government only, and provinces have done their fair share of tax increases. Other IMF suggestion have included better management of public companies (something that in Argentina would only generate marginal improvement).

Almost all countries committed to a tax reform. We think that Argentina would follow suit, as it is probably the only common ground between the government and staff. IMF will want to increase tax compliance, undoubtedly a winning strategy. However, this has been the case for generations and the truth is that very little has been achieved over the years. It works well in excel, as nobody doubts that there are several points of GDP to win including VAT, income tax and others. But this is the classical, easier said than done. IMF has always been against “monotributo” and would prefer a lower minimum income tax, exactly the opposite of the recently passed legislation. So watch this space.

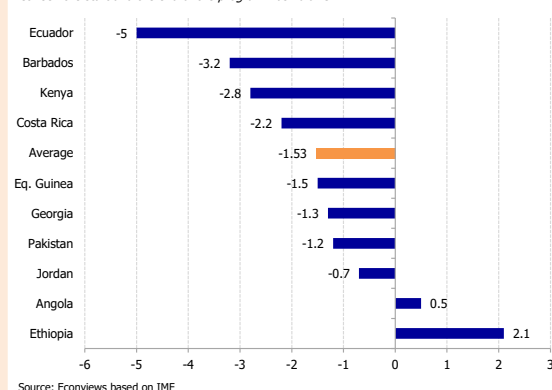
In all countries there are transparency provisions and often technical assistance to improve procurement, better targeting of social spending and often wage bill. In Argentina it would not be unthinkable to work (again) in a new pension scheme. Reduction in subsidies for electricity, gas and water are a must, as this year they may require 3% of GDP, well below the peak of Cristina Kirchner’s era, but far more than Argentine fiscal policy can sustain.

So, the current limbo in which Argentina lacks a macroeconomic program and the target is only the mid-term elections is replaced with a multi-year program under an Extended Fund Facility Agreement, that includes conditionalities and quarterly reviews. That will mean a 3-4 year fiscal program that should eliminate the primary deficit. In monetary policy, the IMF will likely want the Central Bank to strengthen its reserve position. Then the idea will be first to gradually eliminate the FX restrictions and when that is over, move towards an inflation targeting scheme starting in 2023 or 2024.

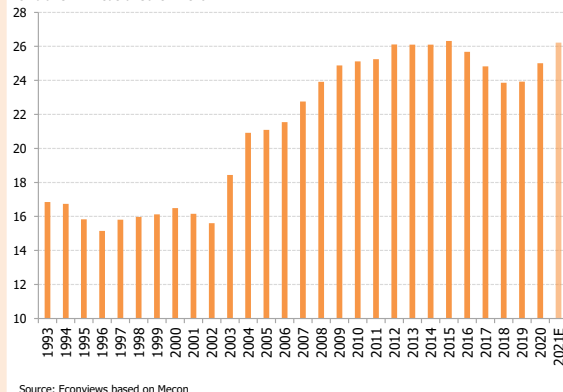
In parallel Argentina will have to engage in structural reforms. Here the agendas of the government and the IMF may be quite different, but there might be some common ground in a tax reform and the need to increase tax compliance, something that looks quite difficult, but is always a silver bullet because it can produce effortless revenues in excel spreadsheets.

The IMF program should produce several outcomes in 2022. On the activity front, the necessary adjustments to improve the fiscal situation will likely mean meagre growth of around 1.5%. Increasing regulated tariffs and dismantling some of the Covid-related programs are only a few examples of the agenda. Inflation will still be high at say 40%, as not only electricity, gas, water, and transport costs will go up, but also there should be a stronger depreciation that is consistent with the lifting of some of the

Variation in Government Expenditures
Between the start and the end of the program - as % of GDP



Tax Pressure in Argentina
As % of GDP - Federal Government



FX restrictions. Following the experience of Macri, we do not think that the IMF will recommend lifting all the FX restrictions straight away.

Low growth and still high inflation will be painful, but we believe that the reduction in country risk can be notorious, going back to the 1,000 points or lower, especially if the Fed remains in its dovish stance and commodity prices remain high. Eventually, Argentina might tap the markets towards the end of 2022 relieving the Central Bank from funding the entire deficit. Against this background, we can be reasonably optimistic about re-gaining some normality. Even when waivers will be requested here and there, the direction of travel will be the right one. Or at least, Argentina may fulfil the necessary condition (Macro stability). The institutional track should take longer.

In monetary terms, most programs have implied important nominal devaluations. In Angola, the currency shot up from 300 to 700. Pakistan, Georgia, and Barbados have followed similar patterns. But in some other cases the launch of the program delivered FX stabilization. For Argentina, we are quite convinced that the features will be about eliminating restrictions over time. This means in plain English some depreciation of the currency, partially offset by some credibility gains, which this time around would not mean massive capital inflows. So, a weaker currency should enable the Central Bank to replenish reserves, making the program safer and ultimately getting closer to getting market access, the big prize both Argentina and the IMF will want, so they can live separate lives at one point.

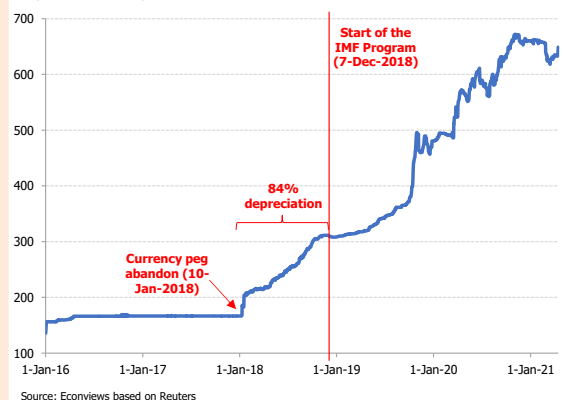
Ultimately, the IMF will want to ban the monetary financing of the treasury. It requested such thing in all the programs. We do not think they can achieve that as early as 2022 but they may try it for 2023 through a combination of lower deficit and greater market access, something beyond the local market. Part of this story will be played abroad. Argentina will desperately need that soft monetary policy in the USA continues by the time the market is prepared to take Argentine debt again.

Structural reforms are perhaps the toughest battle. The OECD and IMF in previous documents have come with a detailed list including greater trade openness, working on product markets, reducing taxation, streamlining government operation and labor market reform of some kind. Argentina ranks very poorly in the Ease of Doing Business of the World Bank and IMF staff is likely to argue that without some of these reforms growth rates will not be high enough to secure debt sustainability.

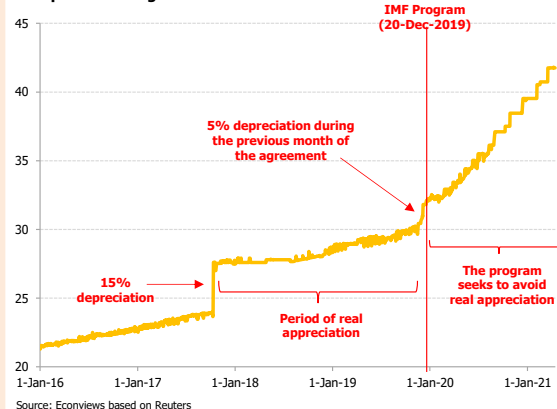
The problem is that these reforms are red flags for the current government coalition, or they touch sensitive nerves of key allies such as unions. The positive development here would be a remaking of the coalition. But for that to happen, the elections need to go especially bad for the government in such way that the president seeks new allies instead of the hard core Kirchnerism. While nothing should be ruled out in Argentina, we frankly do not put money there.

This issue is deeply relevant to understand the main challenges in the years to come. Two of the majors EFF programs, both in terms of amount and in terms of political attention, were the ones that carried out Greece in 2012 and Ukraine in 2015 (we expect to become the third partner in

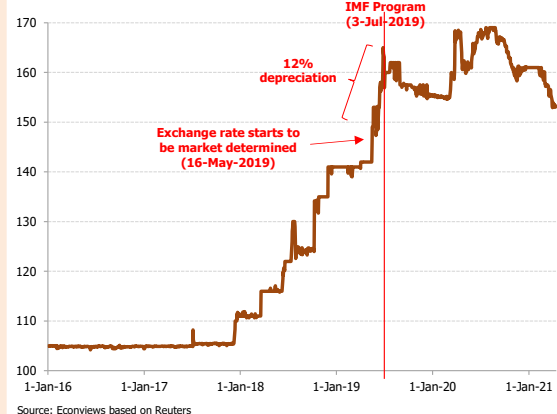
Angola's Exchange Rate



Ethiopia's Exchange Rate



Pakistan's Exchange Rate



that podium). If we look which were the main points in the structural reform's agenda, in the case of Greece labor and product market reforms were the two main components on it. The IMF's vision about the advances reached during the program points out that even though bore fruit from the start, as the political base for reforms was fragile, the authorities reverse more sooner than later the advances in this regard.

In the case of Ukraine, the critical structural reforms concentrate on the energy sector (the deficit of Naftogaz - the largest national oil and gas company of the country - was up to 6 percent of GDP at the time of the program) and on the pension system (accounted for one quarter of total general government expenditures). In the first case, the evaluation of the IMF's staff is that, despite important progress was achieved in restructuring the gas sector during the program, the transformation in the energy sector remained incomplete, with tariffs still below the recovery cost. On the other hand, the passage of the pension reform was successful and become in a milestone for the program, preventing the blow-up of the pension fund deficit and pension spending.

The staff remarks pointed out, in both cases, that "reform momentum dissipated as the economy stabilized and program ownership waned in the face of resistance from vested interests". A red flag, considering the difficulties of the many governments that have passed in terms of unify interests of a very divide society.

A scenario without the Fund (for some time)

If the government does well in the elections and Cristina Kirchner's entourage ends up stronger, there may be chances of departing from the strategy. We think that in this case the derailment of the economy would be considerable and therefore we do not allocate great chances here.

Not seeking an immediate agreement with the IMF will likely mean default, which is very odd for a G20 country. This would probably mean cutting the lines with other Washington-based countries and perhaps getting access to Chinese or Russian resources. This could avoid a total disaster, but only for some time. Country risk would skyrocket and the spread between official and market FX would be such that doing business would be quite difficult. Fiscal deficit financed with monetary emission would be substantial and the distortion of relative prices could be a mortgage for the subsequent stabilization plan. Nonetheless, inflation would be much higher than in 2021.

In practical terms, we foresee a few exceedingly difficult months until a political crisis triggers some kind of U-turn that puts Argentina in the negotiation table again in the second half of next year. The damage can be significant. Instead of a meager growth but with credibility dividends, Argentina would be in recession for most of next year if this scenario materialized.

Yet again, the agreement it would arrive more sooner than later and all the implications that we describe in the first scenario will materialize, only in the middle of an economic downturn. The positive side is that the society could be more willing to address the structural reforms than in the first scenario. Moreover, the rebound in this case would be much stronger, similar to the years that followed to the 2001-2002 crisis.

What would an EFF program entail?

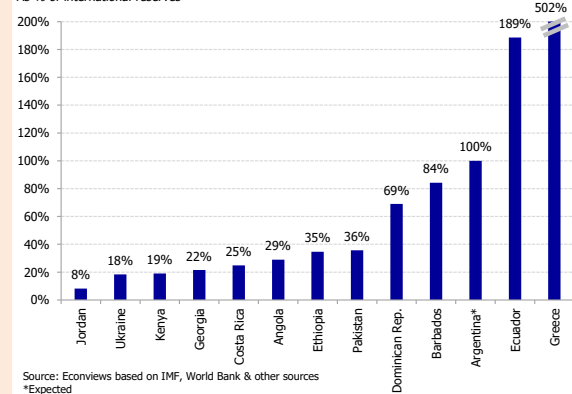
Based on Ecuador, Pakistan & Angola programs

Fiscal Policies	<ul style="list-style-type: none"> - Tax structure reform. Modifications in VAT, PIT, and CIT. Broadening of the tax base. - Reduction in public employment and wage bill. - Improves in government purchases procedures. - Reduction in energy subsidies to high-income households. Tariff structure that reflects production costs. - Targeting social spending to most vulnerable sectors.
Monetary Policies	<ul style="list-style-type: none"> - Market determined exchange rate. - Positive interest rate in real terms. - Tight monetary policy to control inflation. - Eliminate Central Bank financing to the Treasury. - Modification of the Central Bank statute to assure its independence.
Structural Reforms	<ul style="list-style-type: none"> - Make public companies more efficient. - Improve business environment. Eliminate regulations and simplify procedures. - Ensure law compliance. Strength property rights. - Fight against corruption. - Reduce labor market rigidities.

Conclusions, all roads lead to the fund

It seems clear that an agreement with the IMF is inevitable, and the main difference between the two scenarios described above is the timing and, therefore, the condition in terms of stability in which the economy will reach the negotiation. Therefore, in our view fiscal consolidation, limits to monetary assistance to the Treasury, implementation of a gradual redraw of the capital controls and structural reforms are in the horizon for the Argentine economy sooner rather than later. The degrees of success will not only be in the timing but also on the ownership. If Fernandez' government ends up thinking that the necessary evil is indeed an opportunity, then there is hope. If from day one the strategy is about how to bypass conditionality, there is a bumpy road ahead even if the agreement comes early on.

Amount committed in IMF programs
As % of international reserves



Base Scenario

	2019	2020 E	2021 F	2022 F	2023 F
Inflation (eop)	53.8%	36.1%	46.0%	40.0%	35.0%
Exchange rate ARS/USD (eop)	59.9	84.1	116.5	166.7	220.0
Real exchange rate ARS/USD (eop, Dec-01=100)	151.6	158.8	153.6	160.1	159.6
Paralell exchange rate ARS/USD (eop)	74.6	140.3	192.2	250.0	330.0
Spread with official exchange rate (eop)	24.6%	66.8%	65.0%	50.0%	50.0%
Gross reserves (USD billion, eop)	44.8	39.4	41.9	44.4	46.5
Policy rate (eop)	55.0%	38.0%	42.0%	35.0%	28.0%
GDP (YoY)	-2.1%	-9.9%	7.0%	1.5%	3.0%
Private consumption (YoY)	-6.6%	-13.1%	9.0%	2.0%	2.9%
Primary surplus (% GDP)	-0.2%	-6.5%	-3.0%	-2.0%	-1.0%
EMBI Argentina (spread in bps, eop)	1,744	1,350	1,000	850	750
Public net debt (% GDP)	43.6%	52.8%	48.4%	49.7%	49.4%
Soybean price in USD per ton (annual average)	327	350	515	420	420
Exports of goods (USD billion)	65.1	54.9	62.4	65.8	69.4
Imports of goods (USD billion)	49.1	42.4	48.5	50.0	54.1
Trade balance (USD billion)	16.0	12.5	13.8	15.8	15.3
Current account (% GDP)	-0.8%	0.8%	0.7%	0.2%	0.1%

Source: EconViews

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