THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

July 12th, 2021

Mercosur, in **intensive care**

The **fiscal and monetary dynamics will reverse**, will the FX hold?

Activity, wages and employment: what happened and what is coming

(+54 11) 5252-1035
Carlos Pellegrini 1149
Buenos Aires
www.econviews.com
www.facebook.com/econviews
Twitter: @econviews

Miguel A. Kiguel
Director
mkiguel@econviews.com

Andrés Borenstein
Chief Economist
aborenstein@econviews.com

Víctor Ruilova
Senior Economist
vruilova@econviews.com

Isaías Marini
Economist
imarini@econviews.com

Alejandro Giacoia
Economist
agiacoia@econviews.com

Rafael Aguilar
Analyst
raguilar@econviews.com

Editorial: Mercosur, in intensive care

Uruguay has officially said it would seek unilateral trade agreements with other parties. It was a low-risk bet considering how things had been going in Mercosur. It is an open secret that the Uruguayans wanted to have a free trade agreement or some variant of it with China and other powers so as not to be "locked in" between Argentina and Brazil. It sounds logical that a small and open economy wants to trade with the whole world and not remain tied to Mercosur.

What it reveals is that Mercosur has become old and useless. As a commercial platform, nothing has progressed with almost any other world player and the agreement with the European Union is unlikely to be put in place for years. From the geopolitical point of view, where at least the countries relied on each other in international fora, something is broken. All members of Mercosur supported the new president of the CAF proposed by Colombia instead of the Argentinean. Clearly there is discomfort with Argentine voting on issues such as Nicaragua, Venezuela, and others. Commercially, Argentina is a pain in the neck of the other three founding members. This is both due to the desire not to advance in new agreements and in practice where everyone has problems exporting to Argentina between the Trade Secretariat's non-automatic licenses the Central Bank's payment authorizations.

There was also a structural change in Brazil. And this goes beyond Jair Bolsonaro and Paulo Guedes, who, undoubtedly, are prone to a more open economy. Brazilian businessmen, once champions of protectionism, today have another vision. Ten years ago, the CNI and FIESP asked Dilma Rouseff to advance with the European Union Mercosur agreement. And although the equations in Brazil are much more complex than in Uruguay (that is, less linear, with steps back and forth all the time), Brazil would prefer a more modern and multilateral trade scheme.

It is not going to be stated strictly in these terms, but the situation seems to be such that either Argentina relinquishes its old import substitution rhetoric or Mercosur as we know it blows up. Argentine partners do not make much sense of Mercosur. It is not only about greater commercial openness. It is also how issues such as climate change are faced now that Europe is going to charge for the carbon footprint implicit in its imports.

In 2021 Argentina will import goods for around 1,100 dollars per capita not counting energy after having fallen to less than 900 in 2020. In 2013 that number was almost 1,500 dollars. In other words, Argentina today does not offer an appealing market, it is not a reliable partner in terms of the rules of the game, it has international positions that make the rest of the foreign ministries uncomfortable and, perhaps worse, it does not have a roadmap on the matter.

Politicians always say that exporting more is the road to success. But without imports the export way out is either voluntarist or magic. If Argentina does not update its doctrines, integrates more perhaps trying to get some relief (for example, requesting time to defend some vulnerable sectors) it will be difficult to think of long-term development. Furthermore, protection usually does not generate development but monopolistic rents and losses for consumers by reducing their disposable income. In other words, the options available to Argentina seem to be to convince its partners that Mercosur is worth it with a proposal for change or to isolate itself more. **The problem is that to take the first option you need a determination and initiative that today does not seem to be present in any sector of the government.**

LAST WEEK IN REVIEW

✓ The **Treasury obtained ARS 46,224 million in the first auction of July.** The amount awarded represented 60% of the amount offered. This was to avoid higher rates being validated.

✓ Last Tuesday, **the vaccination campaign reached 40% of people inoculated with one dose.** On the same day, the number of vaccinated with two doses reached 10%. The number of new cases and daily deaths remains high, although with signs of slowing down.

✓ According to data from CAME, **retail sales grew 8.6% y/y in June, although compared to the same period in 2019 they show a drop of 16%.** In the first half of the year, they rose 15.2% compared to 2020 and fell 13.7% compared to 2019.

✓ In June, **vehicle production (ADEFA) totaled 40,035 units, which implies an increase of 14.5% compared to the previous month.** The year-on-year comparison shows a rise of 155.7%. It should be noted that both months of comparison (May-20 and June-19) were affected by circulation restrictions.

✓ **Cement shipments (AFCP) increased 5.5% m/m s.a. in June and 20.6% y/y.** The accumulated of the year shows a rise of 44.2%. In this case also the low base of comparison must be considered.

✓ The government **extended the "Precios Cuidados" program** for three more months, authorizing **increases of 5% on average.**

NEXT WEEK'S HIGHLIGHTS

✓ On **Wednesday 14** the INDEC will publish the **use of installed capacity** in the industry for May.

✓ On **Wednesday 14** the **public services data** for April will be released.

✓ On **Thursday 15** the **consumer price index** for June will come out. We expect a number close to 3%.

✓ On **Thursday 15** the **income generation account** will also be published, that is, how the cake was distributed in the first quarter.

✓ On **Thursday 15** the BCRA will publish the **index of credit conditions.**

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	96.0	0.2%	1.0%	35.3%	▲
Blue Chip Swap	167.0	0.4%	1.0%	52.2%	▲
CB reserves (USD million)	42,755	+261	+325	-491	▲
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.	=
Badlar rate (private banks)	34.3%	+0.13 p.p.	0 p.p.	+4.69 p.p.	▲
Merval (in ARS)	62,396	0.5%	-6.0%	46.0%	▲
Country Risk (spread in %)	1,612	1.7%	8.0%	-29.7%	▲
Official exchange rate BRL/USD	5.26	4.0%	3.9%	-1.6%	▲
Soybean (USD/ton)	515.9	-3.3%	-10.1%	56.3%	▼
Oil - Brent (USD/barrel)	78.3	-0.6%	10.2%	81.4%	▼

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q
Industrial production	*May-21*	-5.0%	-1.9%	-5.5%
Automobile production	*Jun-21*	22.8%	8.9%	21.8%
Steel production	*May-21*	11.2%	-1.3%	4.0%
Poultry production	*May-21*	-6.9%	5.5%	-8.5%
Dairy production	*May-21*	1.9%	-0.1%	1.7%
Beef production	*May-21*	-13.9%	-0.5%	-15.1%
Real Estate transactions (CABA)	*May-21*	-13.0%	9.3%	-16.6%
Flour Production	*Apr-21*	-3.8%	6.2%	-1.7%
Oil production	*May-21*	1.0%	4.1%	2.4%
Gas production	*May-21*	3.9%	1.0%	4.0%
Cement production	*Jun-21*	5.5%	3.7%	3.6%
Construction activity	*May-21*	-3.0%	-5.4%	-5.1%
Retail sales	*Jun-21*	5.0%	-6.4%	5.1%
Gas sales	*May-21*	-11.8%	1.6%	-12.5%
Motorcycle licenses	*Jun-21*	66.4%	11.9%	33.5%
Use of electricity	*Jun-21*	3.8%	7.4%	5.9%
Subway rides (CABA)	*Apr-21*	-11.2%	41.6%	3.8%
Imports CIF	*May-21*	3.2%	8.0%	0.2%
Exports FOB	*May-21*	5.4%	13.7%	3.5%
Loans in ARS to private sector	*May-21*	-3.0%	-6.7%	-5.8%
VAT-DGI Revenues	*Jun-21*	-2.4%	2.1%	-3.9%
Formal private jobs (SIPA)	*Apr-21*	1.0%	0.8%	1.0%
Formal private jobs (EIL)	*May-21*	-0.1%	0.3%	0.1%
Consumer confidence	*Jun-21*	-2.3%	-7.8%	-4.6%
Government confidence	*Jun-21*	-11.8%	-2.2%	-6.3%

Note: stoplight color depends on monthly variation

The fiscal and monetary dynamics will reverse, will the FX hold?

In the first semester, fiscal convergence was greater than expected and, therefore, the need to monetize the deficit was less. This, together with the greater availability of dollars because of an increase in international prices, eased the FX market pressure. Manna from heaven. The only monetary pressure in the first six months of the year came from the side of the central bank interventions in the FX market, buying dollars that reinforced the international reserves. I mean, a good problem to have.

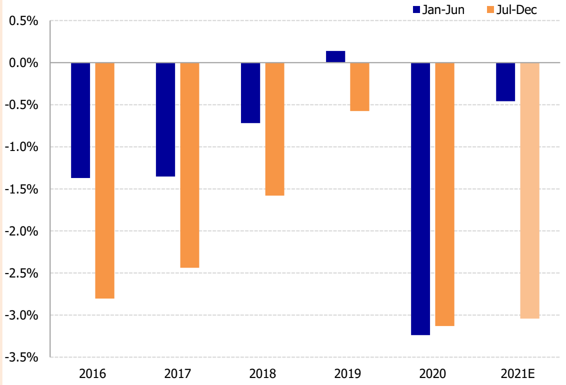
This relatively virtuous dynamic will be put to the test in the second semester, when "seasonality" in both fiscal, monetary, and FX mark **a reversal that will put pressure on the government's main objective for the remainder of the year: do not let the dollar go away.** Our vision is that it will not escape since the government has tools to bank the stoppage.

Starting on the fiscal side, the primary deficit for the first semester was around 0.5% of GDP. The last data corresponds to the accumulated until May, which marks a primary deficit of 0.13% of GDP. And our estimates show us that, in June, driven by the payment of bonuses, reinforcements of social programs and the pensions increases, it will be extended to half a point of the product. A fiscal convergence that was higher than expected, in at least 1% of GDP. **But, more than an "effort", this better performance is explained by the extraordinary revenues that came from the increase in commodity prices** (extra ARS 200 billion in export duties, 0.5% of GDP) **and the solidarity contribution of the large fortunes** (ARS 173 billion, 0.4% of GDP).

In the second semester, the fiscal dynamics will be very different. And history marks it. In recent years, the primary deficit of the second six months of the year doubled that of the first. In 2020 it matched it, due to the shock of the pandemic, which put pressure on the fiscal accounts as of March of that year. **In 2021, if we start from our projection of 3.5% of GDP (the Budget had pointed to 4.2%), between July and December the deficit will multiply by 7 compared to what we saw between January and June. And it is logical that this is the case**. On the one hand, extraordinary revenues will decline. Of the solidarity contribution, less than ARS 50 billion remains to be received, while the exports of the primary sector will decrease as the year passes (not counting that in electoral years there are incentives to delay external sales). On the other hand, the treasury will have to face various pressures to increase expenditures. **The electoral campaign will bring reinforcements or bonds to civil servants, to social programs and to pensions**. Without even talking about energetic subsidies, public investment, transfers to provinces and universities, **everything will put pressure on the primary deficit of the second semester, that is on the way to be the highest, as it was in 2020, since the 80s.**

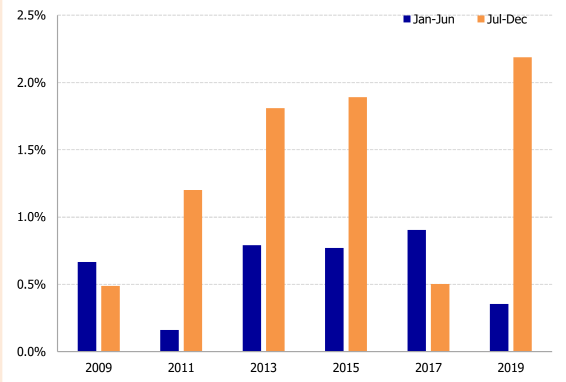
On the monetary side, the contraction of the aggregates indicates that the fiscal pressure was indeed lower than contemplated. But it is also common for the monetary base to grow truly little or fall, in real terms, in the first half

Primary deficit by period
As % of GDP



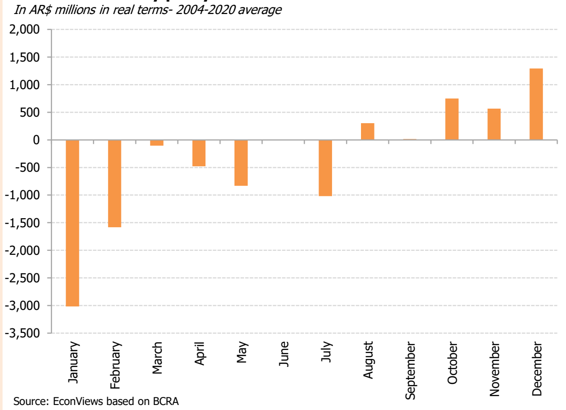
Source: Econviews based on Mecon

Assistance to the Treasury in years with elections
As % of GDP



Source: Econviews based on Mecon

Seasonal monetary policy
In AR$ millions in real terms- 2004-2020 average



Source: EconViews based on BCRA

of the year and then expand. **In terms of monetization of the deficit, it is also observed that the assistance to the Treasury by the Central Bank doubles in the second semester**. The seasonality of fiscal spending marks the seasonality of monetary expansion. 2021 will not be the exception. The monetary base contracted 11% in real terms, in line with almost all the aggregates, except M3, which includes term deposits. **With the government issuing around 1 trillion pesos (2.3% of GDP) to finance the Treasury, recent dynamics will turn around, causing the Monetary Base, which is growing today at an interannual rate of 30%, to close the year growing almost at 50%.**

Monetary Aggregates

In real terms

	jun-21 *	m/m	3 months	YTD	y/y
Monetary Base	2,701,957	3.3%	-3.3%	-11.2%	-16.5%
M1	3,654,080	-1.0%	-0.9%	-9.9%	-9.7%
M2	5,226,789	0.7%	-0.7%	-9.5%	-10.8%
M3	9,264,886	0.6%	0.6%	-2.5%	-2.1%
Private M2	4,650,437	3.2%	-0.4%	-9.3%	-12.4%

* in millon ARS - average up to 30-jun-21

Source: Econviews based on BCRA

With a more auspicious fiscal-monetary balance in the first semester and thanks to the "Maná from heaven" – dollars – caused by the price increase of commodities, **the Central Bank was able to rebuild and quadruple the stock of net international reserves compared to stock that had last year, when the BCS gap rose up to 150%**. Thus, in the first six months of the year, it bought more than 6 billion dollars in the exchange market and loaded gasoline to face the winding electoral road that remains.

If we look at the electoral years of the recent past, the Central Bank had to use an average of almost USD 5 billion between July and December. Our projection is lower, we think that it will leave USD 1,500 million on the way to contain the FX. It is true that it has other instruments more at hand: forward, FX and import market restrictions. Anything is handy to ensure that there are no exchange rate surges next to the midterm election in which the guarantee of society is at stake to address pressing issues, such as the agreement with the IMF, after two extremely negative years.

The other question is whether a devaluation is coming after the elections. It depends how we define it. We believe that the Central Bank will not want to continue appreciating the exchange rate after the elections and when the program with the IMF is in place, there will be requirements to accumulate reserves and lighten the stocks. This necessarily implies a weaker peso, but not necessarily a maxi devaluation. The sequence is not trivial. The devil will be in the fine print of the show and at the risk of implementation.

Monetary Base Growth

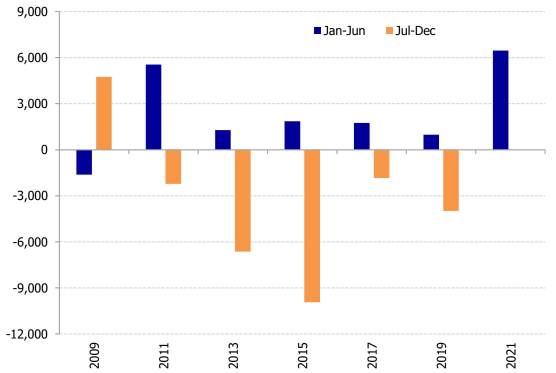
Variation m/m in real terms

	2004-2020 Average
January	-0.3%
February	-3.1%
March	-1.7%
April	-0.6%
May	-0.5%
June	1.1%
July	2.6%
August	-0.6%
September	-1.0%
October	-0.5%
November	0.6%
December	5.0%
Jan-Jun	**-0.8%**
Jul-Dec	**1.0%**

Source: Econviews based on BCRA

Central Bank intervention in years with elections

In US$ millions



Source: Econviews based on BCRA

Factors of Variation of Net Reserves

In million USD - accumulated of the year

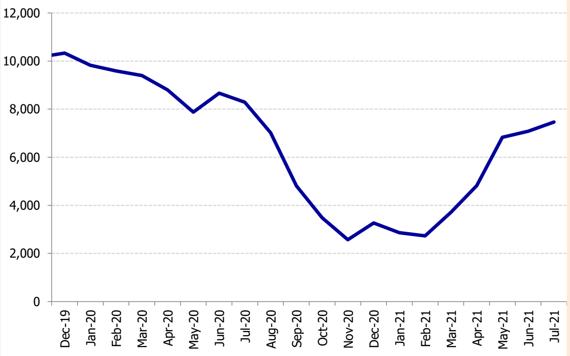
	Accum. 2021
Market intervention	6,778
Treasury sales	-821
Multilaterals	-898
USD bonds repurchase (BCS intervention)	-850
Gold	-249
Net reserves	**3,961**

Source: Econviews based on BCRA and IMF

Up tp Jul-6

Net Interntational Reserves

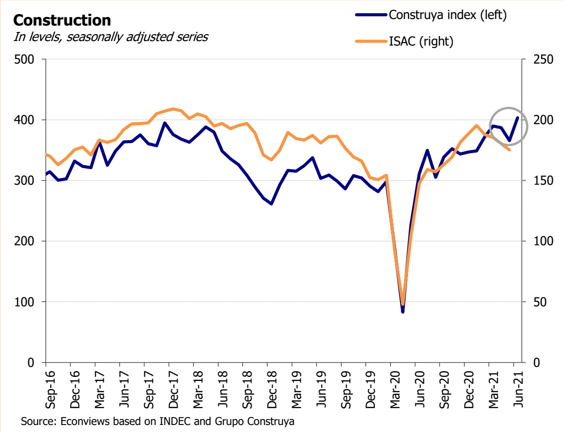
In USD million



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

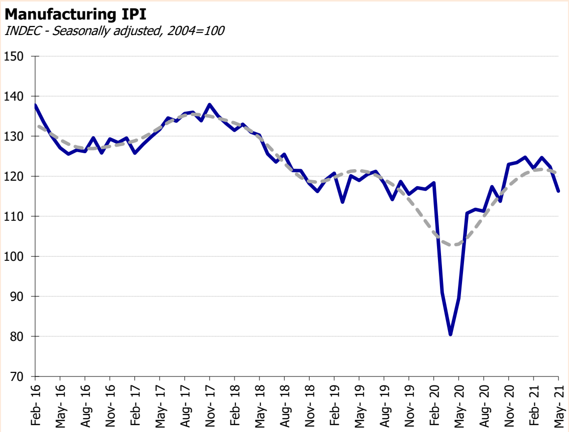
Activity, wages and employment: what happened and what is coming

The INDEC published last week the Industry and Construction data, confirming what we had been anticipating for a month: **the economy suffered a severe blow due to the second wave of infections during May.** Indeed, the Industry recorded a 5% monthly drop without seasonality, the strongest since March 2019 if we exclude the hardest months of quarantine (March and April). For its part, the Construction sector fell 3%, the fourth consecutive decline. **But the first data that came out for June indicate that the setback was temporary and some of the lost ground has already been recovered. Meanwhile, the wage and employment numbers, although very depressed, continue to show improvement. What can we expect in the months before the elections?**



Let's start with Construction. The fall in May, which was added to the previous three, brought activity to a level 10.3% below January 2021, the last month with growth. Year-on-year comparisons are misleading: the 70.9% jump is due to the very low base left by the months of hard quarantine. Now, if we take as a reference the last month without the pandemic, February 2020, the Synthetic Indicator of Construction Activity (ISAC) was 13.5% higher: despite the decreases, activity maintains a good level and the next months will be more auspicious.

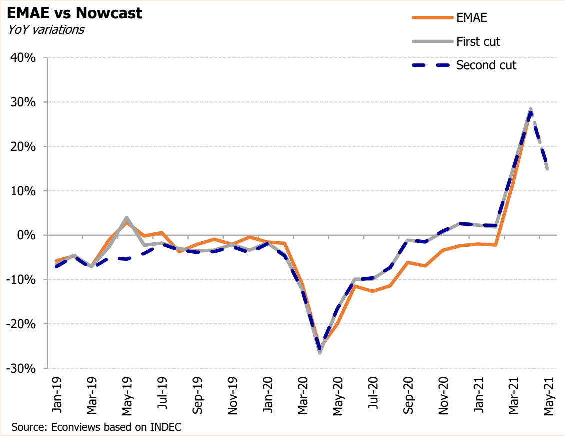
The first available data for June already showed some recovery compared to May. Cement shipments grew 4.8% per month s.a. after having fallen 6.9% a month ago. The Construya Index, which measures the sales of inputs to the private sector by the main companies in the sector, showed a similar behavior. Under our own seasonal adjustment, the index showed a 10.3% rebound in June after the 5.5% drop recorded in May. And with the acceleration of public works as we near the elections, combined with a potential higher FX spread that favors investment in brick in a context of greater openness, the next few months will surely resume growth.



The story of Industry, always linked to the evolution of Construction, is similar. The May decline pushed production back to levels similar to those of October 2020, and for the first time since last November, it was below pre-pandemic records: as a result, production was 1.8% lower than in February 2020. As it happens with almost all the indicators of the real economy, the year-on-year variation is distorted by the very low base of comparison: despite the monthly collapse, activity was 30.2% higher than that of the same month in 2020.

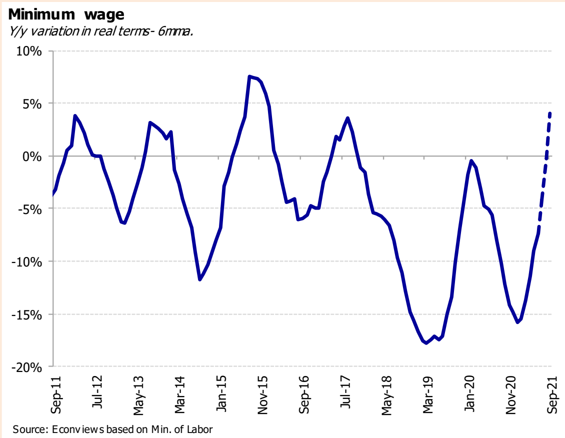
In the Industry, the expectations for the coming months are also favorable. The first data for June already show signs of a rebound; In particular, car production was the highest for a June since 2017, with 40,035 units produced, according to ADEFA. In seasonally adjusted terms, the figure represented a positive monthly variation of 22.8%. In turn, the energy consumption of the industries recorded a biannual variation (that is, against 2019) of 14.6%, accelerating compared to the record of 6.8% in May. And the expectations of businessmen for the coming months continue to be favorable: 33.3% considered that domestic demand will increase, while 24.4% believed that it will decrease. With the reopening of the economy and the advance of vaccination, it is expected that the dynamics of growth of the industrial sector will resume, although we do not discount the possibility that a new wave could generate some reeling.

With the latest data available, we recalibrated our nowcast model for May, and in the second cut the estimate of the interannual variation of the EMAE showed a slight improvement, marking a growth of 14.9% vs. the previous 14.3%. In any case, in seasonally adjusted terms, this implies a monthly decrease of close to 3%. In the coming weeks, a larger set of data will be available for June that will allow us to obtain an early estimate of the activity for the month, which we hope will have gained ground after a forgotten May.



Union wage negotiations: 45% is the new 29%

When negotiations started in 2021, the government tried to "coordinate" an increase of around 29%, in line with the official inflation forecast. In January, the Banks union was among the first to settle for that figure, and in the following months Commerce, Building Managers and other unions closed around 30%. **In mid-April, INDEC announced that the highest monthly inflation (4.8%) had been registered in March since the post-PASO devaluation. Days later, the UOCRA raised the floor of increases a few inches to 35.8%**, and at the end of that month the Metallurgists of the UOM achieved 35.2%. In May, the government validated the new salary floor with a national Teachers wage agreement of 34%, and one more point for state teachers represented by ATE and UPCN. Then UTA got 37.8% for drivers. Recognition as “essential workers” to be prioritized in vaccination had been a relevant point of discussion at the beginning of the year, but with the advancement of the rollout, negotiations refocused on wages.



Although inflation moderated in the second quarter, it maintained a monthly average of 3.5% (the data for June, which we estimate around 3%, will be released next week). With the completion of one year since the passing of the Rental Law in July, the contracts indexed by RIPTE and IPC will add another pressure factor, with an expected increase of around 40%. With the elections just around the corner, the government enabled the unions to stretch the increases 10 more points, to tie it to an annual inflation that we estimate will be at least 46% by the end of the year. Thus, in June the Food and Truckers unions, which had not yet closed their 2021 wage negotiations, agreed to raises of 42 and 45%, respectively. Unions such as Bankers or Building Managers, who had been among the first to settle, made use of the review clause. SUTERH got a bonus of ARS 8,000 that takes the increase from 32 to 44.8% approximately. Two weeks ago, those led by Sergio Palazzo signed an additional 14% that brought their annual increase to 45%, in an event that was attended by Alberto Fernández. Less than three months before PASO, the president endorsed the new salary guideline.

Collective wage negiotations: 45% is the new 29%

Latest wage raises by sector and union

	2020	2021		
	%	before June	after June	Details
Oil and port workers (FTCIODyARA)	35%	**25%**	**?**	25% between Jan and Apr-21, requested renegotiation for Aug-21
Food industry (STIA)	41%		**42%**	13% in May.21, 9% in Aug-21 and two stretches of 10% in Nov-21 and Feb-22
Sugar cane industry (FOTIA)	38%	**39%**		Retroactive to Jan-21
Bank clerks	34%	**29%**	**+14%**	Renegotiation of February's deal, corrected to 43%, in Aug and Oct-21
Truckers (SCC)	30%		**45%**	Three stretches, 20% in Jul-21, 12.5% in Nov-21 and Mar-22, adjustments in Feb-22
Construction workers (UOCRA)	33%	**36%**		Four stretches, Apr-21, Jul-21, Oct-21 and Feb-22 with adjustment in December
Teacher's unions (CTERA, UDA, CEA, SADOP and AMET)	34%	**34%**	**?**	Three stretches, Mar-21, Jul-21 and Sep-21. Unions have requested a renegotiation.
Retail employees (FAECyS)	34%	**32%**	**?**	Union intends to request a renegotiation
Doormen (FATERyH)	29%	**32%**	**+12.8%**	Agreed on an ARS 8k bonus in Jun-21, leaving the y/y rise at 44.8%
Government (UPCN and ATE)	25%	**35%**	**?**	Renegotiation in Aug-21
Metallurgical industry (UOM)	40%	**35.2%**	**?**	Renegotiation in Jul-21
Oilmen	45%	**35%**		Adds 30% to 2020 negotiation (total 45%), 2021 raise to be paid in 2022
Health workers (FATSA)	36%	**?**	**?**	Unions ask for a 45% rise, Min. of Labor has interceded to reach a deal
Transport workers (UTA)	30%	**37.8%**		Deal reached in May-21: 11% retroact. to Apr-21, 14% in Jun-21 and 13% in Sep-21, adjustment in Nov-21

Source: Econviews based on several sources

Which unions have yet to reach a deal? Armando Cavalieri called for the reopening of the Commerce wage negotiations: in April, the union with the most affiliates in the country had arranged 32% in 4 instalments. UOM and UOCRA also communicated their intentions to renegotiate the increases achieved in April. At the pace of the elections, the UPCN brought forward the review of its agreement by three months, from November to August. **For different reasons, workers in the gastronomy and health sectors bore the worst of the pandemic. They share the fact of being one of the few items that have not yet closed their 2021 wage negotiations**. Barrionuevo's union had signed 34% for 2020 in January. The situation in the Health sector is delicate: providers demand an adjustment in Private Medicine fees before discussing salaries, while FATSA claims 45%. On Wednesday June 30, the Ministry of Labor intervened to issue the mandatory conciliation. In between, there were statements of a sector of the ruling party on the reform of the health system, and yesterday the Executive branch extended by decree to one year the mandatory term to remain within the union-provided healthcare.

It should be noted that the arrangements are a "wage year" and not a calendar year, s**o in the stats we are closer to having the fourth consecutive year with salaries growing, on average, below inflation**. The intention is more to give a push in the months before the elections, so that there is a perception is of improvement. As in the case of the Minimum Vital and Mobile Salary, whose increase was anticipated and will become above inflation as of September, although in the year it will fall almost 1% on average.

An overview of registered work

with the incorporation of more than 53,000 people, of which 40,684 are salaried jobs and the remaining almost 13,000 are divided between single-tax paying workers (monotributistas), self-employed and personnel from private homes. They beat the public sector by a wide margin, which added fewer than 1,000 people in April.

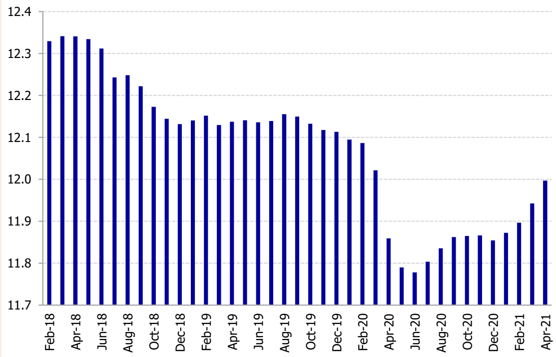
This implies that from the low point of 2020, 100,000 salaried jobs were recovered, a better-than-expected result. Between September and April, the public sector hired 47,000 people and some self-employed workers and family homes workers were lost, while the number of single-tax paying workers rose.

What does the job market hold for us going forward? The signals are ambiguous. On the one hand, the number of employers who expect to hire exceeds those who expect to reduce staff according to the May survey of the Ministry of Labor. The results should be taken with a grain of salt anyway. Employment has been stagnant for 10 years and employers have shown much more optimism in the survey than in reality. On the other hand, the same survey carried out on companies with more than 10 workers showed a decrease in May compared to April. With these data, the feeling is that nothing terrible is coming, but the gain in April will probably not be repeated.

In the last 10 years, formal employment fell 0.9% in absolute terms, much more in per capita terms. It improved strongly in Neuquén and to a lesser extent in Chaco, Corrientes, Tierra del Fuego Tucumán, Salta and Jujuy. It stagnated in the Province of Buenos Aires and fell hard in Catamarca and La Rioja. Also in the City of Buenos Aires there are 6% fewer jobs than a decade ago.

In terms of sectors, the big losers were the construction and hotel and restaurant sectors (pandemic effect), while the public services, health and education sectors were the big winners of the decade.

Evolution of registered work
Millions of jobs, seasonally adjusted



Source: Econviews based on Ministry of Labor