THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

August 17th, 2021

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Editorial: One Year After the Restructuring, Still Orphans of a Plan

A year ago, Argentina reached an agreement with its main creditors and restructured the public debt in default. That allowed to almost clear the maturities schedule completely. The first year in which the market will see Argentine dollars will be in 2025 when between capital and interest it will pay about 10 billion, 2% of GDP. It still sounds like a small amount for a G20 country.

On that occasion, in Econviews we pointed out that the reorganization of the public debt was a necessary but not sufficient condition to regain access to the international capital market, which allows to refinance maturities and not have to make a giant effort in fiscal and external matters to be able to pay that debt. To achieve that goal, it is imperative to have an economic program, as we pointed out in our editorials last year and in the special report published on the day of the announcement.

The program did not arrive. Neither a stabilization plan "fatto in casa" nor an agreement with the International Monetary Fund. The high price of commodities and the IMF's allocation of SDRs gave the government air. But that procrastination was not free. While the government spoke of an "exit yield" of 10%, that is, the yield on bonds after the debt swap, the market entertained the idea of 12%. The reality is that bonds today yield between 17 and 20% with a country risk that for months has moved in a range of 1,500 to 1,600 basis points. Exactly double that of Ecuador, which did a debt restructuring at the same time as Argentina. Ecuador has a program with the Fund, but it also had a pro-market political change. We do not know which of the factors weighs more, but they both add up. A year ago, we assumed that Argentina could regain access to the market in 2022. Today that seems very ambitious given that in the best of cases we will have a program with the IMF back in the first quarter of 2022.

What happened this year vindicates the urgent need for a program. How can it be explained that while the BCRA recovered some international reserves, tax revenues were good, the prices of the products that Argentina sells rose and even so there are no marginal buyers for bonds that yield 17%. Contrary to what the manuals say, fear beats greed this time.

Argentina has a long history of missing opportunities. Can history change this time? World rates will remain low for a while, but they won't last forever. Prices of commodities will not always be that good. The IMF needs to make a program and it is probably more flexible than many of its directors would like. There is a new opportunity to turn the tide and break out of more than a decade of stagnation and make some structural reforms. Looking at the stage from the audience, it does not seem obvious that this time the government decides to face the problems in a professional way and with a long-term perspective. However, it is a bad time to draw conclusions. With the elections ahead, asking politics for a long term is naive, to say the least.

In our base scenario, after the elections, the stars will align themselves towards a program, but we are not quite sure how much "ownership" that program will have. If the government does not believe in the need for a fiscal path, a monetary anchor, and some reforms that loosen the foreign exchange, regulatory, commercial, and labor traps, it will be difficult to regain confidence in a sustained manner. The opportunity is open, but we will have to be willing to navigate through the problems. No one says it is politically easy to cut the deficit or ride the cost of a depreciation that helps build reserves and loosen the FX controls. But not doing it will be bread for today, hunger for tomorrow.

LAST WEEK IN REVIEW

- The **Salary Index prepared by INDEC increased 2.3% in June and 43% y/y.** The informal sector was the one with the lowest increases in the month (1.2%) followed by the registered private sector (1.8%). In this way, all categories except the public sector (4%) had increases below the inflation of that month, which was 3.2%. In year-on-year terms, no sector managed to exceed the 50.2% inflation mark.

- In the second quarter of the year, export prices increased 31% compared to the same period of 2020, while import prices increased 15.1%. Thus, **the terms of trade for the country improved by 13.8%.** If we look at the quantities, the increase in the exported volume was only 7% and somewhat higher for imports, growing by 45.8%.

- The **use of installed capacity in the industry reached 64.9% in June,** 3.4% higher than a month ago and 11.6% over the June 2020 figure, where there were still sanitary restrictions. The sector with the greatest dynamism was that of basic metal industries (78.2% of use). At the other extreme was the automotive industry, which made use of 51.9% of its capacity.

- According to the latest report on the situation and evolution of registered work, **in May, 13.6 thousand public workers and 2.9 thousand private workers were incorporated** considering the seasonally adjusted measurement. Compared to the same month of 2020, the increases in the number of wage earners reach 75 and 78 thousand workers for the public and private sectors respectively.

- Last week **more than 20% of the population with a complete vaccination scheme was reached.** Although the rate of application of second doses was increased, there is still an important part that awaits the second component.

NEXT WEEK'S HIGHLIGHTS

- On **Wednesday 18** INDEC will announce data on **wholesale prices and construction costs.**

- On **Wednesday 18** will be the **second bond auction** and the debut for Finance Secretary Rafael Brigo.

- On **Thursday 19** the **trade balance** of June will be known where a generous surplus is expected.

- On **Thursday 19** the INDEC will publish the **EMAE (GDP proxy)** for June. We expect a recovery to make up for the drop in May.

- On **Friday 20** the Treasury will announce the **fiscal result** for July that will come with a deficit.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y
Official exchange rate ARS/USD	97.1	0.2%	1.0%	32.8%
Blue Chip Swap	168.0	-1.5%	1.1%	29.5%
CB reserves (USD million)	41,987	-76	-938	-1,220
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.
Badlar rate (private banks)	34.2%	0 p.p.	+0.13 p.p.	+4.31 p.p.
Merval (in ARS)	69,471	5.5%	7.9%	40.0%
Country Risk (spread in %)	1,565	-0.6%	-1.5%	-25.5%
Official exchange rate BRL/USD	5.26	0.5%	2.8%	-3.0%
Soybean (USD/ton)	505.6	-4.0%	-5.4%	52.3%
Oil - Brent (USD/barrel)	70.9	1.0%	-6.1%	55.6%

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q
Industrial production	*Jun-21*	10.5%	-0.7%	6.0%
Automobile production	*Jul-21*	-12.5%	26.6%	2.9%
Steel production	*Jun-21*	2.8%	-0.5%	6.1%
Poultry production	*Jun-21*	9.6%	0.2%	0.9%
Dairy production	*Jun-21*	-0.1%	0.9%	1.4%
Beef production	*Jun-21*	13.1%	-3.2%	0.8%
Real Estate transactions (CABA)	*Jun-21*	33.8%	7.0%	17.3%
Flour Production	*Jun-21*	2.7%	-1.3%	1.0%
Oil production	*Jun-21*	1.0%	3.8%	2.2%
Gas production	*Jun-21*	2.8%	3.1%	4.9%
Cement production	*Jul-21*	-0.6%	0.5%	0.5%
Construction activity	*Jun-21*	6.8%	-4.4%	3.7%
Retail sales	*Jun-21*	5.0%	-6.4%	5.1%
Gas sales	*Jun-21*	10.1%	-4.3%	-0.3%
Motorcycle licenses	*Jul-21*	-13.5%	3.4%	6.8%
Use of electricity	*Jul-21*	-4.7%	4.2%	-3.2%
Subway rides (CABA)	*Jun-21*	33.0%	5.7%	17.4%
Imports CIF	*Jun-21*	8.5%	9.9%	7.6%
Exports FOB	*Jun-21*	8.9%	4.7%	12.0%
Loans in ARS to private sector	*Jul-21*	-0.7%	-5.5%	-1.6%
VAT-DGI Revenues	*Jul-21*	4.9%	-0.3%	2.0%
Formal private jobs (SIPA)	*May-21*	0.0%	1.0%	0.6%
Formal private jobs (EIL)	*Jun-21*	-0.2%	0.2%	-0.2%
Consumer confidence	*Jul-21*	9.3%	-3.0%	7.7%
Government confidence	*Jul-21*	-0.3%	0.0%	-5.0%

Note: stoplight color depends on monthly variation

Demolishing Markets

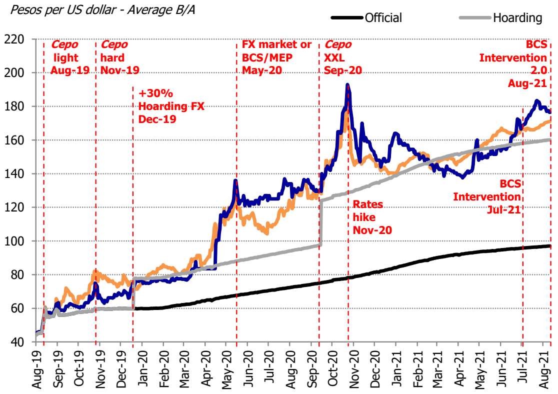
A new communication issued by the Central Bank last Thursday surprised the operators. Officially, the measure aims to "prevent money laundering and tax evasion", but the reality is that it is a new maneuver to reduce the number of lanes on the dollarization highway, reduce the greenback hoarding that accelerate close to the elections. It has been two years since the day after the primaries of 2019 (Aug 11), in which Argentina entered a dynamic that is, slowly but without hesitate, demolishing the exchange market and, together with it, part of the capital market (and others of the economy as a hole).

In line with the restriction that was imposed a month ago (the quantitative limit to the operation of the securities with which the BCS operates), last Thursday the Central Bank determined that transactions with bonds or shares can be carried out only if the bank accounts that are used are effectively in the name of the holder, either in local banks or abroad. In other words, the possibility of making foreign exchange operations from an account opened in a brokerage house (ALyC) was disabled. In practice, this measure implied a kind of "foreign exchange holiday" since Friday morning in the parallel segment, even for those who comply with this standard perfectly, the market is broken without a counterparty and with stockbrokers having to adjust their systems. The informal FX rose slightly but did not explode. If the market does not find a return to the new scheme, the demand for that segment can only increase.

The Central Bank's motivation to reduce the operations in the already intervene BCS market even further is the cost, in terms of international reserves, that implied in the last couple of weeks. In June it was USD 100 million, in July it was USD 350 million, while in the first days of August it already reached USD 200 million. An invoice that is getting bigger and bigger. With a second semester in which there will be excess of pesos, the Central Bank begins to put more and more containment dams to try to ease the devaluation pressures. But the unpleasant monetary arithmetic does not lie: the monetization of the deficit in the month and a half that elapsed in the second semester was ARS 340 billion, when in the entire first half of the year it was ARS 330 billion.

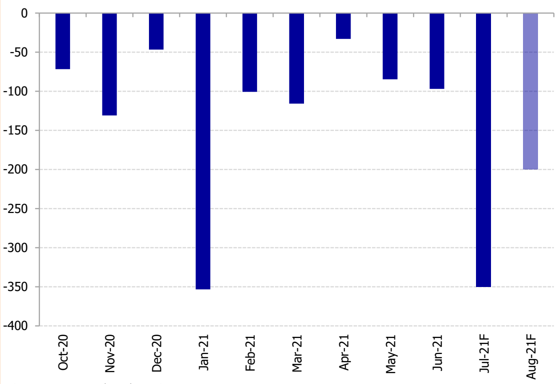
And the problem is that, at a minimum, there is still ARS 800 billion to be issued. In this sense, the lights of the Central Bank desk are all yellow: the last tender of the Ministry of Finance was mediocre (a refinancing rate of 115% is needed and it was 65%) and, while the announcements of more expenditures are multiplying in the campaign, there are doubts as to whether the issuance to finance the Treasury will not be even higher than contemplated. To be dimensioned, if the refinancing percentage of the Treasury debt fell to the level of the last tender, the necessary monetary financing would triple with respect to what was initially estimated. What would happen to the BCS in that case? Or rather, what kind of restrictions would be needed to contain them. Even more so considering that the measures applied are less and less effective, since prices stabilize due to some days, but after a few weeks they gain momentum again.

FX market
Pesos per US dollar - Average B/A



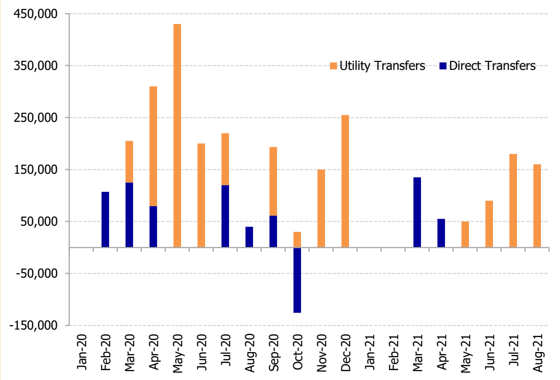
Source: Econviews based on Reuters

The cost of BCS intervention in terms of IIRR
In US$ millons, up to Aug-13



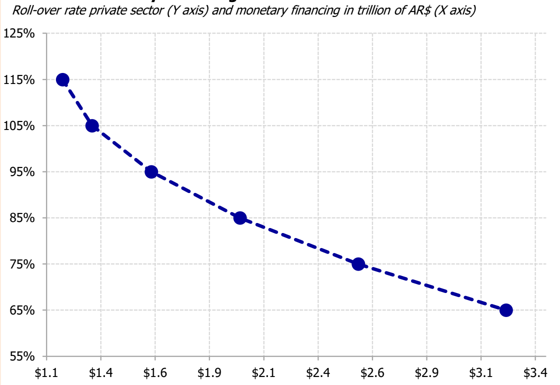
Source: Econviews based on BCRA

Monetary Financing per month
In AR$ millions



Source: Econviews based on BCRA

Potential Monetary Financing 2H 2021
Roll-over rate private sector (Y axis) and monetary financing in trillion of AR$ (X axis)



Source: Econviews based on Mecon

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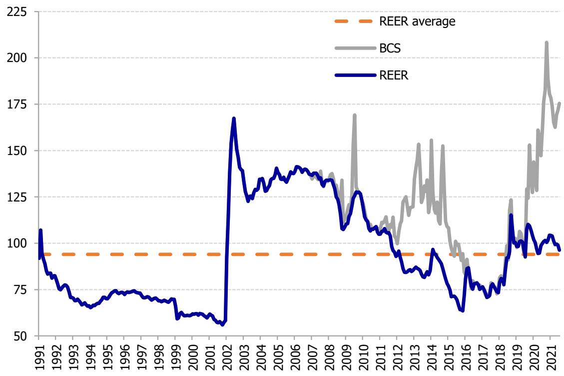
The reflection that triggers this situation is, how can it be that with a RER at the BCS FX that is at 2001 levels, that is, at maximum levels in terms of competitiveness, it is not enough to balance the market (parallel, in this case). Why the almost 8,000 million dollars that will enter through the current account this year or the little more than 6,000 million next year are not enough. The explanation we are aiming at is that there is a growing lack of trust. What does trust have to do with it? Through the "gutter" of the dollarization of savings, which is the measure of the distrust that we have as citizens in our currency, 1,000 million dollars would go away this year and 1,500 million in 2022. How many more would they be if we did not have capital controls?

Real effective exchange rate
At Jul-21 prices



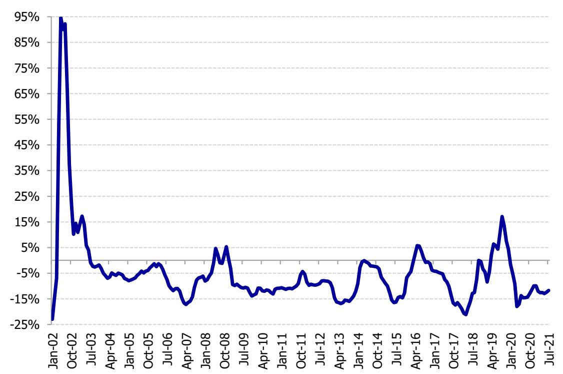
Sources: Econviews based on Reuters and Central Bank

Balance of Payments
In million USD

	IS-21	IIS-21E	2021E	2022E
Current Account	**7,061**	**730**	**7,791**	**6,137**
Balance of Goods	10,561	4,230	14,791	15,262
Balance of services	-1,175	-1,325	-2,500	-4,000
Interests	-2,300	-2,200	-4,500	-5,000
Profits	-55	-25	-80	-250
Financial Account	**-4,017**	**-2,173**	**-6,190**	**-1,150**
Foreign Investment	356	494	850	1,200
Portfolio	7	3	10	250
Net Loans	-2,698	-1,302	-4,000	-1,500
Multilaterals	-567	-383	-950	500
Hoarding	200	-1,000	-800	-1,400
Others	-1,315	15	-1,300	-200
Reserves Purchases	**3,081**	**-1,480**	**1,601**	**4,987**

Memo Ítems: The main items are shown
Source: Econviews based on BCRA

Real interest rate
ANR - Badlar Private Banks



Source: Econviews based on BCRA

Market mechanisms play a role to some extent, if awarding a high price does not work to reduce demand (for dollars in this case), there is a coordination problem. One option, at least temporary, is to raise the interest rate. We reiterate this because although we think that the interest rate is an imperfect substitute for credibility, it is a substitute in the end. If raising the price to the dollar does not work, let's try raising the attractiveness of the peso. The last time it was decided to increase the policy interest rates was in the last BCS crisis, last November. Inflation at that time ran at 40%, today it runs at 50%. I said: how attractive can the peso be with a yield that is more than 10 points below inflation (and expectations for the next 12 months, since a reduction is not expected in the short term).

Multiple spreads
Average bid & ask

	Quote	Spread
Official	97.11	-
Parallel	180.00	85.4%
MEP	169.41	74.5%
Blue Chip Swap	167.99	73.0%
BCS "SENEBI"	177.04	82.3%

Source: Reuters

The obvious risk of going this way is that the more than AR $100 billion of Leliq interest that the Central Bank disburses monthly will increase even more. The only way to absorb this expansion without running the risk of a greater monetary imbalance is to reduce the monetization of the deficit, which brings us to the origin of the current macroeconomic imbalance: the fiscal one. Aiming to reduce the fiscal deficit would make it possible to reduce issuance, which would give more space to the monetary balance for a rise in interest rates, which would alleviate exchange pressure and allow greater market financing, which in turn would allow a further reduction the broadcast. **A virtuous circle that will surely have to wait until the day after the elections.**

Inflation Will Only Fall Marginally in the Remainder of the Year

Headline inflation in July was 3.0%, in line with our expectation, with which **in 7 months prices accumulated an increase of 29.1% and 51.8% in the last 12 months, the highest value since January 2020**. And the next months will not be far from this number. The data only confirmed what we had been saying several months ago: the 29% goal set in the 2021 Budget was just an expression of desire that would become impossible to meet in the current Argentine macro context. It would take much more than freezing rates, slowing the FX depreciation or implementing regulations to reach 30% per year.

A few months ago, the government accepted that the initial objective would not be met and set a new goal of around 40% implicitly, by encouraging wage-agreements that are around or exceed that value so that salaries recover some purchasing power before the elections. To do this, "all the meat was thrown on the grill": the Central stepped on the exchange rate even more and now Minister Guzmán wants the wholesale exchange rate to close the year at 102 pesos (although with the greatest FX pressure in the second semester and in an electoral context we do not believe that this is feasible); public service rates will not have any further adjustment for the rest of the year; and price controls were tightened (directly and indirectly with “Cared Prices”and “Súper Cerca” programs and the “Shelves Law”).

But the new "goal" is also doomed to fail. For it to be achieved, an average inflation between August and December of 1.6% would be needed. At Econviews we believe that inflation could drop a few tenths in the coming months, but it will not move away from cruising speed of 3%. In this sense, we maintain our annual projection of 49%. To reach that number, inflation would have to be 2.9% each month.

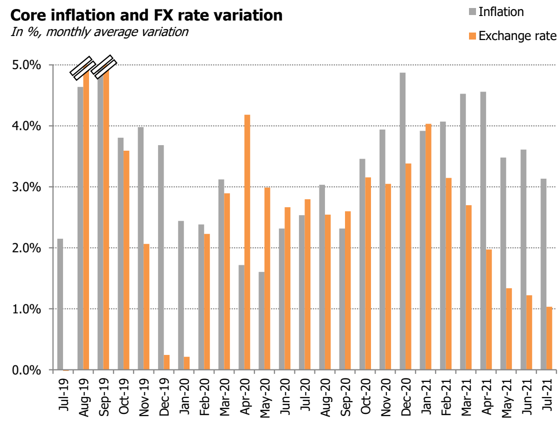
The FX anchor finally yielded some results, although nothing to celebrate. Core inflation was 3.13% and it became the lowest record since September 2020. In June the record had been 3.61%, so it was a reduction of almost half a percentage point. **Although it was not for free**. The exchange rate has been growing below inflation for six months, and in July the Central's strategy deepened: **on average, the exchange rate increased by just 1.0%.**

This shows that the exchange rate anchor lost effectiveness, and one of the reasons for this is the high FX spread, which, measured by the Blue Chip Swap in its “Senebi” version, the freest one, averaged 84% in the past month, an increase of 10 pp from in June. Although alternative exchange rates do not have a direct impact on prices, in a context of import restrictions, companies must increasingly look at alternative FX rates when determining prices because they are a better indicator of the future cost of replacement. In fact, analyzing the spread and inflation since 2011, we find that, on average, monthly inflation grows as the spread increases. Below 30% this relationship is broken, since the spread is no longer a relevant factor.

Headline inflation
YoY variation

Source: Econviews based on INDEC

Core inflation and FX rate variation
In %, monthly average variation



Source: Econviews based on INDEC and BCRA

Monthly inflation and FX spread
Averages, Jan-2011 to Jul-2021

Spread	Average inflation
>60%	3.0%
>50%	2.6%
>40%	2.5%
>30%	2.3%

Source: Econviews based on multiple sources

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The market does not expect a devaluation before the elections, but in recent weeks expectations of an acceleration of the exchange rate (or even a jump) post-elections have increased. If we take January of this year as a base, the wholesale exchange rate should increase by almost 11%.

Regulated prices hit the brakes and helped lower headline inflation. In July, regulated items increased just 1.4%, so they contributed just 0.3 p.p. to headline inflation; in June, with an increase in line with inflation (3.2%), the contribution had been 0.7 p.p. But the extra help from the regulated prices was offset by the prices of seasonal goods and services, which registered a monthly variation of 4.9%, the second highest of the year, although due to their low weight in the index they contributed 0.6 p.p. However, **the determinant of the decline was core inflation** (which weighs 67.9% in the CPI), **which contributed 2.1 p.p. vs 2.5 in June.**

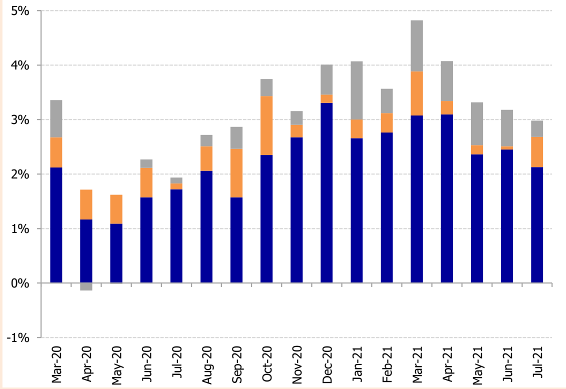
What can we expect in the coming months? At Econviews we believe that inflation will remain around 3% and could possibly drop a few tenths due to the exchange rate and utility rates anchor, but the high inertia leads future inflation to be determined by the past; in our model, at least 40% of a month's core inflation is explained by last month's inflation. And high inflation is widespread: 66% of the prices of a set of foods, beverages and other items in the GBA increased by more than 3%; and 70%, above 2%.

Unlike July, **August will be a month where regulated prices will play a greater role, although seasonal prices should calm down**. One of the most important increases will come from **prepaid healthcare**, for which the Government authorized an increase of 41.5% in four tranches. The first tranche of this increase will be 9% and will be effective as of this month. Expenses related to housing will have increases in two items. On the one hand, the rental contracts signed under the new law will increase between 45 and 47% depending on the week taken. **The other increase will come from building expenses**. Behind these are the wage increase to building managers, of 10% agreed in July and payable in August, added to the bonus of ARS 8000 to be paid from this month until February. Finally**, the cubic meter of CNG** will have an increase of 3 pesos, going from 37 to 40 on average for the AMBA service stations.

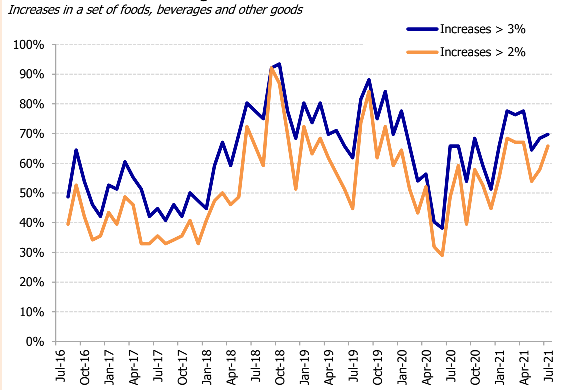
Prices for services arose, and are likely to pick up momentum in the coming months. Although they increased just above goods (3.1% vs 2.9%), since the beginning of Alberto Fernández's administration, this situation has only occurred in December 2020. A large part of this is due to the fact that frozen utility rates are included within services, and another is due to the fact that activity in the services sector was deeply affected by the pandemic. But with the greater openness and increase in mobility to businesses, which is at its highest level since the beginning of the pandemic according to Google data, the prices of services will become more relevant. **Restaurants and hotels were an example of this: in July they increased 4.8% and had the highest impact on the CPI after food and beverages.**

The prices of services, including utilities, have ample room to recover and after the elections, especially if an agreement is reached with the IMF, the

Contribution to headline inflation
Monthly, in %

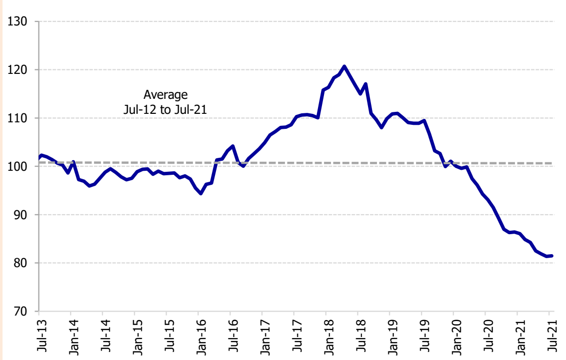


Difusssion index - GBA region
Increases in a set of foods, beverages and other goods



Source: Econviews based on INDEC

Ratio between prices of services and prices of goods
Indices, in levels



Source: Econviews based on INDEC and DGEyC BA rates will have to start to be adjusted. And the exchange rate as well. **In this context, we reaffirm our expectation of 48% inflation by 2022.**