THE WEEK AT A GLANCE

ECONVIEWS

ECONOMÍA Y FINANZAS

August 23rd, 2021

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Editorial: Pro-investment legislation? That's new!

The government announced this week that it will soon send to the Congress the Law that encourages investments in oil and gas. It is not a Hail Mary play, nor will it be a breaking point, but it is a step forward in the recognition that investments are the only key to long-term growth.

The project comes at a time when the energy trade deficit of the last 12 months reached 511 million dollars, the largest in two years after a very brief trade surplus. Remember the fact that Argentina had an energy trade surplus of more than 6,000 million in 2006 and changed it to a deficit of 7,700 million in 2014. The current moderate deficit will continue to widen for a while longer and will almost certainly exceed 1,000 million dollars this year, with gas imports that will exceed 2,500 million both from Bolivia and through the regasification ships of Escobar and Bahía Blanca. The drought that affects Paraná River stream doesn't help either. Without important investments projects, the deficit has everything to increase further. And the energy sector deficit is one of the few sectorial accounts with a macroeconomic impact. The other, of course, is the agricultural sector that, for now, the government has treated very badly.

Regarding the bill itself, it seeks to reward the companies that increase their production with export permits, in at least 20% of the increase, and will open the possibility to access half of those dollars, without having to bring them to Argentina. Export taxes will not exceed 8%. Part of that money will be used to reward projects with less environmental impact and to work "with a gender perspective" for inclusion. The law will also generate changes in the fuel transfer tax, which will once again be ad-valorem, something that makes more sense given Argentina's inflationary trajectory.

Perhaps the most important is the fiscal stability for 20 years and the institutionalization of the Gas Plan. The problem is that Argentina's credibility is so low that these types of laws are not a guarantee of attracting investment. Several laws were made in the past that soon underwent major changes. Another important variable that for now is not clear is what the fiscal cost of these incentives will be. It's mostly about the gas plan.

Some firms had influence in the writing of the bill and for some this is a triumph, especially since other initiatives were deactivated. Apparently, Minister Guzmán blessed this project, which therefore has a more moderate vision than that of the more orthodox Kirchnerism. At the end of the day, it must be recognized that Argentina is in that "stand alone" category, that is, an unclassifiable country that if it does not make an effort will not attract investment. And the oil companies are used to difficult countries, but with an ad-hoc framework they get excited. It would seem that this proposal goes that way. Given the circumstances, it seems to make sense.

Argentina is trapped in a problem of macroeconomic, institutional, and political instability. Starting to discuss how investments are attracted is certainly good news. It would be ideal to start thinking about more general issues such as more modern tax policies, a more open economy, and the reduction of the various traps that impact business: exchange rate volatility, regulation maze and labor inflexibility. But given the specificity of the oil sector, this initiative can be positive. To the extent that it is accompanied by an agreement with the IMF that brings some macro stability and that the authorities create the letter of that agreement, we can aspire to seek new investments. But knowing the current limitations of Argentine politics, this law may be a good second best.

LAST WEEK IN REVIEW

- ✓ The **wholesale price index increased 2.2%** in July, the lowest monthly increase since May 2020. Within this indicator, domestic products rose 2.3% while imported 1.6%. In this way, the year-on-year rise reached 63%.

- ✓ **Construction costs had an increase of 5%** in July and 66.8% in the year-on-year comparison. The item with the highest increase was Labor (7.2%), followed by General Expenses (5%) and Materials (2.8%).

- ✓ In July, the price of the **total basic basket increased 1.6%** (51.8% y / y), and the **basic food basket rose 2.1%** (58.3% y / y). With these increases, a family of 4 members needed ARS 67,577 to overcome the poverty line and ARS 29,003 to be above the indigence line.

- ✓ The **Argentine trade balance had a surplus of USD 1,537 million** in July. Exports totaled USD 7.252 million, growing 47.1% y/y and 1.7% m/m s.a., while imports reached USD 5,715 with a year-on-year increase of 65.6% and a fall of 2.7% m/m s.a.

- ✓ In last Wednesday's auction, **the Treasury raised ARS 95 billion** and already accumulates ARS 240 billion so far this month.

NEXT WEEK'S HIGHLIGHTS

- ✓ Today the Central Bank will publish its quarterly **monetary policy report** (IPOM).

- ✓ On **Tuesday 24** the INDEC will publish the **sales data of supermarkets, wholesale distributors and shopping centers** for the month of June.

- ✓ On **Tuesday 24**, the **sales data of household appliances** for the second quarter of the year will be published.

- ✓ On **Thursday 26** the **information on the sale of agricultural machinery** will be published.

- ✓ On **Thursday 26**, the Universidad Torcuato di Tella will publish the **consumer confidence indicator.**

- ✓ On **Thursday 26**, the **bank report** for the month of June will come out.

- ✓ On **Friday 27**, the Treasury will carry out the **last auction in August** with the minimum objective of renewing the maturities of August 31 for 93,000 million pesos.

- ✓ On **Friday 27** the BCRA will publish the **result of the exchange market** for July.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	97.3	0.2%	1.0%	32.4%	▲
Blue Chip Swap	168.7	0.4%	1.4%	26.8%	▲
CB reserves (USD million)	42,048	+65	-964	-1,044	▲
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.	=
Badlar rate (private banks)	34.2%	0 p.p.	0 p.p.	+4.19 p.p.	=
Merval (in ARS)	67,821	-2.5%	7.0%	42.1%	▼
Country Risk (spread in %)	1,565	-0.1%	-2.6%	-27.5%	▼
Official exchange rate BRL/USD	5.39	2.7%	3.2%	-3.1%	▲
Soybean (USD/ton)	475.4	-9.2%	-10.4%	43.3%	▼
Oil - Brent (USD/barrel)	67.2	-6.9%	-4.7%	48.9%	▼

Note: arrow depends on weekly variation

Stoplight for Economic Activity

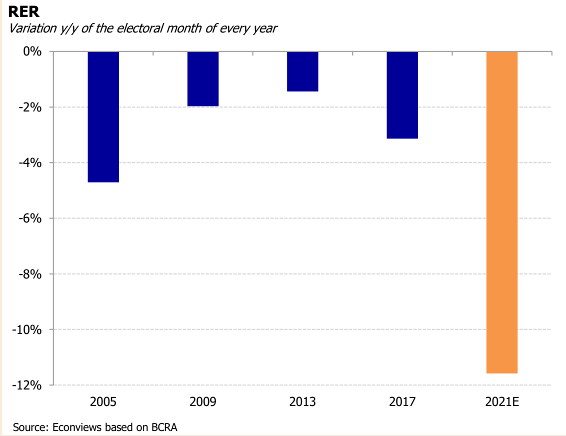
Seasonally adjusted variations

		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	*Jul-21*	-0.7%	7.3%	5.2%
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	*Jul-21*	6.9%	-3.4%	6.6%
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	*Jul-21*	-2.7%	6.2%	4.0%
Exports FOB	*Jul-21*	1.7%	4.7%	11.1%
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

Get smart

We are 86 days away from the midterms and the government will use all the policy tools at its disposal to control the official exchange rate market until then, leading us to the most important RER overvaluation of the last five midterms. This strategy is not exempt of risks, although we are pretty sure that the government's economic policy will make every effort, regardless of the costs in terms of the distortions it generates or the foreign exchange reserves it sacrifices along the way, in order for it to be fulfilled. However, at the end of this period of extreme resistance, we think that it will be follow a summer of exchange rate recalibration, a scenario that finds a foothold in both recent history and macroeconomic "fundamentals". It would be something like putting "99" in command, the only one who had common sense in the duo of agents in the series.



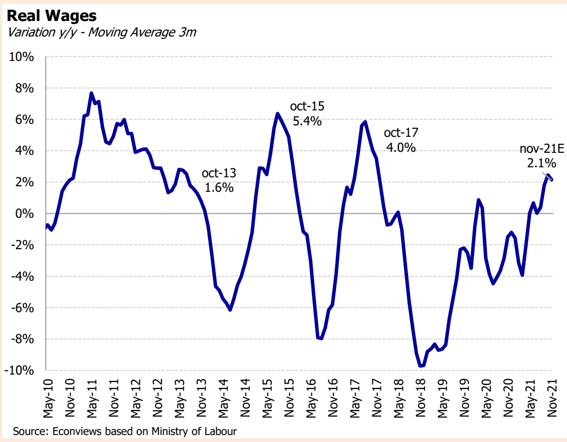
Midterm elections are always seen by the ruler party as the opportunity to strengthen themselves politically and then, almost immediately, advance with economic policies that allow them to be in better shape for the second half of the term. This happened after the 2005 election, which did not have a depreciation of the exchange rate, instead the government made a cash payment to the fund of US$ 9.5 billion, which had an impact on the foregin exchange reserves. In 2009, the financial crisis forced a readjustment that came before, so it was not necessary a summer with shocks. In 2013, the "Fabrega - the president of the Central Bank at that time - plan" implied a depreciation of the RER and a rise in the interest rates. The same situation repeteaded in 2017, although the depreciation of the RER in that time was accompanied by a decrease, not an increase, of the interest rates, due to the change in inflation targets. In short, in the summer after the election, there is always some action.

Midterms	Next Summer	
	FX variation (in %)	FX Reserves (in US$ mill.)
2017	15.7%	-1,507*
2013	28.4%	-3,253
2009	1.3%	686
2005	3.3%	-5,993

Source: Econviews based on BCRA

*Net of the extraordinary debt inflows in that period

This happens because in the period prior to the elections, both in the presidential and midterm elections, policies that have negative consequences are implemented to improve the ruler party's electoral performance. Crawling peg policy, for example, aims to anchor the inflation expectations. A classic from odd-numbered - electoral - years. Along with collective bargaining reopening, reinforcement of social programs, extraordinary bonuses and other measures, the exchange rate policy is aimed to generate a recovery of wages purchasing power, in order to boost disposable income. Although the level of real wages is at the minimum of 2006/2007, there will be some recovery with respect to the recent period and, after being many months in a negative cycle, a positive trend will be perceived in the upcoming election. As several political analysts maintain, voters tend to compare their present situation with a relatively close past, which is what the real-wage-rush that we will see from now to November points to.



The cost of this boost to consumption will be the most significant RER overvaluation of the last 5 midterms. Unlike other periods, inflation inertia made very difficult the FX-anchor policy: despite the nominal exchange rate moved at 1% m/m, inflation still travels at 3% m/m or more, putting even more pressure on the RER. Today, it is between 8 and 9% overvalued in comparison to December 2020 and, in the coming months, with a crawling peg that will continue at 1% and with inflation that refuses to pierce 3% per month, competitiveness will erode by at least another 2-3%. In this way, the overvaluation in December will reach almost 12%. And it would have been more than not having the highest American inflation since the late 80s.

But this anchor must be loosened since the need to strengthen foreign exchange reserves is imperative. From September to November of last year, that is, the last exchange rate of the parallel segment crisis took place, net foreign exchange reserves were reduced by US$ 4.5 billion, a situation that today would force the Central Bank to sell some of the gold reserves. Last week the Central Bank ruled a measure that further reduced operations in the BCS market. This is due to the fact that the intervention to put a roof on it was implying a growing bill in terms of foreign exchange reserves.

Why are we so sure that an exchange rate depreciation will come in the summer? Because of the agreement with the IMF or, in other words, because we have to pay to the IMF. In the period from now until March of next year, almost US$ 12 billion needs to be disbursed between the Paris Club and the IMF, which will not be covered with the sum of the current net foreign exchange reserves and the allocation of SDRs that will arrive at the end of this month (US$ 4.6 billion). This time there will be no cash payment, it will be necessary to renegotiate. With the inexorability of a program with the Fund in the short term, one anticipates that, among other things, there will be a request from the board to reduce the gap between the official FX and the BCS, and accumulate foreign exchange reserves. Thus, all roads point to a correction of the nominal exchange rate.

Why is a higher real RER needed to accumulate foreign exchange reserves? For three reasons. One has to do with the supply of dollars and the other two with the potential growing demands of dollars.

First of all, the external outlook is favorable but it can get complicated. While commodity prices remain high, soybeans are down 18% from the peak it reached last May and, with the future rate hike from the Fed in the horizon, it may continue to decline. Brazil is growing at a good pace, but next year there are elections, and the uncertainty of an increasingly negative political climate could play against it. **Secondly, there is the opening of borders, which is increasingly close to becoming effective and, with it, the possibility that the tourism BoP deficit will widen**. There are not enough dollars in order to finance the "cheap" Brazilian holidays for the Argentines. **Finally, something more structural is that the "R ER protection" required by less competitive, labor-intensive sectors is high**. Without it, imports are more attractive, something that would demand dollars and negatively impact the labor market.

With this outlook in mind, we expect the FX rate to continue operating as an anchor until November inclusive, but then the slide will begin, first with haste, to return to the average post-convertibility competitiveness, and then with greater gradualism, pointing to reverse all the overvaluation that

Net and Liquid International Reserves

In billion USD

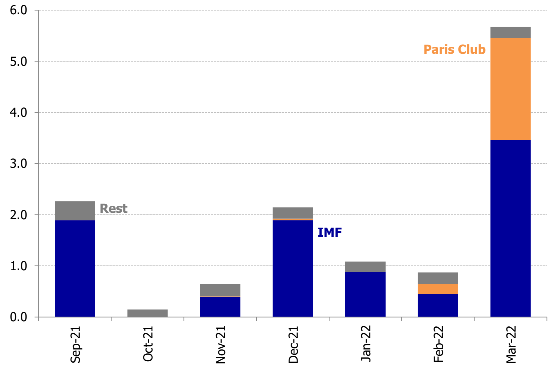
Gross reserves	**42.0**
Reserve requirements in USD	11.2
Swap with China	20.0
Treasury SDRs position	0.7
BIS & Repos	3.8
Net reserves	**6.3**
Gold	3.5
Liquid net reserves	**2.8**

Source: Own estimates based on BCRA and IMF

Up to Aug-20

USD maturities with the private sector and multilateral organizations

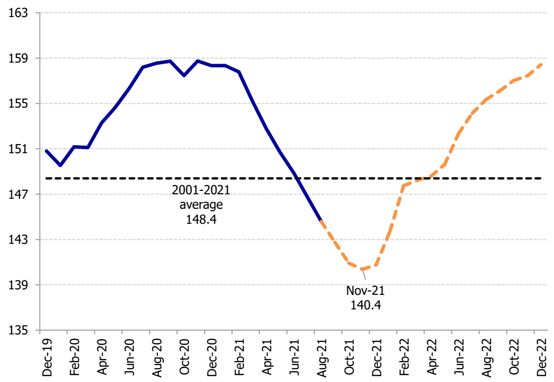
In billion USD - Includes principal and interest



Source: Econviews based on Mecon

RER

Index Base dec-01 = 100



Source: Econviews based on BCRA

the RER suffered in 2021. We expect that this year the FX will close at AR$ 107 (27% y/y), while for december 2022 we project a AR$ 171 (60% y/y).

Activity: a first semester with ups and downs, a second one more stable

Economic activity rebounded 2.5% monthly (without seasonality), in line with our projections. This offset the decrease in May, which had been 2%, meaning that June closed slightly above April, but below March or any other month in the first quarter. In this way, taking the EMAE as a proxy, in the first semester the GDP accumulated a rise of 9.7% against the same period of 2020, but in the comparison against 2019, it was still 3.9% down. **The first half of the year was marked by ups and downs, but the second semester the activity will improve slightly with more stability**, although the arrival of the Delta variant is a risk that could impact the recovery. Even considering this risk, **we expect GDP to close the year with a 7.4% rise. If the activity remained at the current level it would still be 6.8% higher than last year, which means that we expect some more growth, but nothing spectacular.**

After a first quarter of growth, the economy cooled down in the second quarter and the mini quarantine in May worsened the situation, although the decline was not as strong as expected. In effect, in the first quarter, activity had grown by 2.4% compared to the last quarter of 2020, but i**n the second quarter, activity contracted by 1.6% QoQ. But even so, June left a statistical drag of 6.8%.**

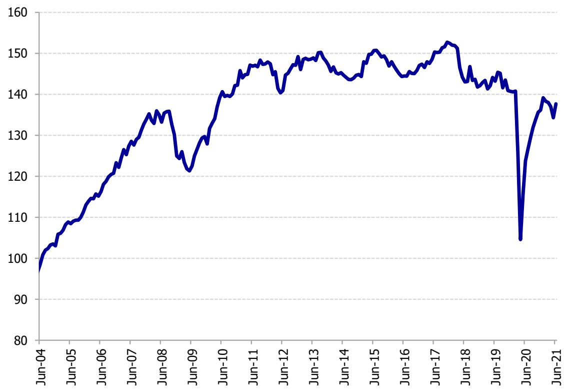
<u>**A sectoral look: what happened and what will come**</u>

The increase in infections in April and May, together with the consequent restriction measures ordered by the Government, affected the entire spectrum of activities, both in those sectors that produce goods and in those that offer services. **But the performance between them has been heterogeneous.**

Undoubtedly, t**he sector that recovered the fastest was Construction**. The boost it received in the last months of 2020, with the reduction of costs measured in dollars due to the increase in the FX spread and families that were able to generate savings during the months of confinement, allowed it to maintain good levels so far from 2021 to despite the cooling of the second quarter. **The sector grew 40.8% y/y in the first semester, although in the comparison with 2019 it is still 8.3% down.** Towards the second semester, we expect the good levels of activity to continue, although mainly due to the impulse of public works before election. **We expect 2021 to end with a growth of 23%.**

The Industry, for its part, **not only recovered from the fall of 2020, but in the first semester it exceeded the levels of the same period of 2019 by 4.1%** (although both Industry and Construction were already in crisis before the

Economic Activity
INDEC -EMAE, seasonally adjusted series 2004=100



Sectoral evolution
Accumulated % variation - 1° half

	1H-21 vs 1H-20	1H-21 vs 1H-19
Agriculture and livestock	-1.9%	-10.7%
Fishing	11.6%	-9.4%
Mining	2.7%	-5.5%
Industry	25.8%	4.1%
Electricity, gas and water	4.0%	4.6%
Construction	41.2%	-8.3%
Commerce and repair	19.4%	3.0%
Hotels and restaurants	-20.4%	-48.7%
Transport and communication	-0.4%	-13.4%
Banking	2.9%	-2.4%
Real estate, corporate and rental activi	10.0%	1.1%
Public administration	0.5%	-4.1%
Education	0.5%	-3.6%
Health	6.0%	-8.5%
Other social services	13.8%	-23.0%
Taxes net of subsidies	11.6%	-1.7%
Activity index	**9.7%**	**-3.9%**

Source: Econviews based on INDEC

Sectoral forecasts

	1H - y/y	1H stastistical carryover	2021 forecast
Agriculture and livestock	-1.87%	-2.53%	-1.64%
Fishing	17.07%	17.32%	9.25%
Mining	3.89%	5.41%	7.40%
Industry	21.23%	12.96%	15.10%
Electricity, gas and water	3.38%	1.90%	1.86%
Construction	40.83%	21.73%	22.98%
Commerce and repair	16.79%	9.59%	11.79%
Hotels and restaurants	-14.20%	1.26%	0.94%
Transport and communication	0.50%	4.18%	4.94%
Banking	2.42%	1.03%	0.23%
Real estate, corporate and rental activi	9.75%	7.15%	7.93%
Public administration	1.62%	2.94%	3.12%
Education	0.96%	0.93%	1.06%
Health	5.72%	0.58%	-1.61%
Other social services	22.49%	25.17%	16.01%
Taxes net of subsidies	11.50%	8.70%	5.64%
Activity index	**9.74%**	**6.80%**	**7.40%**

Source: Econviews based on INDEC

pandemic). Protectionist policies and loans to SMEs will give the sector a little more margin, as well as the recovery in Brazil that has a direct impact on industrial exports. **We expect the year to close with a growth of 15.1%,** but if the government decided to step on imports more in a scenario of shortage of dollars, the sector would face a ceiling due to the lack of inputs. A story that we have already seen.

On the opposite side, in the first semester, **hotels and restaurants and the agricultural sector were the only ones that fell against the same period in 2020**, although for different reasons. The former were particularly affected by mobility restrictions and the mini-quarantine in May paralyzed activity. On the other hand, the agricultural sector was affected by lower production volumes and losses in the livestock sector due to the ban on exporting meat ordered by the government in May. The situation for the end of the year is also different for both: **with the recovery of population mobility, restaurants and hotels will close positively (0.9%), but the agricultural sector will contract by 1.6%.**

What's coming for July and August

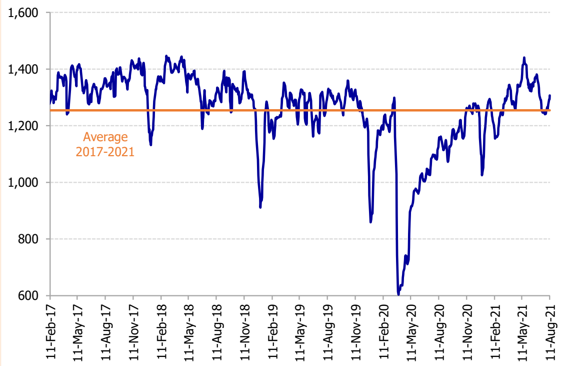
After the rebound in June in Industry and Construction (both the manufacturing IPI and the ISAC posted important monthly increases), the data available for July suggest that activity has been reduced in both sectors, although they will maintain relatively good production levels. The electricity consumption of the industries contracted by 4.5% m/m without seasonality, and the estimate of the CEP-XXI (government think tank) also based on electricity consumption was -3.9%. In turn, automotive production contracted 12.5% monthly after the jump of 22.4% in June. Regarding Construction, cement shipments remained stable compared to June (-0.6%), but the Construya index contracted 5.4% in our seasonal adjustment. However, **the first high frequency data of electrical consumption of the industries indicate a rise in the last weeks of August.**

Although July was a weak month for goods, the story is different for services. The key was in the decline in Covid cases that led to fewer restrictions and an increase in population mobility, which accelerated sharply in July and is currently at the highest levels since the start of the pandemic.

Retail sales rebounded 6.9% without seasonality in July, and with higher capacity, cinemas, bars, theaters and restaurants also benefited. In fact, Google searches for restaurants (which are a very good indicator of actual sales) rebounded in July and soared so far in August.

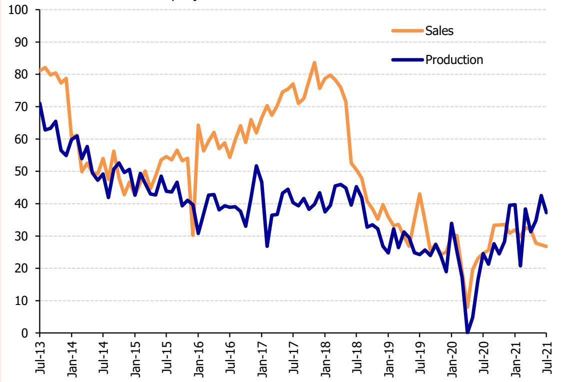
We revised our GDP projection from 7.0% to 7.4% and the final number could be even higher, but the risk of the Delta variant, which is already in community circulation in the City of Buenos Aires, could negatively impact the recovery of the next months. The health authorities estimate that in the next month we could see a new wave as a result of this. We do not believe that the government will opt for a quarantine, but restrictions could be extended that would have an impact on economic activity.

Electricity consumption of industries
In MW - Mov. average last 5 working days



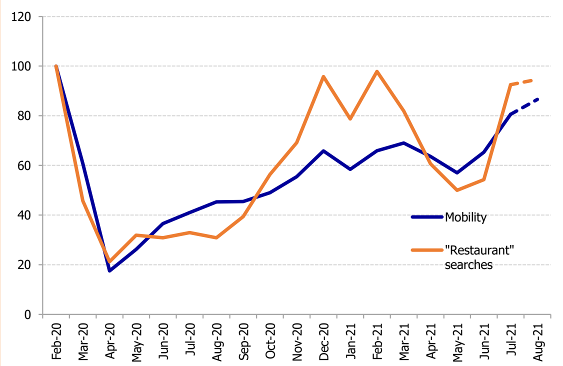
Source: Econviews based on CAMMESA

Production and sales of automobiles
Thousands of units - seasonally adjusted



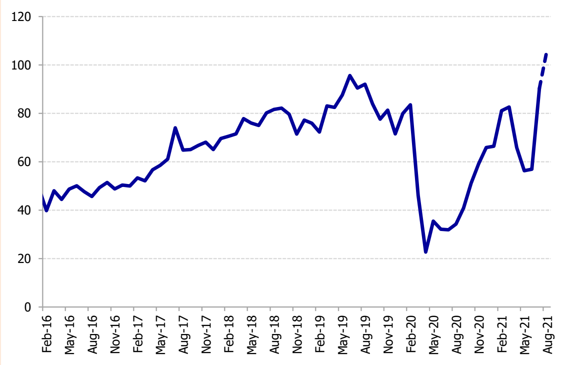
Source: Econviews based on ADEFA

Mobility and Google searches of "Restaurant"
Non-seasonally adjusted indexes, mobility to shops, Feb-20=100



Source: Econviews based on Google

Google searches of "Restaurant"
Seasonally adjusted index



Source: Econviews based on Google