THE WEEK AT A GLANCE

ECONVIEWS

ECONOMÍA Y FINANZAS

August 2nd, 2021

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Editorial: The season of FX stress begins

The last 4 business days of last week the Central Bank had to sell dollars in the FX market so as not to alter the routine of daily devaluation of 3 or 4 cents. The last time it had a seller balance for 3 days in a row was at the end of last November. Until this change of direction, the BCRA had bought USD 7,512 million in the market and managed to accumulate USD 3,638 million. The difference was in payments to international organizations for USD 1,123 million, sales to the Treasury for USD 1,171 million and the item others for USD 1,587 that includes exchange differences with the yuan, the price of gold, transactions with the Bank of Basel and especially operations to control the blue-chip-swap rate, in which the Central Bank sells bonds in pesos and repurchases them in dollars in an operation that sterilizes pesos and consumes reserves.

The change of direction comes from the fact that FX flows from agriculture are beginning to diminish. July was still robust, but at the margin, it ends much worse than it started and producers sold more than in other years, exacerbating seasonality. In numbers, we expect the reduction of proceeds from the agro-export complex to be around USD 1 billion per month. A difficult outlook to keep the FX market without any surprises.

How does film end? Can the government withstand this rate of devaluation of the official rate without the FX spread getting out of hand until the elections? We think so. But it will not be easy or free. The Central Bank will resort to a combination of selling reserves and curbing imports to achieve its objective and will surely also devalue a little faster, going from an annualized depreciation rate of 12-14% to 15-18% at some point in time. that maelstrom so as not to sacrifice so many reserves. Some time ago we estimated that the BCRA would lose about 1,500 million dollars. It will be necessary to see if the payment of interests to the IMF is made with the position of SDRs that are left or use reserves. That number may not be enough.

But the reserves will also suffer because the Central intervenes in the blue-chip-swap market. And it does so at a time when the demand for dollars in the alternative segment increases due to the fact that the monetary issue is beginning to wake up, added to the classic dollarization that always takes place during the electoral period. So that the spread does not skyrocket, the BCRA has been intervening at a rate estimated at around 20 million dollars a day, which is USD 400 million per month. As we pointed out in this space, we believe that the regulation on the *cepo* of July 9 and 10 was inopportune because it caused the market to stir up early.

Considering the panorama described in the official market and in the alternative markets, we can anticipate that we will get into the elections with a very meager reserves position. Not as pressing as in October of last year, but the cushion will be very thin for the type of shocks that Argentina usually goes through.

Even if the situation of reserves were better than expected, we believe that at least in 2022 we will have to recover the lost path in terms of competitiveness and most likely we will have to aim for a higher real exchange rate. This is not a numerical whim. When we think about the program with the IMF, we see that there will be two sure FX requirements. The first is that the *cepo* is relaxed. And while it will be gradual, the IMF will almost certainly ask that imports, debt or dividend payments not be halted, and that the BCS market not be intervened, with which the spread will reflect market pressures. We think it will be more lenient with restrictions on the purchase of dollars for hoarding.

Second, **there will be a request to increase net reserves and this is usually achieved by changing the relative price of the dollar and significantly reducing the FX spread**. Until now the government has the advantage that the tourism account is almost closed, but that will not last forever. The harvest can always be of help, but while prices will likely remain favorable there is a Niña risk that could complicate 2022.

LAST WEEK IN REVIEW

- In May, **supermarket sales fell 2.6%** in real terms, marking the third YoY drop in the first five months of the year (February -5.8% and March -8.8%). This data contrasts with that of wholesale self-services, whose sales grew 7.6% YoY.

- In the last auction of the month, the **Treasury obtained financing for ARS 150 billion**. In this way, it achieved ARS 316 billion in the month, which translates into a roll-over of 112%.

- **The Consumer Confidence Index** prepared by the Di Tella University **grew 9.3% in July**. All the categories that compose it had positive variations: personal situation 8.8%, macroeconomic situation 2.8% and durable goods and real estate 23.3%. Compared to a year ago, the index is 0.8% down.

- During past week, **the BCRA made sales in the FX market in four of the five days, releasing USD 300 million.** The last time it had closed a day with a negative balance was April 30 and to find two consecutive days of sales we have to go back to January of this year.

- **The government announced that an agreement had been reached with Pfizer for the purchase of 20 million vaccines**. This occurs in a context where the country exceeded 50% of people vaccinated with one dose, but there are still many delays in the application of the second component.

NEXT WEEK'S HIGHLIGHTS

- **Today** we will know **tax revenues** from July.

- On **Tuesday 3 the first bond auction** of the month is held. Dollar-linked bonds are placed again.

- On **Wednesday 4**, the **car and cement activity data** for the month of July will be released. First contact with the real economy.

- On **Thursday 5** the **industrial production and construction** data for June are published. Good numbers are expected.

- On **Friday 6** the Central Bank releases the **REM data** with the market's macroeconomic projections.

- On Friday 6 the **unemployment data** for June in the **United States** is published.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	96.7	0.3%	1.0%	33.8%	▲
Blue Chip Swap	168.8	1.0%	1.8%	38.9%	▲
CB reserves (USD million)	42,582	-526	+145	-758	▼
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.	=
Badlar rate (private banks)	34.1%	+0.06 p.p.	0 p.p.	+4.50 p.p.	▲
Merval (in ARS)	65,918	1.7%	5.7%	33.4%	▲
Country Risk (spread in %)	1,599	1.1%	0.2%	-29.8%	▲
Official exchange rate BRL/USD	5.22	0.3%	5.0%	1.2%	▲
Soybean (USD/ton)	519.8	1.0%	-2.4%	58.6%	▲
Oil - Brent (USD/barrel)	77.4	2.8%	-1.1%	79.3%	▲

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	*Jun-21*	2.8%	-0.5%	6.1%
Poultry production	*May-21*	-6.9%	5.5%	-8.5%
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	*May-21*	-2.5%	2.1%	-4.9%
Oil production	*Jun-21*	1.0%	3.8%	2.2%
Gas production	*Jun-21*	2.8%	3.1%	4.9%
Cement production	*Jun-21*	5.5%	3.7%	1.9%
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)	*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	*Jun-21*	0.5%	-6.8%	-2.5%
VAT-DGI Revenues	*Jun-21*	-2.7%	2.0%	-4.2%
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	*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

Loans have been falling for nine months

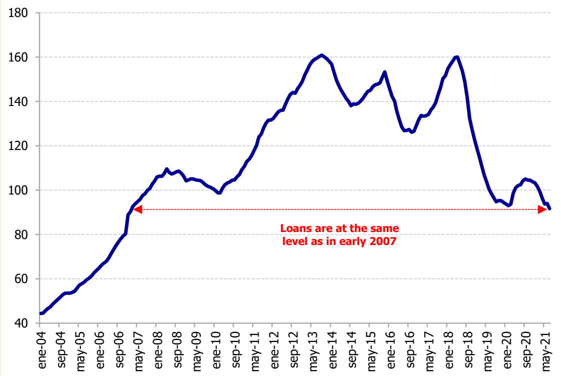
Economic activity has not yet finished recovering what was lost in the pandemic, but it had a significant rebound. However, this improvement in aggregate demand was not accompanied by a demand for bank financing. Loans to the private sector in pesos at 3 business days from the end of July are 12% lower than at the end of October, measured in real and seasonally adjusted terms. Measured against July of last year, total loans in pesos fell 10% in real terms, while the economy in the first 7 months of this year is 10% larger than last year. We are clearly talking about a more deleveraged economy. This raises questions about the ability to grow without credit, on the one hand, but it is also an opportunity. If the planets align and Argentina achieves credibility and stability, there is a lot of space to finance investments, exports and consumption.

This implies that Argentine families have used disposable income or savings to reduce their debt with the financial system. The same goes for companies. It is clear that in the corporate sector you see very few investing and also, for different reasons, few entrepreneurs replenishing stocks. Clearly one of those reasons comes from the obstacles to foreign trade that ends up exempting many entrepreneurs from having to increase their working capital. Clearly the mini quarantine in May helped in the process, but we have already been 2 months of improvement in the level of activity without news of an increase in loans.

What does increase is the stock of loans in SME lines that have an implicit subsidy component. Until June 629,000 million pesos were disbursed, which represents more than 20% of the stock of all current loans in the system. If that number is adjusted for inflation, we reach almost 800,000 million, that is, more than 25% of the stock. In any case, these numbers are not totally correct since part of the granted stock has already been paid, so that the subsidized loans to the firms are important, but not as decisive as the number might suggest.

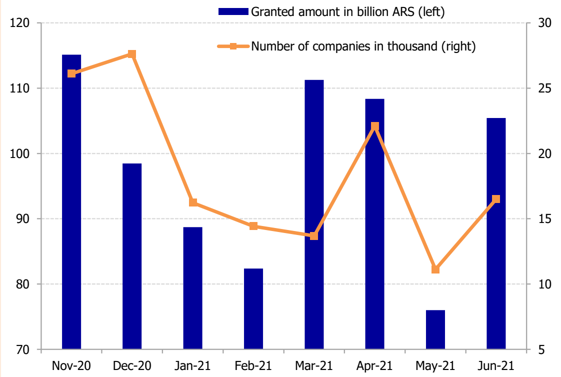
At the household level, it is clear that personal loans (10 points more expensive than credit card financing) have lost interest and people use cards more, which also has another subsidy component through programs such as "Ahora 12". The government in elections mode is interested in creating "Ahora 30" (low-interest 30-installments plan) with the complicity of merchants and industrialists, but it is not clear how and who will pay this consumption subsidy. For this reason, the stock of credit card financing fell only marginally in the last 12 months (-1%), while the stock of personal loans fell almost 13% in real terms in the last year. The only exception are pledge loans, which in the last year doubled their stock in nominal terms, a 32% increase in real terms.

Credit to Private Sector in ARS
Real terms s.a. - Jan-2010 = 100



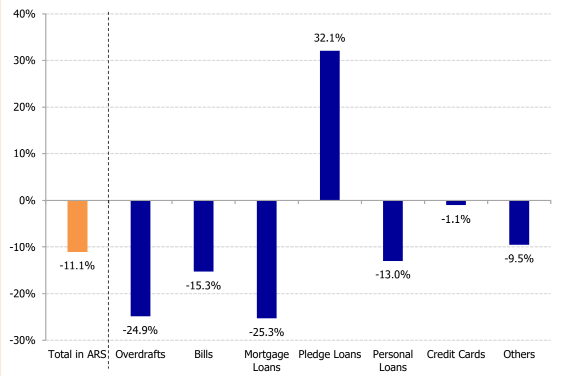
Source: Econviews based on BCRA

Subsidized Financing to SMEs
In real terms



Source: Econviews based on BCRA

Credit to Private Sector
Var. % y/y - in real terms



Source: Econviews based on BCRA

<u>The world of banks</u>

Argentine banks are in good health despite 10 years of stagnation. Liquidity is super high, capitalization is twice what the Basel standards require, and delinquencies are reasonably low, given the frequency and magnitude of the shocks that the economy experienced. The problem is that, without loans, it is difficult to earn money. As of May, loans to the private sector in pesos and dollars only represented 31% of banks' assets. To find a number lower than that, you have to go back to 2006, when the banking system was recovering from the implosion of the “corralito”. For example, by the end of 2002, the banks only had 21% of their assets loaned in part because they were loaded with public titles of compensation for the asymmetric pesification and because the assets included the protection of the clients, an intangible that they amortized in 5 years. Today 26.7% of banks' assets are in public securities and just over 18% in liquidity.

The only good thing for the profitability of the banks is that they are fixing a relatively small part of the liquidity. Although they have 62.9% of deposits in liquid instruments, only 11.4% are in cash, either in bank branches or in reserve requirements. The rest is divided into repos (22.6% of deposits) that yield 32 or 36.5% of the annual nominal rate, 25.3% in Leliqs that yield 38% of APR and 45% of EAR and 3.6% in Botes that yield 22%, under any other instrument, but as they serve to comply with the lace to the banks they serve.

This low-margin, few-loans environment affects profitability. The financial margin as measured by the Central Bank is positive at about ARS 134,000 million per month, but since July 2020 the balance of interests is negative for the system as a whole or since October for private banks. For example, in May the banks billed ARS 81,744 million for interest and paid 122,953 million. This has to do with the obligation to pay 34 and 37% with fixed terms against a financing mix that has become richer in regulated products such as cards (43%) or loans to SMEs of 30%. Loans to SMEs are an obligation of banks for an amount equivalent to 7.5% of their deposits.

Although in May the profitability of the system improved with earnings of ARS 24,000 million compared to the first four months of the year when they earned an average of 5,745 million per month, always measured in pesos from May 2021. **In the first 5 months of 2021 the banks obtained a monthly profit of 9,409 million pesos. Looking at the first 5 months of the previous years, profits seen in real terms never fell below 30,000 million with peaks in 2019 and 2014 with more than 40,000 million**. The ROA and ROE of the banks considering 5 months was 0.7 and 4.3%, that is to say, annualizing it would reach 1.6 and 10% respectively.

The delinquency in banking is at 4.3% considering the private sector and 4.5% considering all debtors. The irregularity of the portfolio in the system is controlled, even though as of May the banks still had some accounting waivers. As of June, the accounting prior to the pandemic returns, with which delinquency would rise a further tenth. But the allowances for bad debts exceed 130% of the delinquent portfolio, with which a marginal rise in the unpaid loans should not impact profitability.

The big difference here is in the type of entity. While the portfolio in distress is 2.8% in private banks (3% in national private banks and 2.6% in foreign banks), delinquency in public banks is 7.3%, 2.6 times greater than in the private sector. This is probably for two reasons. On the one hand, in public banking there are more lax credit conditions and with some political leaks. On

Financial System Assets

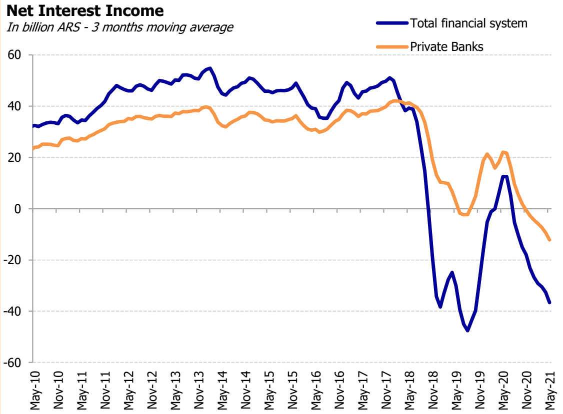
May 2021

	Million ARS	% of Total
Liquidity	2,355,384	18.3%
Public Bonds	3,438,782	26.7%
Loans	4,155,371	32.3%
Public sector	104,845	0.8%
Private sector	3,988,389	31.0%
Financial sector	62,137	0.5%
REPOs	1,848,238	14.4%
Others	1,072,430	8.3%
Total Assets	**12,870,206**	**100%**

Source: Econviews based on BCRA

Net Interest Income

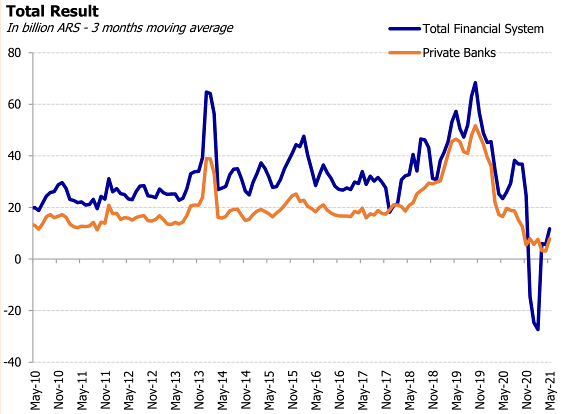
In billion ARS - 3 months moving average



Source: Econviews based on BCRA

Total Result

In billion ARS - 3 months moving average



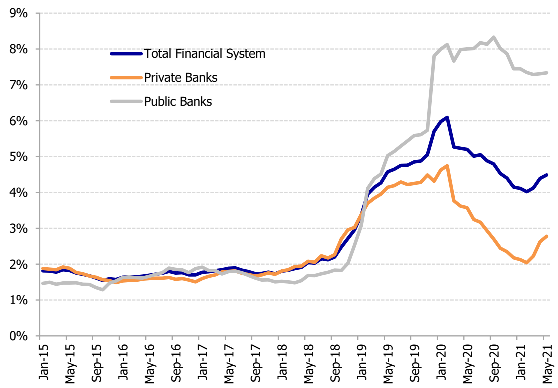
Source: Econviews based on BCRA

the other hand, in the last 12 months, public bank loans grew 47% against 32% in private banks and that by definition increases the probability of default. During the 4 years of the previous government, public banks maintained the same delinquency rate as the private sector, but evidently something changed because the rate between public and private delinquency touched 3, before slightly lowering to the current 2.63.

An interesting fact is that non-banking entities that tend to serve a riskier public increased their loans as much as the public sector, but have a delinquency rate of 3.7%, when a year ago they had 6.5%. Perhaps the influence of the automotive sector may be explaining that.

In summary, loans do not finish taking off and set a question mark about the reactivation, but at the same time having such a liquid system opens an opportunity for taking off. On the other hand, as long as rates are regulated and the percentage of loans in relation to assets does not increase, it will be very difficult for banks to recover the profitability of other times. To this is added the factor that there are scale problems for some and on the other hand the competition from FinTech companies is only going to grow. Consequently, the picture is not straightforward. A rate hike would help, but the latest statements by BCRA officials showed that it is not a priority. For now, the strategy is to navigate the regulations and control administrative expenses, as seems to have been the case in the last month published (May) when entities spent less than in any other month in the last year and a half.

Irregular Portfolio



Source: Econviews based on BCRA

Admin Expenses

In billion ARS of may-21

	Long Term Avg.	2019	2020	2021	May-21
Private Banks	43.0	47.1	45.5	43.8	42.9
National	22.1	24.3	24.1	23.1	22.7
Foreign	20.9	22.8	21.4	20.7	20.2
Public Banks	21.5	24.4	23.4	22.9	21.9
Non-bank financial entities	1.4	1.2	1.1	1.2	1.2
Total Financial System	66.0	72.7	70.1	67.9	66.0

Source: Econviews based on BCRA

Financial System's Total Result

Monthly average up to May - In million ARS of May-21

	2014	2015	2016	2017	2018	2019	2020	2021
Financial Margin	116,908	99,629	106,003	98,805	117,121	136,792	119,558	127,399
Interest Income	112,563	107,911	116,816	99,483	117,510	121,655	95,273	84,479
Interest Expenses	-63,954	-61,371	-77,421	-54,272	-77,224	-152,245	-88,254	-118,327
Result from Securities	31,225	48,886	55,003	37,019	53,304	140,304	83,845	96,486
Others	37,075	4,203	11,605	16,575	23,532	27,078	28,694	64,761
Service-Related Income	31,895	31,457	28,665	28,714	24,436	22,839	19,517	18,186
Bad Debt Charges	-9,295	-8,039	-6,679	-9,250	-13,859	-20,075	-18,741	-10,143
Admin Expenses	-63,818	-64,137	-68,497	-69,939	-72,125	-70,660	-68,081	-67,858
Others	-31,033	-25,032	-23,448	-18,118	-23,363	-19,741	-21,432	-58,176
Resultado total	**44,657**	**33,877**	**36,044**	**30,213**	**32,211**	**49,155**	**30,821**	**9,409**

Source: Econviews based on BCRA

Employment and Activity, two different stories

We believe that economic activity has entered a path of uninterrupted growth since June which, if there is no epidemiological outbreak or FX turmoil, will last until after the elections. That is, practically until the end of the year. Being optimistic, growth in 2021 could be even closer to 7.5% than 7%, which for now we keep as a base scenario, mainly because the aforementioned risks have a non-negligible probability of occurrence.

But if we speak in terms of employment, the certainties are quite fewer. The distortions in the labor market, such as the ban on layoffs and the double compensation requirement, do not let us know with what "genuine" unemployment rate we will start the long-awaited post-pandemic and, more importantly, if with a growth rate moderate growth since 2022 it can be reversed.

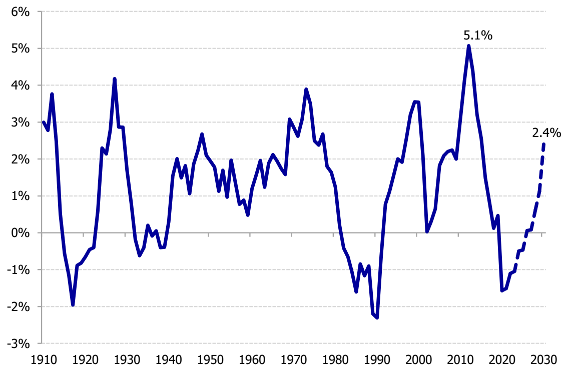
Let's do some historical revisionism first. **The decade that followed the exit from the convertibility crisis had a growth rate of GDP per capita such as has never been seen in more than 100 years of history**. The combination of low interest rates, a commodity super cycle and a period of expansion in world trade allowed Argentina and several emerging countries to enjoy a decade of unparalleled expansion. In the Argentine case, the giant excess capacity especially helped. **Between 2002 and 2012, private registered salaried employment grew at a rate of almost 300,000 jobs per year**. There were 3 million workers who began to fully enjoy all labor rights. Such good times.

The story continues with a decade, 2010-2020, in which two of the three aforementioned factors evaporated (only low interest rates persist) and at the end of the day, a pandemic was added whose consequences can only be fully measured once we get out of it. **Labor results: just 1,000 jobs in the private sector generated per year, not counting the impact of 2020.**

That is to say, taking into account that we will start with at least 2 million unemployed in the post-pandemic, to provide them jobs we need to grow at an uninterrupted 3% per year for 15 years, if we take the elasticity of labor absorption of the private sector registered in the best decade of growth in our history. Why 3%? We think that it is an acceptable range if "everything works out", but of course it could be lower. If we grow at 1.5% then 30 years would be necessary. Why do we take the elasticity of the private sector? **It seems that the state could not finance another million positions as in the decade of abundance.**

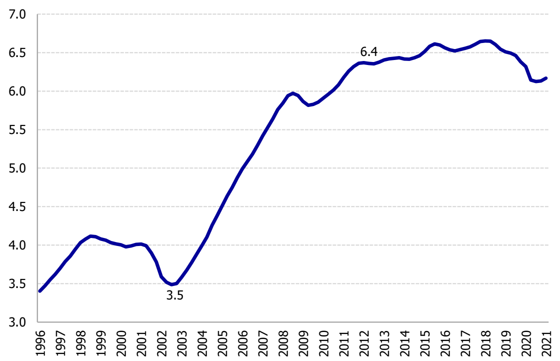
The problem of job creation in the post-pandemic is not unique to Argentina. Developed countries and especially emerging countries will have to find a way to employ all the workers who were left out of the labor market in these almost two years of crisis. **Even in the United States, which with the latest activity data published, it is confirming that it returns to its pre-Covid growth trend, has a huge challenge in terms of job creation**. Partly that's why the Fed has no intention of rolling back the stimuli. The almost certain renewal of the mandate of Jerome Powell at the head of the Central Bank of

GDP per capita growth
As % - 10 years moving average



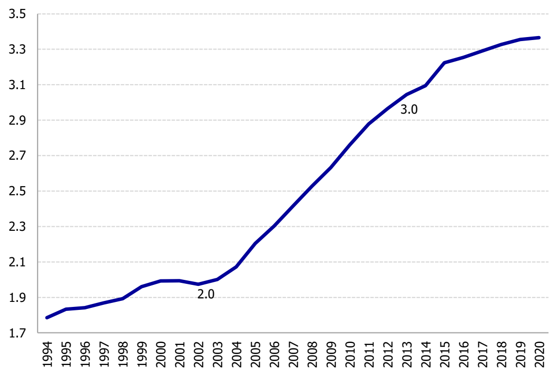
Source: Econviews based on Madisson

Private Sector Jobs
In millions of positions



Source: Econviews based on Ministry of Labour

Public Sector Jobs
In millions of positions - All Government



Source: Econviews based on "Norte y Sur" Foundation that country indicates that the intention is to reduce the unemployment rate in a forceful way, a new "whatever it takes".

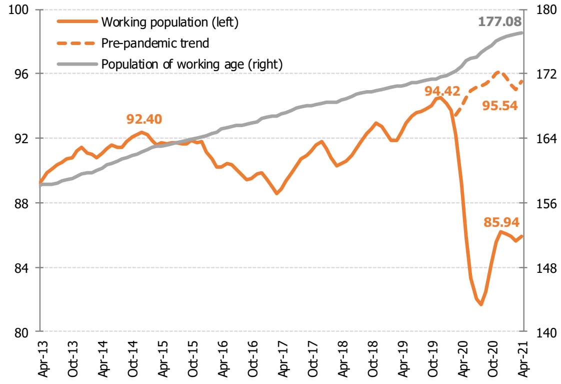
Post-pandemic: activity and employment, separate recoveries

	Brazil	Colombia	Mexico	US
Pre-pandemic workers (millions)	94.6	22.8	55.2	158.8
Current workers (millions)	85.9	20.5	53.0	151.6
Difference (%)	-9.1%	-10.1%	-4.0%	-4.5%
Unemployment rate (last reported)	14.6%	15.6%	4.0%	5.9%
Job creation rate y/y (2018-19)	1.7%	-0.2%	2.3%	1.4%

Source: Econviews based on different sources

For its part, Brazil recovered its pre-Covid product already in 1Q-2021, but in April it still had 8.6 million fewer employed persons. The slow exit from the recession of 2014-2016 meant that in the five years prior to the pandemic, the number of employed persons had grown only 2.5% while the working-age population increased 5.9%. **With a more stable macro performance, Colombia also had difficulties in generating employment**. In 2019 it had 3.6% more employment than in 2014, but the working-age population had grown twice. Today Colombia would need to add almost 2 million employed persons to return to the 2019 average. **Despite suffering one of the worst economic contractions, unemployment in Mexico did not rise as much as in other countries in the region**. It reached a peak of 5.4% in June 2020, and a year later it stands at 4%. As of 1Q-2021, the North American country registered 52.9 million employed persons, 2.7 million less than the same quarter of 2020. **The Latin American malaise.**

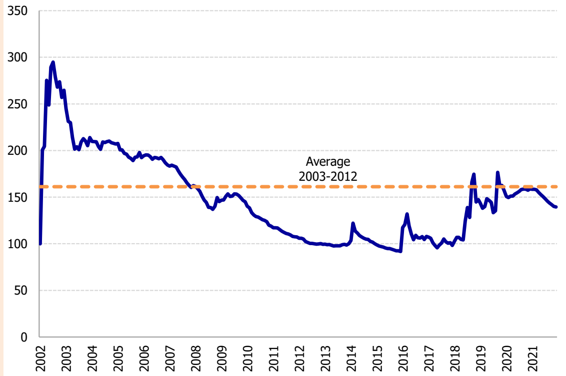
Brazil: population, employed and of working age
In million people



Source: Econviews based on IBGE

Returning to Argentina, it is necessary to have a framework to be able to attract investments in sectors that are labor intensive with low qualifications. We think that this will have the cost of a real exchange rate that cannot be very far from that of that decade of full employment absorption such as that of 2003-2012. We would close the year 12% below that level. **The idea of seeking the development of sectors that generate low-skilled jobs is not a mere whim, but is a matter of necessity**. According to the results of the Aprender tests, in 2019 42.8% of the students evaluated were below the basic level in Mathematics and 18.6% in Language.

RER
Base Dec-01 = 100



Source: Econviews based on BCRA

Added to this are two more issues. **First, based on the same 2019 report from the Ministry of Education, only 62.5% of young people between 18 and 24 years old had completed high school.** This number was even lower in lower-income boys (43.4%), while among those belonging to the highest quintile it reached 90.5%. **In relation to this, the second worrying fact appears: in 2020, more than 60% of children from 0 to 14 years old were below the poverty line and this has a very close relationship with their future education.**

The good news is that this bleak outlook is beginning to have an echo in "politics". The government launched a job placement program and even social organizations explicitly ask for more jobs and fewer social plans. In any case, generating jobs is complex. **It first requires the creation of an enabling environment for the private sector to increase its production and hence its**

demand for labor. A job could be the key so that those groups with the lowest qualifications are inserted in the formality and can begin a virtuous circle of development.

The Argentine ingenuity must be totally focused on generating jobs; the social and the macroeconomic balance depend on that.