THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

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Editorial: Agreement With the IMF: One More Round Is Missing

This week, Argentine financial asset prices soared. Some say that the polls are bad for the government and that is good for the markets. Others attribute the rally to the versions that circulated in the press about an imminent agreement with the IMF. Our base scenario was always that the agreement between the IMF and Argentina was going to arrive. But it seems to us that it is not imminent. It does seem to us that there are broad outlines of the agreement already discussed in terms of a deficit reduction path and some other issues.

However, the programs with the IMF have much more than a broad agreement. They require a detailed analysis of how Argentina can achieve fiscal balance (it is not the same to do it with more taxes than with spending reduction), to understand how much Argentina can grow because growth makes the debt more sustainable. There must also be a detailed chapter of the monetary and exchange rate analysis where the IMF will ask Argentina to increase its level of net international reserves and we will have to see how to do it. Saying that exports are going to increase is not a strategy, it is voluntarism. For exports to rise, it will be necessary to reduce the exchange rate spread, more investment and macro stability, none of which comes by divine grace.

Additionally, when you think about timing, you have to calculate the IMF board and the Argentine Congress. The board is more predictable: when the staff has all the detailed document point by point, we can think about two or three weeks for the board's ok. But the change in legislation that this government introduced obliges the executive branch to submit to congress any agreement with the IMF that is proposed. It is not that we hope that the program will not be finally approved, but the times may be less predictable given the work in commissions, approval on the premises of both chambers, including debates and opportunist comments.

In other words, we continue to think that the agreement is a matter of months, it will probably happen in the first quarter of next year, but we do not see it imminent. Anyway, there is something positive in this soap opera. The versions of an early agreement were leaks from the government itself to different members of the press. This means that there is an interest in changing expectations. Those who leaked the information were not unaware that the market was going to receive this information positively. Although this is obvious, it is not what the authorities have been doing, until now more inclined to send messages to the platform and less to the business sector and the financial market.

One issue that deserves attention is that the agreement with the IMF is a necessary condition, but it is not sufficient to achieve an improvement in the Argentine economic situation. It is necessary because Argentina does not have the resources (nor will it have) to pay the maturities of 2022. And it is necessary because knowing that there will be no default with the IMF removes a source of exchange rate, financial and macroeconomic instability. But we are not satisfied with not capsizing, we are more ambitious! To go up a level and regain access to markets, grow, reduce poverty, the authorities need to take the IMF program seriously. In other words, genuine efforts must be made that will not be politically easy to communicate, such as living with a more depreciated exchange rate and higher utility prices.

We also have to be prepared to move forward with structural reforms. Tax, labor, integration into the world issues are all important things that have an impact in the medium term. But if a clear signal is not given that it is going in that direction, it will be very difficult to attract quality investment, which is necessary for long-term growth. Many politicians believe that the rise in consumption (induced by fiscal spending) will attract investment by itself, something that was known as the Keynesian accelerator theory. Some of that may happen, but it will not be macroeconomically significant. For the long term, important reforms to the organization of the Argentine economy are needed if we want something more than to avoid a crisis.

LAST WEEK IN REVIEW

✓ In line with a higher level of economic activity, in June **sales in supermarkets grew 1% y/y in real terms. Wholesale supermarkets** also had good results with their sales **growing 9.4%** compared to a year ago.

✓ **Home appliance sales rose 68.1% year-on-year** in June (above inflation of the same period). The categories with the highest participation in total sales were: Televisions (20.9%), Telephony (20.8%), and Kitchens, ovens, heaters, and water heaters (13.6%).

✓ In the second quarter of the year, **agricultural machinery sales increased 50.7%.** However, in terms of units, all categories presented decreases compared to the same period of the previous year.

✓ The **consumer confidence index**, prepared by Di Tella University, **grew 5% in August, although it remains 3.8% below the same month of 2020.** Within the subdivisions, the highest increase was recorded by Durable goods and real estate (+ 10.4%), followed by Personal situation (+ 5.9%) and Macroeconomic situation (+ 1%).

✓ According to the latest bank report, in June, **delinquency in total loans reached 5%, while for the private sector it was 4.8%.** These numbers begin to show reality more reliably, given that in previous months another criterion (less strict) was used to measure delinquency. In this way, bad debt charges, together with a lower financial margin, were two of the factors that contributed to a falling in the total result compared to the previous month.

NEXT WEEK'S HIGHLIGHTS

✓ On **Tuesday 31**, there will be **debt maturities** for ARS 93 billion.

✓ On **Wednesday 1**, we will know the **tax revenue** for August.

✓ On **Thursday 2** the INDEC will publish the **information on exporting complexes.**

✓ On **Friday 3** the Central Bank will publish the **monthly survey on economic indicators** (REM).

✓ On **Friday 3** the data for **production, sales and exports of cars** for August will be known.

✓ On **Friday 3**, the AFCP will publish the **cement shipments** for the month of August.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	97.7	0.3%	1.1%	32.1%	▲
Blue Chip Swap	169.0	0.2%	0.6%	34.7%	▲
CB reserves (USD million)	46,198	+4150	+3362	+3302	▲
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.	=
Badlar rate (private banks)	34.1%	-0.06 p.p.	-0.06 p.p.	+4.94 p.p.	▼
Merval (in ARS)	73,201	7.9%	11.4%	65.4%	▲
Country Risk (spread in %)	1,530	-4.3%	-4.4%	-28.8%	▼
Official exchange rate BRL/USD	5.19	-3.4%	0.5%	-6.7%	▼
Soybean (USD/ton)	499.4	5.1%	-4.2%	45.0%	▲
Oil - Brent (USD/barrel)	72.8	8.3%	-3.9%	60.6%	▲

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	*Jul-21*	-0.7%	7.3%	5.2%
Poultry production	*Jul-21*	-5.5%	-4.9%	-2.2%
Dairy production	*Jul-21*	-0.2%	1.7%	0.4%
Beef production	*Jul-21*	-4.2%	-9.0%	-1.6%
Real Estate transactions (CABA)	*Jul-21*	-8.8%	1.3%	2.0%
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*	-0.3%	-6.7%	-2.3%
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	*Aug-21*	5.0%	3.0%	10.5%
Government confidence	*Aug-21*	9.0%	-3.5%	4.1%

Note: stoplight color depends on monthly variation

The Fiscal Convergence Underway

Martín Guzmán will send the Budget project to congress in two weeks, but here we preempt by estimating how 2021 will close and what 2022 will be like from a fiscal perspective. Spolier: there is improvement. From a primary deficit of 6.37% in 2020, we estimate that this year could close something below 3.5% (3.33%) of GDP that once the SDRs sent by the IMF are accounted for, it will be corrected to 2.3%, but since the SDRs do not finance spending the relevant number is 3.3%. For next year we expect the primary deficit to fall to 2.5% of GDP with an interest burden of 1.6%, so the government will have to seek financing for 4.1% of GDP plus debt repayments for USD 43 billion.

The assumptions we use to think about next year are the following

- 2.5% growth
- End-to-end inflation of 48%
- Slightly lower cereal prices and fewer exports
- Better tax compliance thanks to the digitization of the economy
- Slight increase in pension expenses (the number of retirees should increase and benefits would rise on the margin)
- Lower spending on social programs
- Lower subsidies for energy and transportation
- We do not expect the “solidarity contribution” (wealth tax) to be repeated.
- Transfers to the provinces fall, but not infrastructure expenditures, which are nevertheless low in historical terms

<u>**The end of 2021**</u>

While we originally estimated the deficit to be 3.5%, we believe it can close marginally lower. It will depend in part on whether they inflate December accounts to alleviate 2022. This is a common practice where, for example, finance secretaries decide to catch up with Cammesa and pay floating debt with suppliers to reduce the deficit in 2022. This makes sense since this year there is no deficit target and next year there will not only be a target to be defined with the IMF, but Washington will limit the amount of floating debt. Argentina measures the deficit on a cash basis, so that ministers can manipulate the number by increasing or reducing floating debt. The bad news for Guzmán is that the IMF already knows.

Among the highlights of 2021 is that primary spending falls 2% of GDP from 24 to almost 22% of GDP. Part of this "effort" was free as the 7.4% higher economy helps. In summary, retirees gave 1.1 points of GDP to the government and 1.7% social programs since this year there were no ATP or IFE programs, although the Alimentar and Repros programs did increase. On

Fiscal Balance of the National Government

As % of GDP

	2019	2020	2021F	2022F
Primary Balance (without SDR)	-0.44%	-6.36%	-3.33%	-2.50%
Interests	3.38%	1.98%	1.50%	1.60%
Fiscal Balance	-3.82%	-8.34%	-4.83%	-4.10%

Source: Econviews based on Mecon

National Government Expenditures

As % of GDP

	2019	2020	2021F	2022F
Primary spending	18.49%	23.98%	21.95%	21.00%
Retirements and pensions	8.70%	9.51%	8.38%	8.50%
Other social programs	2.67%	5.40%	3.69%	3.45%
Economic subsidies	1.58%	2.55%	3.29%	2.66%
-Energy	1.00%	1.79%	2.53%	2.04%
-Transport & others	0.58%	0.76%	0.76%	0.62%
Transfers to provinces	0.60%	1.18%	0.83%	0.75%
Capital Expenditures	1.10%	1.02%	1.36%	1.40%
Salaries & operating expenses	3.29%	3.30%	3.42%	3.27%
Others	0.55%	1.02%	0.98%	0.97%

Source: Econviews based on Mecon

the other hand, there is a 0.75% increase in GDP in spending on subsidies that could even be higher if they catch up on December 30 with some debts. Other stories say that infrastructure spending increased by 0.35% of GDP, very little given the low level of comparison and the electoral year. This expense was fully offset by lower transfers to the provinces. Operating expenses will not be substantially modified. Interest fell half a point since almost nothing was paid on the foreign debt, while last year in the first quarter the government punctually cancelled the maturities before declaring the default.

On the revenues side, tax revenues grow slightly more than half a point of GDP from 24.15% to 24.68%, not counting the "solidarity contribution" that the government computes as non-tax income. VAT is key, going from 6.93 to 7.14%, although the provinces take most of that increase. The improvement in export tax revues that go from 1.41 to 2.15% of GDP are key in the process and compensate for the drops in other taxes such as profits and the PAIS tax that collects less than half that in 2020 since people neither travelled nor bought dollars on a grand scale this year. What is relevant for the fiscal accounts of the federal government is what remains to the Treasury after tax-sharing and there it goes from 16.02 to 16.22%. The interesting thing is that in non-tax revenues the government will register 2.4% of GDP in 2021, in line with what had happened in 2019, but much more than the 1.6% of 2020. In 2019 the government had privatized two thermal power plants, in 2021, the "solidarity contribution" was key to increasing those resources.

National Government Revenues

As % of GDP

	2019	2020	2021F	2022F
Tax Revenues	23.04%	24.15%	24.68%	25.51%
VAT	7.03%	6.93%	7.14%	7.20%
Income Tax	5.03%	5.34%	5.10%	5.25%
Social Security	5.34%	5.40%	5.42%	5.48%
Debits and Credits	1.60%	1.65%	1.65%	1.66%
Personal Property Tax	0.14%	0.75%	0.71%	0.75%
Export Taxes	1.83%	1.41%	2.15%	2.05%
Import Taxes	0.73%	0.73%	0.82%	0.85%
"Pais" Tax	0.00%	0.49%	0.24%	0.52%
Others	1.34%	1.44%	1.43%	1.75%
National Government Revenues	15.75%	16.02%	16.22%	16.90%
Other revenues (includes tax on large fortunes, privatizations, rents)	2.30%	1.60%	2.40%	1.60%
SDR	0.00%	0.00%	1.00%	0.00%
Total Revenues (without SDR)	18.05%	17.62%	18.62%	18.50%

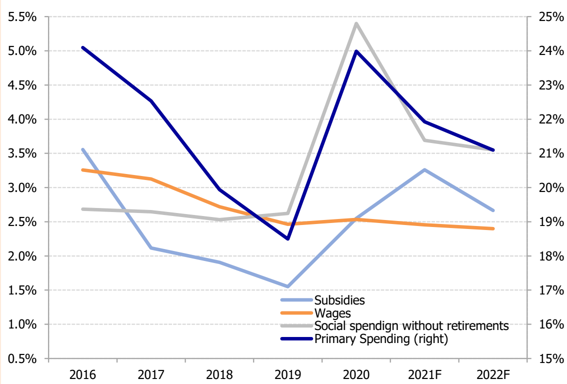
Source: Econviews based on Mecon

First look of 2022

For 2022 we expect a new drop in primary spending close to 1 point of GDP. In this case, the 2.5% growth will contribute little to the cause. Let us hope that the subsidies will generate a saving of 0.63% of GDP, which implies a significant increase in rates that must far exceed inflation. Timing is very important for fiscal accounts. A one-time increase in January is not the same as something fractional, in which case you may not be able to save as much. We believe that social programs will also generate savings of almost a quarter of a point of GDP. We do not believe that they will be discontinued, but the benefits may fall below inflation and the number of beneficiaries will marginally fall. On the other hand, retirement spending should rise marginally in terms of GDP. We believe that there may be a combination of small increases in the formula with small increases in the number of beneficiaries given that many people did not retire in 2020 and the numbers are likely to recover given the demographics. Interest should rise slightly to 1.6% of GDP.

Evolution of public spending

As % of GDP



Source: Econviews based on MEcon

In terms of revenues, we expect collection to increase by almost 1 point of GDP. This comes with small doses of a lot of taxes. The normalization of the economy will bring greater collection for example from the fuel tax, there will be greater collection for the PAIS tax since outbound tourism should take off. Not at the pre-pandemic levels due to a price issue, but there is probably a sector that returns en masse to Punta del Este, Brazilian beaches, Disney so that the PAIS will be even higher than in 2020. The recovery and digitization of the economy will likely generate a few extra dots in VAT, check tax, and earnings. But, despite this improvement, the part of other income should fall if, as we estimate, there will not be a revalidation of the Solidarity Contribution.

How do we finance it?

Our hypothesis is that in 2022 there will be no access to the international voluntary market, although there may be some net flow from international organizations, but we do not expect this to be macroeconomically substantial. So the vision is that the local market will play an important role with a net roll-over financing of just over 2 points of GDP. In 2021 this financing was somewhat lower, but higher than we expected a few months ago given the change in the rules for reserve requirements that the BCRA put in place.

The monetary issue will close this year at least at 2.75% of GDP if the market roll over is 115% of maturities. We are not sure and we do not rule out a number closer to 3% of GDP. Next year we believe that this financing will drop to 2.15% of GDP given the lower deficit. It remains to be seen how much monetary financing the IMF allows in the program. But it is clear that seigniorage is not going to go away overnight. The monetary issue will not be easy in 2022 because in addition to the issuance to solve the deficit, it will be necessary to accumulate reserves. So it will be necessary to calibrate sterilization and a high inflation that does not generate a Leliqs snowball. But that will be covered in detail in the coming weeks. At this same time and on this same channel.

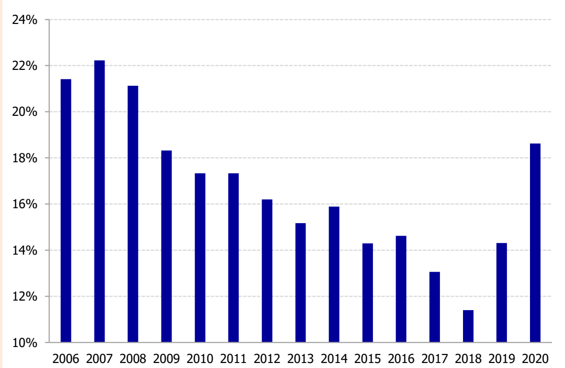
Financial program
In billion USD

		2021F	2022F
Financial Needs	**Primary deficit** (excl. SDRs)	**15.1**	**11.8**
	Interests	**7.0**	**7.5**
	In ARS	4.5	4.5
	In USD	2.5	3.0
	Principal amortizations	**31.4**	**42.7**
	In ARS	23.0	20.7
	In USD (incl. IMF)	8.4	22.0
	Total financial needs	**53.5**	**62.0**
	In ARS	*42.6*	*37.0*
	In USD	*10.9*	*25.0*
Sources of financing	**Local debt market**	**31.4**	**30.3**
	Roll-over	*23.0*	*20.7*
	New financing	*8.4*	*9.6*
	Multilaterals	**5.5**	**21.5**
	SDRs Position	**4.3**	**0.0**
	Central Bank	**12.2**	**10.2**
	Total financing	**53.5**	**62.0**
	In ARS	*43.7*	*40.5*
	In USD	*9.8*	*21.5*

Looking at the Glass as Half Full: In 2020 National Savings Were the Highest Since 2008

We all know the story by now: the pandemic - and the eternal quarantine - hit production and workers' income hard. During the harshest months of restrictions, people could not leave their homes except to buy essential goods, and even supermarkets limited the supply of products so as not to generate “unfair competition”. Construction works were paralyzed, industries severely limited their operations (or directly stopped completely, such as the automotive industry) and many people lost their sources of income. **But those who did not, could not spend either: everything was closed and you could not leave your house. And the (partial) reopening took time.**

Gross National Saving
As % of GDP



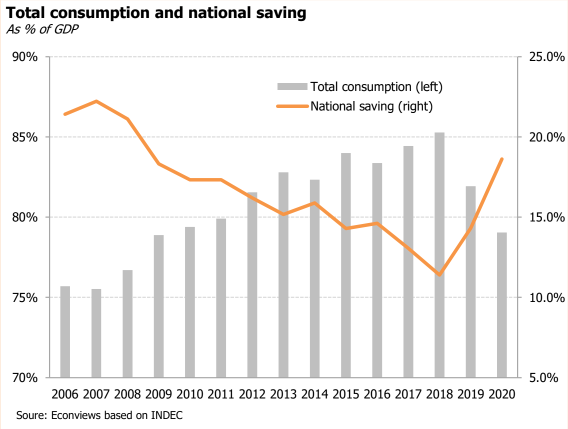
Source: Econviews based on INDEC

In times of crisis, people tend to increase the proportion of income they save, in a precautionary way. The increase in the savings rate, in theory, could have an even greater negative impact on consumption and production, leading to total savings falling. This is what is known in the jargon as the "savings paradox." But in reality, this is rarely observed, and an increase in the saving rate generally translates into an increase in investment and the trade surplus. And, according to the economic literature, **a permanent increase in the**

saving rate leads in the long run to an increase in the growth rate of the economy as a whole.

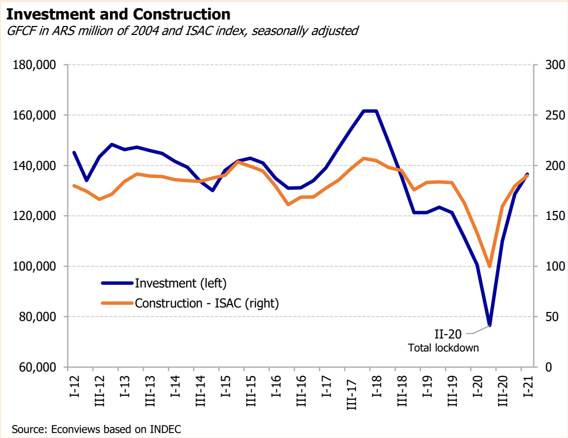
In 2020, national savings reached 18.6% of GDP: the highest level since 2008, and well above the 14.3% observed in 2019. But unlike other times of crisis, the increase in the savings rate did not respond solely to precautionary reasons, but mainly it was forced savings due to the impossibility of making expenses.

The savings rate had been in decline for a decade. The economic model of the first Kirchnerist presidency was, for a number of reasons, very different from what happened in the two presidencies of Cristina Kirchner. High commodity prices, a wide margin of unused installed capacity, and a competitive real exchange rate made it possible to sustain high growth rates and a relatively high savings rate (although lower than in previous periods).



But as external conditions deteriorated, the model began to display its many weaknesses and an attempt was made to sustain the economy by stimulating private and, especially, public consumption. But at the cost of turning the "twin surpluses" -fiscal and trade- into "twin deficits" and a stagnation in investment. **In this context, the savings rate began to decline gradually over the past decade and reached a minimum in 2018.**

The increase in savings in 2020 had a correlation in Investment, particularly in the Construction sector. After the end of the months of total quarantine, construction prices remained stable and, with the increase in the FX spread towards the end of the year, costs measured in dollars plummeted. **And families, out of debt and with savings, found an investment opportunity** - mainly in renovation and small-scale works**- that allowed a very rapid recovery of the sector, and consequently, of investment.**



What does this mean for recovery? Those who were able to save, in turn, were able to get out of debt. Commercial credit stagnated in the second half of 2020 and fell throughout 2021. In this context, **there are conditions for a new cycle of indebtedness that could support consumption, as well as investment**. High inflation is a factor that works against this, but the recovery of wages in the run to the elections will give provide workers' pockets with some oxygen.

The increase in the savings rate, however, is transitory and as the economy recovers we expect it to fall again, especially in a context of high inflation and negative real rates. The authorities are in a hurry to achieve a recovery in consumption, but **stimulating savings in the medium term should be a State policy if we want to get out of the stagnation in which Argentina has been plunged for years**.

The Only Debt That Matters: The Social One

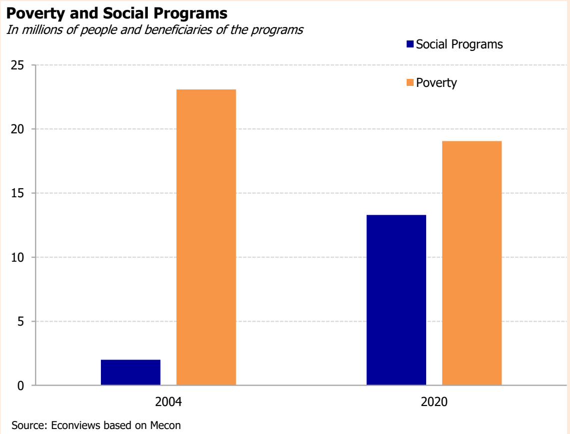
The economic debate in the last week revolved around the size of the debt that the current administration is accumulating and those left by the previous ones. But, beyond the multiplicity of approaches that can be given to the public debt data, with a poverty that it is above 40%, the only debt that should matter is the social one. The result of having, for many years, a number of poor people above 15 million is the growing number of transfer programs, conditional or unconditional, that now is 7 times than at the beginning of the century.

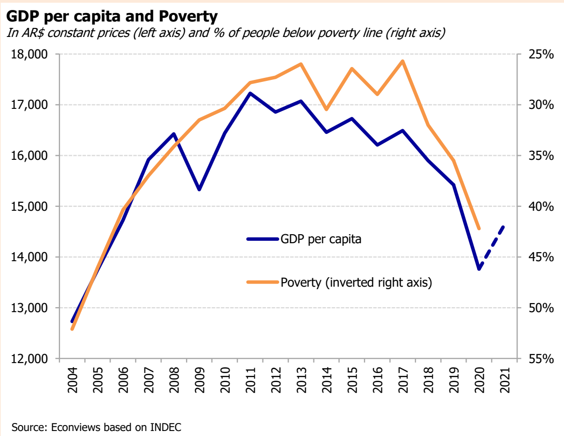
With the impossibility of growing in a sustained manner, the needs for social support are increasing. After the crisis of 2001 and until the international financial crisis of 2009, Argentina showed an expansion of 8% on average (6.5% per capita), the historical growing rates that the decade showed allowed reducing the poverty rate by more than 20 points. However, as of 2011, with the advent of stagnation and crises, GDP per capita fell by 15% and again poverty exceeded 40%. For both public and social debt, there is no better antidote than to establish a development process that increases per capita wealth.

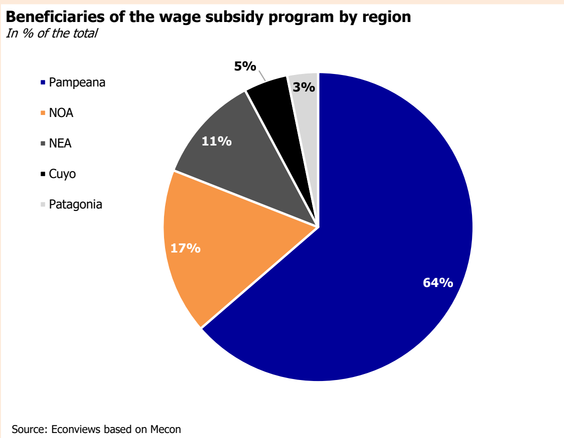
The most shocking thing is that, almost 20 years after the introduction of the Plan Jefes y Jefas, which granted 150 pesos (today it would be AR$ 12,000) to unemployed people in exchange for a minimum labor compensation, we see how another plan, under a similar scheme, emerges again. The Potenciar Trabajo program grants AR$ 14,000 to just over 1 million beneficiaries. A historical loop takes us back to the moment in which Eduardo Duhalde, the presidente in that time, had set himself in April 2002 the objective that "by May 15 at the latest" no Argentine family would be left without income. The Plan Jefes y Jefas had almost 2 million beneficiaries, while the Potenciar Trabajo already reaches half of that number.

This particular program was caught in the middle of the feud between factions within the ruling coalition and was the one that had the greatest impact on the public opinion in recent weeks. With a 78% growth in beneficiaries in the last year, and in view of the growing demand from social movements to expand the quota, in one year Potenciar Trabajo could reach the Jefes y Jefas, a plan that was implemented in the worst moment of the crisis. The distribution of this plan among the regions of the country also marks where the emergency is and, in addition, the dispute for control of its allocation. The Province of Buenos Aires concentrates more than half of the beneficiaries (55%), followed by Tucumán (6%), the province with the largest number of population living in below poverty line neighborhoods, and the City of Buenos Aires (5%).

The good thing about Potenciar Trabajo isthat brought together several programs that had some labor compensation, either through a training program or directly via a community work function (mainly picnic areas). Thus, the "menu" of transfers from the National Government was roughly







divided between allocations aimed at childhood, work-related, food and educational programs. It is a clear reflection of the failures of public policies in these areas, since the emergency replaced planning**.**

Social Programs of the Federal Government

	Programs (in millions)	Amount of the program (AR$)	In % of the minimum wage
Family Allowances	4.8	5,063	35%*
Universal Child Allowance	4.4	5,063	31%*
Wage Subsidy Program (Potenciar Trabajo)	1.0	14,040	50%
Food Stamps	2.4	6,000-12,000	21%-43%
Students Programme (Progresar)	0.8	3,600-9,700	13%-35%
Total	13.3		

Source: Econviews based on Mecon

*There is 2.4 millions of recipients, therefore more than one program is received for each recipient

How much demand in terms of expenditures from the Treasury all this set of transfer programs of the National Government? Just over 3% of GDP, double what it demanded in 2015. It should be noted that, although together it is a considerable sum, the amounts of each program are considerably less than that of an SMVyM (AR$ 28,000) and that, even if a family receives the maximum possible from each program, the total does not cover the total basic food basket (which is the base for the poverty line), although it does cover the food basket (indigence).

With each year that passes without being able to establish a clear roadmap to generate work, it will become more difficult to reduce the 15 million benefits that today are consolidated as an inflexible social expenditure. Although the IFE could be cut and, compared to 2020, spending on social programs will be reduced by 1.5% of GDP this year, by 2022 we expect there will be almost no reduction. Although we project that the primary deficit will be reduced by 1 point of GDP, the adjustment will be via energy and transportation subsidies, poorly targeted and much more regressive in terms of income distribution.

While the numbers of public debt come and go, the number of beneficiaries of social plans continues to grow, and with it, the financing needs, which press on the primary balance that, if it remains in deficit, can only be covered with, of course, public debt.