

THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

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Trash** Under
the Carpet

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Activity Level:
Rebound in June,
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Editorial: Elections and Trash Under the Carpet

The economy is already in electoral mode. June was a very good month in terms of economic activity, recovering the setback of May and even more. July was not so good from the point of view of the production of goods, but services are going to bring good news with the reopening. The government did or will do everything in its power to boost consumption. The list is long and includes holding up the prices of the dollar, of the utilities, and of the gasoline; bonuses for pensions, reinforcements for social programs and increases in the minimum wage; and the consent of more generous collective bargaining agreement and new income tax cuts, among other measures.

If we add to this the gradual reopening of activities that are still restricted today, the result will be a very palpable improvement in the economy. Our estimated 7% growth for 2021 has more risks to the upside than to the downside. Although looking at other indicators such as government confidence and some surveys it does not seem obvious that it will reach. But it is clear that they will do everything. Minister Guzmán got his bosses to let him use the SDRs that come from the IMF to pay the September and December maturities, but he promised that he will inject money for the elections, lowering one of his flags.

But it is not all so linear. First, the market is uncomfortable as this week's bond tender showed. And this implies that if this situation is not reversed, the debt-money printing mix to finance the deficit will be even more biased to money printing. And a lot of money printing will not be harmless to the alternative exchange rates. And just as the government knows that it increases its electoral chances with more money in the voters' pockets, it loses them if the dollar is on the front page of the newspapers.

The other problem is that no matter how the elections come out, the government will have to continue in the front-office for two more years. That is to say that from the second half of November all the problems that are hidden will return to the surface. The RER, which is similar to the historical average, is not adequate for the next stage, the one in which Argentina will need to accumulate reserves and loose the capital restrictions. And if one thinks that a real devaluation of 20% is needed (to name a number), then the nominal devaluation will have to be much higher than that because inflation also plays a role. It operates by regulated prices, the inertia, and the expectations.

On the price side, both regulated and unregulated services lagged either due to political decisions or the dynamics of the pandemic. This relative price problem will have to be corrected.

Wages and pensions have been falling for some time. Something will recover in the second semester. **But in Argentina in 2022 they have more to lose than to win.**

The strongest ally that the post-election economy has is a world that seems to grow strong, with low interest rates for a while longer. The prices of raw materials are still good for Argentina and the Brazilian economy has been going strong, added to the fact that the real, according to Brazilian economists, should appreciate more. Anyway, the 2022 Brazilian presidential elections will be able to put some noise there.

In short, we believe that we will see a good level of activity in the coming months. Our stop light – activity indicator is mostly green. The government will probably regain some popularity, but it will hardly be enough to control the congress. And as soon as the elections are over, they will have to face difficult decisions that, in the context of a program with the IMF, can be passed with manageable surprises. On the contrary, without a program with the Fund, it will be very difficult to handle a devaluation without a plan or, in other words, the “fundamentals” are not good enough to avoid corrections to the current situation.

LAST WEEK IN REVIEW

✓ In July, **tax revenue increased 66.9% in year-on-year terms**. Revenues from Income Tax and VAT grew 68.5% and 86.9% respectively. Foreign trade taxes also performed well with Export Duties growing 131.9% and Import Duties 96.3%. Another relevant tax due to its weight is that of Employer Contributions, which had a rise of 65.8%. It should be noted that, although the recovery in activity was an important factor in the revenues performance, the low comparison base is also part of the explanation for the good results.

✓ In the first auction of the month, **the Treasury obtained financing for ARS 146 billion**. Although it did not manage to cover all the maturities of the week, with two tenders missing, the amount obtained represents almost half of what matures in the whole month.

✓ The **production of cars and light commercial vehicles had a month-on-month drop of 12.5% s.a. in July**, while compared to a year ago it grew 49.8%. For their part, sales to car dealerships accumulated their fourth consecutive month of decline, contracting 1.7% compared to June. The year-on-year comparison indicates an increase of 8.4%.

✓ **Cement shipments totaled 1,053,344 tons and fell 0.6% s.a. in July**. In interannual terms they increased 21.4%, while in the accumulated of the year the growth was 40.0%.

✓ Last Monday, **the IMF approved the largest allocation of Special Drawing Rights in history**. The total amount is equivalent to USD 650 billion and according to its quota (0.67%), Argentina will receive approximately USD 4.350 million.

NEXT WEEK'S HIGHLIGHTS

✓ On **Tuesday 10**, the commercial **terms of trade** for the second quarter of the year will be published.

✓ On **Tuesday 10**, INDEC will publish the **salary index** for June.

✓ May's **public services activity** will also come out on June 10.

✓ On **Wednesday 11** the data on the **use of installed capacity** in the industry will be released.

✓ On **Thursday 12** the INDEC will publish the **inflation** data for July. We estimate it to be around 3%.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	96.9	0.2%	1.0%	33.3%	▲
Blue Chip Swap	170.5	1.0%	2.4%	38.4%	▲
CB reserves (USD million)	42,063	-519	-664	-1,281	▼
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.	▬
Badlar rate (private banks)	34.2%	+0.06 p.p.	0 p.p.	+4.38 p.p.	▲
Merval (in ARS)	65,917	-0.1%	3.7%	29.0%	▼
Country Risk (spread in %)	1,575	-1.0%	-2.0%	-23.4%	▼
Official exchange rate BRL/USD	5.24	0.6%	0.9%	-1.7%	▲
Soybean (USD/ton)	522.6	0.5%	4.3%	61.5%	▲
Oil - Brent (USD/barrel)	72.6	-6.2%	-6.2%	58.8%	▼

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)	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

Confidence: The Key to “External Restriction”

In the first six months of the year, the current account surplus, explained by the extraordinary international prices, together with a capped deficit in the financial and capital account, thanks to the capital controls, improved the international reserves position. However, both situations are not sustainable in the medium term. Sooner or later, the new commodity bull cycle will be reversed, and the program with the IMF will require, among other things, that there be fewer impediments to dividend payouts, debt payments and capital flows in general. The challenge to the government, therefore, is to regain trust before international prices return to “normalize”.

What does trust have to do with it? The “external restriction”, a term used by part of the economic team to refer to the need to increase the flow of dollars from net exports to “finance” economic growth, loses sight of the fact that one of the central problems is the mistrust in the peso. The dollarization of savings (Formation of Foreign Assets - FFA - in terms of the Balance of Payments – cash basis), which is the measure of the distrust that we have as citizens in our currency, summed USD 190 billion from 2003 (beginning of the series) to now. In the same period, the trade balance of goods was USD 230 billion. In other words, of every 100 dollars that were obtained through net exports of goods, Argentines demanded 83 to protect ourselves against the loss of purchasing power of the peso. That’s the trust that must be regained.

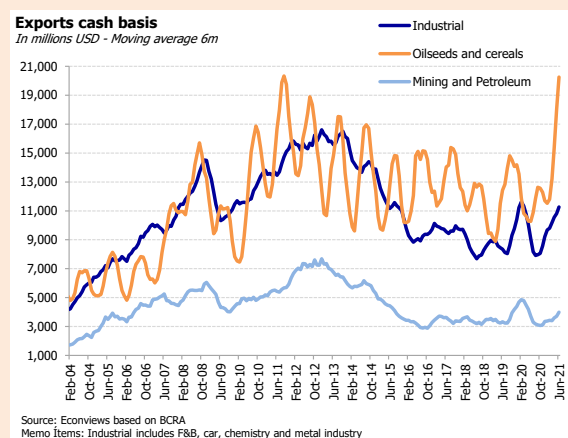
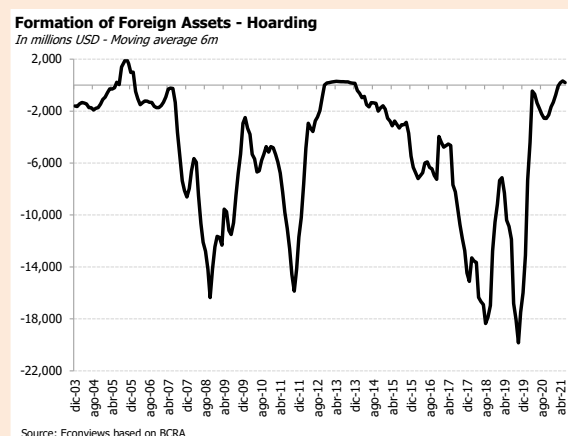
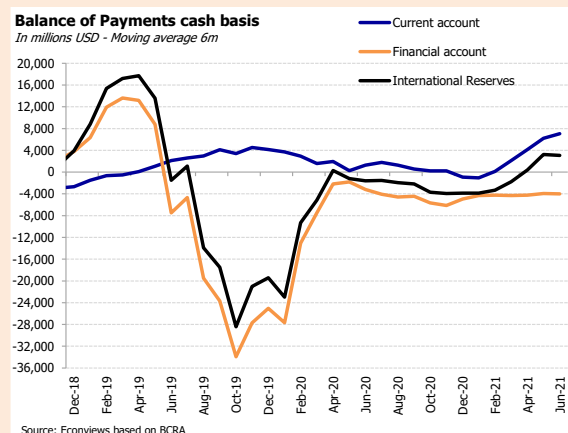
Balance of Payments

In million USD

	IS-19	IIS-19	IS-20	IIS-20	IS-21
Current Account	2,126	4,151	1,259	-937	7,061
Balance of Goods	11,444	12,000	5,640	2,851	10,561
Balance of services	-3,173	-2,310	-280	-1,315	-1,175
Interests	-5,552	-5,415	-4,105	-2,423	-2,300
Profits	-703	-192	-54	-75	-55
Financial Account	-7,472	-25,038	-3,195	-4,944	-4,017
Foreign Investment	1,683	778	666	393	356
Portfolio	-2,701	-1,813	21	14	7
Net Loans	-2,162	-5,059	-3,934	-3,325	-2,698
Multilaterals	9,853	5,978	234	525	-567
Hoarding	-10,881	-15,989	-1,374	-1,679	200
Others	-3,265	-8,934	1,192	-872	-1,315
Reserves Purchases	-1,819	-19,556	-1,881	-5,844	3,081

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

Returning to what the first half of the year left on the Balance of Payments, as we mentioned there was a clear recovery in the international reserves position that was explained largely by the trade balance. Indeed, with a price of soybeans that in the first six months of 2021 was 40% higher than the previous semester and 66% higher than the first semester of 2020, the trade surplus boosted the current account, which was positive by USD 7 billion. In detail, the oilseeds and cereals complex brought, in the last 6 months, USD 20 billion to the country, which is at the best levels of the entire series.

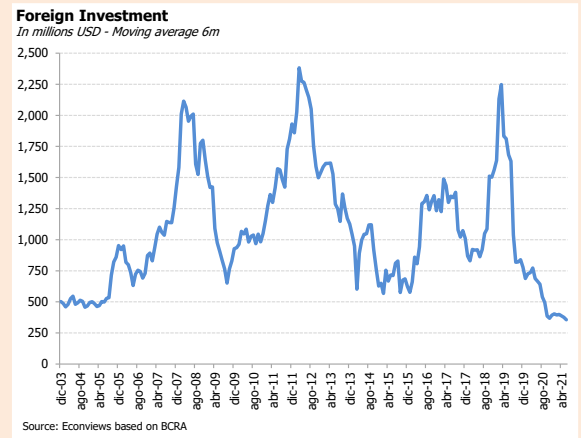
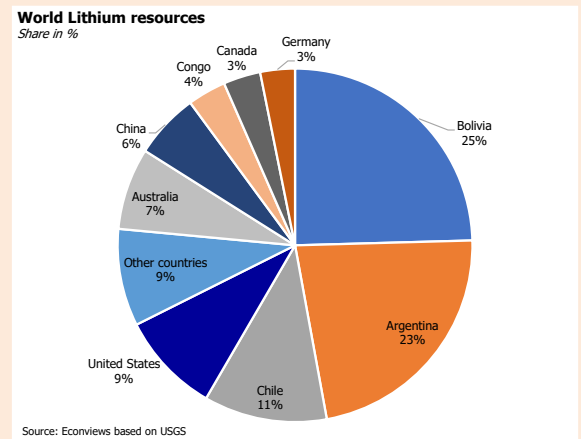


But, as we emphasized before, in the face of a reversal in prices, both industrial exports and those of mining and oil must begin to rebound to sustain the accumulation of international reserves. The potential that lithium has, in that sense, is to highlight. **With 23% of world resources, Argentina is second in the ranking, behind Bolivia (25%), although if we measure it in terms of production, that is, the effective use of these resources, we fall to 4th place with only the 7% of the global share, after Australia (44%), Chile (22%) and China (17%).**

It must be said that to expand the exportable capacity of any industry investment is required. **The first semester of the year was the worst in terms of Foreign Direct Investment (FDI) since the beginning of the series, USD 360 million, a seventh of what came in until the beginning of the capital controls in 2012.** It is difficult to imagine that we can overcome the "external restriction" if we do not reverse this trend. **The same capital controls that made the FFA positive, that is, the sale of dollars exceeded the purchase, by USD 200 million, are those that prevent a company or investment fund from risking entering a country with the current capital restriction level.**

For the remainder of the year, we expect the surplus in the trade balance of goods to be sustained, although with less momentum. This is explained by the seasonality of the harvest, on the export side, and the economic reactivation, on the import side. In terms of the financial account, **hoarding will increase at the rate of electoral uncertainty, although limited by current and future restrictions, which we do not rule out given the firmness that the administration has regarding not validating exchange rate disruptions. All in all, we expect reserves to decline by USD 1.5 billion in the second half, reversing half of what was earned in the first.**

By 2022, we expect the external winds to continue blowing in favor and that the agreement with the IMF will ease part of the capital restrictions, at least in terms of dividend transfers and debt payments. We expect some flow of FDI and portfolio to return, at least tenuously. After all, the prices of Argentine securities and shares have a very large upside to normalization in this regard. **And even though the hoarding and the deficit of services will be factors again, the recovery of a more competitive level of the real exchange rate during the summer, inclines us to project a recovery of the international reserves of USD 5 billion.**



	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 Items: The main items are shown
Source: Econviews based on BCRA

Activity Level: Rebound in June, Doubts in July

The storm is over. After a May that, mini-quarantine in between, was terrible for both producers of goods and service providers, in June different indicators went from red to green and among them **Industry and Construction stood out**, whose data were published last week by INDEC and they were extremely positive. **Will they hold?**

Let's start with the Industry. The manufacturing IPI recorded a monthly rise of 10.5% in June (without seasonality), which not only compensated for the fall in May (-5.6%), but the production level was the highest since May 2018 and the highest for a June in four years. With these numbers, industrial activity accumulated a rise in the first semester of 22.4% compared to 2020 and 4.6% compared to 2019. But the second quarter registered a slight decrease against the first.

At the sectoral level, **13 sectors of the 16 into which the IPI is divided compensated for the fall they suffered a year ago**, that is, **they grew compared to 2019**. However, the performance was quite heterogeneous.

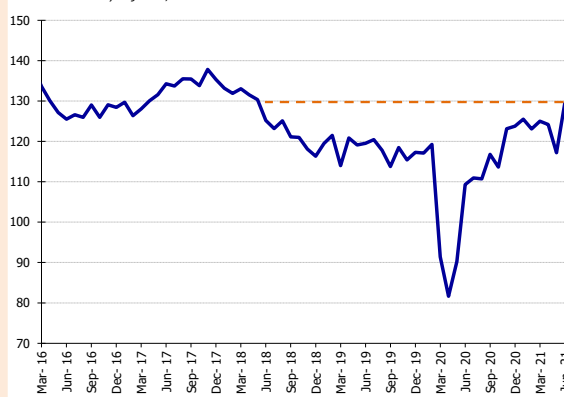
On the podium was the automotive sector, which after suffering some complications from Covid-19 outbreaks in some plants, **in June grew 103.6% y/y and 39.1% compared to 2019**. According to ADEFA, car production reached 40,035 units, 22.4% higher than May in seasonally adjusted terms. But not everything is joy, since **July production was relatively high but could not sustain the June level and fell 12.5%**, after discounting the seasonal effect (with seasonality, the fall reached 20.2%, but July had fewer business days for winter break).

The second place was for the production of machinery and equipment, which grew 16.5% compared to 2019. The main driver came from the side of agricultural machinery, whose production was 109.9% higher than June 2019 -although it also compares against a low base, product of the 2018-19 drought.

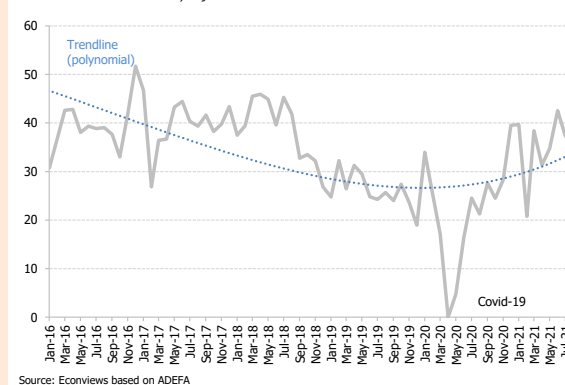
But not everyone managed to recover so quickly. At the bottom of the table is the division "other transport equipment", of very low weight in the IPI, **but within it hides the production of motorcycles, which was actually 52.2% higher than June 2019** and offset part of the fall in other items that have no relevance in the Argentine economy (construction and repair of ships, locomotives and aircraft). **The oil industry**, which does have relevance in the IPI, **despite having grown by 11.3% year-on-year, has not yet recovered from the sharp fall of a year ago.**

Construction also rebounded, although not as much as industry; the index that measures the activity of the sector, ISAC, advanced 6.8% m/m without seasonality in June and thus returned to the levels of February. Although it cut a streak of four consecutive months of decline, it did not exceed the peak of last December. In this way, in the first semester it accumulated a rise of 61.6% compared to the same period of 2020 (in which the activity was paralyzed) and only 0.6% compared to 2019. Both Construction and Industry fell in the second quarter compared to the first.

Manufacturing IPI
INDEC - Seasonally adjusted, 2004=100



Automobile production
Thousands of units - Seasonally adjusted



Manufacturing industry

% Variation

	Jun-20/Jun-19	Jun-21/Jun-20	Net
Manufacturing IPI	-6.3%	19.1%	11.7%
Food and beverages	5.3%	5.1%	10.7%
Tobacco products	92.6%	-46.6%	2.8%
Clothing products	-13.4%	23.9%	7.3%
Clothes	-37.6%	68.2%	4.9%
Wood, paper, edition and printing	-0.8%	7.2%	6.3%
Oil industry	-11.7%	11.3%	-1.7%
Chemical products	8.0%	11.6%	20.6%
Plastic products	-5.8%	21.3%	14.2%
Non-mineral metallic products	-14.0%	29.6%	11.5%
Basic metallic industries	-38.1%	61.6%	0.1%
Metal products	-17.4%	29.4%	6.8%
Machinery and equipment	-2.2%	38.4%	35.4%
Other equipment	-15.8%	38.3%	16.5%
Automobile industry	-31.7%	103.6%	39.1%
Other transport equipment	-45.7%	53.2%	-16.8%
Furniture and other industries	3.0%	-8.2%	-5.4%

Source: Econviews based on INDEC

Like Industry, part of the jump in June was due to the normalization of activity after the difficulties brought about by the pandemic in May. But the sector also benefited from the increase in the FX spread with the parallel dollar, which reduced the cost of inputs measured in dollars, and this effect - which also persisted and expanded in July- will allow the good level of activity to be maintained . **The stocking effect due to the increase in the spread was reflected in the demand for hollow bricks**, linked to private works, which jumped by 10.4%. The demand for asphalt, linked to public works, on the other hand, was reduced by 3.5%.

Is this performance of Industry and Construction sustainable? At Econviews we believe that both sectors will continue to show a good level of activity, but different factors converged in June that are unlikely to be maintained. In the first place, a large part of the rise was related to the recomposition of production after the May strike due to the rise in infections. On the other hand, if the stabilization of the parallel dollar that has been observed in recent days continues, inflation will end up eating away the reduction in brick costs measured in dollars. And this not only has an impact on Construction, but also indirectly on Industry, since the former is one of its main consumers. Even so, the boost to public works in the months before the election and the expansion of financing in installments ("Ahora 24" for construction materials) will contribute positively.

The first preliminary data for July are not so auspicious: cement production stagnated (-0.6% m/m s.a.) and automotive production fell sharply compared to June. But while the goods-producing sectors will probably slow down in July, on the services side we are likely to see an improvement: population mobility reached the highest level since the start of the pandemic and with this, shops, bars, restaurants and transportation will reactivate. In the coming weeks we will have more data that will allow us to confirm and quantify this effect. **With the available data, we reaffirm that the economy will grow at least 7% this year.**

