MONTHLY
REPORT

ECONVIEWS
ECONOMÍA Y FINANZAS

September 2021
Issue #207

THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- US monthly inflation fell for a second straight month, from 0.5% to 0.3%, validating the Fed's view of a transitory spike. The last FOMC announced tapering could begin this year and should be completed by mid-2022, and was divided on rate hikes. Inflation is still accelerating in the Eurozone (3% year-on-year) and the UK (3.2%). The ECB decided to slightly adjust its monthly asset purchases from €80 billion to a range of 60-70 billion.
- The Government faced a stinging defeat in the Sep 12th primaries, and if the results are the same in Nov 14th it could lose both its hold on the Lower House and its Senate Majority in November. The result set loose a political crisis within the ruling coalition, with VP Cristina Kirchner railing against Cabinet members closer to President Fernandez.
- In the middle of the turmoil, the Ministry of Economy presented the 2022 budget, which includes the official forecasts for inflation (33%), FX rate (ARS 133 in December 2022), GDP growth (4%) and the primary deficit (3.3% of GDP), of which 1.8% should be financed through CB emission.
- Stocks and bonds rallied the Monday after the primaries and the Merval index gained 5.5%, but as the cabinet crisis unfolded it lost 8%. Energy linked stocks such as Central Puerto (24%) and Edenor (11%) performed exceptionally well.

FIGURE OF THE MONTH

On a national level, the Government and its allies reached

31%

of the vote in the Sep 12th midterm primaries, Kirchnerism's worst result since the 2009 elections

TO BE ALERT

Though headline inflation moderated in August, the core index remained high at

3.13%

monthly, according to INDEC.

WHAT'S COMING NEXT?

- Biden is expected to re-nominate Powell as Fed chairman in the following days, although some progressive Democrats are pressuring for governor Lael Brainard, considered to be tougher on banks and climate change. Markets are confident that Powell's mandate, set to finish in February 2022, will be extended for four more years.
- The IMF designated Ilan Goldfajn, as Director for the Western Hemisphere. Goldfajn is seen as a hawk in monetary policy. Kristalina Georgieva faces a scandal over irregularities in the "Doing Business" ranking during her tenure in the WB. These two events may not be beneficial for Argentina's chances of securing a rapid IMF program.
- After losing the primaries, the Government revised the hike in the minimum wage from 35 to 48% and is pushing for extraordinary bonuses for pensioners and beneficiaries of welfare programs such as the Universal Child Allowance (AUH), at an estimated fiscal cost of 0.5% of GDP.
- The general elections will be held on November 14th. Afterwards, a weakened Government must close the USD 45 billion deal with the IMF, plus the deferred 2.4 billion maturity owed to the Paris Club.

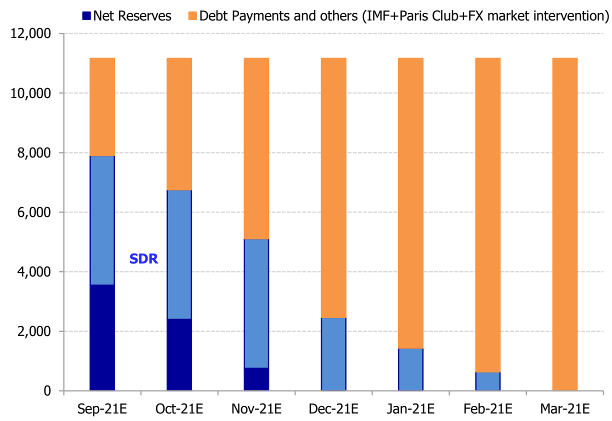
SUMMARY OF MAIN INDICATORS

	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	2.5%	-2.0%	Inflation (monthly)	2.5%	3.0%
Consumer confidence (MoM)	5.0%	9.3%	FX spread (21day avg.)	74.5%	74.5%
Industrial activity (MoM s.a.)	-2.6%	10.6%	Country risk (bps 21day avg.)	1,522	1,584
International accounts			**External data**		
Current Account (USD BN)	2.76	0.54	Soybean price (per ton, 21day av	475.4	512.3
CB Reserves (USD BN 21day avg.)	45.77	42.42	Brazilian activity (MoM s.a.)	0.6%	0.9%
Primary balance (ARS BN)	-124.84	-98.57	Financial Conditions Index	33.8	35.1

Source: Econviews base on multiple sources - Based on working days only

GRAPH OF THE MONTH:

Net International Reserves Projection
In US$ millions



Memo item: Net Reserves = Gross Reserves - USD reserve requirements - China Swap - BIS & Repos
Source: Econviews based on BCRA

AUG 24th	AUG 30th	AUG 31st	SEP 8th	SEP 12th	SEP 20th	SEP 24rd
Econviews Monthly #206: Turning around the economy + special analysis on construction and real estate in Argentina.	**Gustavo Valdés (JxC) wins reelection** for Governor of Corrientes Province, **in a landslide** with 76% of vote	**Government extends limit on beef exports** another two months until October 31st, farmers protest the measure	**Uruguay** announces plans for **bilateral FTA with China,** breaking with Mercosur rules on trade deals	**Ruling coalition flops in midterm primaries** with 31% of national vote against opposition JxC's 40%, loses main districts.	**New cabinet takes office:** Chief of Staff, Security, Education, Agriculture, Science and Foreign Affairs	**Econviews Monthly #207**

POLITICS

Polls were wrong again: the midterm primaries ended in a total rout for the Government, losing 31% to Juntos por el Cambio's (JxC) 40%. Days after, VP Cristina Kirchner ordered her ministers to resign. President Fernandez refused to accept the resignations and a cabinet crisis ensued. At the heart of the matter: Cristina blames the loss on Minister Guzmán's tight fiscal policy in the first semester, and believes any conditionality from an IMF program will be incompatible with re-electing in 2023. Peronist governors and unions aligned behind Fernandez. Finally, the Governor of Tucumán, Juan Manzur, was appointed as new Chief of Staff, with changes in other Ministries. Guzmán remains on board, a win for the president.

PANDEMIC

Despite community circulation of Delta variant, cases continue to fall and average near 2,000 daily. Other Latin American countries have seen similar drops in the contagion curve. 64.3% of population has received at least one shot and 46% is fully vaccinated. Authorities are hopeful of advancing with teenagers in Q4 thanks to the arrival of more Pfizer shots. Most restrictions are being lifted, with large events such as sports matches, concerts and nightclubs allowed at 30-50% capacity. Both inbound and outgoing tourism are still largely limited, requiring negative PCR results and 7 days of quarantine. Chile and Uruguay have similar requirements, while getting into Brazil is somewhat easier.

ECONOMIC ACTIVITY

Activity had rebounded 2.5% monthly, seasonally adjusted, in June after the May lockdowns. Weak figures for Industry (-2.6% m/m) and a slowdown in Construction (from 7.6 to 2.1% m/m) make us think the economy has only grown 0.5% between June and July, or even less. In year-on-year terms, the EMAE index will still be 9.1% above 2020's depressed levels. The first semester of 2021 has left a statistical carryover of 6.9% y/y, so not much is needed in the second half to reach our 7.4% estimate for the full year. The Budget Bill's 8% is not unreachable either, with traction from services as restrictions are loosened. We are less optimistic about the official 4% estimate for 2022, and see next year's growth closer to 2.4%.

INFLATION

Monthly inflation fell to 2.5% in August, its lowest mark in 13 months, and probably in all of 2021. Education and healthcare costs led the index at 4.2% m/m each, followed by leisure (3.7%) due to the reopening. Food prices rose 1.5% between July and August, the least in over a year, with a hand from seasonal prices which moved only 0.6% m/m. Regulated prices' growth was also moderate, at 1.1% monthly. At 3.1%, core inflation is proving harder to tame, averaging 3.8% so far this year. In year-on-year terms headline inflation decelerated slightly to 51.4%. Early readings show prices jumped in the first weeks of September, and we believe inflation will speed up to 3% m/m, closing 2021 at 49% y/y, remaining high in 2022 (48%).

MONETARY SECTOR

The BCRA lost USD 504 million in reserves in the run up to the primaries and in the middle of the cabinet controversies lost another USD 270. A volatile spring. While the parallel FX quotes fell on Monday 13th, they shot back up during last week's political turmoil. The informal dollar stands at ARS 185, an 88% spread with the official FX rate, while the BCS hit ARS 189, a 92% spread. CB assistance of the Treasury has been growing quickly in the second semester, totaling ARS 200 billion in August and another 200 billion in September. The policy rate holds at 38%, and although we believe it will end 2021 at 40%, authorities are understandably reluctant to hike rates with CB liabilities around 10% of GDP.

FISCAL ACCOUNTS

The primary deficit bumped up to ARS 124 billion in August, leaving the accumulated deficit at 1% of GDP in the first 8 months of 2021. Without counting the IMF's SDRs, August had the third-largest primary deficit in the year. Export taxes (131.9% year-on-year) and VAT (75.9%) helped swell revenues, while energy subsidies kept straining expenditures with a whopping 431% year-on-year growth. Pensions (44.6%) and welfare transfers to families (44.2%) both grew below inflation. The 2022 Budget Bill aims to cut electricity subsidies from 68 to 57% of generation costs. We expect 2021 to end with a primary deficit around 3.5% of GDP, and 5% with interest. In 2022, these figures will be corrected to 2.5 and 4% of GDP, respectively.

I. [POLITICS]

A poor election and a Government under pressure

Inflation, the exchange rate, and economic activity are moving in election mode. The government is using all its firepower to keep the main economic variables under control. Inflation, which had reached 4.8% in March is now hovering at around 3%, the official exchange rate continues to crawl at only 1.2% per month, much lower than inflation, while economic activity is slowly picking up pace as evidenced from the recent published figures. So far so good, but the flipside of these outcomes is the build-up of imbalances that will be costly to unwind.

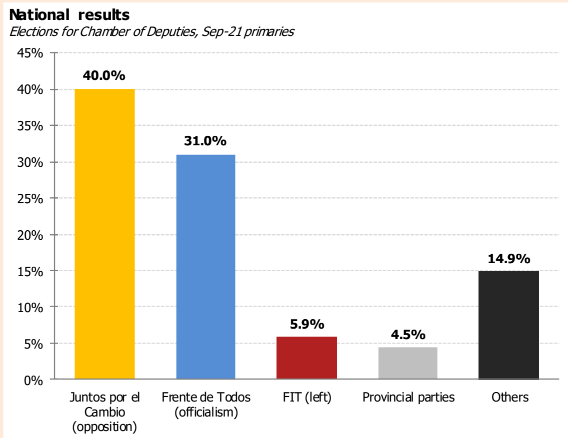
The results of the primary elections (PASO) were surprising. Mainly because the government lost by ten percentage points at the national level and in the crucial province of Buenos Aires by almost five percentage points. If the results end up being similar in the actual mid-term elections on November 14th, it could lose some seats the in the lower house and even its majority in the Senate.

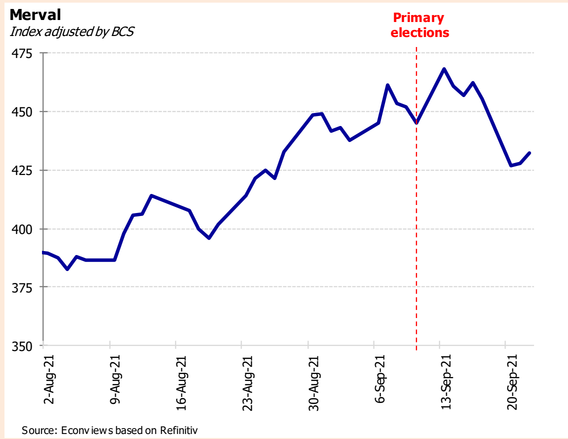
These adverse outcomes generated a major crisis in the Frente de Todos (FdT), as Crisitina Kirchner became an outspoken critic of the Fernandez administration and demanded changes in the cabinet, which Fernandez initially opposed. There was a clear confrontation between the President and his VP, which eventually led to new appointments, including the Chief of Cabinet, as Santiago Cafiero was replaced by the Governor of Tucuman Juan Manzur. Minister Guzman remained in office despite major criticisms for his “orthodoxy”, which in our view indicates that all the factions within the government want an IMF agreement. We see this as good news.

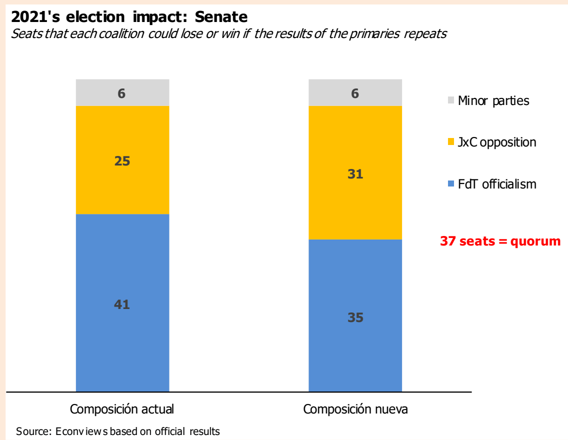
The markets initially reacted favorably to the PASO results, though then became concerned once they saw the confrontation between Cristina and Alberto. One interpretation is that Alberto in the end capitulated and accepted most of the changes that Cristina proposed in a public letter on Thursday, an indication that government could radicalize soon and possibly that there would not be an agreement with the Fund.

There is an alternative interpretation. Alberto resisted Cristina’s pressures for few days, the new chief of Cabinet Manzur is someone who seems closer to Alberto than to Cristina, the new ministers took office with Alberto surrounded by many of the Peronist governors (though Alicia Kirchner and Axel Kicillof were not there). All this suggests that in the end it was closer to a tie, rather than capitulation.

What can the government do to improve its performance in the general election? Perhaps the new cabinet can increase the participation of its followers in November, through a more active political campaign and by increasing social programs (handouts), credit programs and other ways of distributing money. This might allow the government to regain some space, as was the case with Macri in 2019, when the result in the general election were much better that in the PASO. However, it will be difficult to reverse the results as the economy in unlikely to improve significantly in two months, while many voters are disenchanted with the administration for other reasons (schools closed for too long, patchy vaccination campaign, among other issues).



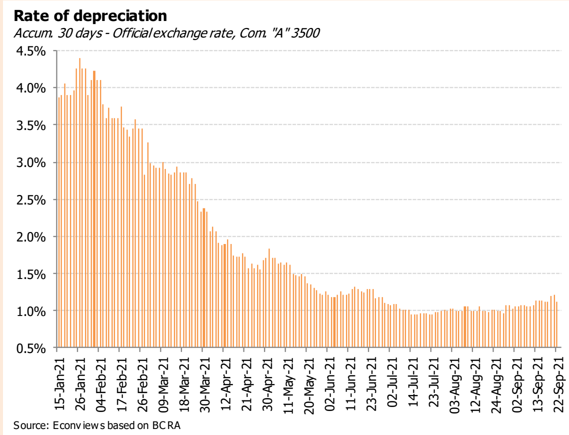




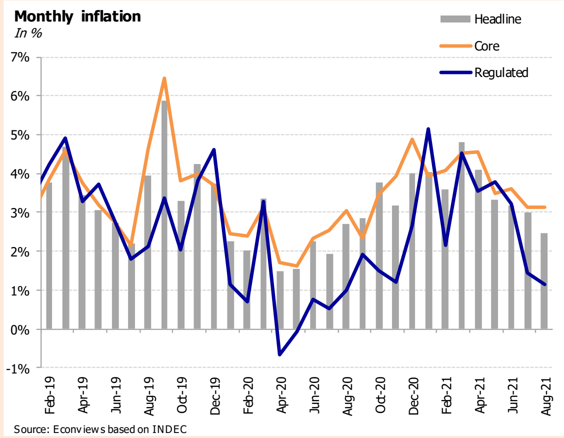
I. [ECONOMICS]

The near and medium-term economic outlook

More of the same in the short term. Despite the changes in the cabinet, we do not anticipate big changes in economic policies until the elections. The Central Bank will continue to depreciate the exchange rate at around 1.2% per month, will maintain the policy interest rates and will continue to lose reserves due to its intervention in the official and the parallel FX markets. The main risk will be a possible increase in the blue-chip swap, though we believe that authorities will try to control it through intervention and this time it will refrain from increasing interest rates, a useful tool that it used in the past, but that it does not want to use it now.



It is a given that the government will increase government expenditures in its efforts to reverse the results of the PASO. Most likely it will target transfers to recipients of social programs and to pensioners, which can quickly be reflected in higher consumption. **The recent sale of SDRs to the Central Bank increases by 450 billion pesos the legal amount the Central Bank can use to finance the Treasury. However, the most likely scenario is that Treasury will still spend 800 billion pesos until the end of the year as we have been projecting, which could finance with the existing limits**. The extra money could become handy to meet the legal limits for next year or this year if the Treasury has difficulties in rolling over domestic debt in the coming auctions.



The additional spending is likely to put a limit to the drop in inflation that we saw in recent months. In August inflation was only 2.5%, marking the lowest rate in 13 months. True, core inflation was still 3.1% and the headline number reflected an increase of 0.6% in seasonal products and 1.2% y regulated prices. We now expect inflation to remain above the figures of Central Bank survey (the REM) and to remain somewhere between 3.0 and 3.5% until November.

The adjustment is all but unavoidable in the medium term

For the medium-term we foresee that the inconsistencies that exist in the current policy framework (or lack of it) imply that there are trade-offs in policy decisions that sooner, rather than later, the government will have to confront.

Net and Liquid International Reserves

In billion USD

Gross reserves	**43.2**
Reserve requirements in USD	11.8
Swap with China	20.1
BIS & Repos	3.8
Net reserves	**7.5**
Gold	3.6
Treasury SDRs position	3.1
Liquid net reserves	**0.9**

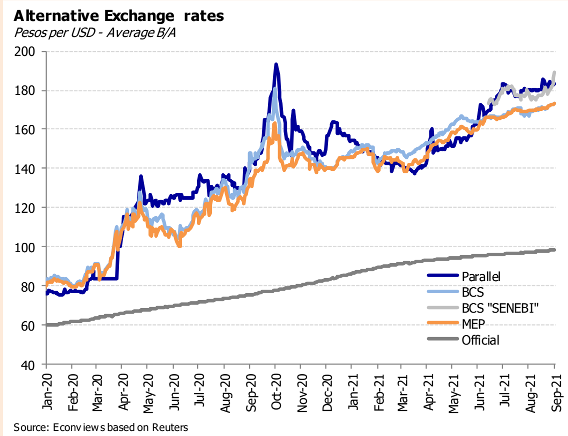
Source: Own estimates based on BCRA and IMF

Up to Sep-22

The most likely scenario is one in which there is an agreement with the IMF that will include targets for the fiscal deficit, for net international reserves (which will end the year be roughly at USD 5 billion of which USD 3.6 B is made of gold), for the spread between the official and the parallel exchange rates, and for a drop in inflation among other goals. Most of these issues have probably not yet been discussed in detail, and the negotiations about the fine print will not be easy. **Each policy decision will have costs, and the burden of the difficulties are related to Central Bank decisions such as the management of the exchange rate and interest rates.**

Accumulation of international reserves. Most likely the program will include a target to increase international reserves by a number that could range between **six and eight billion dollars per year**. To achieve this goal the CB will need to buy the dollars from the private sector, and because it does not have a fiscal surplus, it would need to print money which will later have to sterilize with Leliqs. In short, it will buy reserves issuing short-term debt, which in turn might create another problem: **the spiralizing growth of Central Bank debt.**

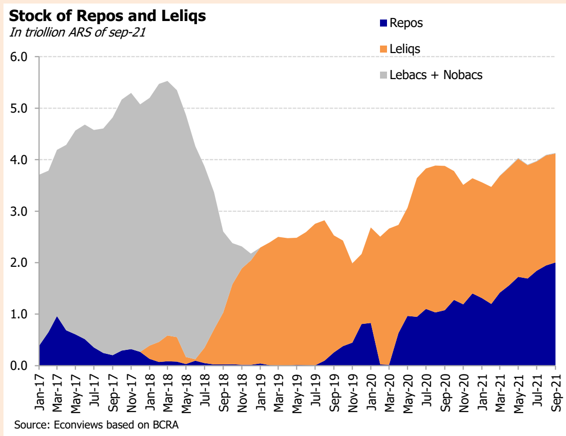
There is a second challenge: a reduction in the spread between the official and the parallel exchange rates. This is also a complex task because the government will not be able to do it through a credibility shock, the CB will need to depreciate the official exchange rate. One option is to accelerate the rate of crawl, to say four or five percent per month during several months. Gradualism might not be an option. It would take too long for comfort to reduce the spread while it would put continuous pressures on domestic interest rates while the spread will drop at slow pace. Besides, the expectation the policy works too slowly and that the expected rate of depreciation is higher that domestic interest rates would lead to the postponement of exports and the advance of imports. Does not seem like a good option to increases reserves quickly and a relaxation of the "cepo".



Alternative Exchange rates

The alternative would be a steep devaluation as in 2014's experience, say 20 to 25% in one shot. If successful, it could bring down the spread and reduce interest rates quickly, though the problem is that devaluations have traditionally been traumatic as they create uncertainty and could move inflation **permanently** one step higher. It would be worse if the government devalues without a plan.

The list of problems and tradeoffs does not stop here. The reduction in the fiscal deficit could be traumatic and would even be more difficult if the government succeeds in reducing inflation because when it drops, the pension bill goes up. In addition, the financing of the deficit will continue to rely on the Central Bank which will also need to print money to buy reserves or increase the already high stock of Leliqs.

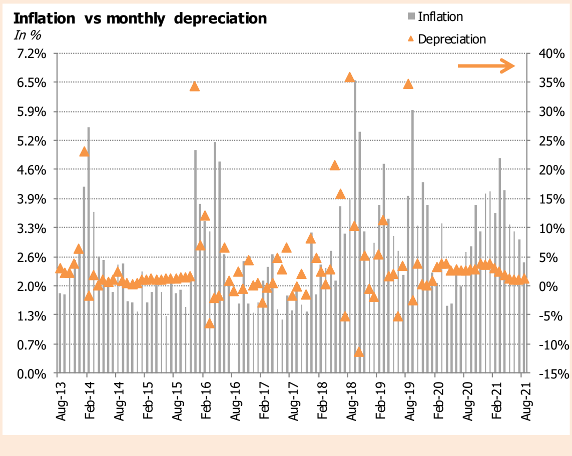


Stock of Repos and Leliqs

Not doing the adjustment is not an option, as the Central Bank is running out of reserves, the fiscal deficit becomes unfinanceable and the parallel rates and inflation could continue to spiralize. Last, but not least, these adjustments will take place in a stagnated economy, with low real wages and almost 50% of population below the poverty line.

<u>In summary: the adjustment jigsaw</u>

A reduction in the FX spread (which is a must) would require a depreciation of the official exchange rate which means the risk of higher inflation, and higher interest rates which would increase Central Bank short-term debt. A lower fiscal deficit will need, among other things, an increase in tariffs. The increase will be even larger if there is a devaluation (because many regulated prices are link to the official exchange rate), and in the short run it means more pressures on inflation.



Inflation vs monthly depreciation

To increase international reserves the Central Bank needs to print money by around 2% of GDP, and to finance the primary deficit another 2.0% of GDP. These figures would put pressure on money supply and on the stock of Central Bank debt. The reduction of inflation will need tight money and higher interest rates, but if interest rates are "too high" they could lead to an unsustainable increase in CB short-term debt.

Is there a way to avoid these tradeoffs? Not entirely, but it seems that life would be easier if there is a reduction of the fiscal deficit to avoid a buildup of debt and drastically reduce the credit spreads to rollover foreign debt.

II. Public debt: a look at sustainability beyond political debates

Public and external debt has been Argentina's Achilles heels for decades with three defaults in this century alone. So, the ghosts of default always haunt the economy and become one of the (many) hurdles to grow and develop.

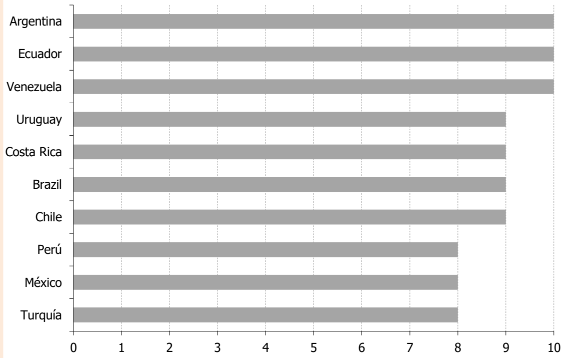
Argentina has an extremely high country-risk (1600 points), which implies that the markets assign a more than 80% probability of default. However, the debt figures appear to tell a different story, because the debt burden does not seem to be so high, the interest payments on the bonds is low, and the meaningful payments of principal come due only in 2025.

The problem seems to be the assessment of Argentina's willingness to pay, measured by the expected reduction in the fiscal deficit and the readiness to take additional policy measures to convince the market that this time is different. After all, Argentina has the reputation to be a serial defaulter.

There are also concerns regarding the growth of Central Bank debt, where the main issue is whether the implementation of tight money could place the Central Bank in a tight strait.

In this report we thus analyse the recent growth in public debt, we carry out a detailed debt sustainability analysis to understand what Argentina's chances are to avoid a new default in the next decade and we conclude with a look at provincial debt.

External Sovereign Defaults Ranking
Top 10, number of defaults

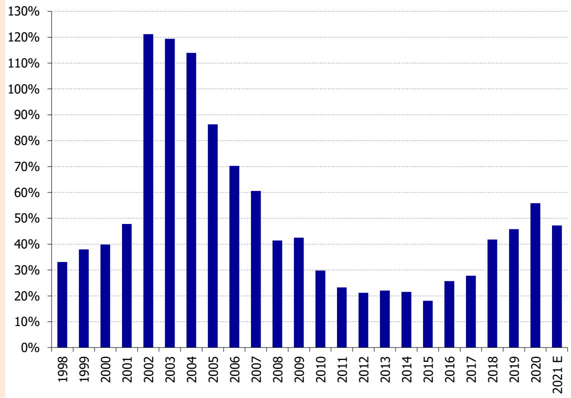


Source: Econviews based on Mecon

DSA analysis: it's a solvency or a liquidity problem? Maybe it's a growth problem

The first issue is to analyze whether Argentina has too much debt and whether it can cope with the principal payments during this decade. This is typically done in a debt sustainability analysis that requires to put together a likely macroeconomic framework and the corresponding evolution of the debt stock, to see whether the debt ratios can stabilize at reasonable levels. Part of the analysis is to evaluate whether the credit spreads would allow the refinancing of capital payments that come due.

Net Public Debt
As % of GDP - Net debt excludes intra-public sector debt; includes warrants



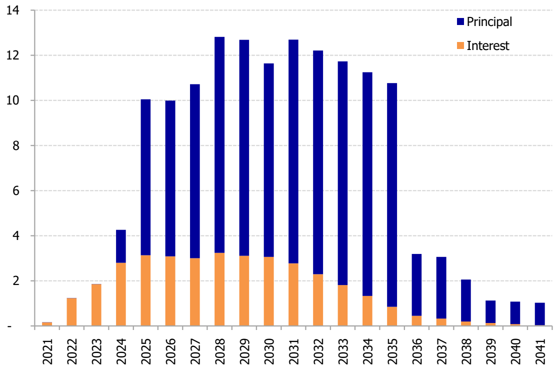
Source: Econviews based on Mecon

Putting it differently, the analysis will asses the levels of debt and financing needs that can be sustained over the medium-to-long term which turn depend critically on the outlook for growth, the real exchange rates, the level of international reserves and the primary balance as well as the interest rates at which the government would rollover the debt. At the same time, it is also critical the investment climate and the rate of economic growth, two macro-variables depend on the structural reforms that a government carries out. In our case it will closely related to the IMF's new program.

Conditional on the macroeconomic and financing projections, a public debt analysis results in a sustainable position if it stabilizes the country's debt to GDP ratio over time with an acceptably low rollover risk. Our projection for the Dec-21 Net Public Debt, the one that excludes intra-public sector debt, is 47% in terms of GDP (using the average FX rate of the period). From that point we will put our DSA model to the test with three macroeconomic scenarios (a base, a positive and a negative one).

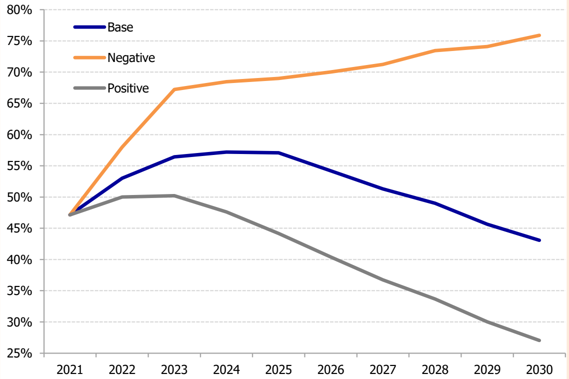
Our baseline scenario implies that in 2022 the IMF program is good enough for Argentina to regain the access to the financial markets and have a smooth transition to the fiscal primary balance until 2025, when major private debt disbursements must be face. The result is that the Net Public Debt to GDP ratio stabilizes close to 55% until 2025 and then smoothly goes down back to the 2021 level. A relatively tight financial market access together with a negative macroeconomic scenario implies that the debt trend is explosive, while the positive scenario puts the trend down the 50% and converging more rapidly. Note that the negative scenario is not so negative in the sense that Argentina would maintain a primary balance, but still the debt dynamics is ugly. **The situation could be far worse if we add a deficit component.**

Maturities in foreign currency with the Private Sector
In billion USD



Source: Econviews based on Mecon

Net Public Debt Dynamic
In % of GDP with different scenarios



Source: Econviews based on Mecon

Macroeconomic Asumptions
Variation y/y, % of GDP and in basis points

Base	GDP	CPI	FX	CPI USA	RER	Primary Balance	EMBI
2022	2.5%	50.0%	50.0%	4.5%	4.5%	-2.5%	850
2023	3.0%	35.0%	40.0%	3.5%	7.3%	-2.0%	750
2024	3.0%	30.0%	30.0%	3.0%	3.0%	-1.0%	650
2025	3.0%	25.0%	25.0%	2.5%	2.5%	0.0%	550
2026	3.0%	25.0%	20.0%	2.0%	-2.1%	0.5%	450
2027	3.0%	20.0%	15.0%	2.0%	-2.3%	0.5%	350
2028	3.0%	15.0%	10.0%	2.0%	-2.4%	0.5%	350
2029	3.0%	10.0%	5.0%	2.0%	-2.6%	0.5%	350
2030	3.0%	10.0%	5.0%	2.0%	-2.6%	0.5%	350

Negative	GDP	CPI	FX	CPI USA	RER	Primary Balance	EMBI
2022	0.0%	60.0%	70.0%	4.5%	11.0%	-3.0%	1300
2023	1.5%	45.0%	60.0%	3.5%	14.2%	-2.5%	1100
2024	1.5%	40.0%	37.0%	3.0%	0.8%	-1.5%	900
2025	1.5%	35.0%	32.5%	2.5%	0.6%	-0.5%	850
2026	1.5%	35.0%	33.0%	2.0%	0.5%	-0.5%	800
2027	1.5%	30.0%	28.0%	2.0%	0.4%	-0.5%	750
2028	1.5%	25.0%	23.0%	2.0%	0.4%	-0.5%	700
2029	1.5%	20.0%	18.0%	2.0%	0.3%	-0.5%	700
2030	1.5%	20.0%	18.0%	2.0%	0.3%	-0.5%	700

Positive	GDP	CPI	FX	CPI USA	RER	Primary Balance	EMBI
2022	4.0%	40.0%	35.0%	4.5%	0.8%	-2.0%	750
2023	4.5%	25.0%	25.0%	3.5%	3.5%	-1.5%	650
2024	4.5%	20.0%	15.0%	3.0%	-1.3%	-0.5%	550
2025	4.5%	15.0%	10.0%	2.5%	-2.0%	0.5%	450
2026	4.5%	15.0%	10.0%	2.0%	-2.4%	1.0%	350
2027	4.5%	10.0%	5.0%	2.0%	-2.6%	1.0%	250
2028	4.5%	5.0%	0.0%	2.0%	-2.9%	1.0%	250
2029	4.5%	5.0%	0.0%	2.0%	-2.9%	1.0%	250
2030	4.5%	5.0%	0.0%	2.0%	-2.9%	1.0%	250

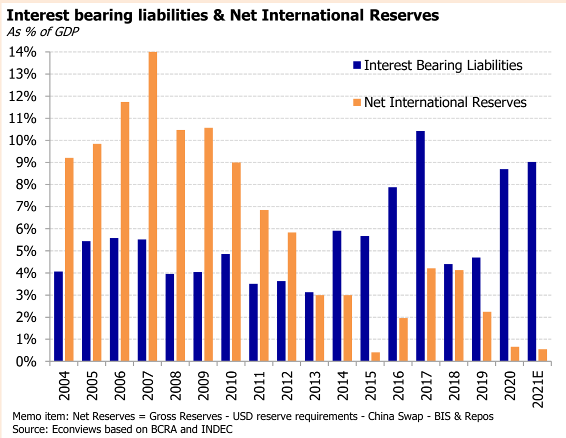
Fuente: Econviews

Central Bank's debt: a potential threat

The Central Bank's debt generates concerns because it has been growing as the Central Bank (CB) sterilizes part of the money supply it issues to finance the Treasury or to buy international reserves, it is very short term (one to twenty-eight days) and it is issued at variable interest rates

It can grow as a share of GDP either because money supply grows due the financing of the fiscal deficit or a surplus in the external account, or because interest rates exceed the rate of growth of nominal GDP. The concerns today come from both fronts. The CB is expected to issue debt to sterilize pesos and to pay the interest of the Leliqs and reverse repos (pases).

The stock of CB debt, which today is estimated to be 9.5% of GDP, this year has been manageable, primarily because interest rates remained well below inflation. One question is what might happen if the Central Bank were to apply a policy of tight money and high interest rates. In that case there is the risk of facing the so called "Unpleasant Monetary Arithmetic" which essentially states that a policy of high interest rates to deal with inflation or the spread between the official and parallels exchange rates could backfire because it could lead to a large increase in short term debt.



A second question focuses on the implications of increases in the money supply associated with large fiscal deficits or external surpluses, which could also lead to an important increase in the stock of leliqs.

The current situation may resemble the problem of the Lebacs that the CB faced back in 2018, the so-called "Lebac snowball". At that time there was an excess of dollars that the CB purchased, strengthening reserves, and issuing pesos to cover its financial gap. To mop up the excess of pesos, CB sterilized via Lebacs, which matured between 35 and 270 days. **The interest rate paid for these instruments was positive in real terms, and as a result they were attractive and could be purchased by banks, mutual funds, or even retail and foreign investors.**

The stock of Lebacs at that time had reached to 11.5% of GDP, though at that time net reserves had increased as a counterpart, so the CB balance sheet was not necessarily weak. Devaluation, as harmful as it can be politically, provided relief to the CB's balance sheet position. The run on Lebacs was handled in part by sacrificing reserves.

Nowadays the Leliqs are not backed by net reserves. In comparison to 2018, the advantage today is that only banks hold CB' sterilization notes, while previously everyone could hold them. This means that the Central Bank has regulatory power over its creditors.

On the other hand, the CB does not have sufficient reserves to unwind Leliqs and defend the currency if the scenario turns to rapid deterioration of the expectations. It means that there are risks and that the CB should a target on the growth of Leliqs.

The only way to deactivate that potential threat to the money balance is to eliminate the monetary financing, which in practice means forcing the Treasury to finance a larger part of its deficit in the domestic market. Essentially the ways to square the circle is to remove some pressure from the CB and put the responsibility of financing the deficit back on the Treasury, as it should be.

Debt Statistics: a comprehensive x-ray

Taxonomy first. Gross Public Debt refers to the national (federal government) public debt, whether in the hands of residents or foreigners; It includes the debt in the hands of national public sector agencies, multilateral and bilateral credit agencies, foreign government agencies and the private sector. As aug-21, Gross Public Debt stood at USD 345,851 million, 81% of GDP (the average of the last 4 quarters) and 532% of exports (the sum of the last 12 months).

In the last 20 years it grew USD 201,629 million, USD 119,229 million during the Peronism governments, essentially during the Kirchnerism years, and USD 82,400 during the non-Peronism governments. Naturally, the Peronism/Kirchnerism was the ruling party in 16 of the 20 years, so the debt grew at a pace of USD 7.5 billion per year in those years, while for Cambiemos, the only non-Peronism political coalition that ruled in the last 20 years, that figure is USD 20.6 billion per year.

However, if we extend the analysis to the change of the net international reserves and of the Central Bank's remunerated liabilities, the figures show that during Peronism governments net international reserves lost were USD 17,009 million and the remunerated liabilities grew USD 72,795 million. In sum, the CB's balance deteriorated in USD 89,804 million (USD 5.6 billion per year). Instead, during Cambiemos administration, the net international reserves grew USD 9,294 million and the CB's remunerated liabilities fell by USD 32,273 million. Therefore, the CB's stance strengthened by USD 41,576 million (USD 10.4 billion per year).

Debt Statistics

As Aug-21

	USD million	As % of GDP	As % of Exports
Gross Public Debt (a)	345,851	81.0%	532.0%
National Public Sector Agencies (b)	135,425	31.7%	208.3%
Net Public Debt (a) - (b)	210,426	50.0%	324.0%
Multilateral and Bilateral Credit Agencies	75,500	17.9%	116.2%
Private Sector	134,926	32.1%	207.8%
External Debt	269,158	63.0%	414.0%

Source: Econviews based on INDEC

The Debt debate

2021-2001 variation per ruling party, in USD million

	Assets	Liabilities			Asset/Liabilities balance	Change Per Year
	RIN	Gross Debt	Interest Bearing Liabilities	Other*		
Peronism/Kirchnerism	-17,009	119,229	72,795	21,605	-230,638	-14,415
Cambiemos	9,294	82,400	-32,273	0	-40,833	-10,208
Total	-7,715	201,629	40,522	21,605	-271,471	-13,574

Source: Econviews based on INDEC

*Memo Ítems: Unpaid debts due to adverse international litigations

Another important feature to understand the political discussion is skeletons. Debt at the end of 2015 did not account the debt in default for US$ 21,605 million, injunctions at the ICSID, delayed payments and other items that artificially swelled the debt of Macri's terms.

Putting together both dynamics, the gross public debt, and the CB's balance sheet, the Peronism/Kirchnerism deteriorate the Treasury and the CBs stance by 14.4 billion per year while Cambiemos did it by 10.2 billion per year.

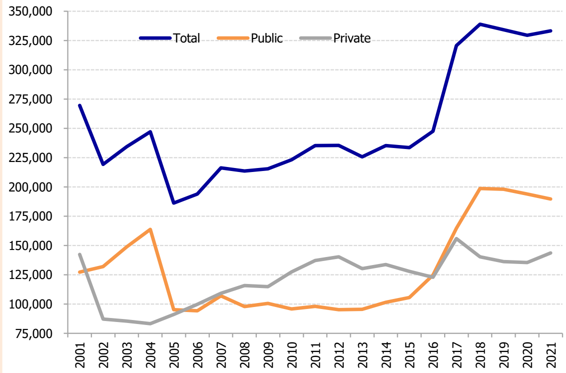
Something that must be noted is that, in terms of currency, the foreign currency denominated debt that was taken during the Peronism/Kirchnerism years was the same that the domestic currency denominated one (50%/50%), while for Cambiemos the composition was 88%/12%, respectively.

In the other hand, **Net Public Debt** is the Gross debt minus the debt in the hands of national public sector agencies, that leaves only de debt that is in the hands of multilateral and bilateral credit agencies, foreign government agencies and the private sector. As aug-21 this debt stood at USD 210,426 million, 50% of GDP and 324% of exports, with USD 75,500 in the hands of IIOO (more than half of that amount corresponds to the IMF's SBA program), and the rest in the hands of the private sector.

The **External Debt** (defined depending on the nationality of the creditor) stood at USD 269,158 million (USD 163,945 million from the federal government), 63% of GDP and 414% of exports as of July. In the last 20 years it grew by USD 37,885 million, essentially because of the growth of the federal government debt (USD 92,293 million) and the reduction of the private external debt (USD 42,447 million).

Both net public debt and external debt ratios point out two important things. The first one is that, considering that the dollar denominated GDP fell 12% since 2018, **the amount of the debt does not look like an issue**. Furthermore, we think that the difficulty concentrates in the capacity to roll-over the maturities when the period of grace that last debt renegotiation granted to the government. A risk-premium that hit 1,500 bps and stayed in that level is almost a default-signalling to all our creditors. It is impossible to roll-over debt at that level. **Is not a liquidity or solvency problem, it is a debt sustainability problem!**

External Debt
In US$ millions



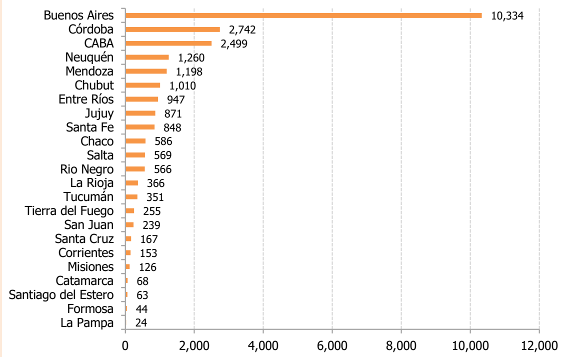
Source: Econviews based on INDEC

<u>**Sub-national Debt: moving behind the sovereign**</u>

After the debt restructuring carried out by the National Government, there have been eleven provinces with debt in foreign currency and under foreign law that followed the same way. The first one was Mendoza, which reached an agreement on September 29th, 2020, just a month after the National Government. Chronologically, it was followed by Neuquén, Chubut, and Rio Negro. The list continues in 2021 with Córdoba, Salta, Entre Rios, Jujuy, Chaco, Buenos Aires, and La Rioja. Tierra del Fuego also has initiated a debt restructuring process, but it did not conclude it and is still paying without arrears.

In general terms, this process did not reduce the debt stock, instead of that, it was successful in smoothing the maturities profile. For example, Buenos Aires, which reached an agreement at the end of August 2021 after 16 months of default, has reduced its coupon average interest rate 1.5% (from 7.5% to 6%) and extended the maturities dates, but in terms of capital, the amount issued after the process was higher (USD 7,182 million vs USD 7,625 million). We can also mention the case of Córdoba, which restructured bonds for USD 1,685 million with an average interest rate of 7.22% and issued new bonds for USD 1,694 million at a rate of 5.95%.

Total Provincial Debt
Up to Q1 2021 - In USD million*



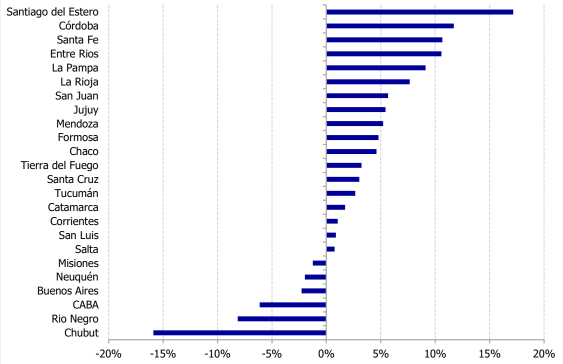
*For Buenos Aires and Tierra del fuego data is up to 2Q 2020 and for CABA up to 2Q 2021
Source: Econviews based on several sources

If we consider all the provincial debt, the amount reaches roughly USD 25 billion. More than 60% of that number corresponds to Buenos Aires (41%), Córdoba (11%), and the City of BA (10%). There is another group with a smaller share composed by Neuquén, Mendoza, and Chubut with 5%, 4.7%, and 4% respectively. All other provinces share is less than 4%.

Provinces should not have problems facing their debt payments. According to the last data available, 21 of 24 districts have a primary surplus. Among the provinces with higher surpluses (measured as the accumulated of the last 12 months), we found at Santiago del Estero with a primary result of 17.6% as percentage of total income, followed by Córdoba with 14.4% and Santa Fe with 12.3%. On the other hand, the only three with primary deficit are Chubut (-9.3%), Rio Negro (-4.1%), and Misiones (-0.8%). Focusing on the result after the interest payments, we can see that the situation is equally good with only 6 provinces having financial deficit.

Provincial Financial Result

Last 12 months up to Q1 2021 - As % of total income

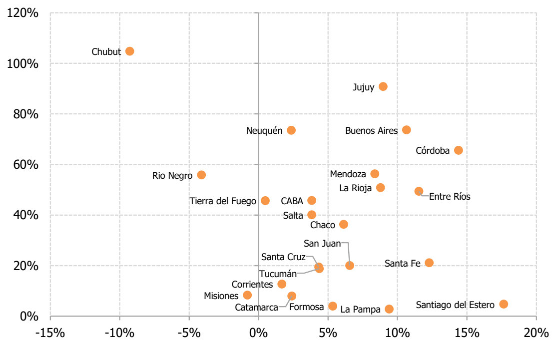


Source: Econviews based on MEcon

The main point is that the "debt issues" are at the federal government, but this situation ultimate drag to the rest of the subnational jurisdictions to a risk-premium that does not correspond to their own debt profile.

Provincial Debt (vertical axis) and Primary Result (horizontal axis)

Last 12 months up to Q1 2021 - As % of total income*



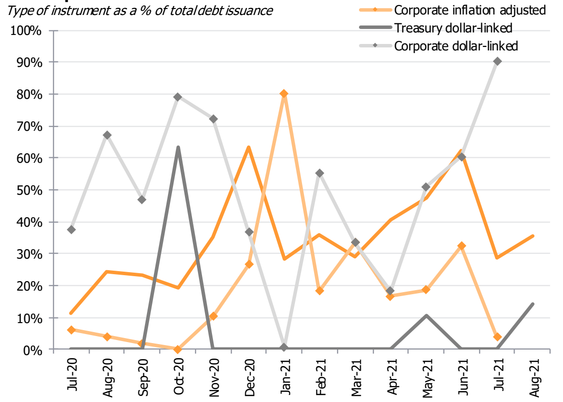
*For Buenos Aires and Tierra del fuego data is up to 2Q 2020 and for CABA up to 2Q 2021
Source: Econviews based on MEcon

Corporate Debt: a sovereign-risk surfer

Noise in the FX market forces the Treasury to add more FX or inflation-adjusted securities to its menu from time to time. This can be seen clearly in Q3-2020 and somewhat in the last couple months. CER (inflation-adjusted) instruments made up 30.9% of the Treasury's issuance in Q1-2021 and went up to 50.2% in Q2. The share has dropped to 36% in the last auctions, but due to the reappearance of dollar-linked securities, a "tighter" form of indexation. Interest for inflation-linked corporate debt has tended to lag slightly behind, representing 22.5% of private sector issuance in Q2 (excluding hard-dollar debt).

Similar patterns?

Type of instrument as a % of total debt issuance

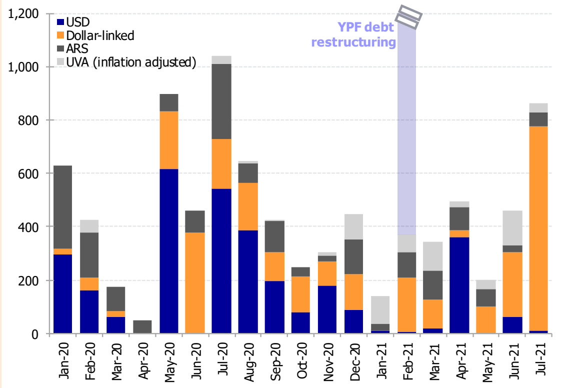


Source: Econviews based on CNV and Min. of Economy

The real star of corporate debt has been dollar-linked securities, which at a record USD 767 million in July represented 90% of all non-dollar issuance. The Treasury had been more loath to issue FX adjusted debt but raked in nearly half a billion with this instrument in its last auction on September 9th. While the tendency towards a more indexed debt is worrying for the economy, most emission of dollar-linked instruments comes from oil companies, which can respond with their export proceeds. In the last 12 months, 28.5% of dollar-linked debt issuance came from YPF and 39% from other companies in the sector, namely PAE, Vista and Compañía General de Combustibles.

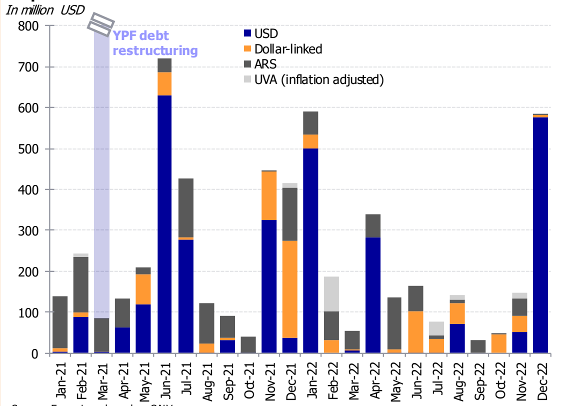
Looking forward, the maturity calendar for the private sector doesn't look that difficult. It must pay USD 391 million of hard dollar debt in what's left of 2021 and 1.5 billion next year. CGC, Genneia, Tarjeta Naranja and Tecpetrol are the only ones facing payments above USD 100 million. Things gets spicier in 2023 (USD 2.8 billion maturities) and 2025 (3.9 billion). The dollar-linked debt agenda looks tricky towards November and December, with the equivalent of USD 354 million of maturities in months where the FX rate is expected to depreciate at a faster pace. A similar amount (363 million) expires in all of 2022. Inflation adjusted securities pose less of a challenge over the next months, other than and USD 72 million maturity for Banco Hipotecario in February.

Corporate bond issuance
In million USD



Source: Econviews based on CNV

Corporate bond maturities
In million USD



Source: Econviews based on CNV

Base Scenario

	2019	2020	2021 F	2022 F	2023 F
Inflation (eop)	53.8%	36.1%	49.0%	48.0%	35.0%
Exchange rate ARS/USD (eop)	59.90	84.15	106.94	171.14	225.92
Real exchange rate ARS/USD (eop, Dec-01=100)	150.8	158.3	140.8	158.4	160.5
Paralell exchange rate ARS/USD (eop)	74.6	140.3	192.5	239.6	316.3
Spread with official exchange rate (eop)	24.6%	66.8%	80.0%	40.0%	40.0%
Gross reserves (USD billion, eop)	44.8	39.4	40.9	45.9	48.9
Policy rate (eop)	55.0%	38.0%	40.0%	40.0%	33.0%
GDP (YoY)	-2.0%	-9.9%	7.4%	2.5%	3.0%
Private consumption (YoY)	-7.3%	-13.8%	8.0%	4.5%	5.0%
Primary surplus (% GDP)	-0.4%	-6.5%	-3.5%	-2.0%	-1.5%
EMBI Argentina (spread in bps, eop)	1744	1350	1350	850	750
Public net debt (% GDP)	43.6%	53.3%	44.9%	45.4%	46.6%
Soybean price in USD per ton (annual average)	327	350	500	480	480
Exports of goods (USD billion)	65.1	54.9	74.8	79.6	84.0
Imports of goods (USD billion)	49.1	42.4	61.2	66.2	71.5
Trade balance (USD billion)	16.0	12.5	13.6	13.4	12.5
Current account (% GDP)	-0.8%	0.9%	0.5%	0.0%	-0.2%

Source: EconViews

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