THE WEEK AT A GLANCE

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(+54 11) 5252-1035
Carlos Pellegrini 1149
Buenos Aires
www.econviews.com
www.facebook.com/econviews
Twitter: @econviews

Miguel A. Kiguel
Director
mkiguel@econviews.com

Andrés Borenstein
Chief Economist
aborenstein@econviews.com

Víctor Ruilova
Senior Economist
vruilova@econviews.com

Isaías Marini
Economist
imarini@econviews.com

Alejandro Giacoia
Economist
agiacoia@econviews.com

Rafael Aguilar
Analyst
raguilar@econviews.com

Editorial: More Short-Term Uncertainty, an Opportunity in the Long Term

The results of the primary elections were surprising, as well as how quickly internal tensions escalated within the ruling coalition. **The market's vote was a cautiously optimistic one, recognizing that the short term is fraught with problems, although the chances of a regime change in 2023 have increased.** The market's logic is that this means good news for the business world. We tend to agree with this interpretation.

Let's start with the short term. The effect of how much the government is going to spend to try to turn the result around can be put aside. **That is not the correct way to look at the situation in our criteria, because the increase in spending was going to occur in any situation. The changes will only be on the margins.** In fact, at Econviews we even believe that 2021 will end with a smaller primary deficit than Minister Guzmán forecasts in his 2022 budget. There is not that much time left for spending.

The uncertainty clearly comes from politics. It would seem that this fight between the president and his VP will not end up in a radicalization of policies, which is good. The chances are growing that Minister Martín Guzmán will stay, which should also be seen as positive. Perhaps the most interesting factor in this battle is that for the first time in almost two years **Alberto Fernández stood up to Kirchnerism**. Since Vicentín's failed nationalization last winter, he had been docile to the initiatives of VP Cristina Kirchner and her allies.

However, the president could face serious governance problems if the hard-line Kirchnerists turn their back on him ahead of the upcoming 2022 fiscal adjustment, although politicians avoid that term. For example, we do not believe wages will grow as the drafted budget indicates because we see a real devaluation on the horizon and in this context non-tradables (wages) are usually the net losers of the equation. Nor do we see much chance that the deficit adjustment will be as marginal as proposed in the Budget Bill.

And a weak government doing austerity is not exactly a winning recipe. The comparisons are bad, but the memory of Fernando De La Rua's resignation in 2001 flies overhead, although we do not believe that a similar situation can occur. The news from Washington is not necessarily good for Argentina. The scandal at the World Bank over the "Doing Business" index is splashing over IMF Managing Director Kristalina Giorgieva and this may weaken her position. At the same time, the designation of Ilan Goldfajn as director of the Western Hemisphere puts a hawk at the forefront of the negotiations with Argentina. Paradoxically, the outgoing Alejandro Werner shares a university and tutor with Goldfajn (they are all academic sons of Rudi Dornbusch), but the Brazilian has a reputation for being much tougher. In addition, his handling of Argentina appears to have cost Werner his job, so it is unlikely Goldfajn will go easy.

In the long term, the situation appears to have improved. The probability that Cambiemos will repeat the result in November and be on track to return to power in 2023 has grown, although they are obviously far from claiming victory. If Kirchnerism begins to leave the political scene or is transformed into something else, the outlook for Argentina will probably improve. One possibility is that some players are slowly moving towards the traditional Peronism of Juan Schiaretti, governor of Córdoba, who never embraced the Kirchners, for example, while others radicalize and blend into the left, which is far from reaching important majorities in Argentina. In other words, we don't know what will happen, but this tumultuous political fight seems to have complicated stability in the short term, but it may open up more opportunities in the long term.

LAST WEEK IN REVIEW

✓ In July, **the use of installed capacity reached 64.1%, that is, 0.8 percentage points below the previous month.** Compared to a year ago, there was an increase of 7.3 p.p. although the comparison can be misleading given that sanitary measures were in place at that time. The sector with the best performance in July was the basic metal industries (81% of utilization), while the worst was the automotive industry (41.1%).

✓ The **total basic basket increased 1.2% m/m in August and 50.3% y/y.** For its part, **the basic food basket rose 0.7% in monthly terms and 55.5% in the year-on-year comparison.** With these increases, a family of 4 members needed ARS 68,359 to overcome the poverty line or ARS 29,213 to be above the indigence level.

✓ In last Thursday's auction, **the Treasury obtained financing for ARS 21,947 million.** 34% of that amount was placed in fixed-rate instruments, while the remaining percentage was in CER (inflation-adjustable) bills.

✓ The **US CPI rose 0.27% in August,** below expectations, marking the lowest mark since January. In year-on-year terms, prices rose 5.3%.

NEXT WEEK'S HIGHLIGHTS

✓ On **Tuesday 21** INDEC will publish the **national accounts for the second semester.** According to the EMAE, a quarterly fall of 1.6% and a year-on-year growth of 17.3% are expected. It will be interesting to see components and sectors.

✓ On **Tuesday 21** August **wholesale prices and construction costs** will come out.

✓ On **Tuesday 21** the Ministry of Economy will publish the **fiscal data** for August.

✓ On **Wednesday 22, foreign trade** data will be published. We expect a positive trade balance, although lower than in previous months.

✓ The Universidad Torcuato di Tella will publish its **leading activity index** for August.

✓ On **Thursday 23** the **labor market** data for the second quarter of the year will be published.

✓ On **Thursday 23** the BCRA will publish the **bank report** for July.

✓ On **Friday 24** the **exchange market** data for the month of August will be published. One of the keys will be to see how many dollars were used to defend the Blue Chip Swap.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	98.5	0.3%	1.2%	30.7%	▲
Blue Chip Swap	172.5	0.9%	2.2%	26.0%	▲
Blue Chip Swap "SENEBI"	183.1	2.4%	1.6%	-	▲
Parallel	182.5	1.7%	1.1%	33.2%	▲
CB reserves (USD million)	45,334	-428	+3345	+2862	▼
Policy rate (Leliq)	38.0%	0 p.p.	0 p.p.	0 p.p.	=
Badlar rate (private banks)	34.3%	+0.06 p.p.	+0.19 p.p.	+4.38 p.p.	▲
Merval (in ARS)	73,635	-8.0%	8.6%	77.5%	▼
Country Risk (spread in %)	1,577	6.3%	-1.3%	16.1%	▲
Official exchange rate BRL/USD	5.33	2.3%	-0.8%	-1.0%	▲
Soybean (USD/ton)	463.9	-0.8%	-2.4%	21.0%	▼
Oil - Brent (USD/barrel)	73.5	1.3%	9.3%	75.1%	▼

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q	
Industrial production	*Jul-21*	-2.6%	0.4%	2.2%	🟢
Automobile production	*Aug-21*	-10.5%	6.9%	-13.5%	🔴
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	*Jul-21*	-0.5%	-0.5%	1.7%	🟢
Oil production	*Jul-21*	0.7%	3.5%	1.8%	🟢
Gas production	*Jul-21*	1.2%	5.3%	3.6%	🟢
Cement production	*Aug-21*	-3.0%	-0.2%	-2.0%	🔴
Construction activity	*Jul-21*	2.1%	0.3%	6.1%	🟢
Retail sales	*Aug-21*	2.5%	11.1%	8.5%	🟢
Gas sales	*Jul-21*	6.5%	-4.3%	9.1%	🟢
Motorcycle licenses	*Aug-21*	-3.1%	20.7%	4.5%	🟢
Use of electricity	*Aug-21*	-3.0%	-1.5%	-5.4%	🔴
Subway rides (CABA)	*Jul-21*	27.4%	19.3%	50.3%	🟢
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	*Aug-21*	0.8%	-4.1%	0.0%	🟡
VAT-DGI Revenues	*Aug-21*	0.1%	-1.0%	2.5%	🟢
Formal private jobs (SIPA)	*Jun-21*	0.1%	1.0%	0.3%	🟢
Formal private jobs (EIL)	*Jul-21*	0.0%	0.0%	-0.1%	🟡
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

You Must Agree With the 33%! Impossible, My Friend

In the midst of the political crisis, which at times threatens to become an institutional crisis, the 2022 Budget was sent to the National Congress. Beyond the fact that the figures on it were established without with a more "normal" situation, so they could not even remotely foresee the impact of the events that are happening in recent days, they contain inconsistencies that are obvious, the largest being the one that it concerns the projection of inflation.

- The projected growth, both for the 2021 (8%) and for 2022 (4%), looks optimistic, but, if certain premises are met, it is within the feasibility margins. The budget problem is not real, it is nominal.
- The inflation projected for Dec-21 is 45.1%, which implicitly expects an average monthly inflation of 2.35% from September to December, which is unlikely given the fiscal and monetary expansion to come. Our scenario foresees a floor of 49%.
- The projected inflation for Dec-22 is 33%, something inconsistent given a) the expected increase in the public utilities; b) the RER correction is necessary to recover a more stable level of reserves; and c) the need to reduce in real terms part of the monetary expansion, product of the issuance to finance the Treasury and the recovery of reserves, so as not to increase the stock of Leliqs / Pases to an unmanageable level. Our scenario foresees an inflation of 48%. The exchange rate level, which must regain lost competitiveness in 2021, is also higher (60% y/y).
- The deficit of 4% of GDP for 2021 is unlikely due to the feasibility of spending the remaining sum until the end of the year (until Aug-21 the result was 1%), while 3.3% of GDP could not be financed without altering the monetary balance.

Macroeconomic Projections Budget 2022

	GDP	CPI	FX	RER*	Primary Balance
	Var % y/y	Var % dec/dec			% of GDP
2021	8.0%	45.1%	24.0%	-10.3%	-4.0%
2022	4.0%	33.0%	28.0%	-0.9%	-3.3%

Macroeconomic Projections Base Scenario Econviews 2022

	GDP	CPI	FX	RER*	Primary Balance
	Var % y/y	Var % dec/dec			% of GDP
2021	7.4%	49.0%	27.0%	-10.5%	-3.5%
2022	2.5%	48.0%	60.0%	11.4%	-2.5%

**Bilateral with the USA*

Source: Econviews based on INDEC and 2022 Budget

The latest economic activity figures marked that if the level of activity of the first 6 months of the year is sustained, the economy hit a 7% growth. **What must happen so that it reaches the 8% that marks the budget? A 0.63% monthly rise from July to December. Our estimate for the third quarter is slightly below that value, so the last quarter of the year should show a value close to 1% of monthly growth on average.** However, although the uncertainty of the last and subsequent days should have some impact, it seems to us that 8% is within the feasibility interval. Regarding the components of aggregate demand, although most of them are implicitly optimistic, it is well known that the Ministry of the Economy expected a promising fourth quarter. Right now, it sounds a little optimistic.

Macroeconomic Aggregates Budget 2022

Variación % interanual

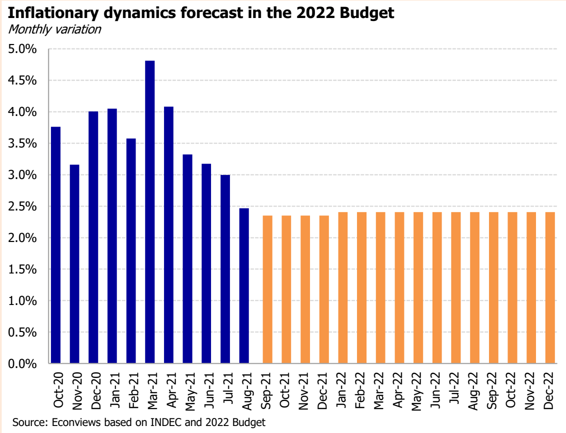
	GDP	Private Consumption	Public Consumption	Exports	Imports	Investment
2021	8.0%	9.0%	5.2%	12.2%	26.2%	31.1%
2022	4.0%	4.6%	3.1%	7.5%	9.4%	6.6%

Source: Econviews based on INDEC and 2022 Budget

Regarding the 2022 projected growth contained in the Budget, 4% sounds somewhat euphoric considering the current context, but within the limits of what is possible. Giving some room for doubt, it must be said that a hypothetical December that coincides with the 8% proposed for 2021 leaves a 2.8% y/y floor of growth. **In a year in which relative prices must align to**

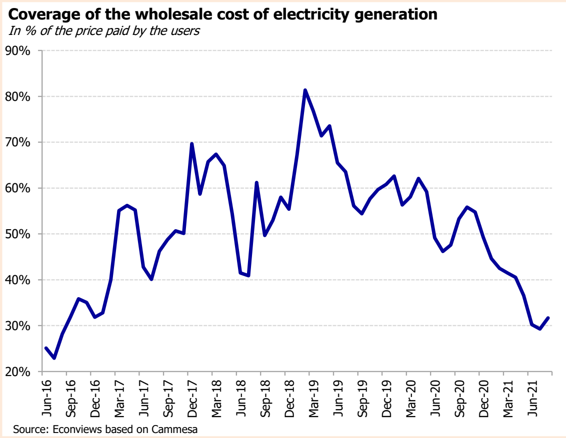
close the renegotiation with the IMF, the economy should grow 1.2% to reach the objective set out in the budget. It is hard but not impossible. A good harvest, although with risks of drought, could give a hand. The risk comes from outside: Brazil has elections in 2022 and everything seems to dance to the rhythm of a combative capoeira rather than a festive samba. The components of aggregate demand are in line with optimism where feasible.

Regarding the nominal variables, the first thing to note is that the budget for December of this year indicates that interannual inflation will be 45.1%. It is implicitly maintaining that from September to December the average monthly inflation will be 2.35%, something that is unlikely. Already in September we think that prices will rise above the August figures, which was the lowest of the year (2.47% vs. July), while for October regulated and seasonal prices could put a floor again of 3%. **That is, the inflation starting point for 2022 is undervalued by at least 3 or 4 percentage points, the interannual inflation of December 2021 will be more similar to the 49% that we have in our base scenario.**



What is totally out of the question is the inflation projection for December 2022. The 33% that marks the Budget, send around midnight last Wednesday, which implicitly expects a monthly increase below 2.5% on average for the entire next year, it is 100% inconsistent.

To begin with, it should be noted that an increase in the receipt of the utilities is predetermined in the same text of the Budget. It is marked by the increase of less than 10% nominal interannual in the expenditures destined to energetic subsidies (CAMMESA), but also the provision that 43% of the wholesale costs of the electricity system are paid by the user, which today it is at 32%. In other words, with a tariff correction in the making, inflation will hardly be reduced by 12 percentage points as expected by the Budget.



Furthermore, and this also is inconsistent with our base scenario, the level of net international reserves that we project for December puts pressure to a RER depreciation, to reverse the overvaluation of the 2021. Considering the inflation and the exchange rate of the Budget, the competitiveness of the economy would be 12% lower in December 2022 vs. December 2020. Our international reserves stock must increase to stabilize the economy and the FX expectations, some of the RER overvaluation suffered in the heat of the electoral contest should be reversed. This means that the dollar would have to end up moving above prices in December of next year and, considering the pass through, that would end up putting pressure on the inflation at a level higher than the one expected by the budget.

Finally, in another part of the project, an additional 1 trillion pesos of issuance is foreseen to finance the Treasury and so that the CB can legally finance that amount the monetary base and the Government revenues, which are the basis for calculating the monetary financing limit, should be growing at 50% / 55% y/y at least in December 2022, that is, 20 points more than 33%.

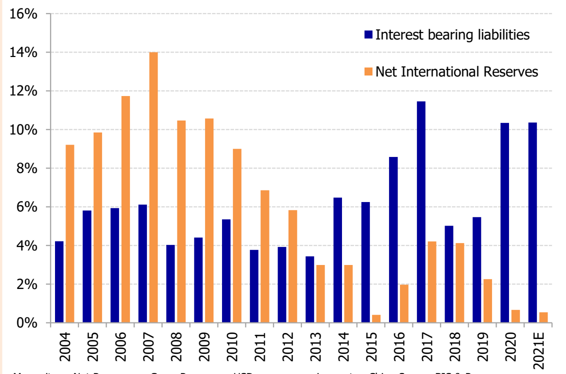
Another way to see why the reflected inflation is inconsistent is on the monetary-fiscal side. We believe that the primary deficit for 2022 will be less than the one claimed (3.3% of GDP and in terms of financing 3% after the contribution that is expected to come from the FGS-ANSES), but let's pretend that this is the case. The level of sterilization that would be needed to re-absorb the trillion pesos that the CB is contemplated to transfer to the Treasury for that level of deficit would lead the stock of Passes / Leliqs to be above 12 points of GDP which, assuming a policy rate without changes, it would imply ending 2022 paying monthly interest for more than AR $ 230 billion. Unsustainable with a level of inflation so low such as the 33%. **And that without adding the expansion that would come from the accumulation of reserves that the CB should have during 2022.**

Therefore, a more consistent deficit target would be around 2.5% of GDP. This is feasible given that the undervaluation of next year's inflation in the budget causes revenue to be underestimated. But, in addition, it causes pension expenditures to be overestimated, since they operate with a lag and in years of low inflation they grow in real terms.

Although the lower growth estimated by Econviews with respect to the budget (2.5% vs 4.0%) will have an effect on collection, the impact of 15 more points (48% vs 33%) will be a dominant positive factor. Thus, with our deficit goal of 2.5% of GDP, which will become 4.1% when interest is recorded, the accounts are different. The monetary issue and the market financing would share the work and the remunerated liabilities would remain below 11% of the GDP, thanks to the inflation liquefaction. **We not only believe that there will be more exchange rate depreciation and inflation, but we believe that it is a necessity.**

At the time, it was reported that the 2021 budget contemplated a year "without a pandemic", which was not such, and it seems that the 2022 budget in some sections would not be taking the agreement with the IMF into account. We do not believe that there will be a recovery in private wages, much less public and we should not see much recovery in retirement expenditures, we expect a greater RER correction, while the need for monetary mope up imposes a higher inflation.

Interest bearing liabilities & Net International Reserves
As % of GDP



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

August Inflation: The Lowest So Far This Year (And the Remainder)

- *Inflation in August was 2.47%, the lowest in 13 months, helped by regulated prices (1.1%) and seasonal prices (0.6%), but core inflation remained at 3.1%*

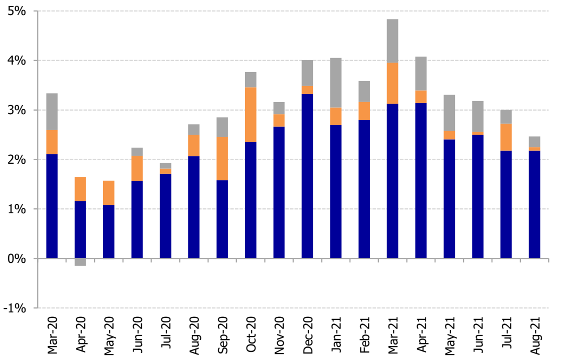
- *The Central's strategy of stepping on the exchange rate finally resulted in lower inflation in tradable goods, but non-tradables continued above the 3% floor*

- *Inflation will remain below 3% in the coming months, but will heat up towards the summer; we expect the year to close at 49% and 48% by the end of 2022*

After an election to be forgotten and the tumult that resulted within the ruling coalition, INDEC delivered good news that went almost unnoticed: the inflation print for August was the lowest in 13 months. The result sounded like too little, too late: lowering inflation a few tenths would not be enough to change the electoral landscape for November. **The other bad news is that inflation is unlikely to continue falling.**

The August CPI registered a monthly variation of 2.47%, taking the interannual inflation to 51.4% and the accumulated one so far in 2021 to 32.3%. But while headline inflation fell half a point compared to July, the same did not happen with **core inflation -which marks the trend- and it remained almost unchanged at 3.13%, marking the eleventh consecutive month above 3%.** The aid came from the regulated prices (1.1%) which had the lowest monthly variation in a year, and the seasonal ones (0.6%). The government will try to further curb regulated prices ahead of the November elections, but the die is cast with the seasonal ones. **And the inertia of core inflation reduces the effectiveness of the exchange rate anchor.**

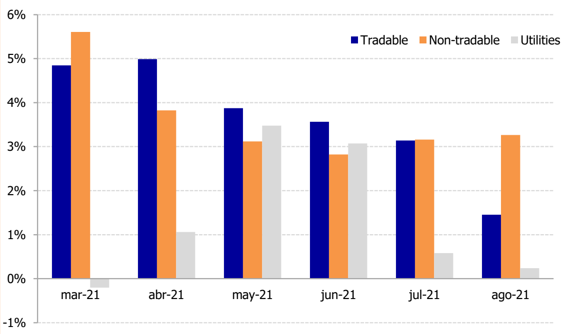
Contribution to headline inflation
Monthly, in %



Source: Econviews based on INDEC

However, after 4 months in which the Central allowed a rise in the official exchange rate of just 1%, tradable goods finally reacted. Classifying goods and services between those with a strong import and/or exportable component (tradables) and those that are traded only within borders (non-tradables), we observe very different dynamics. For the Greater Buenos Aires region - the one with the greatest weight in the national CPI - tradables increased by just 1.5% in August, while non-tradables increased 3.3% and headline inflation in GBA ended just above the national one (2.6%). The division of "electricity, gas and other fuels" (tariffs) also has an imports component, but its prices are defined by government decision and in August they increased 0.2%. In other words, **the lower inflation in August was explained by flat rates and a lagged exchange rate. But inflation in non-tradables continued above 3%, and it was reflected in core inflation too.**

Inflation and tradable, non-tradable goods and utilities*
Weighted indexes and utility rates - GBA



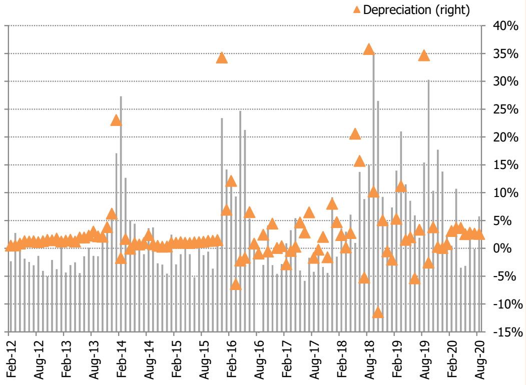
*Tradable goods include those with a high component of imports and/or exports

Source: Econviews on INDEC

Is it sustainable to maintain rates frozen and to continue lagging the exchange rate? The answer is a resounding no, but the government will keep prices tied with a wire until the elections, although **it will have to make adjustments after November, especially if an agreement is reached with the**

IMF. In this context, the 33% inflation forecast in the 2022 budget does not seem like a very consistent number.

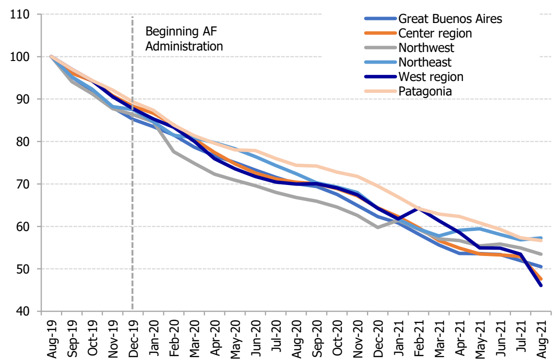
The first adjustment will come from the exchange rate side. Although in historical terms the real effective exchange rate is not overvalued, it is insufficient considering the meager level of reserves and the need for exchange rate intervention to avoid a spike in the FX spread. Until August, accumulated inflation was 32.3% and the nominal exchange rate increased by half, 16.2%. If the government wants to avoid an exchange rate jump that translates into higher inflation (as in January 2014), it must accelerate the crawling peg strategy.



Inflation vs monthly depreciation
In %

Utility rates will also have to be updated to reduce the fiscal and energy deficits. After the defeat of Cambiemos in the PASO of August 2019, the ruling party at that time decided to implement "utilities populism" to improve its chances for the final of that year. And Fernández's administration continued on the same path. Based on August 2019, the "electricity, gas and other fuels" division lagged around 50% relative to core inflation, and ironically even more in those regions that are relatively wealthier, the Greater Buenos Aires and the Center region**. Undoubtedly, energy subsidies to freeze rates are regressive in nature.**

Last April, Guzmán tried to make a rate correction, but did not succeed and the government allowed a rise of only 9% in electricity bills and 6% in gas bills. Although a 3% increase in electricity bills was approved in the Capital last month, **there are no more increases on the agenda for 2021. This situation should be modified within the framework of the agreement with the IMF.**



How lagged are utility rates?
Ratio between indexes of "electricity, gas and others" & core inflation

Fuente: Econviews en base a INDEC

The battery of fiscal measures and the consequent issuance will put a floor to inflation for the next few months, although the greatest pressure will come from the exchange rate side and the Ministry of Economy is aware of this. And September already comes with scheduled increases. The fees of the semi-private schools in the province of Buenos Aires will rise 10%, prepaid healthcare will have the second round of the four increases of 9% authorized by the Government, and building expenditures will increase due to the salary increases of the building managers. **In this context, we expect the August record to be the lowest of the year and inflation to heat up towards the end of the year (3% on average), ending in December at 49%. For 2022, for now we maintain our projection of 48% at the end of the year.**