THE WEEK
AT A GLANCE

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New "Cepo", Old Problems, **No Solutions**

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Editorial: New "Cepo", Old Problems, No Solutions

Last week the Central Bank again intensified the "*cepo*", cutting import payments and making the operation of alternative dollars even more restrictive. **You could see it coming. The sale of reserves was unsustainable, and it did not seem very likely that the government would bless a devaluation before the November 14 elections.**

We have already lived these episodes. Since the Macri government put restrictions in September 2019, there have been about 15 reinforcements of the *cepo* affecting individuals, companies, debtors, importers and everything that creativity asks for. However, the results are always the same: the measures are not enough to reduce the demand for dollars. Spolier: this time they are not going to solve problems beyond some short-term success, either.

The consideration to stop imports is that in recent months more imports were paid than actually entered. Beyond typical operational issues (sometimes suppliers want to see the money before sending merchandise to a country without credibility like Argentina), there are two other important factors to take into account.

On the one hand, Argentine companies have a very important commercial debt accumulated in recent years. Moving from a situation where there was no credit to a free exchange market in 2015, many firms obtained financing from headquarters and suppliers that at some point they will have to cancel. But, more important than the above, is understanding that in an environment of a high exchange rate spread, incentives are generated to delay export settlements and speed up import payments. That the government is surprised because importers want to pay is almost worrying.

It is true that 444 million more imports were paid than those recorded by INDEC, but if the sum is made since January 2016, it is seen that more than USD 80 billion worth of imports have yet to be paid. It is clear that this is not the debt, and that part will have been paid by some other mechanism, but this also shows that there is an implicit demand for dollars there because understandably those who supply importers do not want to increase exposure to Argentina.

What are the consequences of this "mamushka of *cepos*"? On the FX side, it is to be expected that the spread will continue to widen. It went down on the day of the announcement (someone with the inside information?) but was already up on the second day. Second, the regulation destroys the prices of bonds under local law, generating a very high spread with those under foreign law. Third, imports will suffer, and this will have two important consequences: via prices, products will become more expensive given the relative scarcity, and via quantities, there will be fewer imports since, by definition, industrial activity will be affected. There is already anecdotal evidence of people who prefer not to sell until they know if they are going to be able to replace the merchandise.

The widening of the FX spread only exacerbates the problem of lack of incentives for exporters, so it will be difficult to see a solution. The flow that comes from the wheat is not enough. So will we see new versions of the *cepo*? It is not impossible that the government wants to procrastinate what seems inevitable (adjust the exchange rate) and try to reduce the foreign currency position of banks, put more taxes on tourism, pressure exporters to liquidate, etc.

As we have already been there, we know that all these measures buy some time, but they have diminishing marginal returns, that is, they buy less and less time. And more important than that: they have very high costs for the rest of society. It was not long ago that many members of the government rationally explained the damage caused by the *cepo*, yet those arguments have been forgotten today. A FX spread of more than 100% disorganizes the economy and demolishes the demand for pesos, in a way that is as unsustainable as selling reserves every day. Today the situation does not demand that the *cepo* be lifted completely, but it is possible to go towards more moderate levels of FX spread. How do you do that? A combination of credibility and devaluation. The first will be difficult to accomplish, so the second should be relevant. Obviously, we must put into the equation that the issuance of pesos feeds back the demand for financial dollars.

LAST WEEK IN REVIEW

✓ Given the sustained loss of reserves, **the CNV established new restrictions to operate on the MEP dollar.** Additionally, the BCRA ordered that advance payments for imports greater than USD 10,000 must be authorized by the entity.

✓ In September, **43,535 cars were produced, which implies an increase of 11.7% compared to the previous month seasonality adjusted** and of 35.4% year-on-year. In addition, 25,230 vehicles were exported (+ 40.9% YoY). On the other hand, sales to car dealers fell 26.7% in year-on-year terms.

✓ **Cement shipments** totaled 1,121,180 tons in September. In this way they **grew 1.7% m/m** and 7.4% y/y.

✓ In the first auction of the month, **the Treasury obtained financing for ARS 109 billion** between the two rounds (ARS 98 billion in the first and ARS 11 million in the second). With this amount, it covered 134% of the maturities of last week.

✓ **Tax revenues grew 61% YoY in September,** with a good performance of taxes linked to the activity such as VAT (77.8%) and Credits and Debits (80.4%).

✓ The **industrial activity registered a monthly decrease of 0.6% s.a. in August,** although it was 13.8% above the same month of 2020.

✓ **Construction fell 2.6% m / m s.e. in August** and grew 22.7% in year-on-year terms.

NEXT WEEK'S HIGHLIGHTS

✓ **Today** the INDEC will publish the **indicator of public services** for July. Although it is old information, it is important to see some sectors such as public transport.

✓ **Today** the **inflation data for the United States** will be published. The consensus is at 0.3% for the monthly figure and 5.3% for the last 12 months.

✓ On **Thursday 14** we will know the **inflation of September.** We expect a number close to 3%.

✓ On **Thursday 14,** the Treasury will hold the **second bond auction** in October.

✓ On **Thursday 14** the Central Bank will publish its monthly **statistical bulletin.**

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	99.1	0.2%	1.0%	28.5%	▲
Blue Chip Swap	176.7	0.2%	3.7%	13.6%	▲
Blue Chip Swap "SENEBI"	192.4	0.6%	5.9%	-	▲
Parallel	183.5	0.0%	0.0%	11.2%	=
CB reserves (USD million)	42,901	+182	-2861	+1875	▲
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.	+4.38 p.p.	▼
Merval (in ARS)	77,913	-0.4%	2.7%	69.9%	▼
Country Risk (spread in %)	1,624	0.9%	5.5%	20.9%	▲
Official exchange rate BRL/USD	5.53	1.1%	5.5%	0.0%	▲
Soybean (USD/ton)	440.3	-4.2%	-6.0%	15.9%	▼
Oil - Brent (USD/barrel)	84.0	1.2%	16.9%	109.5%	▲

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q
Industrial production	*Aug-21*	-0.6%	4.9%	2.0%
Automobile production	*Sep-21*	11.7%	-1.8%	-1.5%
Steel production	*Aug-21*	-5.7%	3.3%	-5.6%
Poultry production	*Aug-21*	3.5%	-1.1%	2.8%
Dairy production	*Aug-21*	-0.3%	1.2%	-0.5%
Beef production	*Jul-21*	-4.2%	-9.0%	-1.6%
Real Estate transactions (CABA)	*Aug-21*	-4.4%	6.1%	-2.5%
Flour Production	*Aug-21*	2.3%	3.1%	3.6%
Oil production	*Aug-21*	-2.0%	2.0%	-1.2%
Gas production	*Aug-21*	1.9%	5.8%	3.5%
Cement production	*Sep-21*	1.7%	-1.7%	-0.7%
Construction activity	*Aug-21*	-2.6%	4.3%	0.8%
Retail sales	*Aug-21*	2.5%	11.1%	8.5%
Gas sales	*Aug-21*	1.3%	5.3%	9.5%
Motorcycle licenses	*Sep-21*	15.3%	15.0%	9.1%
Use of electricity	*Sep-21*	2.6%	-4.1%	-0.8%
Subway rides (CABA)	*Aug-21*	16.5%	58.1%	48.8%
Imports CIF	*Aug-21*	-0.5%	7.6%	1.6%
Exports FOB	*Aug-21*	11.6%	15.2%	15.0%
Loans in ARS to private sector	*Sep-21*	3.6%	-0.4%	4.0%
VAT-DGI Revenues	*Sep-21*	6.5%	5.0%	8.8%
Formal private jobs (SIPA)	*Jul-21*	0.1%	0.6%	0.1%
Formal private jobs (EIL)	*Aug-21*	0.2%	0.0%	0.2%
Consumer confidence	*Sep-21*	1.9%	12.1%	8.3%
Government confidence	*Sep-21*	-14.7%	-4.4%	-9.7%

Note: stoplight color depends on monthly variation

A Driverless Private Credit

- *Domestic credit to private sector stopped falling in the third quarter, but it is hardly the beginning of a dynamic that reverses a process of long decline*
- *The fiscal dominance of monetary policy imposes a logic that ends up diverting loanable funds*
- *In 2022 and onwards, this dynamic will continue if it is not aimed at financing the fiscal deficit in a genuine way, that is, through the local or international capital market*

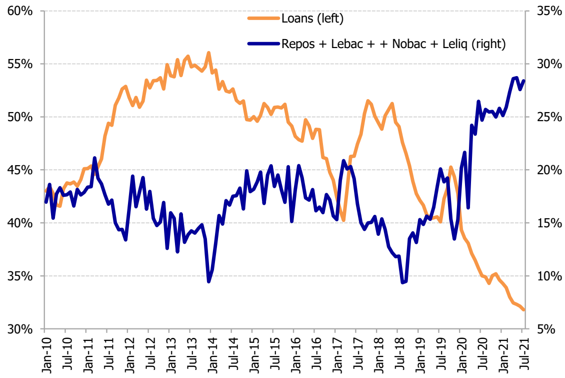
One of the pillars of economic growth is the financial system, which is what channels loanable funds for people and companies to expand production. Instead of growing, domestic credit to private sector falls in Argentina. The main explanation is that the public sector with its financing policy diverts financial flows towards the remunerated liabilities of the CB. An alternative view is that, as the demand for credit is low, banks have no choice but to invest in the Central Bank instruments. Ultimately, the result is that the main productive driver today is absent.

Domestic Credit to the private sector grew 1.2% in real terms in September, accumulating 3 consecutive months without falls (it tied in July and rose 0.7% in August). Although this short-term dynamic is encouraging, it occurs in the midst of a very negative process seen in perspective. Measured as a percentage of the assets of financial institutions, we see that in recent years credit suffered a strong setback. If we take the historical average of this ratio, for the total financial system the current level is 15 percentage points below (32% vs 47%), with private banks being the hardest hit, with a gap of 19 points (31% vs 50%), while for the public it is 9 points (32% vs 41%).

It should be noted that within the total stock of loans, performance over time was not the same for all categories. The sector that suffered the least from this displacement of credit as a percentage of assets was that referred to credit cards, which after two years with strong ups and downs, represents 7.3% of assets, 29% less than in December 2015 when this figure reached 10.3%. On the opposite side we find personal loans, which have been going through a sharp fall since the end of 2017 and are at their historical minimum, occupying only 3.9% of assets (63% less than the maximum).

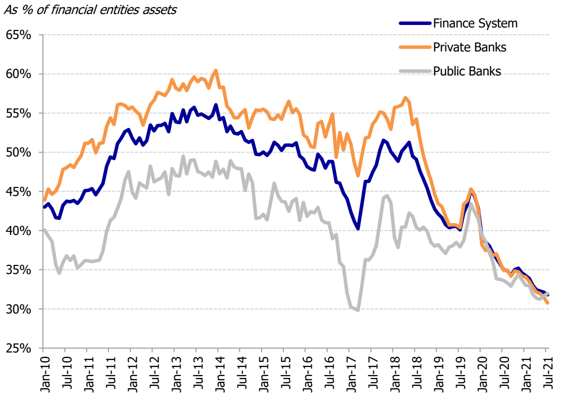
In this case, the crisis and the consequent fall in real wages seem to have been determining factors in driving households to reduce their indebtedness. Mortgage loans are another example of a setback in recent years. After the boom between 2017 and early 2018, they did not stop falling and are currently at their lowest level (1.8% of assets vs 4.7% in May 2018). Additionally, the low participation of mortgages and pledge credits account for the shortening of terms that private financing had in recent years.

Crowding out effect or low credit demand?
As % of financial entities assets



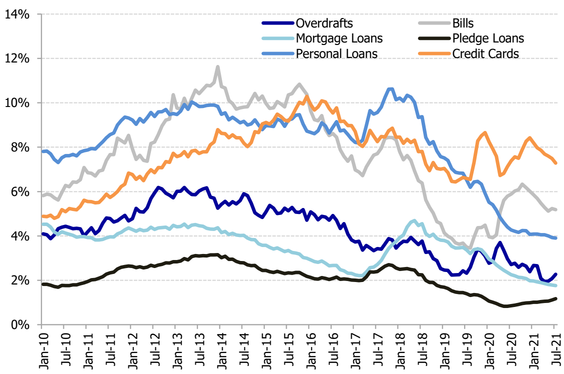
Source: Econviews based on BCRA

Total Loans
As % of financial entities assets



Source: Econviews based on BCRA

Credti to private sector
As % of financial entities assets



Source: Econviews based on BCRA

From these data, the obvious question arises as to what the destination of the financial system's loanable funds is, if they are not going to finance the private sector. And the answer is that the remunerated liabilities of the Central Bank, the Leliqs and Pases, take away all the funds, resulting in a disintermediation of the financial system. While the historical average of these papers as a percentage of assets is 18%, they currently represent 28%. This situation is a clear example of what the bibliography calls the "Crowding out" effect, that is, a displacement of the private sector by the state.

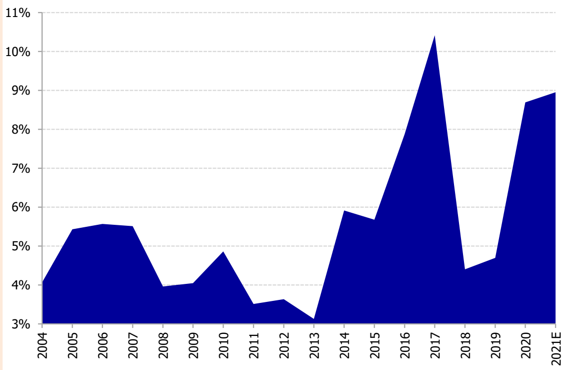
It is the cost of the fiscal dominance of monetary policy, which in other circumstances should point to the expansion of the financial system as the engine of economic growth. But how to do it if it has to help the Treasury to partially finance the fiscal deficit, and then seek to re-absorb this excess money supply to rebalance the monetary balances. More worrying is that the outlook for the future would not be drastically reversed, since it would require fiscal measures in the same sense, which does not seem to be taken.

In order to have an idea of the extent to which this financial disintermediation will continue, we advance on a sketch of what the 2022 monetary program would be. That is, of how much the CB will have to issue, and then re-absorb, next year. On the one hand, there is the interest payment that will have to be made on the current stock of Passes and Leliq. On the other hand, there is the assistance to the Treasury that will have to be carried out. And finally, pesos will also be issued in the process of necessary purchase of international reserves.

Under our macroeconomic assumptions for 2022, which are different from those of the Budget in real terms (we expect growth of 2.5% vs 4.0%) but more than anything in nominal terms (with a difference of more than 20 points, 54% for December vs 33%), the results of the monetary program show that in order not to delve into financial disintermediation, a deficit of 2.5% of GDP is necessary. It is the fiscal premise, so that the re-absorption via Passes and Leliqs at the end of the year does not make the stock of remunerated liabilities grow above the already oversized 9.3% of GDP estimated for 2021. For this, the monetary base in December 2022 it should be growing at 54% annually, in line with the inflation we expect. The main conclusion in this sense is that, as we have been saying, the higher nominality is not only a result of the current macroeconomic configuration, but a necessity to maintain its equilibrium.

And this is where the circle of disincentives to lend in Argentina ends up closing: the combo of more inflation and limits to raising rates complicates bank profitability and promotes that the easy option at hand is the most chosen, the old and always profitable liabilities monetary. It's fiscal dominance, stupid!

Interest-bearing Liabilities
As % of GDP



Source: Econviews based on BCRA and INDEC

Central Bank monetary program
In ARS billion

	2021E	2022E
Payment of interest	1,280	2,287
Assistance to the Treasury	1,612	1,524
Purchase of reserves	667	858
Other factors	-352	0
Issuance needs	**3,206**	**4,669**
Interest-bearing liabilities (annual growth)	1,922	2,642
Monetary base (annual growth)	**1,285**	**2,028**
Memo items*		
Monetary base (stock)	**3,755**	**5,782**
Annual growth (%, eop.)	*52.0%*	*54.0%*
Seigniorage (% of GDP)	*2.8%*	*2.8%*
Interest-bearing liabilities (stock)	**4,766**	**7,407**
Annual growth (%, eop.)	*67.6%*	*55.4%*
As % of GDP	*9.3%*	*9.0%*

**Stocks as AR$ billions, eop*

Base Scenario

	2020	2021 E	2022 E
National inflation[1] (annual var., dec.)	36.1%	51.0%	54.0%
National inflation[1] (annual var., avg.)	42.0%	48.3%	56.7%
Official exchange rate ARS/USD (eop)	84.1	106.0	174.9
Official exchange rate ARS/USD (annual avg.)	70.6	95.2	143.0
GDP (in ARS billion)	27,481.4	45,256.4	72,080.9
Nominal GDP growth (annual var., %)	26.0%	64.7%	59.3%
Monetary base (billion ARS, eop.)	2,470.3	3,754.8	5,782.4
Annual growth (%, eop.)	30.3%	52.0%	54.0%
Annual growth (in ARS billion, eop.)	574.9	1,284.5	2,027.6
Seigniorage (% of GDP)	2.1%	2.8%	2.8%
CB's remunerated liabilities (in ARS billion, eop.)	2,843.7	4,765.6	7,407.5
CB's remunerated liabilities (% of GDP)	8.7%	9.3%	9.0%
Primary surplus (in ARS billion)	-1,750.0	-1,595.2	-1,802.0
Primary surplus (% of GDP)	-6.4%	-3.5%	-2.5%
Fiscal surplus (% of GDP)	-8.1%	-5.0%	-4.0%
Gross international reserves (in USD billion, eop.)	39.4	40.9	45.9

Source: Econviews