MONTHLY REPORT

ECONVIEWS

ECONOMÍA Y FINANZAS

April 2024

Issue #238

Cautiously optimistic,
with a few **wrinkles to iron**

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The **2024 labor market outlook**

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THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- Global markets were troubled by a series of data prints (jobs, CPI), that show disinflation will take longer than expected and the Federal Reserve is in no rush to cut rates, plus the conflict between Iran and Israel. Between April 5th and 19th, the S&P 500 fell 4.6% and 10-year yields shot up 26 bps to 4.66%.
- Argentine assets weathered the change in external conditions well: country risk kept falling from 1,450 to 1,200 basis points in April, and sovereign bonds like the GD30 benchmark won 12%, while stocks advanced 7% this month. The BCS trades at ARS 1,096, a 25% spread with the official exchange rate.
- The government achieved an ARS 1.1 trillion fiscal surplus in Q1-2024, the first since 2008. The adjustment in pensions (-27%), public sector wages (-22%), energy subsidies (-51%) and CAPEX (-87%) explain most of the fall in primary spending. While this cannot be the status quo for all 2024, the government has a strong starting point towards balancing fiscal accounts.
- Inflation is trending downwards, especially in goods. March's CPI print came in at 11%, but our survey of supermarkets shows food and beverage prices rose around 5% in April. Services will leave the CPI closer to 9%. The recession is very deep: activity fell 3.2% year-on-year in February.

FIGURE OF THE MONTH

The government ran a

0.2%

of GDP fiscal surplus in Q1, the first since 2008.

TO BE ALERT

Confidence in the government (UTDT) fell to

49%

in April 2024, marking the "honeymoon period" is coming to an end.

WHAT'S COMING NEXT?

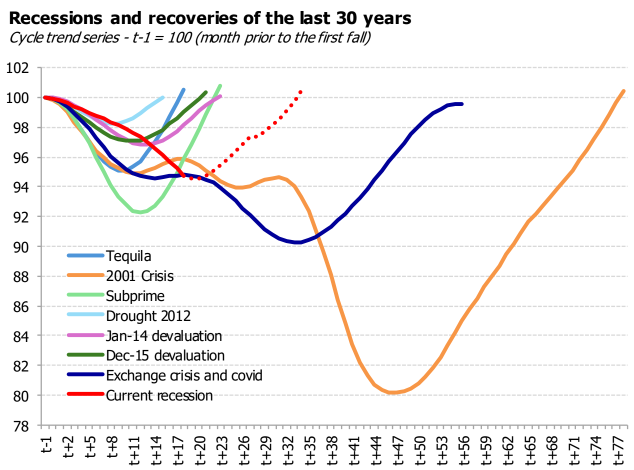
- Seasonally, dollar inflows tend to be highest in Q2 due to the gross harvest of soybean and corn. Agriculture is recovering from last year's terrible drought, though unstable weather conditions and a virus which affected corn crops mean it won't rank among the historical best. The exchange rate for soybean farmers, after 33% export duties, isn't that attractive.
- Congress will treat a new version of the "Omnibus Bill". The labor legislation chapter was supposedly negotiated with allied parties, and the new version of income tax (which lowers the non-taxable threshold from 15 to 9 minimum wages) has good chances of approval.
- A lot hinges on the speed of disinflation. The government is willing to sacrifice exchange rate competitiveness and a quick economic recovery to push inflation deeper into single digits. However, we believe there is a large inertial factor to inflation, which makes it tough to break a 5-6% monthly floor without a stabilization plan. This strategy may also lead to a discrete jump in the exchange rate later in the year, something best avoided.
- The Federal Reserve is set to meet again on May 1st, but markets do not expect rate cuts until at least September, pricing in a 5-5.25% Fed Funds rate by December 2024, 50 basis points above what they had a month ago. A stronger dollar tends to correlate with lower commodity prices, which is bad news for Argentina.

SUMMARY OF MAIN INDICATORS

	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-0.2%	-0.8%	Inflation (monthly)	11.0%	13.2%
Consumer confidence (MoM)	1.3%	1.8%	FX spread (21day avg.)	22.6%	25.5%
Industrial activity (MoM s.a.)	-0.7%	-1.3%	Country risk (bps 21day avg.)	1,310	1,606
International accounts			**External data**		
Current Account (USD BN)	-3.42	-5.95	Soybean price (per ton, 21day avg.)	427.6	433.4
CB Reserves (USD BN 21day avg.)	28.91	27.82	Brazilian activity (MoM s.a.)	0.4%	0.5%
Primary balance (ARS BN)	625.0	1,232.5	Financial Conditions Index	39.9	35.3

Source: Econviews based on multiple sources - working days only

GRAPH OF THE MONTH:



Source: Econviews based on INDEC

RECENT ECONOMIC DEVELOPMENTS

MAR 26th	APR 1st	APR 11th	APR 17th	APR 22nd	APR 30th	APR 30th
Econviews Monthly #237: 10 questions for 100 days of Milei + special report on the real exchange rate.	Gasoline prices adjusted 4.3% due to changes in fuel taxes, **gas bills increase 350% for high-income households**.	**BCRA cuts policy rate again from 80 to 70% APR,** (after March's 20 point cut) an effective monthly rate of 5.8% with 9-10% inflation.	**Government orders private healthcare to lower premiums to December levels**, indexing them to CPI from now on.	On national broadcast, **Milei celebrates Q1 fiscal surplus ARS 1.1 trillion or 0.2% of GDP**, says disinflation goal is closer.	Congress' **Lower House approves new version of reforms bill** and fiscal package, now Senate must decide.	**Econviews Monthly #238**

POLITICS

Government confidence (49%) remain high, though Milei made his first significant political misstep with the debate around university funding cuts, which hit part of his voter base. Congress is treating a new version of the "Omnibus bill" and a fiscal package which includes recovering income tax's base and a new tax amnesty. This time around, there have been more negotiations with allied parties like the UCR, but infighting within the Libertarian block casts a shadow on deals. The May 25th Pact, were Milei together with the governors is supposed to sign 10 guidelines to deregulate the economy, has lost some steam due to ongoing conflicts between the national government and the provinces over funding cuts.

IMF

In its April WEO, the IMF published revised forecasts for Argentina which include a 2.8% GDP contraction and 150% inflation in 2024. Finance Minister Caputo and his team met with IMF director Gita Gopinath and US Treasury Department officials, which commended the "impressive advances" on the fiscal front. A new mission from the IMF will visit Argentina during May, ahead of the planned USD 800 million disbursement scheduled for Q2. Reports are negotiations for fresh funds to back a stabilization program have not advanced much.

ECONOMIC ACTIVITY

Economic activity fell "only" 0.2% monthly in February, after sinking 5% between October and January. The worst of the recession appears to have passed, but we see less chance of a V-shaped recovery, due to the government's focus on lowering inflation through wage repression (which hurts consumption) and an exchange rate anchor (which hurts construction and export-led sectors). In year-on-year terms, the economy was 3.6% down in February. Construction (-19%), manufacturing (-8.4%) and retail (-5.5%) are feeling the worst of the recession, while agriculture (+5.5%) is bouncing back from the drought and mining, oil and gas (+12%) is a world apart. We expect GDP to contract 3.3% over 2024, recovering 5.5% in 2025.

INFLATION

March's CPI print clocked in at 11%, slightly below market forecasts of 12%, the third consecutive month of deceleration after December's record 25.5%. Education (+53%) led the index due to the beginning of the school year, regulated prices rose 18.1% due to the adjustment in electricity bills, core inflation ran at 9.4% and food prices increased 10.5%. Our web scrapping of supermarket prices shows food inflation has slowed to 5.3% month-on-month as of the fourth week of April. However, this month's CPI could be closer to 9% due to the adjustment in gas bills. The 2% crawling peg is helping lower inflation, especially in goods, but we are not sure this is a sustainable strategy. We lowered our forecast for 2024 from 215 to 185%.

MONETARY SECTOR

After March's 20-point cut, the Central Bank lowered its policy rate twice in April from 80 to 60% APR, an effective monthly rate of 5%, 4-5 points below expected inflation. The strategy aims at reducing emission from interests on Central Bank liabilities, and forcing the market into Treasury instruments. The Central Bank has signaled it will maintain the 2% crawling peg as well. Both decisions appear incompatible with lifting FX controls in the short term, which requires real positive rates. There is also risk of a spike in the BCS dollar and the FX spread, although for now it remains at 25%. We lowered our forecast for the official FX rate to ARS 1,770 by December, closer to what the futures market is pricing.

FISCAL ACCOUNTS

The national public achieved an ARS 625 billion primary surplus and a 276 billion fiscal surplus in March, accumulating a 0.6% of GDP primary surplus in Q1, the first since 2008. However, tax revenues fell 8.6% year-on-year in real terms in March, showing two things. One, that the recession is weighting on income, especially from VAT (-16%) and social security contributions (-20%). Two, that the December devaluation which boosted export taxes (+74%) and the PAIS tax on dollar purchases (+326%) has diminishing returns. Primary expenditures fell 29% year-on-year, mainly in pensions (-31%) and economic subsidies (-21%). We expect an 0.5% of GDP primary surplus in all 2024, with a 1% fiscal deficit after interests.

I. Cautiously optimistic, with a few wrinkles to iron

The government is approaching critical times as Congress is starting to debate the "Ley de Bases". The bill includes a fiscal package as well as some structural reforms that should help to improve productivity and increase investment and growth. This is a tone down version from the law that was sent to Congress in February and then withdrawn because the government considered that Congress was softening it too much.

The new version of the bill gives smaller powers to the President to privatize public sector enterprises and to deregulate the economy by decree. While it is much less ambitious regarding much needed structural reforms, its approval is still important to show political strength and governability. Failure to get the approval of this law would be seen as a sign of weakness and would hurt the investment climate.

Our view is that some version of the law will finally be approved by both Houses of Congress. A large part of the opposition does not want to be perceived as obstructing a government that still has a positive image of around 58%. Though Milei will probably need to become less hostile towards the opposition to get the approval of new laws in the future.

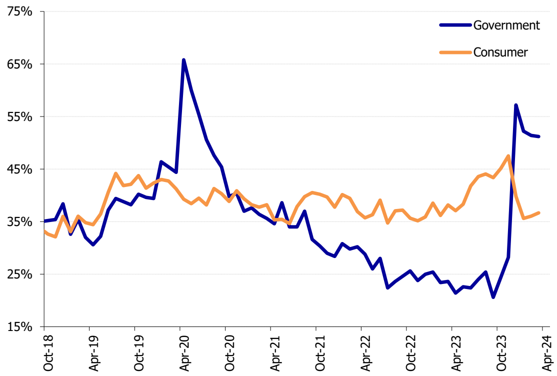
The discussion in Congress takes place just a few days after the government faced the first political and social setback. A large crowd that appears to have exceeded half a million people took the streets to protest against the budget cuts in public education. The demonstrations, which took place around the country, are just a warning indicating that the government will have to take heed to the social humor but does not seem to indicate a turning point in Milei's popular support. It was an important first warning, though.

On the economic side, the program seems to continue on track. The government keeps delivering on the fiscal side, where there was an overall surplus in the financial accounts, which means a primary surplus of around 0.6% of GDP in Q1. True, this surplus is built on the PAIS tax on dollar purchases (that can only be levied while there are FX controls and should end in December), on cuts in expenditures that will be difficult to maintain over time without detrimental effects on infrastructure and without the continuous patience of large parts of the population.

However, the surplus is there and most likely the government will find alternative ways to balance the accounts through increases in income taxes, reduction in energy subsidies and other policy measures that it might come up with. The key issue is that there is a strong commitment to drastically improving the fiscal accounts, and that the government wants to maintain it because it considers it as the anchor of the program. Milei will do "whatever it takes" on this front even if it harms the micro at one point.

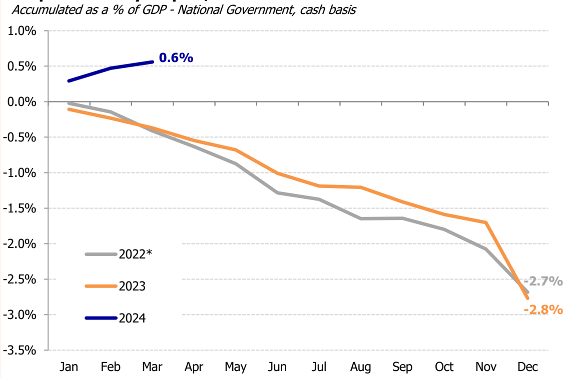
The second leg of the program is the increase in reserves, which is critical to ensure the normal functioning of the economy and to improve the ability to service the external debt. The combination of a sound fiscal policy and increases in reserves is at the heart of the increase in the prices of bonds and stocks and the reduction in Argentina's country risk.

Graph 1. Consumer and goverment confidence
In %



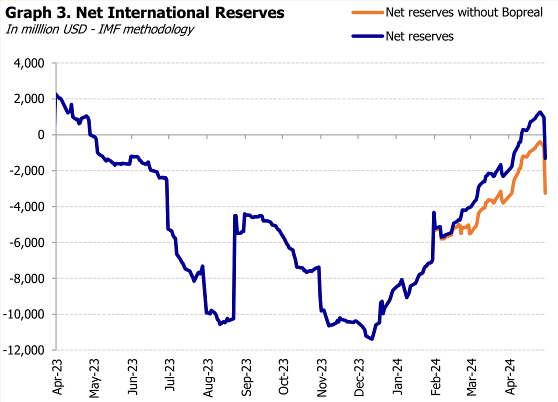
Source: Econviews based on UTDT

Graph 2. Primary surplus/deficit
Accumulated as a % of GDP - National Government, cash basis



*2022 exclude rents from CER bond issuance
Source: Econviews based on MECON and INDEC

Graph 3. Net International Reserves
In milllion USD - IMF methodology



Source: Econviews based on BCRA, IMF & own estimates

Net reserves have increased by around 12 billion dollars. But the Central Bank has built obligations along the way, namely the issuance of Bopreals to reduce the burden of the debt that importers had with foreign suppliers (which in now being extended to payments of dividends abroad). And the new debt accumulated by importers that are forced to pay for imports in installments. The short-term obligations of these items roughly represent over 100% of the reserve accumulation. So, at some point all this will put pressure on reserves (and the exchange rate).

Financial markets have responded in a very positive way to these achievements. Country risk has dropped from around 2600 points last August to 1200 points nowadays, an indication that investors are reassessing Argentina's capacity to pay and are seeing that is less likely that there will be another default. While this reduction in the country risk has happened at times when credit spreads are dropping in most emerging countries, Argentina is clearly an outperformer in recent months.

Graph 4. Country Risk for Argentina
EMBI, in percentage points

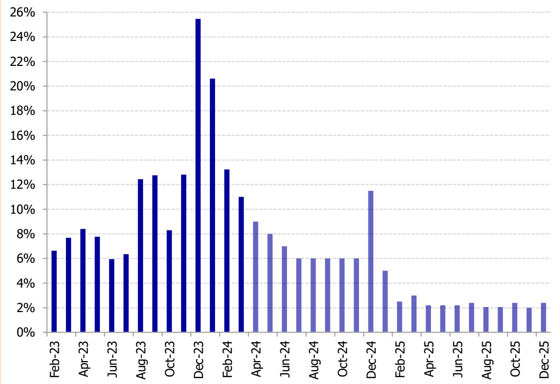
Source: Econviews based on JPMorgan

The government is also celebrating the deceleration of inflation that has been taking place since last December's devaluation. That month the rate of inflation peaked at 25.5%. Inflation in March was 11%, and in April is likely to have dropped to one digit. Market surveys suggest that inflation will continue to decline in coming months and could reach 3% in December. While we agree that inflation is now on a declining path, it seems too early to claim victory at this point. The very deep recession, the significant drop in real wages and pensions and the Central Bank's rule of depreciating the currency at 2% per month are clearly helping the disinflation process. However, as economic conditions improve and relative prices adjust to converge to more reasonable levels there are likely to be bouts of inflation, though at levels that are much lower than those observed during the beginning of Milei's administration.

The process of finding a new equilibrium of relative prices is difficult to achieve in one shot. The initial adjustment in the exchange rate and in many tradeable goods is likely to be followed by new increases in the price of services and in wages, which in turn would be followed by a new round of adjustment in the exchange rate until through an iterative process relative prices reach a new equilibrium. Along this process each increase is smaller than the previous one, and over time inflation will converge monotonically to a lower rate.

If, on the other hand, there is a disruptive event along the way (such as a devaluation) that moves inflation temporarily to a higher level, the disinflation process would have to start again, starting this time from a higher level. For example, if in the second half of the year there is a 30% devaluation then inflation would move from say 6 to 9 percent (which today is not priced in the CER bonds), and a new disinflation process would have to start from the nine percent. In other words, if it happens it would be a temporary disruption that would not derail the overall program. This possibility is captured in our base scenario where we assume that eventually there is an inconsistency between the level of the real exchange rate and the need to accumulate reserves through a large enough current account surplus.

Graph 5. Monthly Inflation



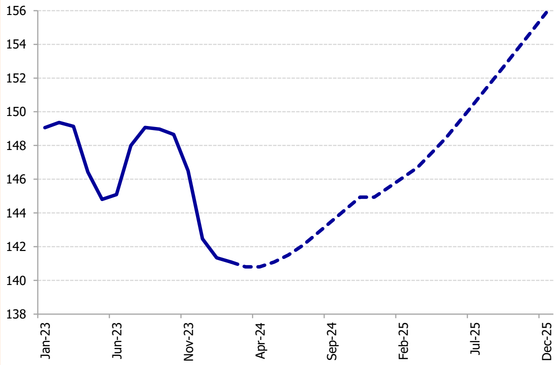
Source: Econviews based on INDEC & own estimates

We continue to have a constructive view on the program. It seems clear that the fundamentals are in much better shape relative to December, the population at large is supporting the policies and has shown much more tolerance to the adjustment program than most analysts had predicted, the progress on inflation is clear, and the response from the financial markets has been very positive. We also perceive more pragmatism in the government in its negotiations to get the approval of the Ley de Bases, which was not seen at the beginning of the year.

However, there are some concerns. First, that the odds are that the recovery will be slow, more likely in Nike pipe shape rather than in V. Second, we don't think that the FX restrictions will be removed soon and fully. We instead anticipate that it will be maintained throughout this year and that Central Bank will start dismantling it gradually in second half. Third, the current monetary policy of extremely negative real interest rates is difficult to understand and to sustain. Its main objective has been to liquify the liabilities of the Central Banks, one that has already been achieved, and it seems that the additional gains from maintaining it are going to be very small. Fourth, we think that the policy of depreciating the currency at 2% per month is very risky and might slow down the accumulation of reserves in the second half of the year and to a rebound in the CCL that recently has been dormant.

All in, we remain cautiously optimistic.

Graph 6. Economic Activity
Base 2004 = 100



Source: Econviews based on INDEC & own estimates

II. The 2024 Labor Market Outlook

Argentina's economy has been in recession for the past six months. A primary concern is the possibility of employment problems. Early-year data gives a sense that things have eased down in the labor sector as well. The most important question is: How long? According to in-house estimates based on previous recessions, private registered employment is expected to reach its lowest point in June, but not across all industries or categories. One of the features will be heterogeneity.

The current market

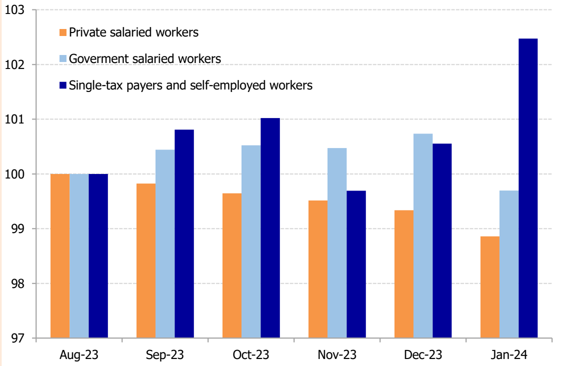
High demand for low-quality jobs. Since the start of the recession in September of last year, the private sector has suffered the most (see Graph 1). These six months have seen 58,000 job losses net. Meanwhile, single-tax payers and self-employed individuals have added 53,000 workers. This shift towards more flexible employment contracts is typical during periods of economic downturn. However, the boom of independent workers is a phenomenon that has persisted for the last decade, particularly after the COVID-19 pandemic. In the case of the public sector, the change of government is an additional factor. The latest data from the Ministry of Labor (SIPA) shows a decrease of 26,000 government-salaried workers from September to January.

The recession primarily affects labor-intensive industries in the private sector. If we analyze the performance of all sectors, undoubtedly, construction has been the worst performer, standing well below average (see Graph 2). In just one semester, it has lost 11% of its workforce. In monthly terms, the average decline was 2.7%, but it has been more intense in recent months. Particularly in January, the decline reached a magnitude like that of March 2020 (-4.6% vs. -4.1%) at the onset of the pandemic.

The strong peso of 2023 has burdened this sector with high costs in dollars, further compounded by the stoppage of public works, a byproduct of fiscal consolidation. On the other hand, the decline in consumption (-1.5% q/q) in Q4-2023 and the estimated decline for Q1-2024 (-6.3%) are key factors in explaining the reduction in staff in hotels and restaurants. The manufacturing industry also felt the recession, but compared to the three industries mentioned above, it seems stronger so far.

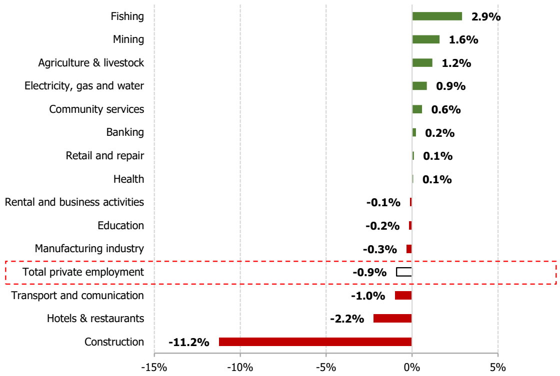
Provinces' private employment. Only four provinces appear to have been unaffected by the recession when we examine their performance (see Graph 3). However, this conclusion is not precisely correct. We need to take into consideration the percentage of the population employed in the formal sector (see Graph 4). If we do so, Tierra del Fuego will be the biggest loser (-6.8%, January vs. September), with a private employment rate of 38%. On the other side, the City of Buenos Aires, where 90% of employment is in the private universe, was less harmed (+0.1%).

Graph 1. Formal employment's evolution under reccession
Aug-2023= 100, s.a.



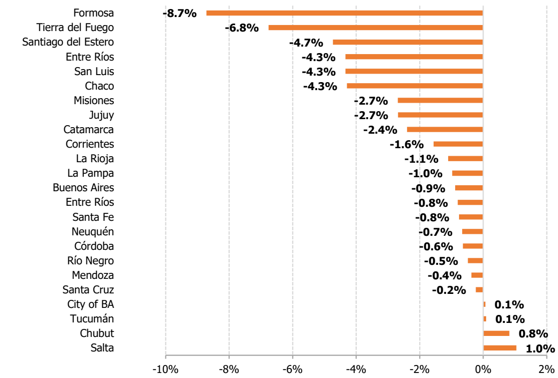
Source: Econviews based onSecretary of Labor

Graph 2. Effects of recession on the private labor market
Jan-24 vs. Sep-23, s.a.



Soruce: Econviews based on Secretary of Labor

Graph 3. Salaried Workers by Province
Jan-24 vs. Sep-23, Variation in %, s.a.



Source: Econviews based on Secretary of Labor

What’s coming next?

The forecasts in the current report are consistent with the base scenario of Econviews concerning the macroeconomic development of Argentina (see Graph 5). To assess the behavior of the labor market during previous recessions, we also performed statistical regressions using statistical software.

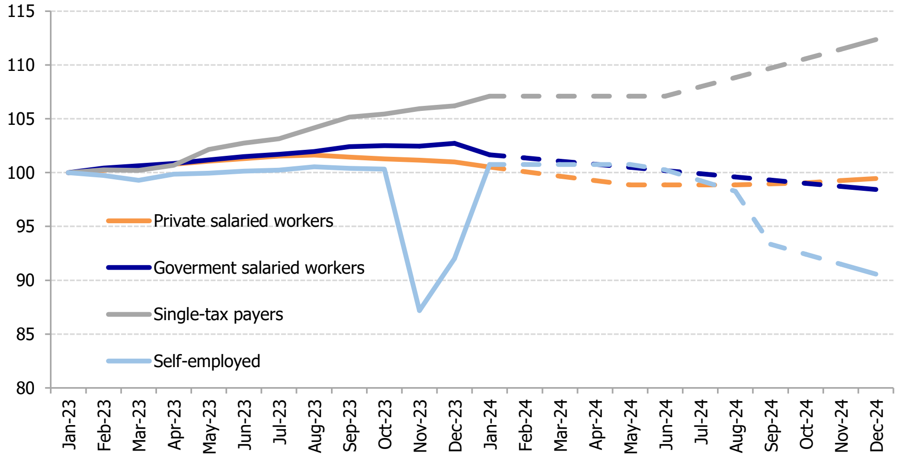
We anticipate a slowdown in activity in the first quarter of the year due to macroeconomic adjustments. There will be some assistance from the mining, gas, oil, and agriculture industries, but not enough to sustain overall economic growth. Negative statistical carryover is also a downside factor, leading us to expect a 3.3% contraction in GDP in 2024. We find a 6% reduction in employing sectors ex agriculture sector (agribusiness is a capital intensive sector).

Regarding inflation, monthly rates will continue to decrease, albeit at high levels due to regulated price increases. The focus will be on reducing subsidies through adjustments in public utility and transportation tariffs. Starting in April, we expect one-digit inflation rates, which we believe will stabilize at about 6% in the upcoming months. But at some time, the currency rate may fix itself; this could happen in November or December. Prices will rise because of the elimination of FX regulation, pushing inflation into double digits for the economy again.

After taking these factors into account, we provide the following projections:

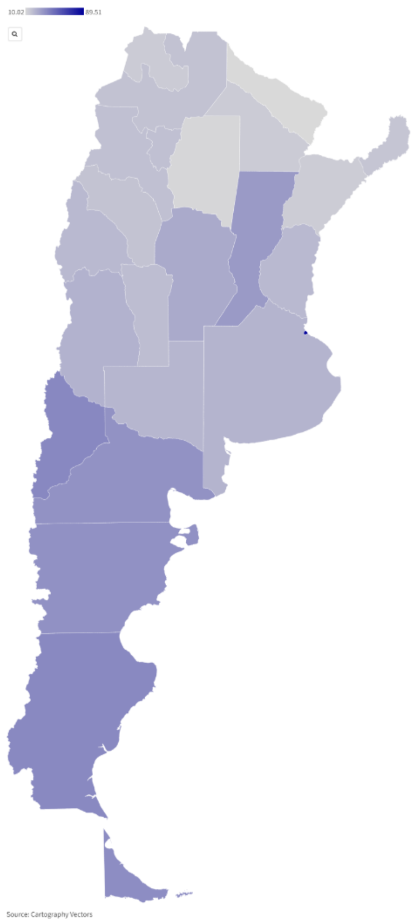
- **A 2% yearly drop in private employment**. Private employment is expected to reach a trough in June, even though we think the decline in activity ceased in March (see Graph 6). The modest rise in the final quarter will not be sufficient to offset the year-to-date decline in the first five months of the economy. When comparing December 2024 and December 2023 from year to year, there will be a loss of about 130,000 positions.

Graph 6. Employment's Evolution by Category
Janaury-2023= base 100, s.a.



Source: Econviews based on Secretary of Labor and own estimates

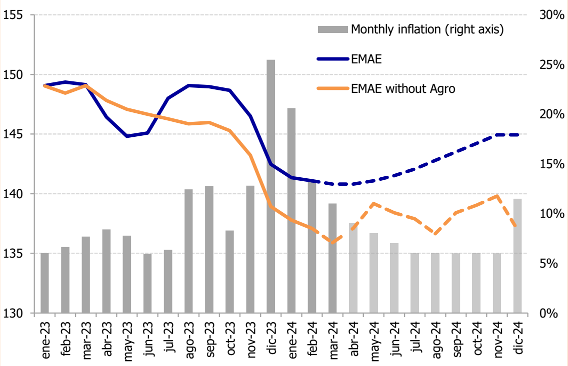
Graph 4. Population employed in the private sector by Province
Jan-24



Note: provinces colored deep blue have a higher percentage of population employed in the private sector.

Source: Econviews based on Sec. of Labor and INDEC

Graph 5. Economic Activity and prices - Base Scenario
Base 2004 = 100



Source: Econviews based on INDEC and own estimates

- **Weak results in key industries.** Considering a selection of 5 sectors that account for 70% of employment, we see a decrease in all of them except for the transportation sector. Workers will be needed in the transportation industry due to growth in the agricultural sector after a drought-affected campaign. Regarding retail and reparations, a monthly decrease is expected throughout the year due to lower sales caused by a sharp decline in consumption, which slowly recovers in the second semester. This will result in a 4% reduction in the workforce of this sector. Both manufacturing and construction show a downward trend during the first 7 months, with a slight recovery expected in the last quarter. The construction sector is projected to be the most affected, with a 9% decrease in jobs, while manufacturing will lose approximately 2% of its positions.

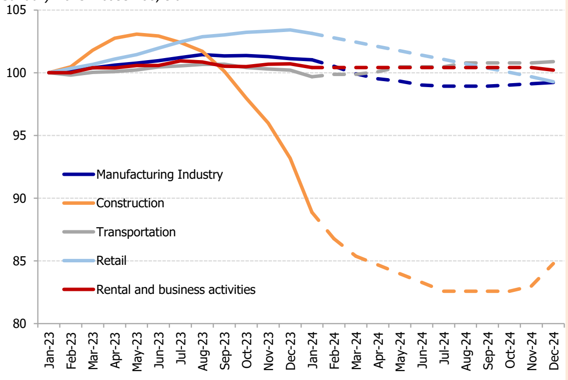
- **The weak performance of construction is explained by two reasons.** On one hand, the cessation of public works due to fiscal cutbacks by the new government. Regarding private construction, activity is very low due to the high dollar costs faced by the sector. We believe the sector will reposition itself once the current pace of devaluation accelerates. In business and real estate activities, only a half-percentage point reduction is expected. This latter sector, which includes higher-skilled professionals, is less elastic to the economic cycle.

- **Annual decline of 3.4% in government-salaried workers.** The national "chainsaw" plan of the new administration is being carried out. Cuts are expected at the provincial level where the public sector accounts for a large part of employment and resources are more constrained. From Econviews, we project a decrease of 10,000 jobs per month.

- **Continuous growth in low-quality employment.** The proposed modifications to the self-employed workers scale in the new Basic Law will expand the number of people registered under this modality and reduce the proportion of self-employed individuals. With this new law, the highest category of self-employed workers can bill up to AR$ 44 M annually, whereas the current amount is AR$ 12 M. Additionally, it's a common pattern in the labor market that during recessions, low-quality positions increase, allowing for more flexible hiring arrangements. At Econviews, we project an annual increase of 4.8% in self-employed workers. For self-employed individuals, we assume a softened reduction of 2 thousand workers per month, resulting in an annual variation of -8%. Regarding informal employment, which behaves pro-cyclically, we expect a decrease of 4.8%.

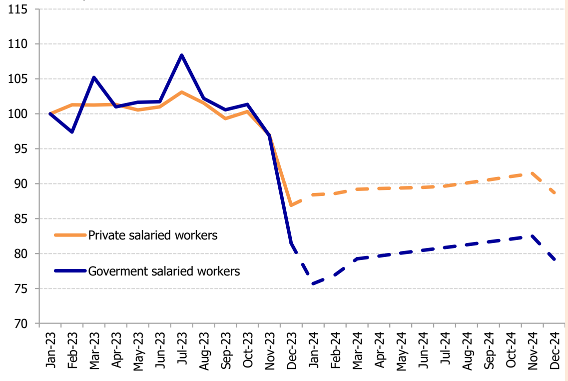
- **Slow recovery of real wages.** The Wage Index published by INDEC indicates that wages grew below the inflation rate from November to January. In February salaries in the private sector went 0.7% above the inflation rate (+13.2) and in the public sector went 1.6% above. Although the recovery in salaries is expected to be maintained throughout the year, it will be a smooth recovery. This recovery will be stopped in December by a double-digit inflation rate. As a result, the year-on-year average

Graph 7. Employment's Evolution by Industry
Janaury-2023= base 100, s.a.



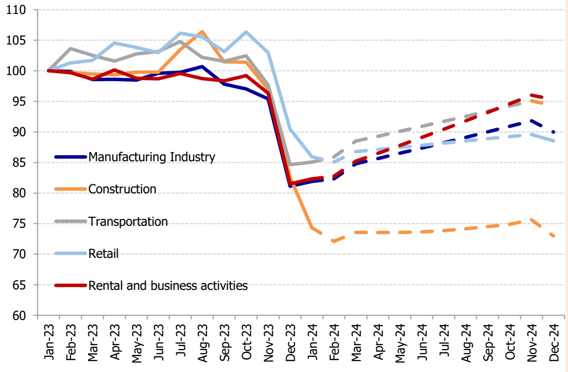
Source: Econviews based on Secretary of Labor and own estimates

Graph 8. Real Wages by Category
At Dec-2024 prices, Jan-2023= base 100, s.a.



Source: Econviews based on Secretary of Labor and own estimates

Graph 9. Real Wages by Industry
At Dec-2024 prices, Jan-2023=base 100, s.a.



Source: Econviews based on Secretary of Labor and own estimates will be -10% for the private sector and -20% for the public sector. Within the registered private sector, the least affected sectors will be business and real estate activities (-8%), and transportation (-9%). For the manufacturing industry (-10%), we expect a similar behavior as the average private sector. Retail (-14%) and construction (-25%) will be the hardest hit.

Conclusion

We expect the labor market to perform poorly in 2024. Private employment will hire fewer personnel compared to the previous administration's performance. On the other hand, the growth of low-quality positions will continue. At Econviews, we project an increase in unemployment rates. We believe that the unemployment rate of +5.75% in the last quarter of 2023 serves as a baseline. Rates should continue between 7% and 8.5% for the rest of the year.

Base Scenario

	2022	2023 E	2024 F	2025 F
Inflation (eop)	94.8%	211.4%	185.0%	35.0%
Exchange rate ARS/USD (eop)	177.1	808.5	1,770.4	2,157.1
Exchange rate ARS/USD (eop, YoY)	72.4%	356.4%	119.0%	21.8%
Real exchange rate ARS/USD (eop, Dec-01=100)	129.8	196.4	157.7	145.9
Paralell exchange rate ARS/USD (eop)	340.8	972.8	1,770.4	2,157.1
Spread with official exchange rate (eop)	92.4%	20.3%	0.0%	0.0%
Gross reserves (USD billion, eop)	44.9	23.1	37.1	45.0
Net international reserves (USD billion, eop)	7.7	-8.6	5.9	14.0
Policy rate (eop)	75.0%	100.0%	80.0%	35.0%
GDP (YoY)	5.0%	-1.6%	-3.3%	5.5%
Formal wages in real terms (aop, YoY)	0.3%	-1.2%	-10.0%	2.5%
Primary result (% GDP)*	-2.7%	-2.7%	0.5%	1.0%
Fiscal result (% GDP)*	-4.1%	-6.0%	-1.0%	-1.0%
EMBI Argentina (spread in bps, eop)	2,196	1,907	800	600
Current account (% GDP)	3.0%	-3.7%	1.2%	1.7%

Source: EconViews

*Excludes rents from primary debt issuance in 2022

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