THE WEEK AT A GLANCE

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To V or Not to V. What Will the **Recovery of Activity** Be Like?

Inflation Slows in January, **the Battle Is Far From Over**

Bopreal: Are They a Solution or a New Problem?

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Editorial: To V or Not to v. What Will the Recovery of Activity Be Like?

Argentina is going through the worst moment of the recession. This was to be expected given the necessary rearrangement of relative prices that, although underway, has not yet ended. The president warned about it when he took office, talking about "stagflation." The vast majority of consultants also estimated a drop in activity in the first months of the year. It's one thing to say it and another to live it. The frustration of many families with loss of purchasing power, of merchants and industrialists who do not sell is more than understandable. It is at the same time a political threat to the government since public opinion less than 3 months ago told Milei to move forward, but perhaps not everyone was aware of the inevitability of a severe adjustment.

Looking forward and in the absence of very adverse political or climate scenarios, we should be hitting the bottom of activity during the second quarter. Hardly before April, but it shouldn't arrive later than June. The logic is that if inflation continues to fall, and given the salary guidelines that are beginning to be discussed, it is possible that a part of the workers will begin to recover at least part of what they lost in December and January. At the same time, the drop in inflation means the fall of a very regressive tax charged to people.

Now the discussion is what form the reactivation will take when it occurs. Will it be in a "V" format or will it draw a curve with a gentler slope? Obviously, no one can be sure. The most relevant question perhaps is what it depends on. Macroeconomics is the most relevant in the short term. In the macro there are three key variables. The first is the exchange rate unification that eliminates a great distortion and resolves one of the conditions that investors need to bring money to Argentina (it is a necessary condition, but not sufficient). The recent drop in the FX spread constitutes an interesting option, although not without costs since it would imply a jump in the official dollar of around 30%. And in any case, unification would surely initially entail some restrictions on fund movements.

The second macro variable is what the new regime will be like that will lead us to lower inflation. Will it be with dollarization, with currency exchange, with price agreement? There are many possible combinations and they all have weaknesses and strengths. The third factor is that the fiscal accounts are organized. The government has been vehement in that regard. But the risk of execution is always a variable to take into account and also when the fiscal adjustment affects pro-Milei political sectors. If these three things go well, the confidence of investors and consumers will play a big role, the country risk will decrease and everything will flow better. It is important to note that since this was not a credit crisis, the exit may be faster. Secondly, if the downward slope is abrupt in these months, possibly the recovery slope will also be abrupt.

Microeconomically, structural and sectoral reforms are very important, but their impact is deferred, that is, they will have little impact in 2024. Some will require laws, others are within reach of a decree and resolution. Labor issues, taxes, pensions, agriculture, aviation, health, quality of public goods and more. It would not be logical to expect all this to turn out and for everything to turn out well. But a good proportion will generate impacts on productivity that, although incipient this year, can also help multiply confidence and a "V"-shaped recovery.

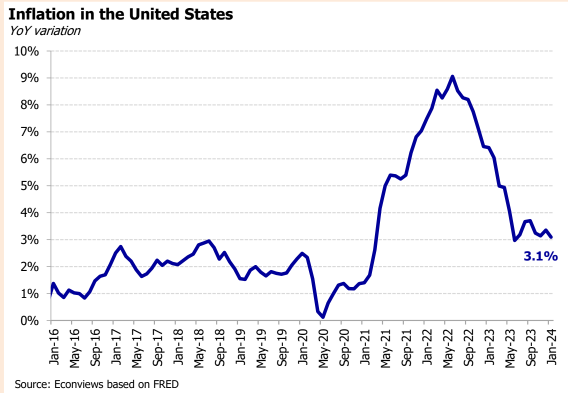
Is all this going to happen? Logically we are not sure. What we can say is that macro problems and micro delays will probably make the recovery more tenuous. Our base case of a 2.6% decline is armed with a strong recovery to prepare for a robust 2025. If things don't work out, we will live with a drop of more than 3% this year and we will start 2025 very low. Political and economic implementation, communication, climate and luck will be the seasonings to see what dish we eat.

LAST WEEK IN REVIEW

US year-on-year inflation fell to 3.1% in January. It's still above the Federal Reserve's 2% target, but it's getting closer.

The monthly increase was 0.3%, higher than the 0.2% in December. It is a sign that inflation has not yet subsided and that is why it is believed that the Fed will wait a little longer to start cutting rates.

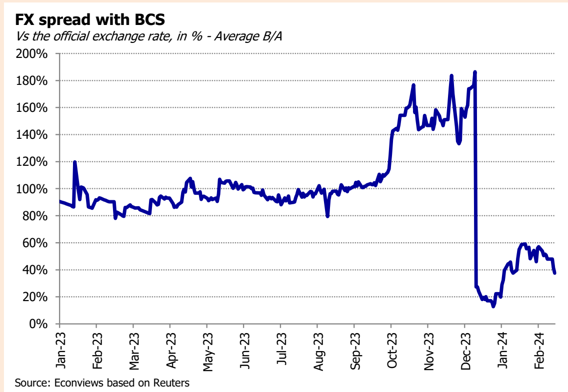
For now, reference rates remain at their two-year high, at 5.25-5.50%. **The market forecast is that the easing of monetary policy will begin in June.**



The FX spread between the official dollar and Blue Chip Swap remained at 38.3% (vs. 51% last Thursday). The BCS fell 8.3% in the last week, going from ARS 1,259 to ARS 1,154.

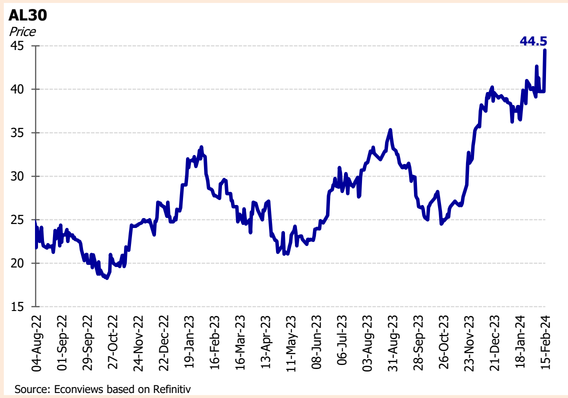
The parallel dollar fell to ARS 1,055, a drop of 6.2%. The spread remained at 26.4%.

The MEP dollar also fell. It closed at ARS 1,095 this Thursday, a decrease of 8.3% compared to last Thursday. The spread remained at 31.2%



The AL30 closed this Thursday at US$44.5, marking a historic high since September 2020. It rose 7.7% compared to last Thursday.

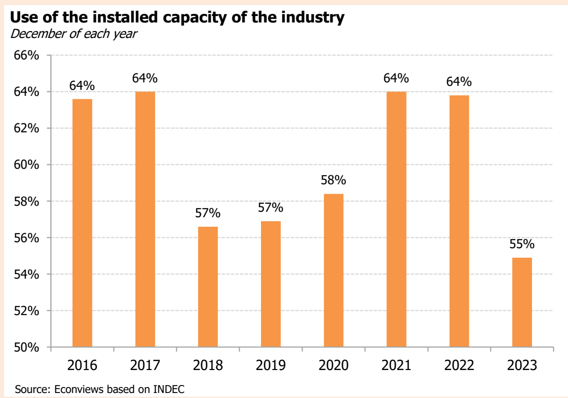
Its New York law twin (GD30) closed at US$ 43.3, 1.9% more than last week.



The industry's installed capacity utilization hit a record low in December. The utilization was 55%, 9 points lower than that of the same month in 2022 and lower than any other December since the indicator was created.

Metal industries, Mineral products, Chemicals, Food, Tobacco products and Printing are the most affected sectors.

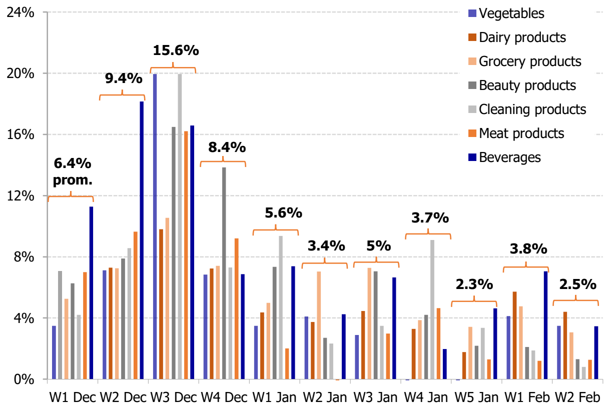
"The difficulty in accessing imported inputs and critical raw materials ended up having an impact on the productive activity of the sector" communicated the Argentine Chamber of Steel regarding the metal industries.



WEEKLY INFLATION

Inflation rate - high frequency data

Weekly price variation in major supermarkets in Great Buenos Aires



Note: The variations are based on the average price per week, from Friday to Thursday.
Source: Econviews based on own estimates

NEXT WEEK'S HIGHLIGHTS

- On **Monday 19**, the **wholesale price indices** for the month of January will also be known.
- On **Tuesday 20**, the **Argentine commercial exchange** corresponding to January will be announced through the INDEC.
- On **Wednesday 21**, INDEC will publish a report with the **evolution of income distribution and main labor market rates** (EPH) for the third quarter of 2023.
- On **Wednesday 21**, the BCRA will publish the **report on banks** for December.
- On **Thursday 22**, the INDEC **monthly economic activity estimator** (EMAE) corresponding to December 2023 will be published.
- On **Thursday 22**, the results of the December **hotel occupancy survey** will also be known.
- On **Friday 23**, the **EPH microdata bases** corresponding to the third quarter of 2023 will be published.
- On **Friday 23**, the BCRA will publish the **report on the evolution of the foreign exchange market and exchange balance** for January.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	834.6	0.5%	2.1%	333.8%	↑
MEP	1095.2	-8.3%	-2.7%	208.9%	↓
Blue Chip Swap	1154.3	-8.3%	-0.4%	214.6%	↓
Parallel	1055.0	-6.2%	-5.0%	182.1%	↓
Official exchange rate BRL/USD	5.0	-0.4%	2.3%	-4.7%	↓
CB reserves (USD million)	26,640	+194	+2,639	-12,921	↑
Policy rate (Leliq)	100.0%	0 p.p.	0 p.p.	+25.00 p.p	=
Badlar rate (private banks)	107.9%	-1.56 p.p.	-1.75 p.p.	+38.19 p.p	↓
Private Deposits (trillion ARS)	39.5	-3.2%	1.7%	134.5%	↓
Private Loans (trillion ARS)	17.1	0.8%	11.2%	147.7%	↑
Merval (in ARS)	1,094	-2.0%	5.3%	329.0%	↓
Merval (in USD)	948	6.9%	5.7%	36.3%	↑
Country Risk (spread in %)	1,895	-3.5%	-0.6%	-5.5%	↓
Soybean (USD/tn)	427.1	-2.6%	-3.6%	-23.8%	↓
Corn (USD/tn)	164.5	-3.6%	-6.5%	-38.2%	↓
Wheat (USD/tn)	208.3	-3.7%	-4.9%	-26.3%	↓
Oil - Brent (USD/barrel)	87.0	1.6%	5.6%	4.3%	↑
Oil - WTI (USD/barrel)	78.5	2.3%	7.6%	-0.1%	↑
LNG (USD/MMBTU)	9.5	-1.0%	-5.9%	-44.1%	↓
Gold (USD/oz.)	2,004.4	-1.4%	-2.4%	9.2%	↓

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q
Industrial production	*Dec-23*	-5.5%	-3.5%	-6.5%
Automobile production	*Jan-24*	3.0%	-12.6%	-6.2%
Steel production	*Dec-23*	-13.7%	-3.5%	-18.2%
Poultry production	*Dec-23*	-3.9%	-0.3%	-3.7%
Dairy production	*Dec-23*	-2.7%	-4.3%	-3.8%
Beef production	*Dec-23*	-11.0%	-5.6%	-9.4%
Real Estate transactions (CABA)	*Dec-23*	-5.2%	-0.2%	-9.6%
Flour Production	*Dec-23*	-10.9%	-0.4%	-6.8%
Oil production	*Dec-23*	2.3%	4.9%	4.0%
Gas production	*Dec-23*	-9.8%	-8.6%	-10.6%
Cement production	*Jan-24*	0.6%	-13.1%	-6.1%
Construction activity	*Dec-23*	-8.8%	-4.9%	-10.1%
Gas sales	*Dec-23*	-6.8%	-2.8%	-6.5%
Motorcycle licenses	*Jan-24*	-11.9%	-4.3%	-15.0%
Use of electricity	*Dec-23*	-1.7%	-0.8%	-3.5%
Subway rides (CABA)	*Dec-23*	-8.0%	-17.5%	-12.2%
Imports CIF	*Dec-23*	-9.5%	-11.2%	-11.9%
Exports FOB	*Dec-23*	3.1%	-5.0%	1.4%
Loans in ARS to private sector	*Jan-24*	-11.5%	-19.7%	-24.9%
VAT-DGI Revenues	*Jan-24*	-5.9%	-10.1%	-10.1%
Formal private jobs (SIPA)	*Oct-23*	0.1%	0.7%	0.3%
Formal private jobs (EIL)	*Nov-23*	0.0%	0.2%	0.0%
Consumer confidence	*Jan-24*	-10.6%	-7.3%	-19.4%
Government confidence	*Jan-24*	-8.7%	95.5%	42.6%

Note: stoplight color depends on last month vs previous quarter variation

Inflation Slows in January, the Battle Is Far From Over

- *The national CPI's variation went from 25.5% monthly in December to a still very high 20.6% in January.*

- *Some regulated prices such as gasoline or public transportation have already adjusted to 2019 levels, while others such as electricity or residential gas are still far behind.*

- *We see a downward path to single-digit monthly inflation in May, although it depends a lot on the official exchange rate's stability.*

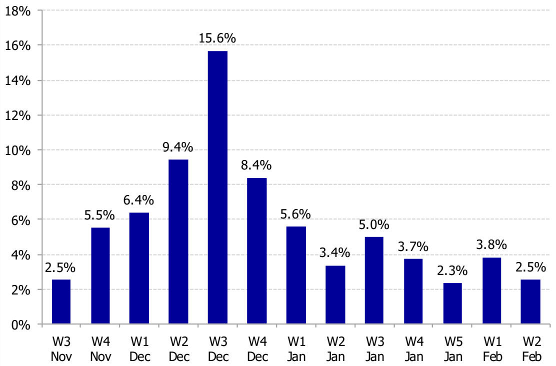
The consumer price index rose 20.6% in January. Another very high print, but less than December's 25.5% and also below most private estimates, including our own (the median in the Central Bank's survey was 21.9%). Core inflation slowed from 28.3 to 20.2%. Our high-frequency nowcast had inflation at 3.8% in the first week of February and 2.5% in the second. If prices keep increasing at this pace over the next two weeks, the full month's inflation will be close to 15%.

The silver lining of January's CPI print is that it quells fears of a spiralization, at least for now. Last month there were sharp increases in regulated prices such as gasoline (+48%), private healthcare (+39%) or telecommunications (+25%) and a statistical carryover of almost 9 points after the December devaluation, but the main anchors were the nearly pegged exchange rate and a deep recession. Ideally, neither of these two anchors should drag on for much longer, with fiscal and monetary policy taking the central role in the war on inflation in the coming months.

Is Argentina expensive in dollars now? The short answer is no. With January's CPI, the real exchange rate is 21% weaker than its historical average. The parallel rate, which is usually used for this type of comparison, is 90% weaker. Converting at the informal exchange rate, in January the INDEC's selected supermarket products (see chart 1) cost a half of their US equivalents. But in October it was a third. In three months, some prices increased 40-100% in dollars. And the estimate for January takes the average prices over that month and an informal exchange rate of 1,140 pesos. If we consider that it has since appreciated to 1,060 pesos and food inflation was around 6.5% in the first half of February, the real appreciation is worse now.

The correction in regulated prices is not done yet. In January they increased 6 points more than the general index. To go back to 2019's relative prices, they should increase another 50 points (not counting second round effects). But the adjustment varies greatly depending on the sector. Gasoline at 700 pesos (as of January) or 61 cents per liter already costs the same as 4 years ago. With the 250% increase in train and bus fares on February 6, Buenos Aires public

Graph 1. High frecuency inflation - Buenos Aires
Weekly inflation for food and drinks, cleaning and self-care products



Note: the variations are weekly averages, Friday through Thursday
Source: Econviews based on own estimates

Chart 1. Prices in dollars in Argentina and the US
At the parallel exchange rate, monthly average

		ARG prices		US prices	Increase in ARG
		Oct-23	Jan-24		
Bread	Kg	1.15	1.57	4.48	**37%**
Wheat flour	Kg	0.29	0.58	1.22	**103%**
Rice	Kg	0.84	1.80	2.21	**113%**
Spaghetti	500g	0.55	0.99	1.45	**79%**
Ground beef	Kg	2.20	3.05	11.22	**38%**
Chicken	Kg	1.17	1.65	4.39	**41%**
Fresh milk	Liter	0.44	0.74	1.05	**68%**
Chicken eggs	Dozen	1.40	1.62	2.52	**16%**
Sugar	Kg	1.08	1.16	2.15	**8%**

Source: Econviews based on INDEC and BLS transportation also returned to late 2019 real prices (this is not enough to cover the cost of the service).

Despite the recent increases, private healthcare is still 38% cheaper than in 2019 and telephone and internet services are 58% below that level, two items that weigh around 3% each in the Buenos Aires index. In addition, double-digit monthly inflation raises the cost of inaction in other areas: the increase required to return to 2019 prices in residential electricity and gas went from 133% in November to 208% today.

This is also a problem for the price of transportation or gasoline. Without a monthly indexation scheme like the one that prevailed between February and August 2023 they will quickly fall behind in real terms. Of course, indexing utilities is contrary to any stabilization plan. In the case of gasoline, the planned hikes in the fuel tax which will increase 211% between February and May (from 61 to 190 pesos per liter) is an additional source of pressure.

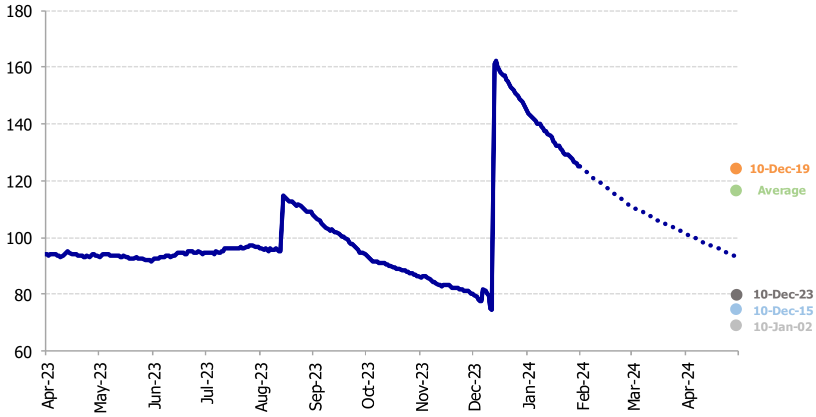
Until now, the government has moved faster in the areas with the highest weight in CPI and lowest fiscal impact (healthcare, gasoline). Yesterday the Secretary of Energy took an important step by announcing increases in Buenos Aires electricity rates of 150% for N1 users (high income) and 65-70% for the rest, with monthly indexation starting in April.

However, regulated prices only make up around a fifth of the CPI (see chart 2). Over the next months, the key factor for inflation will be exchange rate policy. On several occasions we have pointed out that the monthly depreciation of 2% is not sustainable: with our inflation projections it would imply an exchange rate as over-appreciated as in early December towards the end of April (see graph 3).

Both accelerating the crawling peg and a new discrete jump in the exchange rate entail costs, but in our view the first alternative is preferable, at least until the government considers that it has enough reserves to unify the exchange rate. We believe that this could occur in the middle of the year, giving a new push to inflation, although in a positive scenario it could moderate in the second half of the year. At the end of the report we attach our updated forecasts for the official and parallel exchange rates, inflation and interest rates.

Graph 3. Real Effective Exchange Rate

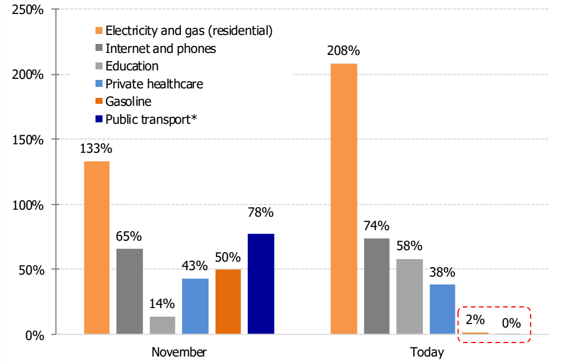
Base 100 = 17/12/2015 - Assuming crawling peg at 2% monthly



Source: Econviews based on BCRA & own estimates

Graph 2. Some regulated prices have adjusted, others haven't

Buenos Aires: necessary increase to return to Dec-19 levels, relative to general CPI



*considering the 250% increase in bus and train fares in February

Source: Econviews based on INDEC

Chart 2. Weight of regulated prices in CPI

	Buenos Aires	National
Housing	**10.5%**	**9.4%**
Water	0.9%	0.8%
Electricity	1.0%	1.2%
Gas	1.5%	1.7%
Healthcare	**8.8%**	**8.0%**
Private healthcare	3.2%	2.2%
Transport	**11.6%**	**11.0%**
Gasoline	3.8%	4.2%
Train fare	0.4%	0.2%
Bus fare	3.3%	2.6%
Communication	**2.8%**	**3.2%**
Phone and internet service	2.7%	2.7%
Education	**3.0%**	**2.3%**

Source: Econviews based on INDEC

Bopreal: Are They a Solution or a New Problem?

- *Yesterday the Central Bank had a good auction of Bopreal. USD 6,441 million have already been issued adding the two series.*
- *The payment of this debt should not be an issue for the BCRA in a context where it accumulates reserves.*
- *Normalizing debt for imports may be the first step to lifting restrictions on the exchange market.*

After two weak initial auctions, the Bopreal gained momentum. At the end of January, the issuance of Series 1 was completed, and the auctions of Series 2 has already begun. This is how the Central Bank has issued USD 6.4 billion (USD 5 billion of the first series and USD 1.4 billion of the second) of this new bond intended for importers with outstanding debts (see chart 1). While the government proposed it as a solution to excess import indebtedness, the opposition sees it as a problem.

One of the criticisms came from former finance minister Martín Guzmán, who pointed to these instruments as part of the plan to dollarize the economy. In addition, he said that they imply a change of liabilities in pesos of the BCRA for liabilities in dollars without reducing the companies' debt.

To begin, it is worthwhile to put the emergence of this bond in context. According to official data, the stock of debt for imports (goods and services) reached USD 53.4 billion in the third quarter of 2023, and we estimate that it added about USD 10 billion more in the last quarter of the year. Taking the average from the fourth quarter of 2017 to the same period of 2021, it can be seen that there was a normal stock of this debt (due to the times set by international trade and the payment system) that was around USD 29 billion (see graph 1). That is to say, between 2022 and 2023 it practically doubled. This is because companies needed to continue importing to maintain the production level, but the BCRA did not authorize payments, so they had no choice but to go into debt.

When the new government took office, it created a registry for importers to enroll their debts. The result of this survey is that there are outstanding debts of USD 42.6 billion. Although there are methodological differences with the BCRA report, this survey indicates that the excess debt (compared to the normal stock) is about USD 13.6 billion. Regardless of whether this is the final number or if it is higher, the truth is that the Central Bank could not face all this demand for foreign currency together. This is where the need to find a solution arises.

Since last Wednesday, some 10,000 MSMEs have been enabled to access the market in a phased manner to settle their debts. This first month, they will

Chart 1. Bopreal Auctions

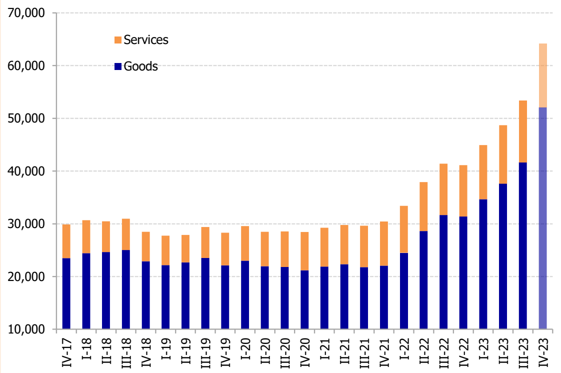
In millon USD

Auction date	Settlement date	Serie	Nominal Value Issued	Accumulated
28-Dec-23	5-Jan-24	1	68	68
4-Jan-24	11-Jan-24	1	57	125
11-Jan-24	18-Jan-24	1	1,179	1,304
18-Jan-24	25-Jan-24	1	340	1,644
25-Jan-24	1-Feb-24	1	2,454	4,098
31-Jan-24	7-Feb-24	1	902	5,000
8-Feb-24	16-Feb-24	2	271	5,271
15-Feb-24	22-Feb-24	2	1,170	6,441

Source: Econviews based on BCRA

Graph 1. Importers debt

In million USD



Source: Econviews based on BCRA and own estimates be able to buy up to USD 50 thousand, rising to USD 100 thousand in the second, and from April onwards, they will be able to complete the remainder if it is less than USD 500 thousand (see chart 2). This already clears up part of the problem.

The government's other proposal was the Bopreal. This bond in dollars maturing in 2025, 2026, and 2027 (depending on the series) allows importers, through pesos, to obtain the dollars necessary to pay off their debts.

To be clear, doing nothing meant either having to maintain the market restrictions indefinitely or, when they will be lifted, having such a large demand that it could have driven the exchange rate to a level much higher than necessary. That is why this bond seems to be an instrument that organizes future demand, avoiding shocks.

This is not the only function that Bopreal fulfills. By subscribing with pesos, it also serves to sterilize. We estimate that in total ARS 5.3 trillion have already been absorbed through this bond, although at the same time, there is a disarmament of Repos to subscribe to it, so the operation does not end up being completely contractive in terms of money issuance. So, indeed, liability in pesos (Repos are dismantled to subscribe to Bopreal) is being exchanged for one in dollars. Is this a problem? Let's see.

Firstly, as the stock of Repos decreases, the amount of pesos that must be issued to pay interest also decreases. This is logically good because otherwise, those pesos would end up being returned to Repos and thus the stock would continue to grow.

The second question is whether the Central Bank can meet this debt in dollars. We believe so. Assuming that the total is tendered for each of the remaining series (USD 2 billion for 2 and USD 3 billion for 3), this year the Central Bank will have to face maturities of US$ 1,170 million. We currently estimate that it has some USD 9.3 billion liquid dollars in its assets, almost the same amount as the reserve requirements (see chart 3). In December, this ratio was much worse. Even if the pace of dollar purchases slows down, we think that the BCRA will accumulate reserves, so it should not be a big problem to pay this debt.

Another point is that series 1 will be divided into four subseries. Of these four, there will be three (representing 70% of the total) that can be used to pay taxes. If we assume that 100% of these three subseries will be used for this purpose, the BCRA, instead of having to pay USD 11,885 million between 2025 and 2027, would pay US 7,860 million (see chart 4). Once again, we believe that in a scenario where the Central Bank continues to accumulate reserves not only this year but also the next, it should have no problems paying this figure. Furthermore, by that time there may be an inflow of foreign currency not only through the commercial account but also through the financial account, which would help the Central Bank add dollars to its reserves.

One last issue remaining to be discussed is whether it solves the problem for companies or not. Here our answer is yes. Those who subscribe to this bond

Chart 2. Potential dollar demand

For debt payments - In million USD

Type of company	From		
	10-Feb	10-Mar	10-Apr
Micro	255	510	1,785
Small	195	390	1,365
Medium	50	100	350
Total	**500**	**1,000**	**3,500**

Note: It is assumed that all reach the limit of USD 500 thousand

Source: Econviews based on BCRA & own estimates

Chart 3. BCRA estimated balance sheet

In million USD - up to 7-Feb-24

Assets		Liabilities	
Gold	4,038	Reserves requirements	9,993
Dollars	9,279	Swap China (Used)	4,900
		BIS	2,169
		Sedesa	1,869
Total (1)	**13,317**	**Total (2)**	**18,931**
		Net Reserves	
		(3) = (1) - (2)	**-5,614**

Source: Econviews based on BCRA & own estimates

Chart 4. BOPREAL estimated cash flow

In millon USD

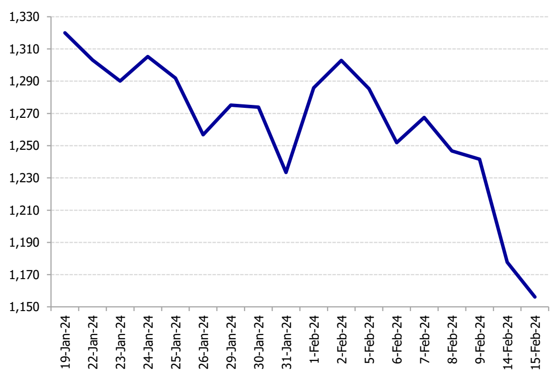
	Total	Using total allowed for tax payment
2024	1,170	1,170
2025	2,990	2,815
2026	3,645	3,470
2027	5,250	1,575
Total	**13,055**	**9,030**

Note: We assume that it is issued the maximum allowed for Series 2 y 3

Source: Econviews based on BCRA & own estimates

Graph 2. Implicit exchange rate in Bopreal

Pesos per dollar



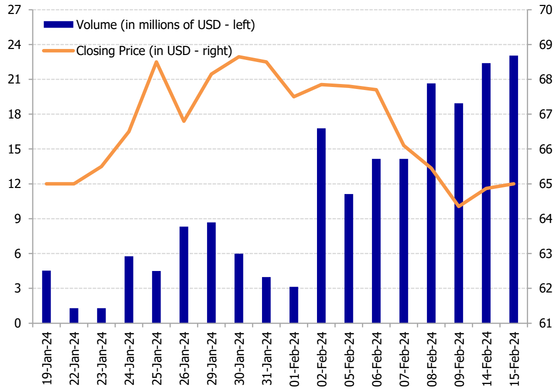
Source: Econviews based on BYMA

can wait until maturity, get the dollars, and cancel the debt. Another option is to sell them in advance on the secondary market and get the dollars that way, although this alternative has its drawbacks. If companies have this debt valued at the official exchange rate, acquiring the dollars in this way implies recording an accounting loss. The size of this liability will depend on the price of the bonds. The closer the exchange rate that arises from this operation is to the official exchange rate, the smaller the loss will be. Yesterday the BP27C closed at USD 65, while in pesos it remained at ARS 75,150, which gives an implicit exchange rate of ARS 1,156 (see graph 2).

This leads us to wonder if this price is reasonable or sustainable. There are several points to think that it has to be worth more than a Bonar. The first is that they have the benefit of being able to be used to pay taxes, which can generate some extra demand. The second is that they are issued by a better debtor (BCRA vs Treasury). Thirdly, they have a shorter "duration". As we said, all this makes us think that the price must have a positive premium, the question is whether it necessarily has to be that high. Yesterday the IRR of AL29 was 34.5%, while for Bopreal it was 20.65%.

In summary, this bond should allow market restrictions to be lifted in the not-too-distant future. For the BCRA it implies a temporary increase in debt in dollars, although in no way do we see it as a nationalization of private debt, far from it. It may have its pros and cons, but it was necessary to normalize the exchange market after two years of Soviet controls.

Graph 3. Price and market volume of Bopreal



Source: Econviews based on BYMA