THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

March 11th 2024

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Editorial: The "May Pact", an Opportunity Worth Seizing

The opening of ordinary sessions of Congress left a lot of content to analyze. There were insults towards politicians. **The middle class in general supported the speech and there was a conciliatory ending. Relief for the provinces and the May Pact.** Beyond the president's particular style, in the end we all know that seeking consensus is a healthy starting point to reduce the volatility of the Argentine economy, perhaps the most obvious symptom of structural imbalances.

The 10 points are all good. They are too general, it is true. Something like private property is already in the constitution, but we insist that it makes sense. Although private property is respected in Argentina in a legal sense, it is often not done in a practical sense. The other principles such as having an open economy, balanced fiscal accounts, a modern labor law, are things with which one can hardly disagree.

The challenge is not to waste the opportunity and not to sign a document with nice principles, but few substantive changes. In that sense, it seems to us that it is not helpful to discuss public spending of 25% of GDP but rather to think about how to build fiscal institutions that generate inter-temporal fiscal balance. How to develop natural resources more quickly (which in practice is a message to the provinces to stop bureaucratizing and overreacting regulations), but at the same time take care of the environment and the social reality of the places where resources are exploited. The symbolic is strong, but if there are no concrete actions in the following months it will be another lost opportunity.

To understand if this is just a slogan or a project for the next few years, we will have a sample in the coming weeks. It is obvious that the executive branch and governors will not reach an agreement on all issues. But if there is progress, there will be good feelings. Perhaps the guidelines of the labor reform are not agreed on May 25, but if the macro is ok, it will be a great step forward. It's not that there aren't technical challenges in the economy. But today we economists are watching very carefully what is happening in the political arena to understand Milei's chances of success. Nothing depends on just one thing. But today, that the central bank has recovered reserves, the peso is strengthening and fiscal accounts are improving, politics and public opinion take a predominant role.

Perhaps the canary in the coal mine is the new personal income tax proposal. We believe it is an opportunity to reformulate the tax so that it not only raises more, but is more equitable. That more people pay, but that not everyone pays 35% of the last peso earned as it was previously, since the system was full of inconsistent patches. We say that it is the canary in the coal mine because having a good income tax law will be a sign of political maturity. The parameters can be discussed since there is no single way to make a good law. What should not happen is that the discussion is blocked again. The good thing is, the provinces need the money and this law could easily give them 0.5/0.6% of GDP. The bad thing: we already heard that not everyone has the will for this law.

The other unknown is how much Milei is willing to negotiate. To reach a successful conclusion, both parties must be moderately happy with the result. The insults in Congress may have been effective for public opinion. But after the show, work must be done. In that sense: Friday's call with the governors was good news. And the fact that some of the most wayward ones went too.

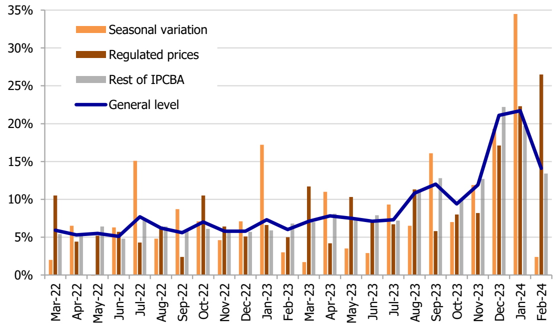
LAST WEEK IN REVIEW

February inflation was 14.1% in the City of Buenos Aires. This figure represents a slowdown in the price increase, after having reached 21.1 and 21.7% in December and January.

Regulated prices increased 26.5%. In February, adjustments were made to the prepaid medicine fees, the urban bus ticket, residential electricity rates, and fuel.

Seasonal prices rose on average just 2.4%. Strong increases in clothing and vegetables were offset by falls in tourist services (air tickets, hotel accommodations and vacation packages).

Inflation in the City of Buenos Aires
Monthly variations



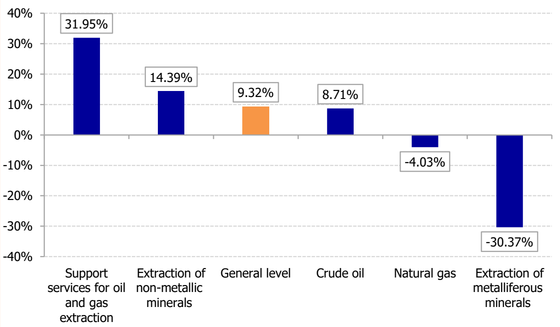
Source: Econviews based on DGESYC

In January, **mining production increased by 9.3% compared to January 2023**. In monthly terms there was a decrease of 0.9%.

The general index is **driven by support services for oil and gas extraction (+31.9% yoy)** and the increase in **crude oil production (+8.7% yoy).**

The extraction of metal minerals (gold, silver and others) suffered a **marked drop of 30.4% year-on-year**.

Extractive activity by category
Year-on-year cumulative variations - 2023



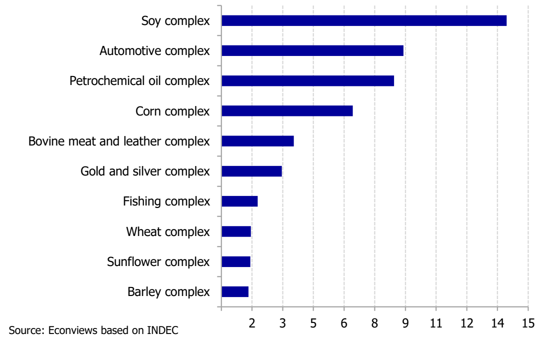
Source: Econviews based on INDEC

The soybean complex was the largest exporter in 2023, despite the drought that caused a 43.9% drop in its exports compared to 2022.

The automotive complex climbed within the ranking, going from fourth to second place. The complex's exports, which include vehicles for transporting goods, people and auto parts, grew 2.6% annually. It represented 13.3% of total exports.

Exports from the oil complex fell 9.2% compared to 2022. It occupies third place in the ranking, with a 12.6% share of total exports.

Top 10 export complexes in 2023
Argentine exports by complex in billions of dollars



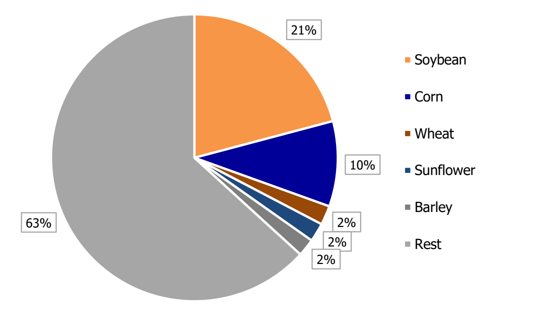
Source: Econviews based on INDEC

The complexes that are part of the cereal and oilseed sector (soybeans, corn, wheat, sunflower and barley) **produced 37% of total Argentine exports in 2023.**

Of the soybean complex's exports, 90% was soybean flour and oil. The main commercial partner of this complex was **India**, with exports of US$ 1,487 million. It is followed by **China** with US$ 1,253 million.

As trading partners, **Vietnam is also positioned among the top positions** in the case of soybeans and corn, and **Brazil** in the case of wheat.

Exports of the oilseed and cereal sectors
Participation of each complex in total exports

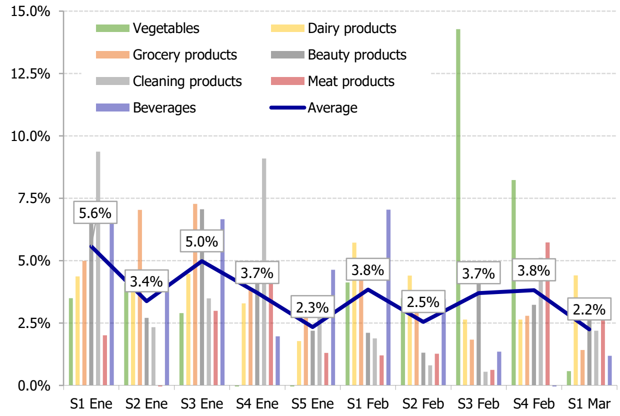


Source: Econviews based on INDEC

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

√ **Today**, the **poverty lines and consumption baskets for the City of Buenos Aires** corresponding to February will be published.

√ On **Tuesday 12,** the INDEC will publish the **inflation** for February. **At Econviews we expect it to be around 15%.**

√ On **Tuesday 12**, the **basic and total baskets** for February from INDEC will also be announced.

√ On **Wednesday 13**, INDEC will publish the **use of the industry's installed capacity** for the month of January.

√ On **Thursday 14**, the BCRA will publish the **statistical bulletin** for March.

√ On **Thursday 14**, the monthly valuation of the **INDEC child and adolescent raising basket** corresponding to February will be known.

√ On **Friday 15**, the **CABA construction price indices** for the month of February will be published.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	846.8	0.5%	1.9%	323.3%	↑
MEP	1005.6	-4.5%	-15.8%	171.1%	↓
Blue Chip Swap	1045.4	-3.3%	-17.0%	177.4%	↓
Parallel	975.0	-5.3%	-13.3%	161.4%	↓
Official exchange rate BRL/USD	5.0	0.6%	-0.2%	-3.1%	↑
CB reserves (USD million)	28,216	+882	+1,839	-10,056	↑
Policy rate (Leliq)	100.0%	0 p.p.	0 p.p.	+25.00 p.p	=
Badlar rate (private banks)	108.1%	-0.75 p.p.	-1.38 p.p.	+37.75 p.p	↓
Private Deposits (trillion ARS)	43.2	8.8%	8.9%	139.8%	↑
Private Loans (trillion ARS)	18.4	1.4%	7.6%	144.8%	↑
Merval (in ARS)	1,002	-5.0%	-10.2%	299.5%	↓
Merval (in USD)	959	-1.8%	8.2%	44.0%	↓
Country Risk (spread in %)	1,690	4.0%	-13.9%	-19.5%	↑
Soybean (USD/tn)	430.1	2.4%	-1.9%	-23.3%	↑
Corn (USD/tn)	167.8	3.4%	-1.6%	-32.8%	↑
Wheat (USD/tn)	193.5	-5.9%	-10.5%	-21.9%	↓
Oil - Brent (USD/barrel)	85.9	-0.7%	0.4%	4.3%	↓
Oil - WTI (USD/barrel)	79.0	-2.4%	3.0%	3.1%	↓
LNG (USD/MMBTU)	8.6	3.6%	-9.5%	-36.3%	↑
Gold (USD/oz.)	2,177.2	4.5%	7.1%	20.0%	↑

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q
Industrial production	*Jan-24*	-1.3%	-6.7%	-7.0%
Automobile production	*Feb-24*	-4.7%	-12.6%	-7.2%
Steel production	*Jan-24*	31.2%	-7.7%	14.0%
Poultry production	*Jan-24*	4.2%	-2.4%	0.4%
Dairy production	*Jan-24*	-4.3%	-5.9%	-6.4%
Beef production	*Jan-24*	12.7%	-2.6%	2.8%
Real Estate transactions (CABA)	*Jan-24*	-3.8%	-12.7%	-11.8%
Flour Production	*Jan-24*	1.5%	-0.8%	-3.4%
Oil production	*Jan-24*	2.3%	4.9%	4.0%
Gas production	*Jan-24*	-9.8%	-8.6%	-10.6%
Cement production	*Feb-24*	-5.8%	-12.3%	-7.7%
Construction activity	*Jan-24*	-10.2%	-11.6%	-16.6%
Gas sales	*Jan-24*	-0.1%	-4.8%	-5.0%
Motorcycle licenses	*Feb-24*	2.9%	-8.3%	-7.5%
Use of electricity	*Jan-24*	0.6%	-3.3%	-1.4%
Subway rides (CABA)	*Dec-23*	-8.0%	-17.5%	-12.2%
Imports CIF	*Jan-24*	-1.7%	-10.9%	-7.2%
Exports FOB	*Jan-24*	9.4%	2.8%	12.5%
Loans in ARS to private sector	*Jan-24*	-11.5%	-19.7%	-24.9%
VAT-DGI Revenues	*Feb-24*	5.2%	-11.2%	-2.2%
Formal private jobs (SIPA)	*Nov-23*	-0.7%	0.3%	-0.5%
Formal private jobs (EIL)	*Dec-23*	-0.4%	-0.1%	-0.5%
Consumer confidence	*Feb-24*	1.2%	-18.1%	-12.0%
Government confidence	*Feb-24*	-1.5%	119.7%	12.1%

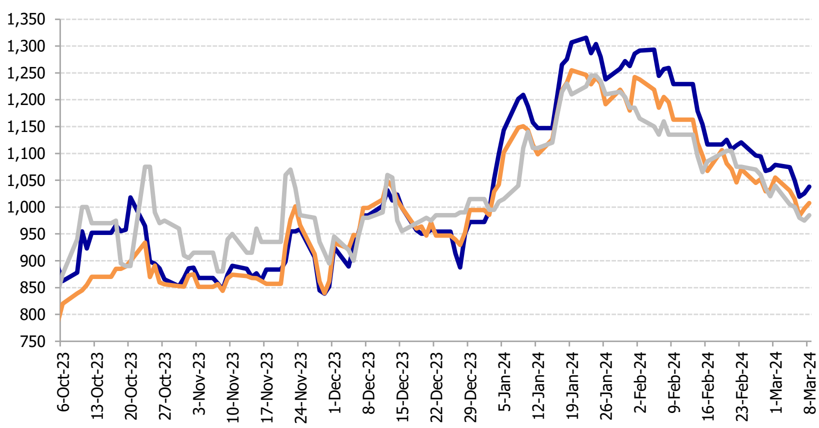
Note: stoplight color depends on last month vs previous quarter variation

What Is Behind the Peso's Appreciation?

- *Since January, parallel exchange rates have fallen by 300 pesos in nominal terms. Measured in constant pesos, the fall exceeds 500 pesos.*
- *We have several hypotheses to explain the decline: contraction in monetary aggregates, correction of the previous overshooting, higher supply from exporters, and dissaving by companies and families.*
- *Exchange rate policy continues to be one of the challenges that face the economic team in the short term.*

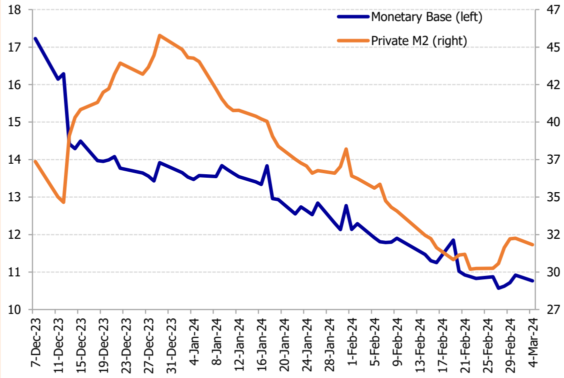
The appreciation of the peso in parallel exchange rates has been surprising the market and raising questions regarding its causes and what the future dynamics may be like. We think that there is no single answer, but rather that there are several hypotheses to explain this fact.

Graph 1. Exchange Rates
Pesos per US Dollar - Average B/A



Source: Econviews based on Reuters

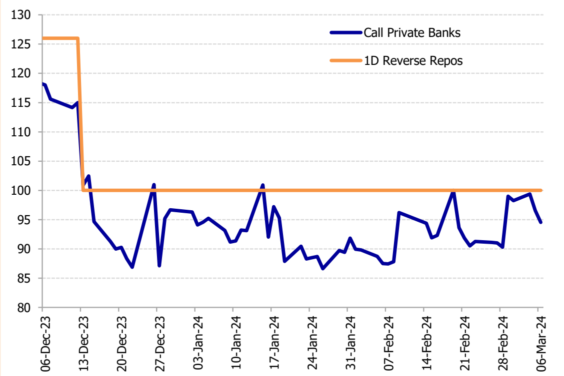
Graph 2. Monetary Base & Private M2
In billion ARS of Mar-24



Source: Econviews based on BCRA

Firstly, we have a very restrictive monetary policy because the monetary base and monetary aggregates in pesos remain stable. Since Milei took office, the monetary base has grown only 6.6% in nominal terms, which implies a contraction of 37.5% in real terms. Private M2, which is a broader measure of the amount of money in the economy, rose 44.6% nominally (mostly due to high seasonality in December) but fell 15% adjusted for inflation (see graph 2). **Therefore, there is evidence of a decrease in the monetary supply, but there are also contradictory signals because, on the other hand, the interest rate remains at the level of the policy rate.** If there were a strong monetary squeeze, the interest rate would rise, something that is not seen. The interbank rate was around 90-95% since mid-December without showing sharp increases (see graph 3).

Graph 3. Interest rates
In p.p.



Source: Econviews based on BCRA

The second idea is that it is a correction of the overshooting that occurred at the beginning of the program. The exchange rate usually moves in overshooting and undershooting. In the past, we have seen episodes of overshooting. Generally, there was an announcement or a measure that generated an increase in the exchange rate that was boosted by fears that it was out of control. The more it went up, the more people bought until the market realized that it had risen a lot and stabilized. **Now we may be facing an inverse phenomenon, in which the fall in parallel exchange rates generates expectations that it will fall further, and people sell, which deepens the fall.**

In October, the Blue-Chip Swap had reached a value of about 2,100 pesos measured in constant prices. As a reference, the highest value of the exchange rate after the exit from convertibility (June 2002) would be 1,750 pesos (see graph 4). In other words, last year's prices reflected political and economic uncertainty, something that is much calmer today. That is why it is also logical to think that the parallel dollar would go down.

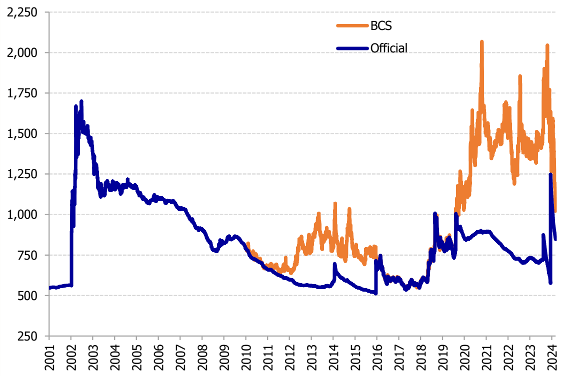
The third point is that the appreciation may have been triggered by the restriction that was imposed on dollar purchases in the BCS from foreign companies. The beginning of the appreciation coincides with the implementation of that restriction. In other words, this measure implies lower demand which in turn is combined with a greater supply because of the 80/20 export settlement scheme. We estimate that in recent weeks there has been an increase in this settlement channel (see chart 5).

The last factor, and perhaps the most important, is that the recession and the decrease in real income lead individuals and some companies to sell dollars to meet their expenditures in pesos. According to the joint agreements of the main unions, we estimate that the loss of purchasing power between November and March will range from 3 to 34% depending on the sector (see chart 1). Paying healthcare bills, local taxes, education, or gasoline in a context where income in pesos does not follow inflation forced people to dissave. And since most Argentines save in dollars, this translated into a greater supply. Until income catches up with expenses, these selling pressures will surely continue.

In short, we do not marry with a single reason, but we believe that there is a combination of several. Looking ahead, the FX spread at 20% appears to be close to the bottom, although it is not obvious either. If we consider that the exchange rate for importers is equivalent to the official exchange rate plus the 17.5% PAIS tax, we might think so. However, if importers purchase at the BCS they lose access to the official market for 90 days, so they should have a large incentive to do so. A difference of a few points would not be a good deal. **We will know the reality when the exchange market is unified, restrictions are eliminated and at that time we will have a better idea of what exchange rate is needed for the external sector to function normally.**

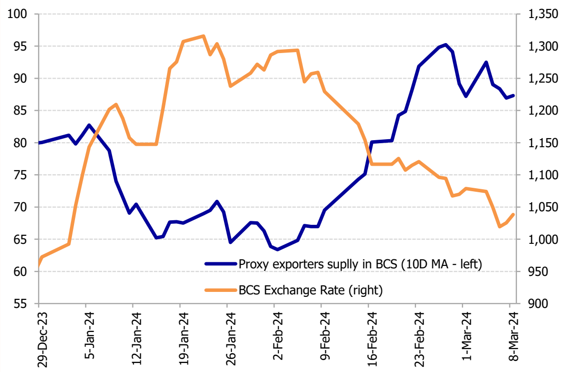
Our vision is that Argentina needs a competitive (high) exchange rate in an environment in which the Central Bank has to accumulate reserves. The USD 9 billion that has been purchased so far was in the context of market restrictions that remain strict, and in which debts continue to accumulate for unpaid imports. In the coming months, import payments will begin to normalize, and if the real exchange rate continues to appreciate there will be incentives for imports to grow above what is necessary. On the contrary, there will be no motivation to settle exports. The combination of these two facts

Graph 4. Exchange rate at constant prices
At Mar-7 prices - Adjusted by ITCRB



Source: Econviews based on BCRA

Graph 5. Export settlements through BCS
In million USD



Source: Econviews based on MAE & own estimates

Chart 1. Loss of purchasing power
Between November and March

	Variation
Retail	-3%
Bank clerks	-4%
Healthcare	-5%
Doormen	-6%
Construction workers	-14%
Truckers	-14%
Sports club employees	-15%
Steelworkers	-23%
Restaurants	-34%

Source: Econviews based on several sources implies that it will be more complicated for the BCRA to rebuild the stock of international reserves. By bringing the devaluation rate to a rate closer to that at which prices rise, this could be solved without major inconveniences and a large inflationary cost.

The Recession Might Be Short Lived, but the Recovery May Not Be Too Fast

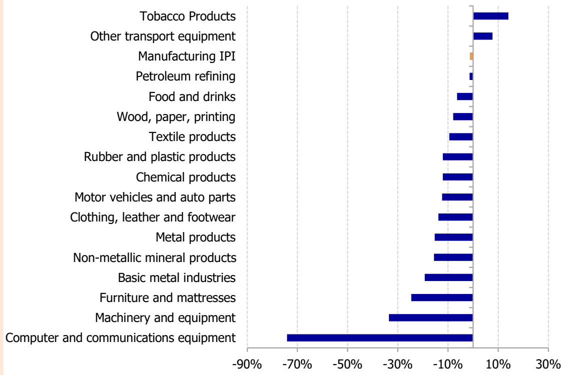
- *The economy has been experiencing a recession since October 2023, although if we look at the trend component of the series, the downturn began in August 2022.*
- *Sectoral indicators for February are not very encouraging: a decline in automobile production, cement dispatch, retail sales, and revenue.*
- *In January, industrial activity and construction contracted with monthly declines of 1.3% and 10.2%, respectively.*

Economy lacking strength. The decline in economic activity that began in October seems to persist at least in the first quarter of the year. The signals are clear: manufactured industrial production and construction performed poorly in January. Although we do not yet have official data for February, some sectoral indicators show that things have not improved. Retail sales, automobile production, cement dispatches, motorcycle registrations, and tax revenues suffered sharp declines (see traffic light on page 4 for more detail).

In January, industrial production experienced a contraction of 12.3% compared to the same period the previous year, marking the eighth consecutive decline. Although 14 of the 16 industrial divisions recorded a decrease in their production compared to the previous year (see Graph 1), certain products were the main drivers of this downward trend. Among them, notable products include tires and plastics manufacturing, cement, agricultural machinery, dairy products, and beverages such as soft drinks and water, among others. This phenomenon is consistent with the impact of drought on the agricultural sector and the reduction in public works, which has significantly affected the construction sector.

In monthly terms, the manufactured industry's decline was 1.3% compared to December, marking four consecutive months of decline. However, when

Graph 1. Production increase in 2024
Annual variation - Jan-24



Source: Econviews based on INDEC-Manufacturing IPI

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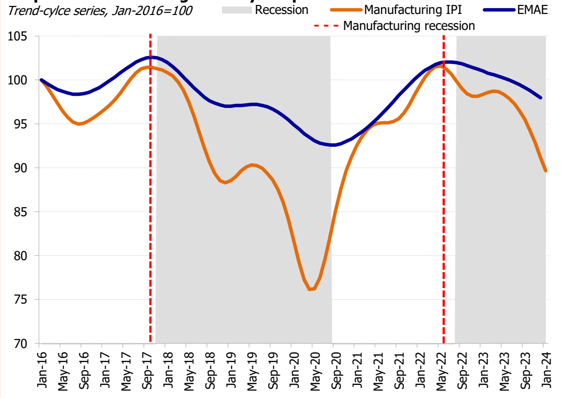
analyzing the trend of the series, it becomes evident that **the recession in the manufacturing industry began in June 2022.** This suggests a certain anticipation on the part of this sector compared to the overall economy, as according to the Monthly Economic Activity Estimator (EMAE), the widespread contraction began in August 2022 (see Graph 2).

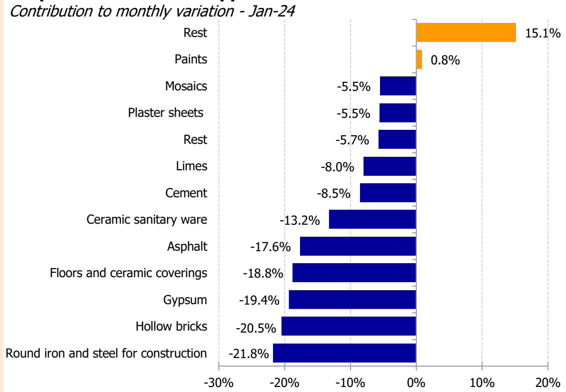
Graph 2. Manufacturing industry antipated the recession
Trend-cylce series, Jan-2016=100



Source: Econviews based on INDEC

Construction activity recorded a monthly decline of 10.2% in January, the strongest setback in the past 10 years excluding 2020. This translated into poor demand for inputs. The most significant declines were observed in round iron and construction steels (-21.8%), hollow bricks (-20.5%), and plaster (-19.4%). The only category that saw increased demand was the "other" category (15.1%), which includes faucets, seamless steel pipes, and flat glass (see Graph 3).

Graph 3. Construction supplies
Contribution to monthly variation - Jan-24



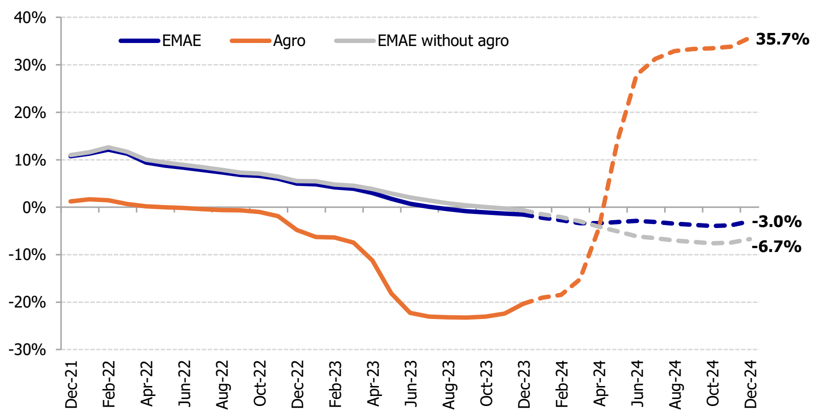
Fuente: Econviews en base a ISAC - INDEC

Construction has been in recession since May 2022. When analyzing the dynamics of the series trend, it is observed that the decline began in the second quarter of 2022, but there was an improvement in the first months of 2023 which ended in the second semester. Similarly to the manufacturing sector, **construction anticipated a widespread recession.**

If we analyze the recent crises experienced by Argentina, we can see that the duration of recessions has been significant. On average, they have persisted for a little over a year, except for the crisis that began in 2018, which was prolonged due to the pandemic.

When do the improvements arrive? From Econviews, we estimate that activity will bottom out in the second quarter of the year and from then on, it will start to take off. The recovery will be mainly driven by the agricultural sector (see Graph 4), but it won't be enough to improve the economy's situation compared to the previous year. We estimate that GDP will fall by 3% this year, although if we exclude the effect of agriculture, the drop reaches 6.7%.

Graph 4. Economic activity pushed by agro
Accumulated variation 12 months



Source: Econviews based on INDEC and own estimates

In the short term, it is essential to closely monitor the leading sectors. These sectors often show signs of improvement several months before the rest of the economy, which can serve as a leading indicator of widespread improvement. Within this group, the hotel and restaurant sector stands out, as well as the transportation sector, especially gasoline sales (see Graph 5).

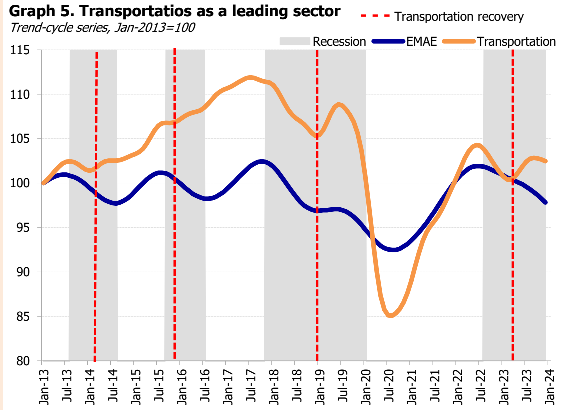
Another important point to consider is that economic recovery is not usually immediate. On average, it takes around 14 months for the economy to reach the level it had before the crisis. **At Econviews, we anticipate that the recovery will not be rapid**, and this is due to various factors.

Firstly, **the fiscal and monetary policies of the current administration are non-expansive**, implying that the measures implemented by the government tend to reduce spending and liquidity in the economy. This means that aggregate demand will not receive a boost from this side. Additionally, with a **real exchange rate below the historical average**, exports and the construction sector are discouraged. Another factor that could delay the recovery is the **lack of capital inflows and foreign investment**, limiting the flow of financial resources that could drive economic growth.

It is also crucial to highlight that not all sectors recover simultaneously. Some may experience a slower recovery, such as the manufacturing industry. While consumption has rebounded relatively quickly in past recessions, in the current crisis, there may be a lag, especially if high inflation persists and wages do not recover.

Graph 5. Transportatios as a leading sector

Trend-cycle series, Jan-2013=100



Source: Econviews based on INDEC