THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

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Editorial: In Caputo We Trust

The economic team's plans are clearly biased towards financial issues. And that is the area where Luis Caputo and Santiago Bausili have achieved the most tangible results. They had the dose of luck that is always needed, since country risk fell sharply in all Latin American countries in a world where the "search for yield" returned. But in this case the achievements were much more than luck.

Let's look at some stylized facts. The country risk the day before the runoff was at 2,411 basis points. The day before Milei's inauguration it had already dropped to 1,896 basis points. Last Friday it closed at 1,432 points. Almost a thousand basis points in 4 months. The market believes in the conviction of eliminating the deficit, in the government's willingness to pay, and the team gives them reasons. Even the Standard & Poor rating agency raised Argentina's rating. We are still very low, but everything contributes.

The recent public debt auction achieved 3 things at once. Firstly, it issued debt at negative rates, thereby reducing public debt in real terms and in relation to GDP. They could have taken much more money, but they prioritized the low rate. With a rate of 5.5%, creditors will capitalize below inflation for a few months in the best of cases or even for the entire life of the bond. Secondly, this helps clean up the Central Bank's balance sheet since part of the money will come from passive repos. One of the government's objectives seems to be to normalize the Central Bank's balance sheet and put a good part of the debt in charge of the Treasury. Thirdly, the government is going to buy nearly 1 billion dollars with the remainder of the auction after paying next Monday's due date. This is equivalent to two-thirds of the interest maturity that operates next July.

At Econviews we have some doubts about the future of the exchange and monetary scheme, but we are more optimistic about the sustainability of public debt. Although we do not believe that the government can obtain 2 points of primary surplus (it can achieve a primary balance), we do believe that the country risk will continue to decline. In our base scenario, the debt continues to rise and closes with a country risk of around 800 points. This would leave Argentina on the verge of having access to the market, which would allow the 2025 debt to be renewed and relieve stress on the Central Bank.

Regarding international reserves, it is clear that the evolution will depend in part on the trajectory of the real exchange rate. But in our scenario net reserves would become positive in May. In any case, in a scenario where dollar deposits grow strongly, companies are encouraged to take out loans in dollars, the net reserves account begins to be less important than in the times when it was difficult to pay for basic imports (4 months ago). If we wanted to do the math, our impression is that if the peso does not continue to appreciate, the Central Bank will end the year with about 4 billion in net reserves.

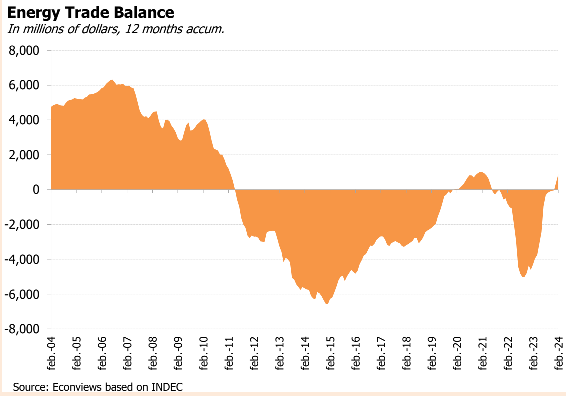
In short, the market chooses to trust. We are also optimistic, although warning about the exchange, monetary and, above all, political challenges that the government faces. Meanwhile, trust is a very important asset, and the numerical evidence says that Caputo and his team have been able to capitalize on it. The game is long, but starting well always helps.

LAST WEEK IN REVIEW

In February, the trade balance had a positive result of 1,438 USD million. **A surplus was achieved in energy trade**, accumulated over the last 12 months. The rebound in crude oil extraction could lead to a sustained surplus.

Total exports increased 5.6% y/y in February, due to the recovery of agriculture after the drought. The export of primary products rose 18.8%, and agricultural manufactures rose 8%.

Imports fell 18.6% y/y, because of the recession. **The import of cars stands out for going against the trend**, with an increase of 41.3%.



In Thursday's debt auction, the Treasury issued ARS 1.32 billion. 41% of that amount (ARS 0.55 trillion) corresponds to the new capitalizable bill maturing in January 2025. The cut-off rate was 5.5% monthly.

The rest is completed with the Boncer TZX25 (ARS 0.51 billion) **and the TG25** (ARS 0.27 billion).

We estimate that the maturities for the month total ARS 0.55 billion, so **the roll-over rate reaches 240%.**

March maturities

In millions of ARS

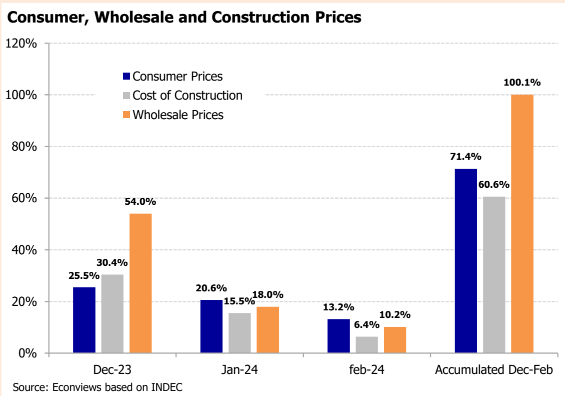
Date	Bond	Interest	Capital
25-mar-24	TX24	4,044	539,248
31-mar-24	PARP	5,281	
22-mar-24	BONTE 26	1,073	170
31-mar-24	BONAR CF	277	714
30-mar-24	T2V4	676	
31-mar-24	TV25	707	
Total		**12,059**	**540,132**

Source: Econviews based on the Ministry of Economy

In February, **the cost of construction rose 6.4% monthly** (vs. 15.5% in January). **Labor became more expensive by 1.9%**, and is explained by an increase of 0.1% for salaried labor and 11.2% for labor subcontracts.

Wholesale prices rose 10.2% (vs. 18% in January). National products became more expensive by 11%, while imported products had a much smaller variation, of 2.7%.

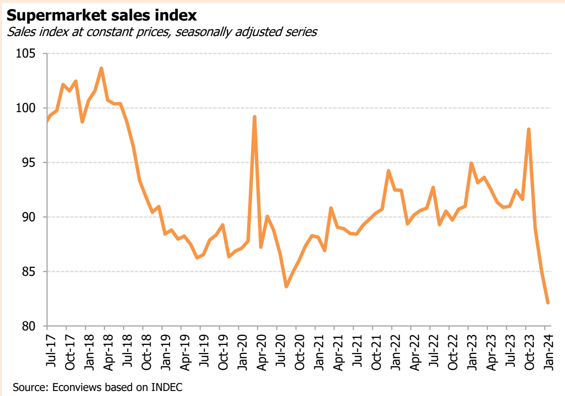
The accumulated inflation since December is 71.4%. The cost of construction runs below it with 60.6%, and wholesale prices exceed it with 100.1%,



In January, **supermarket sales fell 3.4%** compared to December. **The interannual variation was -13.8%.** With this result, 3 consecutive months of decline have accumulated.

Wholesale sales varied -1.9% in monthly terms, after the collapse in November and December (-10.6% and -7.3% m/m). They fell 8.1% compared to the same month of the previous year.

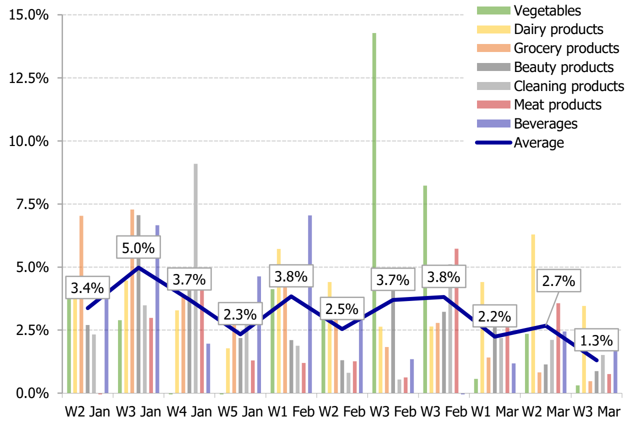
The shopping malls did not recover. Sales in shopping centers have been falling sharply since October. **The monthly variation was -10%** (vs. -10.7% in November and -16% in December). The interannual variation was -21.3%.



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**, INDEC publishes its **balance of payments, international investment position and external debt report** for the fourth quarter of 2023.
- **Today**, INDEC will also announce the **energy sector indicators** corresponding to the fourth quarter of 2023.
- On **Tuesday 26**, the INDEC **monthly economic activity estimator** (EMAE) for January 2024 will be published.
- On **Wednesday 27**, the INDEC **poverty and indigence indicators** will be published for the second half of 2023.
- On **Wednesday 27**, INDEC will also publish the January **salary index**.
- On **Wednesday 27**, the **staffing of the public administration** for February, reported by the INDEC, will be announced.
- On **Wednesday 27**, the BCRA will publish its **monthly retail payments report** for February.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	854.8	0.5%	2.0%	316.1%	↑
MEP	1036.4	0.9%	-0.9%	169.7%	↑
Blue Chip Swap	1095.2	2.3%	-1.6%	176.7%	↑
Parallel	1000.0	-0.5%	-6.1%	158.4%	↓
Official exchange rate BRL/USD	5.0	0.1%	0.8%	-4.5%	↑
CB reserves (USD million)	28,035	-174	+688	-9,561	↓
Policy rate (Leliq)	80.0%	0 p.p.	-20.00 p.p.	+2.00 p.p	=
Badlar rate (private banks)	72.3%	+0.63 p.p	-37.31 p.p.	+0.88 p.p	↑
Private Deposits (trillion ARS)	41.9	0.0%	9.5%	136.7%	↑
Private Loans (trillion ARS)	18.4	1.7%	6.9%	146.9%	↑
Merval (in ARS)	1,227	14.8%	14.1%	445.7%	↑
Merval (in USD)	1,121	12.2%	15.9%	97.2%	↑
Country Risk (spread in %)	1,432	-10.6%	-16.3%	-41.9%	↓
Soybean (USD/tn)	438.2	-0.5%	3.9%	-17.7%	↓
Corn (USD/tn)	172.9	0.6%	8.2%	-30.7%	↑
Wheat (USD/tn)	203.8	5.0%	-4.9%	-16.4%	↑
Oil - Brent (USD/barrel)	85.2	-1.4%	-3.7%	12.1%	↓
Oil - WTI (USD/barrel)	81.1	-1.0%	1.8%	14.7%	↓
LNG (USD/MMBTU)	9.4	9.3%	6.8%	-30.4%	↑
Gold (USD/oz.)	2,164.1	0.4%	6.9%	9.9%	↑

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	*Feb-24*	-5.0%	-5.5%	6.5%
Poultry production	*Jan-24*	4.2%	-2.4%	0.4%
Dairy production	*Feb-24*	-4.1%	-7.4%	-7.1%
Beef production	*Feb-24*	-0.2%	-4.1%	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	*Feb-24*	0.8%	-3.0%	0.6%
Train rides (AMBA)	*Feb-24*	-3.1%	-5.9%	-0.7%
Imports CIF	*Feb-24*	-3.6%	-13.4%	-7.4%
Exports FOB	*Feb-24*	2.5%	10.7%	10.2%
Loans in ARS to private sector	*Feb-24*	-1.1%	-26.1%	-16.5%
VAT-DGI Revenues	*Feb-24*	7.2%	-10.8%	-0.7%
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

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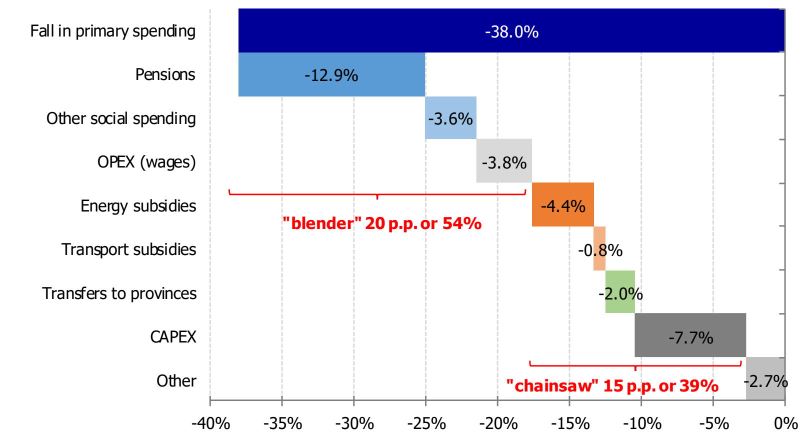
The Fiscal Program's Strengths and Weak Spots

- *Fiscal accounts were positive again in February, with a surplus of 338 billion pesos after interest payments.*
- *The proposed change in the adjustment formula for pensions freezes them at their current level, which could reduce spending by 1% of GDP in 2025.*
- *Removing FX controls mid-year implies losing 1.2 points of the PAIS tax on dollar purchases; exchange rate appreciation also reduces revenues from import and export duties.*

The government ran another financial surplus in February. 338 billion pesos. Before interest payments (which included USD 776 million to the IMF) there was a primary surplus of 1.23 trillion, accumulating a positive balance of 0.5% of GDP in the first two months. Primary spending contracted 38% year-on-year in real terms, while revenues fell only 5.9%, as the devaluation props up taxes linked to foreign trade. The market celebrates putting fiscal accounts in order, but at the same time it is aware that January and February's numbers cannot be projected to all of 2024.

Graph 1. Distribution of fiscal adjustment in January and February
Primary spending, year-on-year in real terms, each item's contribution



Source: Econviews based on Min. of Economy

Chart 1. 2024 fiscal program
Main changes in revenues and spending as a % of GDP

	2023	2024E	Variation in p.p.
Revenues	**17.0%**	**16.9%**	**-0.1%**
5G tender	0.2%	-	-0.2%
Export duties	0.8%	1.7%	0.9%
PAIS tax on dollar purchases	0.8%	0.8%	0.0%
Less revenues due to recession	-	-0.8%	-0.8%
Fuel taxes	0.3%	0.5%	0.2%
Income tax (reverting reform)	1.6%	1.4%	-0.2%
Expenses	**19.8%**	**17.0%**	**-2.8%**
Pensions (exc. bonuses)	7.7%	7.3%	-0.4%
Transfers to provinces	0.8%	0.2%	-0.6%
Energy and transport subsidies	2.1%	1.4%	-0.7%
CAPEX	1.6%	0.8%	-0.8%
Social programs	3.0%	3.0%	0.0%
OPEX (inc. wages)	3.3%	3.0%	-0.3%
Primary result	**-2.7%**	**0.0%**	
Net interest	-3.3%	-2.0%	
Fiscal result	**-6.0%**	**-2.0%**	

Source: Econviews based on Min. of Economy and own forecasts

The adjustment has been more "blender" than "chainsaw". That is, inflation eroding real expenses rather than targeted cuts. The real collapse in pensions (-38%), other social benefits (-17%) and public sector wages (-23%) made up 54% of the total fall in primary spending in January and February. After the initial shock, wages should recover in line with the private sector's. On the other hand, the government's proposed change in the adjustment formula for pensions would freeze them at their current level. The "chainsaw" explains 39% of the adjustment. The reduction in economic subsidies and transfers to the province is 19%. The other 20% corresponds to CAPEX, which is close to zero.

Our base scenario is that the government reaches primary (not fiscal) balance this year through a 2.8 point cut in spending, while revenues remain stable. It has been more aggressive than expected with spending, although the surplus hides the fact that payments are being delayed in several areas. **In the first two months, the difference between accrued spending and cash basis was 1.3 trillion pesos**, something that should be reflected in the floating debt statistics for February.

On the revenues side, the key question is how to replace the PAIS tax on dollar purchases if FX controls are loosened. The government released a new draft for re-imposing Income Tax, an important step in this regard.

1) What will happen with pensions? With the 27% increase in March, the average pension stood at 222,000 pesos. In the last year, they lost 37% in real terms. The current adjustment formula updates them based on a 50/50 mix of formal wages and social security revenues (which move in line with wages) with a lag of one quarter. It didn't protect retirees from the latest spark of inflation (no indexed formula could have done that), but it helps them recover in real terms once inflation slows down. Our projections show nominal increases of 45% in June and 50% in September.

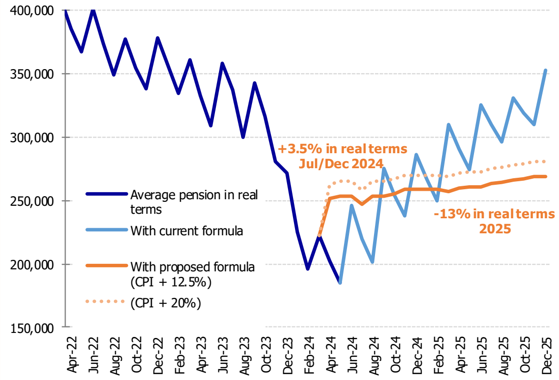
The government proposed replacing the formula with a monthly indexation to the CPI starting in April, with a bonus of 12.5% in the first month. This change would improve retirements in 2024, since they would switch from updating on a quarterly basis to a monthly one. The real gain compared to the current formula between July and December would be around 3.5%. But assuming that the economy stabilizes, inflation slows down and wages grow in real terms in 2025, **the proposed formula keeps pensions from recovering, so they would lose 13% next year compared to the current formula**. If the initial bonus is 20 and not 12.5% as some opposition legislators want, they will still lose approximately 9% in real terms in 2025.

Spending on retirements and pensions could be 7.3% of GDP this year, so cutting them by 13% in real terms saves 1% of GDP in 2025. The total impact would be larger, since the formula also affects child allowances and other social programs. Average pensions would be frozen at 262,000 pesos at today's prices, 30% below their 2022 level. With the current, they would return to that level at the end of 2025.

2) How to replace the PAIS tax on dollar purchases? Expanding the tax base to all “non-essential” imports at an 17.5% rate increased its potential collection from 0.8% of GDP in 2023 to 2% this year. However, eliminating the PAIS tax is a necessary condition to remove capital controls. If this happens in July as we think, the Treasury would lose 1.2 points of revenues. An alternative would be to lower the rate to 5% or less and exempt goods imports. This way it could raise 0.1 points more, without distorting the FX market.

It is true that removing FX controls probably improves the exchange rate at which export and import taxes are paid. But this effect would barely equal 0. 1 points of GDP, because the bulk of the harvest is before July, export proceeds are already settled at the 80/20 “blend” dollar between the official and the BCS rate and in any case the current FX spread is small.

Graph 2. Pensions with current and proposed formula
Average SIPA pension in Mar-24 constant pesos



Source: Econviews based on SIPA, Sec. of Labor and INDEC

Chart 2. Exchange rate policy's fiscal implications
Revenues from taxes on foreign trade as a % of GDP

		FX market unification in July	No unification this year
Base scenario	**Total**	**3.3%**	**4.3%**
	PAIS tax on dollar purch.	0.8%	2.0%
	Export duties	1.7%	1.7%
	Import taxes	0.7%	0.6%
2% crawling peg until Dec-24	**Total**	**2.5%**	**-**
	PAIS tax on dollar purch.	0.8%	-
	Export duties	1.3%	-
	Import taxes	0.5%	-

Source: Econviews based on INDEC and own forecasts

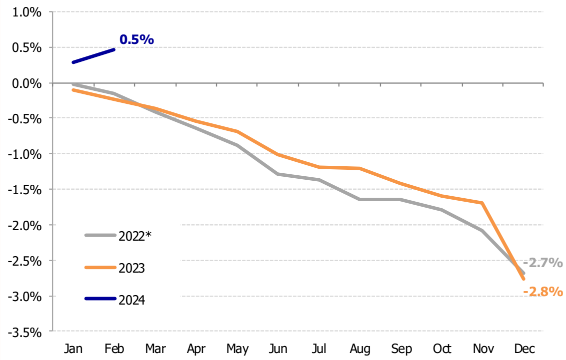
Another exchange rate policy decision with fiscal implications is how long he 2% crawling peg lasts. Finance Minister Caputo wants to keep it for a while and the market is beginning to believe him. Today dollar futures are priced at 1,330 pesos in December, closer to the 1,020 pesos that results from a linear projection of 2% than our base scenario of 2,223 pesos. The resulting exchange rate appreciation would imply losing 0.8 points of GDP in taxes on foreign trade. Although it is a partial equilibrium: a high real exchange rate with FX controls maximizes *these* revenues, but also makes the recession worse, diminishing revenues from other taxes.

3) How strong is the commitment to zero deficit? This week the government announced vouchers for private education of 27,000 pesos, which could reach 2 million beneficiaries. The annualized cost would be 0.1% of GDP, which is not much, but everything counts. It comes after the decision to postpone increases in gas bills and transport fares planned for March.

In the fiscal area, the government's communication strategy is the opposite it has been using for inflation, where it prefers to err on the negative side. From the start, Minister Caputo promised fiscal balance and a primary surplus of 2% of GDP. This announcement – and January and February's numbers – garnered a very positive response from the market. Favorable financial conditions (especially the stable FX rate) make these difficult months more digestible, validating his strategy. In addition, some accounting tricks make it possible to transfer interests on the peso-nominated debt from 2024 to 2025 and reduce the spread between the primary result and the fiscal result. But after this initial shock, putting fiscal accounts in sustainably is a task that requires less "blender" and more negotiations in Congress.

Graph 3. 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

The Good Part of the Adjustment: Starting Point of Unemployment Is Good

- *The unemployment rate was 5.7% in the fourth quarter of 2023. Despite the recession, the unemployment rate did not increase compared to the previous quarter.*
- *GDP fell 1.9% in the last quarter of 2023. In the full year, the fall reached 1.6%.*
- *We estimate that in 2024 activity will fall 3% despite the recovery of agriculture.*

Surprisingly, in the fourth quarter of 2023, the unemployment rate remained at 5.7% (see graph 1). The average for the full year was 6.13%, below the 6.81% in 2022. It is counterintuitive that in a context where the economic activity level falls, unemployment does not increase. It is true that the labor market does not adjust immediately, but in any case, some other factor such as social assistance may be influencing it. We mean that it is likely that there are beneficiaries of social programs that complement it with some working hours and that is enough for them to not be actively looking for work. So, according to the methodology they do not count as unemployed, but probably if they had not gotten the social plan, they would be.

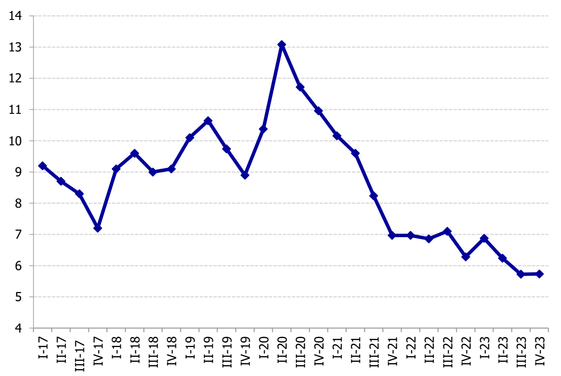
Even when calculating the unemployment rate using the activity level of the previous quarter, unemployment is still low (5%). Added to the hypothesis we proposed in the first paragraph, another factor that also helps is that salaries are at a very low level.

The unemployment rate is not the same between men and women. In the first case, it was 5.4%, while in the second it was 6.1%. In women from 14 to 29 years old, it reached 13.4%, somewhat above the 11.5% that was in men of that same age segment. For the group between 30 and 64 years old, there is also a bias towards the female sex (3.9% vs 3.3%).

In line with what we said previously, unemployment is low, but with a high level of informality. At the end of last year, it reached 35.7% of the total number of workers, slightly below that of the other quarters of 2023 (see graph 2). However, there are sectors such as construction where it is much higher.

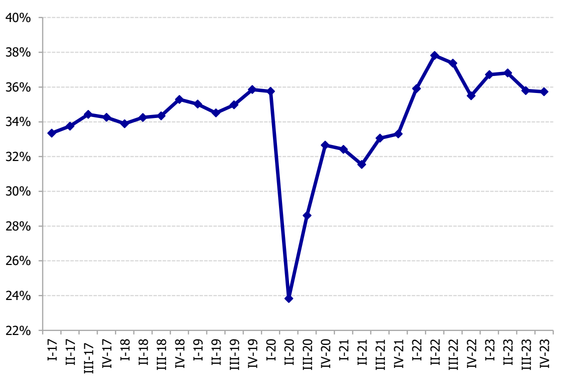
Beyond this, the positive thing is that the correction of macroeconomic imbalances is being done at a historically low level of unemployment. The current level has nothing to do with the 20% that had been exceeded at the beginning of the 2000s when the convertibility plan ended. That is important because there seems to be an inverse relationship between the level of activity and unemployment, and we estimate that the recession would only bottom

Graph 1. Unemployment Rate
In p.p.



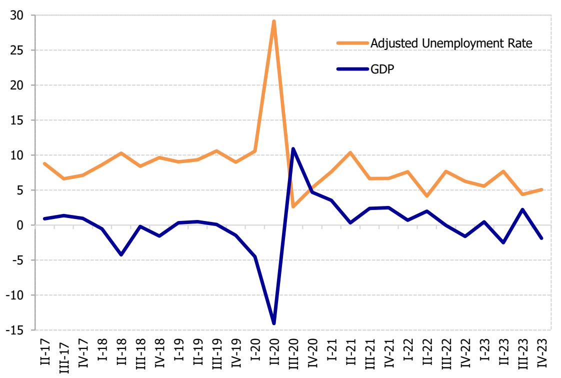
Source: Econviews based on INDEC

Graph 2. Informality Rate
In p.p.



Source: Econviews based on INDEC

Graph 3. Economic Growth & Unemployment
For GDP quarterly variations in p.p. seasonally adjusted



Source: Econviews based on INDEC

out in the second quarter of this year (see graph 3). **In other words, it would be logical for unemployment to continue increasing.**

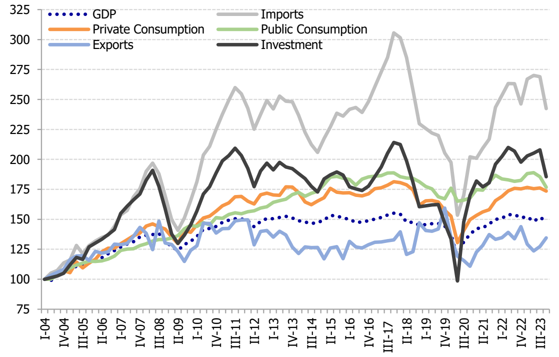
In the fourth quarter of last year, GDP fell 1.9% compared to the previous quarter, that is, an annualized rate of almost 8%. Within the components of aggregate demand, investment fell the most (-10.8% q/q), followed by public spending (-4.7%) and private consumption (-1.5%). Exports were the only item that grew (5.7%), mainly due to the post-drought rebound and the second half of December with the change in relative prices. In any case, when we look at the whole story, exports are the sector that has been most relegated since 2004 (see graph 4). In this period, GDP rose 48.7% but exports only 34.5%. Private consumption had a cumulative increase of 73.5%, somewhat less than public spending (76.8%) and investment (85.6%).

With these data, the 1.6% fall in annual GDP was confirmed, which could already be anticipated with the EMAE. Private consumption, which is the component with the greatest weight, resisted the decrease in real wages and grew 1.1% in the year. Exports and investment contracted 6.7% and 1.9% respectively. On the supply side, the sectors that had the greatest impact on the GDP contraction were agriculture and livestock. The podium is completed by manufacturing and financial intermediation (see graph 6).

Looking ahead to the coming months, we expect activity to remain weak in the first half of the year and only recover from the middle of the year. For all of 2024, we project a GDP drop of 3%, although with a lot of heterogeneity within. As in 2023, the drought had a contractionary role, this year agriculture will be a sector with upward momentum. In fact, in the GDP excluding agriculture, the contraction can exceed 6%. Sectors linked to energy such as oil and gas can be added to agriculture among the positive ones for 2024. Mining should also have a good year. The problem is that these sectors have little weight in employment, so their improvement will not be as noticeable for the most of population.

Graph 4. Exports growth was lower than that of other GDP components

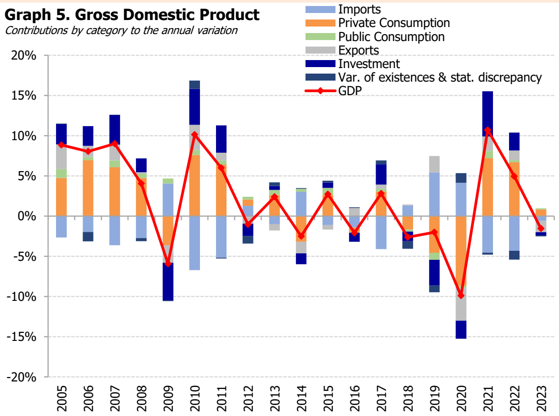
Base 100 = 1st Quarter 2004 - Seasonally adjusted



Source: Econviews based on INDEC

Graph 5. Gross Domestic Product

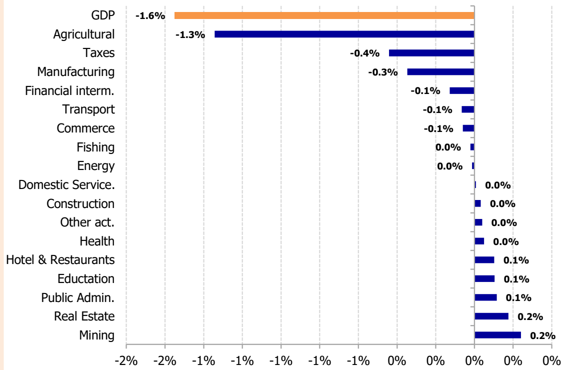
Contributions by category to the annual variation



Source: Econviews based on INDEC

Graph 6. GDP by Sectors

Contributions by sector to the annual variation



Source: Econviews based on INDEC