THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

March 8th 2024

Two-speed **economic policy**

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Without **FX market restrictions** there is no room for **inconsistencies**

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Despite the **drop in tax revenues**, we expect another **fiscal surplus** in March

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Editorial: Two-speed economic policy

It is striking that on one hand, the government has aggressively moved forward with price liberalization and cost reduction without worrying too much about the consequences, while on the other hand, it is being very cautious in relaxing currency controls and unifying the exchange rate. One can understand that there might have been concerns that complete liberalization could result in a currency crisis that could derail the entire program. Therefore, it is understandable that they proceeded cautiously and with great care in the beginning when considering relaxation.

However, almost four months have passed since Milei took office, and the Central Bank has already purchased around USD 12 billion. The specter of commercial debt for imports seems to be largely resolved, leaving only the threat of trapped dividends, which shouldn't be a significant figure.

At some point, we will have to start dismantling the currency Frankenstein, and the fact that the exchange rate spread has recently dropped from almost 200% to around 20% is a good sign that the situation may be ripe for progress. When the Macri government decided to unify the exchange rate overnight in 2015, the spread was over 50%, and the foreign exchange market quickly normalized. The only restriction that remained at that time was a limit of two million dollars for transferring freely available dollars. However, that limit was relaxed within a few weeks.

The current situation is different from that of 2015, mainly because at that time, net reserves were not negative. There was quick access to the capital market, and the country did not have loans with the IMF. In 2015, the unification was to a floating exchange rate, without capital controls, and the Central Bank used the interest rate as the instrument to carry out monetary policy within an inflation-targeting framework. The big question is what the exchange rate/monetary scheme will be adopted upon exiting the currency controls.

Today, it seems that the Central Bank is very comfortable in the environment of financial repression because it can lower interest rates at will without risking the loss of reserves. That is a strong incentive to continue with the current currency controls. However, the cost is high because it delays the recovery of economic activity and employment while keeping many investment projects on hold.

Thinking about what's coming, there's a feeling that the monetary scheme of 2015 won't be repeated. Part of this is because it didn't yield the expected results, and partly because there's fear of transitioning to a floating exchange rate system. It also seems unlikely to adopt a scheme where the exchange rate anchors inflation, simply because there aren't enough reserves, and it's improbable that net reserves will reach levels for the Central Bank to feel comfortable defending a parity.

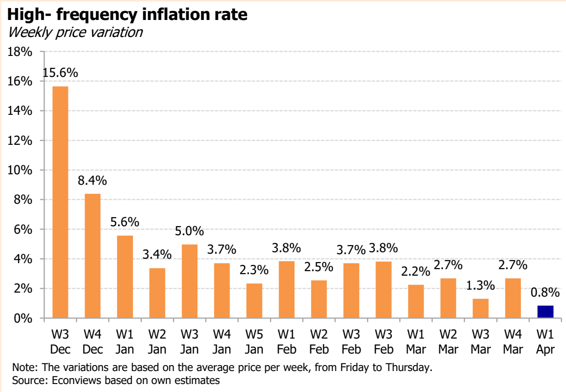
What alternatives are left? One possibility is to set a target for the growth of the monetary base, although it is difficult to implement in an environment where the money demand is increasing. Another alternative would be to adopt an eclectic scheme, such as a currency band, which, coincidentally, is what Luis Caputo implemented during his brief tenure at the Central Bank in 2018.

The advantage of a currency band is that it's an intermediate regime between a fixed and a floating exchange rate. The band sets a ceiling and a floor for the exchange rate, but within the band, the exchange rate floats, meaning the Central Bank doesn't need to defend a specific parity. It's not a coincidence that Chile and Israel, in times of uncertainty, resorted to a currency band regime for stabilization.

LAST WEEK IN REVIEW

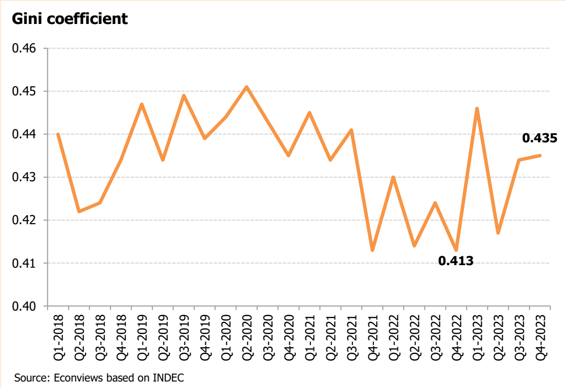
During the first week of April, we observed a deceleration in prices. According to Econviews' price analysis, the month began with a weekly variation of 0.8%, marking a clear contrast with the pace recorded in March.

Performance by category: During this week, there were decreases of 1% and 0.4% in beverages and grocery products, respectively. However, fresh foods experienced an increase. Meat and derivatives increased by 0.8%, due to the rise in processed meats. In the vegetable segment, there was an increase of 4.7%, influenced by seasonal factors, reflected in price hikes for some fruits such as oranges and apples.



INDEC published income distribution data for the fourth quarter of 2023. The per capita income of families in the highest stratum was ARS 515,641, 18 times larger than that of families in the lowest stratum (ARS 28,441).

Increase in inequality. The Gini coefficient was 0.435, showing a slight increase (+0.2%) compared to the previous quarter. However, if we compare it with the fourth quarter of 2022, the increase in inequality was more noticeable (+5.3%). **The gender gap widens**. On average, males earned ARS 280,501, 25.4% more than females. In month-to-month terms, this represented an increase of 2.8 p.p., and in year-on-year terms, an increase of 2.5 p.p.



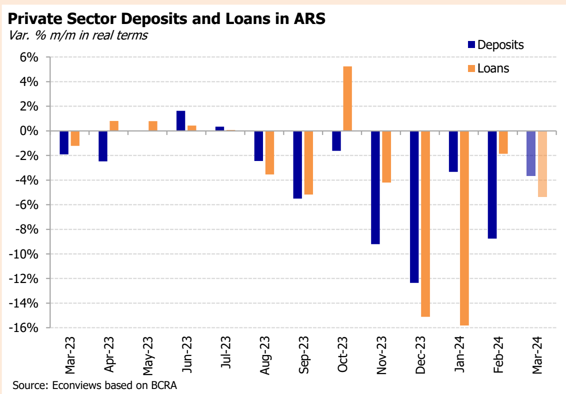
The country risk fell another 130 basis points and closed the week at 1,302 bps. It is the lowest level since September 2020, after Guzmán's restructuring.

The GD30 bond rose by 5.9% and is trading at 56 cents to the dollar.

It was also a good week for stocks. **The Merval adjusted by the CCL rose by 3.3%.** Central Puerto (+14%) and Edenor (+9%) stocks stood out.

Private sector deposits in pesos fell by 3.6% month-on-month in real terms in March. For current accounts, the decrease was 7.8%, and for savings accounts, it was 10.3%. Time deposits had a better performance, growing by 4.4% in real terms despite the decrease in interest rates.

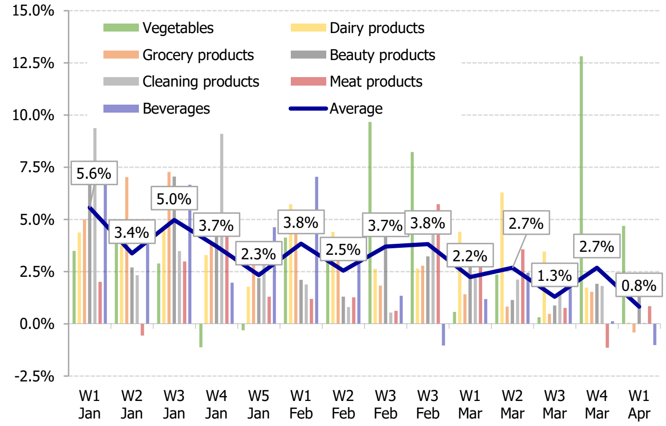
Credit to the private sector continues to struggle, decreasing by 5.4% in real terms in March. The contraction affected all categories. The guaranteed segment was the hardest hit (-7.3% month-on-month), followed by consumer loans (-6.5%) and commercial loans (-3.7%).



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 will publish the **Index of Mining Industrial Production** for February.
- **Today** Central Bank Will release the **Market Expectations Survey** (REM).
- On **Tuesday 9**, **Manufacturing Industrial Production Index** for the month of February Will be released. Also, the **Construction Activity Indicators** will be announced.
- On **Tuesday 9**, **inflation data for March for the city of Buenos Aires will be released**.
- On **Tuesday 9**, the Central Bank will publish its **Monthly Monetary Report**.
- On **Wednesday 10**, **International Tourism Statistics** for February will be published.
- On **Wednesday 10**, The city of Buenos Aires will announce the poverty lines and consumption baskets for March.
- On **Thursday 11**, the **Synthetic Indicator of Public Services** will be released.
- On **Friday 12**, INDEC will publish the **Inflation Rate** for March. Econviews estimates it will be around 12%.
- Also, on **Friday 12**, the INDEC will announce the **Food and Total Basic Baskets** for March.
- On **Friday 12**, the **monthly statistical bulletin** of the Central Bank will be released.

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Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	862.8	0.6%	2.1%	308.4%	↑
MEP	999.8	-1.5%	-1.4%	152.6%	↓
Blue Chip Swap	1048.8	-5.0%	0.1%	158.8%	↓
Parallel	965.0	-2.5%	-2.5%	148.7%	↓
Official exchange rate BRL/USD	5.1	1.1%	2.2%	0.7%	↑
CB reserves (USD million)	28,763	+1,617	+1,008	-9,899	↑
Policy rate (Leliq)	80.0%	0 p.p.	-20.00 p.p.	+2.00 p.p	=
Badlar rate (private banks)	70.8%	-0.13 p.p.	-38.19 p.p.	-1.81 p.p.	↓
Private Deposits (trillion ARS)	44.1	4.9%	12.9%	148.7%	↑
Private Loans (trillion ARS)	19.4	5.4%	8.1%	152.1%	↑
Merval (in ARS)	1,213	0.0%	22.2%	379.8%	↓
Merval (in USD)	1,157	5.2%	22.1%	85.4%	↑
Country Risk (spread in %)	1,302	-10.4%	-19.3%	-44.7%	↓
Soybean (USD/tn)	435.4	-0.5%	3.9%	-21.6%	↓
Corn (USD/tn)	171.0	-1.8%	5.0%	-33.5%	↓
Wheat (USD/tn)	208.4	1.2%	3.9%	-16.8%	↑
Oil - Brent (USD/barrel)	93.1	8.8%	6.4%	8.2%	↑
Oil - WTI (USD/barrel)	87.7	4.4%	10.8%	8.7%	↑
LNG (USD/MMBTU)	9.5	0.0%	14.5%	-24.0%	=
Gold (USD/oz.)	2,323.5	4.1%	9.2%	15.0%	↑

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	*Mar-24*	10.6%	11.0%	51.2%
Steel production	*Feb-24*	-5.0%	-5.5%	6.5%
Poultry production	*Feb-24*	3.1%	0.4%	4.8%
Dairy production	*Feb-24*	-4.1%	-7.4%	-7.1%
Beef production	*Feb-24*	-0.2%	-4.1%	2.8%
Real Estate transactions (CABA)	*Feb-24*	14.4%	-6.9%	10.1%
Flour Production	*Feb-24*	1.4%	-4.9%	-1.3%
Oil production	*Feb-24*	3.1%	3.6%	2.9%
Gas production	*Feb-24*	12.3%	-1.7%	14.5%
Cement production	*Feb-24*	-5.8%	-12.3%	-7.7%
Construction activity	*Jan-24*	-10.2%	-11.6%	-16.6%
Gas sales	*Feb-24*	0.5%	-6.5%	-2.1%
Motorcycle licenses	*Mar-24*	-28.7%	-24.3%	-31.4%
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)	*Dec-23*	0.0%	-0.2%	-0.3%
Formal private jobs (EIL)	*Jan-24*	-0.1%	-0.4%	-0.5%
Consumer confidence	*Mar-24*	1.8%	-18.2%	-1.3%
Government confidence	*Mar-24*	-0.4%	41.0%	-4.5%

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

Without FX market restrictions there is no room for inconsistencies

- *The government had taken the correct measures in several economic issues, although we see inconsistencies in others.*
- *We think that the real exchange rate appreciation policy may cause problems in the future.*
- *We also see drawbacks with the real interest rate being so negative. Without the FX market restrictions, it will be difficult to maintain financial repression.*

In the first 4 months of its administration, the government had successes. That's hard to deny. Putting the fiscal problem at the center of the stage and attacking it decisively is one of them. The correction of regulated prices is also added to the list. The accumulation of reserves also must be mentioned. Behind every point, there is obviously room for discussion. For example, if this fiscal adjustment is sustainable or if the new accumulation of debt due to imports (the other side of reserve purchases) is not a problem as it was with Massa.

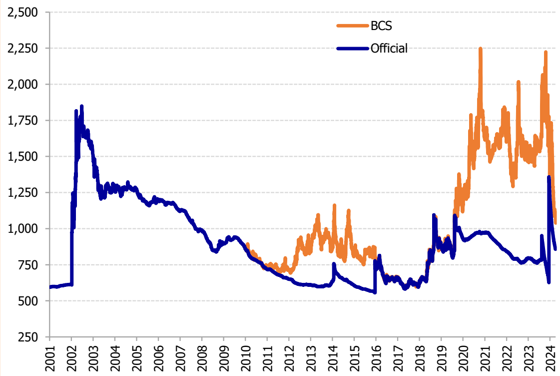
Despite these achievements, we see that there are inconsistencies in both exchange rate policy and monetary policy. If we look at the current photo it may sound strange, but what worries us is not so much the present but the forward dynamic.

Let's start with the exchange rate. Since the December devaluation, the real exchange rate has fallen 36%. If we look at it in current pesos, it went from ARS 1,362 to ARS 863, almost 500 pesos of appreciation (see graph 1). If the 2% crawling rate continues, we estimate that in April it will appreciate another 7%, in May 6.2%, and in June 4.4% (see graph 2). By that time, it will be 26% below the historical average.

Such an overvalued real exchange rate creates several difficulties. Firstly, the incentive to settle the exports will be lower, which conspires against the objective of accumulating international reserves. We are getting into the season of the harvest, which is when most of the exports are settled. However, since the first time a differential exchange rate was implemented (September 2022), it is clear that exporters can delay the settlement if they see that there could be better conditions in the future.

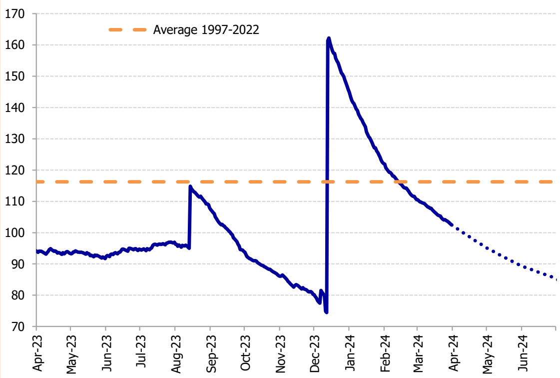
The other problem is that imports could be overstimulated. If agents perceive that the dollar is cheap, they will try to import as much as possible, even above what the economy requires to function well.

Graph 1. Exchange rate at constant prices
At Apr-5 prices - Adjusted by ITCRB



Source: Econviews based on BCRA

Graph 2. Real Effective Exchange Rate
Base 100 = 17/12/2015



Source: Econviews based on BCRA & own estimates

What happened in 2017 is a good example of this. That year the average real exchange rate was like the one that we would have at the end of June. The current account deficit was 4.7% of GDP in the fourth quarter of 2017 and reached a maximum in the third quarter of 2018 (7.2%). Here, not only did the deficit in the goods account weigh, but services also played an important role (see graph 3). Traveling abroad was cheap and people took advantage of it. After that period of low REER, the market perceived it as unsustainable, and the adjustment was all but unavoidable.

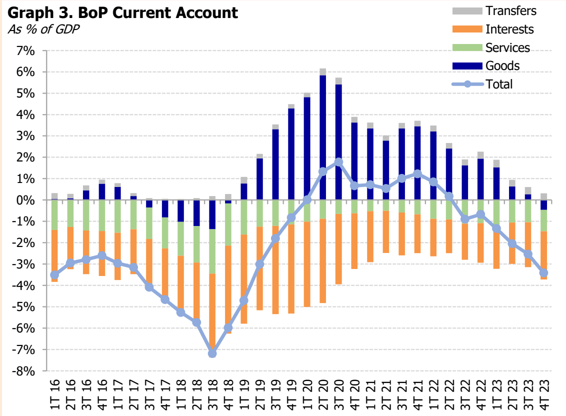
What we mean by this is that this inconsistent scheme may last for a while, but it will not be something indeterminate. The alternative is that the FX market restrictions remain in place, something that does not seem desirable. Therefore, without restrictions sooner or later there must be a correction. It is true that productivity improvements mean that the economy can support a lower real exchange rate, although this does not happen overnight. In fact, the process of increasing productivity is at best just beginning.

On the monetary policy side, we have doubts about the interest rate. Intending to lower the money issuance generated by the payment of interests on the BCRA's remunerated liabilities, the government proposed a policy of very negative rates in real terms. Taking the monthly effective rate, in December and January it was more than 10 points negative, and in February and March more than 4 points (see graph 4). Going forward we do not project new rate cuts, although we cannot rule them out either. With inflation going down, the rate may become less negative, but it will not stop being negative.

This financial repression is sustained thanks to the market restrictions since the pesos do not have many places to go. We think that in a situation where restrictions are lifted the real interest rate should be higher than the current one. In this way, the demand for pesos can be stimulated and pressures on the exchange market are also avoided. Otherwise, the market may end up running against the peso and the Central Bank will be forced to raise the rate. Once again, without market restrictions, there is no room for inconsistencies. At this point, the experience of 2018/2019 also serves as an example.

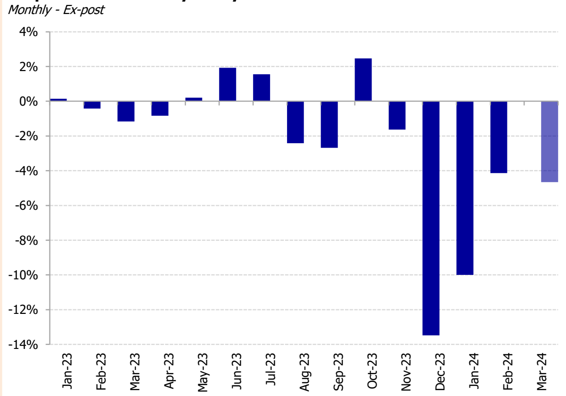
In summary, we think that with the lifting of restrictions, a part of the economic policy will have to change. The ideal scenario is one where the government can act in advance and make corrections in a more orderly manner than would be the case if the adjustment is made by the market.

Graph 3. BoP Current Account
As % of GDP



Source: Econviews based on INDEC

Graph 4. Real Monetary Policy Interest Rate
Monthly - Ex-post



Source: Econviews based on BCRA & own estimates

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Despite the drop in tax revenues, we expect another fiscal surplus in March

- *Tax revenues fell 9.5% real year-on-year in the first quarter; taxes linked to activity are sinking (-25%) but those on foreign trade are soaring (+64%).*
- *In Q2, the harvest, a slight recovery in wages, and possibly the adjustment in electricity and gas bill's effect on VAT can give fiscal accounts some oxygen.*
- *The provinces (-16%) and social security agency (-23%) absorbed most of the fall in revenues, while for the national government (+0.7%) income improved slightly, despite the recession.*

National taxes collected 7.7 trillion pesos in March, 16% less than a year ago in real terms (assuming 12% inflation last month). I**n Q1, revenues contracted 9.5% year-on-year.** It is not distributed evenly: taxes on activity (-25%) are sinking, while taxes on foreign trade are soaring (+64%). As the latter are not part of the federal tax-sharing system, the provinces (-16%) and social security agency ANSES (-23%) are absorbing the fall in revenues, while the income of the national government (+0.7%) remains stable. The dynamic of public sector deposits makes us think that March could be another month of fiscal surplus. If this is confirmed, it would be the first time since 2008 with 3 consecutive months of surpluses.

Taxes on foreign trade made the difference. The only taxes whose collection grew in March were the PAIS tax on dollar purchases (+322%), thanks to the expansion of the tax base in December, and export duties (+64%), helped by the comparison against the worst of the drought. Both are also favored by a real exchange rate 10% above March 2023's. This also plays in favor of import duties (-26%), but they kept falling due to the deferral of payments. None of these three taxes are shared with provinces.

December's devaluation has diminishing returns. Adjusted for inflation, export duties raised more in January (818 billion) than in February and March combined (624 billion). This is also explained because no one wanted to export with the previous exchange rate, and they withheld grains until January. In April, a soybean producer will earn 14% less per ton than Q1-2024's average. Is it enough, or will a libertarian version of the soybean dollar be necessary?

Chart 2. Conditions for soybean exporters

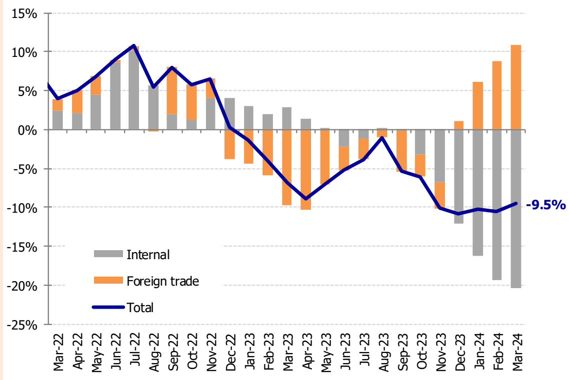
Average for Q1 of each year

	Tax rate	Official FX rate (at Apr-24 prices)	USD/ton (constant)	Constant ARS per ton	
				Exporter	Treasury
Q1-2016	30%	845	422	249,734	107,029
Q1-2019	28%	988	404	286,135	112,938
Q1-2022	33%	857	633	363,741	179,156
Q1-2024	33%	996	436	290,705	143,183
Apr-24	33%	862	434	250,655	123,457

Source: Econviews based on INDEC and own estimates

Graph 1. Tax revenues

Year-on-year in real terms, 3mma, contribution from each type of tax



Source: Econviews based on Min. of Economy

Chart 1. Tax revenues

March 2024 - Central Government

	In BN ARS Mar-24	y/y Mar-24	real y/y Mar-24
Total	**7,726.5**	**231%**	**-16%**
Income	1,056.7	136%	-40%
VAT	2,818.3	232%	-15%
VAT Non-customs*	1838.5	217%	-19%
VAT Customs	995.9	256%	-9%
Credits and debits	600.6	244%	-12%
Personal assets	17.0	-33%	-83%
P.A.I.S.	694.9	1553%	322%
Social security	1,740.3	209%	-21%
Exports tax	310.1	542%	64%
Imports tax	238.5	191%	-26%
Others	250.0	-	-

*Gross of refunds

Source: EconViews based on MECON

In Q1, taxes on foreign trade (excluding VAT on imports) collected 0.5% of GDP, 16% of the total revenues so far this year, and 38% of taxes that are retained by the national government. In 2024 they could collect between 2.6 and 4.2 points of GDP, depending on the level of real appreciation and when FX controls are removed (which means eliminating or at least reducing the PAIS tax).

Taxes linked to activity are still doing badly. The collapse in income tax (-40%) in March is explained by last year's reform. But the recession's effect is clear in less revenues from VAT (-15%), the tax on credits and debits (-12%), and social security contributions (-21%). The fuel tax (-20%) fell despite an increase in rates. Overall, taxes on the domestic market fell 25% year-on-year in the first quarter. This year Easter was in March, but the Memorial Day holiday fell on a Sunday so the comparison even outs. Excluding income tax, the year-on-year contraction was 20%. For comparison, in the first quarters of 2019 (recession) and 2020 (pandemic), these taxes had fallen 9-10%.

Social security contributions suggest January was the worst month for wages. Adjusting for the number of formal employees, contributions fell 28% year-on-year in January, 23% in February, and 22% in March, a path similar to that of the RIPTE wage index. Our Econviews index that follows top unions shows a much smaller drop, 12% year-on-year in March. The difference is due to the fact that part of wage increases are non-contributory bonuses, but many agreements add up these bonuses into basic wages in April, which should reflect on May's social security collection.

Another upside factor in Q2 is the adjustment in electricity and gas bills, which should increase VAT collection in a sector with little room for tax evasion. In 2016 this did not occur, because the energy distributors – who pay the non-subsidized price to CAMMESA – had accumulated tax credit during the years of high energy subsidies. However, inflation ran at 40% year-on-year back then and is closer to 300% now, so that nominal tax credit will evaporate much more quickly.

The current situation is terrible for the provinces and the social security agency. They fully absorbed the 9.5% drop in federal tax revenues in Q1, while the share that goes to the national government rose 0.7%. The provinces received 16% less through the federal tax-sharing system than in Q1-2023. Discretionary transfers, of course, fell much more. Even if VAT or social security contributions recover in Q2, the key piece to strengthen provincial finances (and replace part of the PAIS tax) is implementing a new version of income tax, ASAP.

Chart 3. Fiscal implications of exchange rate policy

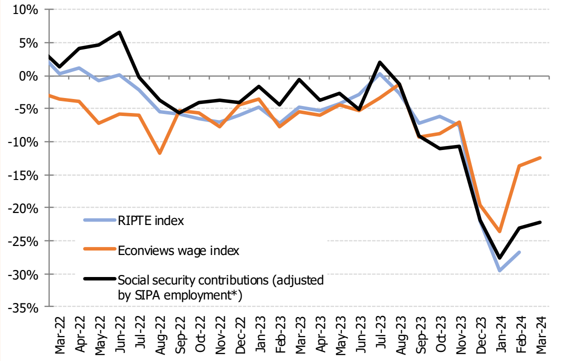
Revenues from taxes on foreign trade as a % of GDP

	Accum. Q1-2024	2024E unifying FX market in July		2024E without unifying FX market
		2% crawl until Dec-24	Base scenario	
Total	**0.5%**	**2.6%**	**3.2%**	**4.2%**
PAIS tax	0.3%	0.8%	0.8%	1.9%
Export duties	0.2%	1.3%	1.7%	1.7%
Import duties	0.1%	0.5%	0.7%	0.6%

Source: Econviews based on INDEC and own estimates

Graph 2. Social security contributions and wages

Year-on-year in real terms, revenues adjusted by private employment (SIPA)

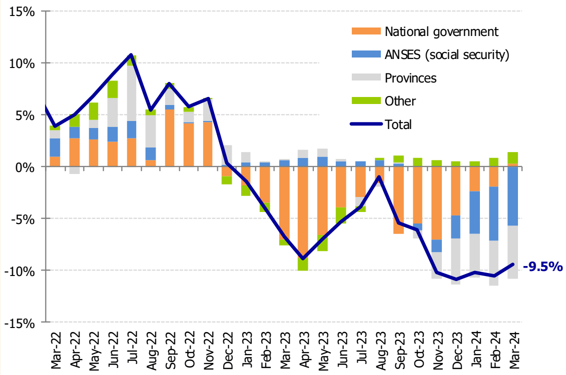


*assuming a 0.3% fall in employment in Q1-2024

Source: Econviews based on Min. of Economy and SIPA

Graph 3. Destination of tax revenues

Year-on-year in real terms, 3mma, distribution as % of total



Source: Econviews based on Min. of Economy

Projections – Base Scenario

Exchange rate Forecast

End of period

	Official	BCS	Spread
Mar-24	857	1083	26.3%
Apr-24	875	1154	32.0%
May-24	927	1252	35.0%
Jun-24	983	1376	40.0%
Jul-24	1376	1376	0.0%
Aug-24	1500	1500	0.0%
Sep-24	1634	1634	0.0%
Oct-24	1765	1765	0.0%
Nov-24	1889	1889	0.0%
Dec-24	2021	2021	0.0%
Jan-25	2021	2021	0.0%
Feb-25	2021	2021	0.0%
Mar-25	2021	2021	0.0%
Apr-25	2021	2021	0.0%
May-25	2061	2061	0.0%
Jun-25	2103	2103	0.0%
Jul-25	2145	2145	0.0%
Aug-25	2188	2188	0.0%

Inflation Forecast

	m/m	y/y
Mar-24	12.0%	291.3%
Apr-24	10.0%	297.1%
May-24	9.0%	301.6%
Jun-24	7.0%	305.6%
Jul-24	12.0%	327.2%
Aug-24	8.8%	313.3%
Sep-24	8.0%	295.9%
Oct-24	8.0%	294.8%
Nov-24	6.5%	272.9%
Dec-24	6.0%	215.0%
Jan-25	3.2%	169.5%
Feb-25	3.1%	145.4%
Mar-25	3.5%	126.8%
Apr-25	2.2%	110.7%
May-25	2.2%	97.6%
Jun-25	2.2%	88.7%
Jul-25	2.5%	72.7%
Aug-25	2.1%	62.0%

Interest rate Forecast

End of period

	Badlar	Monetary Policy Rate
Mar-24	70.9%	80.0%
Apr-24	72.0%	80.0%
May-24	72.0%	80.0%
Jun-24	72.0%	80.0%
Jul-24	90.0%	100.0%
Aug-24	90.0%	100.0%
Sep-24	90.0%	100.0%
Oct-24	81.0%	90.0%
Nov-24	76.5%	85.0%
Dec-24	72.0%	80.0%
Jan-25	45.0%	50.0%
Feb-25	45.0%	50.0%
Mar-25	45.0%	50.0%
Apr-25	45.0%	50.0%
May-25	36.0%	40.0%
Jun-25	31.5%	35.0%
Jul-25	31.5%	35.0%
Aug-25	31.5%	35.0%