THE WEEK
AT A GLANCE

ECONVIEWS

ECONOMÍA Y FINANZAS

May 20th 2024

Lower Rates and a **New Monetay Architecture**

Page 2

Another **Fiscal Surplus in April**, With Some Doubts

Page 5

Inflation to Come Down in May With a Little Help From My Friends

Page 7

(+54 11) 5252-1035
La Pampa 1534
Buenos Aires
www.econviews.com
Twitter: @econviews

Miguel A. Kiguel
Director
mkiguel@econviews.com

Andrés Borenstein
Chief Economist
aborenstein@econviews.com

Alejandro Giacoia
Economist
agiacoia@econviews.com

Delfina Colacilli
Economist
dcolacilli@econviews.com

Pamela Morales
Economist
pmorales@econviews.com

Rafael Aguilar
Economist
raguilar@econviews.com

Editorial: Lower Rates and a New Monetay Architecture

The Central Bank lowered the interest rate three times in less than a month. It went from 70% to 40%, which is quite unusual. Especially for a situation where the volatility is not what it used to be, for example, in June 2022. Inflation is decreasing, and so are expectations. However, 40% implies a negative interest rate under all circumstances. As we mentioned on previous occasions, the negative rate is possible because there is a strict currency control in place, indicating that despite libertarian philosophy, there is no rush to exit. The rate cut aims to achieve two important things: stimulate credit to help economic activity and reduce endogenous money issuance, meaning the interest on repos.

Regarding credit, it is clear that this measure will help, and the economy needs it because almost no one expects a "V-shaped" recovery. The problem is that this operates at the margins, as building a credit portfolio takes time, and the demand for loans during a recession is not explosive. Concerning endogenous money, the government seems to have an obsession with keeping the monetary base fixed in nominal terms, which seems somewhat exaggerated in this context. However, it is true that the issuance of pesos to pay interest is an unnecessary disruption.

Precisely for this reason, the government re-engineered interest rates. While lowering the rates and therefore the returns on time deposits, which now yield something like 2.5% monthly, and perhaps slightly less for liquidity funds, the government decided to auction short-term capitalizable Treasury bonds (LECAPS) with a guaranteed rate of more than 4%. The idea was to shift much of the liquidity parked in Central Bank instruments to Treasury bonds. And it worked. The government auctioned the bonds and secured more than 11.7 trillion pesos. It needed just over 3 trillion to cover its maturities, and the remaining 8.6 trillion will go towards reducing the monetary base.

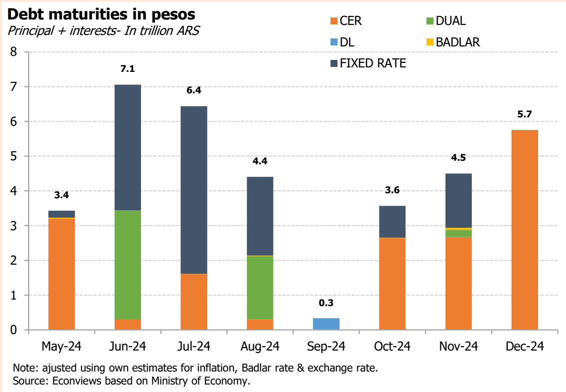
In practice, the people who buy these bonds withdraw money from bank deposits, the banks exit repos, the Central Bank issues money to honor the repos, and then withdraws that issuance with the pesos provided by the Treasury. Monetarily, there are no changes, but the debtor changes. There is a subtle difference in that the Central Bank takes on debt on a one-day basis, while the Treasury auctioned short-term debt, but not so short that it poses a price risk for those needing almost immediate liquidity. To mitigate that risk, the Central Bank says it is willing to intervene in the market to limit such fluctuations. Banks were also allowed to hold more LECAPS, reorganizing the regulation to guide the entire market in that direction.

However, there is a more significant difference. As the Treasury issues new debt and deposits those pesos in the Central Bank, which in turn cancels the repos, it practically means that the consolidated public sector debt remains the same, with only a transfer from the Central Bank to the Treasury. A problem with this strategy is that by contracting the money supply, the Treasury assumes functions in monetary policy that are inherent to the Central Bank. Additionally, if the market needs money in the future and demands that the Treasury repay its debt, the Treasury will most likely have to turn to the Central Bank for liquidity assistance or accept a rise in interest rates.

LAST WEEK IN REVIEW

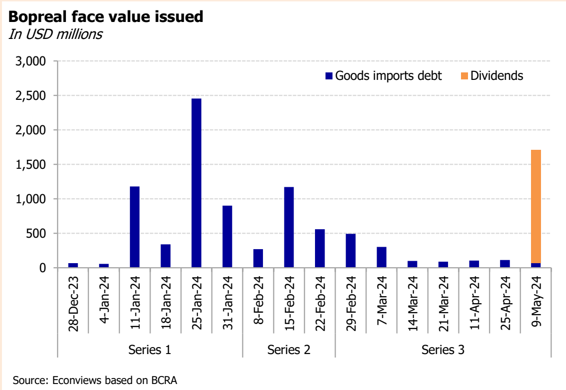
In last Thursday's auction, the Treasury issued debt for ARS 11.7 trillion. This amount is equivalent to 3.7 times the maturities it faced (ARS 3.2 trillion). 85% of the total issued corresponds to the new Lecaps (fixed rate bills) that paid interest rates ranging from 3.8 to 4.2% effective monthly. This preponderance of shorter instruments meant that the weighted average issuance term was 132 days.

Many of these pesos are reverse Repos that were not renewed after the BCRA cut the monetary policy interest rate below the Lecaps rate and also relaxed the limits on public sector financing for banks.



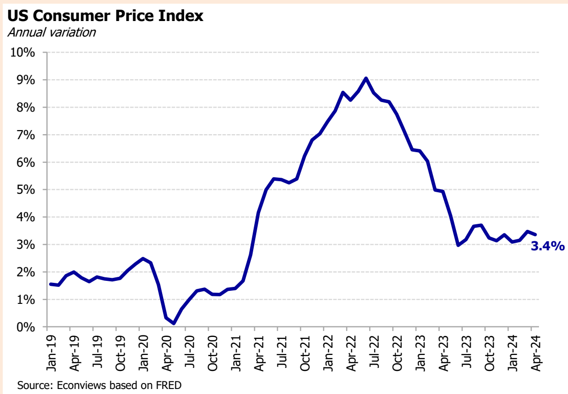
The Buenos Aires Grain Exchange reduced the forecast for soybean production from 51 to 50.5 million tons. This cut is explained by lower-than-expected yields in some areas due to poor weather conditions during March. The harvest progress reached 63% and remained below the minimum of the last 5 campaigns

For corn, the forecast remained constant at 46.5 million tons and 25% of the total has already been harvested.



United States stock exchanges enthusiastically received the April 2024 inflation data. According to the U.S. Bureau of Labor Statistics (BLS), the Consumer Price Index increased 3.4% compared to April 2023, less than the 3.5% registered in March.

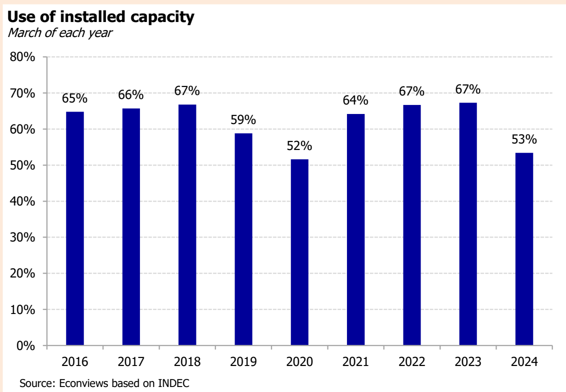
The US Federal Reserve's favorite inflation measure, the core CPI that excludes food and energy prices, **also registered a decrease compared to 2023**. The annual core CPI fell from 3.8% in March to 3.6% in April, the lowest figure since 2021.



The use of installed capacity in the industry was 53.4% in March 2024, below the level registered in the same month last year (67.3%).

Sectors with **utilization levels above the general average** include **petroleum refining** (80%), **chemical products and substances** (64.9%), **paper and cardboard** (63.5%), and **food and beverage** products (54.5%).

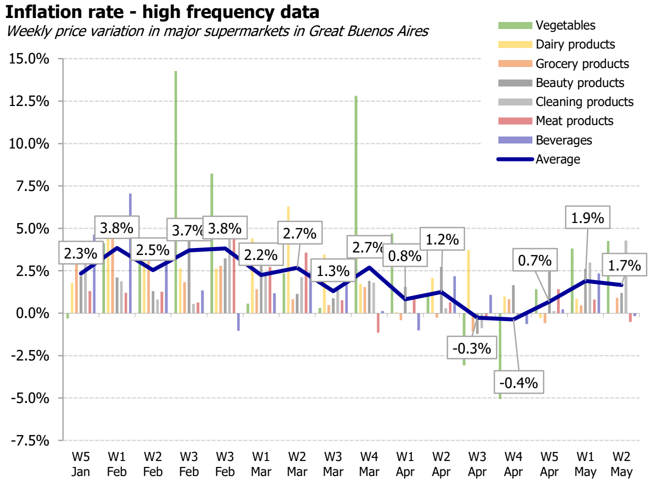
The most pronounced falls were observed in the basic metal industries, metalworking, and the automotive industry, reflecting a context of lower production.



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 **Tuesday 21**, INDEC will release the **statistics of Argentine trade exchange** for the month of April.
- On **Wednesday 22**, the **monthly economic activity estimator** (EMAE) for March will be published.
- On **Wednesday 22**, INDEC will also publish the results of the **hotel occupancy survey** carried out in March.
- On **Wednesday 22**, the BCRA **bank report** for March will be published.
- On **Thursday 23**, the results of the **surveys of supermarkets, wholesalers and shopping malls** for the month of March will be known.
- On **Thursday 23**, INDEC **purchasing data for appliances and household items** corresponding to the first quarter of 2024 will be published.

ECONVIEWS
ECONOMÍA Y FINANZAS

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	886.8	0.5%	2.0%	282.8%	↑
MEP	1069.9	3.4%	5.0%	138.9%	↑
Blue Chip Swap	1090.7	2.2%	3.2%	129.0%	↑
Parallel	1100.0	7.8%	8.9%	128.2%	↑
Official exchange rate BRL/USD	5.1	-1.1%	-2.6%	3.3%	↓
CB reserves (USD million)	28,798	+437	-673	-4,500	↑
Policy rate (Leliq)	40.0%	-10.00 p.p.	-30.00 p.p.	-57.00 p.p.	↓
Badlar rate (private banks)	32.5%	-6.88 p.p.	-28.50 p.p.	-60.56 p.p.	↓
Private Deposits (trillion ARS)	49.2	-3.4%	9.1%	144.8%	↓
Private Loans (trillion ARS)	21.1	-2.6%	9.0%	140.3%	↓
Merval (in ARS)	1,467	4.2%	25.2%	347.6%	↑
Merval (in USD)	1,345	2.0%	21.3%	95.5%	↑
Country Risk (spread in %)	1,263	-0.6%	-0.6%	-50.5%	↓
Soybean (USD/tn)	451.2	1.9%	6.8%	-8.2%	↑
Corn (USD/tn)	178.1	-0.7%	5.2%	-19.4%	↓
Wheat (USD/tn)	239.3	0.9%	21.3%	4.1%	↑
Oil - Brent (USD/barrel)	83.4	-1.4%	-8.0%	7.5%	↓
Oil - WTI (USD/barrel)	81.7	2.3%	-2.3%	12.2%	↑
LNG (USD/MMBTU)	10.9	3.8%	11.2%	3.8%	↑
Gold (USD/oz.)	2,415.8	2.4%	2.3%	21.9%	↑

Note: arrow depends on weekly variation

Stoplight for Economic Activity

Seasonally adjusted variations

		m/m	q/q	LD vs previous Q
Industrial production	*Mar-24*	-6.3%	-9.9%	-7.2%
Automobile production	*Apr-24*	13.8%	-8.0%	6.3%
Steel production	*Apr-24*	44.3%	-13.0%	-0.5%
Poultry production	*Mar-24*	-7.2%	0.0%	-4.1%
Dairy production	*Apr-24*	9.8%	-3.5%	-0.1%
Beef production	*Mar-24*	0.5%	-7.1%	-1.3%
Real Estate transactions (CABA)	*Mar-24*	0.0%	-1.7%	8.4%
Flour Production	*Mar-24*	-3.8%	-3.2%	-2.2%
Oil production	*Mar-24*	-2.7%	1.7%	-1.0%
Gas production	*Mar-24*	-3.8%	9.4%	6.8%
Cement production	*Apr-24*	9.2%	-18.6%	-8.6%
Construction activity	*Mar-24*	-14.2%	-22.7%	-19.4%
Gas sales	*Mar-24*	-2.7%	-5.8%	-2.6%
Motorcycle licenses	*Mar-24*	-23.5%	-25.0%	-27.7%
Use of electricity	*Apr-24*	0.9%	-4.2%	-2.7%
Train rides (AMBA)	*Mar-24*	3.2%	0.7%	2.7%
Imports CIF	*Mar-24*	-0.9%	-9.2%	-3.3%
Exports FOB	*Mar-24*	-0.4%	14.8%	4.5%
Loans in ARS to private sector	*Apr-24*	-1.2%	-16.6%	-2.2%
VAT-DGI Revenues	*Apr-24*	1.7%	-2.9%	1.2%
Formal private jobs (SIPA)	*Jan-24*	-0.1%	-0.2%	-0.1%
Formal private jobs (EIL)	*Mar-24*	-0.5%	-0.9%	-0.8%
Consumer confidence	*Apr-24*	1.3%	-10.6%	2.9%
Government confidence	*Apr-24*	-4.3%	10.2%	-5.0%

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

Another Fiscal Surplus in April, With Some Doubts

- *The national government had a fiscal surplus of 17 billion and a primary surplus of 265 billion, accumulating 0.7% of GDP in four months.*
- *Of the fiscal package, the most important thing is the reimposition of income tax, which can contribute 0.3% of GDP in additional revenues.*
- *The PAIS tax on dollar purchases and debts with energy companies add up to 4 trillion pesos, more or less the accumulated primary surplus between January and April.*

The government ran its fourth fiscal surplus in a row in April. This time it was 17 billion pesos, well below January, February or March's numbers. The primary surplus was 265 billion, accumulating 0.7% of GDP in Q1. At this point, the market does not doubt Javier Milei and Luis Caputo's fiscal commitment, but the positive results are tainted by an excessive dependence on the PAIS tax on dollar purchases (inflated by the Central Bank's BOPREAL issue) and the sloppy treatment of CAMMESA's debt with energy companies. Net of these two items, the accumulated primary surplus becomes a marginal deficit of 0.02%.

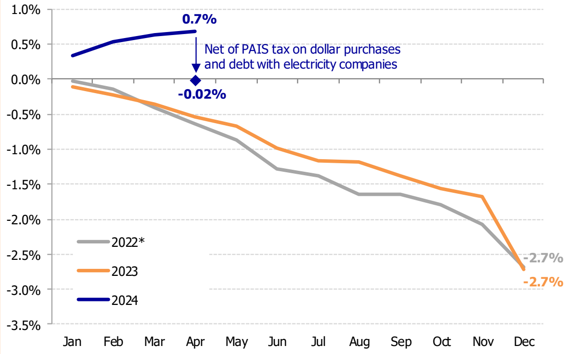
The PAIS tax on dollar purchases gains weight. It contributed 510 billion pesos in April, and 2.25 trillion in the first quarter, 0.4% of our forecast GDP. Seen another way, PAIS tax revenues in 2024 are equal to 71% of the national public administration's wages (of course the money is fungible). In addition to the expansion of the taxable base in December, the collection of the PAIS tax is inflated by the BOPREAL tenders. Until April, the Treasury collected 452 billion through this channel, 20% of the PAIS tax's full revenues. In May there will be at least 284 billion.

Retirements hit a floor... and a roof. In April, seasonally adjusted retirement spending rose 8% compared to March and almost 20% compared to February's minimum, the effect of indexation and the 12.5% increase that the government applied by decree. Now, they will run at par with the CPI, with a lag of 2 months. With the decrease in inflation they will grow somewhat more in real terms, but not much.

Having slumped 36% year-on-year in Q1, using this formula, real spending on pensions will fall 25% throughout 2024, not counting discretional bonuses. It is true that with the previous mobility (wages and social security revenues) they would have fallen further year, due to the quarterly update, but the change in formula takes away their chance at a rebound in 2025, if inflation stabilizes.

The gas and electricity bills arrived, will they be paid? In April, energy subsidies jumped to 780 billion, more than the accumulated amount in the

Graph 1. Primary result
Accumulated as a % of GDP - National government, cash basis



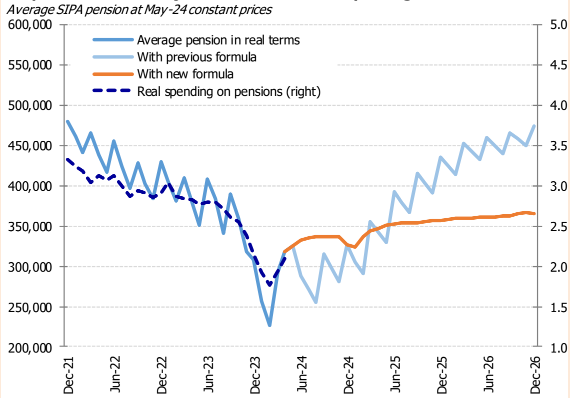
2022* excludes rents from CER bond issuance
Source: Econviews based on Min. of Economy and INDEC

Chart 1. PAIS tax on dollar purchases revenues
In billion ARS

	in billion ARS		Total PAIS as a % of GDP
	Total	BOPREAL	
2023	**1,511**	**-**	**0.8%**
Jan-24	469	-	0.1%
Feb-24	576	292	0.1%
Mar-24	695	145	0.1%
Apr-24	510	16	0.1%
Acum. Jan-Apr-24	**2,250**	**452**	**0.4%**
May-24	no data	284	-
2024E with FX controls	**10,153**	**-**	**1.7%**
2024E with gradual exit	**8,046**	**-**	**1.3%**

Source: Econviews based on Min. of Economy

Graph 2. Pensions: adjust. formula and real spending
Average SIPA pension at May-24 constant prices



Source: Econviews based on SIPA, Sec. of Labor and INDEC first quarter. The bulk corresponds to transfers to ENARSA (estimated at 373 billion by the Congressional Budget Office) to pay for natural gas imports. Instead, the government extended until the offer to energy generators to pay CAMMESA's debt with sovereign bonds until next Thursday. The Ministry of Economy recognizes a debt of 1.07 trillion for December and January. Adding February and March it would be around 2 trillion, although a portion was already paid to the companies that agreed to the bond offer).

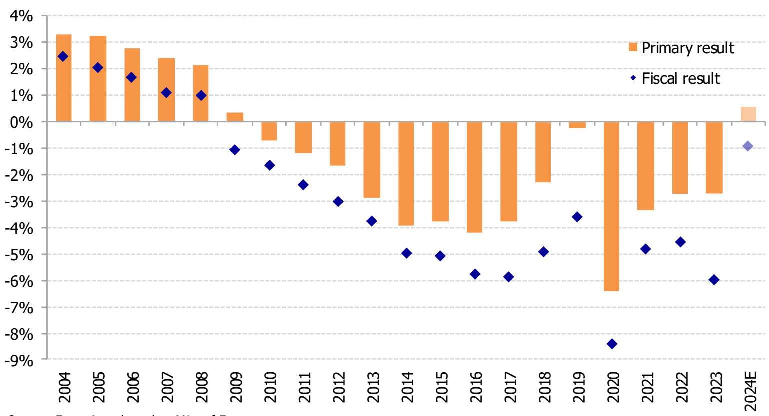
Going forward, the government is discussing freezing utilities during the winter. An all-out bet to control the CPI (and give some leeway to consumption). We see two problems with this. The growth of subsidies could lead to new arguments between CAMMESA and the energy companies, and the offer to pay in 2038 bonds leaves a bad precedent for the sector. If fiscal space exists, it would be better to allocate it to public works, which are not a regressive expense like energy subsidies and have a multiplier effect on employment and activity.

Public works were slightly up in April. Last month, 151 billion pesos in capital expenditures were executed, 52% more than the average for the first quarter of 2024, although 78% below April 2023. 97% corresponds to national government works, when usually a quarter of expenditures are transfers for provincial works. A lot hinges on governors supporting the reform bill in the Senate.

May could be the last month of fiscal surplus. Public sector deposits grew by 1.36 trillion in the first 14 days of the month, although as graph 4 shows, in April they were no longer a good predictor of the primary result. There are several factors that boost May's collection. The Central Bank's new issue of BOPREAL, the large harvest, some rebound of imports and activity. Furthermore, with the April wage increases many non-remunerative aspects of the salary become remunerative and pay social security contributions. On the negative side, there are interest payments of 1.1 trillion, most of it with the IMF. June is always a complicated month. In the second semester, the contradictions between the fiscal goal and lowering the CPI by freezing utilities, or improving the relationship with the provinces, may grow sharper.

All in all, **the government has a good cushion to achieve a primary surplus of 0.5% of GDP this year**. At Econviews we believe that the market is more concerned about the primary than the fiscal result, although in any case financial engineering with short-term debt and exchange rate appreciation can reduce interest payments as a percentage of GDP.

Graph 5. National Government - Fiscal accounts
As % of GDP, excludes rents from primary CER-debt issue, PIPs under the line



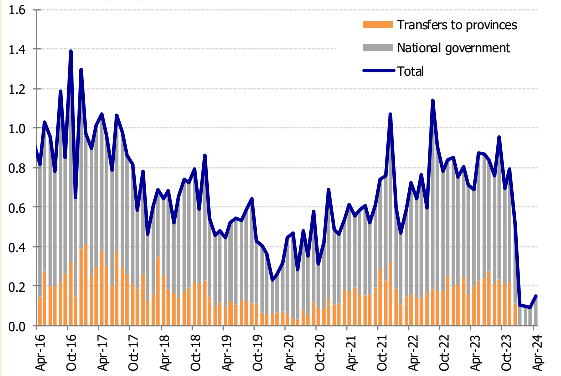
Source: Econviews based on Min. of Economy

Chart 2. Energy subsidies
In billion ARS

	in billion ARS	As a % of GDP
Cash basis Q1-2024	**688**	**0.11%**
Cash basis Apr-24	**780**	**0.13%**
Transfers to ENARSA	373	0.06%
Total debt CAMMESA	**2,074**	**0.34%**
Dec-23 to Jan-24	1,074	0.18%
Feb-24 to Mar-24 (est.)	1,000	0.16%

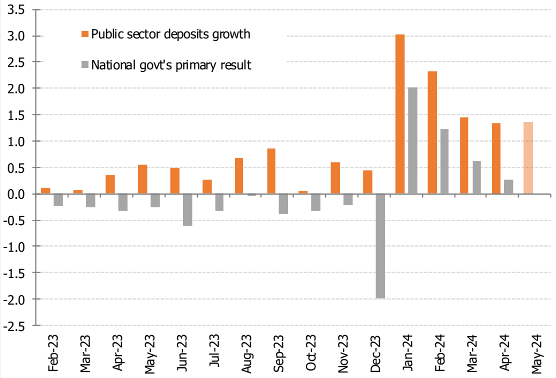
Source: Econviews based on Min. of Economy

Graph 3. National government's CAPEX
In trillion ARS at Apr-24 prices



Source: Econviews based on Min. of Economy and INDEC

Graph 4. Public sector deposits growth
Last day of each month (up to May 14), in trillion ARS



Source: Econviews based on Min. of Economy and BCRA

Inflation to Come Down in May With a Little Help From My Friends

- *The compression of profit margins is helping to lower inflation, but it is a one-time process.*
- *Inertia puts a floor to monthly inflation, while the exchange rate anchor and recession play in the opposite direction.*
- *We forecast 175% inflation for all of 2024 with downward risk.*

April's CPI print came in at 8.8% monthly. At Econviews we were expecting 9%, same as the CB survey median, so the figure was not a surprise, and probably disappointed optimists who were expecting something closer to 8%. It is still good news, especially given core inflation to which the government paid special attention. **The rise in the core index was 6.3%, the lowest figure in 15 months.** In year-on-year terms, the CPI rose 289.4%. We expect 2024 to close around 175%.

May's print will be lower, especially because the scheduled increases in electricity and gas rates were not applied. Additionally, **our high frequency indicator shows that food is running at 1.5% monthly in the last 4 weeks.** If the pace of the last week is maintained (1.2% weekly increase), May could end with a monthly increase of 3.5% in food. If this number is confirmed, it would be the lowest since November 2022. The crawling peg at 2% is playing a very important role here.

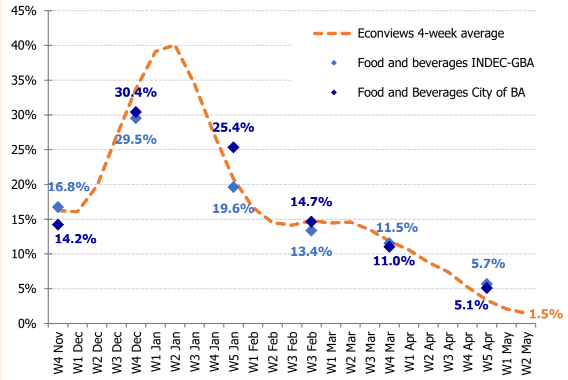
The dispersion between categories is still large. Among the items that rose the most last month, "Housing, water, electricity, gas and other fuels" leads by far with an increase of 35.6%. Communication also stands out with 14.2%. Regulated prices in general rose by double digits for the sixth consecutive month, scoring 18.4% in April. They are still catching up after a long freeze: they have already reached September 2021 levels for the national CPI.

Food and non-alcoholic beverages (6%), the item with the greatest weight in the CPI, and alcoholic beverages and tobacco (5.5%) had the smallest increases.

There is a sharp difference in inflation between regions, due to the correction in public services. While prices in the Greater Buenos Aires rose 9.2%, the general increase for Northeast Argentina was 6.3%. In GBA the increase in "Electricity, gas and fuels" was 63.5%, in the other regions it was as high or higher. The exception is the Northeast, where the adjustment was 14.5%. But this makes sense, given that the region was already paying regulated prices close to the general level (see table 1).

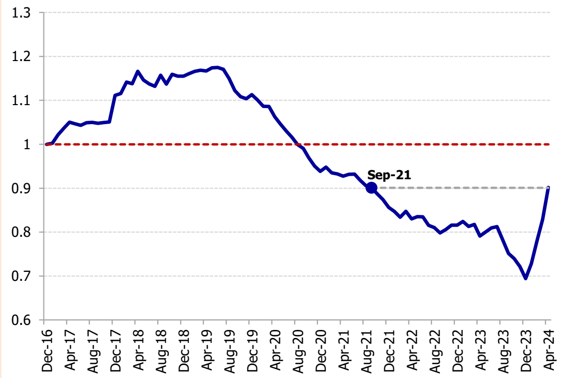
When will regulated prices catch up? At the national level, transportation and health have already corrected most of the disbalance accumulated in the last

Graph 1. Monthly inflation in food and beverages
Average 4-week variation (Econviews online survey) and official data



Source: Econviews based on INDEC, IPCBA and own estimates

Graph 2. Regulated vs. CPI
Ratio between regulated and general level, base Dec-16=100



Source: Econviews based on INDEC

Chart 1. How long until the correction of regulated prices ends?
Ratio between regulated and CPI by region

Region	mar-24	apr-24
NEA	0.93	0.96
Patagonia	0.87	0.95
Cuyo	0.85	0.91
NOA	0.84	0.91
GBA	0.82	0.91
Pampa	0.81	0.88

Source: Econviews based on INDEC

4 years. Telecommunications responded to the liberalization of prices with a 14.2% jump in April, but there is still an important stretch left. More or less 30 percentage points short of reaching 2019 levels. In April, the adjustment in utilities led to a general increase of 30%, but they are still far from correcting the last 4 years.

The scheduled increases in gas and electricity will not be applied in May, and now the government is analyzing freezing rates for both services throughout the winter. The idea seems to be lowering inflation at any cost, but this is not free. On the one hand, postponing the increases implies that subsidies are not reduced and that hurts on the fiscal side. If the Treasury is comfortable, it would do better lowering taxes or reactivating public works. Furthermore, when rates eventually increase it will press on the CPI, meaning that the measure is simply repressing inflation.

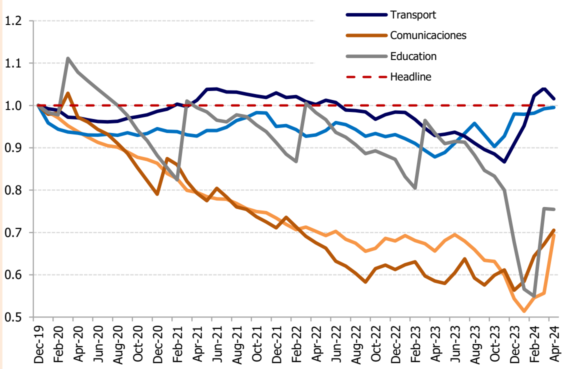
Private healthcare did not give in. In April, on average private healthcare plans in GBA increased by 17.7%, quite similar to the increase in the previous month (18.5%). The government is pressing companies to return quotas to users, arguing that the increases after prices were liberalized in December were excessive. Although it is true that prepaid prices rose well above the general CPI (40% in January, 25% in February), they are still below 2019 levels in real terms. If the government wins the court battle and a rollback in prices is imposed, it would imply a delay in the rearrangement of relative prices. It may be true that the initial increases were very strong and in this case there was no rush since it has no influence on the fiscal matter. However, it is a price that has fallen far behind in recent years and for it to recover the ground it lost it will necessarily for healthcare to grow above the general CPI.

Is inflation collapsing or finding a floor? At Econviews we expect inflation to continue to fall, but not much further. Inertia sets a floor for inflation in the coming months, and it will occur for the following reasons:

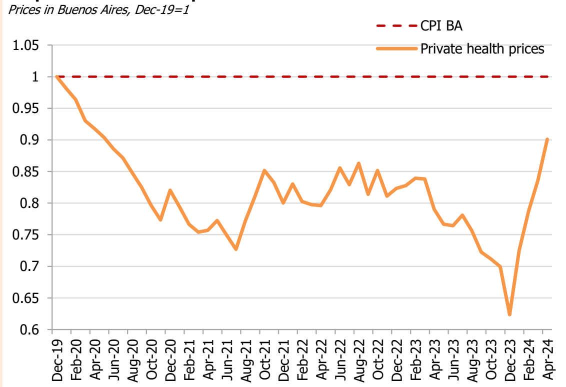
• **Companies' profit margin is shrinking.** There was a sharp drop in inflation associated with the overshooting of margins in December. Many companies priced goods expecting a runaway exchange rate, which did not occur. Thus, they were left with a large profit margin, that shrunk gradually since December. During these months many firms were able to afford fewer markups or even lower prices, but the time is coming when they will be forced to increase at a certain rate to continue operating.

• **New freezes in regulated prices alter expectations**. Not raising the fuel tax or electricity and gas rates help reduce inflation today, but they are prices that sooner or later will have to be corrected.

• **Real wages are beginning to recover and that pushes demand**. Salaries are another key price of the economy and like many others they have been losing in real terms for several months. To the extent that they begin to recover, they will put pressure on inflation. This situation can be thought of as a race between all the prices in the economy in which no one wants to be left behind and that means that at some point the decline in inflation finds a limit.



Graph 3. Regulated prices
Compared to the headline, Dec-19 =1
Source: Econviews based on INDEC



Graph 4. Private health prices relative to the CPI
Prices in Buenos Aires, Dec-19=1
Source: Econviews based on INDEC

The government set lowering inflation as a priority objective, which would allow it to generate short-term credibility. The exchange rate anchor strategy has been showing results, although at Econviews we have been warning that it will have its costs in the future. Now Caputo’s unorthodox toolbox adds the manipulation of regulated prices, which at some point must be corrected.

Is it the best strategy? Our view was always that an accelerated crawling peg (say at 6%) would have very little impact on prices and would prevent the real exchange rate from over appreciating. But this is not the government's vision, and we see it highly likely that the official dollar at 2% per month will continue for a few more months. Inflation will continue to fall, but at the cost of exchange rate appreciation. It is a trade-off between sustainability and generation of short-term credibility.