THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

May 27th 2024

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Editorial: The Dollar and Activity Levels Take Center Stage

Since Milei assumed office, the economy has been moving in one direction: full steam ahead with things improving. Inflation has been steadily falling since its peak in December, the country risk has been dropping from 2,200 points and reached nearly 1,200 a few days ago, and the parallel dollars remained stable. The Central Bank saw no obstacles to lowering the interest rate because, despite having negative real rates, people continued to hold pesos (aided by FX restrictions, of course).

However, a series of events in the past week should serve as a wake-up call for the government. It is a yellow light for now, but it strengthens the hypothesis that the initial stage of chainsaw and adjustments is concluding, and a new phase requiring fine-tuning is starting.

The first alert was the rise of the blue dollar, followed by increases in the CCL and MEP. Although the increase was not significant, approximately between 15 and 20 percent, it was the first notable rise after the initial adjustment in exchange rates. The most likely trigger was the last rate cut by the Central Bank, a reduction by ten percentage points to 40%. Until this episode, the Central Bank had initially decreased the monetary policy rate from 133% to 100% and then to 80%. Subsequently, it lowered the rate by ten percentage points at a time until it reached 50%. Despite these cuts, the exchange rates remained steady without reaction. For some reason, the last cut was the tipping point, and the dollar responded.

This increase occurs in the context of a debate about whether there is an exchange rate lag. The risk is that if inflation remains above the official exchange rate's depreciation rate for several months, the situation could grow more complicated. For now, this rise in parallel rates is simply an alert that we hope will make the Central Bank reflect.

The second alert is the rise in country risk. It jumped to 1,450 points, causing anxiety in the markets. The causes are probably unclear but may have been partly driven by the dollar's rise and the government's difficulties in getting the Bases Law approved in the Senate. The debate in the upper house is turning out to be more difficult than in the lower house, and in fact, many reforms seem to be getting "watered down." In the process, the May Pact, an initiative the government wants to be supported by most governors, was postponed until June or July.

A third issue is the police revolt in the province of Misiones. We still don't know if it is simply an isolated protest in a province whose governor is getting closer to Milei or if it will generalize. It's too early to conclude, but it is essential to follow this situation closely.

A strong recession adds to these events. The INDEC's monthly economic activity estimator (EMAE) showcased a worse-than-expected 8.4% year-on-year decline in March. Although activity seems to have hit bottom in March or April, everything suggests that recovery is unlikely to be V-shaped, which would be another warning sign for the government.

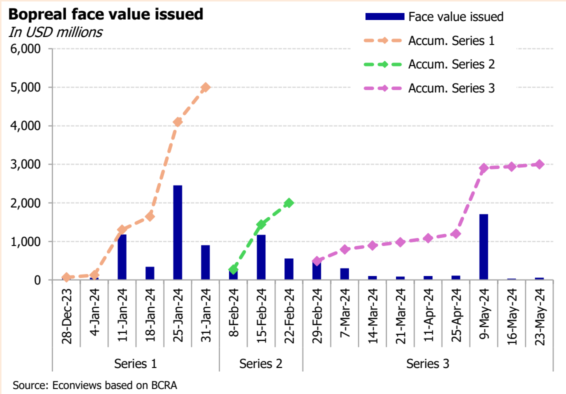
Considering these events, closely monitoring the evolution of Milei's positive image will be crucial. For now, it remains high, being his main political asset. What remains clear is that in this second stage, the pace of economic recovery will be a critical variable to watch.

LAST WEEK IN REVIEW

In last Thursday's tender, the Central Bank allocated US$ 60 million of Bopreal Series 3. **With this amount it completed the US$ 10 billion nominal value to be issued.**

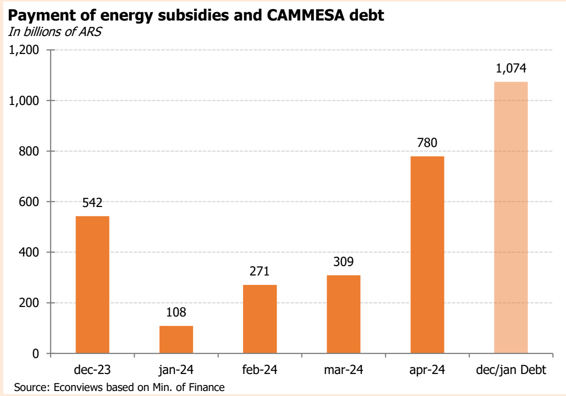
With this bond, the BCRA absorbed AR$ 6.93 billion and the Treasury collected ARS 745 billion from the PAIS tax on dollar purchases.

Starting in July, series 2 begins to be amortized, which will imply greater demand for dollars.



The government negotiated with energy companies over CAMMESA's debt. The companies accepted the payment of the debt corresponding to December and January, which reached 1,074,000 million pesos, with AE38 bonds. At its current price, it is equivalent to a reduction of around 50%.

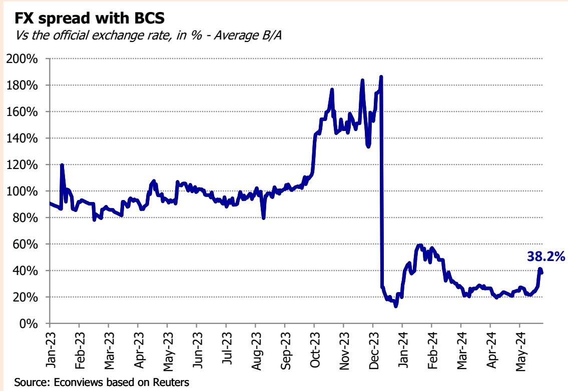
The agreement eases the government's fiscal bills – the amount owed exceeded the payment of energy subsidies in the first quarter – although it is not clear whether the IMF will agree to account for the payment of current expenses with a bond in this way.



Last Friday, the blue dollar closed at 1,200 pesos after reaching 1,260 pesos on Thursday. **With this weekly increase of 9.1%, the FX spread remained at 35%.**

The MEP dollar and the BCS also fell and remained at 1,203 and 1,236 respectively. **In this case, the weekly increases were somewhat larger (12.5% and 13.4%) and the spread with the official dollar remained at 35% for the MEP and 38% for the BCS.**

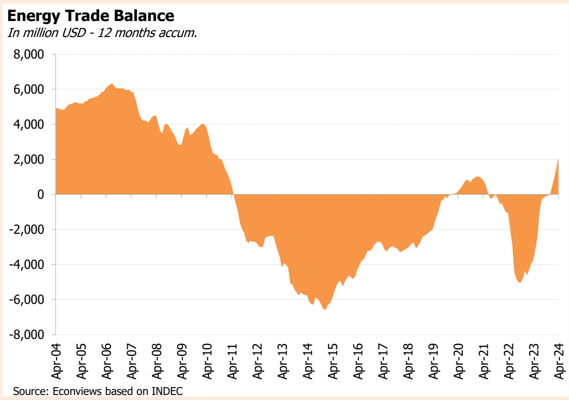
The country risk also rose to 1,443 points (+14.2% weekly).



The trade balance had its fourth consecutive positive balance in April. Argentina exported USD 6,527 million and imported USD 4,708 million, resulting in a positive trade balance of USD 1,820 million. The accumulated trade balance in the quarter is USD 6,157 million.

April exports increased 10.7% year-on-year. Exports of fuel and energy and those of primary products with an increase of 44.4% and 53.8% respectively.

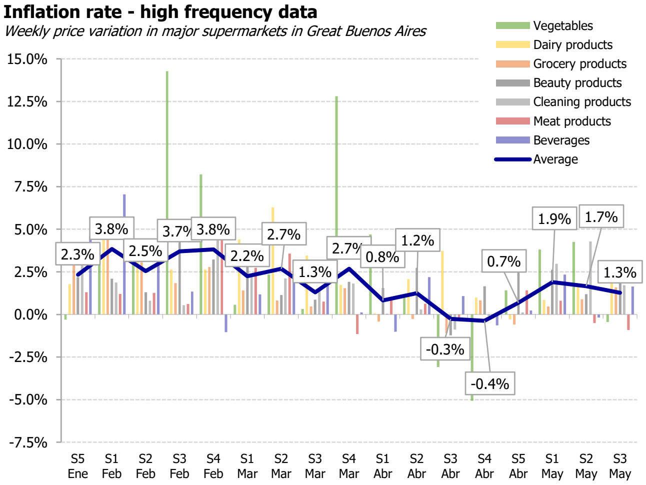
April imports decreased by 22.7% year-on-year. Fuel imports fell 58.9%, leading to **another month of positive energy trade balance.**



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 28**, the **agricultural machinery industry report** for the first quarter of 2024 will be published.

√ On **Thursday 30**, the **staffing of the national public administration, companies and societies** corresponding to April 2024 will be announced.

√ On **Thursday 30**, the BCRA will publish the **monthly report on retail payments and the report on foreign direct investment**.

√ On **Friday 31**, the report on **the Evolution of the Foreign Exchange Market and Exchange Balance** will be released.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	890.8	0.5%	2.0%	278.0%	↑
MEP	1203.7	12.5%	18.9%	162.1%	↑
Blue Chip Swap	1236.8	13.4%	18.2%	155.5%	↑
Parallel	1200.0	9.1%	18.2%	145.9%	↑
Official exchange rate BRL/USD	5.2	1.2%	0.4%	4.1%	↑
CB reserves (USD million)	29,113	+312	-910	-3,853	↑
Policy rate (Leliq)	40.0%	0 p.p.	-30.00 p.p.	-57.00 p.p.	=
Badlar rate (private banks)	31.6%	+0.38 p.p	-29.69 p.p.	-59.94 p.p.	↑
Private Deposits (trillion ARS)	49.0	-0.3%	11.2%	142.0%	↓
Private Loans (trillion ARS)	22.2	4.7%	11.1%	145.6%	↑
Merval (in ARS)	1,521	3.2%	26.5%	345.1%	↑
Merval (in USD)	1,230	-9.0%	7.0%	74.2%	↓
Country Risk (spread in %)	1,443	14.2%	19.9%	-44.2%	↑
Soybean (USD/tn)	458.6	1.6%	7.0%	-5.8%	↑
Corn (USD/tn)	183.0	2.7%	6.2%	-20.9%	↑
Wheat (USD/tn)	256.2	7.1%	17.3%	15.0%	↑
Oil - Brent (USD/barrel)	80.1	-4.0%	-11.2%	1.1%	↓
Oil - WTI (USD/barrel)	78.5	-3.9%	-6.7%	5.5%	↓
LNG (USD/MMBTU)	12.3	12.8%	17.1%	25.5%	↑
Gold (USD/oz.)	2,334.3	-3.3%	0.8%	19.3%	↓

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)	*Apr-24*	7.9%	15.1%	13.5%
Flour Production	*Apr-24*	4.9%	-1.6%	2.3%
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	*Apr-24*	0.1%	-4.0%	-1.7%
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	*Apr-24*	-0.4%	-7.9%	-2.2%
Exports FOB	*Apr-24*	1.0%	11.4%	2.3%
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

ECONVIEWS
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Banks Are Doing Well and Starting to Rebuild Their Core Business

- *Banks had a very good first quarter in terms of profits.*
- *With the deregulation of minimum time deposit rates, banks spread improved, and the financial intermediation business started to recover.*
- The public sector has a large share in the banks' assets. We expect it will begin to reduce and private loans will gain ground again.

In the first quarter of the year, total financial entities accumulated profits of ARS 2.42 trillion (in Mar-24 pesos). With this result, it was the best first quarter for banks at least since 2010 (see graph 1). Annual cumulative return on assets (ROA) reached 5.9% in March and return on equity (ROE) was 23.2%. This good performance may be what explains why banking stocks have had the highest returns so far this year.

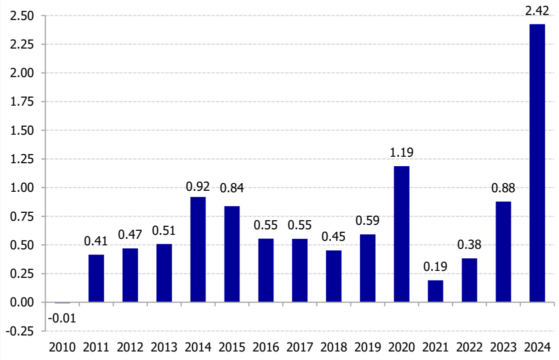
Breaking down the total result we can see there were improvements in almost all areas compared to the same period last year (Q1-23 vs. Q1-24 – see chart 1**). Firstly, the financial margin increased by 105.8% in real terms (+ ARS 7.74 trillion).** Within this number, there are several things to highlight:

-Net interest income begins to improve. Although it is still negative, this negative result has already been cut almost in half. That is why we say the banking core business is being reborn, although it still has a long way to go. Eliminating minimum rates for time deposits played a very important role here. This allowed banks to lower their funding costs, which more than compensated for the reduction in lending rates. This is how interest income fell, but less than expenses, causing an improvement in the net margin. We also think that it may have a positive influence that banks are getting revenues from loans that were agreed at higher rates than the current ones while taking shorter deposits incorporating the lower rates. Given that the evolution of net interest income shows a lag concerning the rate spread, we can infer that in the following months, this account continued to improve (see graph 2).

-The result from public bonds was lower. This is explained because this account included the Leliqs, whose stock was reduced to zero at the beginning of the year. That is, it is not due to a decrease in the holding of public bonds.

-Incomes from Repos had a very strong growth. Here we see the other side of the reduction of Leliqs stock, given that these pesos mostly went to Repos. As the data available is up to March, we still cannot see in the results the rotation that occurred towards public securities in the last auction, but we can estimate that this number will begin to decrease and the result from public bonds will increase.

Graph 1. Financial System's Profits
In trillion ARS of Mar-24 - Accum. up to march of each year



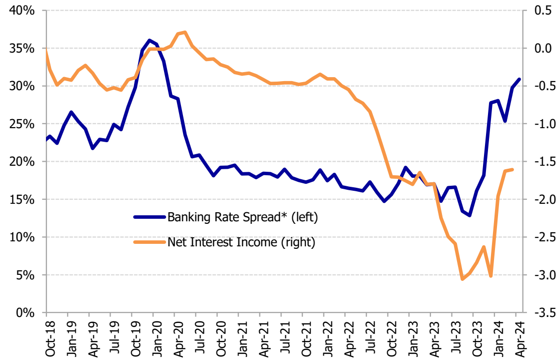
Note: data with own adjustment for Monetary Result between 2010 & 2019.
Source: Econviews based on BCRA

Chart 1. Income Statement - Total financial system
Accum. 1st quarter - In trillion ARS of Mar-24

	2022	2023	Difference
Financial margin	7.32	15.06	7.74
Interest income	4.02	4.04	0.02
Interest expenses	-9.27	-9.23	0.04
Securities	8.84	6.71	-2.13
Repos	1.81	7.52	5.71
Others	1.92	6.03	4.11
Service-Related Income	0.59	0.39	-0.20
Bad debt charges	-0.37	-0.41	-0.03
Administration expenses	-2.40	-2.63	-0.23
Monetary result	-3.37	-8.43	-5.06
Others	-0.89	-1.56	-0.67
Total Result	**0.88**	**2.42**	**1.55**

Source: Econviews based on BCRA

Graph 2. Banking rate spread improved
Spread in nominal terms (left) & Income in trillion ARS of Mar-24 (right)



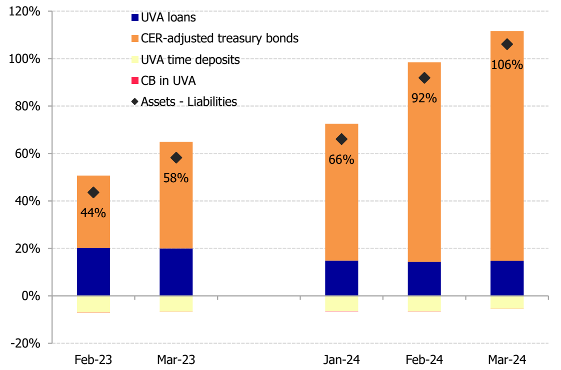
*Weighted average of lending rates - Funding cost
Source: Econviews based on BCRA & own estimates

-Within the “others” item of the financial margin there was also a significant increase, which corresponds almost entirely to CER and CVS adjustments. We estimate that this is due to the acceleration of inflation in the first months of the year and since the CER accrues with a delay of 45 days, it also took December inflation. Furthermore, according to BCRA information, the difference between assets and liabilities in CER became much larger, which may also have helped (see graph 3).

Outside the financial margin, the result from services (it includes bank commissions) fell again, while delinquency charges and administration expenses did not have major differences. There was a strong variation in the monetary result, which reflects the effect of inflation on the balance sheet items that are not re-expressed. This adjustment moves by inflation and in this case, the acceleration had a negative impact (see graph 4).

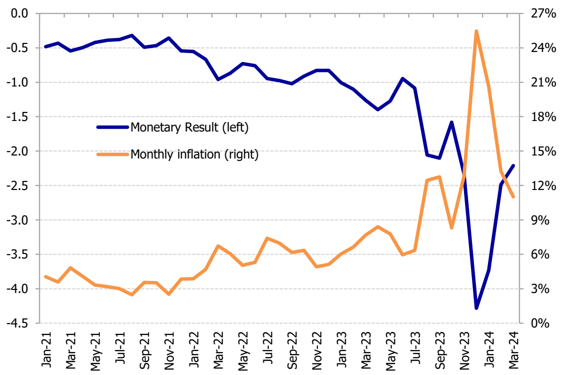
Regarding the assets of financial entities, the presence of the public sector, whether in the form of BCRA instruments or Treasury bonds, has been growing year after year (see graph 5). This was to the detriment of credit to the private sector (crowding out effect) which represents an increasingly smaller percentage of assets. Our vision is that, if the national government balances the fiscal accounts, it can leave more room in the credit market and this situation can begin to be reversed. Lowering rates can also boost private loans and, as the government hopes, be one of the drivers to overcome the recession. Some of this is already happening and probably in May credit to the private sector will record the first increase in real terms after 6 consecutive months of falls. In any case, rebuilding credit portfolios is not a quick process and will not have an immediate effect.

Graph 3. Spread between CER/UVA assets and liabilities
In % of regulatory capital



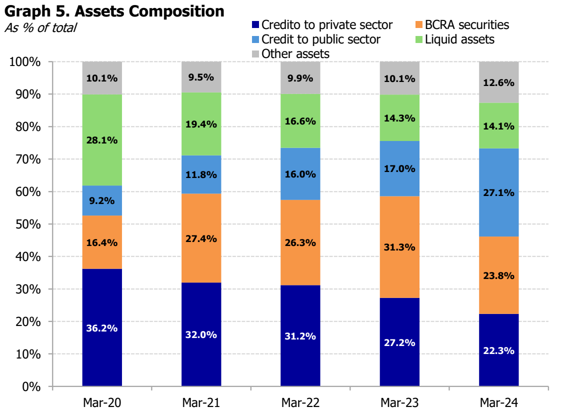
Source: Econviews based on BCRA

Graph 4. Monetary Result and Inflation
In trillion ARS of Mar-24



Source: Econviews based on BCRA & INDEC

Graph 5. Assets Composition
As % of total



Source: Econviews based on BCRA

The Exit From the Recession Begins, More Swoosh-Shaped Than V

- *March was a difficult month for almost all sectors of the real economy.*
- *April shows signs of improvement.*
- *Consumption indicators still show bad numbers, but we expect them to rebound thanks to the slow recovery of real wages.*

The economy fell 1.4% monthly in March. The recession is fierce, but we believe it has already reached its floor. From now on, we expect a slow recovery, although more similar to the Nike Swoosh than a V. The March result leads us to worsen our GDP projection in 2024 to a fall of 3.6%.

So far this year the EMAE has accumulated a drop of 5.2% compared to the first quarter of the previous year. **Agriculture leads with a variation of 11.2% compared to the first quarter of 2023**. This is expected given that we compare it against the drought season. Mining and hydrocarbons is the other sector that will help cushion the fall in GDP, and for now, it stands out with an increase of 8%. Construction is the hardest-hit sector by far, with a cumulative variation of -23.3%. This strongly affects the Investment account. Commerce, a good indicator of consumption, is 10.8% below the same quarter last year.

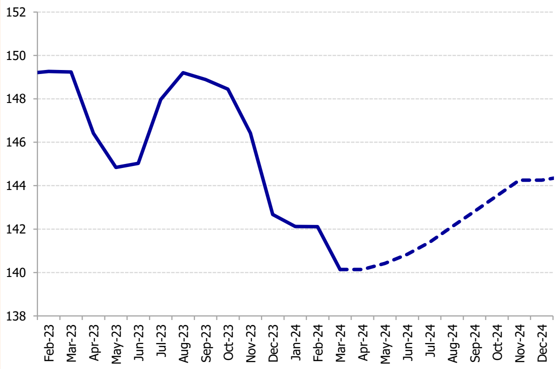
Chart 1. Economic activity by sector
Monthly variations by sector as of March 2024

	jan-24	feb-24	mar-24	Accum. 2024
EMAE	-0.4%	0.0%	-1.4%	**-5.2%**
Agriculture and livestock	-0.1%	4.3%	-2.0%	**11.2%**
Fishing	10.3%	-8.5%	-13.4%	**4.7%**
Hydrocarbons and mining	2.8%	1.9%	-4.5%	**8.0%**
Industry	3.0%	1.9%	-8.2%	**-13.4%**
Energy	7.7%	14.5%	-8.1%	**-2.2%**
Construction	-9.9%	-4.6%	-8.8%	**-23.3%**
Retail	3.6%	-0.1%	-6.6%	**-10.8%**
Hotels and restaurants	-8.0%	-1.1%	-0.1%	**-0.7%**
Transport and comunication	-0.7%	0.3%	-1.5%	**-0.5%**
Banking sector	2.2%	-1.6%	-2.4%	**-12.5%**
Real estate	-0.4%	0.1%	-1.4%	**-1.5%**
Public administration	-0.9%	0.3%	-0.5%	**0.8%**
Education	-0.3%	0.2%	-0.3%	**1.6%**
Health	0.1%	0.2%	0.1%	**1.4%**
Other social services	0.2%	0.0%	0.1%	**-1.9%**

Source: Econviews based on INDEC

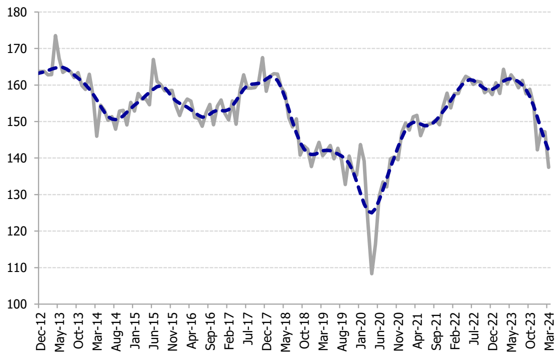
On a month-over-month basis, **March was notably worse**. All sectors, except Health and Other social services, worsened compared to February (see Graph 3). Among those that weigh the most in the GDP, Construction (-8.8%), Manufacturing Industry (-8.2%), and Commerce (-6.6%) stand out. Agriculture, which in February had helped mitigate the fall, this time also fell 2%. Poor weather conditions in March led to a delay in the soybean harvest, and the

Graph 1. Economic Activity
Base 2004 = 100



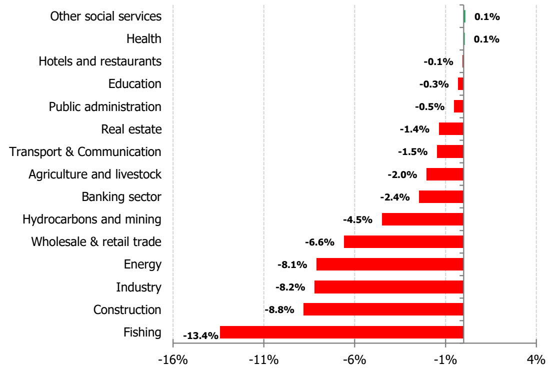
Source: Econviews based on INDEC & own estimates

Graph 2. Commercial activity
Seasonally adjusted EMAE - Wholesale, retail and repairs sector



Source: Econviews based on INDEC

Graph 3. Sectors of the economy in March
Monthly variation - seasonally adjusted



Source: Econviews based on INDEC

Buenos Aires Grain Exchange reduced its soybean production projection from 51 to 50.5 million tons.

April shows signs of rebound. At our Stoplight for Economic Activity (page 4) **some green lights turned on for industry and construction.** There are good signs for the industry, which could at least slow its decline. Crude steel production rose 44%, after a complicated March between the closure of Acindar plants and union conflicts. Car production also changed trend, with a monthly increase of 13.8%. Deseasonalizations with the XL holiday cast doubt on the numbers, but the direction seems to be positive.

Among other traffic light indicators, dairy production (+9.8%) and flour (+4.9%) improved. Real estate deeds in CABA increased by 7.9%. Consumer confidence increased by 1.3%. The data on loans to the private sector goes in the opposite direction, with a variation of -1.2%. The balance remains positive. **With these numbers in our favor, we hope that in April the economy will at least stop falling.**

April may have been better for construction because cement production rebounded 9.2% monthly after 5 months of declines. The fiscal report shows that national public works also began to move. In addition, shipments from Grupo Construya companies registered an increase of 4.5% compared to March.

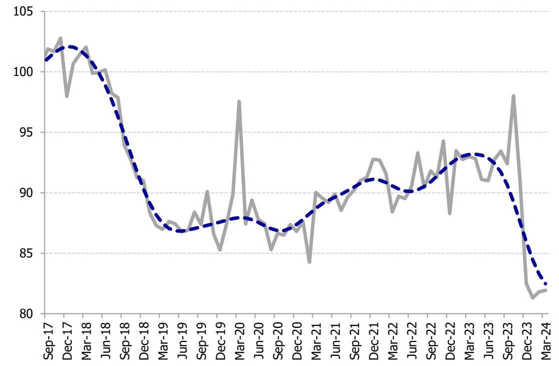
The "Strong Peso" does not help construction (it raises costs), but it can give air to consumption, which still shows bad numbers. In March, sales in supermarkets remained practically the same compared to February (+0.1% m/m), while wholesale sales fell 2%, accumulating 5 consecutive months of decline. These are numbers that support the 6.6% drop in the Commerce sector within the EMAE. The positive data is the sale of shopping malls, with a monthly increase of 8% in sales. It is his second consecutive month of recovery.

Is consumption expected to rebound in the coming months? At Econviews we see a (slow) recovery in real wages, as inflation settles at around 6% monthly and union agreements are signed one or two points higher. Although they are far from recovering what was lost in December and January, those months will have been the floor for income. Taking the INDEC index, it is seen that real salaries have recovered 10% since January. In April they rose 1.1%, and it is expected that the trend will continue to increase. Given the magnitude of the recession, the parallel dollar movements of the last week should not have much impact on prices, but they may lead some consumers to rethink or postpone spending on the margin. The government is betting that the reappearance of credit will drive the recovery. For now, it is not reflected in the data on loans to the private sector (-1.2% m/m in April) but it may grow with the drop in inflation and the interest rate.

In April, exchange restrictions, public spending cuts, and the appreciation of the exchange rate continue to harm general activity. But the early indicators in our traffic light, the promise of a credit reactivation, and the fall in inflation lead us to think that **we have already hit bottom in March and that a slow recovery follows.**

Graph 4. Supermarket sales index

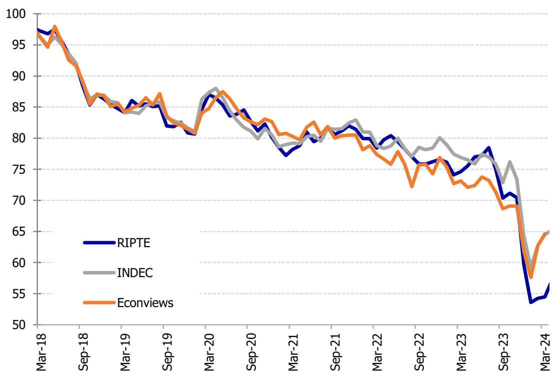
Sales index at constant prices, seasonally adjusted series



Source: Econviews based on INDEC

Graph 5. Real wages in the formal private sector

Jan-18=100



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