MONTHLY REPORT

ECONVIEWS

ECONOMÍA Y FINANZAS

May 2024
Issue #239

A **second stage** for economic policy, from the "**chainsaw**" to the "**scalpel**"

Page 4

Provinces' new **difficult fiscal reality**

Page 7

THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- After tumbling in April due to stronger than expected CPI data and the Iran-Israel conflict, global markets recovered in May. The S&P 500 bounced back to 5,266 points, though 10-year yields remain above 4.6%. US CPI inflation lowered slightly to 3.4% year-on-year in April.
- April's CPI print came in at 8.8%, in line with market expectations. However, high frequency indicators point at 3-4% monthly rates in food and beverages during May. This led to an overeager Central Bank cutting the policy rate by 20 bps in May, first from 60 to 50% APR and then to 40% APR. The second time the market reacted with a 12% increase in the informal FX rate, which rose to ARS 1,215 an 36% spread with the official rate.
- Economic activity fell 1.4% between February and March and 5.2% year-on-year in Q1-2024. Banks closed 275,000 payroll accounts in the first quarter of the year, a sign of the depth of the recession. It is possible activity bottomed in March and will begin a slow recovery in April.
- The government had its fourth consecutive fiscal surplus in April (and is likely to score another in May), accumulating 0.2% of GDP in four months of 2024. It also struck a deal with energy companies to pay the debt over unpaid subsidies in AE38 bonds, which implies a 50% haircut.

FIGURE OF THE MONTH

Real GDP contracted by

5.2%

year-on-year in Q1-2024. We expect this to be the floor of the recession.

TO BE ALERT

The FX spread rose to

36%

in late May, the highest since mid-February.

WHAT'S COMING NEXT?

- The Senate is treating the "Ley Bases" reform bill. Although the content may be watered down, key fiscal aspects such as the reimposition of income tax, which will add 0.3% of GDP in revenues (0.2% for provincial coffers) are expected to pass.
- Former Interior Minister Guillermo Francos replacing Nicolás Posse as chief of staff shows how the government is struggling to push forwards its legislative agenda, and also the need for a political relaunch, after a first phase of adjustment. Former Central Bank governor Federico Sturzenegger is expected to hold an important position in this cabinet reshuffle, although Milei is also very supportive of Finance Minister Luis Caputo.
- After quick progress on disinflation between December and April, we expect the monthly rate to hit a floor of 6% between May and July, as inertia sets in, and wage increases and smaller margins force firms to reprice goods which have been stable in Q2. The government is confident its fiscal and FX rate anchors will suffice to lower inflation and may also delay adjustments in utilities and fuel taxes to speed up the process.
- The Federal Reserve will meet again on June 12th. Markets do not expect rate cuts until the November meeting at least. Today, they are pricing only one 25 bps cut to 5.25%, though they assign a 29% chance to two or more cuts by December.

SUMMARY OF MAIN INDICATORS

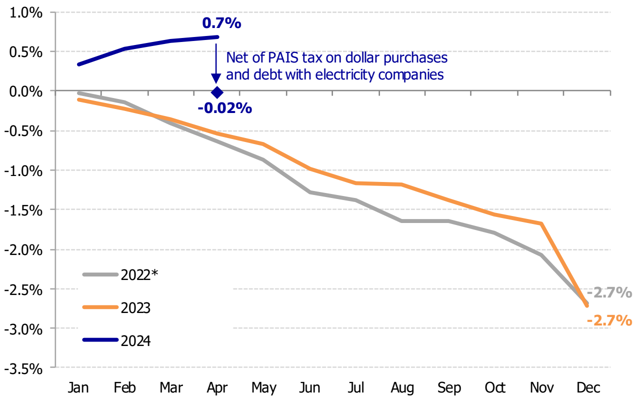
	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-1.4%	0.0%	Inflation (monthly)	8.8%	11.0%
Consumer confidence (MoM)	1.3%	1.8%	FX spread (21day avg.)	27.2%	19.9%
Industrial activity (MoM s.a.)	-6.3%	-0.7%	Country risk (bps 21day avg.)	1,276	1,319
International accounts			**External data**		
Current Account (USD BN)	-3.42	-5.95	Soybean price (per ton, 21day avg.)	447.9	427.6
CB Reserves (USD BN 21day avg.)	28.65	28.91	Brazilian activity (MoM s.a.)	-0.3%	0.3%
Primary balance (ARS BN)	265.0	625.0	Financial Conditions Index	35.6	39.8

Source: Econviews based on multiple sources - working days only

GRAPH OF THE MONTH:

A fiscal surplus... with some caveats

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

RECENT ECONOMIC DEVELOPMENTS

APR 30th	MAY 3rd	MAY 9th	MAY 14th	MAY 23rd	MAY 27th	MAY 30th
Econviews Monthly #238: Cautiously optimistic + special report on the Argentine labor market in 2024.	Court ruling forces **private healthcare firms to adjust plans to increase in CPI** and reimburse users for overcharge.	**CGT unions hold second general strike against Milei,** with high observance due to participation of transport unions.	After April's 8.8% CPI print, **Central Bank cuts rates again by 10 bps to 40% APR,** a 3.3% effective monthly rate.	Lower rates and reform bills stalled in Senate lead informal FX rate to increase 12% to ARS 1,215, a 36% FX spread.	Nicolas Posse resigns as chief of staff, **former Interior Minister Guillermo Francos takes over,** in cabinet reshuffle.	**Econviews Monthly #239**

POLITICS

Milei's approval remains high, and the Di Tella Government Confidence index actually grew 2.7% in May, after falling in April. His personal popularity contrasts with slow progress on the "Ley Bases" reform bill in the Senate and an ongoing cabinet reshuffle. Chief of staff Nicolás Posse resigned in late May and was replaced by Interior Minister Guillermo Francos, who handled the relation with the provinces. However, Milei's 25th of May Pact was also a disappointment, with little attendance from governors. Former Central Bank chief Federico Sturzenegger is expected to join the cabinet soon, although Finance Minister Luis Caputo will stay in place. Nearing six months in office, Milei wants to refresh the cabinet.

IMF

The IMF staff reached an agreement on the 8th review of the 2022 Extended Fund Facility, a move which permits the disbursement of USD 800 million in late May. The staff lauded the "strong fiscal anchor, lack of monetary financing and initial correction in relative prices" which have allowed for "faster-than-expected progress in restoring macroeconomic stability". However, Fund officials are worried about the "quality and fairness of consolidation efforts" and suggested FX policy should become "more flexible", a hint at easing FX controls.

ECONOMIC ACTIVITY

The economy fell 1.4% between February and March, an 8.4% contraction year-on-year and 5.2% in Q1. In monthly terms, construction (-8.8%), manufacturing (-8.2%) and retail (-6.6%) fared the worst in March, while agriculture slumped 2% and even mining and oil and gas (-4.5%) fell, after showing positive variations in January and February. We believe March may have been the floor of the recession, but the recovery will look more like the "Nike" logo than a V-shape, with the appreciated exchange rate raising labor costs for construction and manufacturing. The government's hope of a credit-led rebound is too optimistic. With March's data, we corrected our yearly GDP forecast from -3.3 to -3.6%.

INFLATION

April's CPI print came in at 8.8%, in line with market forecasts. Inflation decelerated for the fourth month in a row. The core index rose by 6.3% monthly, the lowest since January 2023. Food and beverages rose 6%, while household, energy, gas and water prices shot up 36% due to the adjustment in utility rates. The communication sector (+14%) also increased sharply. Overall, regulated prices were up 18.4%. We expect May's inflation to be near 6%, with our web scrapping of supermarkets in Greater Buenos Aires pointing at a 3.5% monthly increase in food, beverages and other basic staples. The decision to postpone utility and transport increases will help contain services. We see 171% inflation over all 2024 and 59% in 2025.

MONETARY SECTOR

The Central Bank cut rates by another 20 points in May, from 60 to 40% APR (it had already done so in the previous two months). This left the effective monthly rate at 3.3%, half of expected inflation. This strategy aims at reducing emission from interests on Central Bank liabilities, forcing the market into Treasury letters and hopefully reactivating credit for the private sector. However, the market's reaction was different this time around, with the parallel FX rates increasing 12% to ARS 1,215 for the BCS, an 36% spread with the official rate. The message appears to be that even with tight FX controls, the Central Bank cannot offer peso-investors such negative real rates and not expect some flight to the informal exchange rates.

FISCAL ACCOUNTS

The national public sector ran an ARS 265 billion primary surplus and 17 billion fiscal surplus in April. In the first four months of 2024, it accumulated a 0.7% of GDP primary surplus and 0.2% fiscal surplus, the highest since 2008. However, the debt with energy companies (which will be settled with bonds) and revenues from the PAIS tax on dollar purchases explain practically all of the primary surplus. After pensions fell 36% in real terms and CAPEX collapsed by 87%, the government should shift into a more focused phase of the fiscal adjustment, with energy and transport subsidies explaining most of the reduction in expenditures. We expect a 0.5% primary surplus and 1% fiscal deficit for the full year.

I. A second stage for economic policy, from the "chainsaw" to the "scalpel"

From the very beginning the program had two distinct phases. In the first one the main objective was to restore the basis of macroeconomic balance for which the government used a cold turkey approach, a broad-brush adjustment on the fiscal side and policies that signaled a strong commitment to fiscal balance and a return to a market economy.

This first phase has been by and large successful. Financial markets applauded these commitments, and a large part of the business community supported the new views on regulation. Price controls were removed, the Central Bank devalued the currency, the government lifted import controls, it also achieved and maintained a fiscal surplus during the first four months and reached an agreement with the IMF. Clearly more than anyone would have expected.

Evidence of this success was an increase in net international reserves by around 10 billion dollars, the reduction in inflation from 25% in Decembrer to 8.8% in April, the drastic reduction in the FX spread from 200% to around 30%, the stability of the parallel exchange rates throughout most of the period and a drop in Argentina´s country risk from around 2,500 points to a minimum of 1,250 points. The cost of these efforts was a deepening of the recession, reflected in a drop of 8.4% in economic activity in March relative to a year ago, and significant drops in real wages, in pensions and in consumption.

This stage is coming to an end for several reasons. First, there are political issues; the government encountered significant difficulties in passing two key reforms in Congress: the "Ley Bases" omnibus bill and the fiscal package, which initially were sent to the Legislative in February and are still waiting for approval. The government expected to have them approved by May 25th, Argentina´s National Holiday, but they got stuck in the Senate and are still there, though they likely to be approved soon. The delays raised some concerns about the lack of political muscle of Milei´s administration and has been a source of frustration among investors.

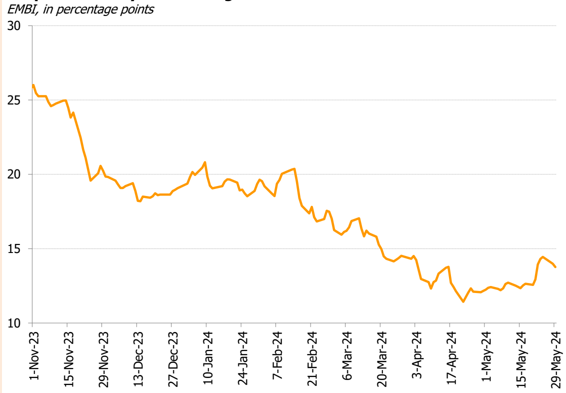
Their approval is finally likely to take place in the Senate next week. From there, they will go back to the Lower House, and soon after it should be a boost for the government. However, the fact that the whole process has taken almost four months is an indication that Milei's administration needs to strengthen the relationship with Congress. The recent appointment of Guillermo Francos as Chief of Cabinet is a step in the right direction. The expectation is that the approval of these two laws in Congress will open the door to more in the future.

On the economic front there are also some indications that the initial achievements are encountering some "fatigue". The first signs were the recent pressures on the FX market, where the spread between the official and the parallel exchange rates in a matter of days moved from 20 to almost 40 percent while the country risk increased almost 200 points as measured by Argentina's EMBI. The suspects for these setbacks on the exchange rate front were on the one hand the excessive cuts in interest rates. Although the Central Bank has been implementing reductions in interest rates from the very beginning, it seems that reduction in interest

Graph 1. FX spread with BCS
Vs the official exchange rate, in % - Average B/A

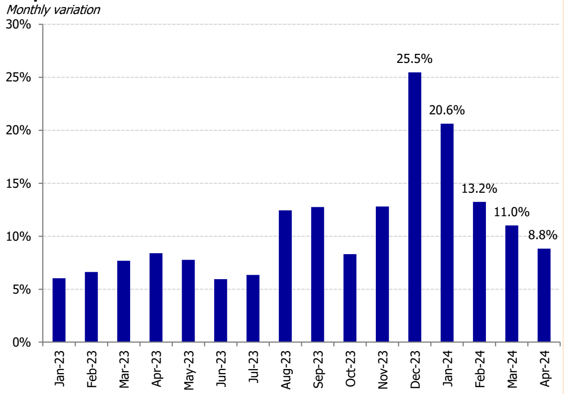
Source: Econviews based on Reuters

Graph 2. Country Risk for Argentina
EMBI, in percentage points



Source: Econviews based on JPMorgan

Graph 3. National headline inflation
Monthly variation



Source: Econviews based on INDEC

rates from 50% to 40% was the straw that broke the camel's back, as the return on peso assets became ridiculously low and led to a shift in portfolios towards dollars. The delays in the approval of the two laws was perhaps the other trigger of these events.

While Milei is maintaining its popularity as his positive image remains above 55% according to most opinion polls there are concerns because the economy is not recovering in a V shape, as was expected. The economy could have found a floor in March/April, but the monthly index of economic activity (EMAE) dropped 8.4% year-on-year indicating that the recession is deeper than had been previously anticipated.

On the policy front the government has been losing steam. There has been lack of progress in implementing some reforms due to the lack of effectiveness in Congress, while there have been delays in the removal of FX controls. True, it is unlikely that controls will be removed in one stroke. However, so far there was basically no progress whatsoever in this front, although the Central Bank took important steps in the reduction of the interest-bearing liabilities of the Central Bank (one of the conditions that the government said is needed to remove it). The other condition was to obtain a USD 15 billion loan from the IMF or from other lenders to boost reserves, though on this front the outlook remains blurred. Nevertheless, the surprising thing is the little amount of progress that there has been on this front, especially because the removal is a pre-condition to jumpstart investment.

The second stage has somewhat different objectives. The government succeeded in reducing the risk of runaway inflation, and the spread between the official and parallel exchange rates has been reduced significantly, while most price controls have been removed and the commitment to a sound fiscal policy has been clearly stated and it is widely understood that will be the anchor of the program.

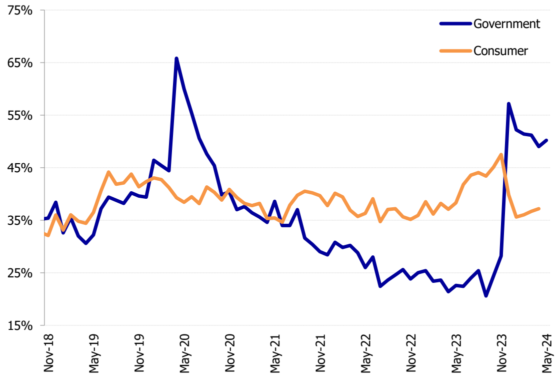
The priorities of the second stage should be to continue the normalization process which means the need to take steps to have a well-functioning foreign exchange market (i.e. the removal of FX controls and unifying the market), to improve the quality of expenditure cuts, to continue to remove energy subsidies and to delineate policies to increase reserves, where there has been progress though the situation remains fragile.

In terms of broad objectives, we see this second period as one of consolidation, of shifting from the "chainsaw" to the "scalpel", from broadbrush to finetuning. We also believe that in terms of policy objectives there is a need to shift the emphasis from stabilization to recovery and growth.

It seems that in political terms the government is making moves in this direction. The appointment of Guillermo Francos is an effort to improve relations with Congress and make more progress on structural reforms. he announcement that Federico Sturzenegger will join the Cabinet in a new ministry in charge of the deregulation of the economy means putting more emphasis on structural reforms and privatizations.

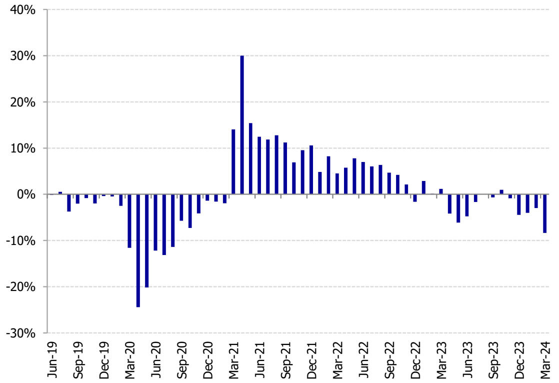
Many of the impressive gains such as reducing the country risk in half in a couple of months or bringing down inflation by almost 20 percentage points in a short period cannot be replicated. The gains are likely to be

Graph 4. Consumer and goverment confidence
In %

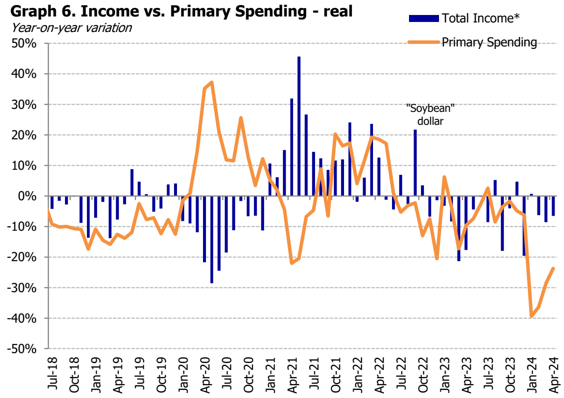


Source: Econviews based on UTDT

Graph 5. Economic Activity
EMAE-INDEC, year-on-year variations



Graph 6. Income vs. Primary Spending - real
Year-on-year variation



*Excludes SDRs in Sep-21
Source: Econviews based on MECON

smaller in the second stage, simply because the imbalances are smaller, and the "easy" part is over. The argument is that even with the right policies it is quicker to bring down inflation from 26% to 6% than from 6% to 3%. Simply observe what happened in the US where annual inflation dropped rapidly from 8.8% to 3.5% but bringing it down from this lower level is becoming extremely difficult.

In summary, the government was successful in what we defined as the first stage. The adjustment was a good step to improve macroeconomic stability and the population maintained its support of the program despite the side effects. We believe that that we are entering a second stage in which the payoffs are going to be smaller (because the imbalances have been reduced), that requires more fine tuning and in which the population might start to feel the fatigue of the adjustment.

II. Provinces' difficult new fiscal reality

Last August, in our monthly report #230 on the provincial fiscal accounts we argued that after years of deficits, **subnational governments had run primary surpluses between 2018 and 2022**, reaching a record 0.7% of GDP that last year. In 2021 and 2022 they achieved financial fiscal surpluses of 0.3% of GDP as well.

But things in Argentina can change rapidly, and while until last year the provincial finances were sound, the **situation has turned upside down for three big reasons.**

1. Income tax reform. In October 2023 then Finance Minister and presidential candidate Sergio Massa cut personal income tax for around a million workers, in a bid to improve his electoral standing. Income tax was one of the key pieces of the federal tax sharing system (COPA), which redistributes funds to the provinces.

2. Recession. The economy contracted 8.4% year-on-year in Q1-2024. This hurts federal taxes shared with the provinces, like VAT or fuel excise duties, and also provincial taxes. Provinces tax property, mainly vehicles and real estate, and economic activity through the infamous *ingresos brutos* or "turnover tax" (more on that later). Years of high inflation left assessed values well below actual market values, reducing property taxes' overall weight in revenues and thus creating a more pro-cyclical tax structure.

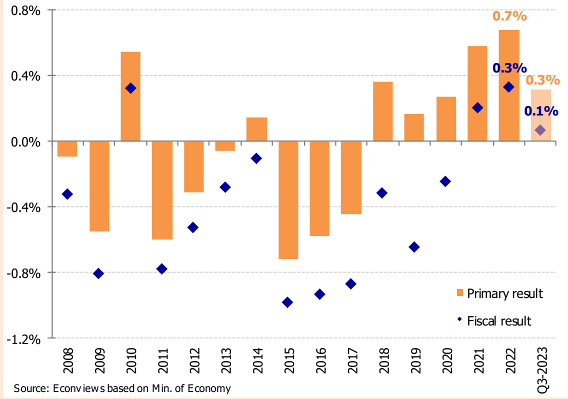
3. Milei's "there's no money" approach. With a strong commitment to fiscal consolidation, the new government cut discretionary transfers to provinces by 76% in real terms and transfers for public works by 98% in the first fourth months of 2024. For provinces like La Rioja, which got 89% of all its resources from the national government (5% in direct transfers), this was basically like removing life support (La Rioja defaulted on a 26-million-dollar bond in February). But the policies affects all provinces to greater or lesser extent.

It is unclear whether Milei's resolve will hold, or his need for votes in the Senate and the Lower House as well as social pressure will force him to loosen up. For example, after transferring zero pesos of the FONID (education fund, used to pay teachers' wages) in January and February and under threat of litigation, finally payments rose to ARS 575 billion in March and April (still 73% down in real terms).

Consolidated final data for 2023 is still not available, **but as of Q3 provinces accumulated a primary surplus equal to 0.3% of GDP, well below the 0.9% on average for that period in the previous three years** (spending always grows in Q4 due to end-of-the-year bonuses and other factors).

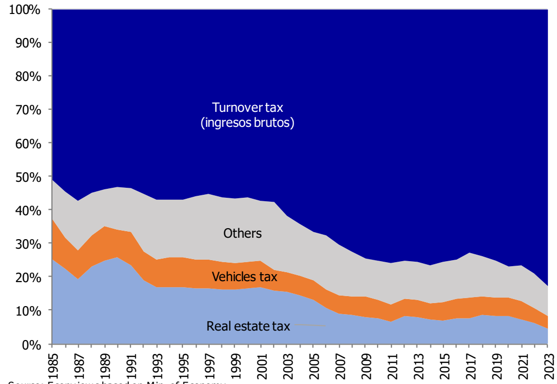
Individual data for some provinces show a sharp deterioration in the last quarter of 2023. The City of BA, Córdoba or Mendoza, which had run large primary surpluses in 2022, saw them shrink relative to their current income. Santa Fe slipped from surplus to deficit after 4 years. Buenos Aires or La Rioja, who were already running deficits, saw them widen.

Graph 1. Provincial fiscal accounts
Consolidated, as a % of GDP



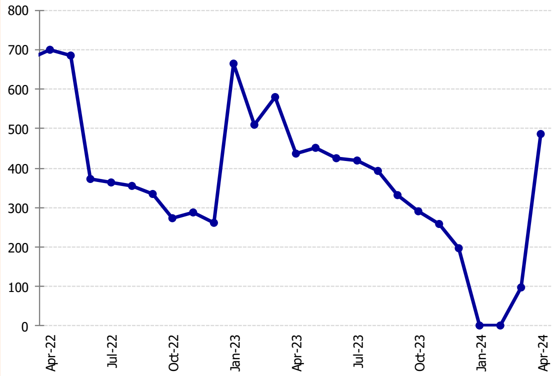
Source: Econviews based on Min. of Economy

Graph 2. Provincial property taxes' weight fell from 40 to 10%
Share in total provincial tax revenues



Source: Econviews based on Min. of Economy

Graph 3. FONID (education fund) transfers to provinces
In billion ARS at Apr-24 prices, year-on-year variations



Source: Econviews based on Min. of Economy

Chart 1. Provincial fiscal accounts up to Q3
Consolidated, as a % of GDP

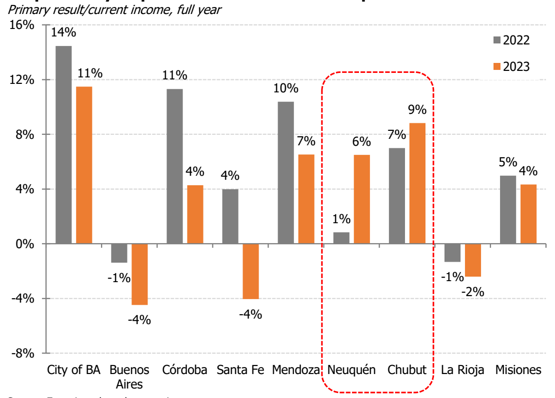
	2019	2020	2021	2022	2023
Incomes	11.5%	12.1%	11.2%	11.2%	10.7%
Provincial taxes	3.5%	3.6%	3.5%	3.5%	3.3%
Federal shared taxes	5.5%	5.7%	5.4%	5.3%	4.9%
Outlays	10.5%	11.1%	9.7%	9.4%	9.5%
Wages	5.2%	5.6%	4.7%	4.5%	4.7%
CAPEX	1.2%	0.9%	1.0%	1.1%	1.4%
Primary result	**0.5%**	**0.7%**	**1.0%**	**1.1%**	**0.3%**
Fiscal result	0.0%	0.3%	0.7%	0.8%	0.1%

Source: Econviews based on Min. of Economy

The outliers were in the oil and gas belt. Neuquén's primary result grew from 1 to 6% of current revenues, boosted by 16% real growth in royalties from Vaca Muerta, which explain 37% of all income for the province. Chubut's royalties grew below inflation (-36% in real terms), but still explain 20% of the province's income.

In this special report, **we will zone in on provinces' new fiscal reality, explore their options and discuss implications for sub-sovereign and sovereign debt.**

Graph 4. Only oil provinces' fiscal accounts improved in 2023
Primary result/current income, full year



Source: Econviews based on provinces

i. Loss of resources from the national government

Up to Q3-2023, **51 cents of each peso of provinces' income came from the national government**. This figure varies widely from 88% for La Rioja or 86% for Santiago del Estero to only 12% and 20% for the City of BA and Neuquén, respectively.

Chart 2. Dependence on national government
Shared taxes and direct transfers as % of current receipts, up to Q3-2023

		Total	Federal shared taxes (COPA)	Current transfers
1	La Rioja	88%	84%	4%
2	Santiago del Estero	86%	83%	3%
3	Jujuy	83%	77%	6%
4	Formosa	79%	76%	3%
5	San Luis	78%	76%	2%
15	Santa Fe	56%	53%	3%
	Total	**51%**	**46%**	**4%**
19	Córdoba	47%	44%	3%
20	Buenos Aires	46%	37%	8%
23	Neuquén	20%	19%	1%
24	City of BA	12%	10%	2%

Source: Econviews based on Min. of Economy

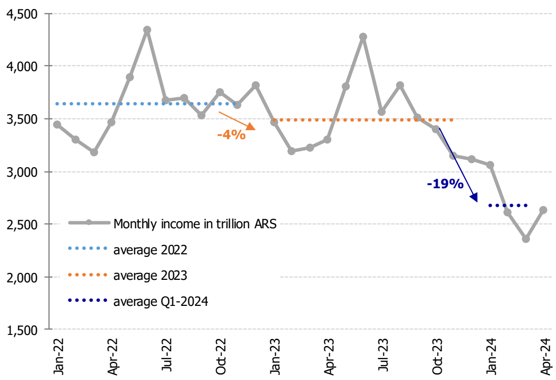
These figures (in chart 2) hide as much as they tell. Buenos Aires province receives 46% of its income from the national govt, a comparatively low figure. **But it receives one of the highest shares of discretionary transfers, 8% of its income**. This was designed to correct the structural imbalance in federal tax allocation (Buenos Aires receives 21% of COPA taxes despite holding 38% of total population). It also leaves the province at the mercy of political winds; it was favored by Alberto Fernandez and is being penalized by Javier Milei. **Jujuy, Chaco, Tucumán, Santa Cruz, and Misiones also received a high share of discretional transfers in 2023**.

Chart 3. Resources from the national government
In billion ARS at Apr-24 prices

	January-April		y/y
	2024	2023	
Federal shared taxes (COPA)	11,222	13,386	-16%
Income tax	2,899	4,668	-38%
Discretionary transfers	257	1,809	-86%
Current expenditures	243	995	-76%
CAPEX	14	814	-98%
Total	**11,480**	**15,195**	**-24%**

Source: Econviews based on Min. of Economy

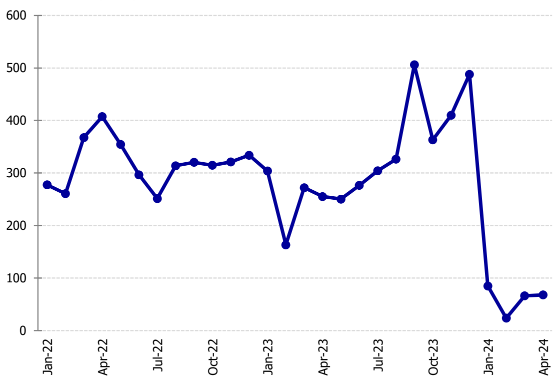
Graph 5. Provinces' income from federal taxes and funds
In billion ARS at Apr-24 prices, year-on-year variations



Source: Econviews based on Min. of Economy

Given this provincial dependence on the National government, it is worrisome that shared federal taxes' collection is down 16% in 2024. It had already contracted 4.4% in 2023, with weak activity levels and the income tax reform's impact in Q4. This year's fall widens to 19% if you include semi-automatic transfers like the FONID fund. In addition, the government cut discretionary transfers by 76% (not counting CAPEX). Considering that 51% of provinces' current income comes from the national govt, **the rough math is that provinces lost 11% of their resources**, *before* considering the decrease in local tax collection.

Graph 6. Provinces' income from current transfers
In billion ARS at Apr-24 prices



Source: Econviews based on Min. of Economy

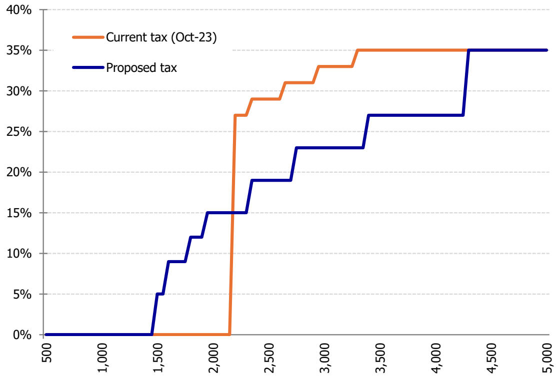
A new personal income tax will be a huge improvement. Massa's October 2023 reform had increased the non-taxable minimum for employees from 6 to 15 minimum wages (that is, from roughly 700 to 2,000 dollars in that moment). Real revenues crashed 38% year-on-year between January and April 2024. Before the tax cuts, income tax contributed around 35% of the mass of federal shared taxes, and now the figure is closer to 25%.

The fiscal bill sent to the Senate would leave the minimum closer to 1.5 million pesos, or 1,250 dollars, along with introducing more progressive tax brackets (under the current scheme, contributors go directly to a 27% marginal rate). If the bill is approved, the **Congress' Budget Office estimates a 0.3% of GDP increase in revenues in 2024**, of which 0.17 points would go to the provinces.

For the 2025 fiscal year the impact could be closer to 0.5% of GDP, but this year part of the damage is already done, as there is little chance of retroactively taxing January to May.

There is less to be done on other federal shared taxes, such as VAT, until the economy begins to recover. The government increased fuel taxes from 9 to 23% per liter, but suspended further increases to contain the CPI. Some governors have asked to include the PAIS tax on dollar purchases (or other taxes) in the tax-sharing system, a view that the Federal Government should resist because once **a tax is shared with provinces, it is very difficult to eliminate it.**

Graph 7. New marginal income tax rates for workers
Rate on income above non-taxable minimum, in thousand pesos



Source: Econviews based on OPC

Chart 4. Fiscal impact of proposed income tax reform
As a % of GDP

	as a % of GDP
Income tax revenues in 2023	4.6%
National govt's share	1.6%
Provinces' share	2.2%
Estimated impact of proposed reform in 2024	**0.3%**
For provinces	0.2%
Estimated impact of proposed reform in 2025	**0.5%**
For provinces	0.3%

Source: Econviews based on Congressional Budget Office

ii. What's going on with provincial taxes

Provincial tax collection adjusted for inflation grew around 1.5% last year. Part of a longer trend, *ingresos brutos* or "turnover tax" revenues increased 4.3%, while property taxes on real estate (-23%) and vehicles (-23%) dipped (see chart 5).

Briefly, *ingresos brutos* is a sales tax. Unlike VAT, it is collected at every phase of the production chain, leading to a cascade effect for final consumers and a gigantic effective rate. The Macri administration's Fiscal Pact sought to limit provinces' use of this tax, lowering its weight in GDP from 4% in 2013 to 3.6% in 2019. After the change of government, it swelled back to 4% of GDP, and represents 80% of all provincial tax revenues.

The current crisis may lead to further "turnover tax" overreach. There is little official data, but several provinces, like Buenos Aires, Entre Ríos or Río Negro, have all raised rates for some branches of activity in 2024. The last two chose banks and finance, an "easy" sector to tax due to its higher formality. Since 2021, the City of BA taxes banks' interest on Central Bank liabilities. Interest rate hikes helped the City's "turnover tax" revenues grow 21% in 2023. La Pampa (+14%), Neuquén (+12%) and Salta (+9%) also increased their income from this tax last year.

Chart 5. Provincial tax revenues' growth in 2023
Year-on-year variation in real terms, incomplete data for some provinces

		Total	Turnover tax (IIBB)	Real estate tax	Vehicle tax
1	City of BA	13.4%	21.4%	-10%	-11%
2	Neuquén	10.2%	11.8%	-18%	-
3	Salta	8.4%	9.3%	-44%	-
4	Catamarca	6.0%	6.3%	-12%	-15%
5	Jujuy	4.2%	6.0%	-27%	-
	Total	**1.5%**	**4.3%**	**-23%**	**-23%**
8	San Juan	0.7%	7.4%	-17%	-18%
9	Río Negro	0.3%	5.8%	-22%	-20%
10	Misiones	-1.6%	-1.3%	-12%	-20%
14	Tucumán	-3.3%	-0.8%	-31%	-24%
15	Santa Fe	-4.3%	-0.4%	-37%	-22%
16	Buenos Aires	-5.7%	-0.3%	-25%	-33%
17	Córdoba	-6.3%	-0.5%	-30%	-17%
18	Entre Ríos	-7.2%	-1.1%	-32%	-18%

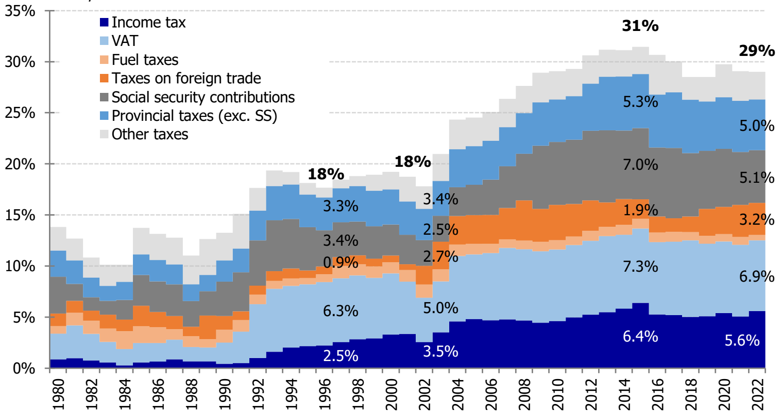
Source: Econviews based on Min. Of Economy

Provinces also want to recover lost ground on property taxes. Buenos Aires raised rural and urban real estate taxes by 140-200% in its 2024 budget law, indexing payments to CPI (though this was later suspended). Other provinces like Entre Ríos applied increases of 150-160%, slightly above 2023's average inflation of 133%.

Provincial taxes' weight in GDP grew from 3.4% in 2003 to 5.3% in 2015. It currently stands at 5%. The 2017 fiscal pact shows that coordinated efforts with the national government can reduce fiscal pressure.

However, unilateral cuts in transfers could end up having the opposite effect.

Graph 8. Consolidated fiscal burden
National and provincial taxes as a % of GDP



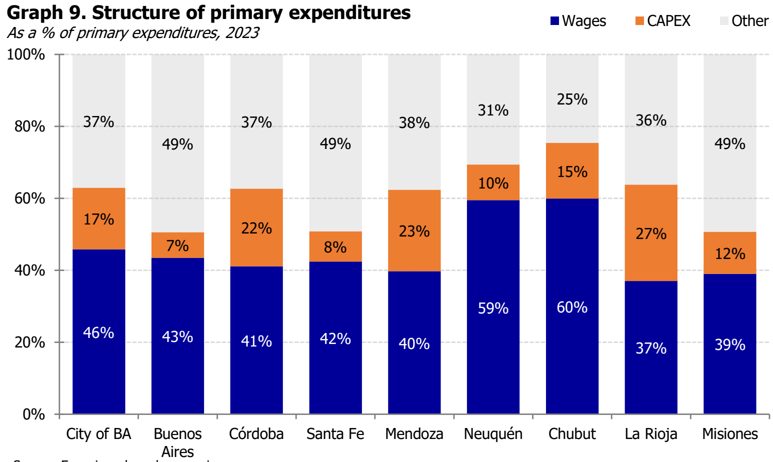
Source: Econviews based on Min. of Economy

iii. How stressed are provinces' budgets?

Governors' elections played their part in 2023. 22 out of 24 provinces elected authorities last year, 17 of them on separate dates than the national elections (meaning the focus was on local governance). Predictably, real wage bills grew in most provinces, especially Córdoba (+11%), the City of BA (+10%) or Santa Fe (+10%), while private wages slumped 4% over 2023. Some provinces also amped up CAPEX, such as Mendoza (+37%), the City of BA (+24%) or Córdoba (+16%), but this was a more disparate phenomenon.

Provinces spend between 40-60% of their budget on wages, which have already fallen sharply. Capital expenditures, whose weight ranged 7-27% last year, are a likely candidate for cuts. 13 provinces have their own social security regimes, which are partly financed by the national agency (ANSES). The Milei administration initially suspended these payments, but later resumed them.

Graph 9. Structure of primary expenditures
As a % of primary expenditures, 2023



Source: Econviews based on provinces

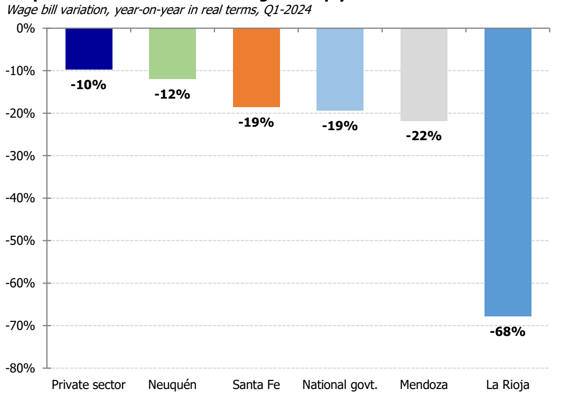
Provinces do not have much room to cut wages. As of Q1-2024, the salaries of provincial public sector employees had fallen as much or more than their national government counterparts (-19%), in year-on-year, and more than private sector workers (-10%). The fall in real wages ranges

Chart 6. Growth in expenditures in 2023
Year-on-year variation in real terms

	Primary expenditures	Wage bill	CAPEX
City of BA	11.8%	10.0%	24.2%
Córdoba	9.1%	11.4%	16.3%
Mendoza	8.4%	1.3%	37.3%
Santa Fe	0.9%	9.7%	-0.7%
Buenos Aires	0.3%	3.9%	0.3%
Misiones	-5.8%	-1.8%	-26.3%
Chubut	-8.2%	-20.6%	-12.6%
Neuquén	-13.6%	5.4%	-3.1%

Source: Econviews based on provinces

Graph 10. Provinces have cut wages sharply
Wage bill variation, year-on-year in real terms, Q1-2024



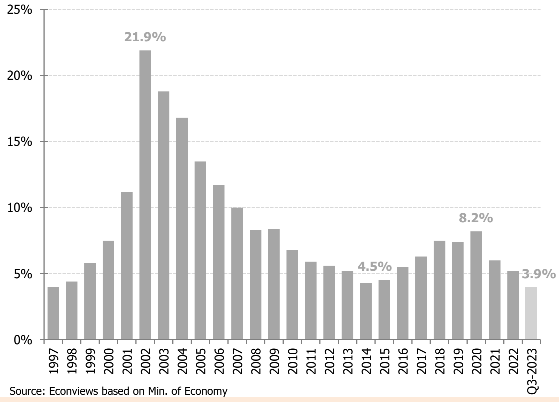
Source: Econviews based on provinces and INDEC from 12% in Neuquén to an extreme 68% in La Rioja (though that province had inflated wages ahead of the 2023 election). The recent **policemen's strike in Misiones** may be a canary in the coal mine for provincial public sector labor conflict.

With depressed wage bills, cuts in CAPEX and an eventual pickup in tax collection and funds from the national government, provinces may muddle through 2024, but it will be a conflictive year.

iv. The provincial debt market under Milei

Provinces remain relatively unindebted. After the 2020-21 restructurings, their consolidated debt stock as a percent of GDP fell from 8.2% in 2020 to 3.9% in Q3-2023, though the improvement last year is partly due to exchange rate appreciation. Capital and interest payments rose to 0.5% of GDP in the first three quarters of 2023. On average, 74% of this debt is due in bonds and 17% with multilateral organizations.

Graph 11. Provincial debt stock
Consolidated, as a % of GDP

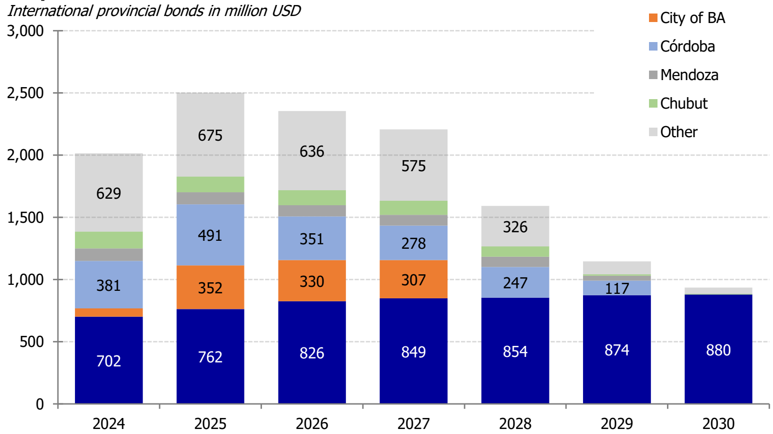


Source: Econviews based on Min. of Economy

This relatively small debt poses some challenges, namely because of the high country risk and the deterioration in the fiscal position due to the reasons we mentioned above. In addition, it seems less likely that the Milei administration will be willing to assist any province in case they face a liquidity problem and cannot access the market.

The calendar for dollars bonds is uphill. Maturities increase from around USD 1.3 billion last year to 2 billion in 2024 and a peak of 2.5 billion in 2025. The main concerns are the province of Buenos Aires with maturities of around 350 million in the second half of the year (which we believed will be paid), and to a lesser extent the province of Cordoba with roughly 140 million. In general, provincial dollar bonds can be grouped into three categories.

Graph 12. Dollar debt maturities
International provincial bonds in million USD



Source: Econviews based on Min. of Economy

Patagonian provinces like Neuquén, Tierra del Fuego and Chubut have issued bonds guaranteed by royalties on oil extraction. **Oil-backed bonds yield 7-14%**, making them the premium segment of the subnational debt market.

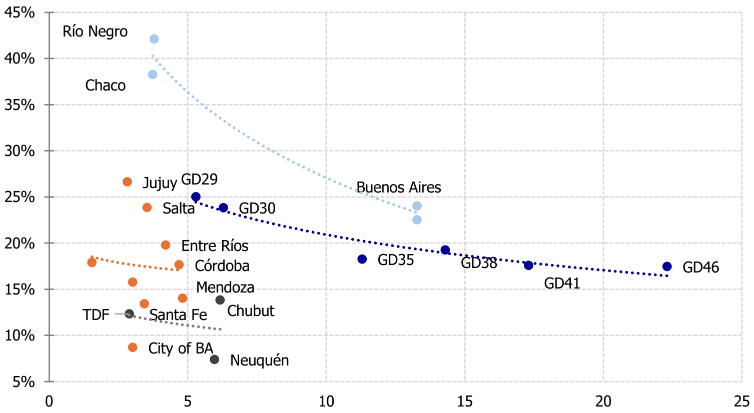
A second pack of provinces, which includes most of the large ones like the City of BA, Córdoba, Santa Fe or Mendoza, **has dollar bonds yielding from 9-27%**, slightly below the sovereign. Roughly, this is the group with better *fundamentals*, in terms of primary balance to current income, reliance on the national government, etc. Though some provinces like Jujuy or Salta, which are especially dependent on discretionary transfers, are at risk of slipping into the high-yield group.

Excluding La Rioja which defaulted in February, **Buenos Aires, Chaco, and Río Negro's dollar bonds yield 23-42%**, and are perceived to be the riskier ones.

Provinces did not capture the compression in country risk since the November run-off. While sovereign Global (GD) bonds' yields fell by 15 points in the last six months, provincial bonds only cut yields by 2-3 points. The royalty-guaranteed provinces performed relatively better. Jujuy and Salta's bonds yield higher than before the election. It is true that before the elections, provincial bonds traded above the sovereign's and thus had less ground to recover. But yields are also reflecting the provinces' increased fiscal difficulties, with no easy solution in the short term.

Graph 13. Sovereign and provincial dollar bonds

Yield (y axis) and years to maturity (x axis), 27th May 2024



Source: Econviews based on Min. of Economy and IAMC

Chart 7. Change in bond yields since November

Sovereign and subsovereign dollar bonds, yield

		Nov-23	May-24	Var. in p.p.
High-yield		**36.1%**	**34.3%**	**-1.8**
Buenos Aires	PBA37	29.1%	22.5%	-6.6
Chaco	CH24D	38.1%	38.3%	0.1
Río Negro	RND25	41.0%	42.1%	1.2
Lower-yield		**19.1%**	**17.5%**	**-1.5**
City of BA	CABA27	11.0%	8.7%	-2.3
Córdoba	CO21D	29.1%	17.9%	-11.2
Córdoba	CO24D	19.3%	17.7%	-1.7
Córdoba	CO27D	15.8%	15.8%	-0.1
Entre Ríos	ERF25	20.3%	19.8%	-0.5
Jujuy	JUS22	24.4%	26.6%	2.2
Mendoza	PMM29	16.7%	14.0%	-2.7
Salta	SA24D	20.9%	23.8%	2.9
Santa Fe	SF27D	14.0%	13.4%	-0.6
Royalty-guaranteed		**13.8%**	**11.2%**	**-2.6**
Chubut	PUL26	17.6%	13.8%	-3.8
Neuquén	NDT11	8.8%	7.4%	-1.4
Tierra del Fuego	TFU27	15.0%	12.3%	-2.7
Sovereign bonds	**GD**	**35.7%**	**20.2%**	**-15.4**

Source: Econviews based on Refinitiv and IAMC

Base Scenario

	2022	2023 E	2024 F	2025 F
Inflation (eop)	94.8%	211.4%	171.0%	59.0%
Exchange rate ARS/USD (eop)	177.1	808.5	1,608.5	2,293.3
Exchange rate ARS/USD (eop, YoY)	72.4%	356.4%	98.9%	42.6%
Real exchange rate ARS/USD (eop, Dec-01=100)	129.8	196.4	150.8	138.6
Paralell exchange rate ARS/USD (eop)	340.8	972.8	1,608.5	2,293.3
Spread with official exchange rate (eop)	92.4%	20.3%	0.0%	0.0%
Gross reserves (USD billion, eop)	44.9	23.1	36.4	44.0
Net international reserves (USD billion, eop)	7.7	-8.6	4.4	12.0
Policy rate (eop)	75.0%	100.0%	80.0%	45.0%
GDP (YoY)	5.0%	-1.6%	-3.6%	5.0%
Formal wages in real terms (aop, YoY)	0.3%	-1.2%	-4.7%	2.4%
Primary result (% GDP)*	-2.7%	-2.7%	0.5%	1.0%
Fiscal result (% GDP)*	-4.1%	-6.0%	-1.0%	-1.0%
EMBI Argentina (spread in bps, eop)	2,196	1,907	800	600
Current account (% GDP)	-0.7%	-3.3%	1.3%	1.3%

Source: EconViews

*Excludes rents from primary debt issuance in 2022

(+54 11) 5252-1035
Av. La Pampa 1534 – 8A
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