THE WEEK AT A GLANCE

ECONVIEWS
ECONOMÍA Y FINANZAS

June 24th 2024

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Editorial: External Shocks and the FX Spread Compromise International Reserves

The fifth consecutive fiscal surplus and inflation below 5% are important points in favor of the government. In addition, the activity starts a recovery path. What is still under discussion is whether the exchange rate is appreciated. It is a question that has a thousand possible answers many of them with consistent justifications.

Our vision is that, regardless of whether the exchange rate is appreciated, we see challenges in the external sector. The international context does not help. It is a problem that is becoming notorious, although it is not so terrible.

The Real in Brazil was quoted a few weeks ago at 4.9 per dollar while today is above 5.4. Other Latin American currencies followed similar roads. Beyond idiosyncratic factors such as elections in Mexico and the fear that Morena will make institutional reforms to the market does not like, there is a common factor: the dollar is strengthened in the world. The Federal Reserve was slow to climb the rates and is now slow to lower them (perhaps for good reasons, that analysis is outside the spectrum of this editorial) and now that leaves a strong dollar. In other words, Argentina has a stronger Peso than the government was willing to assume with the small positive effect that Brazil's and other countries imports are cheaper.

Another problem, which is not independent of strengthening the dollar, is the weakening of agricultural commodities. Soybean is already under USD 420 a ton. While it is not a disaster, the soybean of 2008 (crisis with the farming sector) measured at today's prices would be almost USD 900. Compared to the average of 2023, soybeans fell 14% in nominal terms or 17% in real terms. It is not a minor loss. Wheat prices also fell strongly, and those of corn a little less. The terms of trade are not so bad in absolute terms, but they also reflect a 3% year-on-year drop to the first quarter of the year.

Some clouds also appear at the local level. The parallel dollars rose when the Central Bank lowered the interest rate and there were doubts about the approval of the Base Law, and it did not fall significantly once the law was approved. The FX spread is above 40%, a worrying figure.

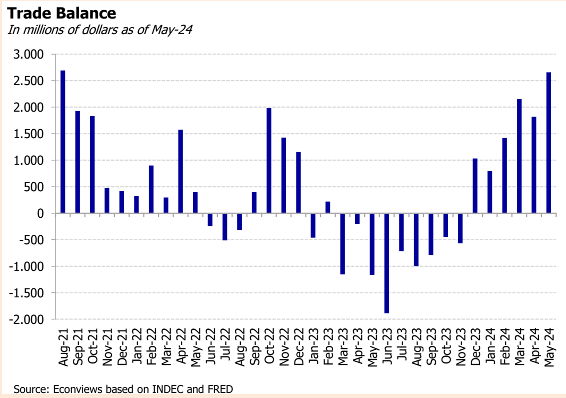
The second fact is that in June the Central Bank almost did not buy dollars in the exchange market, unlike previous months in which it purchased more than three billion dollars per month. Now the BCRA urgently needs to increase international reserves and is not achieving it.

This leads us to think that if the situation does not improve, more exchange flexibility will be needed, in line with what the IMF recommends in the staff report.

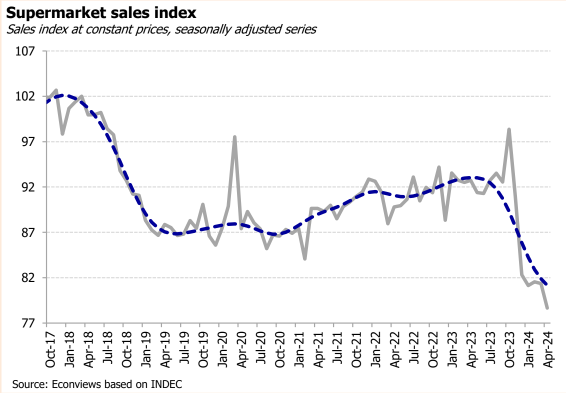
This is the great challenge that Milei is facing in economic and political terms since surveys continue to show favorable data on financial and fiscal issues, but now there is a demand for greater activity and employment. Our vision is that the risk of removing exchange restrictions must be run for that to happen. This operation potentially has more benefits than costs, especially since the fiscal fundamentals are solid. In addition, a more flexible exchange rate will bring the needed antidotes if the external issue becomes even more difficult.

LAST WEEK IN REVIEW

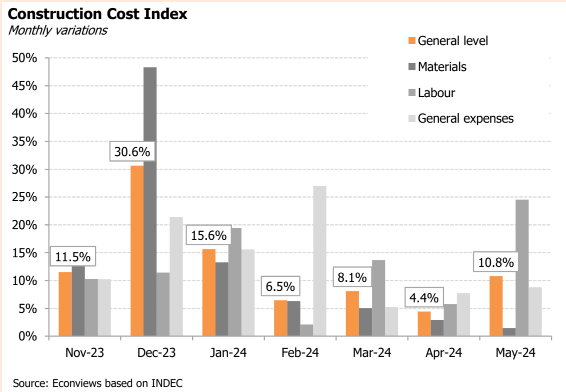
- **In May the trade balance returned to a positive balance**. The country exported USD 7,622 million and imported USD 4,966, giving a positive balance of USD 2,656 million, which is the best monthly balance since September 2021 in constant dollars.
- **Exports increased 21.7% compared to the previous year**. Primary products and fuels and energy lead the interannual variation with 51.1% and 52.8% respectively.
- **Imports continue to fall, with an annual variation of -32.8%.** Fuel and energy imports fell 61.5% compared to the previous year. Regarding capital goods and consumer goods, they registered drops of 33.2% and 27.5% respectively.



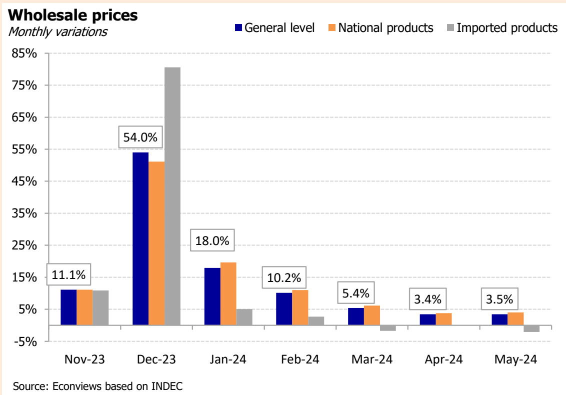
- **Sales in supermarkets fell again.** In April, consumption in supermarkets worsened 3.3% compared to March. So far this year, it has accumulated a variation of -13% compared to the same period of the previous year.
- **April was not a good month for wholesalers either**, whose sales fell 2.4% monthly. The accumulated result is -11.9% so far in 2024.
- **Shopping malls continue to recover**. For the third consecutive month, sales show a monthly improvement (+4.5%), although it was lower than previous data (+6.7% and +8.4% in February and March).



- **The cost of construction accelerated**. The construction cost index varied by 10.8% monthly in May, after three months of single-digit increases.
- **The increase is mainly explained by the cost of labor**, which rose by an average of 24.5%. Salaried labor saw an increase of 28%, while subcontracting costs increased by 9.3%.
- **This increase occurs alongside the economic downturn in the sector**, which has already accumulated a 32% decline so far this year. So far, 75,000 formal jobs have been lost.



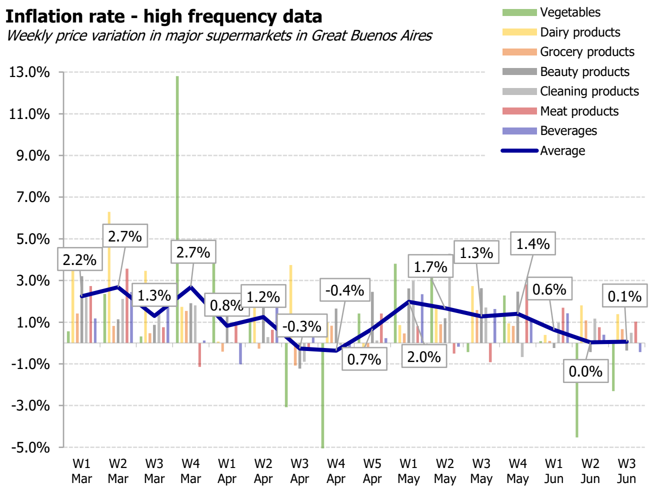
- **Wholesale prices rose 3.5% in May, breaking the slowdown streak**. So far this year, they have accumulated an increase of 46.6%.
- **In the breakdown by category, imported products stand out, with a deflation of 2.1%.** After the exorbitant increase of 80.5% in December, imported products continue to have pressure to maintain or lower their prices.
- **National products rose 4%.** While manufactured products became more expensive by 3.1%, primary products increased by 7.3% monthly.



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**, the INDEC will publish the **level of activity** for the first quarter of 2024.
- **Today**, INDEC will report the **rates and socioeconomic indicators of the labor market** for the first quarter of 2024.
- On **Tuesday 25**, INDEC will release the **Industrial Products statistics**.
- On **Tuesday 25**, INDEC will publish the **Hotel Occupancy Survey** for April 2024.
- On **Tuesday 25**, INDEC will publish the **Evolution of income distribution** for the first quarter of 2024.
- On **Wednesday 26**, INDEC will report the **Balance of Payments** for the first quarter of 2024.
- On **Wednesday 26**, INDEC will release its **energy sector indicators** for the first quarter of 2024.
- On **Wednesday 26**, INDEC will publish the **Wage Index** for April 2024.
- On **Thursday 27**, the Ministry of Economy will probably release the **Oil and gas production data**.
- On **Thursday 27**, the Ministry of Economy will probably announce **gasoline sales**.
- On **Friday 28**, the INDEC will report the **monthly estimator of economic activity** for April 2024.

Market dashboard

Weekly, monthly and yearly variations

	Last data	w/w	m/m	y/y	
Official exchange rate ARS/USD	906.0	0.4%	2.2%	263.6%	↑
MEP	1273.9	-0.1%	19.1%	167.3%	↓
Blue Chip Swap	1281.1	-1.2%	17.0%	158.7%	↓
Parallel	1280.0	1.2%	16.4%	162.8%	↑
Official exchange rate BRL/USD	5.4	0.4%	6.5%	13.8%	↑
CB reserves (USD million)	29,944	+676	+1,143	-1,908	↑
Policy rate (Leliq)	40.0%	0 p.p.	0 p.p.	-57.00 p.p.	=
Badlar rate (private banks)	32.6%	-0.81 p.p.	+1.44 p.p	-59.88 p.p.	↓
Private Deposits (trillion ARS)	52.0	-1.9%	5.7%	142.5%	↓
Private Loans (trillion ARS)	24.8	1.4%	16.9%	165.9%	↑
Merval (in ARS)	1,576	0.5%	7.0%	285.1%	↑
Merval (in USD)	1,231	1.8%	-8.6%	48.8%	↑
Country Risk (spread in %)	1,384	-6.6%	9.5%	-41.3%	↓
Soybean (USD/tn)	431.4	-0.3%	-4.4%	-19.9%	↓
Corn (USD/tn)	177.2	-0.9%	-0.6%	-29.7%	↓
Wheat (USD/tn)	213.8	-5.7%	-10.6%	-15.4%	↓
Oil - Brent (USD/barrel)	86.8	6.3%	4.1%	13.8%	↑
Oil - WTI (USD/barrel)	82.7	3.9%	1.2%	15.1%	↑
LNG (USD/MMBTU)	12.6	5.0%	15.6%	-6.7%	↑
Gold (USD/oz.)	2,326.3	0.2%	-3.7%	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	*Apr-24*	1.8%	-7.1%	-1.5%
Automobile production	*May-24*	-9.8%	-4.5%	-4.5%
Steel production	*May-24*	-10.4%	-21.0%	-4.7%
Poultry production	*Apr-24*	5.2%	1.3%	1.1%
Dairy production	*May-24*	2.2%	-3.0%	2.4%
Beef production	*May-24*	0.4%	-3.6%	2.0%
Real Estate transactions (CABA)	*Apr-24*	7.9%	15.1%	13.5%
Flour Production	*Apr-24*	4.9%	-1.6%	2.3%
Oil production	*Apr-24*	0.6%	1.9%	0.4%
Gas production	*Apr-24*	2.4%	14.0%	4.9%
Cement production	*May-24*	14.2%	-15.9%	11.6%
Construction activity	*Apr-24*	1.7%	-22.7%	-10.3%
Gas sales	*Apr-24*	0.1%	-4.0%	-1.7%
Motorcycle licenses	*May-24*	0.6%	-11.0%	13.2%
Use of electricity	*Apr-24*	0.9%	-4.2%	-2.7%
Train rides (AMBA)	*Mar-24*	3.2%	0.7%	2.7%
Imports CIF	*May-24*	-4.3%	-5.6%	-5.2%
Exports FOB	*May-24*	4.7%	8.5%	6.3%
Loans in ARS to private sector	*Apr-24*	-1.2%	-16.6%	-2.2%
VAT-DGI Revenues	*May-24*	-1.6%	-1.5%	-2.0%
Formal private jobs (SIPA)	*Mar-24*	-0.4%	-0.5%	-0.4%
Formal private jobs (EIL)	*Apr-24*	-0.3%	-1.1%	-0.8%
Consumer confidence	*May-24*	3.1%	0.6%	4.6%
Government confidence	*May-24*	2.4%	-6.5%	-0.7%

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

Fiscal Balance: The Hallmark of Milei's Administration

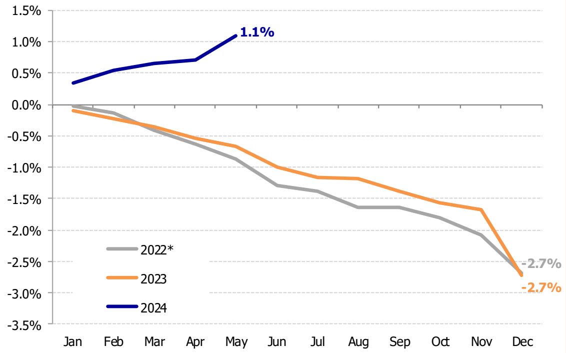
- *The government had a primary surplus of 2.3 billion in May, accumulating 1.1% of GDP in five months of 2024.*
- *The number was inflated by corporate income tax; Milei warned that the fiscal deficit may return in June, although he has some cards in his favor.*
- *The fiscal package is worth 0.4% of GDP and the reduction of PAIS tax rates is equivalent to 0.5%; whether the switch is made depends on Congress.*

The government achieved a primary surplus of 2.3 trillion in May. After interest (higher due to the payment of 800 million dollars to the IMF) there was a fiscal surplus of 1.2 trillion pesos. In five months of 2024, it accumulated a primary surplus of 1.1% of GDP and a fiscal surplus of 0.4%, something unprecedented since 2008.

The number was inflated by extraordinary corporate income tax revenues. 2.15 trillion, 13% more in real terms than the sum of the first four months. In a typical May, income tax explains 10-14% of revenues and this time it was 23%. This is explained by December's devaluation, which increased companies' dollar-link bonds or deposits' value at the end of 2023, impacting on balance sheet statements which are taxed in May and June.

Energy subsidies indicate pending accounts with companies. In May, subsidies amounted to 948 billion on a cash basis, 22% more than in April. However, the number is not enough to cover the 500 billion transferred to CAMMESA to buy dollar bonds and settle its debt with energy companies, the 230 billion to ENARSA to import gas (accrued, according to Congress' budget office) and the regular payment of subsidies, in a month in which the average user covered only 40% of the cost of electricity. The energy companies issued a statement complaining that they only collected 35% of what they were owed in April and that payments for May and June are also pending.

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



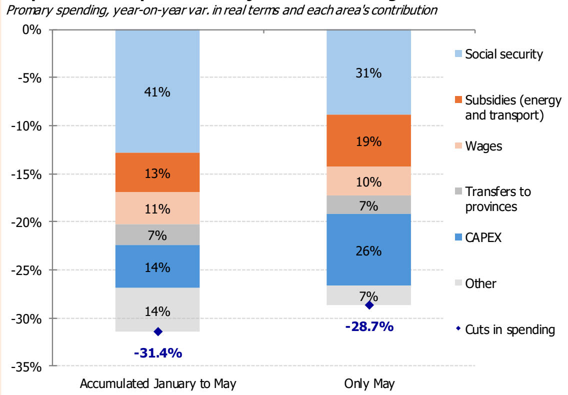
2022* excludes rents from CER bond issuance
Source: Econviews based on Min. of Economy and INDEC

Chart 1. Energy subsidies
In billion ARS

	in billion ARS	As a % of GDP
Cash basis Q1-2024	**688**	**0.12%**
Apr-24	**780**	**0.13%**
May-24	**948**	**0.16%**
CAMMESA debt Dec./Jan.	500	0.08%
Transfers to ENARSA	230	0.04%
CAMMESA debt Feb./Mar.	1,000	0.17%
Accumulated subsidies Jan./May.	2,416	0.41%
Government target 2024	-	1.40%

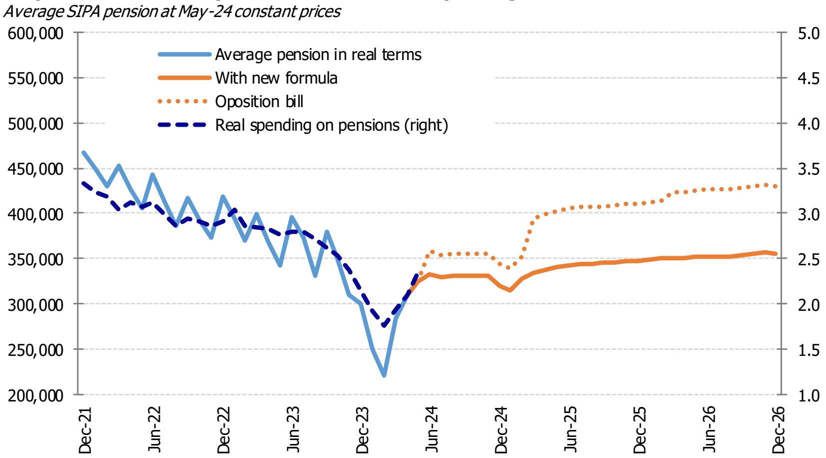
Source: Econviews based on Min. of Economy

Graph 2. The composition of adjustment in shifting
Promary spending, year-on-year var. in real terms and each area's contribution



Source: Econviews based on Min. of Economy and INDEC

Graph 3. Pensions: adjust. formula and real spending
Average SIPA pension at May-24 constant prices



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

There were no surprises in the other items. Primary spending fell 31% year-on-year in five months of 2024 and 29% in May. Slowly, the weight of the adjustment is moving from pensions to subsidies and public works. YTD, social security explains 41% of the cut in spending, but in May "only" 31%. With the April bonus, the year-on-year decrease in pensions shrank from 38 to 15%. Although as shown in graph 3, indexation to the CPI does not leave them much room to recover going forward. Cuts in subsidies went from representing 13 to 19% of the total. And in CAPEX it went from 14 to 26%.

Will the fiscal deficit return in June? The president said so. It makes sense, due to the payment of June bonuses and pending energy bills. Although Milei may also be lowering expectations to surprise with a positive figure, as he usually does with inflation.

The government has some cards in its favor: part of the tax on credits and debts accrued in May will be accounted for in June, there are almost no interest payments (in July things change, with 1.5 billion dollars from sovereign bonds) and if the case arises, it would not be the first time that the payment of bonuses to state employees is delayed. As of June 13, public sector deposits had grown by 1.7 trillion compared to the end of May.

The second half of the year looks more difficult. In its staff report, the IMF makes a list of how the government's plan to adjust 5 points of GDP is coming along. It chooses to compare the fiscal accounts for 2023 against the accumulated 12 months to April 2024, a strange criterion because it includes 7 months of the previous administration. The Fund sees an overzealous adjustment in wages and public works. It is concerned about the delays in raising income tax rates for salaried workers and updating the fuel tax, for now offset by the PAIS tax on dollar purchases.

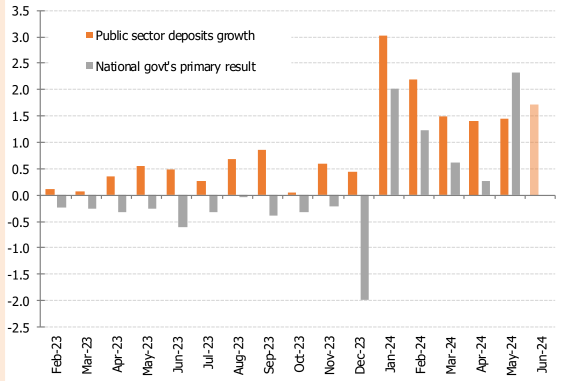
The Senate voted against the fiscal package. According to IMF calculations, the combined measures would contribute 0.4% of GDP to the Treasury this year. The government promised that if the "Ley Bases" reform bill passed, it would lower the PAIS tax rate by 10 points to 7.5%, giving up revenues of 0.5% of GDP, although it did not clarify what it would do if Congress approved the Law, but not the attached fiscal measures. Now, it depends on the Chamber of Deputies.

Regarding the fuel tax, we are more optimistic than the Fund. Due to decree 466/24, in July it will rise by 115% (inflation from September to March). If we return to the scheme of increases of the 2018 law, in October it should rise by 20% (inflation in the second quarter). Assuming that gasoline sales fall by 10% this year, **the ITC can collect 0.6% of GDP, 0.3 points more than in 2023.** It is an important advance, although it does not reach the additional 0.5 that the government is seeking.

At Econviews we continue to see a primary surplus of 0.5% of GDP in 2024 and a fiscal deficit of 1%. The government can achieve better results, at the cost of maintaining distorting taxes such as the PAIS and stepping on the reactivation via public works. We believe that the market will happily settle for less.

Graph 4. Public sector deposits growth

Last day of each month (up to June 13), in trillion ARS



Source: Econviews based on Min. of Economy and BCRA

Chart 2. Argentina: Fiscal adjustment 2024

As a % of GDP

	Authorities' plan	Progress acc. to IMF*	Evaluation
Fiscal consolidation	**5.0%**	**2.9%**	
Structural measures	2.7%	1.6%	
Personal income tax	0.2%	-0.3%	delayed
Fuel excises	0.5%	-0.1%	delayed
Pensiones	0.4%	0.3%	in line
Phase out workfare program	0.4%	0.4%	in line
Wage bill and administrative reforms	0.5%	0.7%	above target
Subsidies (energy and transport)	0.7%	0.6%	in line
Other measures**	2.3%	2.3%	
PAIS tax on dollar purchases	0.8%	1.1%	above target
Lower CAPEX	0.7%	0.8%	above target
Lower transfers to provinces/SOEs	0.5%	0.4%	in line

*Comparing execution in 2023 with 12-month cumulative execution until April 2024

**figures taken from staff report, items do not add up

Source: Econviews based on IMF

Chart 3. PAIS tax on dollar purchases revenues

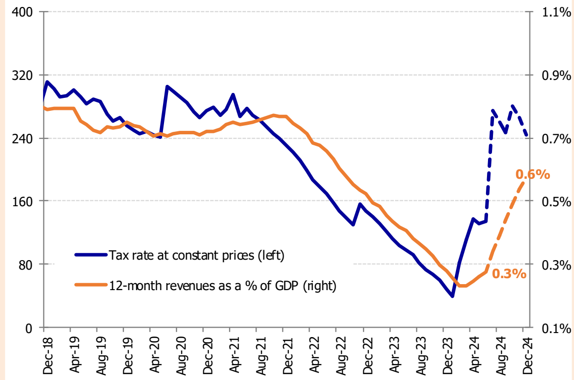
In billion ARS

	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%
May-24	563	284	0.1%
Acum. Jan-May-24	**2,813**	**452**	**0.5%**
2024E with FX controls	**9,290**	**-**	**1.6%**
2024E with lower rates	**6,575**	**-**	**1.1%**

Source: Econviews based on Min. of Economy

Graph 5. Forecast increase in fuel tax rates

Tax rate at May-24 prices and 12-month accum. revenues as a % of GDP



Source: Econviews based on Sec. of Energy

The IMF Gave Clues About the Next Monetary Regime

- *The IMF approved the eighth review of the program and enabled the arrival of USD 800 million.*
- *According to the report prepared by the technical staff, the monetary scheme will move to currency competition, and the idea of dollarization remains in the past.*
- *Restrictions on the market and multiple exchange rates are expected to begin to be removed while the real interest rate becomes positive.*

On June 13th the IMF board approved the eighth review of the current program. This enabled the disbursement of USD 800 million, although they will not last long because USD 640 million must be paid next month. Last Monday, details about the discussions and what to expect in the future were released.

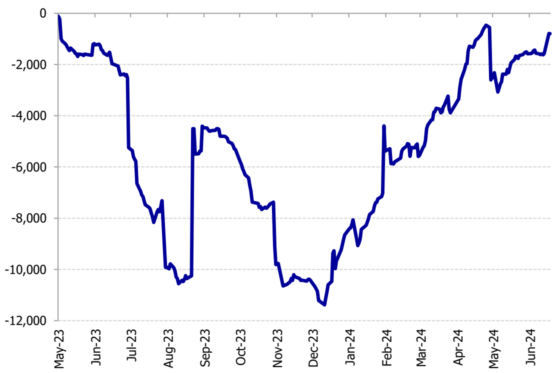
In fiscal policy, the government decided to move forward very strongly from the beginning to achieve fiscal balance this year. This decision was welcomed by the Fund, who may also have settled for a less ambitious goal. **In the report prepared by the technical staff, emphasis is placed on the need to improve the quality of the measures to make the fiscal adjustment sustainable.** The text, written before the Senate votes on the "Ley Bases", describes the restitution of the income tax as vital, something that the upper house rejected. The law also included the revocation of the, in IMF terms, costly and ineffective 2023 pension moratorium, as well as the obligation for the Government to present a plan to reduce tax expenditures. Both measures were well-regarded by Washington, but not by most senators. Within the fiscal issue, top importance is also assigned to continuing to reduce energy subsidies and supporting social assistance (see more in the previous note).

For the coming years, the IMF proposes that to maintain fiscal balance, reforms will be necessary in the tax, pensions, and revenue-sharing systems.

In our opinion, the most interesting part of the document is the section dedicated to monetary and exchange rate policy since it clarifies the panorama of what may come. **The first thing that is indicated is that progress will be made towards a currency competition regime, where the exchange rate floats in a managed manner** as happens in Peru and Uruguay. The Central Bank will have price stability as its first objective, it will be prohibited from financing the Treasury, it will continue to be the lender of last resort for financial entities, will sterilize reserve purchases, and regulate the liquidity of the system through open market operations with public securities.

A very important point is that in this new context, individuals will be able to save in the currency they wish, but other currencies will not be legal tender,

Graph 1. Net International Reserves
In milllion USD



Source: Econviews based on BCRA, IMF & own estimates

Chart 1. Net International Reserves
In million USD

Reservas brutas	**29,944**
Reserve requirements in USD	8,653
Swap (China)	17,914
SEDESA	1,901
BIS	0
Net Reserves	**1,476**
Bopreal (principal)	1,833
Bopreal (principal + interests)	2,274
Net reserves without Bopreal (principal)	**-356**
Net reserves without Bopreal (total)	**-797**

Source: Own estimates based on BCRA and IMF
Up to 19-Jun-24

and tax payments will continue to be made in pesos. This is far away from the dollarization campaign speech, while at the same time, it is closer to what most countries in the world do.

Regarding exchange rate policy, the International Monetary Fund indicates that it needs to become more flexible and that the authorities will adapt it to sustain the reserve accumulation process. There is also a commitment to lift all restrictions on the market and eliminate differential exchange rates. It would start with the "blend dollar" for exporters (the target is set for the end of June). In addition, the PAIS tax would be eliminated before the end of the year. Regarding the latter, the government said that, if the Bases Law is approved, it would lower the rate from 17.5% to 7.5% but it also said that the differential exchange rate for exporters will not be modified. This difference between the government and the IMF generates some uncertainty about what the timing of the measures will ultimately be.

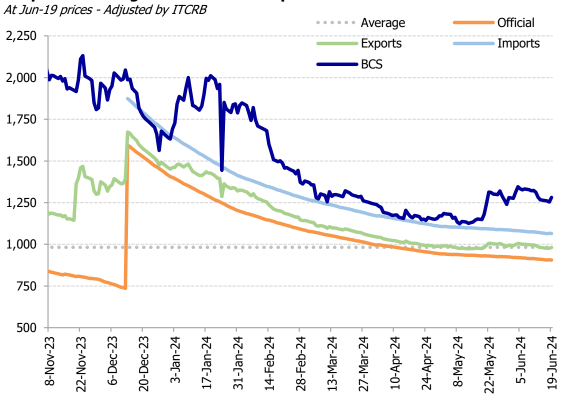
Regarding the interest rate, it was agreed that to support the transition to the new monetary regime and avoid market pressures, the monetary policy rate has to be positive in real terms. This will also help recover money demand as capital controls are lifted. In the last debt auction, the Treasury paid a monthly rate of 4.25% on Lecaps and said that the negative rate process had ended. However, for this rate to be positive, inflation must be lower, something that was verified in May, but we doubt it will be repeated in the coming months. It is also unclear how the real interest rate will be calculated. It is not the same using past or expected inflation.

As of the projections on the main variables, we do not see major differences with our base scenario. The IMF expects a GDP drop of 3.5% this year, in line with our -3.6%. For non-agricultural GDP, the contraction would be 6%, just below what we expect (-6.5%). By 2025 we agree on a 5% recovery.

The inflation forecast was reduced compared to the previous review, going from 149.4% to 139.7%. Here we are a little more negative. The difference is that the Fund sees monthly inflation hovering around 4%, while at Econviews we expect figures closer to 5.5%. In 2025 it would drop to 45% according to the Fund, which is consistent with an average monthly inflation of 3.1%. It means that they do not expect a collapse. Our forecast is 59% for December 2025 with the first part of the year a little stronger and a second half very similar to what the IMF sees. For the result of the current account, we also have very similar visions. We project a surplus of 0.7% of GDP and the IMF of 0.6%.

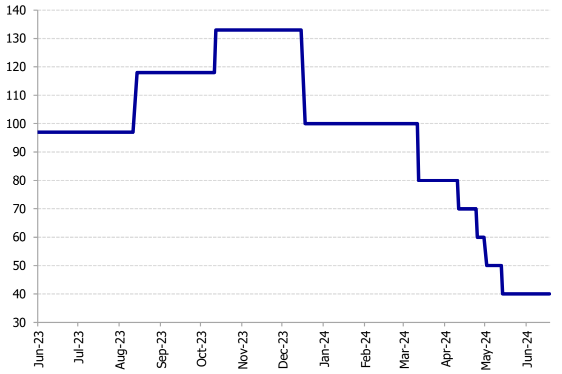
Finally, the Fund mentions the risks of the program. Although the Government's initial measures helped to moderate them, they still exist and there are several of them. The recession may last longer than expected and inflation may be more difficult to bring down. That can lead to greater social tension. Politically, the delay in passing key laws in Congress also poses a threat to the stabilization plan. Nor can we underestimate the international situation, where the strengthening of the dollar and the decline in commodity prices can play against us. **In short, the program is on track, the targets have been met and there is a roadmap forward. The government's task will be to implement it.**

Graph 2. Exchange rate at constant prices
At Jun-19 prices - Adjusted by ITCRB



Source: Econviews based on BCRA

Graph 3. Monetary Policy Interest Rate
In percentage points



Source: Econviews based on BCRA

Chart 2. IMF Forecasts

	2023	2024	2025
GDP Growth	-1.6%	-3.5%	5.0%
Non-agro GDP	-0.8%	-6.0%	5.0%
Inflation (Dec)	211.4%	139.7%	45.0%
Primary fiscal balance (% of GDP)	-2.9%	1.7%	2.3%
Overall fiscal balance (% of GDP)	-4.6%	0.0%	0.5%
Current account balance (% of GDP)	-3.4%	0.6%	0.8%
Accum. of net reserves (USD bn)	-16.4	7.0	5.0

Source: Econviews based on FMI

Chart 3. Projected cash flow with the IMF
In million USD

	Disbursements	Repurchases	Charges
Jul-24		-641	
Aug-24	526		-806
Sep-24			
Oct-24			
Nov-24	544		-795
Dec-24			

Source: Econviews based on IMF