MONTHLY REPORT

ECONVIEWS
ECONOMÍA Y FINANZAS

August 2022
Issue #218

New Minister, old problems, **same policy dilemmas**

How the **economy** will reach **2024: the good, bad and ugly scenarios**

THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- US inflation slowed down in July with a 0% monthly variation that took the year-on-year rate from 9.1 to 8.5%. The labor market is still going strong with 528,000 new jobs last month. The Federal Reserve hiked rates another 75 basis points in July to a 2.25-2.5% range.
- Gabriel Rubinstein, an orthodox-leaning market consultant, was appointed Secretary of Macroeconomic Policy, making him Massa's de facto Minister.
- The financial meltdown sparked by Minister Guzmán's resignation on July 2nd bled into CPI, with a 7.4% monthly print, the worst figure since April 2002. Prices rose 71% year-on-year at a speed unseen since the early 90s. The parallel FX rate and BCS calmed down in the latter half of July, closing at a 120% spread.
- A voluntary debt conversion on August 9th allowed the Government to clear USD 15 billion from this year's maturities, in exchange for a "dual-bond" which pays the best of devaluation or inflation in Q3-2023, with an 85% acceptance rate. Some ARS 769 billion of fixed rate letters turned into indexed debt.
- The BCRA reacted to July's inflation figure by abruptly hiking its policy rate 950 basis points to 69.5%. At an effective annual rate of 96.8%, this is slightly above expected inflation for the next 12 months, 83.7% according to the REM survey.

FIGURE OF THE MONTH

July's monthly CPI print read

7.4%

the highest for a single month since April 2002.

TO BE ALERT

The Central Bank lost USD

548mn

of its international reserves during August and net reserves are running low.

WHAT'S COMING NEXT?

- July's low US CPI print opened up the possibility of a "Fed pivot", with markets now pricing 41-58 odds of a 50 basis point hike on September 21st. Markets are also more focused on the recession risk, with the spread between 10 and 2-year Treasuries 24 points inverted. The Atlanta Fed's GDP nowcast has growth at a 1.4% yearly rate for Q3 so far.
- We have once again raised our inflation forecast for 2022 from 90 to 95%, keeping next year at 105%. Not so much due to July's 7.4% print, a foreseeable consequence of the FX rate jump, but rather due to news of 2% week-on-week printings this month, high statistical carryover and energy and transport hikes, which could leave August's inflation at 6.4%.
- On August 17th, unions rallied against "inflation and price gougers". Without explicit criticism towards the Government, they demanded lump sum increases and reopening of wage negotiations. Recent deals are near 80% and retail employees agreed on a 10% advance, reflecting entrenched inflation expectations.
- Energy subsidies will be removed for high income users and for middle-income users above 400 kWh monthly consumption as of August 31st. Electricity bills could rise up to 200%, while gas up to 90%. The expected fiscal savings for 2023 amount to 0.6% of GDP.

SUMMARY OF MAIN INDICATORS

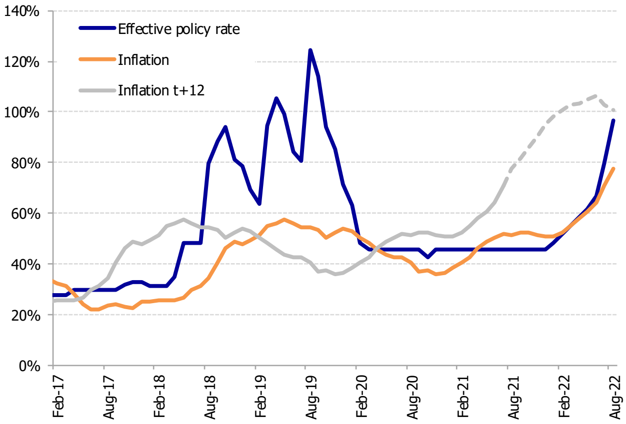
	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	1.1%	0.1%	Inflation (monthly)	7.4%	5.3%
Consumer confidence (MoM)	-11.1%	7.7%	FX spread (21day avg.)	120.9%	127.2%
Industrial activity (MoM s.a.)	2.6%	-0.7%	Country risk (bps 21day avg.)	2,465	2,650
International accounts			**External data**		
Current Account (USD BN)	-1.13	0.29	Soybean price (per ton, 21day avg.)	577.5	581.7
CB Reserves (USD BN 21day avg.)	38.09	40.63	Brazilian activity (MoM s.a.)	0.7%	-0.3%
Primary balance (ARS BN)	-75.95	-321.64	Financial Conditions Index	-18.2	-13.7

Source: Econviews base on multiple sources - Based on working days only

GRAPH OF THE MONTH:

Near-neutral rates

Annualized and year-on-year rates



Source: Econviews based on BCRA and INDEC

JUL 21st	JUL 22nd	JUL 26th	JUL 28th	AUG 11th	AUG 16th	AUG 24th
Econviews Monthly #217: Tough decisions to avoid a full-blown crisis + special analysis on Argentina's public debt	**Parallel FX rate reaches peak of ARS 333**, an 157% spread against official dollar rate. BCS also at ARS 337 record.	In the midst of the currency crisis, BCRA announces a **15% increase in FX rate allowed for agricultural exports**.	With Batakis in Washington, Congress boss **Sergio Massa steps in as new Minister of Economy, Agro and Production**.	July's CPI print comes in at historical 7.4%, BCRA counters by **hiking policy and fixed term deposit rates by 950 bps**.	New Secretary of Energy Flavia Rollón details **removal of electricity and gas subsidies**, with 90 to 200% hikes.	**Econviews Monthly #218**

POLITICS

Silvina Batakis' tenure as Minister of Economy was short-lived: after only 24 days in office, she was relieved by Sergio Massa, who also took control of Agriculture and Production. Massa`s arrival coincided with a rally in emerging markets, which brought the parallel FX rate down 16% and sovereign bonds soared 24%. The new Minister has been able to take some steps his predecessors couldn't, such as adjusting energy subsidies –for users over 400 kWh– and taking interest rates to near-neutral levels. But problems in assigning vice-minister Rubinstein or scuffles over the energy cabinet show Massa is far from absolute power, within a very divided coalition. UTDT's survey warned about a 20% drop in the Government's image during July.

IMF

IMF chief Kristalina Georgieva met former Minister Batakis on July 25th, and is set to meet new Economy head Sergio Massa later this month, as a part of the Minister's US tour scheduled from August 29th to 31st. Argentina is set to receive a fresh disbursement of USD 4 billion during September after passing the current revision. Recently, authorities unlocked 1,220 and 740 million loans from the IADB and CAF, respectively. Real expenditures ought to fall 7.6% in the second semester to reach the 2.5% primary deficit target. 0.4 points less of GDP in subsidies, 0.4 from public goods and services 0.2 from welfare and 0.2 from transfers to provinces are the guidelines to reaching this figure. The reserves goal appears even more difficult.

ECONOMIC ACTIVITY

Activity surprised with 1.1% monthly growth in June, 6.4% in year-on-year terms. Construction slumped 1.6% against May, but manufacturing recovered 2.6% after slipping 0.7% in May, with a 4.1% surge in steel production. Meat (-0.9%) and diary (-0.8%) output was below May's levels. We have less hope for July, with a 0.8% fall due to the currency crisis. Available data for the month such as cement output (-5.2%), electricity consumption (-0.1%) or motorbike licensing (-17%) show a sharp drop in consumption. In quarterly terms, we expect a 1.6% contraction in Q3-2022 and a further 0.7% fall in Q4, although 2022 will still close 3.5% positive due to statistical carryover. In 2023, growth should slow down to 1% yearly.

INFLATION

As expected, July's monthly CPI hit a 20-year record of 7.4%. After Minister Guzmán resigned, the parallel FX rates jumped 20% in just two weeks, leaving many retail stores without a reference price for restocking. Leisure and hospitality (+13%) led the index with push due to winter break, followed by import-dependent household appliances (+10%) and restaurants and hotels (+10%). Apparel (+8.5%) also rose above general inflation. Healthcare increased 6.8% with another adjustment in insurance costs. Food prices grew 6% with some leeway from meat (-0.5%). The upcoming tariff adjustment will factor into August's print, which we see around 6.4%. We have raised our end-of-year forecast to 95%, but are holding 2023 at 105% for now.

MONETARY SECTOR

Only 14 days after the previous hike, the BCRA reacted to July's CPI print by raising its Leliq policy rate 950 basis points to 69.5%, a near-neutral effective rate of 96.8%. The repo rate was adjusted to 64.5%. Effective credit card refinancing rates are over 100% yearly, a level that will surely hurt consumption. However, the effect on the parallel FX rates was limited: the informal dollar is trading at ARS 295, an 115% spread, and the BCS stands near ARS 300. And aside from its impact on the real economy, the higher rates also imply an extra ARS 3.1 trillion in interest payments for the Central Bank, leaving its total liability stock around 8% of GDP.

FISCAL ACCOUNTS

The public sector's primary deficit stood at ARS 75.9 billion in July, 23% below the nominal result from the same month of 2021 despite 71% inflation. This initial fiscal adjustment was accomplished by stepping on transfers to provinces, which only grew 17% year-on-year, less investment in public works (+68%) and cuts in transport subsidies (+4.9%). Tax revenues (+83%) kept growing above inflation in July, led by income tax (+133%) and VAT (+83%). With three Ministers of Economy during July, accrued expenditures far surpass actual ones, both due to instability and Batakis' decision to withhold financing. With little savings to gain from the energy adjustment this year, we expect a 3.1% primary deficit to GDP for 2022 and 3% in 2023.

I. New Minister, old problems, same policy dilemmas

This has been a hectic period in Argentina. Minister Batakis had a short interregnum in which she made the right announcements, but markets did not believe she could deliver. The currency depreciated sharply in the free markets, Argentina's country risk increased, and the government became nervous. After just three weeks in her position and a trip to Washington to introduce herself to the IMF and the US Treasury, she was replaced by Sergio Massa, a lawyer with good connections within the government coalition, including with Cristina and Máximo Kirchner, and with the business community.

Massa is generally believed to be market-friendly. He has good relations with the U.S. and with the multilateral financial institutions, including the IMF as well as with the private sector. His appointment calmed financial markets, at least initially, as investors ruled out the worst-case scenarios, including the risks of "super-high" inflation or a default on domestic debt, and gave him the benefit of the doubt.

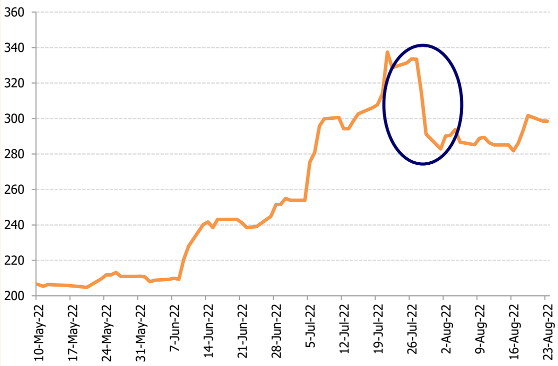
His appointment generated some hope as well as some doubts. On the positive side, he understands that the economy needs to reduce the fiscal deficit in line with the targets set in the IMF program, and the need to have a tighter monetary policy including higher interest rates, while he favors a better business climate. He also announced negotiations with the private sector and multilaterals to increase the possibility of a special exchange rate for agricultural exports (namely soybeans).

At the same time there are doubts. The main concern is the poor prospects for increasing reserves in a meaningful way from the very low levels that they are today, of just 1.3 billion dollars or less than one week of imports. One of the key problems is that according to press reports, Cristina was willing to give the blessing to Massa's appointment as minister, but she put one condition: that there would not be a steep devaluation, which in practice means that Massa loses the ability to use one of the key variables to deal with the situation and that reserves will continue to be under pressure.

Massa has to deal with three fronts to improve the macroeconomic situation: the external accounts (namely the exchange rate and international reserves), the fiscal accounts and monetary policy.

The weakest link and most worrisome is the external one. International reserves are dangerously low and there are little prospects of an improvement any time soon. Changes in reserves are driven by either capital flows or an improvement in the current account of the balance of payments (which includes the trade balance and interest payments). Massa's initial announcement talked about roughly three billion dollars in new loans. However, the likelihood of receiving them is slim. The hope was that the government could obtain a one-billion-dollar repo, which is difficult under current market conditions, would be expensive and could not be included in net reserves if it is for less than a year. It is also doubtful that it can get significant funds from multilateral institutions because the exposure is already large. The best scenario is that in the next couple of

Blue Chip Swap
Pesos per dollar



Source: Econviews based on Reuters

Net and Liquid International Reserves
In billion USD

Gross reserves	**37.0**
Reserve requirements in USD	11.9
Swaps (incl. China)	20.7
SDRs	0.1
BIS	3.0
Net reserves	**1.3**
Gold	3.5
Liquid net reserves	**-2.2**

Source: Own estimates based on BCRA and IMF
Up to Aug-22

months the country can get new disbursements for around a billion dollars from the IDB and the CAF. It seems clear that these flows are not enough to make a difference while some short-term financing from the private sector would be small and would not increase net reserves.

It also seems unlikely that reserves can increase as a result of an improvement in the current account without a more competitive exchange rate. Exporters complain because they argue that currency is overvalued (which in fact it is), while it will be difficult to cut imports with an FX spread that exceeds 100%, which provides a big incentive to over-invoice or to increase the stock of imported goods at a "subsidized" exchange rate.

These factors explain the difficulties that the Central Bank has been having lately in the FX market, where to avoid a larger drain in reserves it was forced to strengthen the controls, as it did in late June when it included a regulation that requires a six-month delay in the payment of many imports. This regulation not only tightened the controls, but it led to shortages and to sharp increases in prices, in part due to difficulties to forecast where the exchange rate would be six months from then.

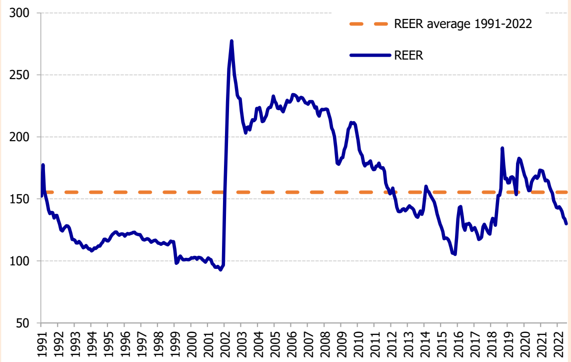
The most likely outlook is that the Central Bank will continue to struggle to increase reserves, and that eventually it will be force to either devalue the currency (an option that clearly does not want) **or to split the market** between a commercial exchange rate and another that can be used for capital flows and/or tourism. It also seems that the FX controls (or *cepo*) will remain in place for the rest of the President Fernández term and that there will be a sizable FX spread during this period.

The reduction in the primary deficit to 2.5% of GDP is the second front. The numbers for the first seven months are well off-target, and we estimate that there must be a reduction of 7% in government expenditure in real terms to reach a drop in the primary deficit of around 600 billion pesos. **The actual target is 2.8% of GDP**, because the IMF accepts to include 0.3% of GDP from a spurious capital gain from the issuance of CPI linked bonds that does not generate any revenues.

The government is taking measures towards that target. It has increased utility rates to reduce subsidies, though this year it is only going to yield 50 billon pesos, which helps but does not close the gap; it issued a decree to reduce expenditures that would mean a saving of 210 billion pesos; and it has introduced an additional advance on the income tax that is expected to generate 200 billion pesos, though only 40% goes to the central government and the balance to the provinces. All in all, there is still some distance to go, and perhaps the hope is that high inflation will erode expenditures and do the rest of the job. A solution that has significant economic costs.

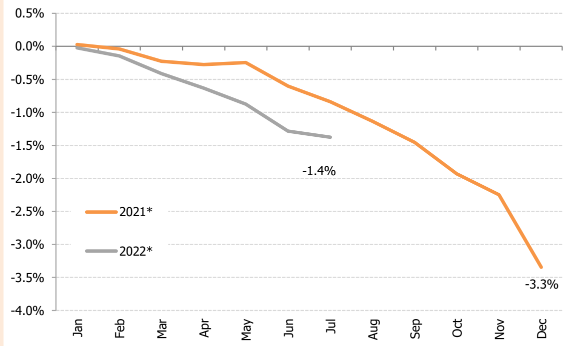
In fact, the third challenge is inflation, which in July gained again momentum and reached 7.4%, the highest monthly figure in the last three decades. This jump in inflation seems to be related to the tightening of the FX controls and the requirement to delay payments for imports for six months. The shortages generated by the new controls and the uncertainty created by the exposure to the exchange rate risk for six months, in an environment where the parallel exchange rate moved to 350 pesos and remains difficult to predict, was an explosive mix whose

Real effective exchange rate
At Jul-22 prices



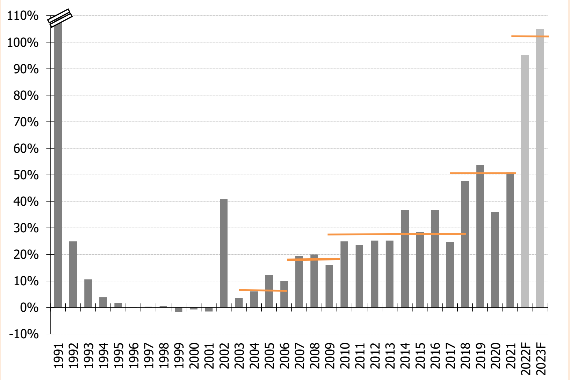
Sources: Econviews based on Reuters and BCRA

Primary fiscal balance
Accumulated as % of GDP - National government, cash basis



2021* and 2022* exclude rents from primary debt
Source: Econviews based on MECON & INDEC

¿Back to triple digits?
Year-on-year inflation, eop.



Source: Econviews based on INDEC

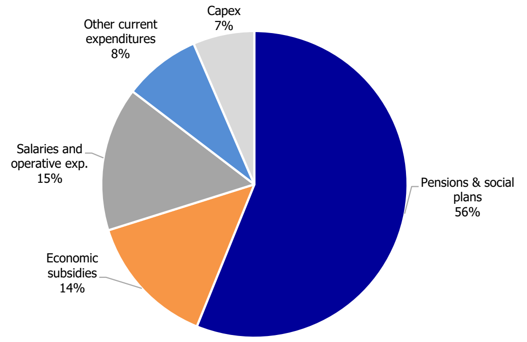
consequence was a significant rise in inflation in July and most likely also in August.

Our most recent base case scenario assumes that inflation will reach 95%, and we don't see any reason to make us think that inflation will fall next year. In fact, our assumption is that it will be even marginally higher in 2023 (around 105%), in part because it is an election year and in this sense there is little incentive for more austerity, because the risk of devaluation will remain alive and kicking while reserves continue to be low, and because higher inflation is the way the government has avoided an increase in pensions and social plans which represent around 55% of total expenditures.

The large increase in interest rates, which is welcome from a policy perspective, **now approaches the target set in the IMF program to have positive real interest rates.** This policy decision certainly helps to control inflation and the parallel exchange rates, though it is not expected to bring down inflation in a relevant way, given the inertia that now exists in the inflation process, the problems generated by the lack of reserves and the need to use inflation to erode government expenditures.

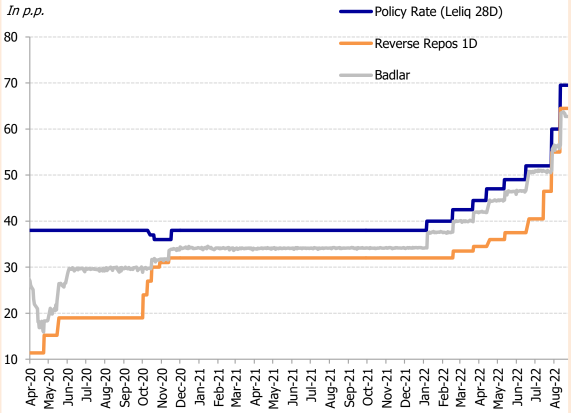
In summary, the appointment of Massa is helping, primarily because he is taking measures to reduce the fiscal deficit, to start addressing the much-needed increases in utility rates, and to adopt a tighter monetary policy in which the Treasury will not receive additional transitory advances from the Central Bank. It is also encouraging that he maintains the program with the IMF. **However, he fails to present in a convincing way the deal with the external imbalance, where the announcements of additional sources of dollars are at best questionable, and where the potential solutions have so far been all rejected. We thus expect that the best scenario is one of muddle-through.**

Distribution of primary expenditures
Jan-Jul 2022



Source: Econviews based on Min. of Economy

Interest rates
In p.p.



Source: Econviews based on BCRA

II. How the economy wil reach 2024: The good, the bad and the ugly scenarios

When it comes to macroeconomic policies Argentina is a can of worms. And this time is no different, as the country faces a very difficult macroeconomic context where the way out implies adopting costly policy measures that the government has be reluctant to put in place. Rising interest rates, cutting subsidies, and acting -besides pledging- to reduce the deficit are policies that were out of question a year ago.

But reality has shown that hard times call for difficult decisions and the government knows that if it doesn't act quickly, the situation can easily get out of control and its low chances of winning the 2023 presidential elections would fall to zero.

But the measures taken so far were more focused on bringing some calm and avoiding the worst-case scenario than turning around a very difficult scenario and deal with the imbalances in a comprehensive way.

In this context, we analyze three different scenarios until 2024, with different assumptions and implications for key variables of the economy.

Scenario n° 1 is our baseline scenario, **in which the government muddles-through until the elections**, attempting to maintain the current situation without a significant deterioration but without significant gains in terms of reducing inflation, reducing the FX spread or accumulating reserves. In this scenario, the government loses the 2023 elections, and a more market-friendly party takes power. We assign a probability of 60% to this scenario.

In scenario n° 2 the situation takes a turn for the worse in the short term, and without reserves the Central Bank cannot avoid a devaluation, perhaps with an overshooting of the exchange rate. In this scenario, the government also loses the election, and the next government needs a softer correction of the FX rate. We assign a probability of 25% to this scenario.

In scenario n° 3 the government makes a moderate correction of the FX rate and reduces the deficit this year, which allows for some real appreciation and a lag in utility rates in 2023, leading to temporary lower inflation and managing to gain the elections. But the accumulated imbalances mean the situation worsens in 2024. We assign a probability of 15% to this scenario.

Scenario 1: Baseline scenario

Scenario 1

	2019	2020	2021	2022 F	2023 F	2024 F
Inflation (eop)	53.8%	36.1%	50.9%	95.0%	105.0%	80.0%
Exchange rate (eop)	59.9	84.1	102.8	179.8	350.6	694.4
FX spread (eop)	24.6%	66.8%	97.7%	120.0%	90.0%	30.0%
Interest rate (eop)	55.0%	38.0%	38.0%	71.5%	85.0%	65.0%
Net reserves (USD million, eop)	12,555	3,793	2,325	4,285	5,093	8,843
Bilateral real FX rate* (eop)	151	158	137	133	132	150
GDP (var %)	-2.0%	-9.9%	10.4%	3.5%	1.0%	0.0%
Primary deficit (% of GDP)	-0.2%	-6.4%	-3.3%	-3.1%	-3.0%	-1.0%
Country risk (bps, eop)	1,770	1,372	1,697	2,200	1,200	750

*Dec-2001=100

Source: Econviews based on multiple sources

Under scenario 1, there is no stabilization plan in 2022 nor 2023 and the government takes a set of measures to avoid a crisis in the FX market as observed in July. This implies an acceleration of the crawling peg which could be combined with a decoupling of the exchange rate to avoid losing reserves to tourism and dollar hoar ding.

The recent rise of interest rates fails in lowering inflation as high inertia and upcoming utility rates increases put pressure on prices.

On the political front, the changes in the Ministry of Finance and the more prudent fiscal stance fail in significantly improving the government's credibility, leading to higher expenditures to help winning the election. As a result, the fiscal goal with the IMF is not met neither this year nor next.

However, the efforts are not sufficient, and the government loses the election to a more market-friendly opposition, which carries out a stabilization plan in 2024 that leads to higher short-term inflation due to the correction of relative prices but results in falling inflation by 2024's second half. The stabilization plan leads to a reduction of the primary deficit, but it comes with a cost in terms of economic activity.

• Inflation, exchange rate and interest rate

With no anchors and a high inertia added to rising wage demands, inflation closes 2022 at 95%. It accelerates to 105% in 2023 as utility rates are partially corrected, growth slows and the government increases spending to raise the odds of a reelection.

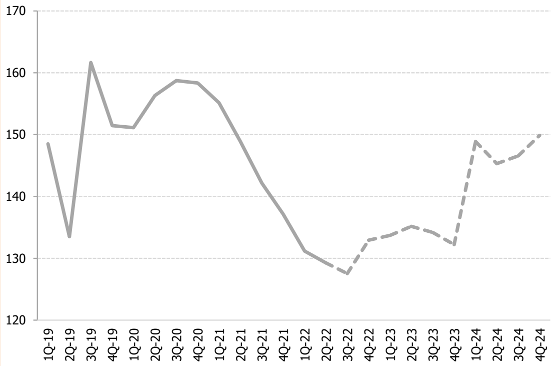
An acceleration of the FX rate is not sufficient to avoid a further appreciation of the real exchange rate. Under this scenario, the FX rate grows 75% YoY by December 2022 and 95% YoY by December 2023.

The interest rate is raised a bit higher ending 2022 at 71.5% and for most part of 2023 is located at 74% but jumps to 85% with the new government in December 2023.

With the real exchange rate appreciated and few reserves, plus utility rates still lagging inflation and with economic subsidies still in place, the new government's stabilization plan includes a correction of relative prices -including a devaluation of 30%- that takes inflation to the area of 120% annually in the first months of 2024, but it decelerates through 2H-2022, closing the year at 80%.

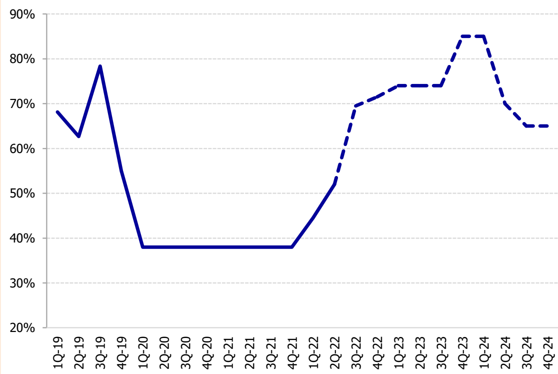
Interest rates are raised as part of the stabilization plan, and the monetary policy rate peaks at 85% in 1H-2024, but is lowered to 65% in the second half of the year as inflation converges to 3% monthly.

Bilateral real exchange rate: scenario 1
Jan-01=100 - Average of period



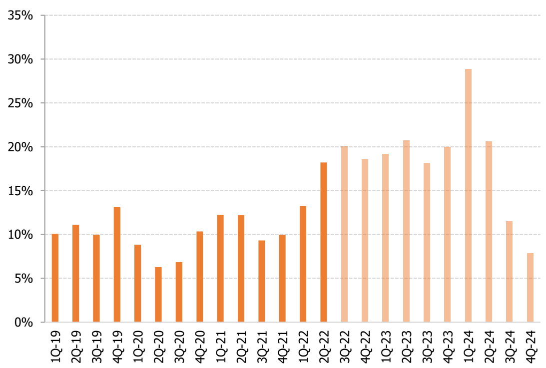
Source: Econviews

Monetary policy rate: scenario 1
28-day Leliqs - End of period



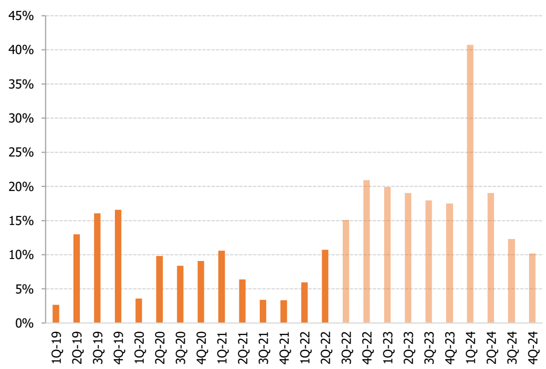
Source: Econviews

Inflation: scenario 1
QoQ - average of period

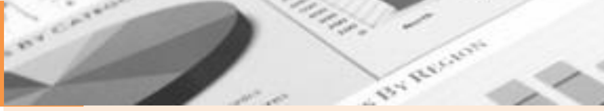


Source: Econviews

Exchange rate: scenario 1
QoQ - Average of period



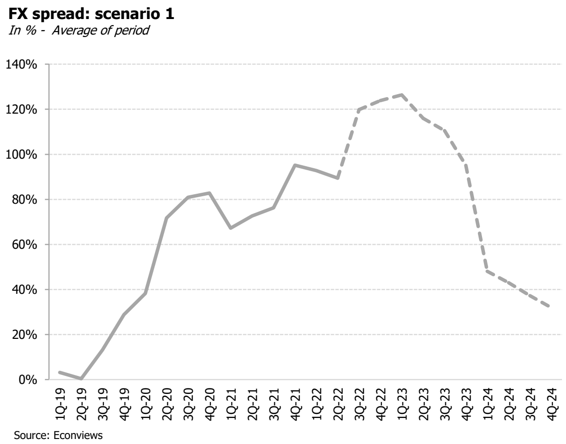
Source: Econviews

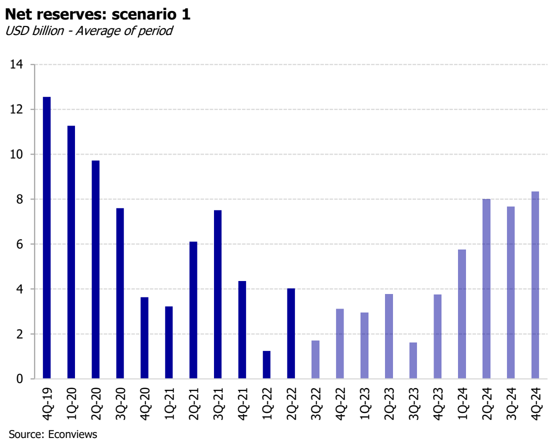


- **FX spread and reserves**

The spread continues above 100% through the second half of 2022 and it moderates slightly with the liquidation of the gross harvest in the second quarter of 2023. As the election approaches and the likelihood of the opposition winning rises, the FX spread continues to fall and reserves grow -particularly due to deposits in USD- after the temporary drop due to fuel imports in mid-2023.

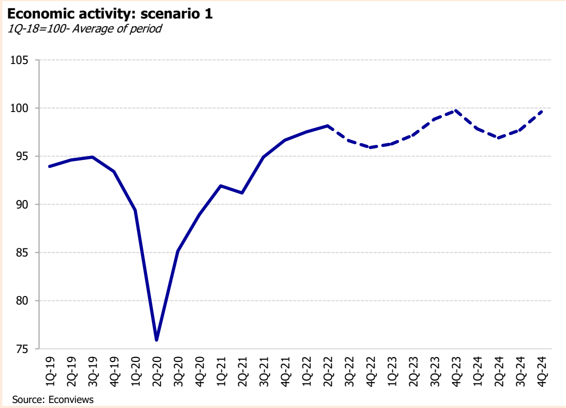
After the FX correction in early 2024, the spread drops significantly and reserves start to grow owing to a higher trade surplus and increased confidence that leads to growing deposits in dollars. Net reserves end 2023 above USD 8 billion.





- **Economic activity**

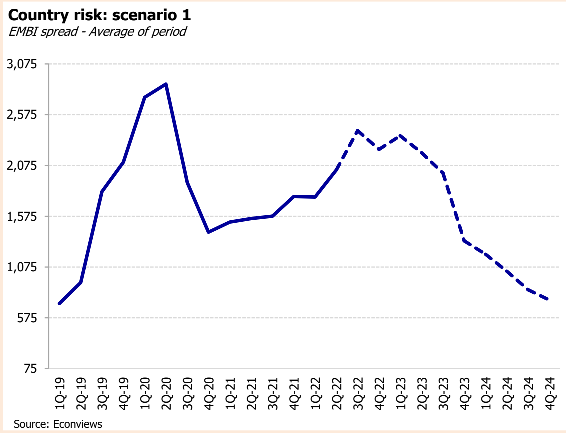
2022 closes the year with an average growth of 3.5% thanks to the carryover effect from 2021 but decelerates in the second half of the year and only grows 1% 2023 thanks to fiscal stimuli. In 2024 it remains flat on average, as it contracts in the first half of the year after the devaluation and starts to recover in the second half as inflation recedes and real wages recover.



- **Deficit and country risk**

Efforts to reduce the deficit in 2022 fall short of the IMF goal, ending at 3.1% of GDP net of rents from primary debt issuance (the goal being 2.8% after this adjustment). The complex social context amid the presidential election leads to higher social spending in 2023 and the deficit ends at 3% of GDP despite lower economic subsidies.

The new government puts in place a stabilization plan that takes the deficit in 2024 to 1% of GDP, which includes a correction of utility rates. This results in a marked drop in country risk, falling to levels of early 2019.



Scenario 2: the situation worsens

Scenario 2

	2019	2020	2021	2022 F	2023 F	2024 F
Inflation (eop)	53.8%	36.1%	50.9%	95.0%	145.0%	60.0%
Exchange rate (eop)	59.9	84.1	102.8	179.8	483.2	797.2
FX spread (eop)	24.6%	66.8%	97.7%	110.0%	40.0%	20.0%
Interest rate (eop)	55.0%	38.0%	38.0%	71.5%	85.0%	60.0%
Net reserves (USD million, eop)	12,555	3,793	2,325	4,285	9,593	14,093
Bilateral real FX rate* (eop)	151	158	137	133	152	162
GDP (var %)	-2.0%	-9.9%	10.4%	3.4%	-3.4%	1.0%
Primary deficit (% of GDP)	-0.2%	-6.4%	-3.3%	-3.1%	-3.0%	-1.0%
Country risk (bps, eop)	1,770	1,372	1,697	2,900	1,300	750

*Dec-2001=100

Source: Econviews based on multiple sources

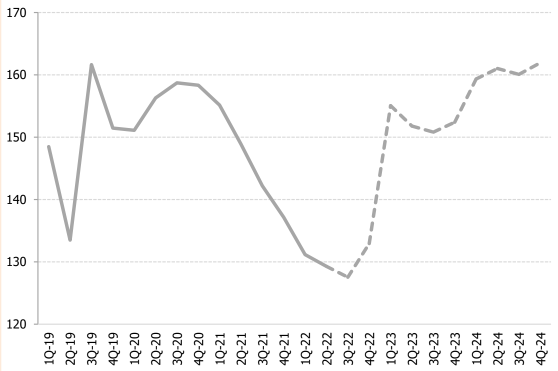
Under scenario 2, the macroeconomic situation worsens in the next few months. The government fails in accumulating reserves, the FX spread goes up as well as country risky, and the Central Bank is not able to avoid a disorderly devaluation of around 50% in the summer, when the demand for dollars for tourism is peaking due to the summer holidays.

The political and social context worsens and the government increases spending but fuels inflation and ends up losing the elections.

There is a silver lining to this scenario, as the devaluation in 2022 allows for a softer devaluation in late 2023/early 2024 that gives place to a higher real exchange rate and results in a significantly higher accumulation of reserves in the medium term than in scenario 1.

Bilateral real exchange rate: scenario 2

Jan-01=100 - Average of period



Source: Econviews

- **Inflation, exchange rate and interest rate**

In this scenario, inflation closes 2022 at 95% and the sharp devaluation in early 2023 takes the FX rate 169% higher by the year's end. In result, inflation ramps up in the first half of 2023, reaching levels of 150%

The overshooting of the exchange rate is partly eroded by inflation but remains at high levels. A softer correction of the exchange rate is done in early 2024 to help maintain the competitivity of exports, which helps to lower the rate of inflation.

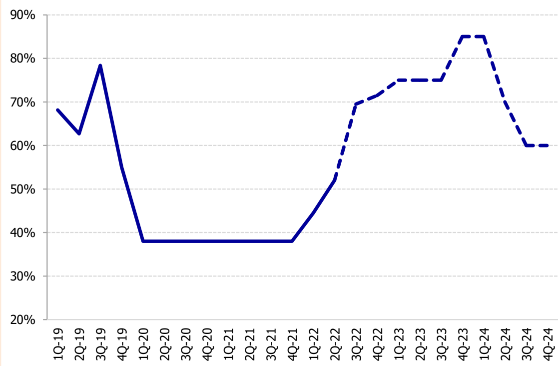
The monetary policy is taken to 75% after the devaluation and remains in that level for most of 2023. The new government takes it to 85% nominal in December 2023 as soon as it takes power.

It later takes it to 60% in the second half of 2024 provided inflation shows a fast convergence to an average of 3% monthly. Compared to the previous scenario, the rate is slightly higher through 2023 end ends up lower in 2024 as inflation falls faster.

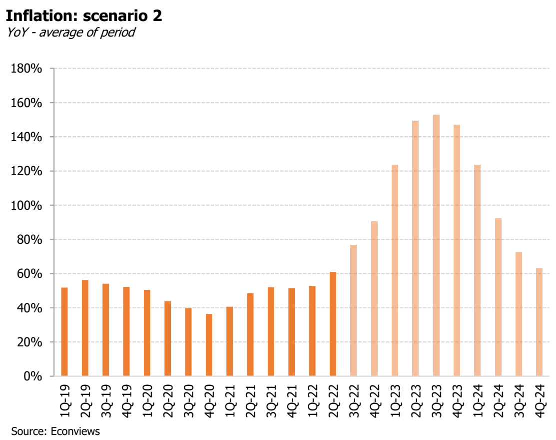
Under this scenario, and provided the new government puts forward a stabilization plan, we could expect inflation to sharply decrease to 60%.

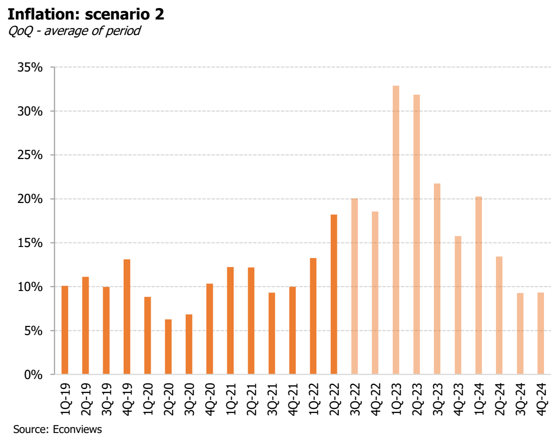
Monetary policy rate: scenario 2

28-day Leliqs - End of period



Source: Econviews

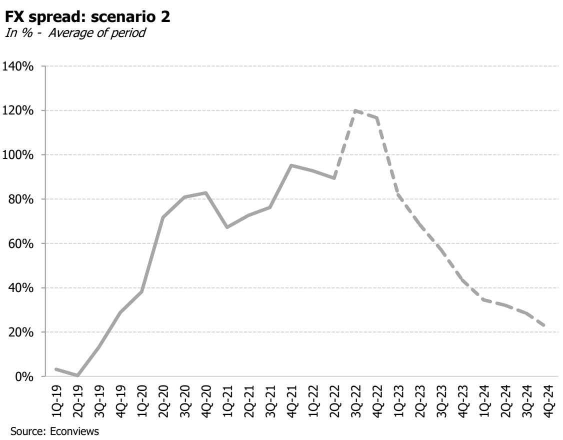


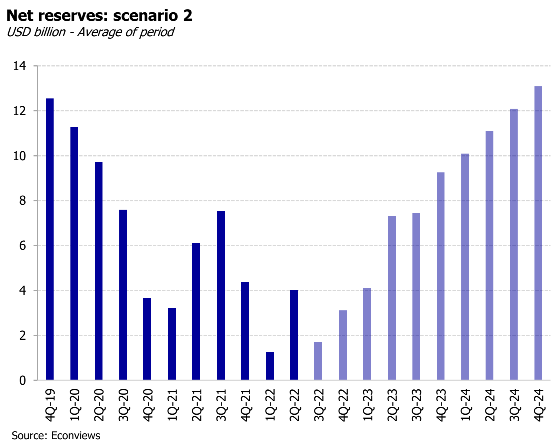


- **FX spread and reserves**

After a discrete jump of the exchange rate, the spread reduces significantly due to lowering of the base, though we could expect the ceiling to rise a bit higher. The expectation of a new government could even fuel a further narrowing of the spread, which under this scenario would be lower by 2024's end than in scenario 1.

The devaluation in 2023 could quickly help enlarge the trade surplus and accumulate some reserves before the elections. Reserve accumulation would speed up in 2024, as a more competitive FX rate combined with a lower spread would lead to a higher trade surplus, and a higher confidence in the government would reduce capital outflows.

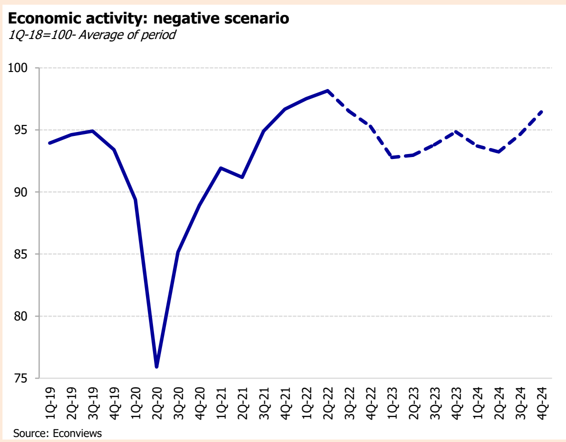




- **Economic activity**

Under this scenario, economic activity further decelerates in the second half of 2022, leaving a negative carryover effect, and posts a strong contraction after the discrete jump in the exchange rate.

Fiscal stimuli contribute to a very moderate and temporary recovery of activity but, overall, GDP shrinks 3.4% in 2023. The correction of relative prices -softer under this scenario- leads to a decrease in activity in the first months of 2024, but it picks up in the second half of the year, allowing for an average rebound of 1% in the whole year.

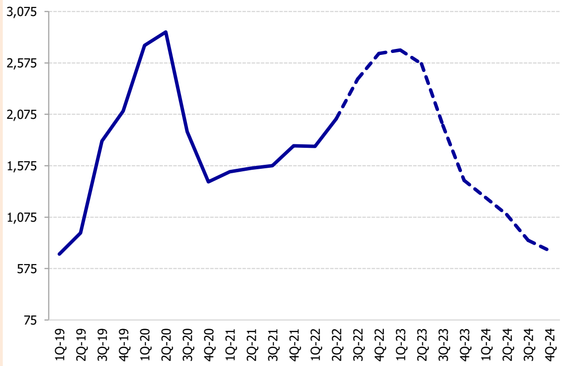


- **Deficit and country risk**

Despite higher revenues in 2023 thanks to higher inflation, a jump in expenditures keeps the primary deficit at 3% of GDP. Like the previous scenario, a new administration puts forward a stabilization plan that takes the primary deficit to 1% of GDP in 2024.

Country risk remains above 2,500 bps for much of 2023 under this scenario, and only starts to decrease after the chances of a new government being elected become more palpable. It continues to decrease throughout 2024 and ends in levels of early 2019 by 2024's end.

Country risk: scenario 2
EMBI spread - Average of period



Source: Econviews

Scenario 3: a short-term victory for the government

Scenario 3

	2019	2020	2021	2022 F	2023 F	2024 F
Inflation (eop)	53.8%	36.1%	50.9%	100.0%	95.0%	144.0%
Exchange rate (eop)	59.9	84.1	102.8	205.5	328.7	803.2
FX spread (eop)	24.6%	66.8%	97.7%	110.0%	140.0%	100.0%
Interest rate (eop)	55.0%	38.0%	38.0%	69.5%	65.0%	80.0%
Net reserves (USD million, eop)	12,555	3,793	2,325	4,285	3,843	2,593
Bilateral real FX rate* (eop)	151	158	137	148	127	131
GDP (var %)	-2.0%	-9.9%	10.4%	3.9%	0.5%	-3.1%
Primary deficit (% of GDP)	-0.2%	-6.4%	-3.3%	-2.8%	-3.0%	-2.0%
Country risk (bps, eop)	1,770	1,372	1,697	2,600	2,400	2,400

*Dec-2001=100

Source: Econviews based on multiple sources

Scenario 3 assumes the macroeconomic situation is kept under control and economic activity ends 2022 at a higher level than the previous scenarios, but so does inflation.

With inflation ending slightly lower than 2022 under this scenario, the odds of the government marginally winning the elections increase. Under this scenario, Sergio Massa could become the next president and his policy choices in 2024 would be more moderate than under a Kirchnerist administration.

There is an effort to reduce the deficit in 2024, but there is no stabilization plan. The appreciation of the real exchange rate in 2023 leads to a discrete jump in 2024 that coupled with a correction in utility rates takes inflation to a much higher level and GDP contracts significantly.

- **Inflation, exchange rate and interest rate**

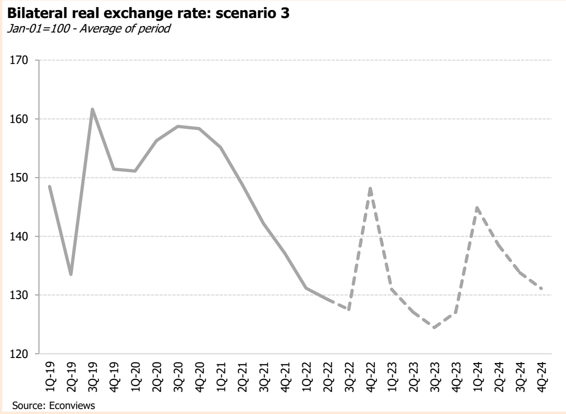
A devaluation of 20% occurs by the end of the year, taking inflation to 100%. A more competitive real exchange rate is nonetheless quickly eroded as the government now uses the FX rate as an anchor for inflation.

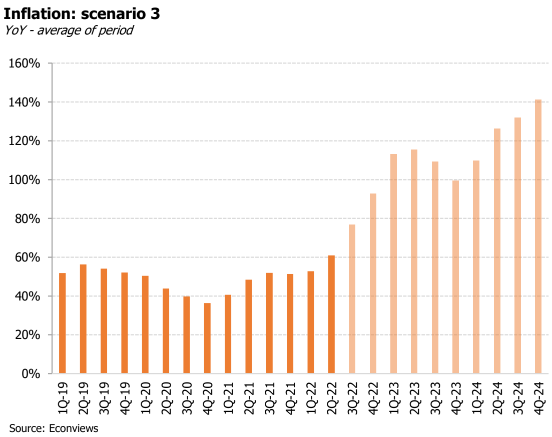
Inflation runs high in the first months of the year but partially moderates with the FX rate being anchored. Inflation ends 2023 at 95% and the exchange rate posts a variation of 60% December to December.

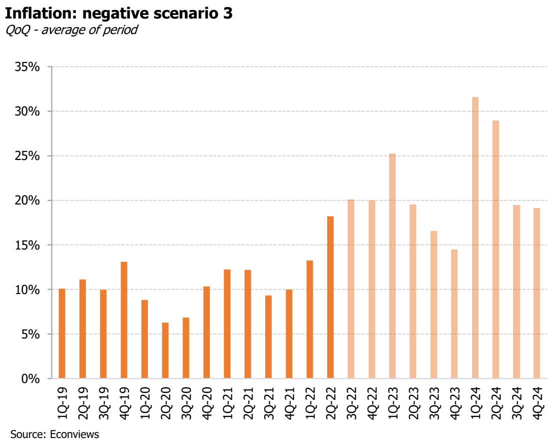
But the appreciation of the real exchange rate in 2023 leads to a disorderly jump in 2024 which fuels inflation, and without a stabilization plan, it ends the year at 144%.

As for interest rates, they are kept at the current levels in 2023 to avoid putting more pressure on activity and thus raise the chances of the government being elected.

But in 2024 they must be raised again after the devaluation prompts an acceleration of inflation, and throughout 2024 they remain at 80% nominal.



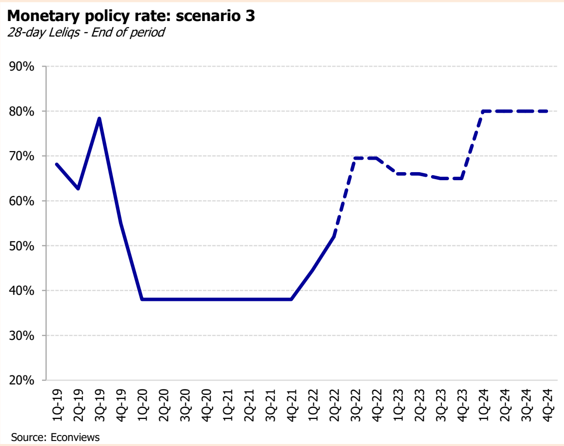




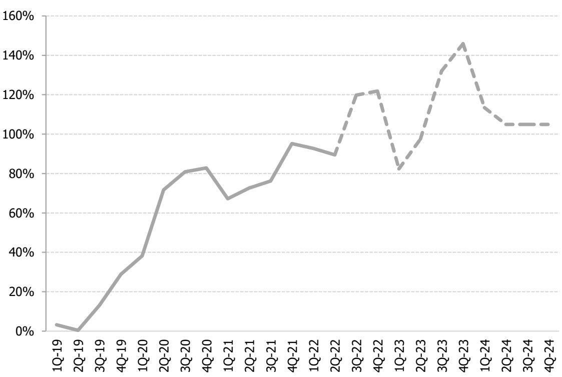
- **FX spread and reserves**

Under scenario 3, the FX spread shrinks after the devaluation in late 2022 but grows again during the elections. There is some accumulation of reserves after the devaluation, particularly through the gross-harvest season, but as the spread grows and the exchange rate turns less competitive, reserves start to decrease.

A similar pattern is shown in 2024, but with net reserves falling faster as inflation now runs at a higher speed. They end 2024 at a slightly higher level than the current one. In this scenario, there are is no significant growth of deposits in dollars.

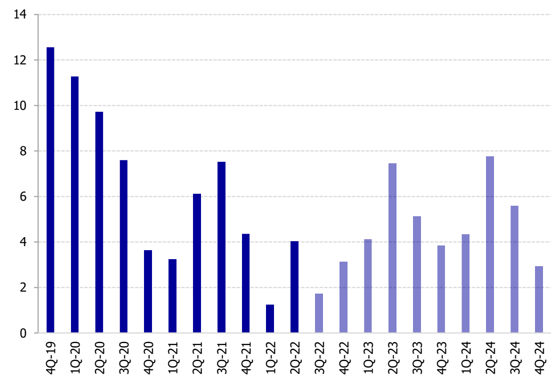


FX spread: scenario 3
In % - Average of period



Source: Econviews

Net reserves: scenario 3
USD billion - Average of period



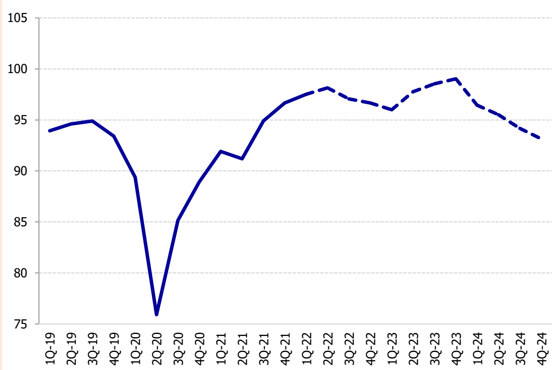
Source: Econviews

- **Economic activity**

  Activity ends up higher in 2022 than in the previous scenarios (3.9%), thus leaving a higher carryover effect that is eroded by the negative impact of the devaluation.

  But with fiscal stimuli in place to win the elections, GDP closes the year at 0.5%. However, the sharp devaluation of early 2024 coupled with some fiscal tightening, yet without a stabilization plan, leads to a contraction of 3.1% of GDP in 2024.

Economic activity: scenario 3
1Q-18=100- Average of period



Source: Econviews

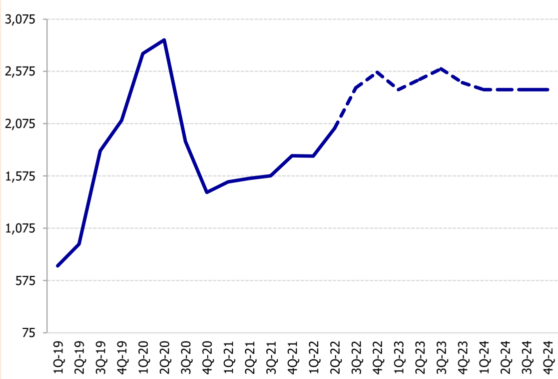
- **Deficit and country risk**

  The government reduces the deficit to 2.8% of GDP in 2022 and leaves more room for spending in 2023.

  Like in the previous scenarios, we assume primary deficit closes 2023 in the area of 3% of GDP. Unlike the other scenarios, there is no stabilization plan in 2024 but there is some fiscal tightening which takes the deficit to 2% of GDP 2024.

  But the marginal victory for the officialism does and the lack of a stabilization plan mean that, despite a reduced deficit, country risk remains at the very high levels we have recently observed.

Country risk: scenario 3
EMBI spread - Average of period



Source: Econviews

Base Scenario

	2019	2020	2021	2022 E	2023 E
Inflation (eop)	53.8%	36.1%	50.9%	95.0%	105.0%
Exchange rate ARS/USD (eop)	59.9	84.2	102.8	179.8	350.6
Exchange rate ARS/USD (eop, YoY)	58.4%	40.5%	22.1%	75.0%	95.0%
Real exchange rate ARS/USD (eop, Dec-01=100)	151.5	158.3	137.1	132.9	132.2
Paralell exchange rate ARS/USD (eop)	74.6	140.3	203.1	395.5	701.3
Spread with official exchange rate (eop)	24.6%	66.8%	97.7%	120.0%	100.0%
Gross reserves (USD billion, eop)	44.8	39.4	39.5	40.0	40.5
Net international reserves (eop, USD bn)	12.6	3.8	2.3	4.2	5.1
Policy rate (eop)	55.0%	38.0%	38.0%	71.5%	80.0%
GDP (YoY)	-2.0%	-9.9%	10.4%	3.5%	1.0%
Formal wages in real terms (aop, YoY)	-6.0%	-1.9%	0.4%	-1.5%	-0.5%
Primary surplus (% GDP)*	-0.2%	-6.4%	-3.3%	-3.1%	-3.0%
Public net debt (% GDP)	43.6%	52.7%	42.1%	38.4%	40.3%
Current account (% GDP)	-0.8%	0.6%	1.2%	-0.1%	0.6%

Source: EconViews

*Excludes rents from primary debt issuance in 2021 and 2022

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