MONTHLY REPORT

ECONVIEWS
ECONOMÍA Y FINANZAS

September 2022
Issue #219

THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- US inflation surprised at 0.12% monthly in August, as many analysts expected deflation due to falling gas prices. The CPI print pushed the Federal Reserve towards a third 75-basis point hike last September 21st, to a 3-3.25% range. The S&P 500 lost 7.5% on fears of a tighter monetary policy.
- Gazprom closed Nord Stream 1 in early September with Putin straightforward on restricting gas exports to Europe until sanctions are lifted. Natural gas futures are at 190 euros per MWh, and the European Union set out a rationing plan. The ECB hiked rates by 75 basis points to 1.25%, to counter 9.1% inflation.
- Massa signed a temporary ARS 200 exchange rate for soybean exporters and achieved fresh credit from the IADB and CAF to rebuild international reserves. The Central Bank bought USD 2.8 billion in reserves since the measure came into effect on September 5th. In this period, the parallel FX rate fell from ARS 283 to 268, an 100% spread against the official rate which has also been depreciating faster at an 109% annualized rate.
- August's CPI surprised at 7% monthly, with wholesale prices increasing 8.2%. The market is forecasting 100% inflation by December. The BCRA reacted by hiking its policy rate for the ninth time this year by 550 basis points to 75%, an *ex-ante* near neutral effective rate of 107.4%.

FIGURE OF THE MONTH

The Central Bank bought USD

2.8 bn

in reserves with its new exchange rate for soybean exporters

TO BE ALERT

Three consecutive months of deficits add up to a

1.02 bn

negative trade balance between June and August 2022.

WHAT'S COMING NEXT?

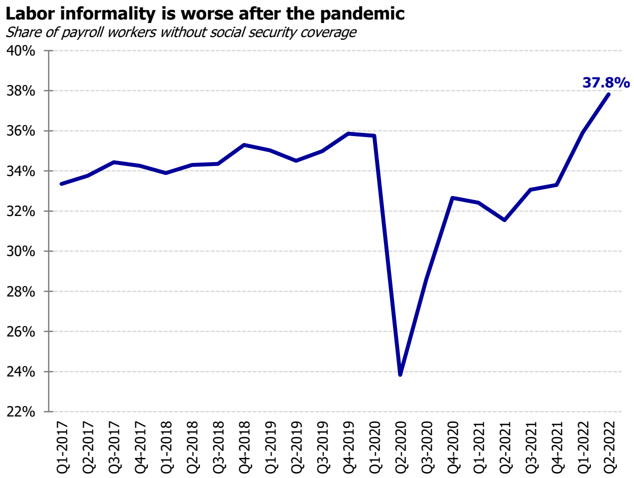
- In a hawkish turn, the last FOMC forecast a Fed Funds rate around 4.25-4.5% for December. GDP growth forecasts for Q3 slowed from a 1.3 to 0.3% annual rate per the Atlanta Fed and analysts are wondering if the recession risk will force the Fed to unwind policy in 2023.
- Argentina formally applied for BRICS membership. A Lula win in Brazil's October 2nd election could also help refloat the EU-MERCOSUR trade deal, although today it seems far off.
- Minister Massa sent a 2023 Budget Bill to Congress with projections of 60% annual inflation, 2% GDP growth and an ARS 269 exchange rate for December, at odds with most market forecasts. Underestimating inflation allows for a more discretionary use of expenditures. The Bill sticks to the IMF's 1.9% primary deficit target, but we believe that given the elections, the figure will end up closer to 3% of GDP.
- The truce in the parallel FX market runs the risk of being short lived: in the last days the BCS heated up 10% to ARS 307 and futures are pricing an 114% annualized devaluation during Q4-2022. After the "soybean dollar", more sectors are lobbying for preferential FX rates.
- Inflation showed little sign of slowing in the first weeks of September, and a series of service, wage and utility increases will keep it running above 6% monthly in Q4 and most of 2023.

SUMMARY OF MAIN INDICATORS

	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	1.1%	0.1%	Inflation (monthly)	7.0%	7.4%
Consumer confidence (MoM)	6.6%	-11.1%	FX spread (21day avg.)	106.9%	120.9%
Industrial activity (MoM s.a.)	-1.2%	2.9%	Country risk (bps 21day avg.)	2,367	2,511
International accounts			**External data**		
Current Account (USD BN)	-0.89	-1.13	Soybean price (per ton, 21day avg.)	555.3	575.4
CB Reserves (USD BN 21day avg.)	37.28	37.96	Brazilian activity (MoM s.a.)	1.2%	0.9%
Primary balance (ARS BN)	-210.05	-75.95	Financial Conditions Index	8.1	-18.3

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

GRAPH OF THE MONTH:



Source: Econviews based on INDEC

RECENT ECONOMIC DEVELOPMENTS

AUG	SEP	SEP	SEP	SEP	SEP	SEP
24th	1st	4th	6th	15th	19th	22nd
Econviews Monthly #218: New Minister, old problems, same dilemmas + three scenarios for the economy.	**Assassination attempt on VP Cristina Kirchner** condemned by all sectors, but political climate continues to deteriorate.	Minister Massa announces **special ARS 200 exchange rate for soybean exporters**, set to expire on September 30th.	**IABD unlocks USD 3 billion in fresh credit for Argentina**, of which 1.2 bn for BCRA reserves. Parallel FX rate falls to ARS 268.	August's higher than expected 7% CPI print prompts **BCRA to hike Leliq policy rate by 550 basis points to 75%.**	**IMF approves second review of Argentina's SAF**, paving the way for a new USD 3.9 billion disbursement to pay maturities.	**Econviews Monthly #219**

POLITICS

A failed assassination attempt of VP Cristina Kirchner, after weeks of rallies at her Buenos Aires residence amidst her ongoing corruption trial, shocked the political world. The Government rallied around her figure and denounced "media influence" on the shooter, while the opposition mainly condemned the attack with some caveats. The incident shifted focus -at least temporarily- from the economy, allowing Minister Massa to move forward with unpopular measures such as a special FX rate for soybean exporters or cuts in Health and Education expenditures. The *Juntos por el Cambio* coalition won local elections in Marcos Juarez by a larger-than-expected margin, although Cordoba is a favourable district for the opposition.

IMF

On September 19th, Fund staff formally approved the second review of Argentina's SAF program, allowing for the disbursement of USD 3.9 billion in SDRs. The IMF recognized "recent decisive policy actions aimed at correcting earlier setbacks", which weighed against the failure to reach the net reserves accumulation target for Q2. The 2023 Budget Bill sent by Massa to Congress maintained the 1.9% primary deficit to GDP target set out in the initial program in March. Days earlier, IMF Director Kristalina Georgieva singled inflation out as "topping the list of Argentina's problems" but acknowledged that the current program served as an anchor for the economy. Her September 19th meeting with President Fernández was "excellent".

ECONOMIC ACTIVITY

GDP growth was higher than expected in Q2-2022, 1% above the previous quarter and 6.9% year-on-year with strong performance from consumption (+1.8% quarterly). However, July's exchange rate volatility set out a tough second semester. Manufacturing slumped 1.2% against June, with steel production down 5%. Construction (+2.2%) was better off with some positive effect from the FX spread. Initial electricity use data for August (-2.5%) isn´t promising either. Retail sales fell 2.1% year-on-year in August, with inflation eroding consumers' purchasing power. But as a strong carryover effect persists and industrial production has relatively remained stable, we revised our GDP growth forecast to 4% this year but down to 1% in 2023.

INFLATION

August's 7% monthly CPI print caught private forecasters off guard, with the BCRA survey median at 6.5%. Apparel (+10%) led the index, with sharp increases in home appliances (+8.4%) and food and beverages (+7.1%) as well. In light of this data, we updated our year-on-year forecast from 95 to 100% and adjusted 2023 from 105 to 110%, with a 6% floor for monthly inflation. Wholesale prices rising 8.2% in August is not a positive sign and increases in gas (+21%) and electricity bills (+56%), subway tickets (+25%), private schools (+9%) and healthcare insurance (+11.5%) in September and October will add pressure. Wages are being renegotiated with new contracts ranging between 80 and 100% year-on-year increases by December.

MONETARY SECTOR

By now it has become somewhat customary for the BCRA to hike rates after each hot CPI reading. August was no exception, and on September 15th the Leliq policy rate went from 69.5 to 75%, a practically neutral effective rate of 107.4%. Despite the timing of the announcements these latest hikes are more directed towards reining in the parallel FX rates than controlling inflation. The BCS fell a spread as low as 97% at ARS 280 earlier this month, after the initial success of the preferential ARS 200 rate for soybean exports. But producers' attempt to convert pesos back into dollars through the BCS heated it back up to ARS 307, leading to new restrictions. The official devaluation rate sped up from 80 to 109%, annualized.

FISCAL ACCOUNTS

The public sector's primary deficit stood at ARS 210.1 billion in August, 68% above the nominal result from one year ago with inflation running at 79%. The government celebrated "real expenditures decelerating" for the fourth straight month. Social welfare (+62%), energy subsidies (+47%) and transfers to the provinces (+72%), which make up three-fourths of primary expenditures, all grew below inflation. Tax revenues rose 74% YoY totaling ARS 1.2 trillion, although in August 2021 includes 23 billion from the extraordinary Tax on Wealth. VAT (+86%), Income Tax (+93%) and import tariffs (+105%) increased the most, while export duties (0%) stayed flat. We expect a 3.1% of GDP primary deficit in 2022, above the IMF's 2.8% (adjusted) target.

I. Massa: good start, same challenges

Massa has been almost two months commanding the economy, and the results so far have been mixed, though probably better in some important respects that one could have expected. The challenges remain large, because they were significant in the first place, especially on the external front (including the exchange rate and reserves) and on inflation, where the outlook remains rainy.

One important element is that Massa is showing leadership and the capacity to move forward some initiatives that have been on the table for some time but where there had been little progress. This includes the increase in utility rates or the introduction for a limited time of a more attractive exchange rate for soybean exports. He has the advantage over Guzman and Batakis that he is one of the political leaders of the government coalition with full access to Cristina and Alberto Fernandez.

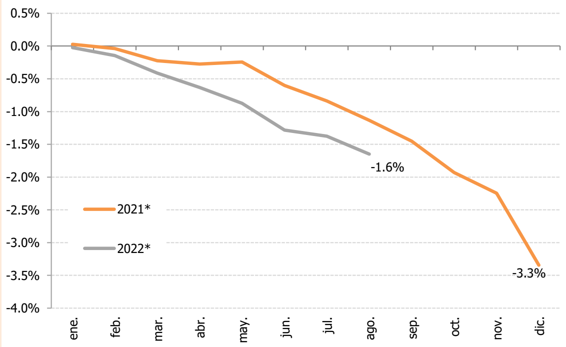
His first statement, in line with the previous ministers, was that he was going to maintain the program with the IMF and meet the targets for the third and fourth quarter. He visited Washington and met with officials of the US Treasury (where Janet Yellen stopped by for a few minutes), with top officials at the Fund and with the President of the IDB where he managed to unblock a 500 million dollars loan. The overall reception in DC appears to have been good, though he received more goodwill than money. He got 800 million dollars from the IDB (in two tranches one now, and the other in December) and the promise to continue the disbursements of projects loans.

As part of the effort to meet the targets of the IMF program, he announced reductions in the fiscal deficit. Probably, this is the area where the government has shown more results. Most of the policy measures are oriented towards containing government expenditures, as can be inferred from the 2023 budget that the government sent to Congress. It will be difficult to meet the 2.5% of GDP target (which in fact is 2.8% once one considers some creative accounting on capital gains on bonds), but if the figure is around 3.1% of GDP it should be easy to get a waiver from the IMF.

Massa managed to take control of the strategic secretary of energy and implemented an increase in utility rates, which this year will only yield 50 billion pesos or (0,025% of GDP) as most of the effect is expected to be next year. **However, with inflation running at an annual rate of 100%, the rates will need to be increased again next year during the presidential election**. A big problem for the government.

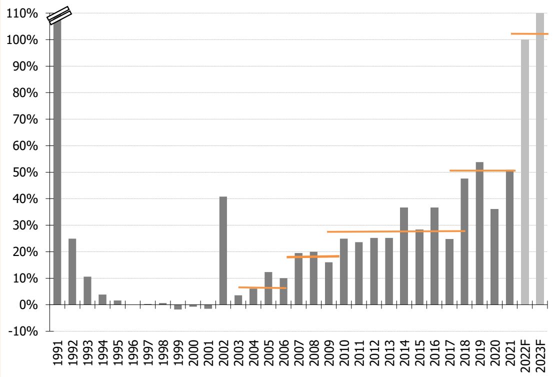
There was some progress on the external front, though it continues to be an area of concern, but one wonders whether it is just temporary and hence there are still doubts about the sustainability of the accounts. September will bring good news, following months of persistent drops in reserves. The turnaround will be achieved by a one-time, temporary increase in the exchange rate for soybean exports to ARS 200, above the ARS 143 official exchange rate. Soybean exporters have responded well to the incentive, though it waits to be seen how much of the **additional three billion dollars** that are estimated to be exported this month will be

Primary deficit
As % of GDP - National government, cash basis



2021* & 2022* exclude rents from CER bond issuance
Source: Econviews based on MECON & INDEC

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



Source: Econviews based on INDEC

compensated by lower exports in the last quarter. In normal months soybean exports remain between 2 and 3 billion dollars.

The new dollar soybean raises some intriguing questions. First, it seems clear that the temporariness of the measure generates doubts about the behavior of the flows of trade. Will October, November, and December show deficits again as it happened last year? Will other sectors ask for a more competitive exchange rate leading to a split of the foreign exchange market? What can the government do to avoid further losses in reserves?

The last question is at the core of the problem. Argentina has an overvalued currency, and equally important a large spread between the official and the parallel exchange rates. The most common solution is devaluation of the currency or letting the exchange rate float. However, the government is not willing to go this route, in part because there are understandable concerns about the impact of a large depreciation in an economy that already has 100% inflation and is largely dollarized, and in part because it is has become a dogmatic issue. In the end, a devaluation will eventually take place, perhaps in 2024, but we cannot rule out that the current administration will continue to adopt a series of patches (such as the soybean dollar) and try to endure until a new government takes over.

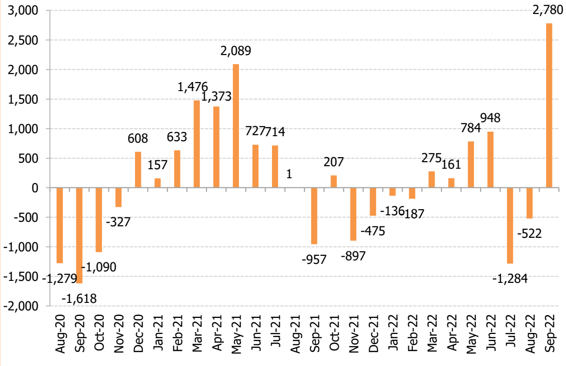
Within this framework there are now talks about a new exchange rate for tourism. The government has been trying to discourage the use of credit cards abroad by introducing new taxes and tax advances on tourism, which have not been enough to take a dent on them. The Central Bank sells around 700 million dollars a month in tourism, a figure that if reversed, can help to equilibrate trade flows of goods and services.

The certainty is that something must change, though there are questions regarding when and whether it will be a devaluation, a split of the foreign exchange market or a tightening of foreign exchange controls. What the Central Bank does in the exchange rate front has fiscal implications, and in some cases quite large. For instance, the cost of the dollar soybean at ARS 200 is roughly ARS 60 per USD dollar, which means that if exports rise to six billion dollars, the Central Bank will lose ARS 360 billion. It not clear, however, who bears the cost, The Central Bank says not me, because it receives from the treasury a new bond in pesos for that amount. The Treasury apparently does not include the bond in the deficit. In our view this is a quasi-fiscal deficit that the Central Bank final finances with leliqs. A very murky situation and we are still waiting what the IMF will say about it.

Likewise, if there is a new floating exchange rate for tourism, the Treasury will lose revenues for the tourist tax, which are estimated at 0.4% of GDP. The trade-offs are everywhere, and it is not clear who will make the final decision.

Inflation is a second worrisome issue, as it peaked at 7.4% in July and only fell to 7.0% in August. We believe that a realistic estimate is 100% for this year, and somewhat higher in 2023, an inflation has become the mechanism to contain the fiscal deficit. The government does not have a plan to bring down inflation, and this is the second weakness of Massa's tenure. True, many would argue that the Central Bank has the main responsibility of dealing with inflation, which does not appear to the case

Central Bank reserves purchases
In million USD - Up to Sep-21



Soure: Econviews based on BCRA

Net and Liquid International Reserves

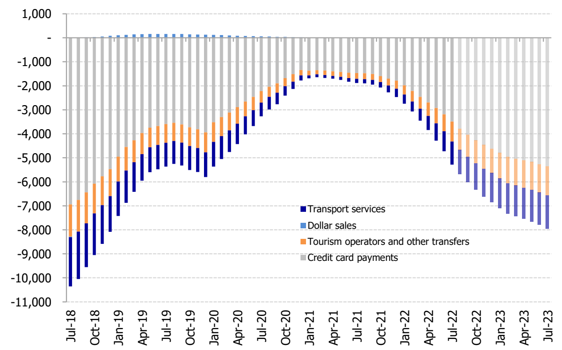
In billion USD

Gross reserves	**38.3**
Reserve requirements in USD	11.4
Swaps (incl. China)	20.4
SDRs	0.1
BIS	3.0
Net reserves	**3.5**
Gold	3.4
Liquid net reserves	**0.1**

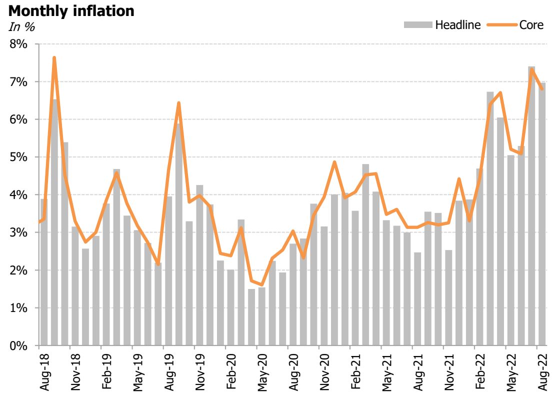
Source: Own estimates based on BCRA and IMF

Up to Sep-20

Net result of tourism
In million USD - Accum. 12 months



Monthly inflation
In %



Source: Econviews based on INDEC

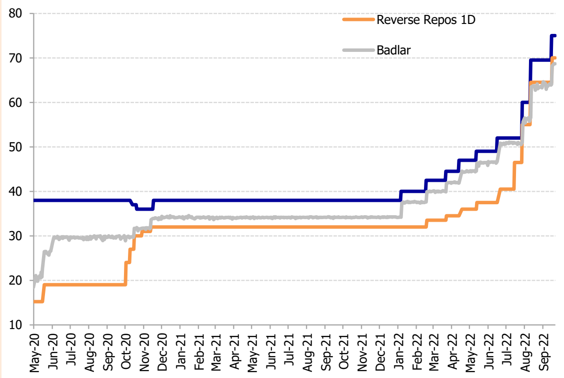
based if one looks at the evidence of the last two and a half years. When government officials talk about bringing down inflation they emphasize the role of the Secretary of Commerce, they never talk about the roles of money supply or interest rates.

True, the Central Bank has aggressively increased interest rates in recent months, and more clearly during Massa's tenure. Probably this was in response to two issues: first, the IMF program states that interest rates must be positive in real terms, a target that required very large increases in nominal interest rates. In fact, the policy rates doubled in nominal terms since the beginning of the year. The second is that although the government considers that interest rates do not have an impact on inflation, it does think that they affect the spread between the official and parallel exchange rates; a reason that is much more important for the government than inflation.

Finally, the one bright spot is that the economy has been growing at a strong pace. GDP will probably grow by 4.0% this year, with consumption being the star in this picture. However, we have indications that the economy is decelerating rapidly, which is not surprising once one considers a contractionary fiscal policy driven by cuts in expenditures, the large increase in nominal interest rates that affects credit and the difficulties to access the foreign exchange market which generates shortages of intermediate goods.

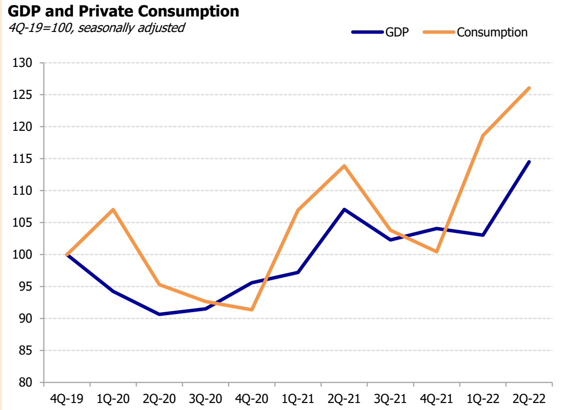
All in all, Massa has reinvigorated the government and provided some temporary relief in the short term on the external front. However, the concerns regarding inflation, reserves and the exchange rate continue, and we don't expect much progress in these fronts. **Our base case is a muddle through scenario**.

Interest rates
In p.p.



Source: Econviews based on BCRA

GDP and Private Consumption
4Q-19=100, seasonally adjusted



Source: Econviews based on INDEC

II. Fiscal opportunities and challenges of the provinces

Provincial finances are in good shape. Despite the long history of fiscal mismanagement of both the federal government and the provinces, the subnational governments have been behaving well, at least most of them. **For the past four years, provinces posted primary surpluses and, in 2021, they reached a fiscal surplus of 0.2% of GDP once grouping the 24 subnational districts.**

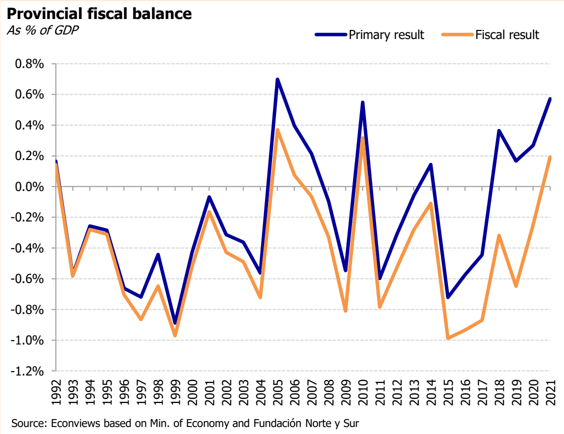
Not all that glitters is gold. Dependency on discretional national resources is uneven but widespread, and the provincial tax resources are highly distortive, as is the case of the "turnover" tax. Improving the efficiency of provincial fiscal resources would also imply redesigning the federal tax-sharing system ("*coparticipación*") but discussions regarding the subject have proved futile for the last three decades.

Yet, there are still opportunities for improvement, though many challenges persist, and some provinces are better positioned than others. **In this report we will assess the fiscal situation of the provinces and we will discuss some of these opportunities and challenges ahead.**

I. An X-ray of the fiscal situation of the provinces

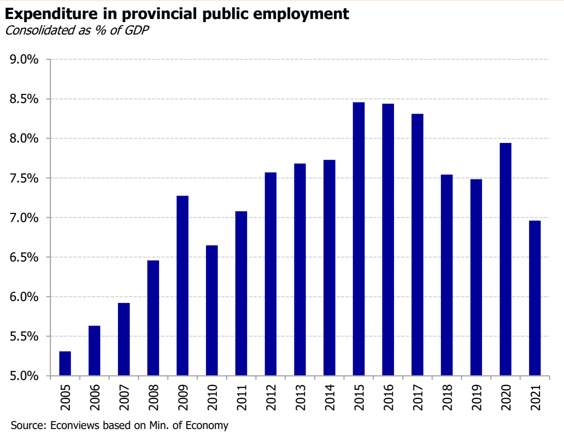
The fiscal history of the provinces is full of deficits. In 20 of the last 30 years, they displayed primary deficits and only in 5 years they achieved fiscal surpluses.

The 90's were a troublesome period for the provinces. Provincial fiscal accounts had already shown important deficits throughout the 80's, and for most of the following decade they showed little improvement. They were also loaded with public debt and were burdened by the transfer of education and healthcare responsibilities from the national government, allegedly without a proper financial compensation, but this is a long historical debate.



The recovery of the economy in the early 2000's, after the 2001-2002 crash, led to a significant improvement in provincial fiscal accounts. In 2003 they managed to reach a fiscal surplus for the first time since 1983, owing to a strong recovery in both provincial tax revenues and automatic transfers of national tax resources. Provinces displayed primary surpluses from 2003 to 2007 and fiscal surpluses until 2006. But then surpluses mostly evaporated.

Provincial deficits returned during Cristina Kirchner's first government. Despite an increase in provincial incomes, expenditures rose at a faster rate. The chief driver has been the sharp increase in the provinces' public employment. Expenditures in provincial public wages rose 110% in real terms from 2005 to 2008, or measured as share of GDP, went from 5.3% to 6.5%. The situation took a turn for the worse, as payrolls kept rising as share of GDP, and it leapt in 2015, reaching 8.5% of GDP. In turn, the provinces ran a primary deficit of 0.72% of GDP, the largest since 2001.



But inflation started to erode public wages, which brought down the expenditure, and the combination with higher transfers from the Nation have helped provincial fiscal accounts in recent years.

Consolidated primary expenditures, which had risen during the pandemic, reached 15.9% of GDP in 2021, the lowest print since 2012, and were 1.91 percentage points lower than the peak reached in 2017. Payrolls reached 7% of GDP in 2021 (8.3% in 2017) and were the most decisive factor in the reduction of the provinces' expenditures relative to its peak and also compared to 2020. Capital expenditures, in particular financial investments, were the second component to shrink relative to 2017's peak.

Provincial primary expenditure

Consolidated, as % of GDP

	2015	2016	2017	2018	2019	2020	2021
Public wages	8.5%	8.4%	8.3%	7.5%	7.5%	7.9%	7.0%
Consumption goods	0.4%	0.4%	0.4%	0.3%	0.4%	0.5%	0.6%
Services	1.1%	1.0%	1.1%	1.1%	1.0%	1.1%	1.0%
Current transfers	3.3%	3.4%	3.4%	3.2%	3.4%	3.9%	3.7%
Social security	2.1%	2.1%	2.2%	2.1%	2.2%	2.3%	2.0%
Capex	2.1%	2.0%	2.5%	2.2%	1.8%	1.5%	1.7%
TOTAL	17.5%	17.4%	17.8%	16.5%	16.2%	17.2%	15.9%

Source: Econviews based on Min. of Economy

The increase in the primary surplus in 2021 was totally driven by lower expenditures, as incomes also fell compared to 2020, and remained slightly above 2019's levels. Tax revenues of national origin and discretional transfers shrank by 0.56 percentage points compared to 2020, as they had been temporarily increased to aid the provinces during the pandemic, and also due to a fall in revenues from Social Security contributions -which is explained by the fall in the provincial public wage bill.

Provincial total incomes

Consolidated, as % of GDP

	2015	2016	2017	2018	2019	2020	2021
Provincial tax revenues	5.3%	5.2%	5.4%	5.2%	4.8%	5.0%	5.0%
National tax revenues	7.0%	6.8%	7.1%	7.3%	7.6%	8.2%	7.7%
Social Security	1.9%	1.8%	1.9%	1.7%	1.7%	1.8%	1.5%
Royalties	0.4%	0.3%	0.3%	0.4%	0.4%	0.3%	0.4%
Current transfers	0.8%	1.2%	1.2%	0.8%	0.6%	1.2%	0.9%
Others	1.5%	1.4%	1.5%	1.3%	1.3%	0.9%	1.0%
TOTAL	16.8%	16.8%	17.4%	16.8%	16.4%	17.5%	16.5%

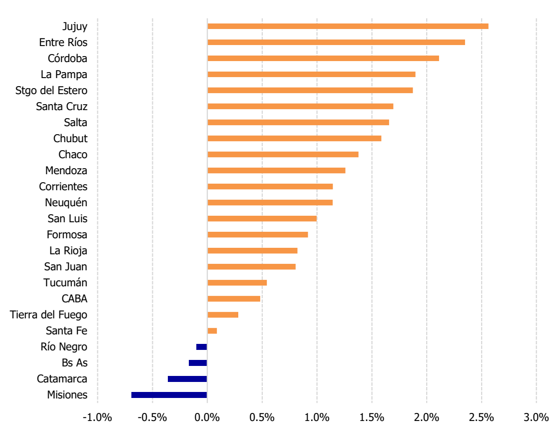
Source: Econviews based on Min. of Economy

In 2021 the provinces reached a primary surplus of 0.57% of GDP and a fiscal surplus of 0.19%, but this combined result was not evenly spread among the provinces. Measured against their own gross domestic products, the small province of Jujuy posted a primary surplus of 2.6% of its GRP, followed by Entre Ríos (2.3%) and Córdoba (2.1%). Only four provinces registered primary deficits in 2021, with Misiones on the bottom of the table (-0.7% of its GRP), followed by Catamarca (-0.4%), Buenos Aires (-0.2%) and Río Negro.

But as the gross regional products differ significantly, the impact of these provincial results also differs. **By far, it was the province of Córdoba that contributed the most to the overall primary surplus** with an incidence of 0.17 % of GDP, followed by the City of Buenos Aires, with an incidence of 0.1%.

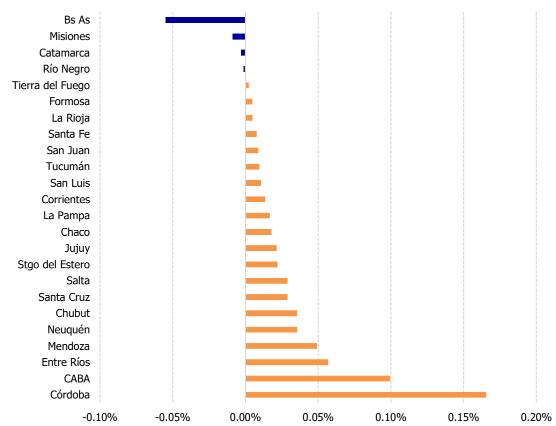
Primary balance per province

2021 - As % of gross regional product



Contribution to the consolidated primary surplus

2021 - As % of national GDP



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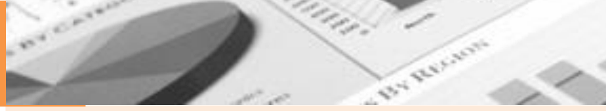
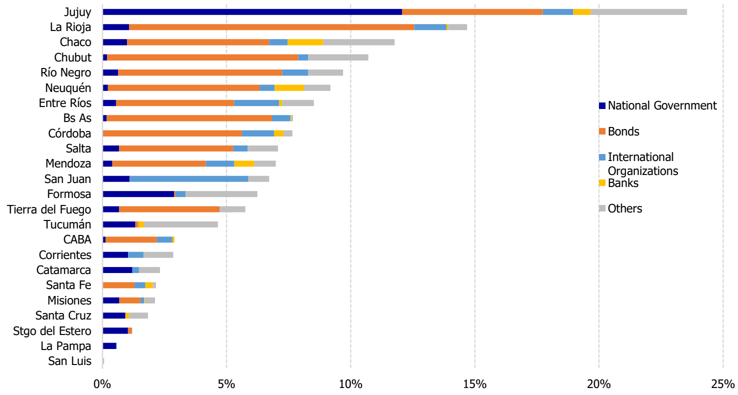


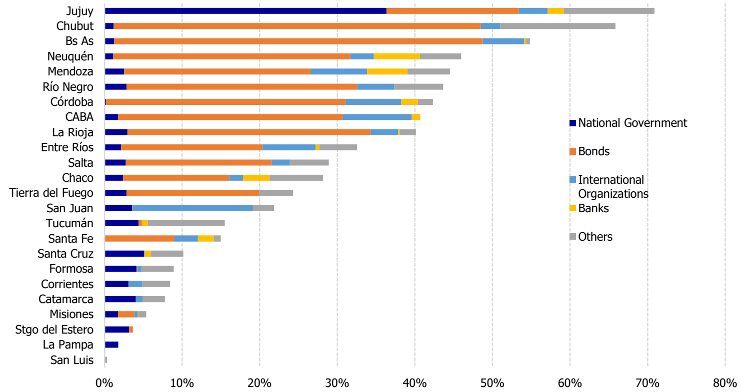
The fiscal panorama would not be complete without a look into the state of the provinces' debt. On this matter, the situation varies significantly across provinces, but the restructuring carried out in 2021 helped their maturities profile.

Provincial debt as % of their GRP
2021 - by item



Source: Econviews based on Min. of Economy

Provincial debt as % of their total annual income
2021 - by item



Source: Econviews based on Min. of Economy

In terms of their GRP, the most indebted provinces are Jujuy, La Rioja and Chaco, but their composition differs. Jujuy's debt reaches 23.5% of its GRP, but 51% of the debt in the hands of the national government; in La Rioja, debt issued in bonds and with international organizations reaches 12.8% of its GRP, and this figure falls to 6.5% in the case of Chaco. In contrast, San Luis, La Pampa and Santiago del Estero are the least indebted provinces. As of 2021, San Luis only registered an insignificant amount of debt owed to the national government and fiduciary funds.

This panorama changes a little when we compare the provincial debts with their total fiscal incomes. In particular, in 2021 the City of Buenos Aires (CABA) registered a total debt of 2.9% of its GRP but it represented 40.7% of its total income. In contrast, the province of Córdoba's debt represented 7.6% of its GRP and 42.3% of its income. **These differences arise because there is not a linear relationship between GRP and fiscal income.** The City of Buenos Aire's GRP is roughly 3 times Córdoba's own GRP, but Córdoba's income in 2021 was barely 4% lower than CABA's. **This difference is explained by the transfers from the national government.**

Between 2020 and 2021 several provinces carried out a restructuring of their debts in foreign currency, which has helped their maturities profile.

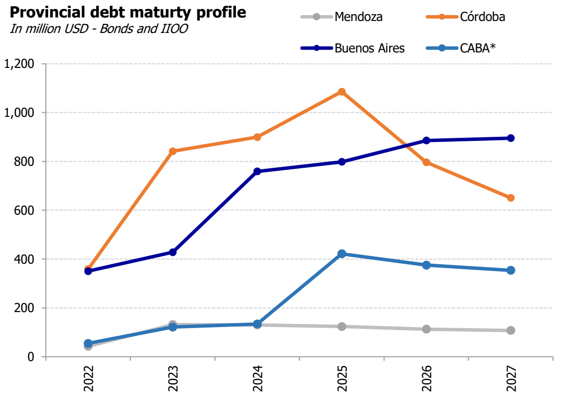
According to the government's estimates, the combined reduction of debt services after the restructuring of 10 provincial debts reached USD 2,378 million in 2021; USD 1,494 million in 2022; and USD 1,465 million in 2023. **This implies a net reduction of the debt services of 5,336 million dollars in three years. The restructuring has thus significantly improved the maturities profile of the provinces' debt in the short term, and its total maturities in USD until the end of 2023 amount to nearly 2 billion dollars.**

Reduction of debt services after restructuring
USD million - official estimates

	2021	2022	2023
Buenos Aires	1,319.4	824.8	1,256.0
Chubut	96.0	61.5	19.6
Córdoba	769.5	-26.5	-283.5
Entre Ríos	30.8	17.9	115.6
Jujuy	12.5	213.0	-64.4
La Rioja	29.3	87.5	75.4
Mendoza	19.4	156.5	47.5
Neuquén	66.1	24.7	116.7
Río Negro	17.0	9.6	109.5
Salta	18.3	124.4	72.6
TOTAL	**2,378.0**	**1,493.5**	**1,464.8**

Source: Econviews based on Min. Of Economy

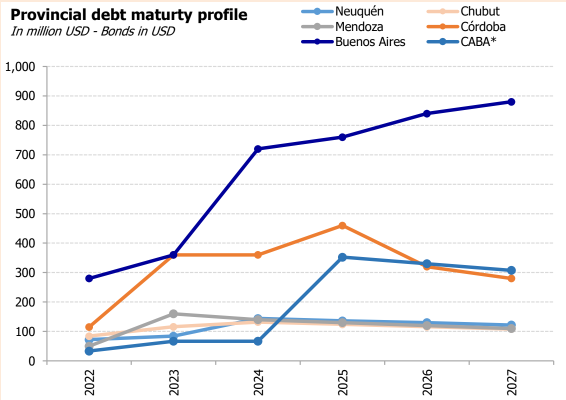
Due to its size, the most important was the restructuring of the province of Buenos Aires. The original profile consisted of 11 bonds with important maturities over a billion dollars per year between 2021 and 2023. **Its stock of foreign-currency denominated debt stood at USD 8.9 billion** by the end of 2021, between bonds and debt with international organizations, **representing 58% of its total debt**. Total maturities in foreign currency, including interest and principal, amount to USD 350 million in 2022, 430 million in 2023 and 760 million in 2024. **In the case of maturities of bonds in foreign currency, they amount to 280 million in 2022, 390 million in 2023 and 720 million in 2024.**



*As of June 2022
Source: Econviews based on provincial Ministries of Finance

In the case of Córdoba, the second province in terms of GRP (third considering the Autonomous City of Buenos Aires), the restructuring alleviated maturities in 2021 (a reduction of USD 769.5 million) but increased them in 2022 and especially in 2023. As of August 2022, **the stock of Córdoba's debt denominated in foreign currency amounted to USD 2.3 billion and makes up 96% of its total debt.** Maturities in foreign currency, with bondholders and international organizations amount to USD 359 million in 2022, 842 million in 2023 and 900 million in 2024, according to the province's official estimates. **But maturities of its three restructured bonds are significantly lower. They amount to USD 95 million in 2022, 347 million in 2023 and 331 million in 2024.**

Another important restructuring was Mendoza's. It restructured a single bond issued in 2016 which allowed a reduction of payments between 2021 and 2023 of USD 223 million. As of June 2022, **Mendoza's stock of debt in foreign currency stood at USD 711 million, representing 65% of its total debt**. Total maturities in foreign currency amount to USD 43 million in 2022, 132 million in 2023 and 130 million in 2024. **But maturities of its USD-bond sum up USD 23 million in 2022, 107 million in 2023 and 106 million in 2024.**



*As of June 2022
Source: Econviews based on Ministry of Economy

The City of Buenos Aires, the second district in terms of GRP, did not undergo any restructuring, along with Santa Fe province. **Its stock of debt in foreign currency**, including debt with international organizations and the outstanding debt of its "Tango" bond, **amounts to USD 1.5 billion and makes up 70% of its total debt.** The City of Buenos Aires does not face any principal maturities of its USD bond until 2025, and its maturities of principal with international organizations are very low. As of June 2022, maturities in foreign currency amount to USD 54 million this year, 122 million in 2023 and 134 in 2024, and though they jump to 422 million in 2024, the figure remains relatively low. And maturities of its USD-bond, as of June 2022, amount to USD 33 million this year, and 67 million in 2023 and 2024.

In the short term, the provinces do not face unmanageable maturities in foreign currency, though some are in a better position than others. Perhaps the greatest risk in the medium term does not arise from the provinces themselves, but rather from their ability to get dollars from a foreign-currency deprived Central Bank.

In a nutshell, the fiscal health along with the profile of the provincial debts have significantly improved in recent years, and the provinces no longer make up a threat to macroeconomic stability. But there is room for improvement and many challenges remain, though there are also important opportunities. We will review some of them in the next section.

II. Challenges and opportunities for the provinces

In the vast Argentinian territory, there are important geographical, historical, and economic differences that impact the ability of the provinces to obtain fiscal resources. But this ability is also heavily influenced by their own economic policies, and the sufficiency of resources is directly proportional to their expenditures.

Dependency on national resources is widespread but uneven. Tax revenues of national origin, which are comprised of automatic transfers of the tax-sharing scheme *("coparticipación")* and other ad-hoc agreements, make up the bulge of resources in nearly half of the provinces. In the case of La Rioja, in 2021 these automatic transfers made up 85% of the total fiscal incomes of the province, and it was closely followed by Santiago del Estero (82%) and other provinces of the Argentinian North, the poorest region of the country.

These figures worsen when adding discretional transfers. In the case of La Rioja, the sum of tax resources of national origin plus current transfers makes up nearly 90% of the total provincial income (though this figure could be slightly lower as current transfers also include other resources, particularly those from provincial institutions of gambling).

The richest and most resources-abundant provinces contrast with the provinces of the north. In the City of Buenos Aires, the richest district of the country, automatic transfers made up only 11% of its total income in 2021, while in Neuquén -where Vaca Muerta is located- this figure rose to 21%. Yet in relatively rich provinces like Santa Fe, Mendoza and Rio Negro, tax resources of national origin comprised over 50% of their total income.

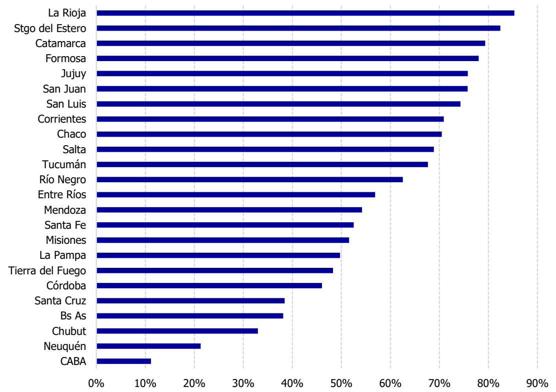
The fight over transfers from the national government is longstanding and has impeded the implementation of a new tax-sharing law as dictated by the 1994 constitution. **As a result, the old 1988 tax sharing regime has been extended with ad-hoc agreements that have led to controversies.** A recent example is the case of the resources received by the City of Buenos Aires. In 2016, the national government increased the share of national tax resources transferred to the City from 1.4% to 3.5%, but in turn it was made responsible of much of the federal police turned into City police. Yet in late 2020, the new administration reduced the rate back to 1.4% -without changes to its fiscal responsibilities- and part of the resources were transferred to the province of Buenos Aires.

Improving the tax-sharing system and reducing the dependency of national resources is not the only challenge the provinces face. The composition of their own tax resources is highly distorsive and ought to be improved in the long term.

There are four main taxes in the provinces. These are the "turnover" tax, the real estate tax, the stamps tax and the automotive tax. These single four taxes explained 98% of total tax revenues of provincial origin in 2021.

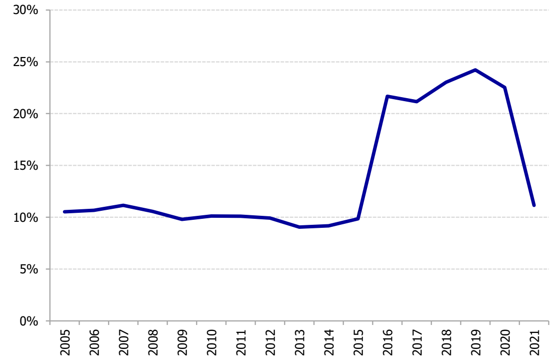
But their contribution has changed over the years. Throughout the 90's, the turnover tax represented on average 55% of the provincial tax resources, in the 2000's 65% and in the 2010's 75%. In contrast, the real estate tax's contribution has shrunk. While in the 90's it was nearly 20%

Dependency on national resources - 2021
Automatic transfers of national resources as % of total current provincial income



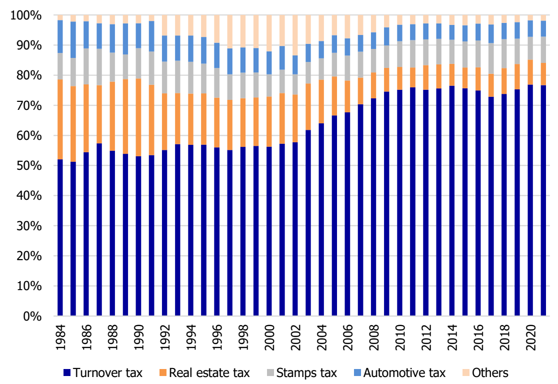
Source: Econviews based on Min. of Economy

National resources as % of total income
City of Buenos Aires



Source: Econviews based on Min. of Economy

Provincial taxes through the years
Composition of provincial tax revenues



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of tax resources, by the decade of 2010 its share had fallen to 7.7% on average, as a result of undervaluation of properties. For the same reason, the contribution of the automotive tax has also shrunk, though in a much less magnitude, while the share of the stamps tax has remained relatively stable.

The turnover tax is probably the most distortionary of all taxes in Argentina and is ever increasing. It levies revenues in nearly all economic activities with a few exemptions, regardless of profits, and gives way to double imposition. If a single product is produced in stages by different companies, the tax will levy the revenues of all these companies, and therefore its sum is much higher than the case the same product is manufactured by a single company. Besides double imposition, it incentivates concentration.

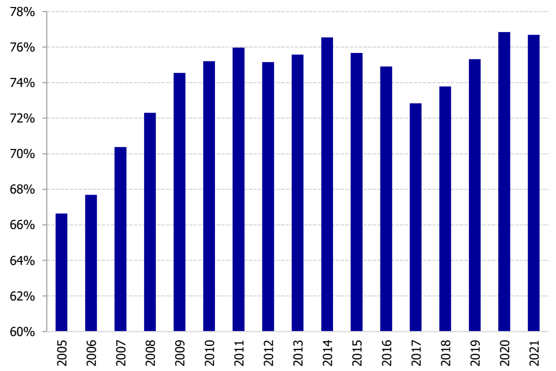
The latest Fiscal agreement cleared the way for the provinces to raise it even more. In the past decade, it made up 75% of provincial tax resources, **but the previous national administration attempted to lower its weight by bringing down the rate in 2017.** As a result, the weight of the tax in the provinces tax revenues fell to 72.8%, the lowest level since 2008. Yet by 2021 it was already at 76.7%. **Reducing the weight of this highly distorsive tax is a challenge that the provinces must face to improve their fiscal and economic health.**

Provincial public employment is another issue. In the early 2010's, the dynamic of the provincial public employment was not too different to that of private employment, but in the second half it has not contracted as much as private employment, and during the pandemic the fall in private employment was much more prononuced. Yet from 2017 it has slightly fallen, and the erosion of wages has helped lower the wage bill as discussed above. **Maintaining the downward trend is an opportunity to improve the provinces' fiscal accounts.**

There are significant differences between the provinces on this matter too. Public employment in many provinces of the northern Argentine territory far outweigh formal private employment. In 2017, the latest data available, Formosa registered 144 public provincial employees per 100 private sector employees, while Catamarca's figure was 132/100, La Rioja 124/100 and Santiago del Estero 122/100. In contrast, Salta and Misiones, both located in the north, had much lower figures (61/100 and 59/100 respectively). The City of Buenos Aires (13/100), the province of Córdoba (25/100), Santa Fe (27/100) and the province of Buenos Aires (35/100) were all below the national weighted average (37/100). **Encouraging private activity, and therefore private employment, is key to improving provincial fiscal accounts: it is no coincidence that the provinces that receive the most transfers from the national government relative to their own resources are those with a disproportionate size of public employment.**

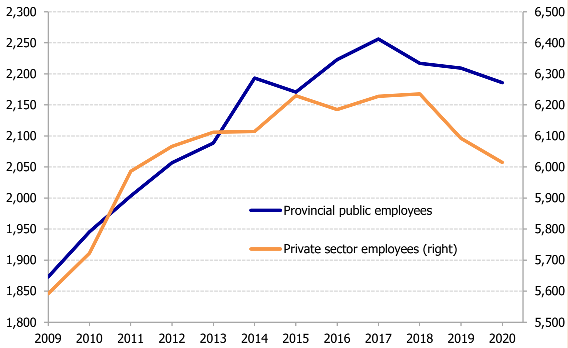
In the same regard, encouraging and developing provincial exports can yield higher private employment, more tax resources, and higher royalties (in the provinces that get them). Argentina has comparative advantages that are mainly related to the agricultural and livestock sector, and natural resources abound, but are far from being taken advantage of. Developing activities like mining or oil exploitation can play a relevant role

"Turnover" tax makes up the bulge of provinces' tax resources
Turnover tax revenues as % of tax revenues of provincial origin



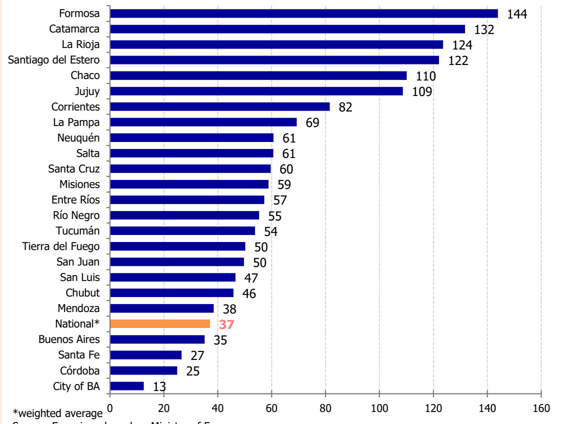
Source: Econviews based on Min. of Economy

Provincial public employees
In thousands

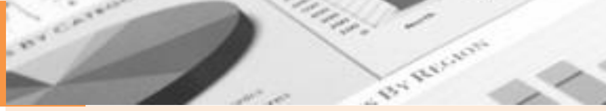


Source: Econviews based on Min. of Labor and Fundación Norte y Sur

Weight of provincial public employment
Provincial public sector jobs per 100 private sector jobs - 2017



*weighted average
Source: Econviews based on Ministry of Economy



in the country´s exports and in the local development of the provinces. And also, in their fiscal resources.

During the first semester of this year, the Pampas region, which includes the province and the City of Buenos Aires, Córdoba, Entre Ríos, La Pampa, and Santa Fe, exported USD 34.9 billion out of USD 44.4 billion in the whole country (79%), where the oilseed complex stood out with exports of USD 13,572 million. **However, these exports are not subject to royalties and export tax revenues go entirely to the national government.**

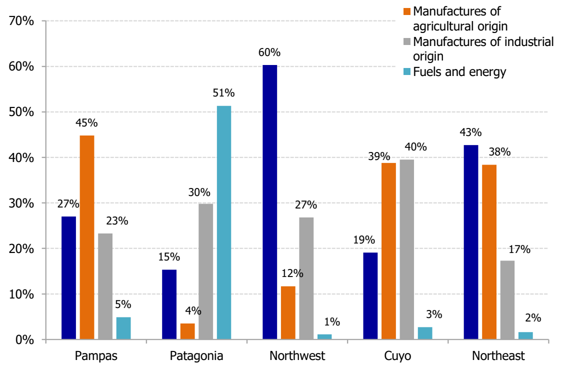
The second region in terms of exports is Patagonia. It represents 9.7% of the total exports in the first semester with USD 4.3 billion. This region includes Chubut, Neuquén, Río Negro, Santa Cruz and Tierra del Fuego. When it comes to mining and, Patagonia represents 46% of the total exports of the sector, even more than the Northern provinces. Although Neuquén's exports are lower than other provinces of the region, it receives the most royalties due to the importance of the oil industry, and due to Vaca Muerta's hydrocarbon deposits. **In 2021, Neuquén received USD 789.3 million in royalties, twice as much as those received by Chubut, the second in the ranking.**

Perhaps the biggest opportunities for economic development lie in the northwest region, the third in terms of exports (USD 2.2 billion in 1H-2022, or 4.9% of the total exports). This region includes the provinces of Catamarca, Jujuy, La Rioja, Salta, Santiago del Estero, and Tucumán. The mining exports of the region are based in lithium (53.5%) and the remaining are of gold and silver. There are already several mining projects underway and particularly those related to lithium in provinces such as Salta and Jujuy have great potential in the coming years. **This could lead to a jump in royalties and economic activity, thus improving their fiscal resources.**

But there are significant obstacles to development. In Córdoba, Chubut, La Pampa, Mendoza, San Luis, Tierra del Fuego and Tucumán**,** mining is prohibited, though in practice there are some mining activities in Mendoza.

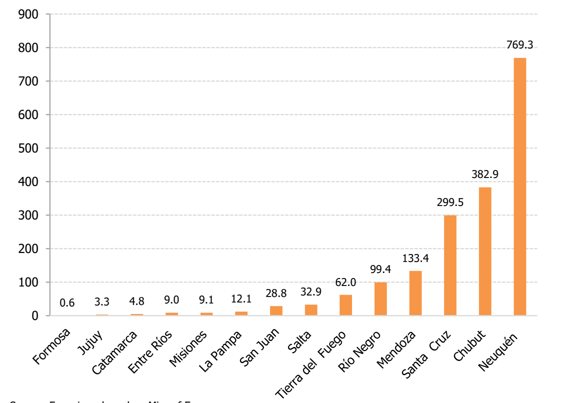
The provinces are in a much better fiscal position than some years ago. As we have shown above, there is still room for improvement and there are significant opportunities for them too. Their fiscal health could, however, lead the national government to reduce its transfers and demand a bigger effort in the next years as it adjusts its own fiscal accounts. But they are better prepared to do so than in the past.

Type of exports by each region
In %- 1st semester of 2022



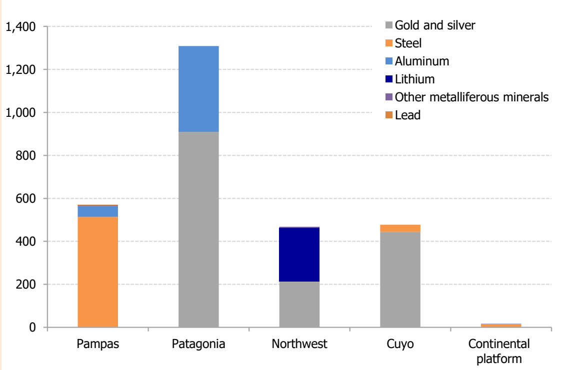
Source: Econviews based on INDEC

Royalties in 2021
In million USD



Source: Econviews based on Min. of Economy

Exports of the mining sector by region
In million USD- 1st semester of 2022



Source: Econviews based on INDEC

Base Scenario

	2019	2020	2021	2022 E	2023 E
Inflation (eop)	53.8%	36.1%	50.9%	100.0%	110.0%
Exchange rate ARS/USD (eop)	59.9	84.1	102.8	179.8	350.7
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	129.6	125.8
Paralell exchange rate ARS/USD (eop)	74.6	140.3	203.1	395.5	596.1
Spread with official exchange rate (eop)	24.6%	66.8%	97.7%	120.0%	70.0%
Gross reserves (USD billion, eop)	44.8	39.4	39.7	40.0	40.5
Net international reserves (eop, in thousands of M USD)	12.6	3.8	2.3	4.3	5.1
Policy rate (eop)	55.0%	38.0%	38.0%	75.0%	85.0%
GDP (YoY)	-2.0%	-9.9%	10.4%	4.0%	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%	0.8%	1.4%	-0.1%	0.3%

Source: EconViews

*Excludes rents from primary debt issuance in 2022

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