MONTHLY REPORT

ECONVIEWS

ECONOMÍA Y FINANZAS

November 2022

Issue #221

THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- The FED hiked the Fed Funds rate another 75 basis points to 3.75-4% this month. Markets rallied on better-than-expected CPI print, a 0.44% increase against September, while the labor market is proving resilient with US unemployment at 3.7% in October. The Democrats did better than expected in the midterms.
- Center-left candidate Lula da Silva was elected President of Brazil in a runoff election, returning to office for a third term after his 2003-2010 spell. Markets initially rallied 3% but then slumped 6.3% with uncertainty around his Finance Minister.
- With October's CPI print a notch above September at 6.3% monthly and 88% year-on-year, Minister Massa announced new price controls for 2,000 basic staple products, which after a 4% increase should stay frozen for 120 days. The stated goal is to bring inflation back down to a 4% monthly range, although it seems unlikely.
- Manufacturing slumped 0.2% in September and construction shrank 2.9% that month. Overall activity fell 0.3%. After August's record was revised upwards to 0.7%, statistical carryover from the first half of 2022 means the economy will grow 5.2% against 2021 on average. But lack of dollars, input shortages and a weak harvest spell out trouble for 2023.

FIGURE OF THE MONTH

The Government's real primary expenditures were down

-13%

against one year ago, although October 2021 had the elections.

TO BE ALERT

The Central Bank has sold USD

967 mn

international reserves before the soybean dollar came into effect on Nov-28th.

WHAT'S COMING NEXT?

- Recession fears are on the rise again, with the OECD cutting its 2023 growth forecast to 2.2% in what would be the worst year since the 2008 financial crisis (other than 2020). Big banks like JPMorgan (1.6%) or Barclays (1.7%) are also counting on a global slowdown.
- The government announced the renewal of the soybean dollar scheme starting this week. It allows the liquidation of soybeans and its derivatives at an FX rate of 230 ARS per USD. On its first day, the CB managed to purchase USD 192 million and today USD 122 mn, summing up purchases for USD 314 mn since its implementation yesterday.
- The Central Bank's 180-day deferral on import payments will begin to expire in December. Businesses are doubtful whether they will be able to access the dollars to pay for their debts.
- The 2022-23 wheat crop is expected to be 45% below this year's, at an USD 3.4 billion cost. However, recent rains have improved the prospects for soybean, which is currently trading at 527 dollars per ton.
- The Central Bank sold USD 967 million before the soybean dollar was implemented in November 28th and pressure on the parallel exchange rates heated up with the informal rate trading at ARS 319 (+11%) and the BCS at 332 (+7.2%). The official FX rate is likely to grow above inflation for the third month in a row, but the REER will end the year 12% below December 2021.

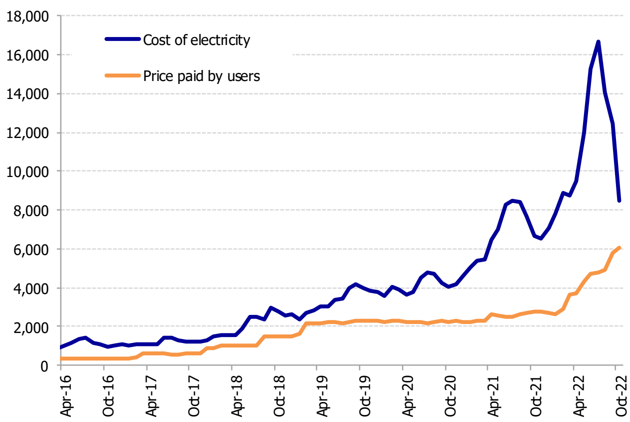
SUMMARY OF MAIN INDICATORS

	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-0.3%	0.7%	Inflation (monthly)	6.3%	6.2%
Consumer confidence (MoM)	-1.4%	-4.1%	FX spread (21day avg.)	95.8%	103.6%
Industrial activity (MoM s.a.)	-0.2%	0.5%	Country risk (bps 21day avg.)	2,493	2,729
International accounts			**External data**		
Current Account (USD BN)	-0.89	-1.13	Soybean price (per ton, 21day avg.)	525.2	508.1
CB Reserves (USD BN 21day avg.)	38.51	38.06	Brazilian activity (MoM s.a.)	0.0%	-1.1%
Primary balance (ARS BN)	-103.05	5.28	Financial Conditions Index	-14.6	-3.3

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

GRAPH OF THE MONTH:

Cost and price of electricity
In ARS



Source: Econviews based on Cammesa

RECENT ECONOMIC DEVELOPMENTS

OCT 27th	OCT 28th	OCT 29th	NOV 7th	NOV 11th	NOV 16th	NOV 29th
Econviews Monthly #220: IMF meeting in Washington + special analysis on seigniorage and the inflation tax.	**Truckers' union signs a 107% wage increase** until October 2023, setting a new standard for wage negotiations.	Government reprograms **USD 1.97 billion debt with Paris Club**: 13 instalments from 2022-28, lowers rate from 9 to 3.9-4.5%.	The proposed bill to **suspend the 2023 primaries was scrapped**. The first round of voting is set for August.	Minister Massa unveils **new price freeze for 2,000 products,** which should adjust 4% and then stay put for 120 days.	**Senators approve 2023's Budget Bill** with 60% inflation forecast and 1.9% primary deficit in line with IMF target.	**Econviews Monthly #221**

POLITICS

VP Cristina Kirchner and her son Maximo made several public appearances with harsh criticism against the economic situation, although taking care not to directly attack Minister Massa. Cristina's proposal for a lump-sum wage increase does not sit well among unions, which remain closer to President Fernández. After the proposed bill to suspend the 2023 presidential election primaries (PASO) floundered in Congress, it is unclear whether Fernandez will run for re-election or if his space will allow internal competition. Recent polls give the opposition a 7-point edge over the governing coalition. But there is no clear leader among Mayor of BA Horacio Rodriguez Larreta, ex-president Macri and other would-be opposition candidates.

IMF

In October, maturities with the IMF amounted to USD 2,536 million corresponding totally to principal maturities, while the Fund disbursed 3,848 million after approval of the second review, resulting in net inflows for the month to USD 1,311 million. As a result, the stock of outstanding debt with the IMF amounted to USD 41,725 million. Projected payments for the remainder of the year totalize approximately USD 3,213 million and disbursements totalize USD 5,917 after the third review is approved in December, which we expect to happen. As a result, the outstanding credit with the IMF will end 2022 at USD 44,938 million. In this context, the IMF basis rate (market-determined SDR rate + 100 pbs) stands now at 3.76%.

ECONOMIC ACTIVITY

Activity slumped 0.3% between September and August, after five straight months of expansion, although with August's print revised to 0.7% the economy will still grow at least 5.2% in 2022. However, the outlook is getting bleaker for 2023. We have lowered our forecast from 1 to 0%. Import controls and cooling demand already weighted on manufacturing (-0.2%) and construction (-2.9%) in September, while retail sales fell 3.2% year-on-year in October. And the drought's effect on the wheat crop could cost Argentina up to USD 3.4 billion, a lack that will be felt in Q1-2023. After the latest rains we are more optimistic on soybeans. Hotels and restaurants (+30%) are still recovering strongly from their pandemic lows.

INFLATION

Inflation accelerated slightly to 6.35% monthly in October, but was nevertheless below the market's expectations, and reached 88% in the last 12 months. Core inflation remained at 5.5% and helped lower the general result, since seasonal prices posted a 9% increase and regulated prices accelerated to 7.4%, pushed by Communications (which jumped 12.1% monthly, but remains well behind in the YoY comparison) and "Housing, water, electricity and other fuels" (7.5%) as the first round of the utility rate updates went into effect last month. As new rounds of tariff increases are on schedule and lack of inputs constrains supply, we maintain our forecast of 101.5% for 2022.

MONETARY SECTOR

Despite the mild acceleration of inflation, the Central Bank maintained its Leliq monetary policy rate at 75% APR, a 6.25% effective monthly rate slightly below headline inflation. We maintain our base scenario that rates will sit at this level for what's left of 2022, as the CB's stock of interest-bearing liabilities is raising eyebrows among investors. The peso-debt dynamics have been worrisome, and a gradual dollarization of portfolios is likely in coming weeks. In this context, the financial dollars started to raise and the blue chip swap went up 7.2% relative to November's minimum, taking the spread temporarily back to 100%. The official FX grew for two months above inflation, but the REER is likely to appreciate 12% this year.

FISCAL ACCOUNTS

In October the public sector reached a primary deficit of ARS 129.12 billion, a poor result given that export tax revenues were still inflated due to the one-off "soybean dollar" scheme from September. Total revenues grew 3.5% YoY in real terms, with export duties jumping 108.4% YoY nominal or 10.8% real; VAT grew 10.9% in real terms, aided by a low comparison base. Expenditures contracted 13% YoY real, with a sharp drop in economic subsidies (-20.7% YoY) that was aided by a significant fall in the electricity generation cost. Social spending and transfers to provinces also fell in real terms (-9.3% and -31.9% YoY respectively), but CAPEX grew 5% in real terms. The accumulated deficit reached 1.8% of GDP.

I. The costs and perils of policies to muddle through

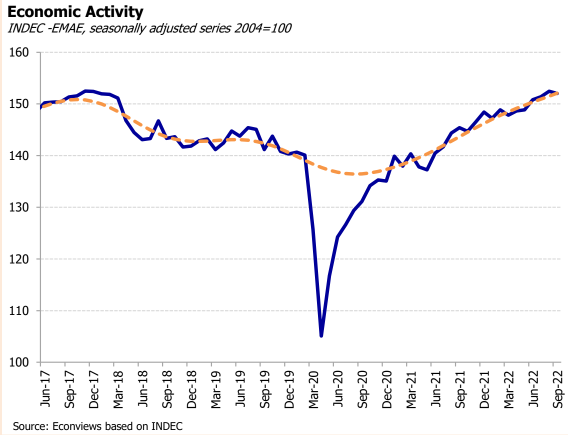
The economy continues to be in slow motion mode, as there is a gradual deterioration in economic activity, inflation remains relatively stable in the 6.3% range, international reserves dropped but have not collapsed while the parallel exchange rates remain relatively stable. While there are still concerns about one of the typical Argentine crises that leads to an explosion of the exchange rate, inflation, and domestic interest rates, and which is some cases includes a restructuring of the domestic or foreign debt, the explosion has not happened yet. The government has been able to maintain what at first sight are unsustainable policies through intervention and creative unorthodox policies. In this way, it has been managing to postpone the "inevitable" and its bet is that is it will be able to muddle through throughout the election year.

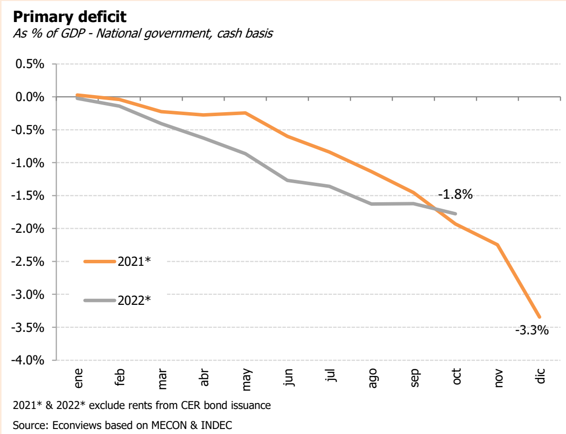
Markets are skeptical about the sustainability of current policies, but after waiting for more than a year for an "explosion" that has not taken place, they are now starting to believe that perhaps it will not happen with this government. **The challenges will be left to the next administration which will have the difficult task of deactivating the time bombs that are left everywhere.**

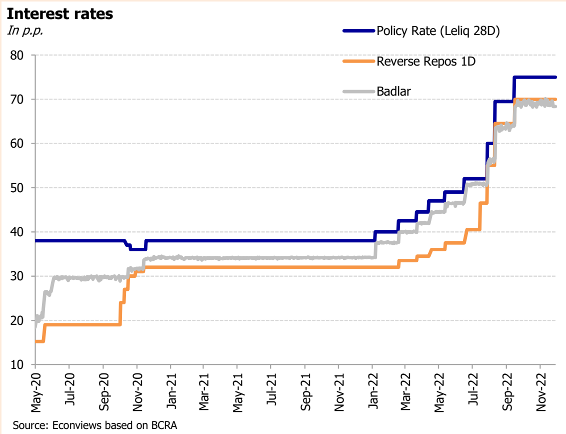
The question that comes up time and again is whether the government has the tools to avoid the "explosion" and continue to muddle through. The current strategy has two clear costs that will have political consequences and two threats that could destabilize the economy and lead to the much-feared macro-crisis.

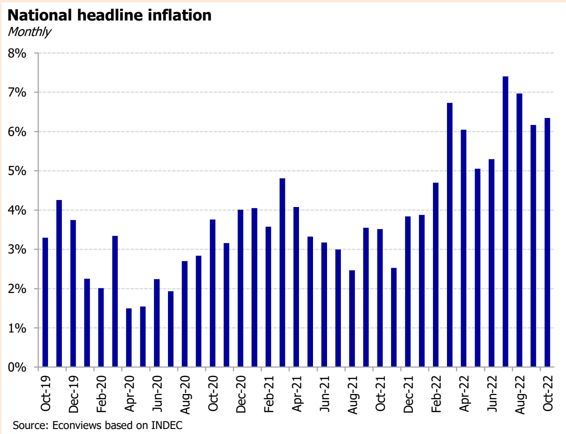
The first cost of the muddle through strategy is that economic activity is falling gradually, and a recession seems to be on the way. This is happening due to a combination of factors; on the one hand the government implemented contractionary macroeconomic policies, that include a reduction in the fiscal deficit and a tightening of monetary policy through increases in interest rates that are affecting aggregate demand. But on the other hand, the tightening of import controls to deal with the very low level of reserves is taking a toll on production in most industries, as firms face tremendous difficulties to import inputs, spare parts and capital goods that are necessary for the production process. There are numerous stories about firms that are forced to stop production lines as the government does not authorize their import requests. And there does not seem to be any relief in the horizon.

The second problem is inflation, which is not accelerating, but does not show any indications of dropping significantly soon. True, the government is attempting to slow it down through price agreements and the fall in aggregate demand that is taking place might help. But the inertia is significant, and the Central Bank will need to continue printing money as the government is facing difficulties to rollover the debt in the market and to obtain credit to finance the fiscal deficit. In addition, the government needs inflation to continue to erode public expenditures (especially wages and pensions) and is probably not ready to pay a big cost to bring it down, especially in an election year.









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ECONOMÍA Y FINANZAS

The high rates of inflation and the weakness that we expect in economic activity do not portent well for the government's chances of winning next year's election. However**,** the main problem is that the government does not know, does not want, or simply cannot apply the policies that are needed to turn around the situation.

The threats come from two places: the external accounts and the access to the domestic capital market. On the external side the challenge is substantial, as net international reserves continue to be extremely low (around three billion dollars), with little chances of improving in the near future.

The current account (which mainly includes the trade balance and interest payments) will continue to be under pressure because importers will do whatever they can to import as much as they can at the official exchange rate. The peso is obviously grossly overvalued, while exporters are finding that the costs at the official exchange do not provide incentives to export. In addition, the large spread between the official and the parallel rates continues to be a strong obstacle to generate dollars; with these spreads there is no way to improve the current account.

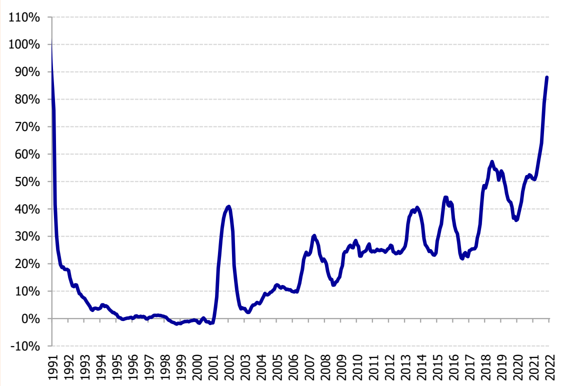
There is not good news on the financial account either. Argentina's huge country risk, to which one needs to add the deterioration in financial conditions abroad, is a strong deterrent to obtain external loans, as most banks have tightened credit lines to Argentina and access to the bond market is all but impossible. Besides, loans from multilateral institutions have reached a ceiling, and even currency swaps, like the one announced with China seem that can at best provide small change. To make things worse, and despite some recent rainfall, the drought will take a toll on agricultural production and exports limiting even more the chances of receiving dollars to alleviate the situation.

The government continues to have an adamant position towards devaluation and continues to come up with multiple exchange rates through taxation. Recently, it announced a second tranche of a differential exchange rate for soybean exports, following the success of a similar program in September. However, the stock available of soybean is much smaller and more soybean dollars today mean less of them in the future. True, the second "transitory devaluation" for soybean will generate some additional dollars to go through the summer but it is not a solution. The government hopes that then the new crop (probably with a new transitory devaluation) will generate enough dollars in the autumn, which added to the savings in energy imports that could take place if the new gas pipeline from Vaca Muerta is completed by June would allow the government to muddle through till the elections. Though this is a big bet.

The government is keeping its fingers crossed because there is essentially no margin of error, and since Massa took over in August it has used most of the possible cushions available. In a world where Murphy's law is the rule rather than the exception one should remain skeptical about the sustainability of the current exchange rate framework and worried because there is not an obvious alternative plan.

It seems that the government will eventually have to choose between a rock and a hard place. Avoiding the devaluation (which seems to be a religious promise that Massa made to Cristina) will require tight controls

Annual Inflation



Source: Econviews based on several sources

Net and Liquid International Reserves

In billion USD

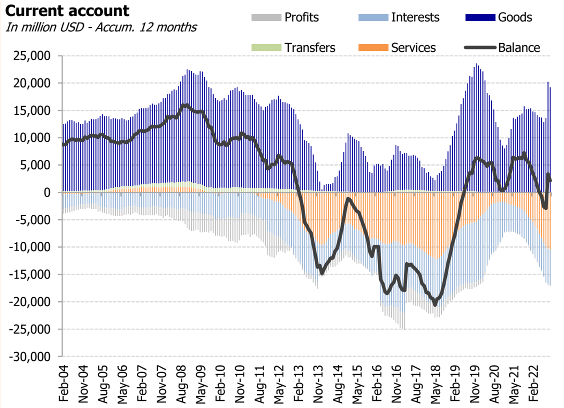
Gross reserves	**37.7**
Reserve requirements in USD	11.7
Swaps (incl. China)	19.9
SDRs	0.0
BIS	3.0
Net reserves	**3.0**
Gold	3.5
Liquid net reserves	**-0.5**

Source: Own estimates based on BCRA and IMF

Up to Nov-28

Current account

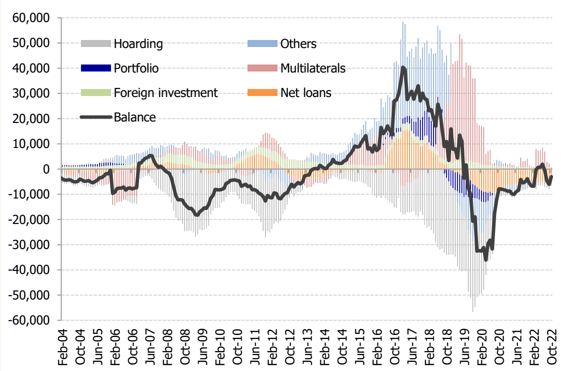
In million USD - Accum. 12 months



Source: Econviews based on BCRA

Financial account

In million USD - Accum. 12 months



Source: Econviews based on BCRA

and pain and suffering for firms, while making it will pose risks on the inflation front.

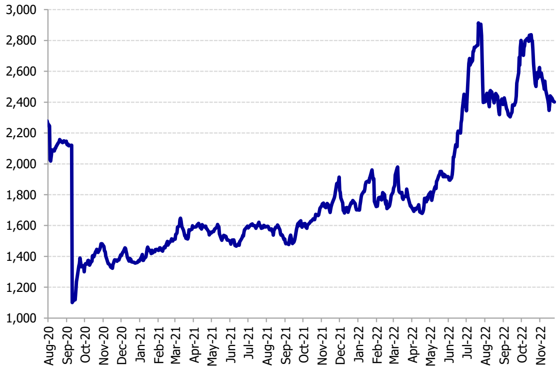
The second front is domestic debt. Guzman was enthusiastic about developing the peso market and offered different types of instruments (including treasuries at fixed interest rates, and bonds indexed to the CPI or the official exchange rate). But there were no efforts to broaden the investor base, which continues to be extremely small, or to create a market in long-term bonds. Investors are worried about what might happen in the elections next year, and what attitude the new government will take towards a potential restructuring of the domestic debt. As a result, the Treasury is finding difficulties to rollover the debt, and it can only issue short-term debt that matures prior to the primary elections that will take place next August.

Is a restructuring unavoidable? The answer is no, though this is primarily a confidence game. Domestic debt with the private sector is around 6% of GDP, a level that would not be a problem in almost any country. But in Argentina it is, because it is still fresh in people's minds when the Macri administration restructured the domestic debt in 2019 after it lost the primaries. Investors' concern is that perhaps it will happen once again, and hence they are reluctant to hold government bonds. The opposition does not want to dispel those concerns, because they prefer that the prevailing ambiguity will refrain the government from borrowing in the market to increase expenditures on the way to the election.

The consequence of these attitudes is that there has been a shortening of domestic debt, and we expect a big concentration of maturities as we get closer to the primaries in August. And if the concern is that there could be a restructuring it is not a situation that can simply be addressed by raising interest rates.

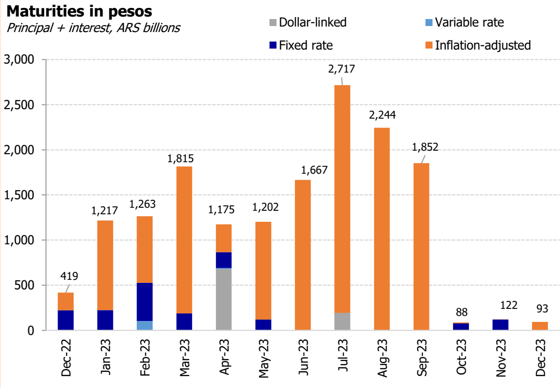
Though it is unclear how this story will end, we believe that still the most likely outcome is that there will not be a restructuring of domestic debt. This will require at some point an agreement between the government and the opposition whose terms are difficult to envisage at this stage. In summary, the current policies of not addressing the problems in a comprehensive way is generating costs and threats to the economy.

Argentina Risk Premium
In basis points



Source: Econviews based on JP Morgan

Maturities in pesos
Principal + interest, ARS billions



*Maturities of dual and CER bonds and bills adjusted by projected inflation; dollar-linked bonds adjusted by FX forecast
Source: Econviews based on Min. of Economy

II. Are taxes too high in Argentina?

The Argentine tax structure is becoming part of the electoral debate and will certainly be one of the topics that presidential candidates will want to discuss. Some of them are becoming advocates of a tax cut, something that perhaps makes sense in terms of structural reforms, but clashes with the need to reduce the fiscal deficit as soon as possible.

Beyond short term needs, we want to take stock of the nitty-gritty details of the complex Argentine tax system with 165 levies at three different government levels, which involves a heavy administrative duty for firms, which in the end become a drag on productivity. **There are many**

distortions (inefficiency in economic terms) and equity issues to discuss. In both accounts there is room for improvement.

Argentina has general government revenues for 33.5% of GDP, the highest in Latina America. This is more than the USA and Switzerland among the developed countries and slightly below Japan and the UK. It is well below the likes of the Nordic countries, Germany, and France. In the region, the only relevant county above 30% of GDP in government income is Brazil. Uruguay, Colombia, Chile, Mexico, and Peru are far behind. Other key emerging markets such as Turkey has government income for 28% of GDP.

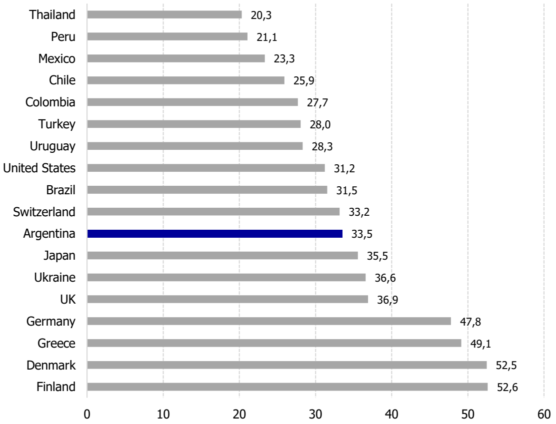
If we adjust for GDP per capita, it seems clear that Argentina takes too much from the private sector. There is a robust correlation between size of the state and population income, as rich countries can devote more taxation to finance a larger state with more public goods. Using this methodology, countries like Argentina and Brazil have large governments, Japan and the UK are on the line, the US has a small government and Germany, France and the Nordics have large states.

In Argentina the size of total government spending including the federal government, 24 provinces (including Buenos Aires city) **and almost 2,000 municipalities reach almost 40% of GDP, having peaked in 2020 at close to 45%, but this is mostly Covid-driven**. In 2020 the federal government spent 27% of GDP, provincial government over 16 points and municipal governments over 3% of GDP taking the total number to 46% but given that there is double accountancy in some items such as transfers for public works we can think that a more appropriate number is 45% for 2020 and 40% for last year.

The first conclusion is that Argentina should address the fiscal deficit by reducing spending rather than increasing taxes and once the deficit is eliminated or reduced to a more sustainable level, authorities should review their tax policies.

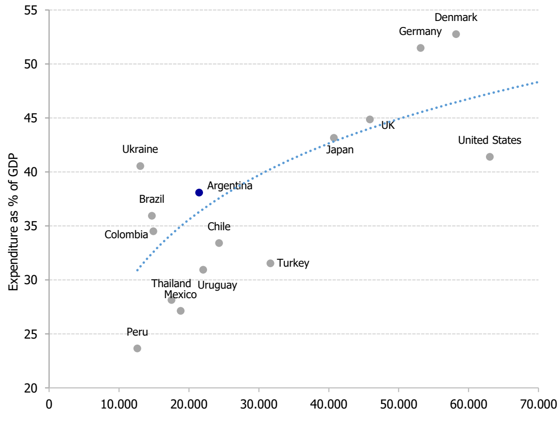
Above and beyond the size of the tax structures there are many design and management issues to consider. For instance, Argentina has one of the highest corporate income tax rates in the world at 35%, which could be more for those who pay dividends. Today only three countries have a higher rate than Argentina and 7 other countries are as high as Argentina. There are 129 countries with rates of less than 30%, and 41 that levy between 30 and 34%. So Argentina is comfortably in the top 10% more expensive countries in terms of tax payments for corporations.

Revenues as % of GDP
2021 - General Government



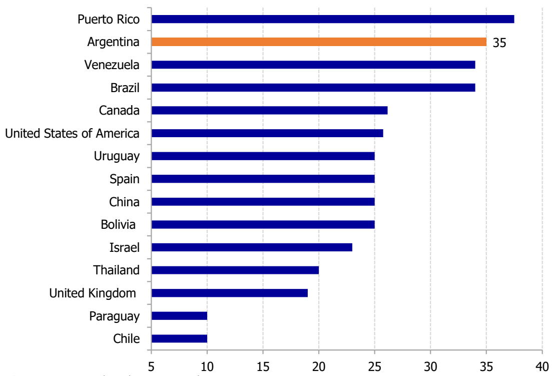
Source: Econviews based on IMF

Total expenditure and per capita GDP
International dollars PPP - 2021



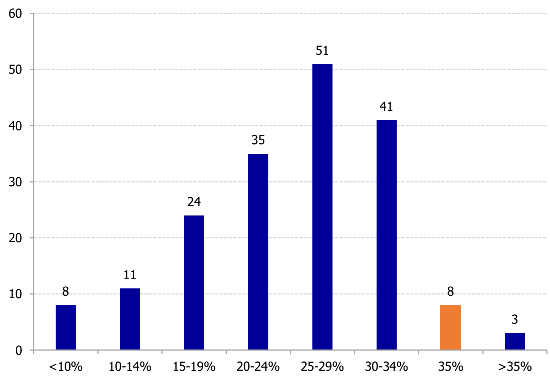
Source: Econviews based on IMF

Corporate Tax Rate
Worldwide- Rate per country- 2021



Source: Econviews based on Tax Foundation

Distribution of Worldwide Corporate Tax Rates
2021- Vertical axis: Number of countries



Source: Econviews based on Tax Foundation

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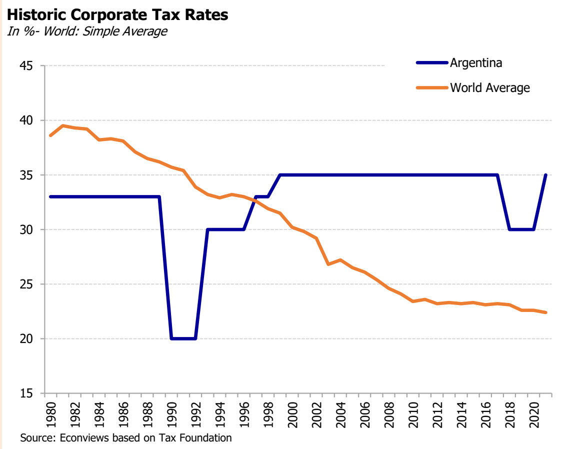
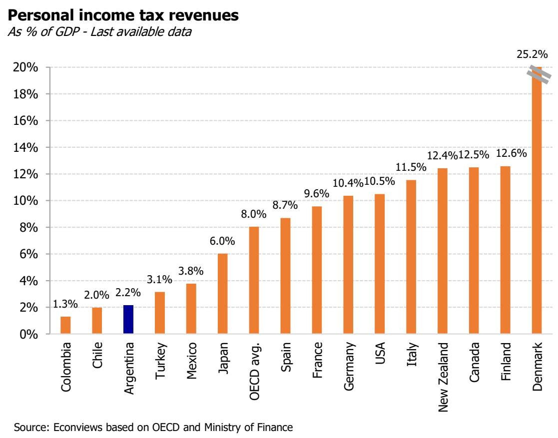
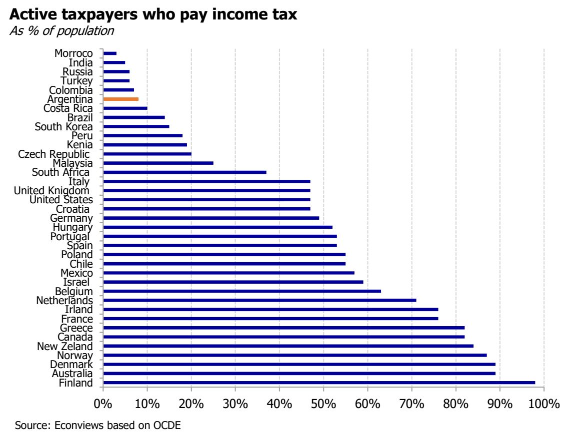
The world has made a huge change in this area. The world average was almost 40% in the eighties, then it crossed the 35% line in the early nineties and kept falling to the current 23%, according to Tax Foundation, an NGO. Argentina increased the tax rate in the nineties and then briefly reduced it in the previous government, but one of the first actions of the current administration was to undo the tax reform of 2017. Just for reference Chile and Paraguay have a 10% rate while Canada and USA are at an average of 26%. Clearly, there is a competition for global investing and a lower corporate income tax is one of the levers to attract capital.

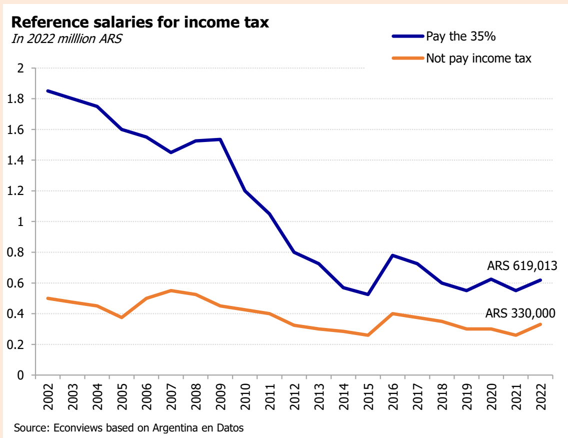


The other side of this coin is a very low personal income tax collection. Personal income tax receipts are just 2.2% of GDP compared to 3.1% in Turkey, 3.8% in Mexico and over 8% in the OECD average. The minimum taxable income is quite high compared to average income resulting in less than 10% of working population paying the personal income tax. This is one of the lowest numbers even considering emerging economies. On top of this, there are many exemptions. For instance, judges and workers in the judiciary system do not pay (only those appointed in the last couple of years are partially reached), truck drivers enjoy special deductions and many more cases.





The very many changes to the personal income tax introduced by the current government have altered the nature of it. Now those who do pay, promptly get to the maximum rate of 35%. So, in theory the most progressive levy has two inconsistencies. A junior manager making 2,000 USD gross per month will pay the same rate than the CEO of a multinational firm making several times that amount. And somebody in the second richest decile will pay nothing along the lines of those earning a minimum wage. In 2002 the difference between the minimum taxable income and the floor in which taxpayers start paying a 35% rate was almost 4 times. In 2008 it was almost 3 times. Today that gap is at 1.8.



This is one of the equity problems in Argentina's tax system. Another important element is the low importance of the real estate taxes. Properties are worth a fraction of their real value for the taxman and therefore provinces lose revenues. But for political reasons, it is often hard for governors to update prices in line with inflation.

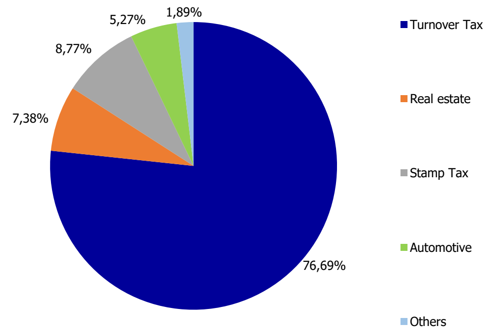
Distortions all around

In terms of distortions, Argentina has very many issues at stake. There are at least four taxes to highlight in this field. One of them is the tax on exports that collects around 2% of GDP or 8% of the federal taxes (6% of total state revenues). It is one of the many anti-exports bias features of the Argentine regulatory framework. The soybean value chain pays a 33% of export proceeds, wheat and corn pay 12%, oil and gas 8%. Beef, fisheries, and dairy products also pay export duties as well as mining stuff. Very few countries in the world have similar duties and the WTO had to ban export subsidies rather than taxes. Back in 2007 Argentina had over 14,400 exporting firms. The current number does not reach 10,000. It is not exclusively a taxation issue, but clearly it is a factor. It is worth reminding that many firms pay export taxes on top of receiving official dollars, which are at 50% of market dollars, resulting in export proceeds being between a third and 45% of normal revenues.

The advantage of these taxes for policy makers is that they kill tow birds with one stone. They generate income while keep some domestic prices at bay, by reducing the export parity of such goods. There is a third element: export duties go 100% to Federal coffers (the constitutions says so) and by the same token they reduce corporate income tax payments as export taxes are deductible. Income tax is split between the Federal government and provinces with roughly 60% of proceeds going to subnational jurisdictions. So, eliminating or reducing export duties has an important distributional effect in the Fed-provinces tax share. This is the sixth most important tax in Argentina considering the three levels of government.

A second important distortion comes from turnover taxes charged at provincial levels. This tax cascades at all levels unlike the VAT that only generates payments on the value added by each part of the value chain. So turnover taxes mean charging tax over tax and often means that the consumer pays the same tax 3 or 4 times. It is also an incentive for vertical integration. Each province charges different rates and often there are one rate for every sector of the economy. Typically, tradeable sectors face lower taxation than services. In the tax reform of 2017 provinces agreed to cap these rates and a schedule to reduce them over time. But given that the reform has been killed, provinces seized the opportunity to increase them again. This is the second most important levy of the 165 that Argentina has.

Provincial Taxes
2021



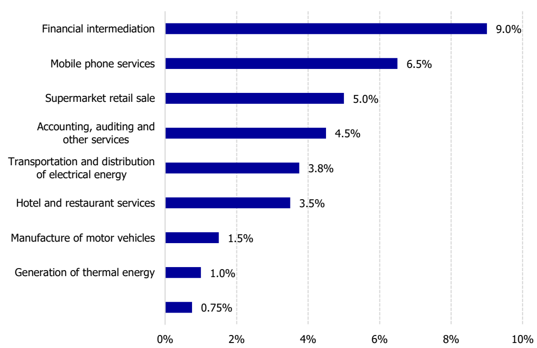
Source: Econviews based on Finance Ministry

Maximum rates for turnover tax by activity
According to 2017 Fiscal Consensus vs the current rates

	2017 Reform	2022
Financial services	5.00%	9.00%
Financial intermediation	5.00%	9.00%
Cell phone	5.00%	6.50%
Paper industry	3.00%	6.00%
Communications	3.00%	5.50%
Trade	5.00%	5.00%
Real estate activities	4.00%	4.75%
Social and Health Services	4.00%	4.50%
Hotels and restaurants	4.00%	4.00%
Residential electricity, gas and water	0.00%	3.75%
Electricity, gas and water-non-residential	0.00%	2.50%
Construction	2.00%	2.00%
Transportation	0.00%	1.50%
Manufacturing industry	0.00%	0.75%
Agriculture, livestock, hunting and forestry	0.00%	0.75%
Fishing	0.00%	0.75%
Mining and quarrying	0.00%	0.75%
Mortgage credits	0.00%	0.00%

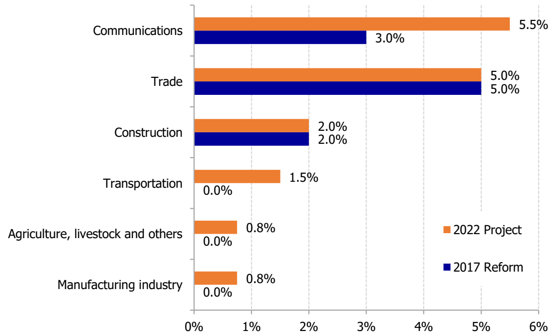
Source: Econviews based on Argentina en datos

Buenos Aires Province: turnover tax rates by activity
Selected activities



Source: Econviews based on Ministry of Finance

Maximum rates for turnover tax by main activities
According to 2017 Fiscal Consensus vs. this year new Project



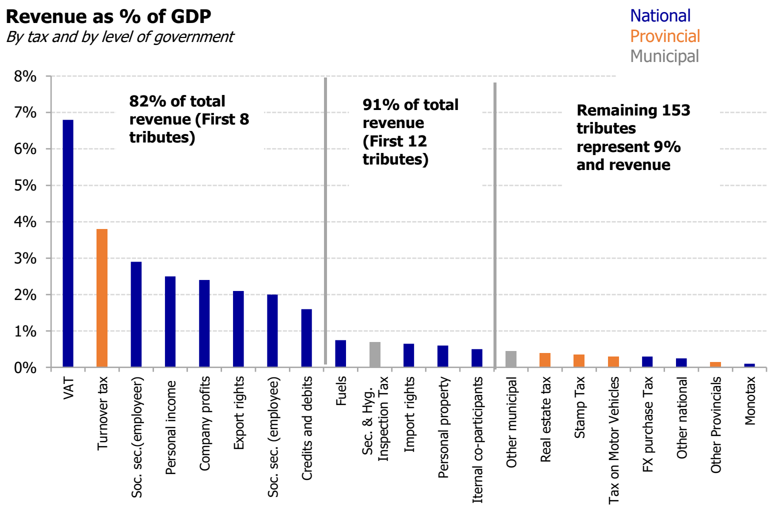
Source: Econviews based on Argentina en datos

There is also an administrative point with this tax. As companies do business across the nation face different rates in different provinces and the government created some years ago a system under which firms or individuals get withholding taxes on behalf of the provinces as soon as money touches a bank account.

The third distortion is the 1.2% tax on checking accounts, the eight most important levy. It collects over 1.6% of GDP. A small part of this can be taken as an advance income tax payment, though. This incentivizes the excessive use of cash and in turn tax evasion. There is a large tradition in Argentina that cash transactions fly under the radar.

The fourth levy is a municipal tax, which is technically speaking not a tax. Local governments charge between 0.5 and 2% with the excuse of hygiene and security to firms that produce in the district. This goes straight to the cost structure of firms. There are two important implications here. Firstly, those who charge more are not providing a better quality of public goods. So higher security taxes do not translate into safer cities. Secondly, there is an element of voting with your feet, which could be seen as beneficial as a carrot and sticks policy.

Another anomaly of the Argentine tax system is the tax on assets. Some people call it a wealth tax, but it is not exactly that. Debts are not deductible, so anyone buying properties with mortgages will pay a disproportionate tax compared to their wealth. The tax has a low minimum taxable asset, so everyone with a medium-sized house is likely to be included. People must include cash, securities, cars, real estate, and bank deposits in their tax returns. Some elements such deposits in the Argentine banking system and government bonds are exempt. Foreign holdings are taxed at a 2% rate. With global inflation and higher rates, this is less of a problem, but still, those who want to diversify from Argentine risk and invest in US treasuries will devote have of the nominal return to pay the asset tax.



Source: Econviews based on IARAF

Argentina has 165 taxes, but the 8 most important ones generate over 80% of the revenue and the top 12 take over 90% of the revenue. The rest are a big problem for firms in terms of the administrative burden but collect very little (see chart above). The problem for eliminating these taxes is that often levies have their resources ring-fenced for some activities and therefore lobby groups will defend them fiercely. In the last congressional debate on the 2023 Budget one lawmaker added an ARS 250 per air ticket issued to strengthen salaries of the airport police. And worse, the new levy will increment at the same pace as policemen salaries. Examples of this sort abound. Another one is the 7% tax on international air tickets. Part of the revenue goes to promote Argentina as a touristic destination abroad. Some other levies finance security issues, others training for truck drivers or for port workers and so on and so forth.

The administrative issue is important not only in terms of the number of taxes and the complication of having 3 different jurisdictions (federal government, provinces, and municipalities) but also the fact that companies are withholding agents for the tax agency. **It is globally common that employees get income tax withholdings, but in Argentina there is at least one withholding item for every payment.**

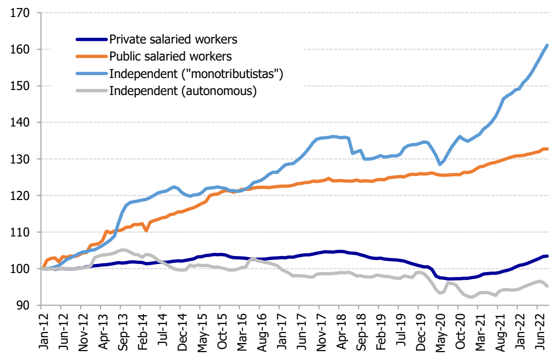
An important topic in the design of the Argentine system is that its complication and voracity over certain figures has meant that there is a growing tax evasion and a search for tax elusion. In the recovery of the Covid-19, most of the new jobs created have not been formal private jobs. The economy is at the same level of its previous peak, but formal private jobs aren't. And unemployment at 6.9% is quite low for Argentine standards.

Some 15 years ago the government created something called "single tax" scheme that can be used by self-employed and very small firms. In one payment you can cover income tax, VAT, and social security. This is limited to around USD 15,000 a year for self-employed people or USD 30,000 at the official rate. The problem has always been that whoever crosses that barrier starts paying several orders of magnitude more. So, nobody wants to earn more unless it becomes a significant increase. Over the years payers of the "single tax" have reached 4 million and the number of those paying in the regular system has shrunk and is basically reserved for well-known professionals. This ill-designed system is also a huge problem for social security, as the contribution of single-tax payer is minimal compared to the minimum pension that they are entitled to. Another negative externality is that the 4 million single-tax payers do not need to request invoice, so this also incentivizes the informal circuits. For example, a lawyer in the normal regime would deduct some of their car expenses, office supplies and many other things that forces the taxpayer to request invoices to be able to deduct. The problem is that there are fewer invoice-requires and more that don't care.

Tax evasion in Argentina is at least 30% of the economy. In a world of data, the firm that decides to avoid VAT would hardly have employees registered, as it would be able to show consistency before an inspection. So, one thing leads to the other and many firms work almost entirely in the darkness or have significant operations off the books. It is not a secret that there is a secondary market for invoices under which some need to invoice to justify their wealth and others buy the invoices to reduce their tax payments. It is not socially penalized, as it would be paying a salary below the minimum wage.

Finally, Argentina has tax exemptions worth 2.5% of GDP. The finance minister has done a light attempt to discuss this in the budget but found

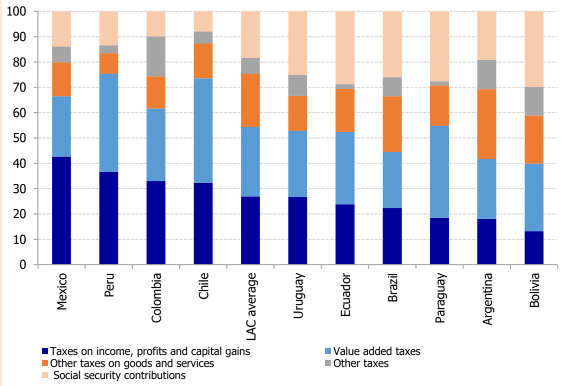
Evolution of registered work
Jan-12=100 - Seasonally adjusted



Source: Econviews based on Min. of Labor no echo in his own party for such discussion. There are several topics there from the income generated in public bonds, judges' income tax, the special regime in Tierra del Fuego, truck drivers and many more. Most of these exemptions have no clear economic explanation beyond the fact that politicians are unwilling to go through the pain. The special regime in tierra del Fuego is 50-years old, and pundits claim that the system would not work without it, a clear sign that it has not met its goal.

All in, it seems clear that Argentina has an inefficient tax system that does not carry much horizontal or vertical equity. It is costly to manage and has been punctured almost across the board to the point that evasion is not socially punished as it would be in most Anglo-Saxon countries or even in some Latin Americans. In the medium term, there should be space to reduce taxation on top of redesign the system. But in our view, Argentina will have to balance its book before gets into a supply side approach. The recent failure of Liz Truss in the UK is perhaps an example to bear in mind for those planning a swift tax cut.

Tax structure in LATAM and the Caribbean countries
2020 - OECD



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	178.8	375.5
Exchange rate ARS/USD (eop, YoY)	58.4%	40.5%	22.1%	74.0%	110.0%
Real exchange rate ARS/USD (eop, Dec-01=100)	151.5	158.3	137.1	128.6	134.7
Paralell exchange rate ARS/USD (eop)	74.6	140.3	203.1	357.6	638.4
Spread with official exchange rate (eop)	24.6%	66.8%	97.7%	100.0%	70.0%
Gross reserves (USD billion, eop)	44.8	39.4	39.7	42.7	40.5
Net international reserves (eop, in thousands of M USD)	12.6	3.8	2.3	6.6	5.1
Policy rate (eop)	55.0%	38.0%	38.0%	75.0%	85.0%
GDP (YoY)	-2.0%	-9.9%	10.4%	5.2%	0.0%
Formal wages in real terms (aop, YoY)	-6.0%	-1.9%	0.4%	-1.3%	0.0%
Primary result (% GDP)*	-0.2%	-6.4%	-3.3%	-2.8%	-2.5%
Fiscal result (% GDP)*	-3.6%	-8.4%	-4.8%	-4.3%	-4.3%
EMBI Argentina (spread in bps, eop)	1,744	1,350	1,600	2,400	1,500
Public net debt (% GDP)	43.6%	52.7%	42.1%	34.9%	35.4%
Current account (% GDP)	-0.8%	0.8%	1.4%	-0.8%	-0.2%

Source: EconViews

*Excludes rents from primary debt issuance in 2022

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