MONTHLY REPORT

ECONVIEWS
ECONOMÍA Y FINANZAS

December 2022
Issue #222

2022: Another year in the **roller coaster**

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2023: A year of **muddling through**

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THE MONTH AT A GLANCE

RECENT DEVELOPMENTS

- The Fed slowed its pace of hikes to 50 basis points in December, leaving the Fed Funds at 4.25-4.5%, but the dot-plot for 2023 shows governors expect rates above 5.25% for some time, despite US inflation lowering to 7.1% in November.
- Massa re-enacted the preferential exchange rate for soybean exporters, this time at an ARS 230 parity per dollar until December 31st. The BCRA managed to purchase USD 1.1 billion in the last 24 days. However, the parallel exchange rate heated up to ARS 323 (+3.5%).
- VP Cristina Kirchner was sentenced to six years on corruption charges, though appeals could stretch out for years. Afterwards, Cristina declared she would not run for any office in 2023, something that many had speculated on.
- Argentine sovereign bonds posited a strong recovery over the last month. The 10-year benchmark yield on the GD30 bond lowered from 39 to 35% and its price increased 15%. The Merval stock index also won 15% in dollars. However, local currency debt was further stressed with yields on inflation-adjusted CER bonds which mature in 2023 increasing from 3 to 6%.
- The Treasury's successful ARS 786 billion auction on December 14th allowed it to take some pressure off fiscal accounts in a seasonally difficult month.

FIGURE OF THE MONTH

In November monthly inflation decreased to

4.9%

the lowest mark since February's 4.7% record.

TO BE ALERT

In December the Central Bank bought

54%

of export proceeds, below 65% in September's version of the "soybean dollar".

WHAT'S COMING NEXT?

- China's messy exit from its Zero Covid strategy casts another shadow on the outlook for global growth in 2023. After gloomy forecasts from the IMF or OECD, Fitch cut its expected growth by 0.3 points to 1.4%, a figure on par with the 2009 crisis.
- The regional outlook for 2023 is very uncertain, with Lula returning to Brazil's presidency 12 years later, widespread protests and possibly advanced elections in Peru, a recession in Chile and high inflation and rate hikes practically everywhere.
- Due to the drought the 2022-23 wheat crop will be 46% below last year's, at an USD 4 billion cost and the soybean and corn crops are also in danger. During the summer the Central Bank will struggle to find the dollars for imports and outbound tourism. However, in the last days the official exchange rate's depreciation has slowed from 120 to 91% annualized.
- After November's 4.9% monthly print, year-on-year inflation will close 2022 still in double digits. However, recent union wage updates such as steel (+110%) or construction workers (+105%) are setting a three-digit floor for negotiations in 2023.
- While US stocks fell 16% in 2022, Argentine ADRs had a very good year, with energy stocks like YPF (+127%) or TGS (+129%) more than doubling their value. After this strong recovery, their 2023 performance will likely be marked by the elections and political uncertainty.

SUMMARY OF MAIN INDICATORS

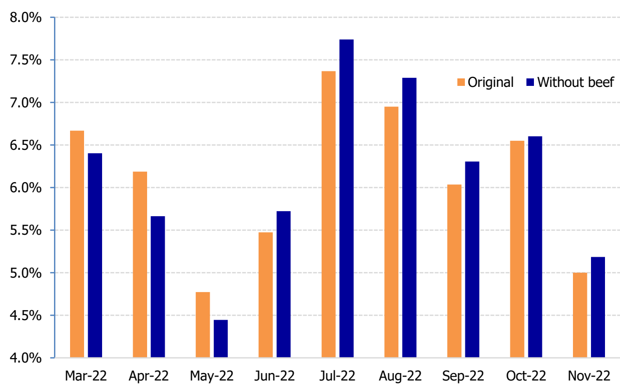
	Last	Previous		Last	Previous
Economic activity			**Financial data**		
Economic activity (MoM s.a.)	-0.3%	-0.2%	Inflation (monthly)	4.9%	6.3%
Consumer confidence (MoM)	-1.4%	-4.1%	FX spread (21day avg.)	95.1%	96.6%
Industrial activity (MoM s.a.)	-1.1%	0.1%	Country risk (bps 21day avg.)	2,293	2,524
International accounts			**External data**		
Current Account (USD BN)	-3.03	-0.83	Soybean price (per ton, 21day avg.)	537.5	524.3
CB Reserves (USD BN 21day avg.)	38.38	38.81	Brazilian activity (MoM s.a.)	-0.1%	0.0%
Primary balance (ARS BN)	-134.65	-103.05	Financial Conditions Index	-15.7	-14.3

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

GRAPH OF THE MONTH:

CPI Great Buenos Aires: beef is helping lower food prices

m/m, CPI index reweighted without beef



Source: Econviews based on INDEC

NOV 29th	DEC 3rd	DEC 6th	DEC 14th	DEC 15th	DEC 21st	DEC 22nd
Econviews Monthly #221: The perils of muddling through + special analysis on taxes in Argentina	Considering Argentina met targets for Q3-2022, **IMF staff approves USD 5.9 billion disbursement** in December.	Sentenced to six years on corruption charges, **VP Cristina Kirchner says she will not run in 2023.**	**Treasury raises ARS 786 billion to rollover debt and finance deficit**, but 74% is in instruments that mature in March or April.	November's **monthly CPI print comes in at 4.9%**, less than expected and the lowest since February's 4.7% mark.	**Supreme Court rules in favour of City of BA** on national tax-sharing system, over funds equal to 1% of GDP.	**Econviews Monthly #222**

POLITICS

The last month the center of the stage was taken by the FIFA World Cup. The victory of the national team brought some happiness to the population, and this is good news for the government at the end of a difficult year. The most relevant event during this time was that VP Cristina Fernandez was found guilty of fraud. After the sentence, she announced that will not compete in the 2023 elections. In this sense, it is still a mystery who will be the officialism's candidate. Minister De Pedro, the Buenos Aires governor Kicillof or even Maximo Kirchner are possible names. In the opposition, the mayor of BA, Rodriguez Larreta, and the former security minister Bullrich seem to be with the most chances in the race for the presidency.

IMF

Technical staff and government authorities reached an agreement on December 2nd about the third revision as all targets were met. Once the IMF board approves it, Argentina will receive around USD 5.9 billion. This amount will be used to face capital repurchases in December and January (USD 2.6 billion each month), and interest payments in February (USD 500 million). The press release also emphasized the importance of fiscal consolidation due to the fragility of the economy. Targets for the fourth quarter will probably be met thanks to the second edition of the soybean dollar, which will bring extra revenues and reserves accumulation.

ECONOMIC ACTIVITY

GDP grew 1.7% in the third quarter s.a. related to Q2 and 5.9% year-on-year. From the demand side, the investment showed an increase of 14% (Q3 2022 vs Q3 2021), followed by private consumption with 10.2%. Exports contracted by 4.6%. Considering the supply side, Hotels and restaurants (+37.3%) and Mining (+14.4%) were the sectors with higher increases. However, for their share, the most relevant sectors were Industry (+6.4%) and Commerce (+7.3%). In the last quarter of the year, economic activity has cool down and we think that 2022 will end with a GDP growth of 5.5%, most of it explained by the statistical carryover. For 2023 we expect that economic activity will stay stagnant with a null expansion.

INFLATION

Inflation decelerated in November with a monthly print of 4.9%, the lowest figure since February. The accumulated for 2022 reached 85.3% and 92.4% year-on-year. The slowdown in seasonal prices (+4.1%) explains this downside surprise. Food and beverages prices grew only 3.5%, down from October's 6.2%. Inside this category, there were some products with price reductions such as tomatoes, onions, and meat. On the other hand, regulated prices increased by 6.2% with water, electricity, and gas (+8.7%) and communication (+6.2%) at the top. For December we expect inflation to be around 5.8%, ending the year at 96%. In our base scenario, the government will not manage to reduce it in 2023 and it will be 110%.

MONETARY SECTOR

After losing reserves in October and November, the government put in place a new edition of the "soybean dollar". It allowed the Central Bank to buy USD 789 million so far in December. Net reserves now stand at USD 4.4 billion but they will increase after the IMF disbursement. Since last week the BCRA is depreciating the official exchange rate at a slower pace. Now the annualized rate of depreciation is 91.1% while it was above 120% in the first week of the month. The BCS is trading at ARS 333 and the FX spread stands at 91%. The monetary policy interest rate kept unchanged at 75% and will probably continue at this level through most of 2023.

FISCAL ACCOUNTS

Up to November, the primary balance accumulated a deficit of 2.0% of GDP excluding non-cash rents from CER bond issuance. In November revenues contracted 6.8% y/y in real terms, mainly due to a sharp contraction of export duties (-64.7% y/y real) after the advancement of exports caused by the first soybean dollar scheme. Primary expenditures (-7.5% y/y real) accumulated five consecutive months of real drops. The largest drops were registered by economic subsidies (-29.9%) and transfers to provinces (-27.1%). Pensions also fell 9.1% in real terms. We expect December's deficit to reach 0.8% of GDP, with which 2022 will close at 2.8%, reaching the IMF goal (2.5% + 0.3% rents from CER bond issuance).

I. 2022: Another year in the roller coaster

A year full of volatility and uncertainty is coming to an end, and everything suggests that next year will not be very different. But many things happened throughout the year, some better than expected and others worse. There were some worrisome months, but the worst-case scenarios that some analysts predicted (such as hyperinflation or a default with the IMF) did not materialize.

The year started with uncertainty as to whether Argentina was going to reach an agreement with the IMF. A default would have been a disaster and compromised access to financing from the multilateral banks, and an isolation from the world economy. Fortunately, there was finally an agreement, though it was a very light program, which did not include structural reforms, no steep devaluation of the currency and only modest improvements in the fiscal accounts. It was a program to allow the economy to muddle through until the end of this administration, and it seems to be achieving that objective.

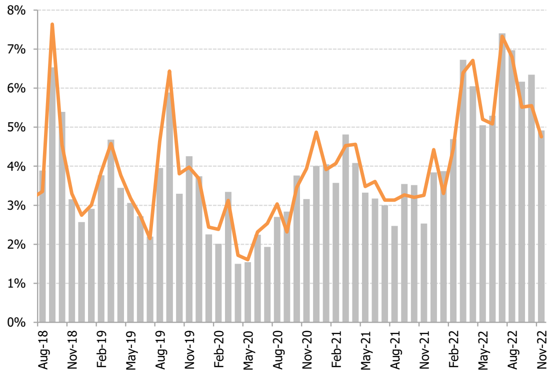
On the negative side, inflation was much higher than expected, and there were two episodes that were particularly disrupting. The first one, in March and April, when seasonal factors and increases in world prices led inflation to rise to 6.7% in March and the second in July and August when in response to a tightening of the FX restrictions domestic prices moved closer to the blue-chip swap and inflation reached 7.4% in July. The expectation now is that inflation will double last year's level and finish close to 100%.

The external accounts represented another area that remained under pressure. International reserves dropped throughout the year, reaching worrisome levels in August when the Central Bank had reserves for less than two weeks of imports. One of the consequences of this low level of reserves was the increase in the blue-chip swap and the spread over the official exchange that has remained at around 100% for a large part of the year.

On the exchange rate front the Central Bank, after a slow start, finally decided to accelerate the rate of depreciation of the currency, which last year was just 20%, a rate that was completely out of line with an inflation of 50%. Pressures from the IMF, and the need to limit losses in international reserves where behind these changes in policies, and the year is ending with the rate of depreciation that is slightly higher than the rate of inflation. One implication is that the exchange rate is not any more the anchor for inflation, as it was in 2021.

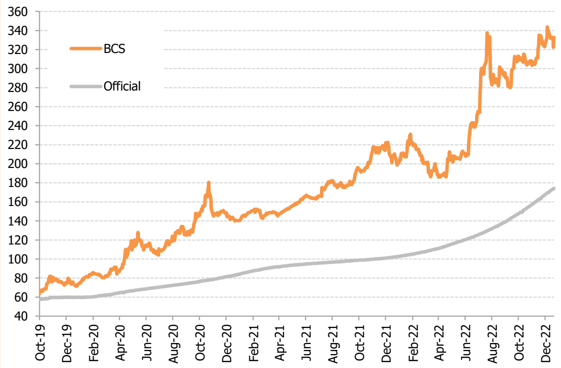
Domestic debt is the third area that has been worrisome. This has started in May and June, when rumors started about a possible restructuring of domestic along the lines of the one that the Macri administration did in September 2019, after the government did poorly in the primaries. While the rumors have persisted since then, the intervention of the Central Bank trying to stabilize the markets has so far been successful and is likely to help to avoid a new restructuring of domestic debt that has the potential of disrupting the payment system and trigger a deep recession.

Monthly inflation
In %



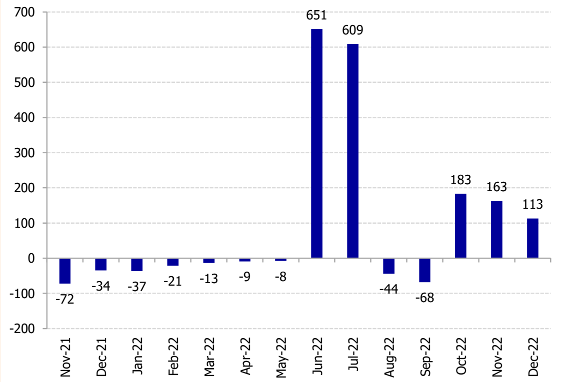
Source: Econviews based on INDEC

Exchange Rate
Pesos per US Dollar - Average B/A



Source: Econviews based on Reuters

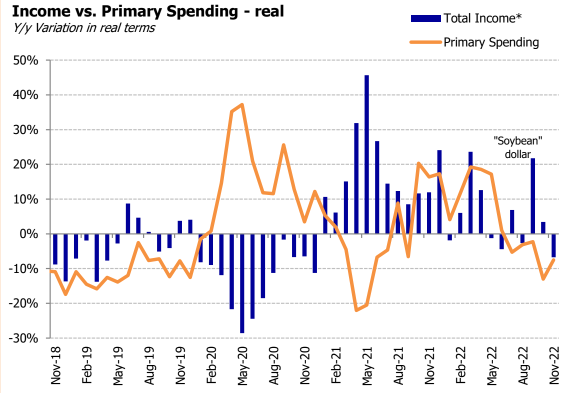
Central Bank bond purchases
Item "Others" of monetary base factors - In million ARS



Source: Econviews based on BCRA

There was more positive news on the monetary and fiscal side, especially since the appointment of Massa to the Ministry of the Economy. The Central Bank drastically increased interest rates on leliqs and reverse repos and promised to restrict financing to the Treasury, while the government showed a strong commitment to meet the fiscal targets of the IMF agreement which aimed at a primary deficit of 2.5% of GDP. There were some accounting tricks along the way that made possible the reduction in deficit (such as 0.3% in revenues on the issuance of indexed bonds that were creative accounting, or from the additional export taxes thanks to the preferred exchange rate on soybean exports), though it is clear that there was an effort to reduce expenditures. The increase in inflation helped out a lot too.

Income vs. Primary Spending - real
Y/y Variation in real terms

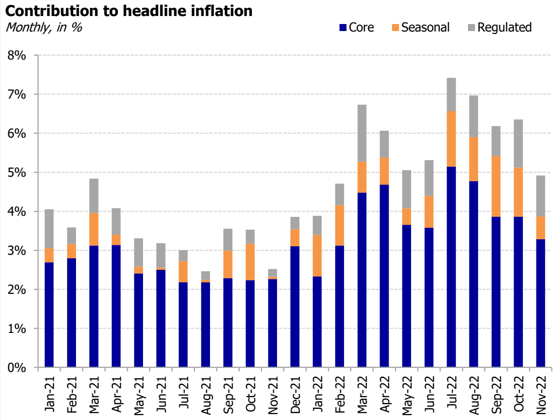


*Excludes SDRs in Sep-21
Source: Econviews based on MECON

November provided some good news. Inflation dropped to 4.9%, generating some hope that price increases are going to soften in coming months or at least they won't spiralized, while there has been a rally in prices of domestic bonds.

In the next section we provide a more thorough analysis of the base case scenario for next year and the risks that we foresee. In broad terms 2023 will be another difficult year in which reserves will continue to be under pressure, the market will remain anxious about the rollover of the domestic debt, inflation will continue to be a problem, the exchange spread will remain high, and the economy will have meager growth. But the expectation of change in government that will most likely generate expectations of improvements in economic policies is likely to provide some financial stability, as it happened in 2015 when markets were anticipating a victory of Macri in the election. This time there will not be euphoria, as was the case at that time, but we should expect lower FX spreads and reductions in the country risk towards the end of the year.

Contribution to headline inflation
Monthly, in %



Source: Econviews based on INDEC

Politics will take center stage throughout the year, as the electoral calendar will start early on (towards April) with provincial elections, as governors are by and large decoupling their elections from the national ones in order to increase their chances. This is not new, but most Peronist governors are concerned about the possibility of being dragged by a poor performance of the party at the national level.

Country Risk for Argentina
EMBI, in percentage points

Source: Econviews based on JPMorgan

Cristina Kirchner has publicly announced that she will not run for office next year, which if true, means that the Peronist party does not have a clear candidate. Massa could be the one, but he needs to be able to bring down inflation, avoid a devaluation and maintain economic activity, a difficult endeavor. If he manages to achieve all these goals, he is likely to be the candidate. But it won't be easy, because he still faces the risk of a severe drought that could destabilize the external front and force a devaluation or a more profound split of the foreign exchange market, while the rollover of the debt will be a continuous threat, though one that should be easier to manage than the former one.

The government will have some incentive to increase expenditures, especially in the second half of the year as the elections get closer. Perhaps it could generate some tensions with the IMF, especially if it means a deterioration in the fiscal accounts and that the government does not meet the fiscal targets. However, the Fund would probably give a waiver and negotiate a new program with the new administration. Such agreement is expected to be more demanding than the current one (which is not difficult) and should be the basis for a new stabilization program that restores the basic macroeconomic balances in Argentina.

The opposition has one issue in mind for next year: to avoid a deterioration in the fiscal and external accounts and to restrain the government from leaving hidden liabilities or potential ticking bombs. The obvious suspects are on the one hand the fiscal accounts, where some expenditures can be accounted below the line or just simply ignored from the budgetary process (as apparently has happened with Cammessa or with the Central Bank losses from the soybean exchange rate). The other suspect is on the external accounts, where reserves are already low and there are numerous liabilities form unpaid imports, and dividends, which could be a sizeable amount, that doubles or trebles the current level of reserves. The opposition thus has an incentive to limit government's borrowing in the domestic capital market.

The other issue is to develop policies to bring down inflation, the FX spread and the country risk, as well as structural reforms to reignite growth. There are several teams already working on alternatives to turnaround the economy, and there is consensus among them about the need to have a fiscal shock in order to move as quickly as possible to a primary fiscal surplus, to implement a policy to reduce inflation and some structural reforms to restore growth.

II. 2023: A year of muddling through

Next year is marked with presidential elections and the hopes for a change of direction in economic management. Elections tend to equal more spending and uncertainty, while the prospect of having a pro-market coalition in charge could potentially offset some of these problems. In our base scenario, 2023 will be a year of muddling through with only a slim chance of improvement and not-so-slim probabilities of a worsening of economic conditions with more inflation and recession.

In our baseline scenario inflation only increases at the margin. From the 96% rate that should post in 2022 it could increase to 110%. Activity should remain flattish. The USD will increase in line with inflation in its "official" version and will keep a spread of around 100% with the market versions throughout the first 3 quarters of the year, shrinking as the change of guard comes closer in time and some of the opposition candidates makes more explicit his or her economic strategy.

Different macro scenarios

	2021	2022 E	Base scenario 2023	Negative Scenario 2023	Positive Scenario 2023
GDP (var %, aop)	10.4%	5.5%	0.0%	-2.0%	1.0%
Inflation (var %, eop)	50.9%	96.0%	110.0%	150.0%	85.0%
FX rate (ARS/USD, eop)	102.8	178.3	374.5	454.6	303.2
FX rate (var %, eop)	22.1%	73.5%	110.0%	155.0%	70.0%
FX spread (%, eop)	97.7%	95.0%	70.0%	120.0%	70.0%
Primary balance (% of GDP)	-3.3%	-2.8%	-2.5%	-3.5%	-1.9%
Net reserves (USD bn, eop)	2.3	6.6	5.1	1.0	8.0

Source: Econviews

Probability matrix

Base scenario	70%
Negative scenario	20%
Positive scenario	10%

Some of the conditions for the baseline scenario are politically driven. One question for us is how much fiscal restraint Massa will be allowed to implement. Will there be utility price increases during the campaign? We frankly do not know but have planned based on a middle ground scenario whereby the finance ministry pushes in the direction of the IMF program objectives but does not fulfill everything. Our primary deficit forecast is 2.5% of GDP, an improvement of just 0.3 percentage points over 2022 (excluding non-cash rents from bond issuance), opposed to the 0.9 pp committed in the IMF program. And this number is not the whole truth, as elements such as the subsidy for soybean exporters are not properly accounted for.

There are other conditions that are important to consider. A key question is how bad will the drought be? Skeptics are putting the soybean harvest at less than 40 million tons (and a similar number for corn), while others still consider the chance of having 46 million of both corn and soybeans. Those 12 million tons of difference matter a lot in terms of exports and activity. The difference in just these two crops could mean more than USD 5 billion in exports.

A second related question is about the inauguration of the gas pipeline from Vaca Muerta. The government hopes to finish it by June 20th, in which case gas imports could be drastically cut. But others are less hopeful on the dates. Chances are that the pipeline can be operational by September and therefore imports will be a drag on the scarce FX position of the government. The good thing is that import prices are unlikely to be as high as in 2022 for both diesel and LNG, although hardly back to 2021 levels.

Diesel, which is in part used to generate electricity, was by far the highest energy import in 2022. From January to November, imports of diesel totaled USD 4,494 million, whereas in 2021 they amounted to USD 1,746 million through the same period; its price in 2022 averaged USD 960 per thousand m3. It remained in the USD 1,000 range in October, but lower world demand should take it to USD 700-800 (it averaged USD 575 in 2022). **Yet demand could remain high if the pipeline is not ready on time**.

The timely finishing of the pipeline could also sharply reduce LNG imports. Between January and November, they amounted to USD 2,567 million, an additional USD 1,466 million compared to the same period a year before. In 2022, LNG prices shot up and at their peak they reached nearly USD 60 per million BTU, but the government paid throughout the year an average of little more than USD 28 per million BTU. Futures are priced at close to 30 dollars, half their peak but more than what the government paid on average in 2022 but could continue to decline unless the energy crisis in Europe deepens. **Potential savings could add up to USD 5 billion.**

Fiscal accounts

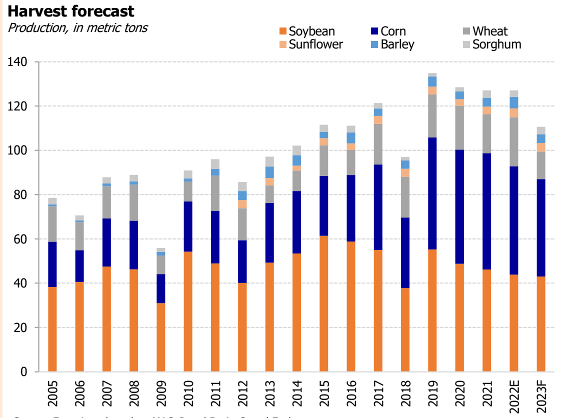
Cash basis - net of rents from primary debt issuance

	2021	2022	2023
Total revenues	**17.8%**	**17.7%**	**17.5%**
Tax revenues	16.1%	16.4%	16.1%
Primary expenditure	**21.1%**	**20.5%**	**20.0%**
Social security	7.9%	7.7%	7.6%
Other social spendig	3.7%	3.7%	3.6%
OPEX	3.3%	3.1%	3.0%
-Wages	2.3%	2.4%	2.2%
Economic subisides	3.0%	2.8%	2.5%
-Energy	2.3%	2.3%	2.0%
-Transport	0.7%	0.5%	0.5%
Transfers to provinces	0.8%	0.7%	0.6%
CAPEX	1.4%	1.6%	1.5%
Others	1.1%	1.0%	1.1%
Primary deficit	**-3.3%**	**-2.8%**	**-2.5%**
Interest	1.5%	1.4%	1.6%
Fiscal deficit	**-4.8%**	**-4.3%**	**-4.1%**

Source: Econviews based on Mecon

Harvest forecast

Production, in metric tons



Source: Econviews based on MAGyP and Bs As Cereal Exchange

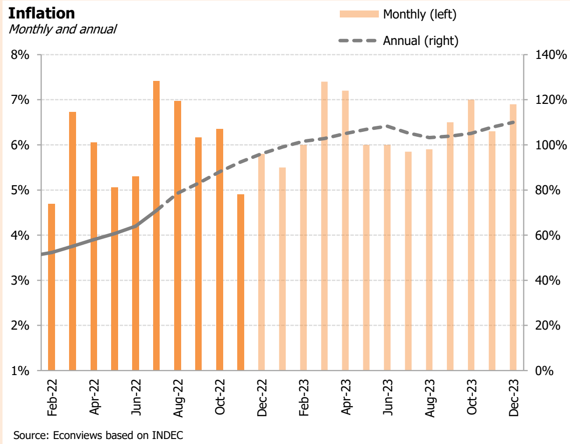
Inflation and the unpleasant monetary arithmetic

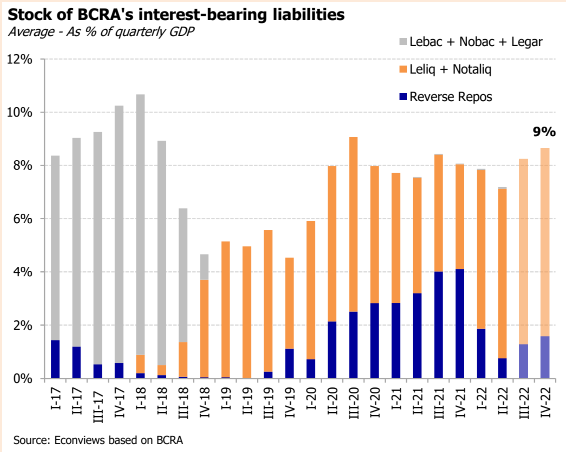
While inflation is clearly off the peaks of last winter when it hit 7.4% in July and then 7% in August, the situation is far from being under control. The 4.9% of November was the result of the effect on price agreements, which typically work better upon inception than later on, and the fact that seasonal prices worked well in November. It won't last long. Looking beyond the short term, there are several issues to consider.

- **The weak supply of dollars will make it impossible to depreciate the currency below 6-7% per month**. The only solution to that is to press the screws of import restrictions, which in turn harm economic activity and induce more inflation through scarcity of many goods.

- **Reducing inflation has a harmful effect on fiscal accounts, as pensions outlays (the chief spending line in the budget by far) increase when inflation goes down and the opposite is true for accelerating processes.** Actually, the improvement in fiscal accounts this year has been almost exclusively because inflation eroded pensions and other spending lines. Increasing the deficit is not only missing the IMF target, but there is also a problem to finance such deficit. In the case of Argentina, more deficit to finance tends to mean more money issuance and hence the loop with inflation. Our view for 2023 is not one of recovery of money demand, so reducing inflation needs reduction on the nominal increase of money supply.

- **The third problem to push for lower inflation without a proper stabilization program is the famous "Leliq snowball"**. Remunerated liabilities of the Central Bank are due to finish the year at around 9% of GDP, which is a historically high level. The main problem is that if inflation falls quicker than interest rates, then real interest rates would be positive, and the dynamics of the Central Bank liabilities could become explosive. Much depends on the size of the real interest rates and on whether there is enough confidence so that money demand increases. This is an issue that will need to be monitored closely, though does not seem an immediate risk.

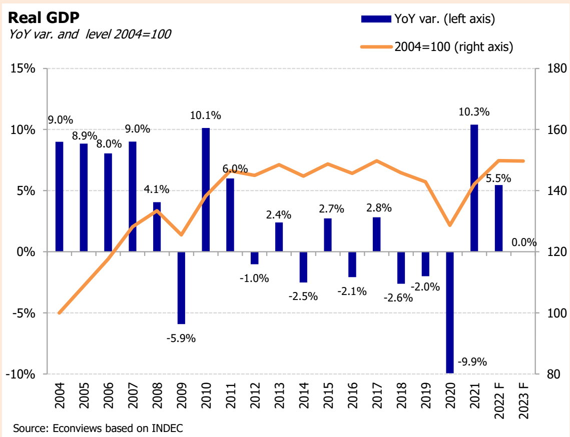




Activity: hard to be optimistic

Argentina grew around 5.5% in 2022, a much better outcome than we thought a year ago when our numbers hovered between 3.5 and 4%. The first half was clearly better with a harvest that threatened to be ugly but was all right in the end. In the winter, people consumed as if there was no tomorrow, as the need to get rid of the pesos outweighed any concern regarding real income. The last quarter of the year has already shown negative numbers for activity, meaning that the statistical carryover for 2023 is neutral.

So, thinking in 2023, out baseline is no growth, but not a disaster either. The import restrictions are taking a toll on production in several sectors of the economy, but at the same time we think that a dose of electoral spending will curb the situation in the services sector. The weak Q4 of 2022 left no carryover for 2023. The statistical drag is just 0.1% taking the



entire quarter or negative by 0.3 percentage points taking December 2022 as the base.

In terms of sectors the 0% growth hides the fact that there are a few very interesting businesses. For example, mining & hydrocarbons are going to grow north of 4% and we expect hotels and restaurants to continue outperforming the economy, with an expected improvement of 4%. They suffered a bad January in 2022 due to a Covid outbreak, which will help through a low comparison base. Health, education, public administration will all post positive growth, although nothing to write home about.

Sectoral forecasts
% variations

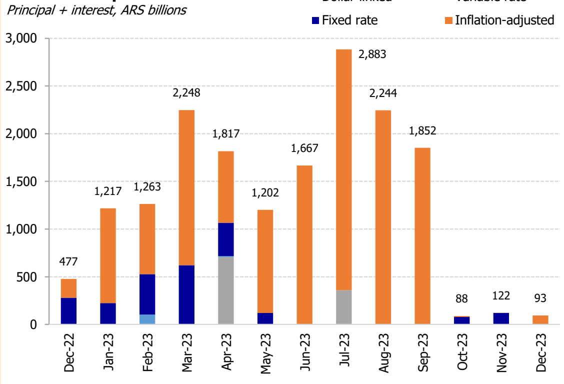
	4Q carryover	2022 E	2023 F
Agriculture and livestock	0.0%	-2.2%	-2.5%
Fishing	-5.7%	11.5%	-3.7%
Mining	4.2%	13.8%	4.2%
Manufacturing	-2.6%	5.1%	-2.1%
Electricity, gas and water	-2.3%	1.7%	-0.3%
Construction	-2.9%	6.6%	-0.9%
Retail, wholesale & repair	-2.1%	6.4%	0.4%
Hotels and restaurants	2.0%	38.2%	4.2%
Transport and communication	-0.7%	8.5%	-1.7%
Banking	-3.1%	-0.3%	-1.9%
Real estate, corporate and rental activities	-0.1%	5.2%	1.2%
Public administration	-0.3%	7.2%	1.4%
Education	0.4%	4.5%	0.7%
Health	1.8%	1.9%	2.8%
Other social services	2.5%	10.7%	4.5%
Taxes net of subsidies	-0.8%	5.5%	0.5%
GDP	**0.0%**	**5.5%**	**0.0%**

On the negative side, we expect manufacturing to reduce activity by 2.1% on the grounds on severe import restrictions. Argentina needs at least USD 5 billion in goods imports to function at this low activity level of Q4 and we think that this is the best the Central Bank can provide in the absence of a more important devaluation. Construction starts 2023 with a negative carryover of almost 3%, so declining just 1% is not terrible for the sector. Transportation will fall almost 2%, as the problems in manufacturing coupled with the drought prospects mean that 2023 is not going to be a good year for freight. As for agriculture, our number is -2.5%, but there is time for better and worse. Just for reference, in 2018 the agriculture, livestock and forestry sector plummeted by 15.6%. It is more about rain in the next 30 days than anything else.

The government would try to work on real incomes blessing wage negotiations and providing one-offs to pensioners and beneficiaries of social programs, but that would only offset loses if inflation goes to 110%. And given that the economy has generated more informal and independent jobs than salaried work, the influence of union-led increases is much less than in used to be. All in, we are not suggesting a big fall in incomes, but rather something that is compatible with zero growth and a flattish consumption.

The debt puzzles

One of the limitations to think of a better 2023 is the heavy calendar of peso-debt maturities. It is over 16 billion pesos before the presidential election in October, though over 50% is in the hands of the public sector. In theory, with the FX restrictions, pesos have nowhere to go. So, if we think that the primary deficit is financed by the Central Bank, all the market needs to do is to roll over existing maturities plus interest payments. The problem is that the market is not willing to take the electoral risk and is rolling over only with titles due in the next few months. But this is mathematically impossible to work out as elections approach. So, either the market takes the risk of buying bonds and bills due in 2024 or there will be skirmishes.



*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

So, what does 2023's financial program look like? Given our macroeconomic assumptions, the primary deficit will amount to USD 15.8 billion, and interests could add up USD 10.1 billion, of which 4.9 are denominated in dollars. Principal maturities are mostly peso-denominated, while maturities in foreign-currency are predominantly with the IMF. But the IMF's disbursements in 2023, added to some USD

3.3 billion that will be left over after this month's disbursement, mean that principal maturities in USD are covered.

Under our baseline scenario, the local market will roll-over 100% of principal maturities in pesos and could add new financing up to 0.8% of GDP destined to face interest payments in pesos. **But it seems unlikely that the local market could add any further financing, so the primary deficit will have to be financed entirely by the Central Bank, and it should also provide financing in dollars for 0.7% of GDP needed to face interest payments in foreign currency. Thus, the total Central Bank financing for 2023 adds 3.2% of GDP in our baseline scenario.**

This scenario implies issuance for nearly 17 trillion pesos, which after sterilization lead to a growth of the monetary base of 75%, comfortably under inflation. But the stock of interest-bearing liabilities could grow 150% and end the year at a very high 11.5% of GDP. If inflation goes down and rates remain positive in real terms, the Central Bank's liabilities could turn problematic. But the cost of sterilizing less is even more inflation.

Financial program

In USD billion

		2023 F	% of GDP
Financial needs	**Primary deficit**	**15.8**	**2.5%**
	Interests	**10.1**	**1.6%**
	In ARS	5.2	0.8%
	In USD	4.9	0.8%
	Principal	**76.0**	**12.0%**
	In ARS	55.7	8.8%
	In USD	20.2	3.2%
	IMF	*17.7*	*2.8%*
	International organizations	*2.6*	*0.4%*
	Private sector	*0.0*	*0.0%*
Financing sources	**Total financial needs**	**101.9**	**16.1%**
	In ARS	*76.7*	*12.1%*
	In USD	*25.2*	*4.0%*
	Local debt market	**60.9**	**9.6%**
	Principal roll-over	*55.7*	*8.8%*
	New financing	*5.2*	*0.8%*
	IMF + IIOO	**21.0**	**3.3%**
	Central Bank	**19.9**	**3.2%**
	Total financing sources	**101.9**	**16.1%**
	In ARS	*80.8*	*12.8%*
	In USD	*21.0*	*3.3%*

Source: Econviews based on different sources

Central Bank monetary program - Base scenario

In ARS billion

	2023F
Payment of interest	11,178
Assistance to the Treasury (BCRA)	2,698
Purchase of reserves	529
Other factors	2,529
Issuance needs	**16,935**
Interest-bearing liabilities	-12,961
Monetary base (annual growth)	**3,974**
Memo items*	
Monetary base (stock)	**9,272**
Annual growth (%, eop.)	*75.0%*
Seigniorage (% of GDP)	*2.4%*
Interest-bearing liabilities (stock)	**25,139**
Annual growth (%, eop.)	*149.5%*
As % of GDP (Q4)	*11.5%*
Inflation (eop)	**110.0%**
Monetary policy interest rate (avg.)	**75.4%**

*Stocks as ARS billions, eop

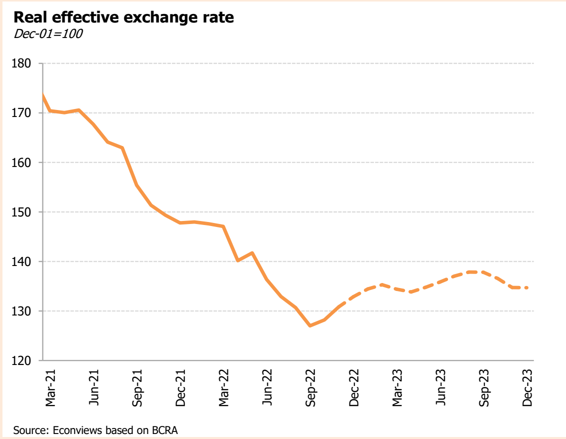
The IMF, the current government and debt holders are pushing the opposition to state that they will comply with debt payments. This is not in the opposition interest, as it would allow the government to raise more debt to spend more, increase the deficit and worsen the conditions for the stabilization plan. So, the most likely scenario is that opposition leaders continue evading statements on this issue. Against this background we need to prepare for different skirmishes along 2023.

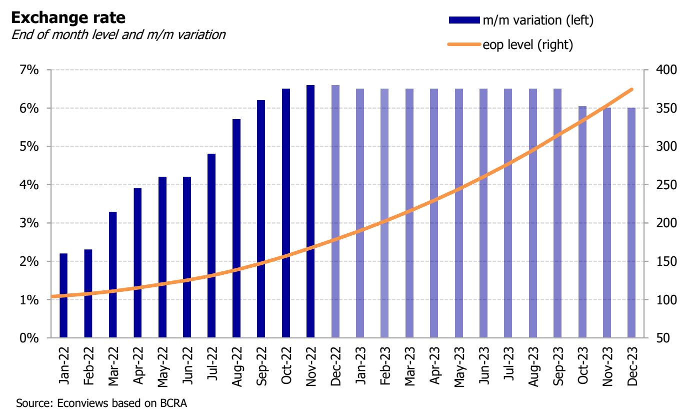
One of the alternatives is that treasury paper owned by investors shrinks and the Central Bank debt increases, which means that there is not an increase in public sector debt, though the Central Bank would become the largest issuer. **This creates a monetary challenge but does not mean an increase in public sector debt.**

Some real depreciation in the cards

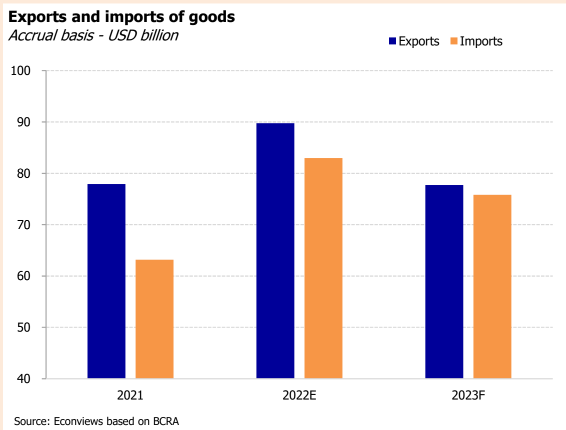
As the government does not have too many dollars to spend in sustaining the exchange rate and there is only so much, restrictions on imports it can present before making the economy collapse, we think that there will be some real depreciation along the year. This would run, in the baseline scenario, under the philosophy of no discrete jumps. **But the dollar would increase 110% along the year, which means that given the international inflation, there would be a (minor) real depreciation for Argentina**.

We have drawn a straight line of depreciation, but this may be more random than we put it. At times the government may feel comfortable depreciating while there will be better months in which the situation could work for holding the dollar quieter, as it is the case in December.



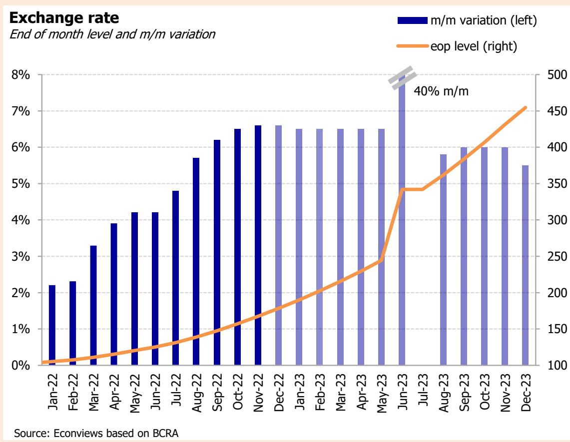


This would allow to maintain a trade surplus in 2023, but considerably lower than 2022's. Exports are expected to shrink as a result of the lower harvest, but also due to lower commodity prices. Imports are also expected to shrink, mainly due to a considerable reduction of energy imports provided the pipeline is finished on time, but also due to slowing economic activity. 2022 will close with a trade surplus of USD 6.8 billion, which we see shrinking to less than 2 billion next year.



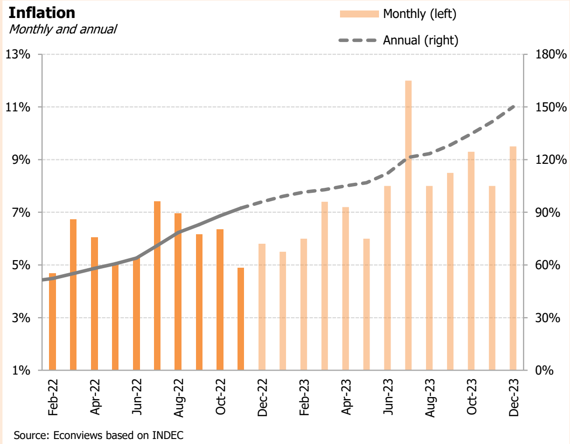
Other scenarios: the case for a tougher economy

What if Argentina does not muddle through? One possible way of thinking in a stressed scenario is one in which the harvest fails big time and soybean and corn production do not surpass 40 million tons each. That would reduce export proceeds by more than USD 8-10 billion. Without that money, imports controls will be harder to implement, as they would have to cut to the bone. In these circumstances, chances are that the government throws the towel and we face a discrete jump in the FX. We think that the shortfall could be somewhat higher in the sense that it would be wise for farmers to hold grain until the next government when they would clearly get a better exchange rate and a lower FX spread. This is something to consider in all scenarios, but in one of abundant harvest, this factor could be dealt with. If the harvest is poor and farmers don't sell, the situation could become really difficult for FX management.



Another possibility would be a devaluation paired with a decoupling of the FX market, in which a financial FX rate would be used for financial operations, tourism, and others, and a lower commercial rate would be established for imports and exports.

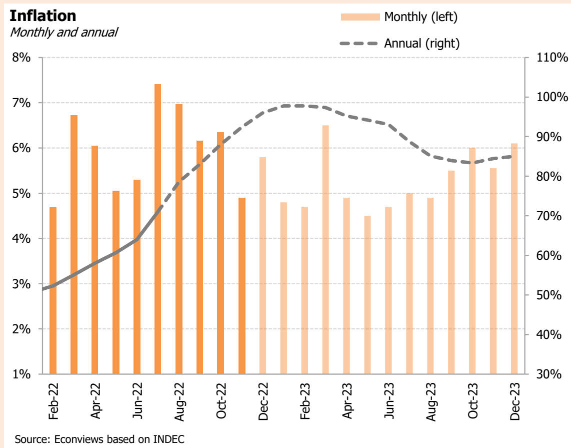
Against this background, inflation is due to increase, as devaluation with no plan tends to imply a much higher passthrough to inflation. This may provide temporary relief for the FX market but would mean a loss for real incomes and therefore economic activity would decline by at least 2%. A 10% reduction in agriculture, livestock and forestry would determine a fall of 0.8% in GDP, but with multiplier effects on transportation and consumption in the interior of the country coupled with the reduction in crushing activity (which is accounted in the manufacturing part of GDP) the effect is at least twice as much. If we add the decline in real salaries, 2% sounds like a benevolent outcome for such a drought.



Another shock to the system can come from the monetary side of things. If the Central Bank has to monetize part of the domestic debt that comes due by acquiring paper in the secondary market and then finance the deficit, it basically implies paying the bills with inflation. Our approach is that in such a scenario demand for money would fall further (i.e., increasing the velocity of circulation) and then generating the same real income decline than through the devaluation descripted above.

The millage that Massa has earned with Cristina Kirchner means that an increased deficit that complicates the monetary and debt situation is not our most likely scenario. **But we don't rule it out and therefore allocate a 20% probability.**

Other scenarios: the magic works and inflation falls



Under no scenario we consider inflation to reach 60% next year. More so, because in the last two months of the years with the prospects of a stabilization plan that aligns relative prices, everyone will try to preempt and increase ahead of the rest. But we do consider a more benevolent scenario in which inflation falls to 85%. In this case real incomes improve at the margin and the economy regains some confidence and output increases by 1.5%.

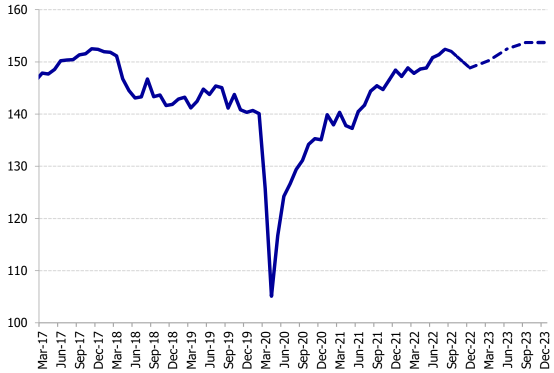
While this is not totally impossible, it has a few loose ends. Lower inflation would probably mean two fiscal problems. Firstly, a slowdown in price increases would make pensions rise in real terms. Considering that pensions represent roughly 40% of primary spending, it seems hard to reduce deficit with the main spending line soaring. Secondly, if inflation was somewhat tamed, it would probably be due to a slow adjustment in regulated prices.

Getting lower inflation, some growth has an implicit confidence recovery that is hard to see even with the euphoria of the victory in the Football (Soccer) World Cup. In the current political scenario, we judge that as very unlikely, and this is why we only allocate 10% probability to this scenario. The government coalition is quite divided with the owner of the votes fighting her own judicial battle and, in theory, out of the electoral game. The president has lost legitimacy and all popular appeal. Finance minister

Massa is the only one pushing from the government side, but his negative image is still quite high, although he is in a better position than a few months ago.

All in, we put our chips in the muddle through scenario, but not considering it as a straight line. There will be times when optimism will rise, and people will allocate more chances to Massa's rationality. At some other points the debt or the dollar situations will take us to doomsday analysis. In the end, we think that rationality to get to the elections in a decent shape will prevail and on the other extreme the challenges are so huge that reality will restrict optimism when it arises. This is why we vote for the middle ground view: zero growth, 110% inflation and just a slim currency depreciation. The opposition in one of its formats is likely to win the 2023 presidential election.

Evolution of economic activity
EMAE, 2004 = 100



Source: Econviews based on INDEC

Base Scenario

	2019	2020	2021	2022 E	2023 E
Inflation (eop)	53.8%	36.1%	50.9%	96.0%	110.0%
Exchange rate ARS/USD (eop)	59.9	84.1	102.8	178.3	374.5
Exchange rate ARS/USD (eop, YoY)	58.4%	40.5%	22.1%	73.5%	110.0%
Real exchange rate ARS/USD (eop, Dec-01=100)	151.5	158.3	137.1	129.9	136.0
Paralell exchange rate ARS/USD (eop)	74.6	140.3	203.1	347.7	636.6
Spread with official exchange rate (eop)	24.6%	66.8%	97.7%	95.0%	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	4.3	5.1
Policy rate (eop)	55.0%	38.0%	38.0%	75.0%	80.0%
GDP (YoY)	-2.0%	-9.9%	10.4%	5.5%	0.0%
Formal wages in real terms (aop, YoY)	-6.0%	-1.9%	0.4%	0.0%	-0.5%
Primary result (% GDP)*	-0.2%	-6.4%	-3.3%	-2.8%	-2.5%
Fiscal result (% GDP)*	-3.6%	-8.4%	-4.8%	-4.1%	-4.1%
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%	-1.2%	-0.5%

Source: EconViews

*Excludes rents from primary debt issuance in 2022

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