BBVA Research

Argentina Economic Outlook

October 2022

Creating Opportunities

Main messages. Global

Recent developments

Growth is weakening after a relatively positive 1H2022. Commodity prices and supply bottlenecks are easing, but in Europe gas prices have skyrocketed on Russia's supply cuts. Inflation remains high and keeps surprising upwards despite some moderation signs, driving central banks to tighten monetary conditions faster and more aggressively than expected, which has increased financial volatility and reinforced recession fears. Uncertainty remains high, mainly on the Ukrainian war.

Macro outlook (I)

The outlook is now more negative given prospects of higher inflation, tighter for longer monetary policy and weaker growth than expected.The Fed's front-loaded tightening (US rates are likely to reach 4.75% and stay at that level till 2024) paves the way for weaker growth and, probably, a mild recession by mid-2023. The ECB is likely to hike rates to 2.75%, which together with very high gas prices will set the conditions for (soft) falls in Eurozone GDP over the next few quarters, but inventories, saving measures and flows from alternative sources should prevent large gas shortages.

Macro outlook (II)

Global growth is forecast to ease sharply from 6.2% in 2021 to 3.2% (-0.2pp in comparison to previous forecasts) in 2022 and 2.4% (-0.1pp) in 2023. Inflation will ease gradually as demand weakens, monetary conditions are tightened and the effects of ongoing shocks wane ahead, but will remain high, well above the target at least until 2024.

Risks

The main risk is that inflation pressures require even larger interest rate hikes, pushing the global economy into a deep recession and increasing the odds of financial turmoil. Other downside risks include a further deterioration of the war in Ukraine (which could create significant energy shortages in Europe) or other geopolitical tensions, and a hard-landing in China.

Main messages. Argentina

IMF Program

The IMF Board approved the second review of the program with an evaluation of the 2Q22 targets, despite the non-compliance with the international reserves target. The decision of the IMF Board is awaited for the disbursement of USD 3.8 billion. Thanks to the "soybean exchange rate" (a different FX rate for the soybean sector) and the control of the fiscal and monetary issuance, the 3Q22 targets could also be met.

Fiscal results

In order to get closer to the target set with the IMF, Minister Massa has implemented a series of fiscal measures. However, we estimate that they will be insufficient, leaving a primary deficit of 2.8% of GDP in 2022 and 2.5% of GDP in 2023.

Monetary issue

Faced with stress in the peso debt market during June and July, the CB acted to stabilize the price of Treasury bonds by issuing 30% of the monetary base, which it has in turn sterilized by increasing its interest-bearing liabilities. This increase in the monetary overhang reduces the CB's room for maneuver with respect to the interest rate.

Inflation

Inflation accelerated sharply in the last 3 months and averaged 6.6% MoM. In response, the CB raised interest rates from 52% to 75%, a stronger monetary tightening than expected. We believe that there will be a further rate hike to 78% in October, after the September inflation figure is released (BBVAe: 6.6% MoM). We revise our 2022 forecast upward from 95% YoY to 97% and we expect inflation to reach 105% in 2023.

Main messages. Argentina

Exchange rate

In order to purchase international reserves, during September the CB implemented a differentiated exchange rate (more depreciated than the official exchange rate) for exporters of the soybean sector. This way, the CB was able to buy USD 5 billion in the month. In addition, a special FX rate for tourism and another for cultural events were introduced in October, deepening a multiple FX rate scheme.

Activity

In 2Q22, GDP performed better than expected (+1.0% QoQ s.a.) in the absence of sharp monetary and exchange rate corrections, but with great heterogeneity in the different productive sectors. We revise our GDP forecast for 2022 upward (from 2.5% to 4%) and maintain the contraction scenario for 2023 (-1.0%) under the assumption that the government will not manage to dissipate the uncertainty and will maintain its attitude of avoiding abrupt corrections of the imbalances.

Employment

The unemployment rate remains at very low levels (6.9% in 2Q22) but masks the poor quality of labor market hiring conditions. The proportion of informal workers reached its highest point in recent years while the proportion of formal workers continues to fall.

External sector

The trade balance is affected by commodity prices from opposite sides: on the one hand, the high price of agricultural products is driving exports in a sustained way, but on the other hand, the jump in energy prices is triggering imports. We expect the trade balance to reach USD 7.1 billion in 2022 and USD 6.1 billion in 2023.

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Global Economic Outlook October 2022

Creating Opportunities

A further deterioration of macroeconomic prospects: higher inflation, tighter monetary policy and weaker growth than previously expected

BBVA RESEARCH CENTRAL SCENARIO: MAIN ASSUMPTIONS AND IMPACTS

MONETARY TIGHTENING
Interest rates remain higher for longer as central banks remain committed to low inflation

DISRUPTIONS IN GAS MARKETS
Russia's supply cuts keep prices close to current levels, but saving measures, flows from alternative sources and inventories prevent large shortages

COMMODITIES (EX-GAS)
Prices decline on decelerating global demand, but supply restrictions keep prices relatively high

SUPPLY BOTTLENECKS
Bottlenecks continue to ease gradually as the effects of ongoing shocks wane away

SHARP GROWTH SLOWDOWN
Global growth is forecast to ease sharply from 6.2% in 2021 to 3.2% (-0.2pp) in 2022 and 2.4% (-0.1pp) in 2023. Mild recessions in the Eurozone, due to gas disruptions, and in the U.S., due to interest rate hikes. Low growth, but no hard-landing in China.

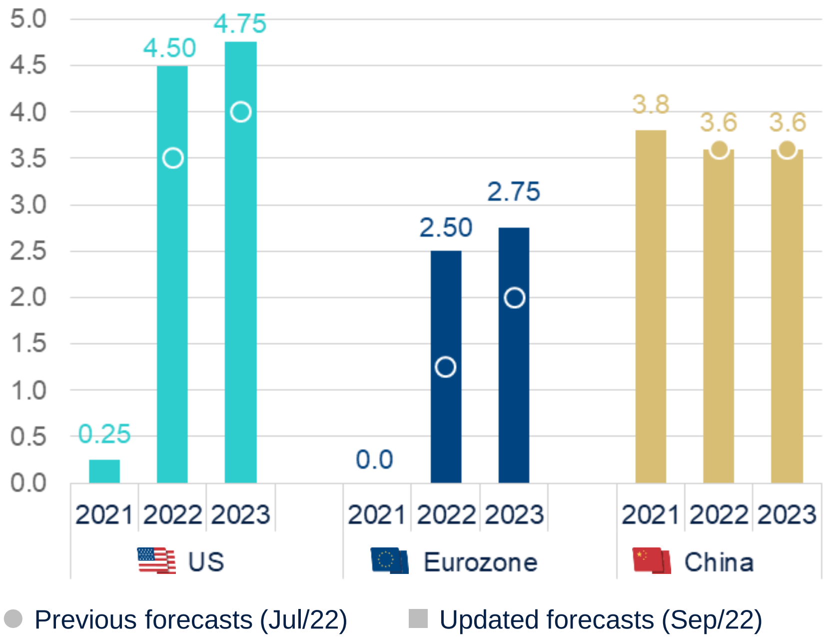
INFLATION MODERATES SLOWLY
It remains above targets at least till 2024, but eases from 2023 as current shocks lose steam, monetary tightening reigns on expectations and no significant second-round effects emerge.

FINANCIAL VOLATILITY
Strong dollar, high risk premia, capital outflows from EM.

Central banks will keep the focus on inflation despite increasing signs of growth weakening: interest rates will remain higher for longer

MONETARY POLICY INTEREST RATES*

(%, END OF PERIOD)



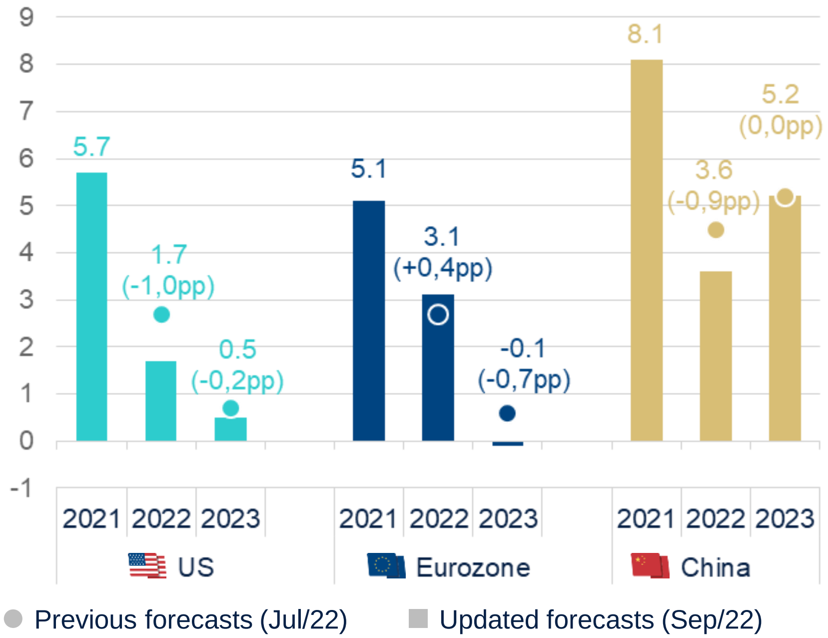
* In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- The Fed is likely to raise rates to 4.75%, and to keep them at that contractive level till the end of 2023 in order to engineer a slowdown of the economy, and of labor markets in particular, for inflation to converge to 2%.
- The ECB is expected to hike refi rates to 2.75%, well above neutral levels, pressured by high inflation and a more aggressive Fed, and despite the bleak growth prospects.
- Fiscal policy will be more supportive in the EZ than in the US, mostly through NGEU funds and the suspension of fiscal rules until 2023.
- In China, policies are expected to continue exhibiting a moderately expansionary tone.

Global growth will ease significantly ahead on price pressures, rising interest rates, gas disruptions in Europe and idiosyncratic problems in China

GDP: ANNUAL GROWTH IN REAL TERMS

(%)

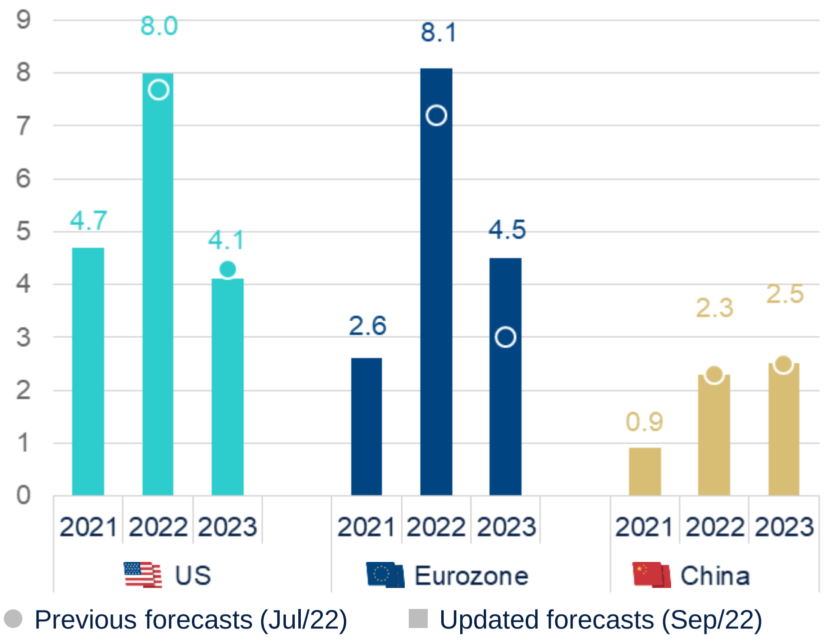


* Forecast change in parentheses.
Source: BBVA Research.

- In the US, growth is revised downwards on (surprising) GDP contractions over 1H22 and higher Fed rates; a recession coupled with a labor market easing is likely by mid-2023.
- In the EZ, positive incoming data supports an upward revision of 2022 growth, but a sharper easing ahead is expected on gas disruptions and higher rates; a recession is likely over the next few quarters.
- Recessions in the US and the EZ are set to be mild given the relative strength in balance sheets of households, firms and banks.
- In China, 2022 growth revised down on the impact of new covid waves and real estate tensions; a recovery is expected in 2023.

Inflation will remain high (more than expected) and well above central bank targets, but is still forecast to trend downwards from 2023 onwards

INFLATION:CPI
(Y/Y %, PERIOD AVERAGE)



Source: BBVA Research.

- Inflation forecasts are revised to the upside, in line with evidence of more widespread and more frequent price adjustments and, in the case of the Eurozone, with prospects of higher gas prices and a weaker Euro.
- Still, recent moderation signs (mainly in the US), reinforce the view that inflation will ease ahead as current shocks lose strength and monetary conditions continue to be tightened.
- While inflation's convergence to the target will take a relatively long time, expectations are forecast to remain broadly anchored.
- Growth deceleration is expected to reduce the room for relevant wage increases, making significant second-round effects unlikely.

Risks: in the current context , a sharper slowdown in global growth and financial turmoil episodes cannot be ruled out

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

PERSISTENT INFLATION
Second-round effects, new shocks or policy mismanagement could further spur inflation, requiring higher interest rates

UKRAINE WAR AND GEOPOLITICS
A deterioration of the war and new geopolitical conflicts; significant gas shortages in Europe are among the main risks

HARD-LANDING IN CHINA
“Zero-covid” policy coupled with real estate tensions and other local problems could pave the way for weaker growth in China

SOCIAL TENSIONS AND POPULISM
Macro weakness, political polarization, among other reasons, could trigger social unrest and populist policies

SHARPER GROWTH DECELERATION
Global growth could decelerate faster and more significantly than expected, increasing the odds of a global recession

FINANCIAL TURMOIL
Higher policy rates and risk aversion could trigger financial crises, in particular in debt and EM markets

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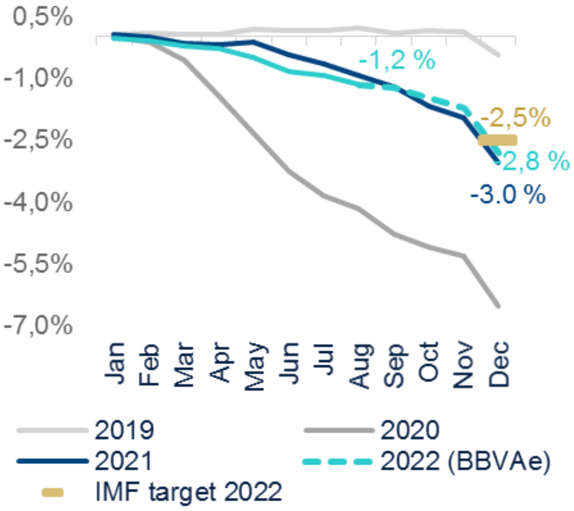
Argentina Economic Outlook

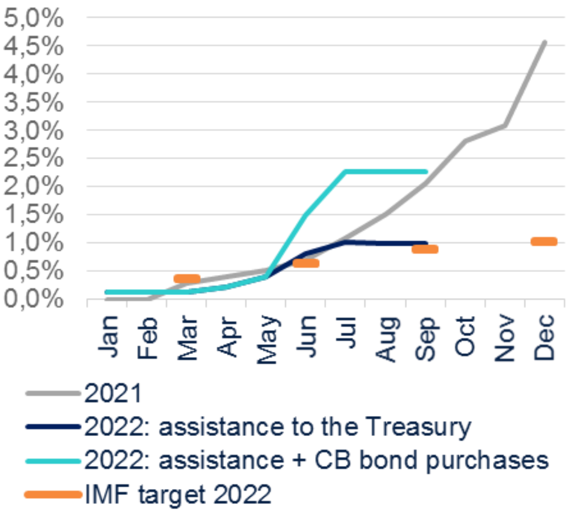
Creating Opportunities

The government's objective after the changes of the Minister of Economy is to contain the deviations from the IMF program without applying shock policies

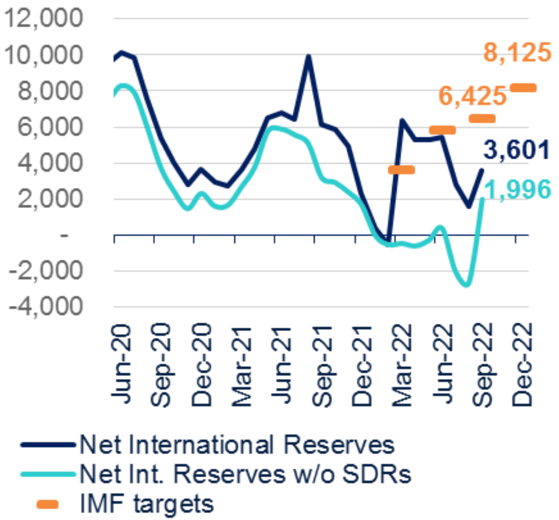
PRIMARY FISCAL BALANCE
(YEAR TO DATE, % GDP)



MONETARY ASSITANCE TO THE TREASURY (% GDP)



NET INTERNATIONAL RESERVES
(USD MILLIONS)

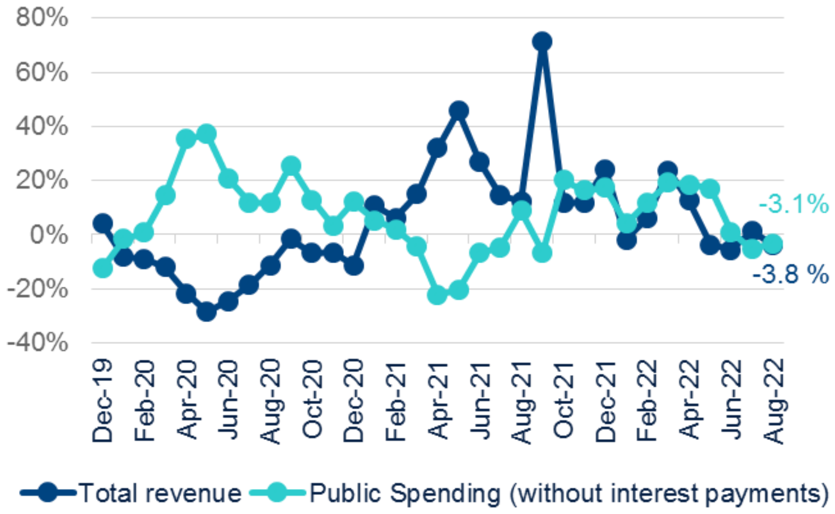


Source: BBVA Research, BCRA, Ministry of Economy and IMF.

The IMF staff approved the second review of the Program (2Q22 targets), even though the international reserves target was not met. The 3Q22 targets were probably met and its examination by the IMF staff will take place in December.

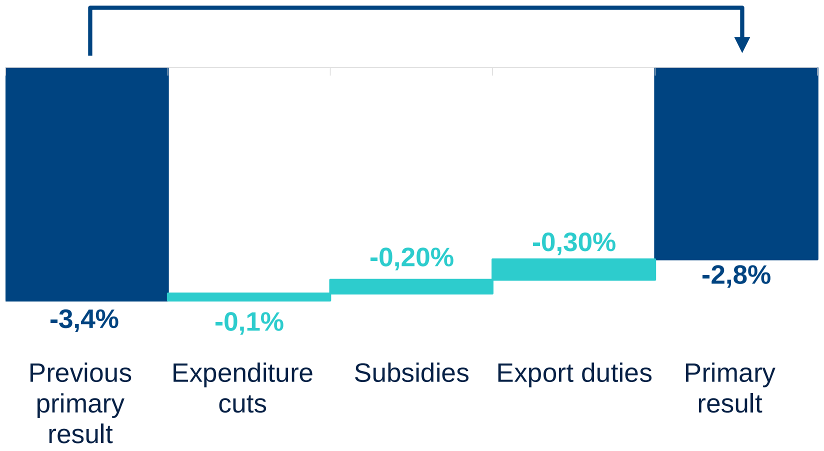
The new Minister of Economy's has more political power than his predecessors to carry out a fiscal adjustment to contain the deterioration of the economy

TAX REVENUE AND EXPENDITURE
(YOY % CHANGE IN REAL TERMS)



Source: BBVA Research, Ministry of Economy.

PRIMARY BALANCE: NEW FORECAST 2022
(% GDP)

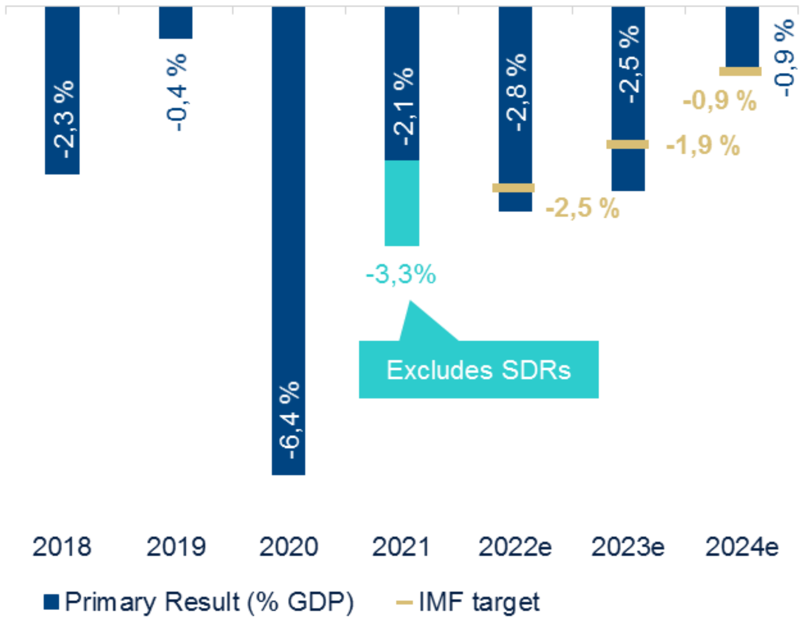


Source: BBVA Research, Ministry of Economy.

Payments to suppliers are postponed, public works are slowed down and Ministries' budgets are cut. The reduction of subsidies will have little impact in 2022 (0.2% of GDP). Revenue collection is slowing down due to the weakness of economic activity in 2H22, but export duties increased in September due to the "soybean dollar" (approx. 0.3% of GDP).

This adjustment would slow down in 2023 due to higher electoral spending and lower tax revenue resulting from the economic contraction

FISCAL RESULT
(% GDP)

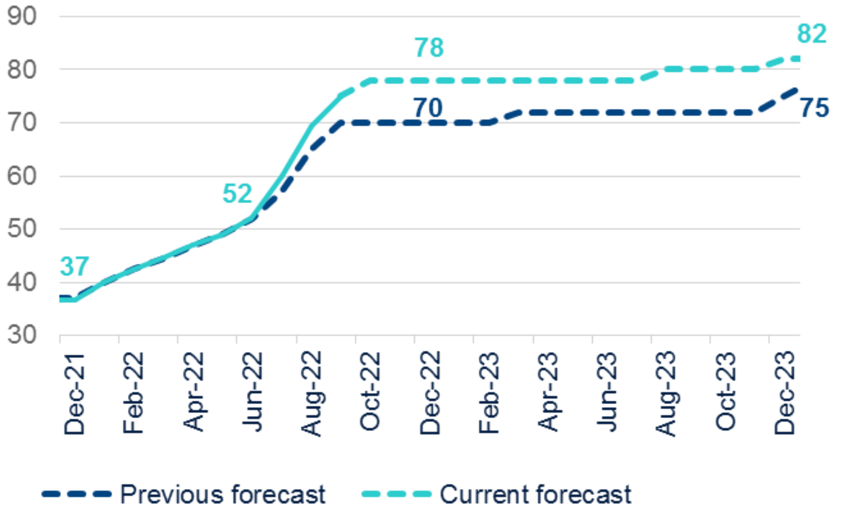


Source: BBVA Research, Ministry of Economy.

- We forecast a primary deficit of 2.5% in 2023 and 0.9% in 2024.
- Utilities prices increase will have its full impact in 2023 and will allow a cut in subsidies of 1% of GDP. However, there will be other discretionary expenditure in view of the presidential elections that will counteract this effect, moving away from the IMF target.
- A context of higher inflation will continue to erode government liabilities and increase revenues, albeit in a limited extend due to the expected drop in the level of activity.
- In 2024, after the elections, we expect a policy shift toward fiscal consolidation.

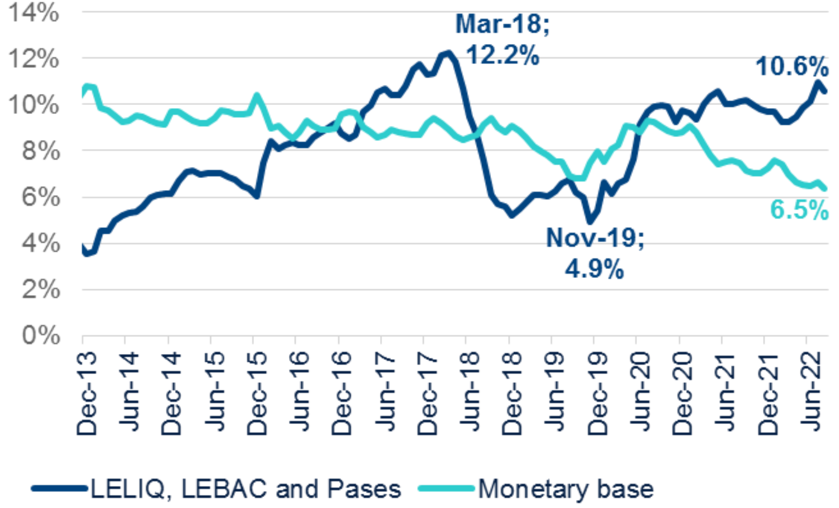
Along with fiscal restraint, interest rates increased to values which are closer with the expected inflation

MONETARY POLICY RATE
(% ANNUAL RATE)



Source: BBVA Research and BCRA.

INTEREST-BEARING LIABILITIES CB AND MONETARY BASE (% GDP)

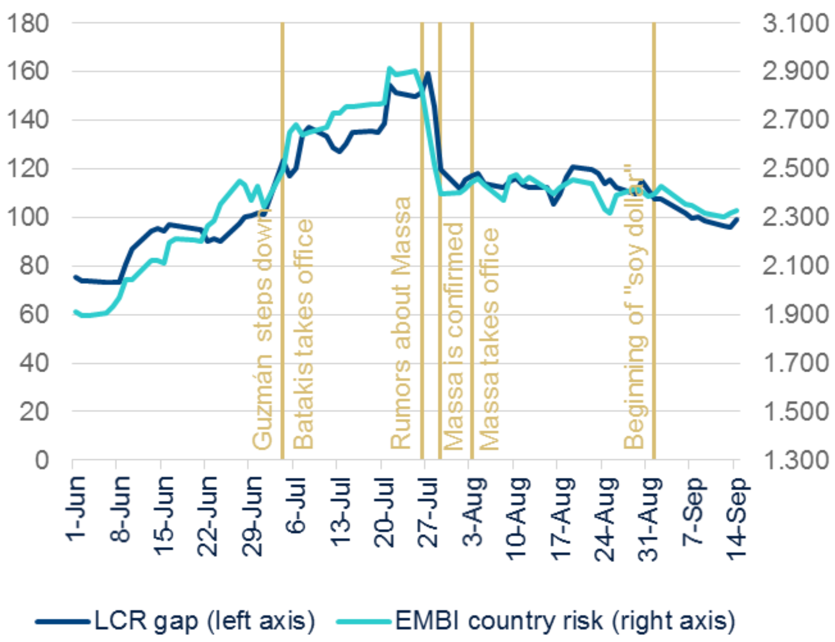


Source: BBVA Research and BCRA.

We expect the Central Bank to continue to tighten the monetary policy rate to 78% by December 2022, but its balance sheet vulnerability limits further interest rate increases.

The government implemented a differentiated exchange rate for soybean exporters, which opens the door to a multiple FX regime

RISK INDICATORS
(EXCHANGE RATE GAP IN %; EMBI IN BP)

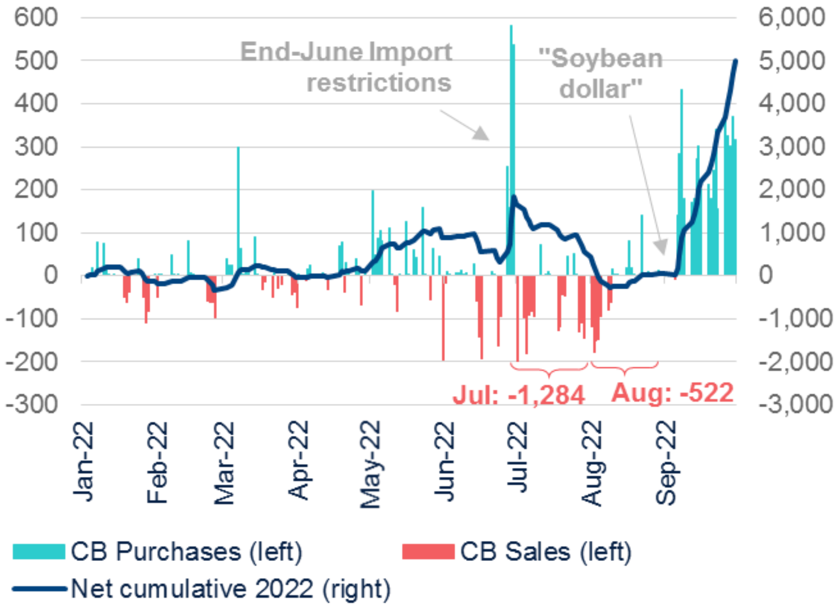


Source: BBVA Research and HAVER.

- In order to restore international reserves, the CB implemented a differentiated exchange rate for exporters of the soybean sector ("soybean dollar"), 43% above the official rate solely during September.
- This measure increases the likelihood of establishing a multiple FX rate system since other sectors will demand the same treatment (this could also be implemented through differential taxes). But it may not extend to the sectors that have the greatest impact on inflation.
- However, the chances of the scheme failing and of an FX rate jump remain high.

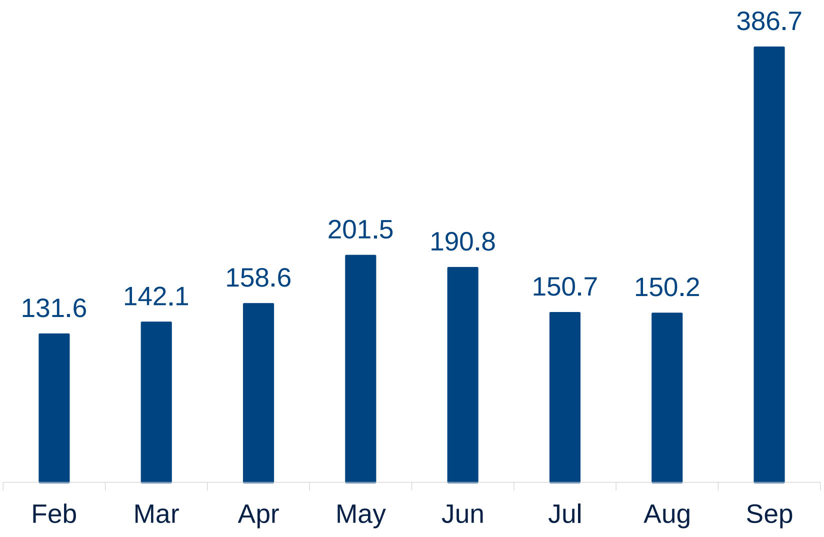
The implementation of a different FX rate for the soybean sector would help to meet the target agreed on with the IMF for the 3Q22

DAILY BCRA FX EXCHANGE TRADING ON THE OFFICIAL EXCHANGE MARKET (USD MILLION)



Source: BBVA Research and BCRA.

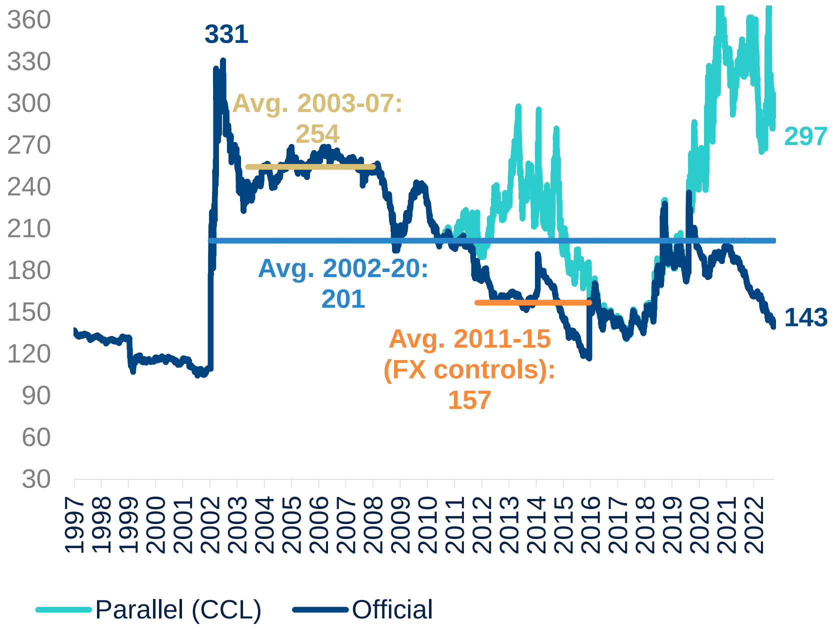
EXPORT SETTLEMENT FROM THE SOYBEAN SECTOR (DAILY AVERAGE)



Source: BBVA Research and Cámara de Exportadores.

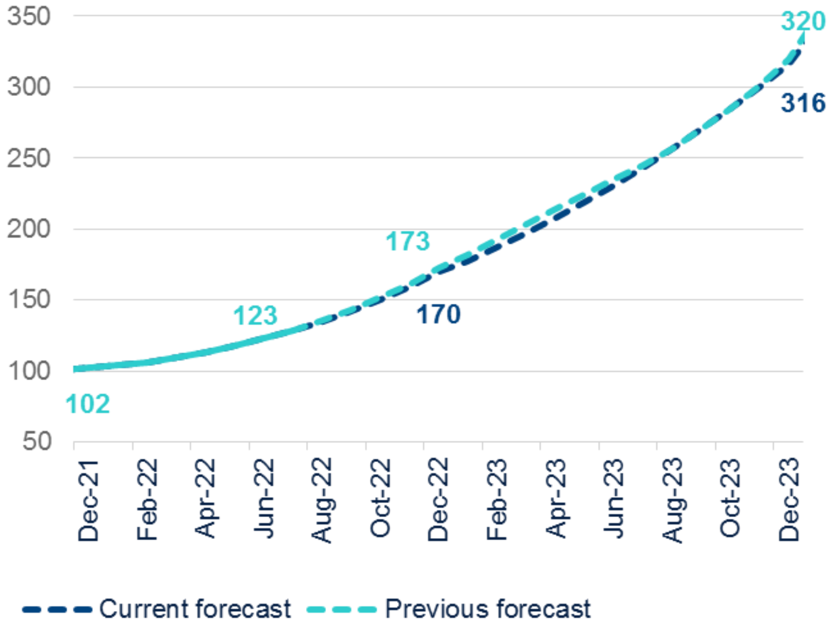
The recent acceleration in the FX depreciation rate leads us to adjust our 2022 and 2023 annual forecast for the official exchange rate

REAL OFFICIAL AND PARALLEL FX RATE (CCL)
(PESOS PER DOLLAR, AT CURRENT PRICES)



Source: BBVA Research and BCRA.

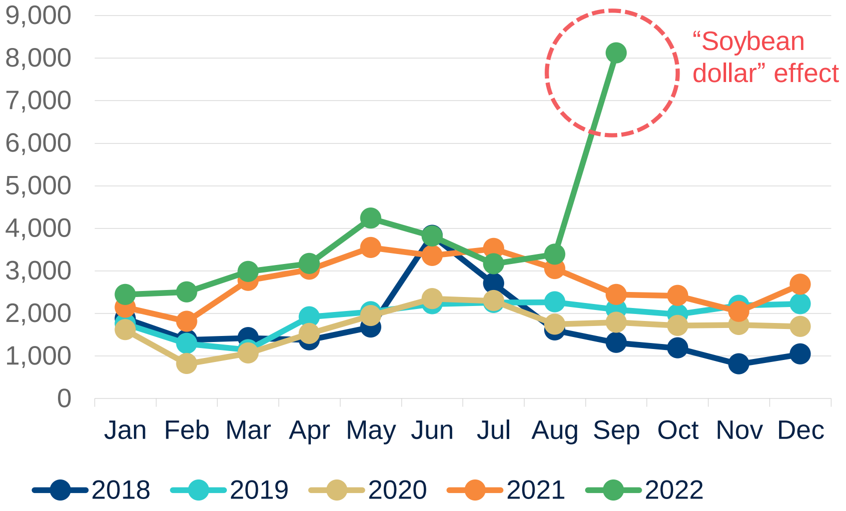
NOMINAL OFFICIAL FX RATE
(PESOS PER DOLLAR)



Source: BBVA Research and BCRA.

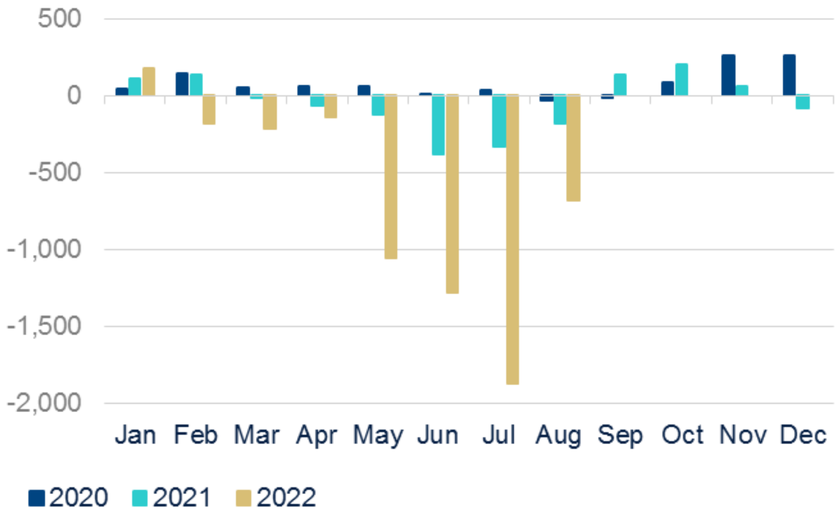
The "soybean dollar" allowed for extraordinary export revenues in September, while energy imports declined

EXPORTER SETTLEMENT
(MILLIONS OF DOLLARS)



Source: BBVA Research and CIARACEC

ENERGY BALANCE (EXPORTS – IMPORTS)
(MILLIONS OF DOLLARS)

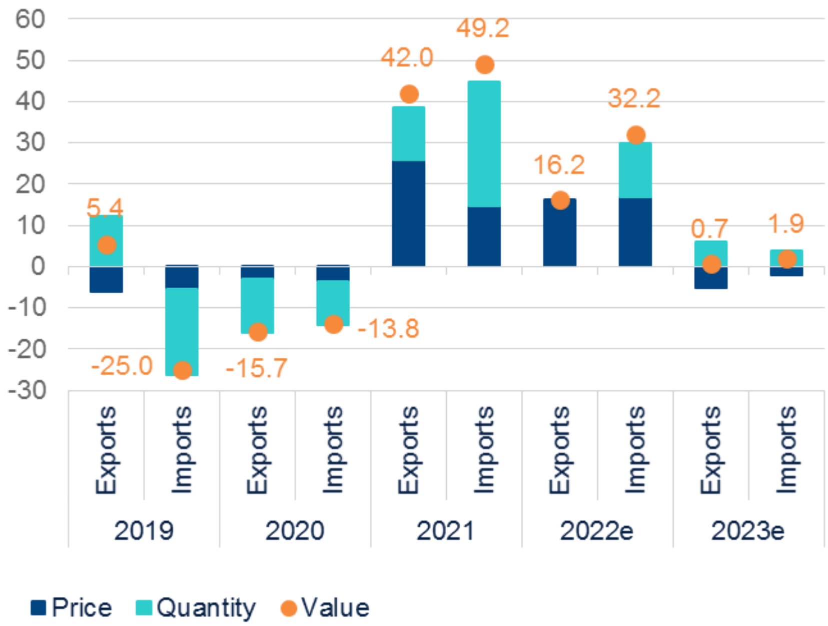


Source: BBVA Research and INDEC.

The differential exchange rate for the soybean sector (which represents 27% of total exports) allowed the normalization of settlement that had been delayed since 2Q22, obtaining an additional USD 6.0 billion.

In 2023 we estimate a slight correction in commodity prices but they will remain high in historical terms, maintaining a trade surplus of USD 6.1 billion

EXPORTS AND IMPORTS PRICE, QUANTITY AND VALUE (% YOY CHANGE)

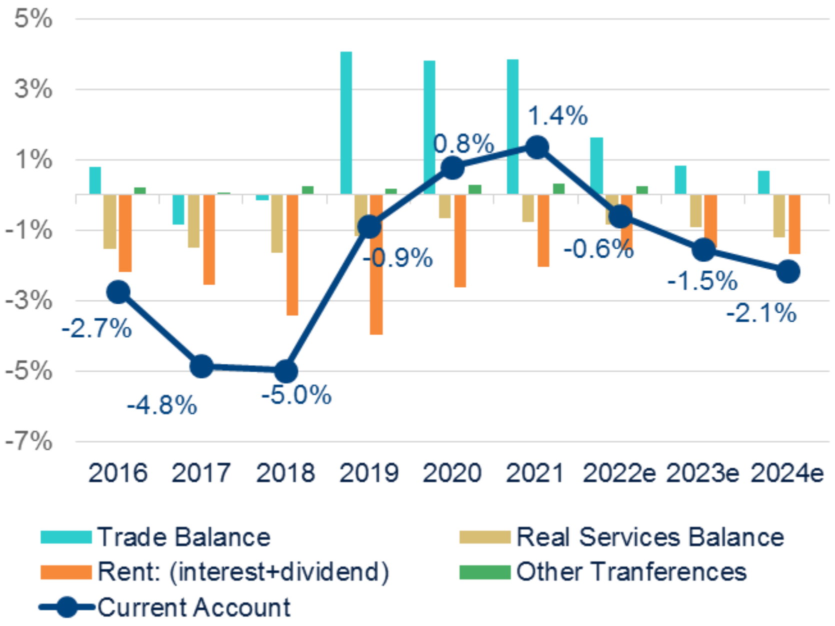


Source: BBVA Research and INDEC.

- In 2022, the trade balance will be around USD 7.1 billion because, despite high agricultural prices, imports remain strong.
- The quantities exported will have little dynamism since we do not expect jumps in agricultural supply or in other export sectors.
- Imports will remain restricted due to lower economic activity and import controls.

The current account will accelerate its deterioration due to a lower contribution from trade and a larger deficit in real services

CURRENT ACCOUNT AND COMPONENTS
(% GDP)

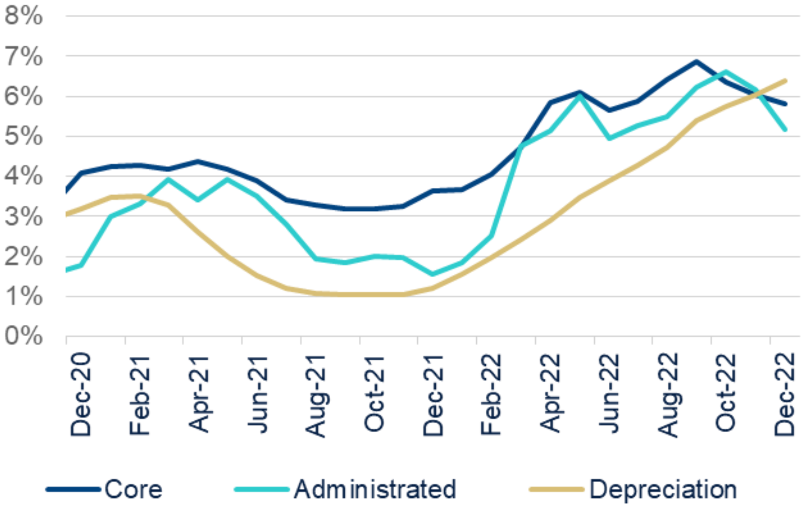


Source: BBVA Research and INDEC.

- The current account will reach -1.5% in 2023: the lower contribution of trade will be coupled with a larger tourism deficit.
- Foreign travel increased when mobility restrictions ended, and it may continue to rise as FX restrictions are lifted.
- Interest rates remain limited in terms of GDP, as well as the remission of profits and dividends, the former as a result of the rescheduling of maturities and the latter due to restrictions in the FX market.

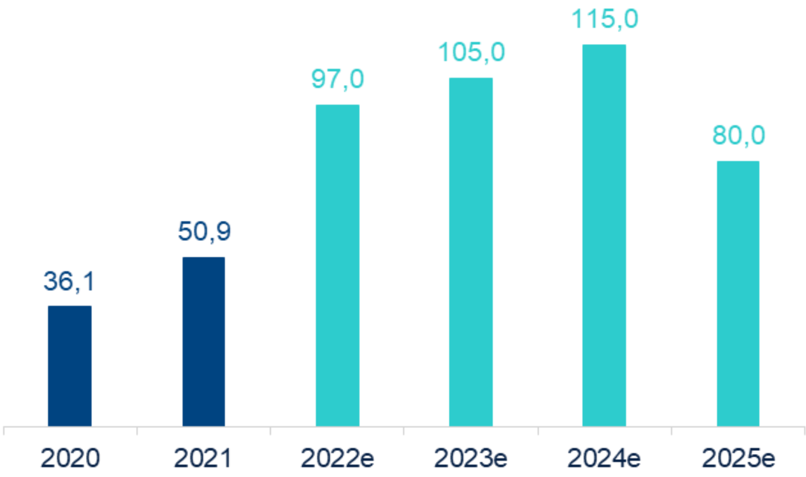
The strength of the inflationary process leads to a scenario of price increases of over 100% in 2023-24

CORE CPI, ADMINISTRATED CPI AND DEPRECIATION
(% MOM CHG.; 3M MOVING AVG.)



Source: BBVA Research and INDEC.

ANNUAL INFLATION RATE
(% YOY CHG.)

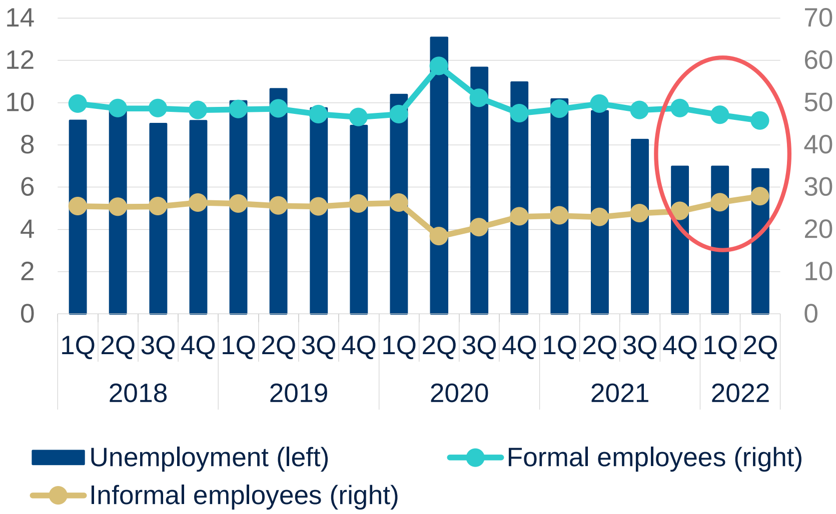


Source: BBVA Research and INDEC.

The persistence of strong inflationary inertia and the recent dynamics of high-frequency data lead us to raise our inflation forecast for 2022 from 95% to 97%, implying a monthly average of 5.9% for the rest of the year. We maintain our forecasts of 105% for 2023 and 115% for 2024

The low unemployment rate hides weak labor conditions and falling real wages

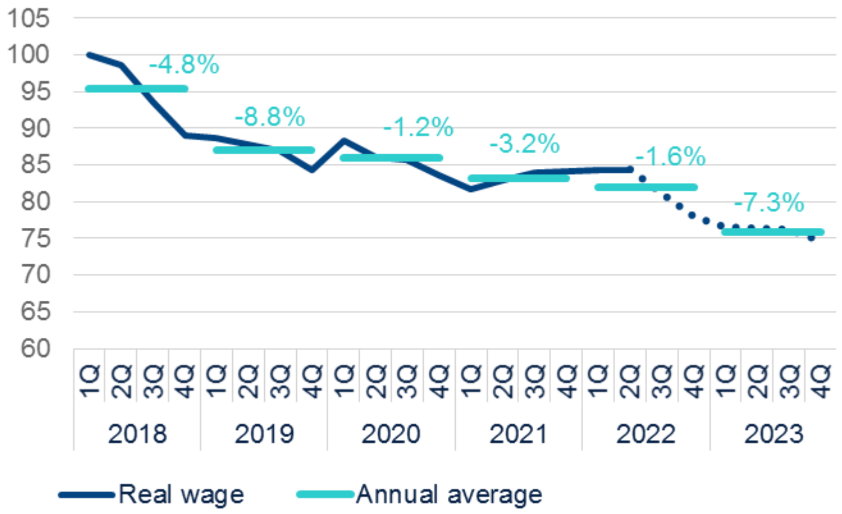
UNEMPLOYMENT RATE AND PROPORTION OF FORMAL AND INFORMAL EMPLOYEES (IN %)



Source: BBVA Research and INDEC.

REAL WAGES

(BASE 1Q'18 = 100; CHANGES IN % YOY)

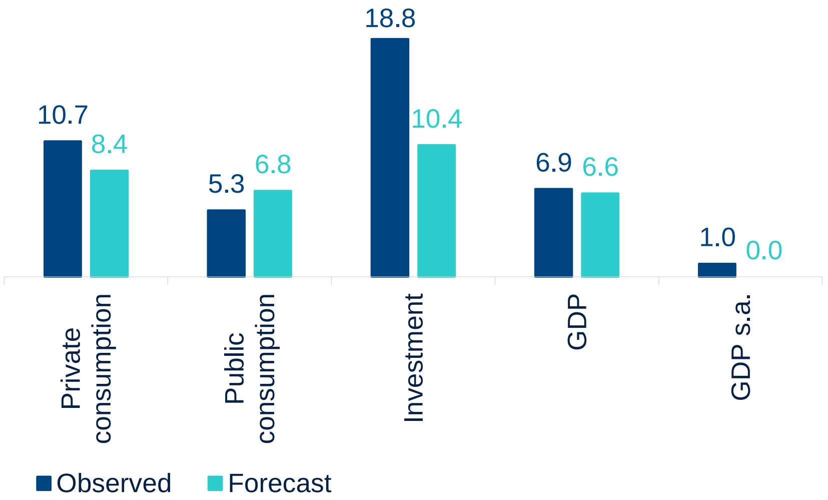


Source: BBVA Research and INDEC.

The low unemployment rate is explained by the fact that social plan beneficiaries are included among the employed. The decreasing proportion of formal employees reflects the worsening of labor contracting conditions.

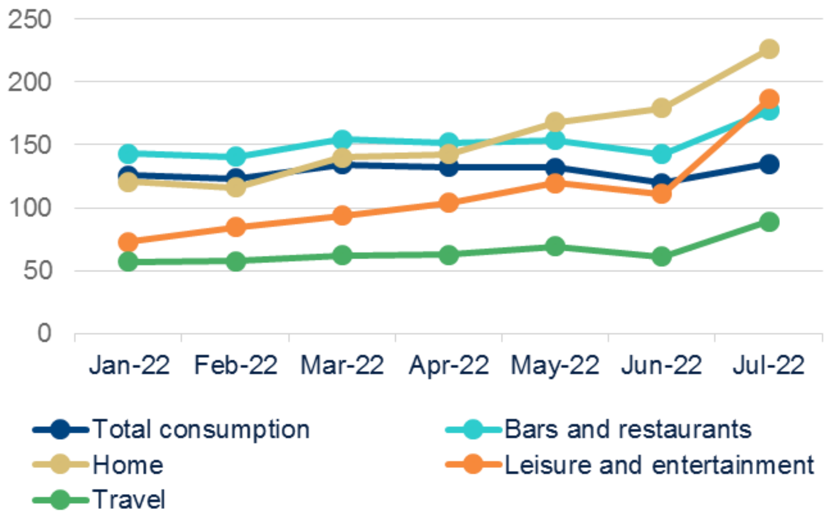
Economic activity in the 2Q2022 performed better than expected, driven by purchases of durable and non-durable goods

GDP, CONSUMPTION AND INVESTMENT
(% YOY CHANGE; S.A. GDP IN % QOQ CHANGE)



Source: BBVA Research, INDEC AND Focus Economics.

CONSUMPTION WITH BBVA CARDS
(AVERAGE BASE 2019 = 100)



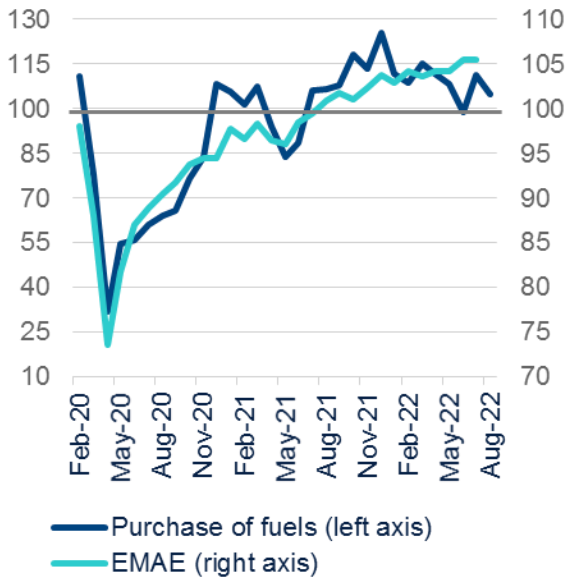
Source: BBVA Research and INDEC.

The high levels of inflation and the FX rate gap drove both types of consumption: durable goods (as an alternative to dollarization) and non-durable goods (due to the rapid depreciation of the peso).

Contractionary signals and adverse expectations are ahead, but positive 2Q data leads us to raise our 2022 growth forecast

FUEL CONSUMPTION AND ECONOMIC ACTIVITY (EMAE)

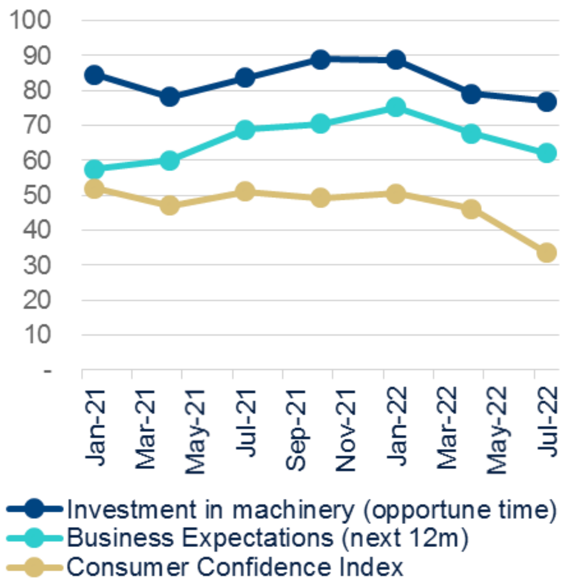
(AVG. 2019 = 100; Q OPERATIONS; S.A.)



Source: BBVA Research and INDEC.

INVESTMENT EXPECTATIONS

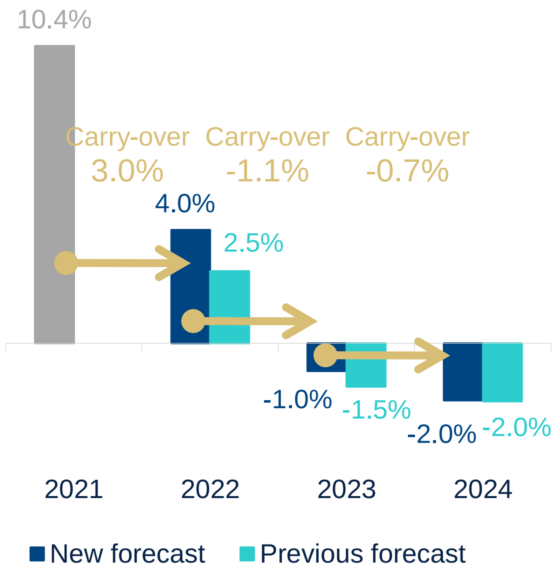
(CCI BASE 100 = HISTORICAL AVG.; INVESTMENT AND EXPECTATIONS IN % OF COMPANIES)



Source: BBVA Research, UIA and UTDT.

GROWTH AND STATISTICAL CARRY-OVER

(% YOY CHANGE)

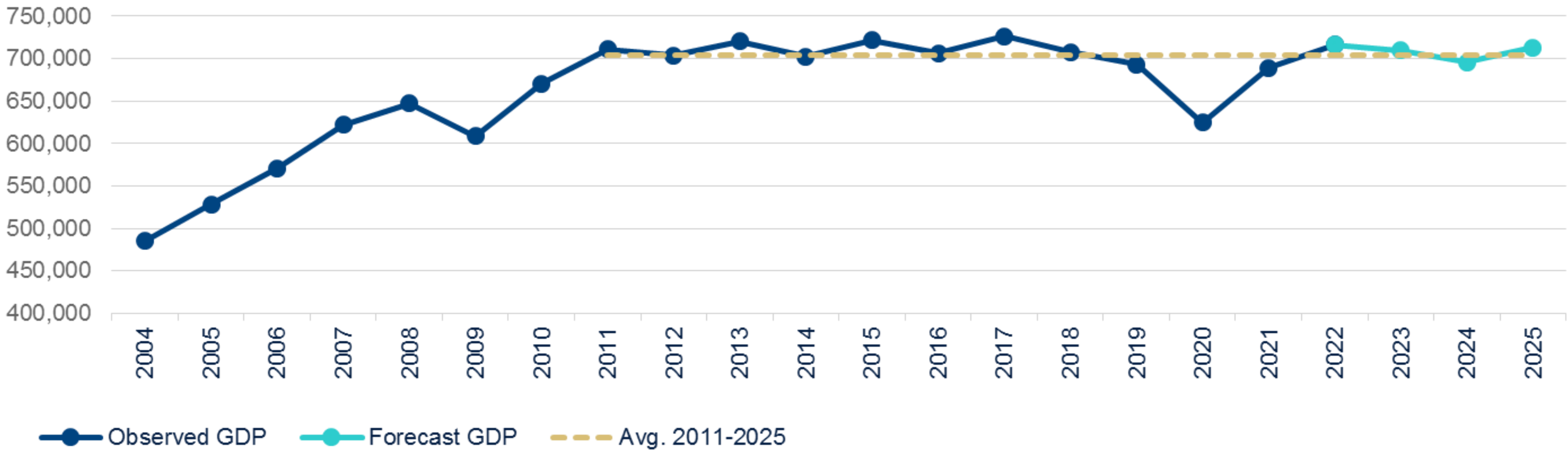


Source: BBVA Research and INDEC.

However, structural solutions are needed to achieve a sustained growth path for the future

GDP PERFORMANCE

(BASE 2004 = 100; IN MILLIONS OF PESOS)

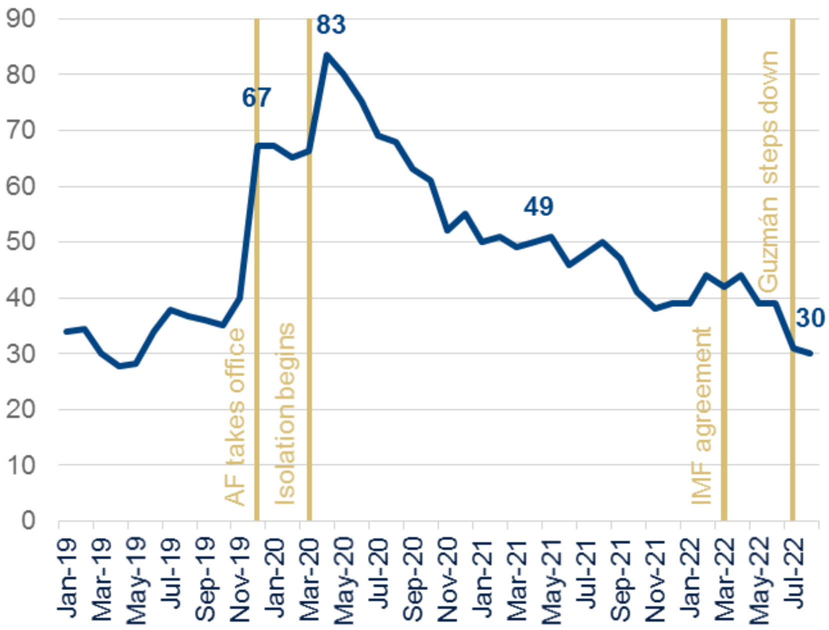


Source: BBVA Research and INDEC.

For more than a decade, Argentina's real GDP has been stuck in a unsteady path that reflects the difficulty of implementing structural measures to boost sustained growth. Only a rigorous policy change would make this possible.

All the macroeconomic challenges that the government must face are taking place in a context of low public approval

GOVERNMENT APPROVAL RATING
(IN %)



Source: BBVA Research and Poliarquía.

- The prolongation of the economic crisis triggered by the COVID-19 pandemic (in the midst of a recession that began in 2018) continues to erode the image of the ruling coalition — and, in particular, that of President Alberto Fernandez (AF).
- There is a feeling of distrust toward the current administration in the resolution of macroeconomic imbalances, which results in a lack of investment for sustained growth.
- A greater depth of adversity in the current context could increase expectations of a substantial change in policies around 2024 to address the main economic problems.

The risk areas for 2023 are mainly domestic, in terms of debt rollover in the local market and in terms of the exchange rate

Debt

In 2023, the government will face challenging maturities of peso-denominated debt for rollover (especially during March and July, above ARS 1 billion). If this is not done successfully, the government could expand the BCRA's financing, thereby pushing inflation and putting pressure on the FX rate.

BCRA

The CB's balance sheet could suffer from the need to sterilize the expansion of the monetary base through its interest-bearing liabilities (Leliq and REPOs). A significant increase in interest rates would exacerbate the quasi-fiscal deficit, putting the BCRA in a highly vulnerable situation and reducing the margin for private sector credit expansion.

IMF

A potential breach of the program established with the IMF would deepen the imbalances pending resolution. Considering that the agreement is lax and that the government is having some difficulty complying with it, an abandonment of the agreed targets would lead to greater controls in the FX market and higher inflation.

Soybeans

The fall in soybean prices could affect foreign currency inflows, in addition to the likelihood of a poor agricultural season due to weather conditions (low water reserves). Lower foreign currency inflows may result in a breach of the exchange targets with the IMF and in a more serious crisis in the balance of payments.

Oil

A spike in oil prices could wipe out the already narrow trade surplus by preventing genuine foreign currency inflows into the country, putting further pressure on the CB's reserves and further straining the balance of payments.

Macroeconomic Forecasts

	2020	2021	2022f	2023f	2023f
Gross Domestic Product (% YoY)	-9.9	10.4	4.0	-1.0	-2.0
Inflation (% YoY eop)	36.1	50.9	97.0	105.0	115.0
Exchange Rate (vs USD eop)	82.6	101.9	173.0	320.0	705.0
Monetary Policy Rate (% eop)	37.1	36.7	78.0	82.0	78.0
Private Consumption (% YoY)	-13.7	10.0	8.9	-0.2	-4.4
Public Consumption (% YoY)	-1.9	7.1	2.8	-0.4	-4.3
Private Investment (% YoY)	-13.0	33.4	12.9	-3.5	7.0
Primary Fiscal Balance (excl. SDRs, % GDP)	-6.4	-3.0	-2.8	-2.5	-0.9
Current Account Balance (% GDP)	0.8	1.4	-0.6	-1.5	-2.1

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