BBVA Research

Argentina Economic Outlook

June 2024

Creating Opportunities

Global. Main messages

Recent developments

A very soft landing so far. Growth has surprised upwards and inflation has halted its downward trend, mostly due to the service sector dynamism. With fiscal policy to some extent offsetting the contractionary impact of monetary tightening, the room for central banks cutting interest rates has declined. Still, financial volatility remains low.

Growth outlook

Growth will weaken in the next few quarters and recover somewhat in 2025. In the US, 2024 growth was revised up, but a soft-landing, with weaker demand and labor markets, is still expected. In the Eurozone, a cyclical recovery is expected to gain momentum ahead. In China, despite positive incoming data and increasing stimuli, structural challenges will eventually drive growth down.

Inflation and rates outlook

The ECB has started cutting interest rates, but the Fed will wait more than anticipated to launch its easing cycle. Domestic demand will eventually weaken, paving the way for further disinflation and rate cuts. However, inflation concerns will not fully subside and, therefore, interest rates are likely to remain at contractionary levels.

Risks

If activity doesn't weaken due to the dynamism of the services sector and/or a manufacturing recovery occurs, inflation converging to 2% would be at risk. In the current geopolitical context, new supply shocks could also prevent inflation from slowing. All this would leave little room for lower interest rates.

Key points. Argentina

Political outlook

Six months after taking office, Javier Milei's government maintains high levels of public approval, mainly thanks to the fact that it is beginning to show results in terms of inflation, but its agenda of structural change met with resistance in Parliament. However, the “Base Law” has been passed by the Senate (after several changes).

Fiscal balance

The fiscal equilibrium is the cornerstone of the economic program. The government has achieved faster and higher surpluses than expected. The challenge now is to make this dynamic sustainable in the future, replacing distortionary taxes and consolidating expenditure cuts.

Inflation

Inflation has been on a solid downward path from the peak of 25.5% m/m in December 2023 to 4.2% in May. Remaining relative price adjustments will slow down the decline in inflation going forward, which we project to end at 140% y/y in 2024.

Monetary Policy

In a scenario of acute monetary tightening, the government has initiated a process to manage the liquidity of the economy through short-term Treasury Bills (LECAPs) instead of reverse repos from the BCRA. By the end of the year, we expect real interest rates to be in slightly positive territory.

Key points. Argentina

Economic Activity

The exchange rate and utilities tariffs' rate adjustment, together with the strong fiscal adjustment, deepened the economic downturn. We expect a 4% contraction in GDP this year and a recovery of 6% in 2025 driven by investment and the reactivation of private consumption.

External Sector

The external accounts will improve in 2024, explained by the fall in imports due to the recession, the recovery of agricultural exports in a year without drought and the positive trade balance of the energy sector due to lower purchases of imported gas and an increase in oil exports.

Risks

Given the socioeconomic fragility and the government's limited power in Congress and at the provincial level, a decline in social support could hinder fiscal consolidation (the pillar of macroeconomic policy), which could in turn slow down disinflation and trigger exchange rate instability.

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Global Economic Outlook June 2024

BBVA Research baseline scenario: inflation and interest rates are likely to decline, but will remain relatively high, favoring subdued activity growth

Scenario drivers

Interest rates to gradually fall, also in the US, where cuts were postponed amid large uncertainty, but will remain at contractionary levels

Fiscal policy will scarcely contribute to ease inflation pressures, mainly in the US; some consolidation is likely in Europe from 2025, given new fiscal rules

Supply conditions: geopolitical context makes negative shocks more likely than in the past, but no particular shock is assumed in baseline scenario

Macro trends: prospects

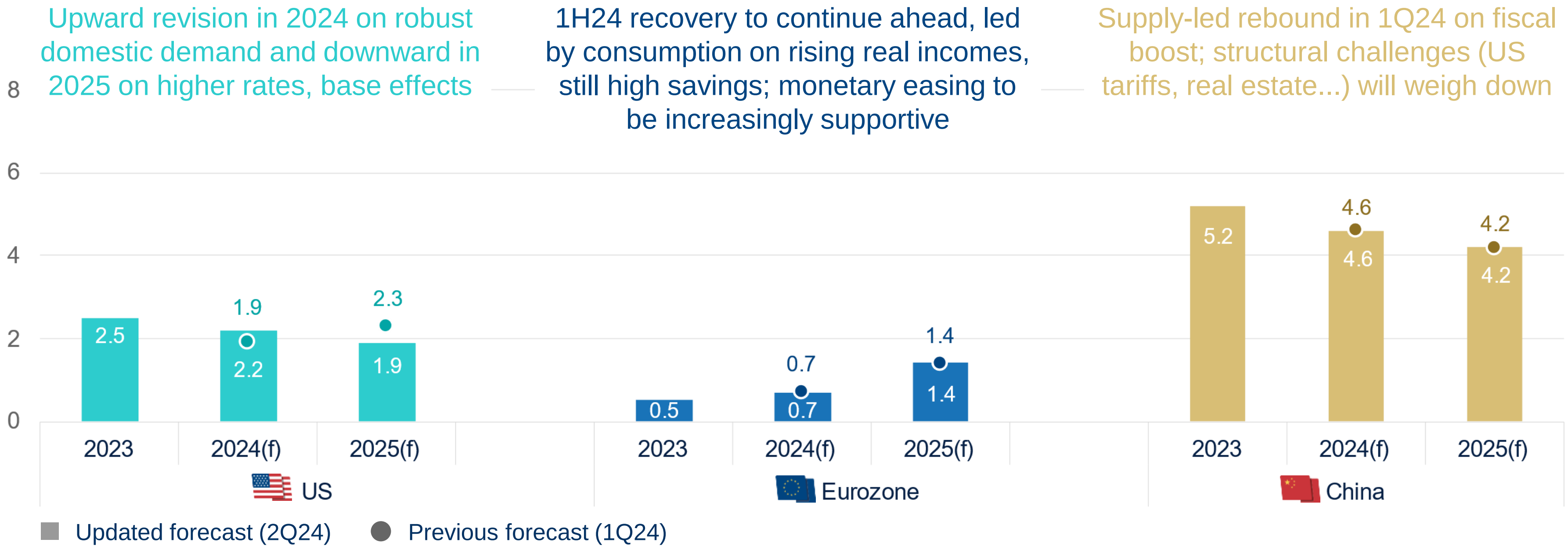
Global growth to be weak in 2H24 and recover somewhat in 2025; China's structural deceleration will weigh down

Inflation will ease further, but is set to remain higher than in recent decades on demand (fiscal policy, etc.) and supply (geopolitics, protectionism, etc.) issues

Volatility on geopolitics and US elections, likely offsetting the positive effects triggered by lower Fed rates

GDP growth prospects: a softer landing in the US, a cyclical recovery in the Eurozone and a structural deceleration in China

GDP GROWTH (*)
(%)



(f): forecast.

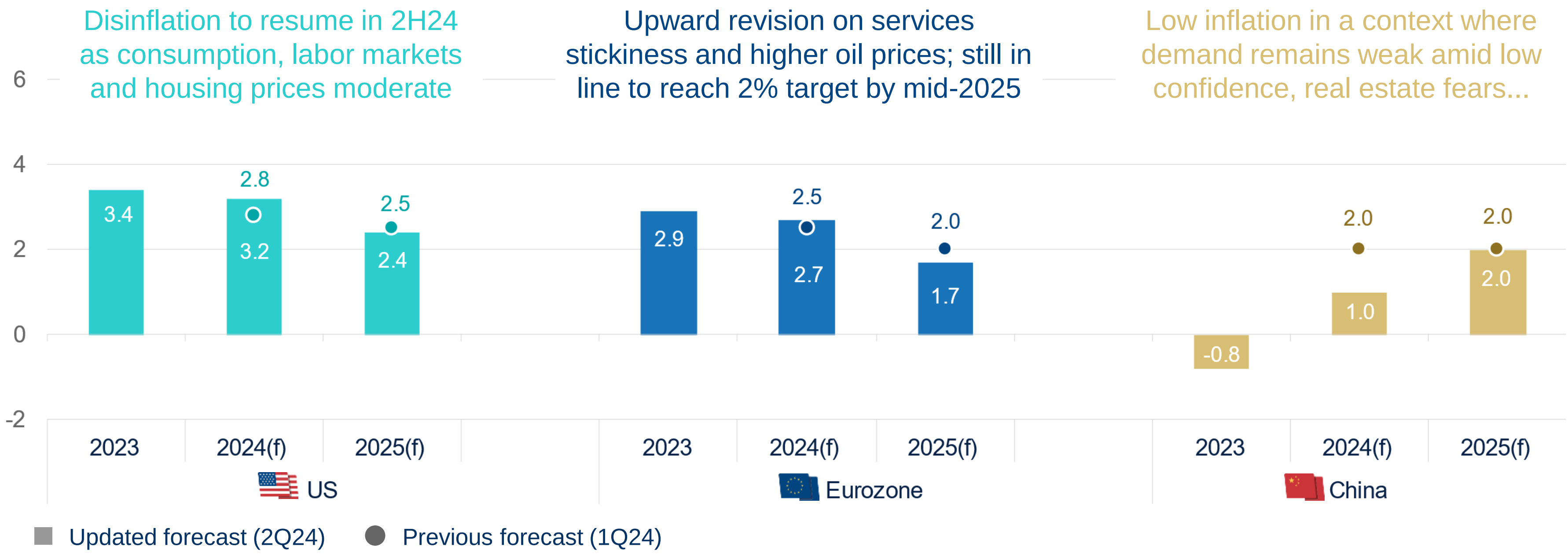
(*) Global GDP growth: 3.2% in 2023, 3.1% (+0.0 pp in comparison to previous forecast) in 2024 and 3.3% (+0.0 pp) in 2025.

Source: BBVA Research.

Inflation forecasts revised upwards in the US and Eurozone, mostly on service stickiness, and downwards in China, amid deflation concerns

HEADLINE INFLATION: CPI

(YOY %, END OF PERIOD)

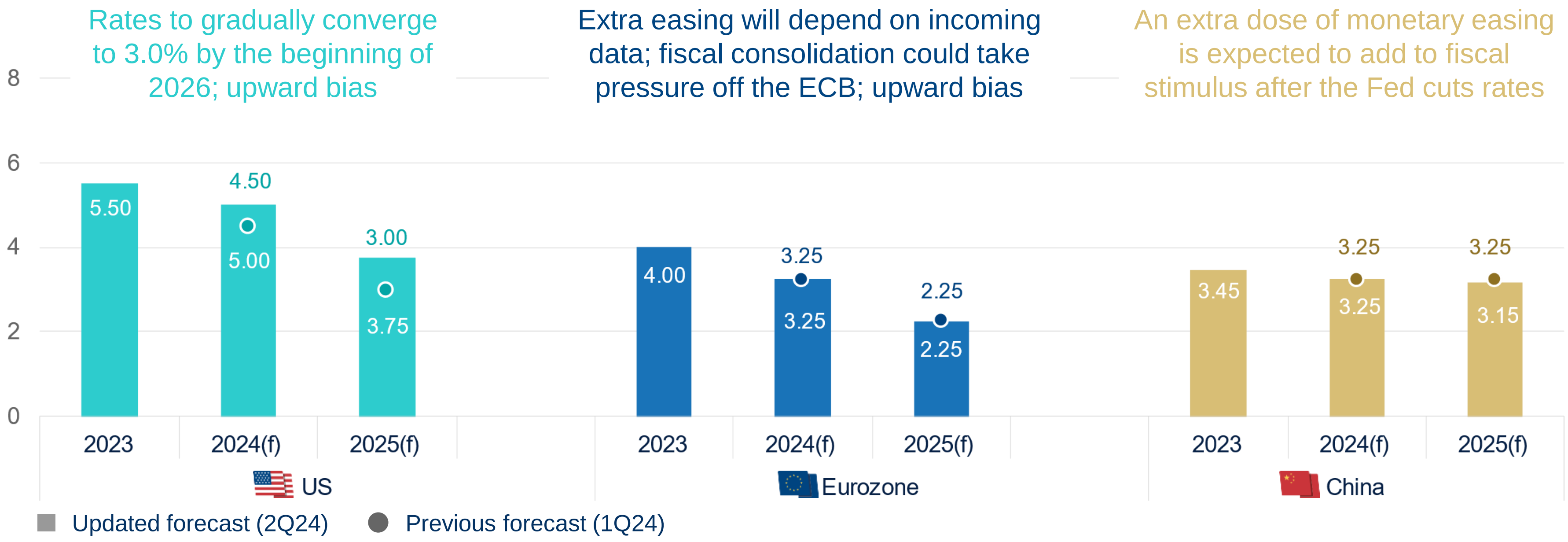


(f): forecast.

Source: BBVA Research.

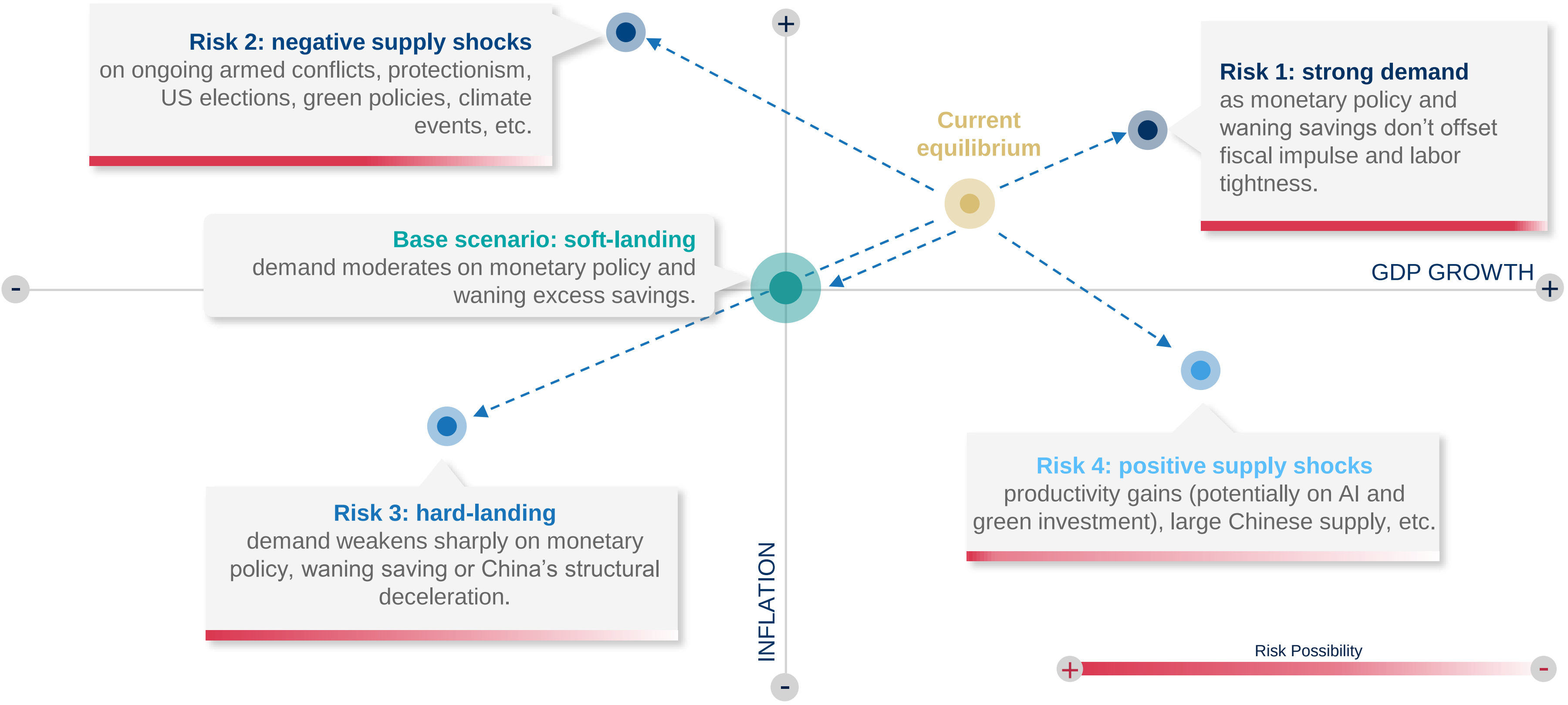
The ECB has started cutting rates; the Fed will wait at least until Sep/24 to launch its easing cycle amid still uncertain growth and inflation moderation

POLICY INTEREST RATES (*)
(%, END OF PERIOD)



(f): forecast.
(*) In the case of the Eurozone, interest rates of the deposit facility.
Source: BBVA Research.

Risks: demand strength, protectionism, geopolitics, among other factors, could prevent inflation and interest rates from declining ahead



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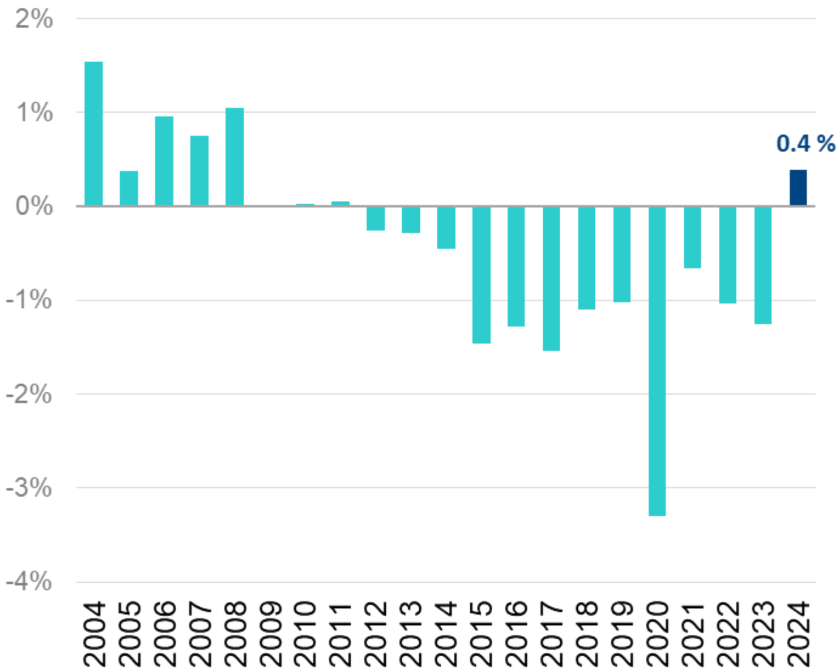
Argentina Economic Outlook
June 2024

The government firmly addressed the problem of persistent fiscal imbalance and achieved a remarkable positive result in the first five months of 2024

TOTAL FISCAL BALANCE
(% GDP, FIRST FIVE-MONTH PERIOD OF EACH YEAR)

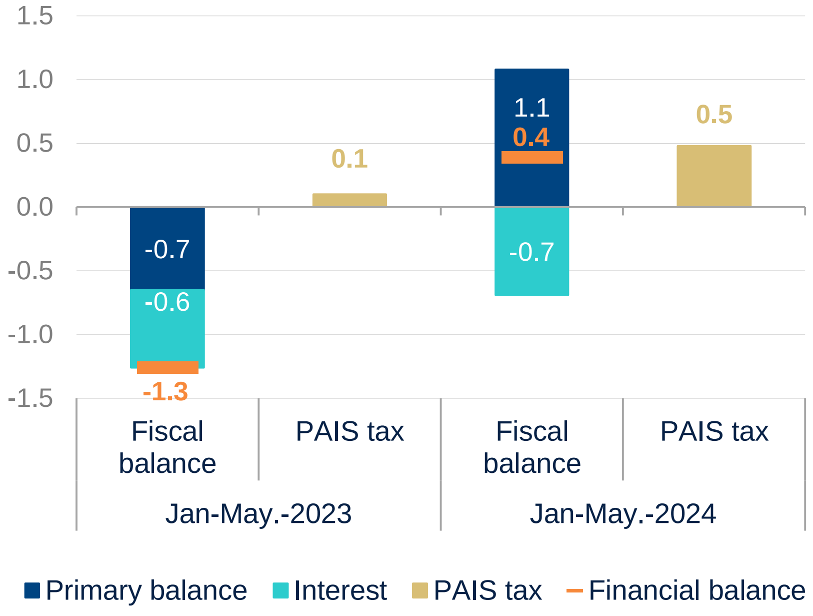


Source: Ministry of Economy, INDEC and BBVA Research.

- The sharp decline in primary expenditure (-31.7% in real terms) improved the fiscal balance in the first months of the year. The fall in revenues was 3% in real terms, due to the contraction of activity, but taxes linked to the external sector supported collection.
- In addition to a more aggressive expenditure adjustment than originally estimated, the government postponed some payments to achieve its goal of eradicating the fiscal deficit.
- We adjusted our primary fiscal result forecast for this year from -0.8% of the GDP to 0.1%, based on an increase in revenues due to the expansion of the tax base of the PAIS tax and a stronger than expected adjustment on the expenditure.

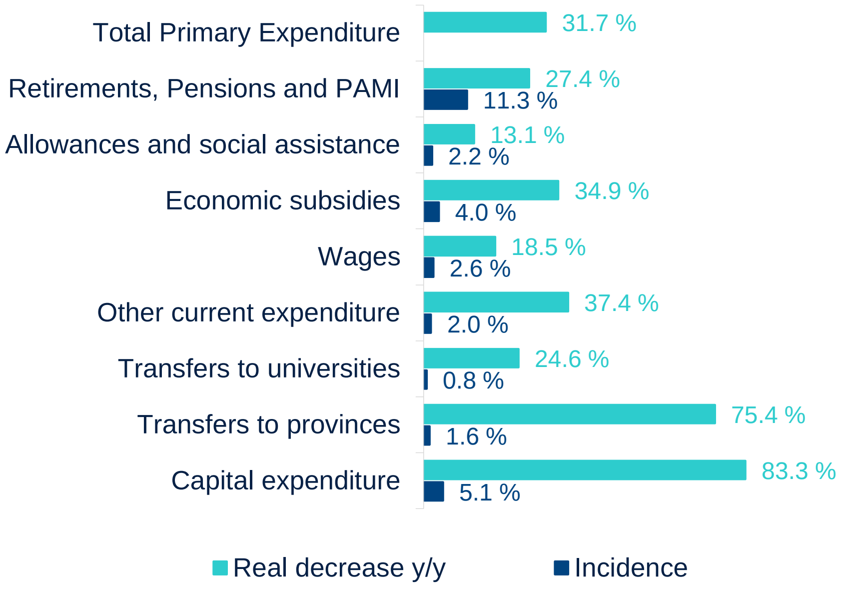
However, the challenge is now to make the fiscal surplus sustainable beyond delaying payments and avoid relying on distortionary taxes...

FISCAL BALANCE AND PAIS TAX
(% OF GDP)



Source: Ministry of Economy and BBVA Research.

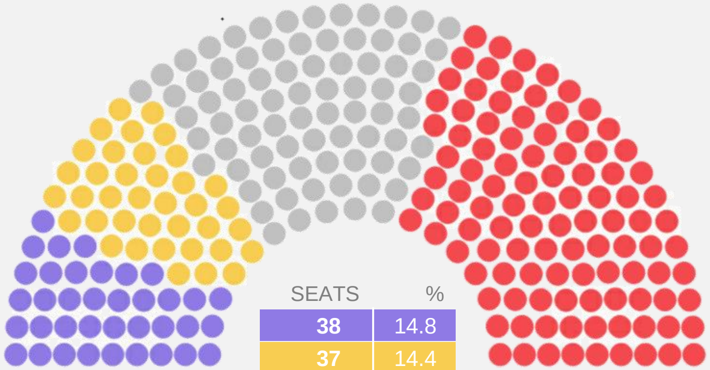
PUBLIC EXPENDITURE BY SEGMENT, ACCUMULATED 1ST FIVE-MONTH PERIOD
(VAR. % Y/Y IN REAL TERMS AND INCIDENCE)



Source: Ministry of Economy, INDEC and BBVA Research.

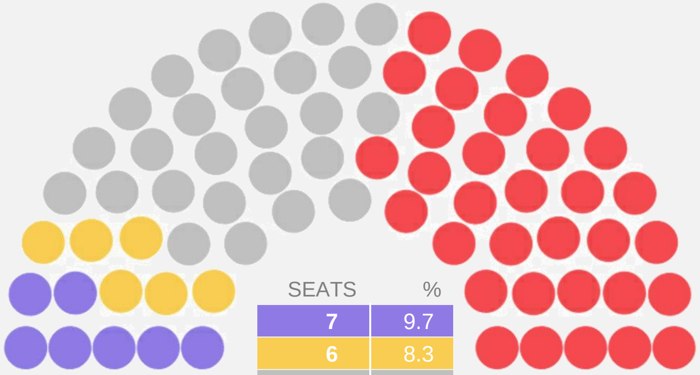
… for this, the approval of the tax chapter of the “Base Law”, whose processing has been delayed in Congress, will be key

CHAMBER OF DEPUTIES
MEMBERS: 257 – QUORUM: 129



SEATS	%
38	14.8
37	14.4
78	30.3
104	40.5

CHAMBER OF SENATORS
MEMBERS: 72 – QUORUM: 36



SEATS	%
7	9.7
6	8.3
26	36.1
33	45.8

- La Libertad Avanza (ruling party)
- PRO ("allies")
- PJ “K “+ Left ("hard" opposition)
- Other

The “Base Law” was passed by the Senate, but it rejected the Personal Income Tax and the changes in the Wealth Tax, which represent the core of the fiscal package. However, we remain optimistic that the government will find a way to include both in the pending final revision by the Lower House during the first days of July.

The approved bill presents positive points for the organization of the economy

State reform

- Declaration of emergencies: delegated powers for the PEN in several areas.
- Power to reorganize and restructure government agencies.
- Permit for total privatization: ~~Aerolíneas Argentinas, Argentine mail service, Argentina TV and radio~~, Enarsa, Intercargo. Partial: AYSA, Belgrano Cargas, SOFSE; Corredores Viales. !
- Powers to renegotiate public works contracts.

Labor market

- Formalization of labor.
- Expansion of the probationary period. Employment termination fund. Role of worker as "collaborator".
- Elimination of multipliers of severance payment.

Energy

- The objective of self-sufficiency is eliminated. It prevents the State from intervening in prices.
- Deregulation of the natural gas sector. Unification of gas and electricity regulatory bodies.

Social Security

- Increase in the retirement age for women (from 60 to 65). ✕
- Dismissal of the moratorium for those who do not complete 30 years of contributions. ✕

Tax chapter (+0.8% TOTAL COLLECTION 2024)

- Reinstatement of the capital gains tax. ✕
- Money laundering.
- Suspension of tax, customs, and labor obligations.
- Gradual reduction of Personal Assets Tax. 5-year advance payment. ✕
- Increase in the tobacco tax from 70% to 73% on the sale price.

Incentive Regime for Large Investments (RIGI)

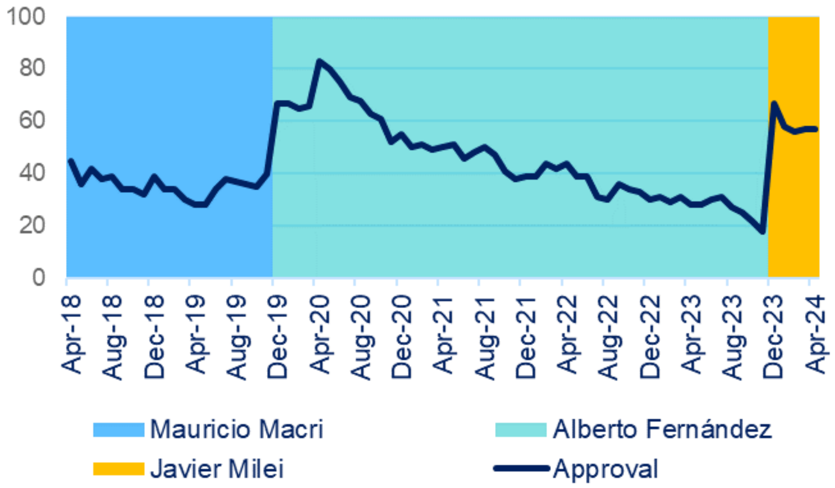
- Projects between USD 200 and 900 million dollars.
- Only for: Forestry, Mining, Energy, Infrastructure, and Technology. !

✕ Rejected by the Senate

! Amended by the Senate

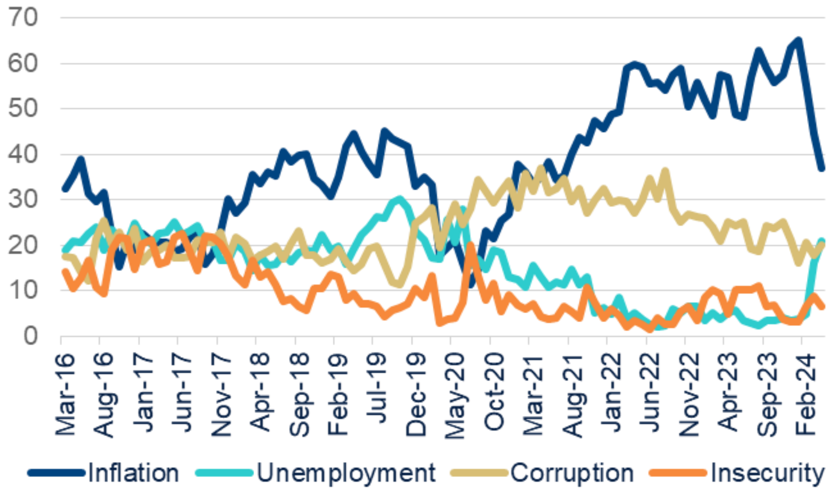
In his first six months in office, Milei maintained high levels of public approval, according to the consensus of political polls

PRESIDENTIAL APPROVAL
(SURVEY, IN %)



Source: Poliarquía and BBVA Research.

MAIN CONCERNS OF THE PEOPLE
(SURVEY, IN %)

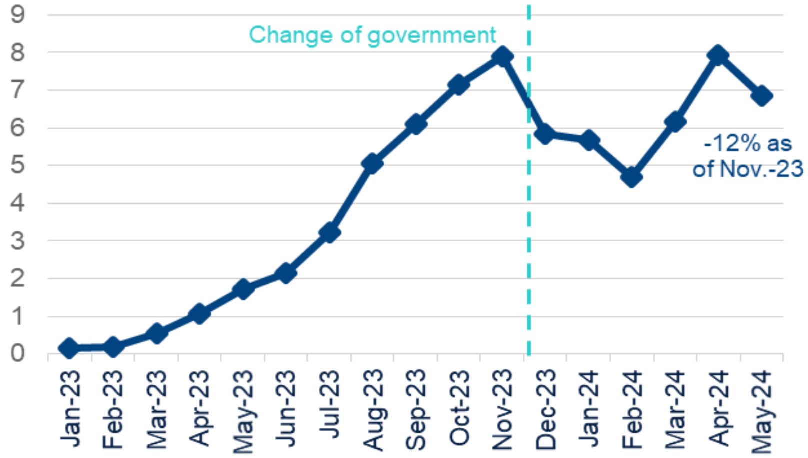


Source: Synopsis and BBVA Research.

Milei enjoys similar (and high) levels of public approval as when he took office, despite the macroeconomic adjustment he is carrying out. This support is key for him to continue implementing his policies and is sustained by the success in his battle against inflation, society's main concern (although given its slowdown, unemployment is beginning to gain priority).

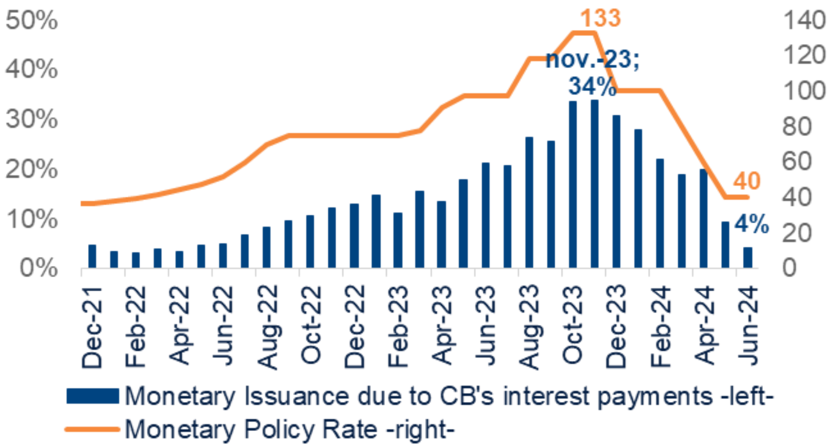
Monetary assistance to the Treasury stopped as a result of the fiscal surplus while lower rates reduced the CB's interest-bearing liabilities

MONETARY ASSISTANCE TO THE TREASURY, NET OF BONDS BUYBACKS TO THE BCRA
(TRILLIONS OF CURRENT PESOS; ACUM. FROM JAN-23)



Source: BCRA, Ministry of Economy and BBVA Research.

MONETARY ISSUANCE FOR INTEREST PAYMENTS BY THE BCRA AND MONETARY POLICY RATE
(LEFT AXIS: % OF THE MONETARY BASE OF THE PREVIOUS MONTH, RIGHT AXIS: % NOMINAL ANNUAL RATE)

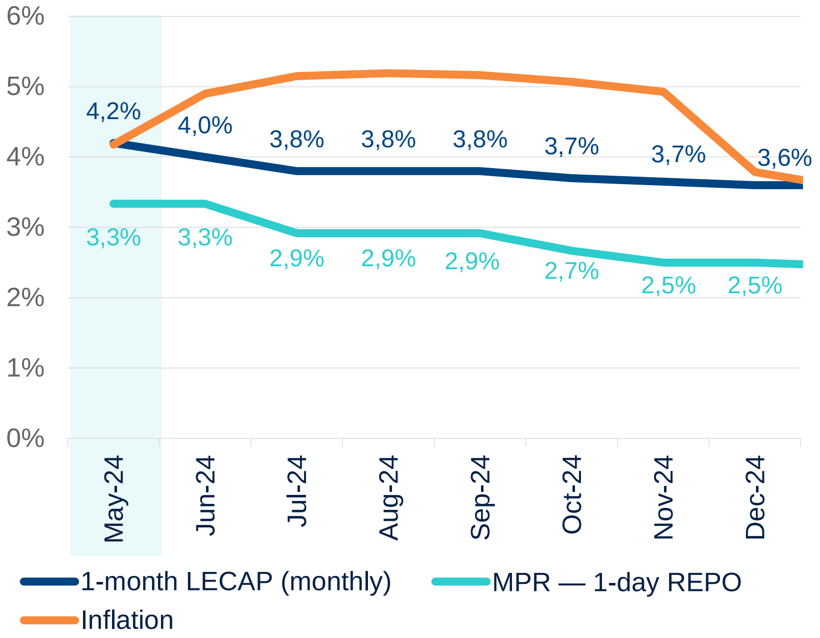


Source: BCRA and BBVA Research.

The Government has dramatically reduced monetary issuance. It managed to eliminate the issuance to assist the Treasury and substantially cut the one derived from the interests on the BCRA's liabilities. The government announced its intention to remove the PUTs held by banks on several peso bonds, in order to avoid this potential source of contingent issuance.

The government seeks to start managing the liquidity conditions of the economy with Treasury securities instead of interest-bearing liabilities of the BCRA

INTEREST RATES AND MONTHLY INFLATION
(% MONTHLY)

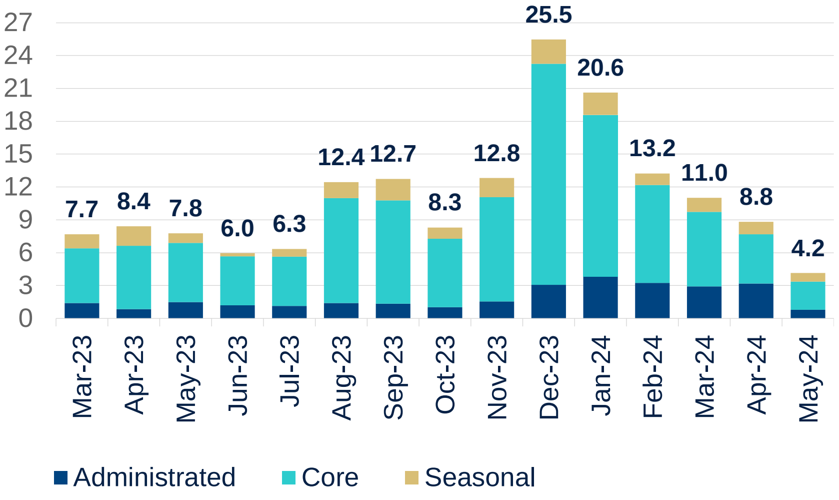


Source: BCRA, INDEC, and BBVA Research.

- The government intends to define the 1-month Treasury Bills (LECAP) as the economy's reference interest rate.
- To encourage banks to rotate positions from REPOs to LECAP, it lowered REPO rate to 40% annual (3.3% monthly) and kept the rate of the shortest LECAP at 50% annual (4.2% monthly).
- Banks have already carried out a large part of this rotation, so the BCRA's interest bearing liabilities fell by half in nominal terms.
- This is an usual way of conducting monetary policy in developed economies, but in the local context the price volatility that LECAPs may have makes the liquidity management through this instrument more complex.
- By the year end, LECAP rates would be aligned with inflation in an environment of lower FX restrictions.

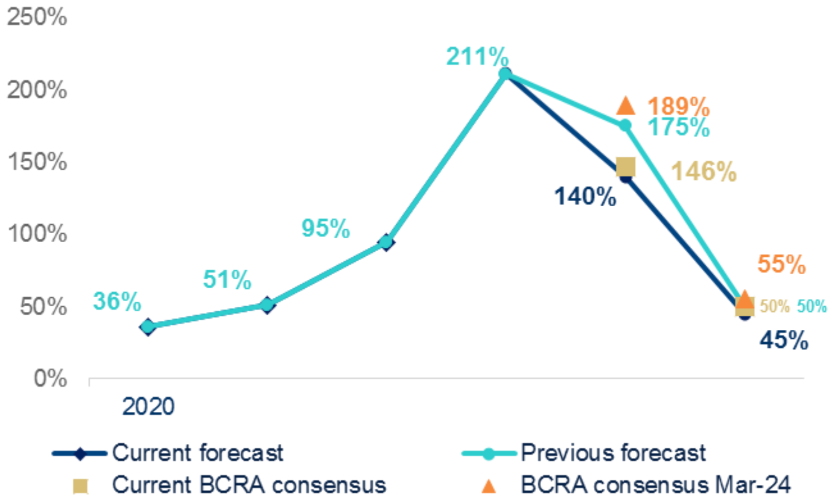
Despite the aggressive interest rate cut, inflation has fallen sharply, but there are still relative prices to adjust

INFLATION BY COMPONENT
(VAR % Y/Y)



Source: INDEC and BBVA Research.

BBVA EXPECTED INFLATION VS BCRA CONSENSUS
(VAR % Y/Y)

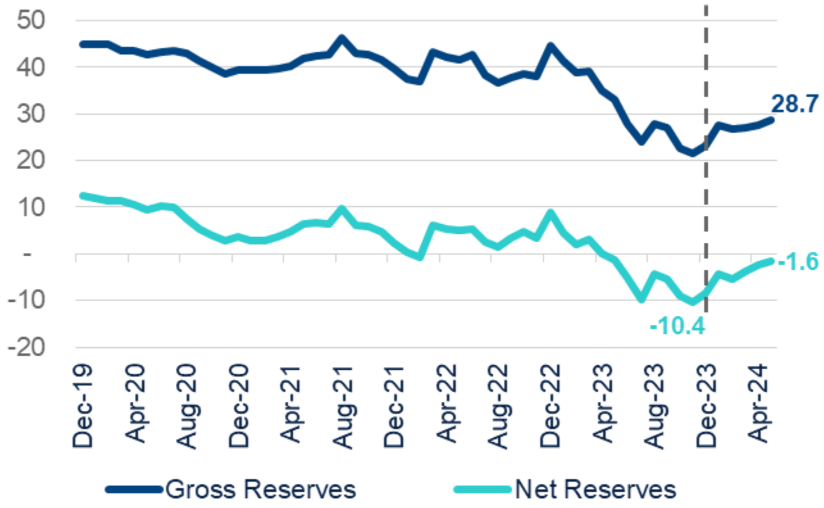


Source: INDEC and BBVA Research.

The government is holding the crawling peg at 2% m/m for longer than expected and decided to moderate the speed of relative price adjustments. This caused inflation to be lower than expected in 1H24 and that is why we reduced the projection for Dec-24 to 140% y/y. Services (mainly regulated) drove inflation in 1H24, growing 1.5 times more than goods.

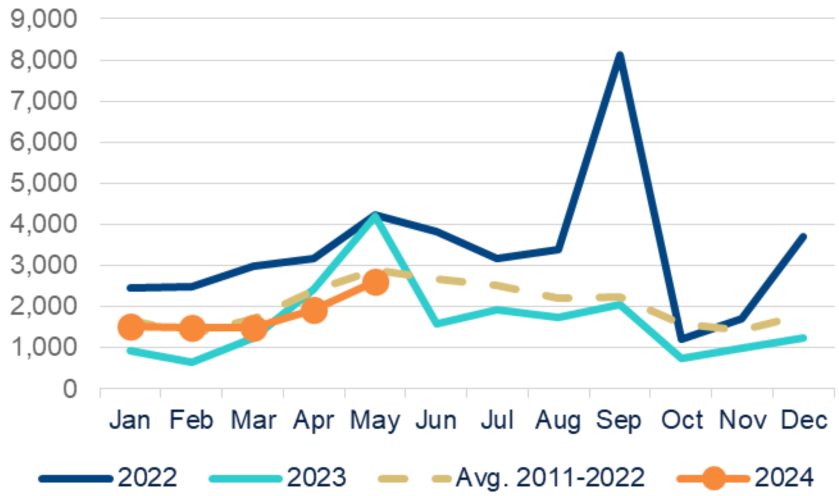
The BCRA managed to substantially recompose international reserves in its six months in office, although they still stand at low levels

INTERNATIONAL RESERVES
(IN BILLIONS OF DOLLARS)



Source: BCRA and BBVA Research.

GRAIN AND OILSEED EXPORT LIQUIDATIONS
(IN MILLIONS OF DOLLARS)

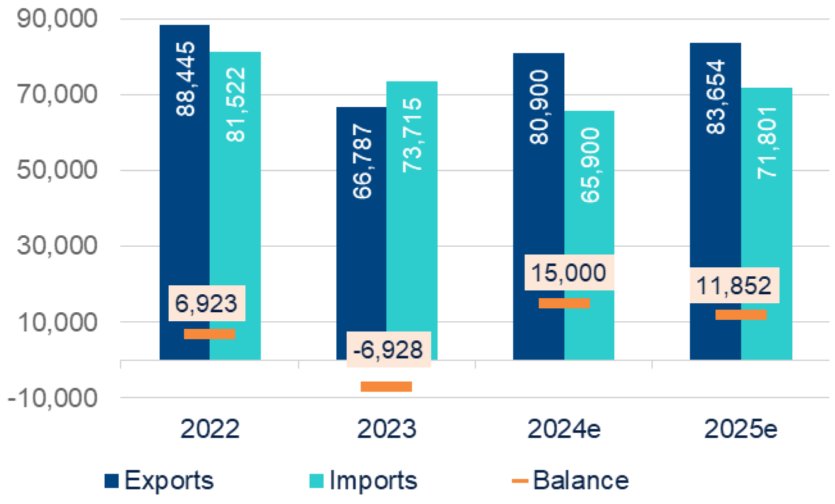


Source: CIARA-CEC and BBVA Research.

Net reserves have grown by USD 9.5 billion since the change of government. The second quarter of the year is usually the most favorable in terms of export settlement in the agricultural sector. In the second half of the year, the accumulation of international reserves will be more challenging.

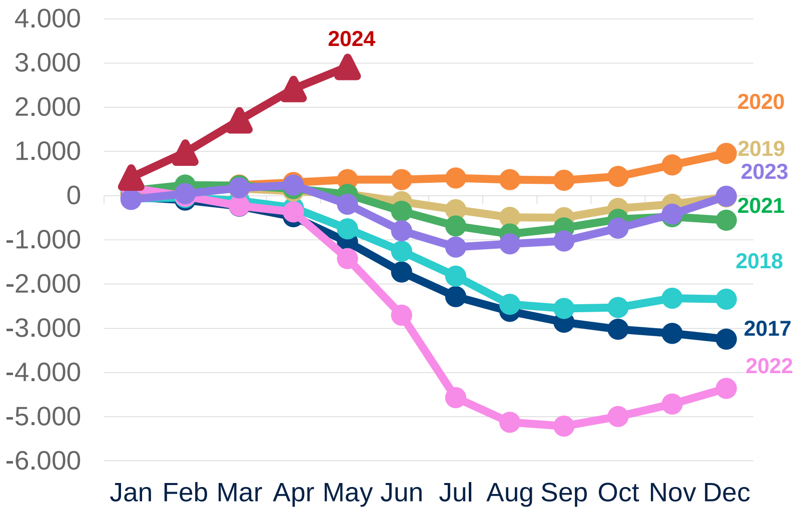
The trade balance should improve substantially this year, thanks to the contribution of agriculture and the Oil & Gas sector

TRADE BALANCE
(MILLION DOLLARS)



Source: BBVA Research based on INDEC data.

ENERGY SECTOR: TRADE BALANCE
(MILLION DOLLARS)

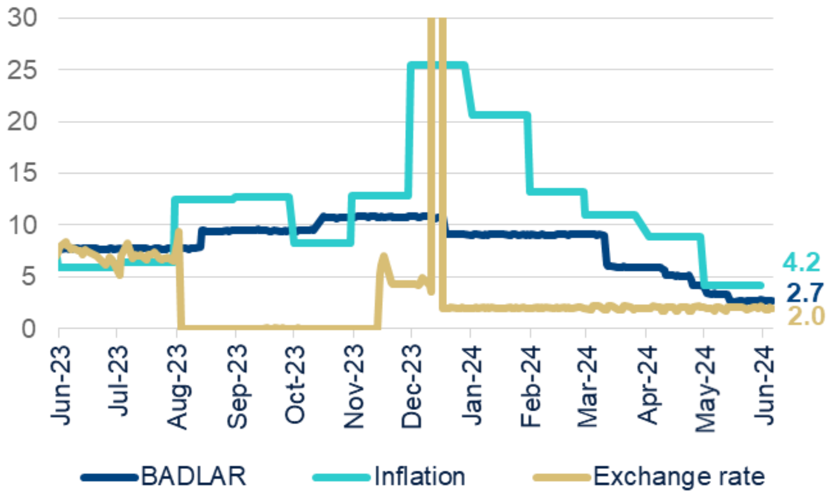


Source: BBVA Research based on INDEC data.

The trade balance would show a USD 15 billion surplus this year (versus a deficit of USD 6.9 billion in 2023). In addition to the better climatic conditions that favor agriculture, this result is also explained by a growing contribution from the Oil & Gas sector, which in 2024 could achieve a trade surplus of around USD 4 billion.

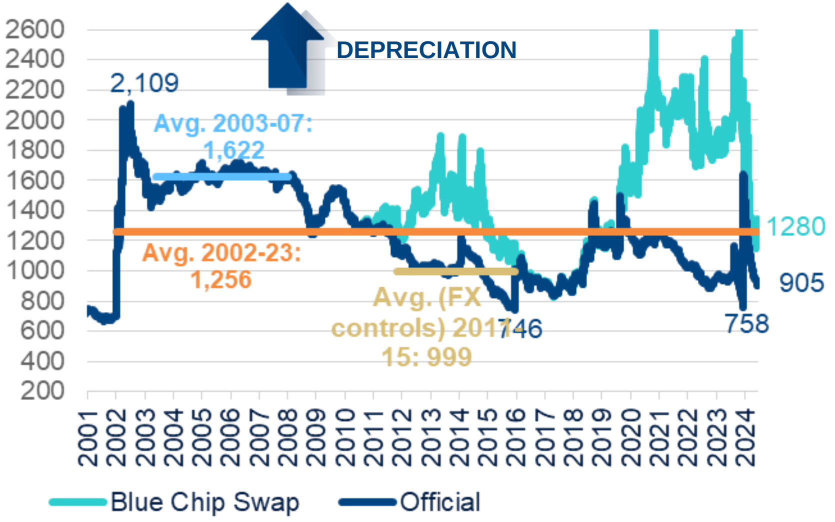
However, the crawling peg of the currency at 2% MoM was widely outpaced by inflation. This scheme could finally find its limits by 3Q24

INTEREST RATES, EXCHANGE RATE CHANGE AND MONTHLY INFLATION (% MONTHLY, EXCHANGE RATE: MONTHLY DAILY CHANGE, AVG. 20 DAYS)



Source: BBVA Research based on BCRA and INDEC.

REAL EFFECTIVE EXCHANGE RATE (AT CONSTANT PRICES AS OF 6/12/2024)

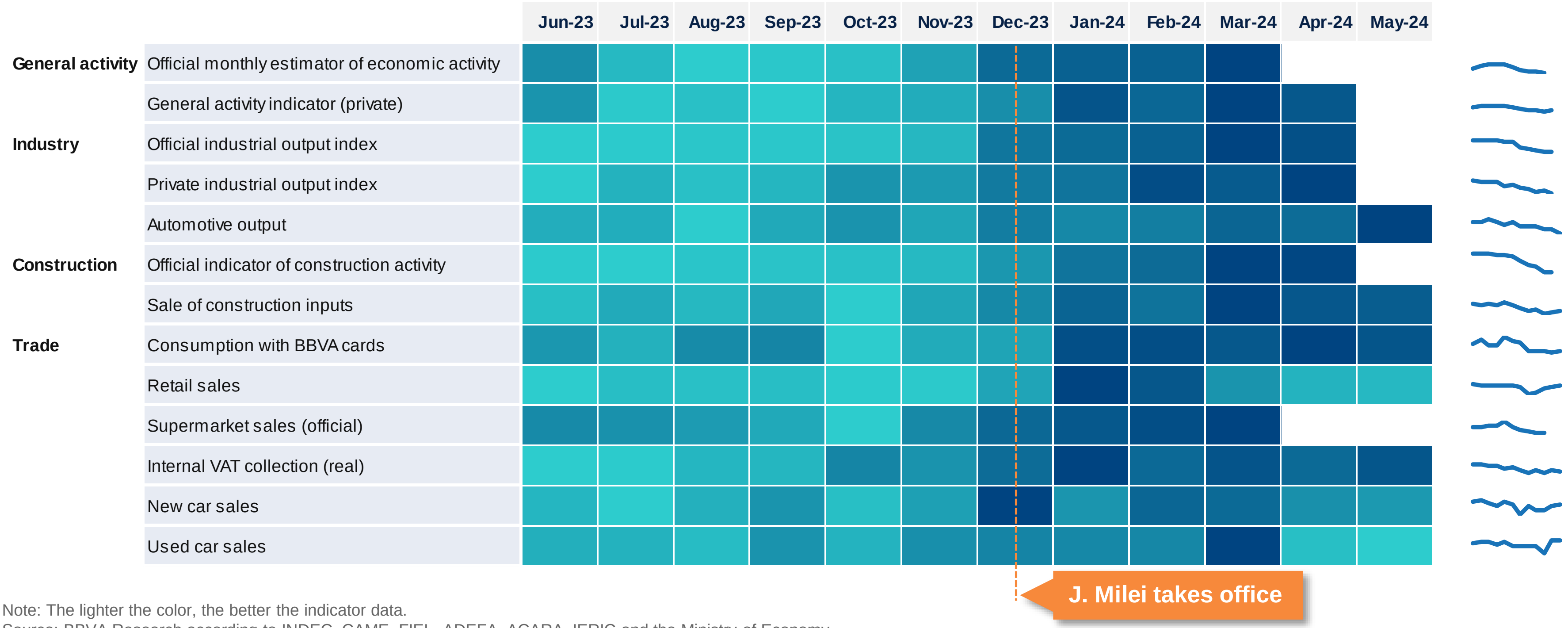


Source: BBVA Research based on BCRA.

We expect that in the second part of the year the government will gradually ease exchange restrictions. In that framework, the official exchange rate could show a change of pace (either a jump or acceleration of the daily depreciation). We project an official exchange rate of 1,200 ARS/USD by the end of December.

The necessary macroeconomic adjustment has caused, as expected, an intensification of the previous recession...

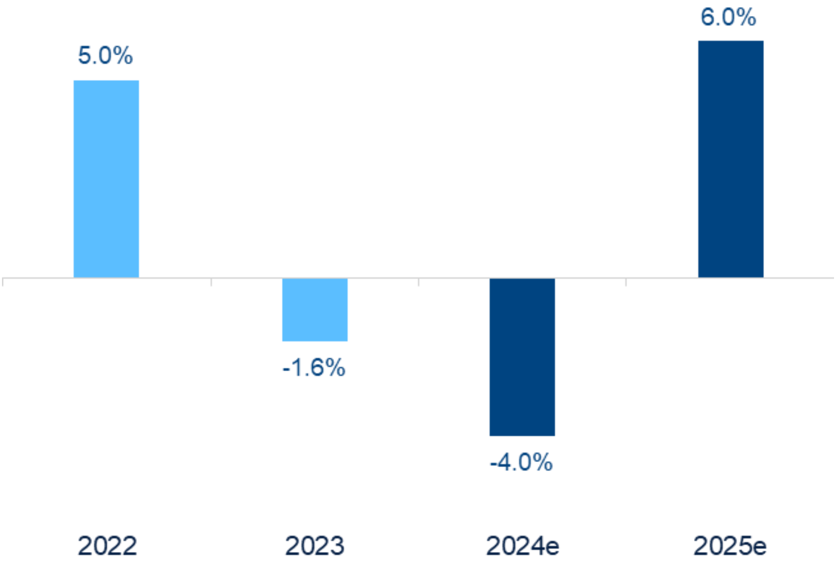
PERFORMANCE OF ECONOMIC ACTIVITY BY SELECTED SECTORS
(SERIES NOT SEASONALLY ADJUSTED)



Note: The lighter the color, the better the indicator data.
Source: BBVA Research according to INDEC, CAME, FIEL, ADEFA, ACARA, IERIC and the Ministry of Economy.

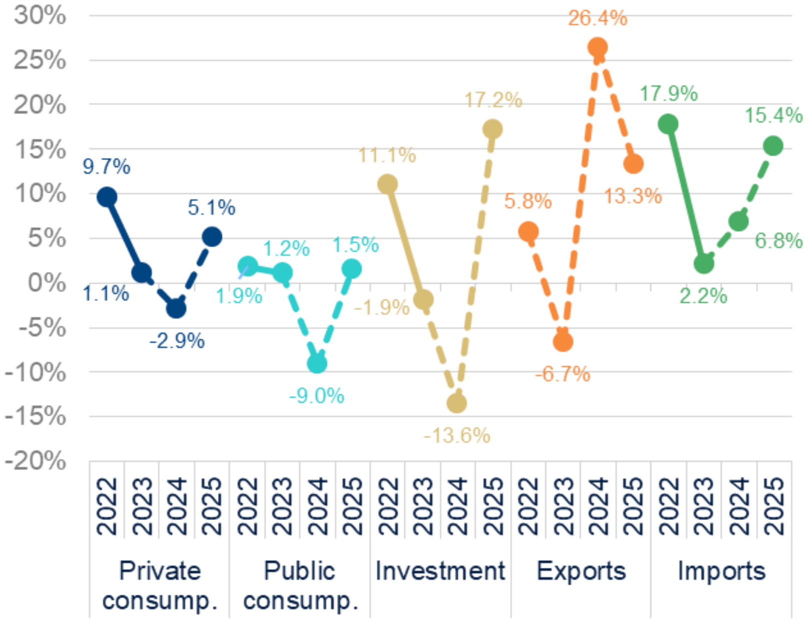
…so we maintain the forecast of a 4% drop in GDP in 2024 and a 6% rebound in 2025 due to the expansive effects of lower inflation.

GDP FORECAST
(CHG. % Y/Y; CONSTANT ARS)



Source: BBVA Research based on INDEC.

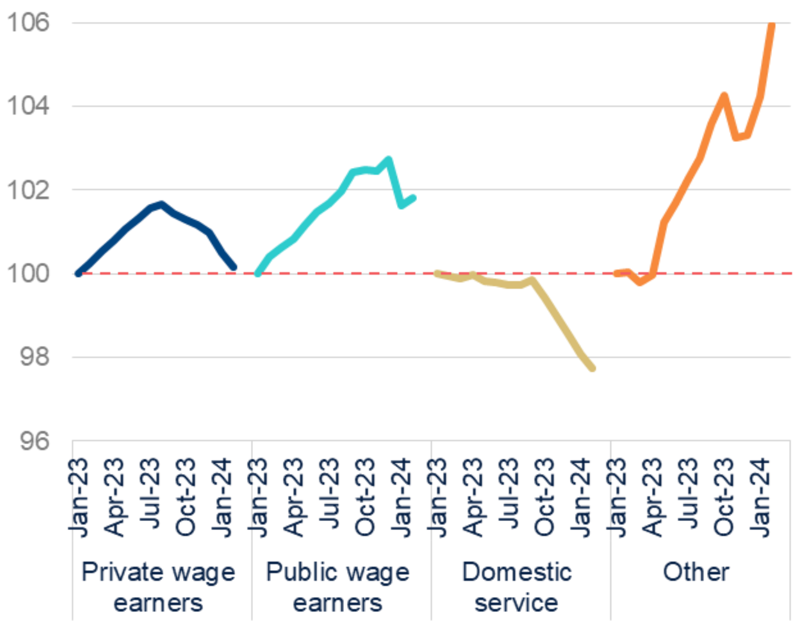
GDP FORECAST BY COMPONENT
(CHG. % Y/Y; CONSTANT ARS)



Source: BBVA Research based on INDEC.

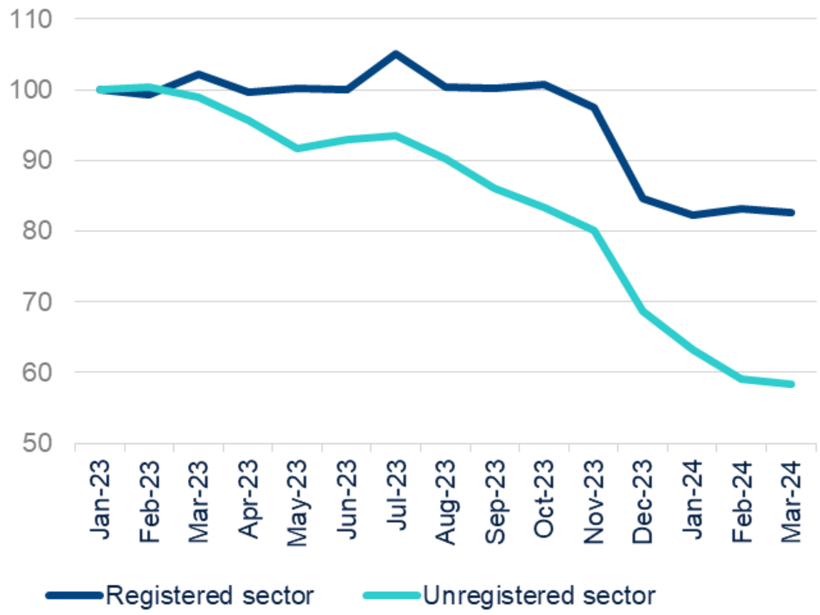
Real wages have continued to decline and the labour market also reflects the economic setback, intensifying job insecurity

REGISTERED WORKERS
(BASE JAN'23 = 100; SERIES NOT SEASONALLY ADJUSTED)



Source: BBVA Research based on Ministry of Human Capital.

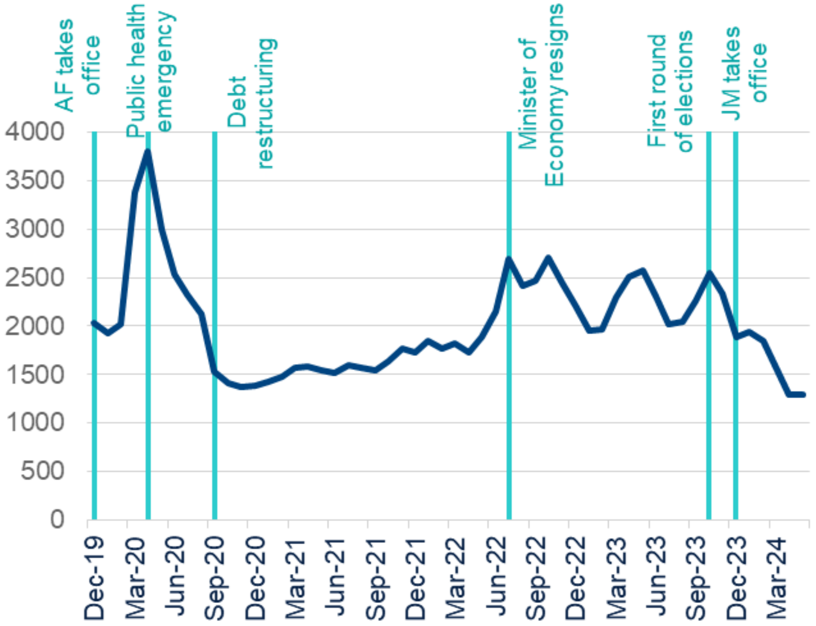
REGISTERED WORKERS
(BASE JAN'23 = 100; SERIES NOT SEASONALLY ADJUSTED)



Source: BBVA Research based on INDEC.

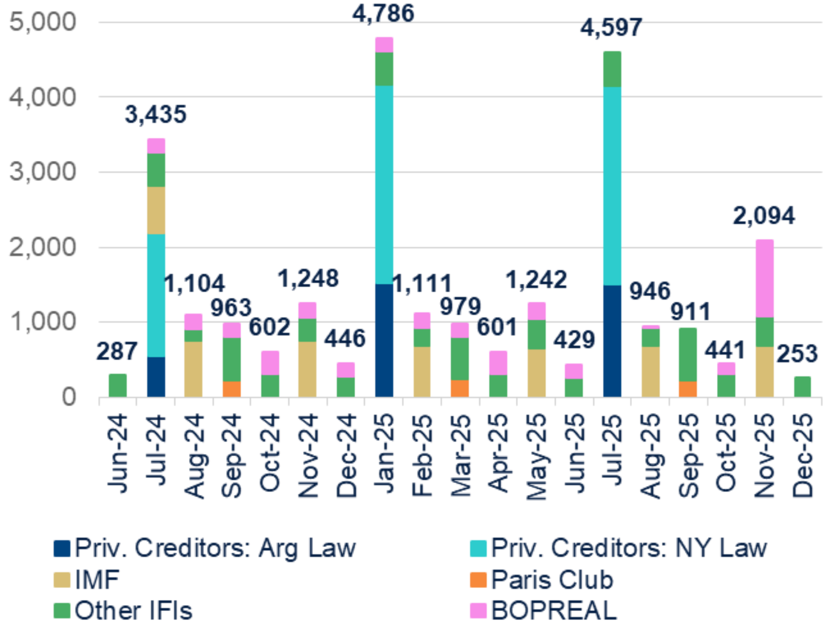
Despite the drop in Argentina's country risk, it is necessary to continue reducing the spread in view of next year's debt obligations

COUNTRY RISK
(EMBI, IN BP)



Source: BBVA Research.

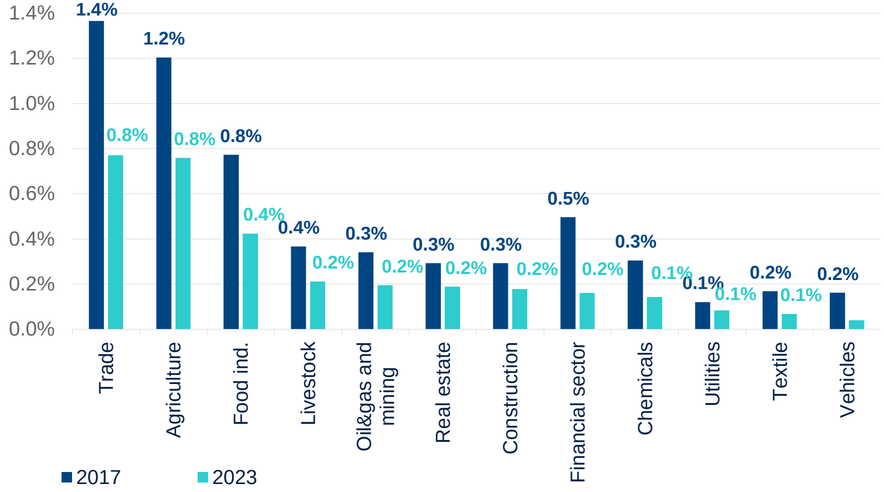
FOREIGN CURRENCY MATURITIES
(IN MILLIONS OF DOLLARS)



Source: Ministry of Economy and BBVA Research.

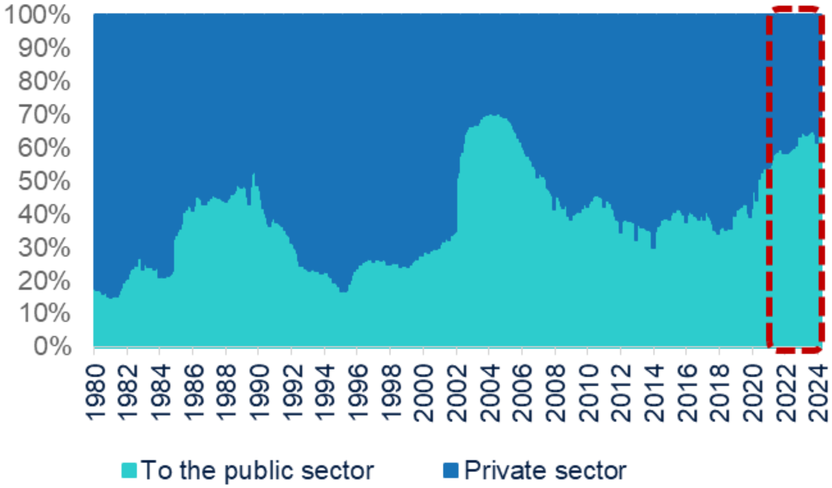
The drop in inflation, jointly with the removal of financial repression and FX controls will boost private sector credit and the lengthening of loan maturity

CREDIT BY PRODUCTIVE SECTOR
(% GDP)



Source: BCRA and BBVA Research.

BANK CREDIT BY TYPE OF CREDITOR
(AS % OF THE TOTAL, INCLUDES HOLDINGS OF PUBLIC AND PRIVATE SECURITIES)

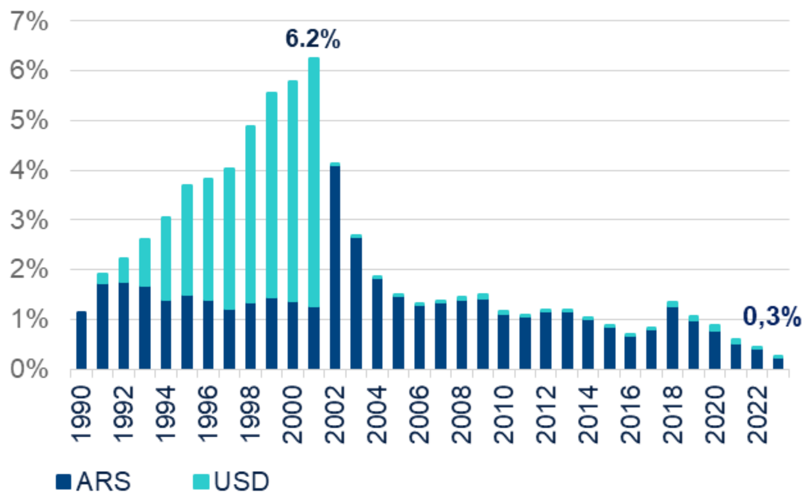


Source: BBVA Research based on BCRA.

The reduction of inflation and of fiscal needs, the removal of the FX controls and the free determination of interest rates will increase the financing available for private investment. Private credit will grow both in local and foreign currency, gradually replacing the public sector's share in bank´s balance sheets.

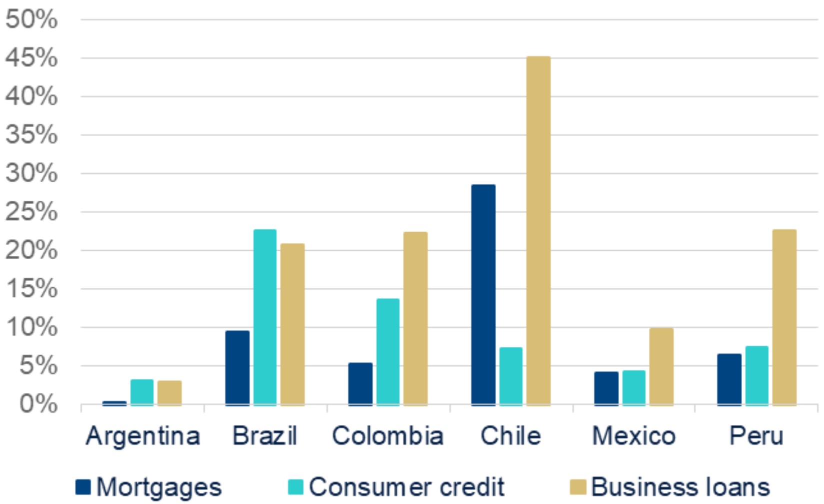
The credit line with the greatest growth potential is mortgages, given that it is currently at historically low levels

MORTGAGE LOAN IN PESOS AND DOLLARS (AS % GDP)



Source: BCRA and BBVA Research.

CREDIT LEVELS IN ARGENTINA VS. SELECTED LATAM COUNTRIES (AS % OF GDP)



Source: BBVA Research.

In Argentina, the housing deficit is 6.5 million households, while the level of mortgage loans is the lowest since the 1980s. The absence of these loans explains much of the difference between the size of the local financial system and the rest of the countries in the region, although there is also a lot of potential for growth in commercial and consumer loans.

Macroeconomic forecasts

	2020	2021	2022	2023	2024e	2025e
GDP (% YoY)	-9.9	10.7	5.0	-1.6	-4.0	6.0
Inflation (% YoY eop)	36.1	50.9	94.8	211.4	140.0	45.0
Exchange rate (vs USD eop)	84	102	177	808	1200	1620
Monetary Policy Rate (% eop)	37.1	36.7	75.0	100	30	24
Private Consumption (% YoY)	-12.2	10.4	9.7	1.1	-2.9	5.1
Public Consumption (% YoY)	-2.0	6.3	1.9	1.2	-9.0	1.5
Investment (% YoY)	-13.1	33.8	11.1	-1.9	-13.6	17.2
Primary Fiscal Balance (% GDP)	-6.4	-3.0	-2.4	-2.7	0.1	0.4
Fiscal Balance (% GDP)	-8.4	-4.5	-4.2	-4.4	-2.0	-1.7
Current Accoun (BoP, % GDP)	0.7	1.4	-0.7	-3.3	0.4	-0.5
Public Debt (% GDP)	103.8	80.6	85.0	157.9	89.0	77.4

Source: BBVA Research.

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Argentina Economic Outlook

June 2024

Creating Opportunities