Macro scenario - Argentina

May 14, 2024

Delivering results

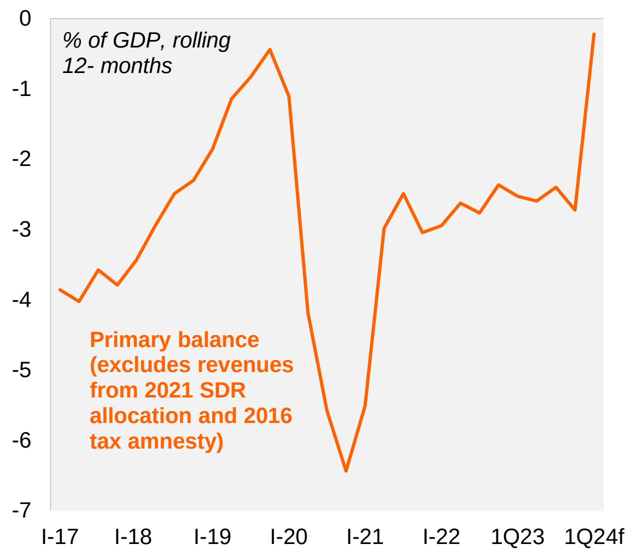
- The stabilization program, while costly from an activity viewpoint, is working. It has delivered an unprecedented fiscal surplus in 1Q24, a faster-than-expected deceleration in monthly inflation, and a gradual accumulation of reserves. We envisage a primary fiscal surplus of 0.5% of GDP in 2024, although approval of the fiscal package under discussion in Congress could further improve our fiscal forecast.
- We revised our YE24 nominal exchange rate forecast to ARS 1,200/USD (from 1,500 in our previous scenario), assuming a more gradual acceleration of the crawling peg policy, which we now expect for 3Q24. We consequently lowered our inflation forecast to 160% for YE24 (from 180% previously), and now estimate a policy rate of 40% for December (from 70% previously).
- Activity contracted in 1Q24, affected by the fallout from the stabilization program. We maintain our GDP growth forecast at -3.0%, with downside risk from the significant decline in real wages and the short-term impact of the swift fiscal consolidation, despite the normalization of the agriculture sector.

Unprecedented fiscal surplus in 1Q24 and fiscal package in the pipeline

The administration's fiscal results have been impressive so far, comfortably exceeding IMF targets. Argentina's Treasury showed another primary surplus in March, taking the 1Q24 primary and nominal balances to 0.6% of GDP and 0.2% of GDP, respectively – the latter is the first quarterly fiscal surplus since 2008. Although the fiscal accounts started off on the right foot, it appears challenging to maintain the steep reduction of expenditures to achieve a primary surplus of 2.0% of GDP (a target in the IMF program) in a stagflationary scenario.

After being approved in the Lower Chamber, the Senate is discussing the omnibus Law, which includes a tax package that aims to raise additional revenues of around 1.0% of GDP, although negotiations in Congress could eventually lead to lower revenue.

Primary Balance



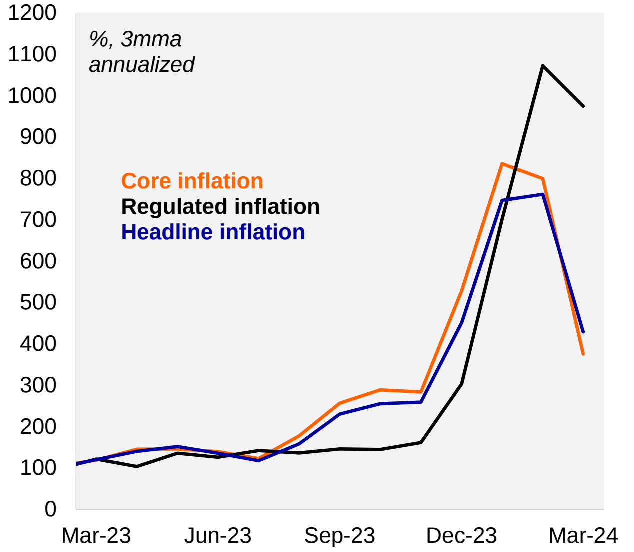
Source: Ministry of Economy, Itaú

Monthly inflation continued to decelerate in March, with core in the single-digit range

The faster-than-expected disinflation has been supported by the real appreciation of the ARS and the sharp decline in economic activity. Consumer prices rose by 11.0% mom in March, from 13.2% in February and a peak of 25.5% in December. The monthly core measure fell to 9.4% mom in March, entering single-digit territory for the first time since

October 2023. The appreciation of the currency and weaker consumption driven by the sharp contraction in real wages, contributed to the slow sequential increases, in our view. Monthly headline inflation is now expected to fall into the single digits sooner rather than later. The Eco Go price tracker estimates inflation of 8.8% MoM for April.

Inflation



Source: INDEC

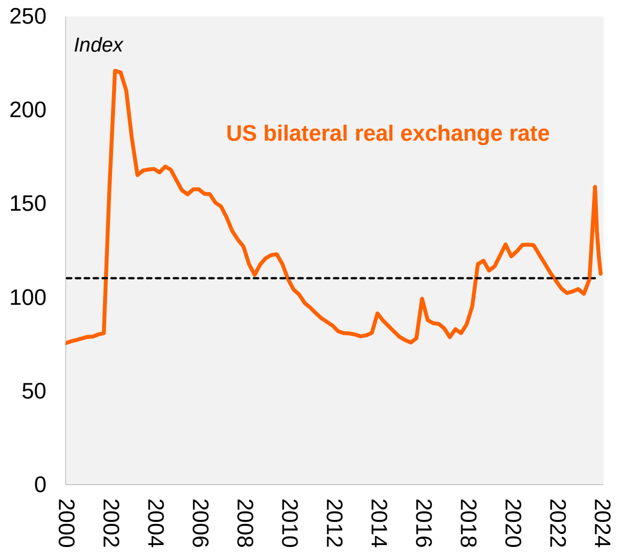
Lower rates

The central bank cut the monetary policy rate to 50% in May, from 60% in April. The decision to reduce rates followed a sharp deceleration in monthly inflation. Furthermore, the Treasury issued bills (Lecaps) with a 4.10% mom yield in April (from 5.50% mom in March). While interest rates are negative in real terms, they remain above the official exchange-rate depreciation pace of 2.0% mom, favoring a carry amid the sharp contraction in activity. We believe that expectations of an extended 2.0% mom crawling peg may open room for additional rate cuts.

Crawling peg for a while?

The central bank appears to be satisfied with the results of the crawling peg policy thus far. Faster-than-expected disinflation and a reduction in inflation expectations, accompanied by a significant narrowing of the spread between the official exchange rate and the blue-chip swap, as well as reserve accumulation (supported by multiple exchange rates), may lead the central bank to extend the current regime to continue to reduce inflation. Meanwhile, market consensus and NDF market prices indicate a gradual acceleration of the 2% monthly currency depreciation from May on. In our view, the likely extension of the crawling peg policy will lead to a further appreciation of the real exchange rate to stronger levels, higher than those seen before the currency's depreciation last December. On the other hand, the discussion on the lifting of capital controls has been postponed, at least in the short term.

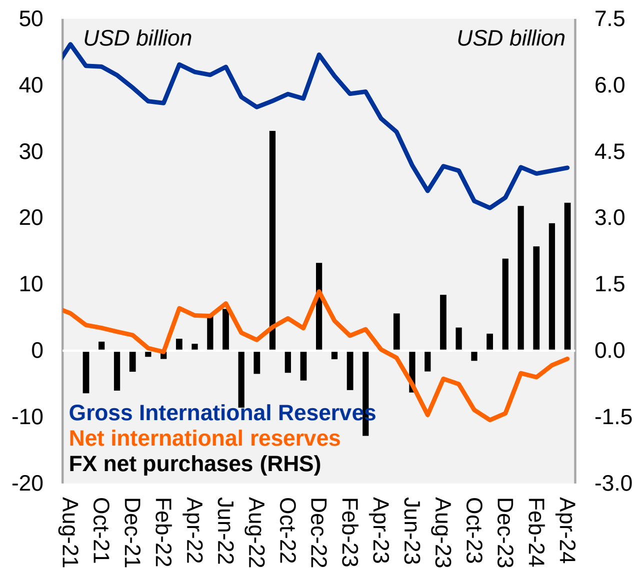
Real exchange rate



Source: BCRA

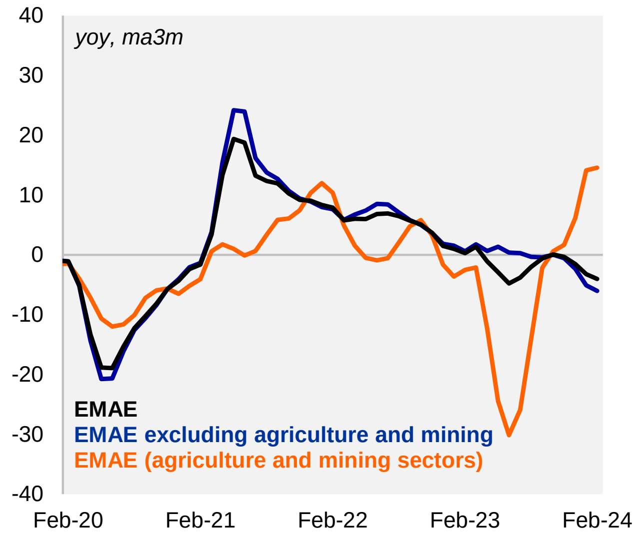
Net international reserves ended April at negative USD 1.4 billion, compared with negative USD 10.4 billion before the administration took office. In fact, since the devaluation of the currency in mid-December 2023, the central bank has purchased USD 14.7 billion, facilitated by the new import payment regime, which requires that import payments be made in instalments depending on the type of goods (most in four equal monthly payments), leading to a higher debt to foreign suppliers. Thus, the quantitative target included in the seventh review of the IMF's Extended Fund Facility (cumulative net reserves of USD 7.6 billion by the end of 2024) seems achievable. However, it will be challenging for the government to continue to accumulate reserves in 2H24, once the USD supply from the agriculture sector tapers off, given the real exchange rate appreciation under the current crawling peg policy, which stimulates outflows.

International reserves



Source: BCRA

Economic Activity by Sectors



Source: INDEC

Activity continues to fall

Activity showed another sequential contraction in February. According to the EMAE (official monthly GDP proxy), activity fell by 0.2% mom/sa in February (marking a sixth consecutive contraction), leading to a drop of 4.4% qoq/sa in the quarter ended in February (down from -1.9% qoq/sa in 4Q23). On a year-over-year basis, activity declined by 3.2% in February and 4.0% in the quarter ended in that month (-1.5% yoy in 4Q23). Results were mixed across sectors. Construction fell by 13.2% yoy in the quarter ended in February, hit by the freeze in public works, while manufacturing contracted by 12.1% yoy in the same period. On a positive note, primary activities rose by 14.6% yoy in the period, reflecting the normalization of agriculture after the severe drought last year, while services recorded a gain of 1.3% yoy in the period.

A more benign outlook for nominal variables

We lowered our nominal exchange-rate forecast for YE24 to ARS 1,200/USD (from ARS 1,500 in our previous scenario), assuming a slower acceleration of the crawling peg policy, now beginning in 3Q24 (previously we reckoned acceleration would begin in 2Q24). This led to a downward revision of our inflation forecast for December 2024, to 160% (from 180% in our previous scenario), in line with expectations of a stronger ARS and a faster deceleration in monthly inflation. We also lowered our policy rate forecast for YE24 to 40% from 70%, reflecting the high demand for T-bills and our lower inflation expectation. We maintain our GDP growth forecast for 2024 at -3.0%, with downside risk. In our view, a significant portion of the expected annual GDP contraction already materialized in 1Q24, and activity is likely to show a sequential improvement with the normalization of the harvest (base effects from the severe drought in 2023) and the expected recovery in real wages amid lower inflation. We continue to see a primary fiscal surplus of 0.5% of GDP in 2024, but the approval of the fiscal package under discussion in the Senate could further improve our fiscal projection.

While the stabilization program has begun to reduce the economy's severe imbalances at a faster-than-expected pace, the political and social challenges are daunting. According to the Universidad Di Tella survey, confidence in the government fell again in April, to 49% (from 51% in March), as larger protests have started to emerge, suggesting that more significant headwinds may materialize.

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Argentina | Forecasts and Data

	2019	2020	2021	2022	2023F	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-2.0	-9.9	10.7	5.0	-1.6	**-3.0**	-3.0	**2.5**	2.5
Nominal GDP - USD bn	444.6	382.8	487.3	632.3	597.6	**643.5**	561.8	**723.4**	554.8
Population (millions)	44.9	45.4	45.8	46.2	46.6	**47.1**	47.1	**47.5**	47.5
Per Capita GDP - USD	9,894	8,559	10,640	13,679	12,810	**13,670**	11,935	**15,230**	11,681
Unemployment Rate - year avg	9.8	11.6	8.8	6.8	6.1	**8.5**	8.5	**8.0**	8.0
Inflation									
CPI - % (*)	53.8	36.1	50.9	94.8	211.4	**160.0**	180.0	**60.0**	60.0
Interest Rate									
Reference rate - eop - %	55.00	38.00	38.00	75.00	100.0	**40.0**	70.0	**40.0**	60.0
Balance of Payments									
ARS / USD - eop	59.90	84.15	102.75	177.10	809	**1200**	1500	**1900**	2350
Trade Balance - USD bn	16.0	12.5	14.8	6.9	-6.9	**15.0**	15.0	**15.0**	15.0
Current Account - % GDP	-0.9	0.8	1.5	-0.6	-3.6	**1.5**	1.5	**1.7**	1.7
Foreign Direct Investment - % GDP	1.5	1.1	1.4	2.6	3.8	**1.0**	1.0	**1.0**	1.0
International Reserves - USD bn	44.8	39.3	39.6	44.6	23.1	**31.0**	31.0	**35.0**	35.0
Public Finances									
Primary Balance - % GDP (**)	-0.4	-6.5	-3.0	-2.4	-2.9	**0.5**	0.5	**1.0**	1.0
Nominal Balance - % GDP (**)	-3.8	-8.5	-4.5	-4.2	-4.7	**-1.6**	-1.6	**-1.2**	-1.2
Gross Public Debt - % GDP	93.8	108.7	82.8	87.7	163.3	**169.5**	97.2	**166.4**	95.8
Net Public Debt - % GDP (***)	57.8	66.9	48.1	48.7	92.6	**96.6**	56.3	**95.3**	56.0

(*) National CPI since 2017.
(**) Excludes central bank transfer of profits from 201
(***) Excludes central bank and social security holding
Sources: Central Bank, INDEC and Itaú

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