Macro scenario - Argentina

October 4, 2024

Building a fiscal anchor

- Following this year's unprecedented fiscal consolidation, the 2025 budget bill reaffirms the government's plan of strengthening the credibility of the fiscal anchor, despite mid-term legislative elections scheduled for October 25.
- With the economy still shaking off the effects of the much-needed stabilization program, and shortly after the presidential veto on higher pensions, confidence in the government fell sharply in September, raising concerns about society's patience for the macro adjustment.

Nominal fiscal balance is a must

Fiscal balance is non-negotiable. Building a credible fiscal anchor has been one of the administration's structural priorities. Following the unprecedented fiscal consolidation this year, the administration's 2025 budget bill goes a step further, proposing an ambitious nominal fiscal balance and a primary surplus of 1.3% of GDP, albeit in the context of a swift projected inflation decline to 18.3% yoy by YE25 (from 104% by YE24), and a V-shaped GDP recovery at 5% in 2025 (-3.8% in 2024). The exchange rate is forecasted at ARS 1,207/USD by YE 2025 (implying depreciation equal to the projected inflation). In addition to next year's budget, the administration proposed a new fiscal rule that legally enshrines a nominal fiscal balance; that is, if the government's projected revenues were reduced, discretional expenditures would have to be cut proportionately, maintaining the nominal fiscal balance. While the proposed design could eventually exacerbate the amplitude of business cycle fluctuations, we believe the announcement is a step in the right direction of building credibility for the fiscal anchor. However, the bill's approval seems challenging, considering the administration's minority position in Congress and falling approval (discussed in the next section). If not approved, the 2023 budget would be extended for a second consecutive year without major consequences for the administration.

Meanwhile, the fiscal surplus marches on. In August, the government recorded another nominal fiscal surplus, leading to a cumulative nominal surplus in the year of 0.4% of GDP and the primary surplus at 1.5% of GDP. We estimate a consolidated nominal deficit of around 1.4% of GDP year-to-date (including net interest payments by the central bank), down from a deficit of 6.4% in the same period of 2023. Importantly, the swing to monthly fiscal surpluses is still driven by declines in expenditures that exceed the revenue contractions; tax revenues fell by 11.2% YoY in real terms in the quarter ended in August, affected by weak economic activity, while primary expenditure fell by 27.5% YoY in real terms over the period.

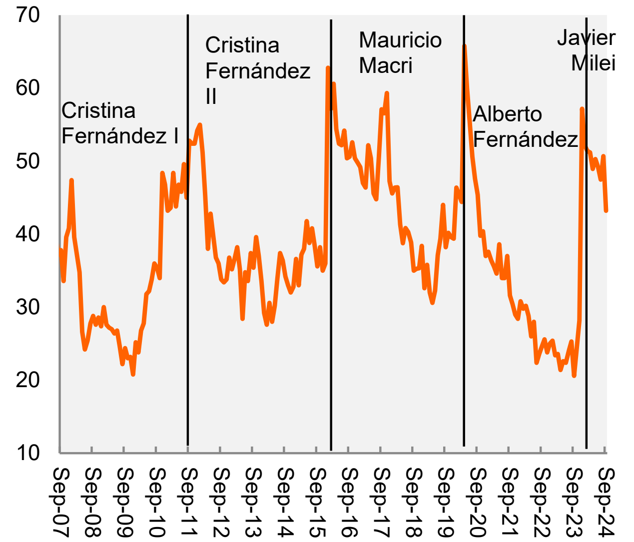
Fiscal accounts January-August 2024	
Primary expenditures *(YoY, in real terms)*	-29.4
Social security *(pensions and assist. to families)*	-19.5
Subsidies	-34.9
Payroll	-19.5
Capital expenditures	-79.4
Transfers to provinces	-69.1

Source: Indec and Mecon

Shaking confidence?

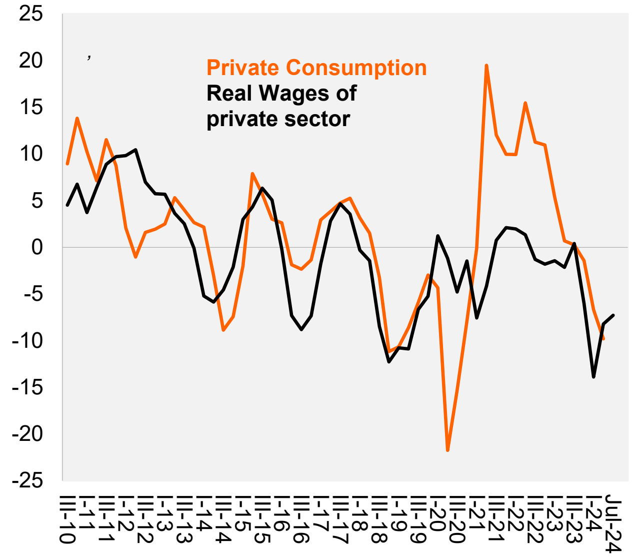
Confidence in the government plummeted in September. The administration's ability to push forward with the stabilization program has been closely monitored by market participants with different metrics of government approval. So far, confidence in the government has remained high, despite the costs of adjustment. Nevertheless, confidence in the government (according to the Universidad Torcuato di Tella's survey) fell to 43.2% in September, from 50.7% in August, below the level of the past two administrations during the same period. Confidence in the government is 24.5% below its December peak, when the administration took office. While the drop in the confidence is a warning for the government, support remains unusually high given the contraction in economic activity, high inflation, and falling real wages.

Confidence on the Government Index



Source: UTDT

Consumption and Real Wages



Source: INDEC and Itaú

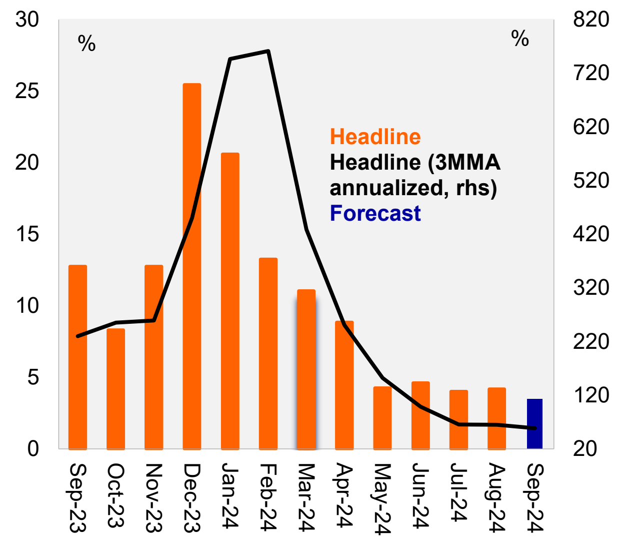
Green shoots blossom in 3Q24

Activity rebounded sequentially in July. According to the EMAE (official monthly GDP proxy), activity bounced back by 1.7% mom/sa in July, from a 0.3% mom/sa drop in June. Despite the rebound in the month, activity still contracted by 0.2% qoq/sa in the quarter ended in July (from -1.7% qoq/sa in 2Q24). On an annual basis, activity fell by 1.3% in July (declining significantly less than the Bloomberg median of -4.2%) and contracting by 1.3% in the quarter ended in July (-1.7% yoy in 2Q24). All sectors declined in the quarter ended in July (but at softer rate), except for agriculture. Construction fell by 20.1% yoy in the period (from -23.6% yoy in 2Q24), affected by the freezing of public works, while manufacturing contracted by 13.5% yoy in the same period (vs. a drop of 16.7% yoy in 2Q24). Services (including the commerce sector) fell by 4.5% yoy in the period (vs. -4.8% in 2Q24), likely affected by the decline in real wages. On the positive side, primary activities expanded by 46.5% yoy in the quarter in July (vs. +57.4% yoy in 2Q24), reflecting the normalization of agriculture after last year's severe drought. Real wages rose by 2.5% mom in July, marking the fifth consecutive monthly gain, and should support private consumption during the rest of the year.

Monthly inflation to finally start at 3?

After a bitter surprise in August, September's monthly inflation reading is projected to finally begin with "3", helped by the reduction of import taxes. The Eco Go price tracker estimates 3.4% mom inflation for September, while the median value of the latest central bank survey estimates 3.2%. In our view, the continuation of the crawling peg policy (which leads to a significant real appreciation of the ARS) should contribute to continue the disinflation process in the coming months.

Falling inflation



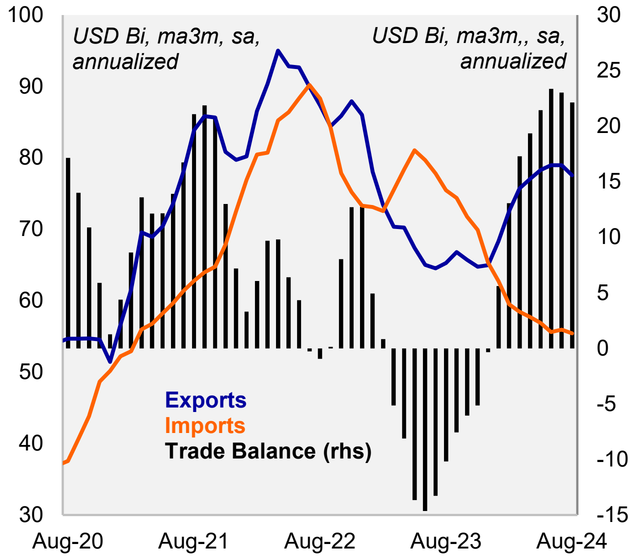
Source: INDEC and Itaú

Crawling peg for a while. With analysts convinced that the central bank will continue with the crawling peg for the rest of the year, the government seems to be reinforcing its intention to maintain the policy in 2025. Indeed, the projected exchange rate included in the budget bill (ARS 1,207/USD; +18.3% yoy) is consistent with a deceleration of the current crawling peg policy to 1.4% mom from 2.0% in 2024. Thus, the appreciation of the real exchange rate will continue if inflation does not decelerate sharply in the coming months. As we have mentioned in previous months, the appreciation of the currency poses challenges for accumulating reserves, in a context of negative net international reserves and large global bond maturities at the beginning of 2025. Thus, a repo line with banks and financing from multilaterals appears to be the main, or only, option for the treasury. On the positive side, the spread between the official exchange rate and the blue chip-swap reached minimum levels (below 25% at the end of September), likely supported by tax-amnesty-related USD inflows.

Weaker imports support a large trade surplus

The trade balance rose to a surplus of USD 2.0 billion in August, well above the USD 1.0 billion deficit registered in the same month of 2023. The 12-month rolling trade balance rose to a surplus of USD 13.5 billion in August, from USD 10.5 billion in the previous month. At the margin, the seasonally-adjusted annualized trade balance fell to a surplus of USD 22.1 billion in August, from a surplus of USD 23.0 billion in the previous month. Exports increased 18.5% yoy in the quarter ended in August, driven by the normalization of the agricultural sector, after last year's severe drought, while imports contracted 27.5% in the period, amid a weaker currency and soft activity.

Trade Balance



Source: INDEC and Itaú

Our scenario

Our 2024 GDP growth forecast stands at -4.0%, and pencils in a sequential recovery in activity starting in 3Q24, which would continue in 2025. The recovery of real wages should support private consumption over the rest of the year.

We maintained our inflation forecast for this year at 125%, supported by the appreciation of the currency amid the current crawling peg policy until the end of the year. For 2025, we expect 45% inflation, now with risks tilted to the downside also supported by the extension of the crawling peg next year. Thus, we envisage the nominal exchange rate at ARS 1,030/USD for YE24 and ARS 1,450/USD for YE25, still stable in real terms. Our policy rate forecasts remain at 40% for both 2024 and 2025. In our view, the Treasury will require net financing in early 2025, and a repo line with banks and financing from multilaterals appears today as the main option. As we mentioned earlier, we believe the administration is inclined to maintain the crawling peg policy for the time being, with the objective of contributing to a faster disinflation process, even as the policy challenges reserve accumulation and poses headwinds for a swifter recovery in economic activity.

We improved our fiscal projections for 2024 and 2025, in line with the budget bill's forecasts, reflecting this year's progress and the administration's commitment to the fiscal accounts. Now we expect a balance nominal fiscal result for 2024 and 2025.

Finally, we revised our 2024 trade surplus forecast to USD 17.0 billion, from USD 15 billion in our previous scenario. For 2025 we still expect a surplus of USD 12 billion driven by lower commodity prices and higher imports consistent with a recovery in economic activity.

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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	10.4	5.3	-1.6	**-4.0**	-4.0	**3.0**	3.0
Nominal GDP - USD bn	452.0	385.3	487.3	630.6	597.6	**634.0**	639.2	**749.4**	771.6
Population (millions)	44.9	45.4	45.8	46.2	46.6	**47.1**	47.1	**47.5**	47.5
Per Capita GDP - USD	10,057	8,490	10,640	13,643	12,810	**13,469**	13,578	**15,779**	16,246
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	**125.0**	125.0	**45.0**	45.0
Interest Rate									
Reference rate - eop - %	55.00	38.00	38.00	75.00	100.0	**40.0**	40.0	**40.0**	40.0
Balance of Payments									
ARS / USD - eop	59.90	84.15	102.75	177.10	809	**1030**	1030	**1450**	1450
Trade Balance - USD bn	16.0	12.5	14.8	6.9	-6.9	**17.0**	15.0	**12.0**	12.0
Current Account - % GDP	-0.9	0.9	1.4	-0.7	-3.4	**1.6**	1.5	**0.3**	0.3
Foreign Direct Investment - % GDP	1.5	1.1	1.4	2.4	3.8	**1.0**	1.0	**2.0**	2.0
International Reserves - USD bn	44.8	39.3	39.6	44.6	23.1	**29.5**	28.0	**31.5**	30.0
Public Finances									
Primary Balance - % GDP (**)	-0.4	-6.5	-3.0	-2.4	-2.7	**1.5**	1.0	**1.3**	1.0
Nominal Balance - % GDP (**)	-3.8	-8.5	-4.5	-4.2	-4.4	**0.0**	-1.1	**0.0**	-1.2
Gross Public Debt - % GDP	93.8	108.7	82.8	87.7	163.3	**84.0**	84.5	**82.2**	82.6
Net Public Debt - % GDP (***)	57.8	66.9	48.1	48.7	92.6	**46.3**	46.5	**45.7**	45.9

(*) National CPI since 2017.
(**) Excludes central bank transfer of profits from 2016.
(***) Excludes central bank and social security holding.
Source: Central Bank, INDEC and Itaú

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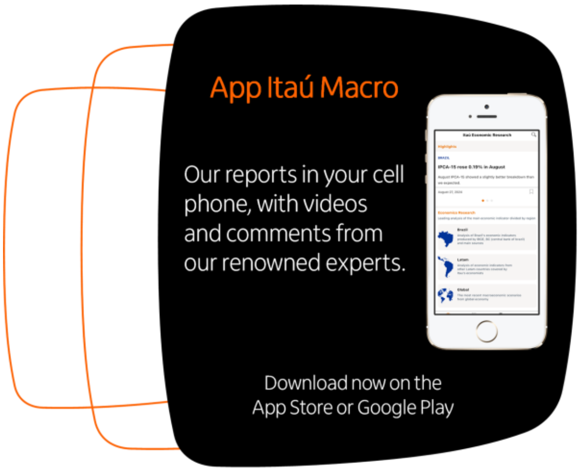
To access our reports and forecast visit our website:
https://www.itau.com.br/itaubba-pt/macroeconomic-analysis



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