Macro scenario - Argentina

November 18, 2024

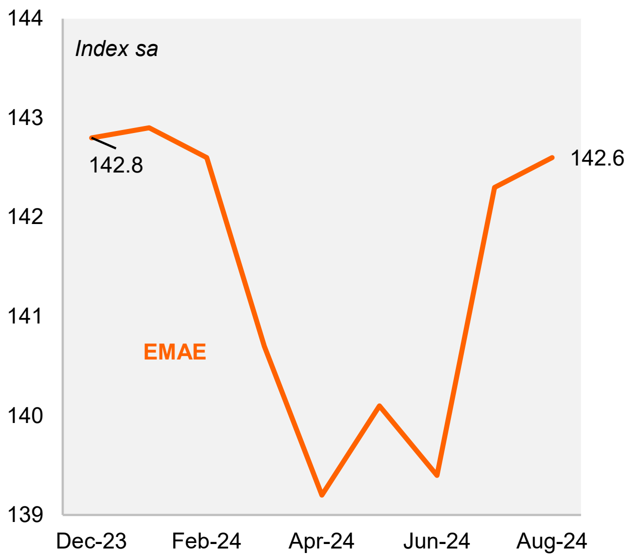
The pieces are falling into place …

- After we saw signs of stabilization last month, activity rebounded sequentially in 3Q24, with leading indicators suggesting that the recovery has legs. We now expect a GDP contraction of 3.5% in 2024, followed by a 4.0% expansion in 2025 (-4.0% and +3.0% in our previous scenario). Importantly, surveys suggest that confidence in the government rebounded in October, remaining high despite high inflation and aggressive economic adjustment.
- Disinflation continues to be driven by the crawling peg policy, despite the real appreciation of the ARS. We now foresee 2024 inflation coming in at 120% by the end of the year, down from 125% in our previous scenario. For 2025 we see inflation at 35%, down from 45% in our previous scenario. Following recent policy rate adjustments, we have also revised our interest rate forecasts for YE24 and YE25 to 30%, down from 40% for both years in our previous scenario.

Cementing green shoots?

Last month we flagged the stabilization of economic activity and the improvement of leading indicators as green shoots. Since then, data at the margin has all pointed in the same direction. According to the EMAE (official monthly GDP proxy), economic activity increased by a modest 0.2% MoM/SA in August, following a 2.1% MoM/SA increase in July. The consecutive sequential gains led to an increase of 1% QoQ/SA in the quarter ended in August, the first rise since October 2023 (+1.9% QoQ/SA). On an annual basis, activity fell by 3.8% in August, contracting less than expected (Bloomberg median was -5.3%), leading to a decline of 2.9% in the quarter ended that month. Leading indicators such as manufacturing activity (+2.6% mom/sa) and construction activity (+2.4% mom/sa) are pointing to another sequential gain in September. Activity has recovered most of the losses seen during the worst moments of the adjustment shock.

Recovering lost ground



Source: INDEC

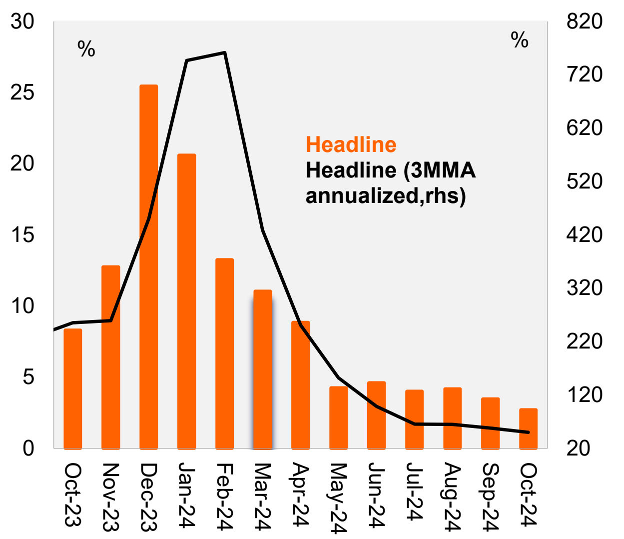
Disinflation continues…

Consumer prices rose by 2.7% MoM in October, down from a 3.5% MoM gain the previous month. Thus, the monthly reading was the lowest since YE21, helped by the appreciation of the ARS in real terms. Annualized quarterly inflation in October fell to 50.1%, down from 57.8% in the previous month. On an annual basis, inflation declined to 193.0%, from 209.0% in September. The monthly core measure increased by 2.9% MoM in October, marking a deceleration from the previous month (3.3% MoM). In our view, the continuation of the crawling peg policy (which has led to a significant real appreciation of the ARS) will likely contribute to further disinflation in the coming months. In fact, the 2025 budget bill suggests that the crawling peg policy will be eased if inflation declines as expected, while the adjustment of utility tariff will continue given the expected reduction in subsidies.

… leaving room for new rate cuts

The central bank cut the monetary policy rate by 500 bps in November, to 35%. After a series of seven cuts to the policy rate between December through May, the central bank cut the policy rate again, bringing the cumulative reduction to 9,800 bps. The decision was taken in the context of a significant reduction in inflation expectations. For context, in May (at the time of the previous rate cut), analyst inflation expectations for the following three months were at 4.9% mom, but expectations had declined to 3.0% mom in the latest survey. Twelve-month inflation expectations were at 65.6% mom in May but were down to 35.0% mom in the latest survey.

Falling inflation

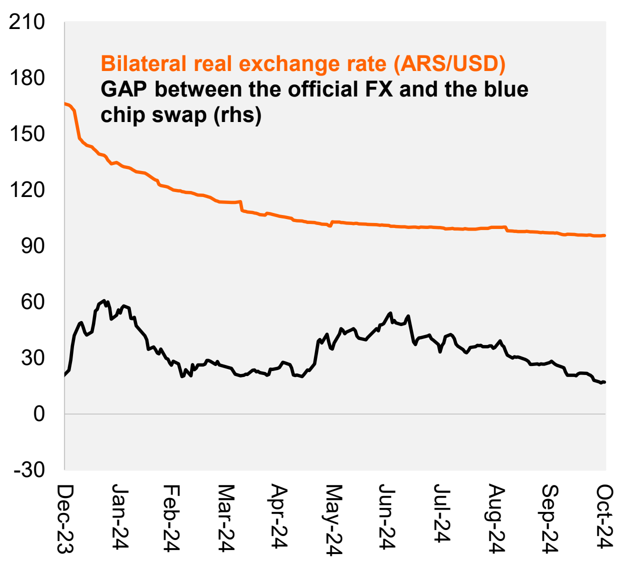


Source: Indec, Itaú

All quiet on the foreign exchange front

News from several fronts led to a narrowing of spreads in the exchange rate market. In addition to progress on the fiscal anchor and falling inflation, the central bank also managed to purchase USD in the exchange rate market, likely supported by USD inflows from the extension of the tax amnesty and still-high export liquidation. Greater deposits and loans denominated in USD (driven by the tax amnesty), news on net financing from multilaterals, and a likely repo line with private banks brought calm despite still negative net international reserves (-USD 6.0 billion by end October) and large global bond maturities in 2025. Domestic interest rates at around 3.0% mom (treasury bills), with a crawling peg running at 2.0%, has also contributed to reducing pressure on the exchange rate due to the carry trade. As a result, the average spread between the official exchange rate and the blue-chip swap dropped to below 20% in October from 30% and 37% in September and August, respectively (from an average spread of 45% over the last ten years). In our view, the central bank will continue its crawling peg policy (with a depreciation rate of 2% mom for now and an even lower rate in 2025) to support the disinflation process, despite the appreciation of the real exchange rate.

Exchange rate market

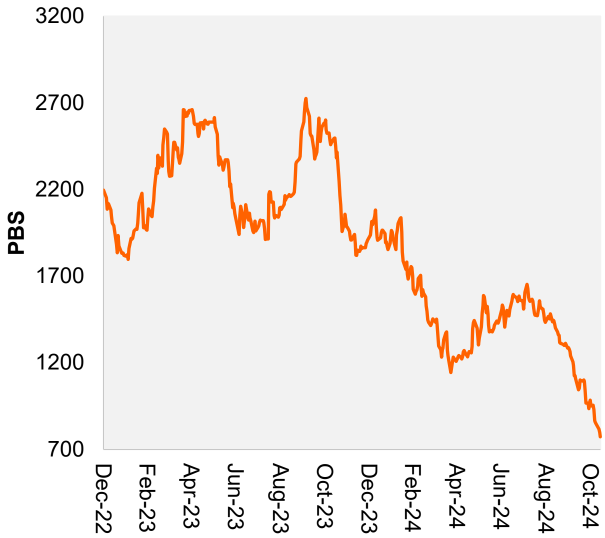


Source: BCRA and Bloomberg

Fiscal surpluses continued in October

Fiscal consolidation marches on. The primary surplus reached 1.8% of GDP in the first ten months of the year, and a nominal balance of 0.5% of GDP. Based on these figures, we estimate a consolidated nominal deficit of around 1.6% of GDP for the year to date (including net interest payments from the central bank), significantly narrower than the 10.6% deficit registered in the same period of 2023. Real tax revenues fell in the quarter ended in October, mainly affected by the cyclical contraction in economic activity, while strict expenditure control led to a 29.3% YoY real decline in primary expenditures in the same period. On the other hand, the Treasury recently announced that it will use its own ARS deposits to purchase dollars and meet the amortization of global bonds maturing in January (USD 2.7 billion), while net financing from multilaterals will likely be positive in 2025 and a new program with the IMF is possible. Also, the Treasury would be working on a repo line with private banks to strengthen reserves. The combination of faster and better-than-expected results on the fiscal front, and more clarity regarding the sources to cover short-term maturities, have contributed to the significant decline in the country's risk premium.

Argentina Embi +

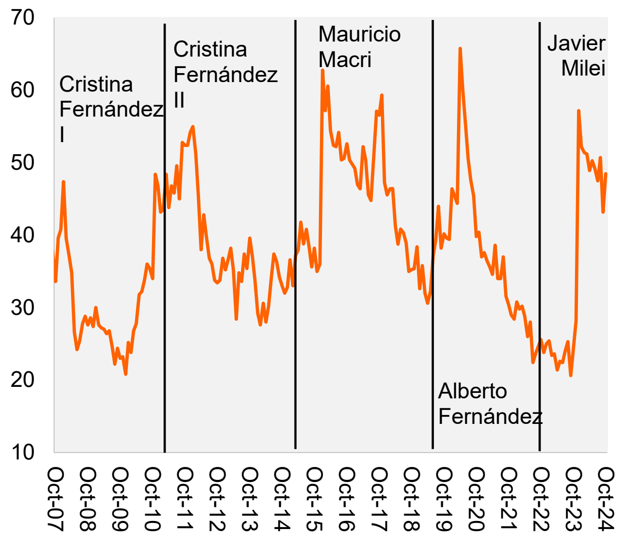


Source: JP Morgan

Confidence in the government rebounded in October

Confidence in the government rose to 48.5% in October, up from 43.2% in September. According to the Universidad Torcuato Di Tella's monthly survey, confidence in the government increased by 12.3% MoM in October, partially offsetting the sharp decline recorded in September. As a result, confidence in the government is 15.2 points below the peak registered when it took over in December. In our view, support for Milei's leadership remains unusually high, considering the contraction in economic activity and continued high inflation. It is notable that confidence in the administration rose sequentially even though President Milei vetoed the university funding bill. In fact, the confidence indicator components that increased the most were those related to the fiscal adjustment (efficiency in the management of public spending and honesty of public officials), which we believe shows support for Milei's fiscal consolidation.

Confidence on the Government Index



Source: UTDT

Improved outlook

The sequential rebound in economic activity has gained some steam, prompting us to revise our GDP growth forecasts for 2024 and 2025, driven by a higher statistical carryover. We now expect a GDP contraction of 3.5% in 2024, followed by an expansion of 4.0% in 2025 (-4.0% and +3.0% in our previous scenario). The recovery of real wages and a better environment for investment are the main drivers behind our revision.

We expect lower inflation in 2024 and 2025. We now foresee a 2024 inflation rate of 120% at year-end, down from 125% in our previous scenario. For 2025 we see inflation at 35%, down from 45% in our previous scenario. In our view, the government's strategy of obtaining dollar financing to cover debt maturities in 2025 will allow it to maintain the crawling peg policy next year with the objective of speeding up the disinflation process. Also, lower country risk may lead the government to return to international markets next year. We now forecast nominal exchange rates of 1,030 ARS/USD at YE24 and 1,350 ARS/USD at YE25 (1,450 ARS/USD in our previous scenario), lower but still stable in real terms. We foresee the policy rate at 30% for both YE24 and YE25 (from 40% in our previous scenario), in line with lower expected inflation.

In our view, the government's strategy of diversifying dollar funding may delay the elimination of multiple exchange rates in the short term. The USD blend is an ace up the BCRA's sleeve. While the program discourages reserve accumulation (as BCRA only buys 80% of total exports), it allows the authorities to keep the spread between the official exchange rate and the blue-chip swap at minimum levels due to the exporters' liquidation in that market. However, if the BCRA eventually decides to eliminate the USD blend (a unified foreign exchange market), it would be able to purchase around USD 20 billion in 12 months, at the cost of fueling inflation in the short term.

Good mates. Trump's election seems positive for the Milei administration. In the short term, relations with multilaterals, especially the IMF, may be smoother. On the other hand, the large investment law (so called RIGI) approved earlier this year could pave the way for greater US investment, particularly in strategic sectors such as energy, mining and services. Looking towards 2025, all eyes will be in the mid-term elections in Argentina, when half of the Lower House and a third of the Senate will be up for grabs. While the elections will be held in October, the calendar starts in May with the selection of precandidates for each party. The government should increase its low participation in Congress (as there are almost no seats at stake), but the focus will be on the province of Buenos Aires, where the Kirchnerism still has strong support.

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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	**-3.5**	-4.0	**4.0**	3.0
Nominal GDP - USD bn	452.0	385.3	487.3	630.6	597.6	**634.7**	634.0	**750.4**	749.4
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	**13,484**	13,469	**15,800**	15,779
Unemployment Rate - year avg	9.8	11.6	8.8	6.8	6.1	**8.2**	8.5	**8.0**	8.0
Inflation									
CPI - % (*)	53.8	36.1	50.9	94.8	211.4	**120.0**	125.0	**35.0**	45.0
Interest Rate									
Reference rate - eop - %	55.00	38.00	38.00	75.00	100.0	**30.0**	40.0	**30.0**	40.0
Balance of Payments									
ARS / USD - eop	59.90	84.15	102.75	177.10	809	**1030**	1030	**1350**	1450
Trade Balance - USD bn	16.0	12.5	14.8	6.9	-6.9	**17.0**	17.0	**12.0**	12.0
Current Account - % GDP	-0.9	0.9	1.4	-0.7	-3.4	**1.6**	1.6	**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	**30.5**	29.5	**31.5**	31.5
Public Finances									
Primary Balance - % GDP (**)	-0.4	-6.5	-3.0	-2.4	-2.7	**1.5**	1.5	**1.3**	1.3
Nominal Balance - % GDP (**)	-3.8	-8.5	-4.5	-4.2	-4.4	**0.0**	0.0	**0.0**	0.0
Gross Public Debt - % GDP	93.8	108.7	82.8	87.7	163.3	**83.9**	84.0	**82.1**	82.2
Net Public Debt - % GDP (***)	57.8	66.9	48.1	48.7	92.6	**46.2**	46.3	**45.7**	45.7

(*) 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

Macro Research – Itaú

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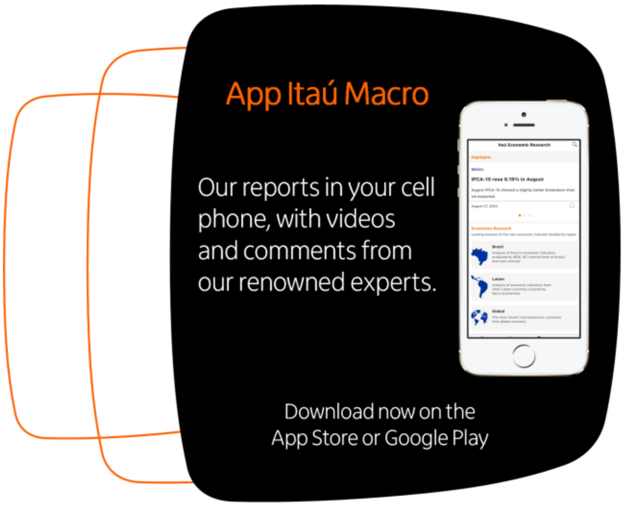

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