

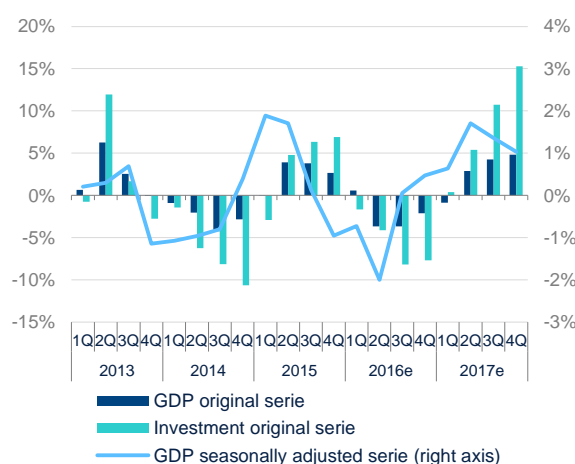
3. Argentina: U-shaped recovery

The economy gradually takes off

The data from the Q4 2016 national accounts confirm that the economy had begun to grow rather tepidly in Q3 to increase the growth rate to 0.5% Q/Q s.a. in the last quarter of the year. Although we expected a recovery path in this shape, the increase in GDP and, in particular, in investment, during the last quarter of the year it was, in the end, more moderate than forecast (BBVA(e) 1.3% Q/Q), which caused the economy to contract by 2.3% in 2016.

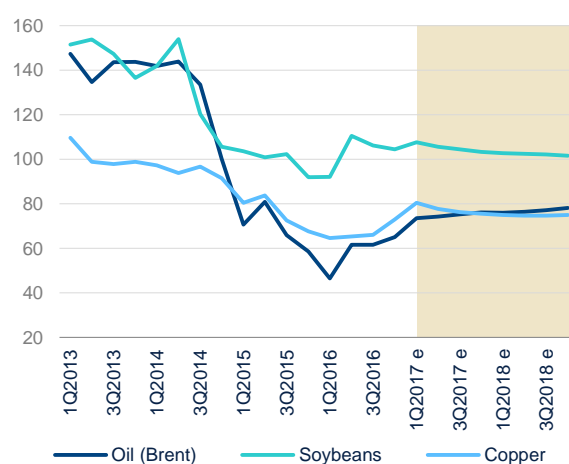
In line with what our MICA nowcasting model suggests, using the information available to date, we estimate that the economy will have also grown 0.6% Q/Q in Q1 2017 and that it will continue to grow during the next quarters of the year at an average rate of just over 1% Q/Q, with an accumulated growth of 2.8% in 2017, the same as the GDP forecasted last January. Although investment will be the component with highest growth rate in 2017 and 2018 (7.9% and 7.1% y/y), we have revised our previous forecasts downwards by around 1 percentage point due to lower momentum in the start up of private investment projects (see Figure 3.1). Public investment continues to grow at a steady pace, as shown by statistics for infrastructure projects tenders, while at the same time private construction is beginning to show signs of recovery driven by the purchase of properties with funds from the tax amnesty plan. In this context investment's share of GDP may reach 20.7% in 2018 which is a similar level to the highs prior to the imposition of exchange rate restrictions, although still lower than the ratios seen in other countries in the region.

Figure 3.1 GDP original and seasonally adjusted series (% change Y/Y and Q/Q)



Source: BBVA Research and INDEC

Figure 3.2 Prices of major commodities (Base index 2010 = 100)*



Source: Bloomberg and BBVA Research

In spite of a certain downward correction in the growth forecasts for investment, domestic absorption will continue to be the main driver of GDP in 2017, contributing 3.4% to total growth since a slight improvement in private consumption will offset this slower growth in capital expenditures, while the contribution from the external sector will

continue to be negative, at -0.6% of GDP. This mix of aggregate domestic and external demand will be repeated in 2018 to achieve growth of 3% in a year where private consumption will continue to increase based on lower inflation and improved confidence as the positive results of the economic programme become evident. Nevertheless, after the strong recovery in 2017, GDP growth will fall to a quarterly average of around 0.5% which we expect to be maintained in the following years.

Gradual growth based on domestic absorption slowly improves employment

The mildly negative contribution of the external sector mainly arises from a greater increase in imports than exports given the increased need for imported inputs and capital goods in an economy on a growth path. In spite of an improved international trade environment, the recovery in growth by the members of Mercosur and a slight average rise in agricultural raw materials prices (See Figure 3.2), exports will continue to grow at a rate of around 4% per annum in a context of appreciation of the real exchange rate and the slow improvement in structural competitiveness problems.

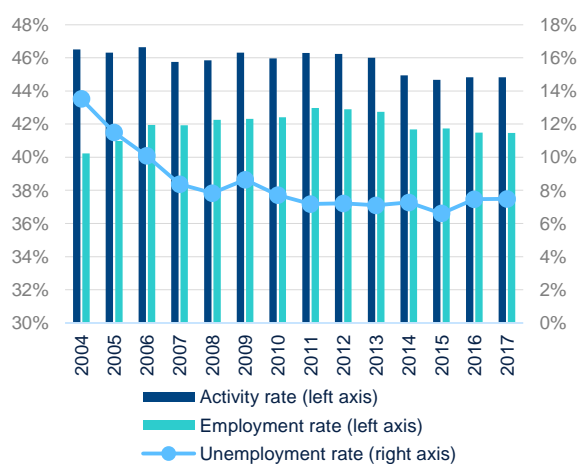
Throughout 2016, job recruitment in the formal sector fell by less than GDP suggesting a certain optimism prevailed amongst employers with regard to the future prospects for demand for their products, while, at the same time, official subsidy programmes (such as REPRO) contributed to shoring up employment in certain industrial sectors. It is likely that unemployment and underemployment in the informal sector increased at a stronger rate as a consequence of the 2016 recession, but the lack of reliability of previous information from the household survey makes assessment difficult. According to social security (SIPA) statistics in the private formal sector on average, the number of employees decreased by 0.7% last year. However, total formal employment did not fall, but instead increased by 0.6% due to an increase in salaried employees in the public sector (+2.4%) and self-employed workers. At a sectoral level, the most problematic sectors were Construction (-9%), due to the suspension of public works, followed by Mining, due to the decline in oil prices (-5.8%), and the manufacturing industry (-2.2%), while some services sectors, such as financial intermediation, recorded an increase in employment.

The employment situation began to improve from August onwards and there is a 0.8% accumulated increase in formal workers between then and February 2017 (last available data). In the Ministry of Labour's (EIL) survey of large companies the same trend can be seen with 0.6% growth between August 2016 and February 2017 in the private formal sector. Nevertheless, the sharp drop in the unemployment rate from 9.3% in Q2 2016 to 7.6% in Q4 2016 reflects not just an improvement to the employment rate of 0.2 percentage points but also, fundamentally, a sharp reduction in labour force participation from 46% to 45.3%, particularly amongst the youngest and, more particularly, women, which is probably the result of discouraged workers leaving the labour market.

Assuming progressive recovery in labour force participation rates towards levels which are more similar to historic averages, and a relatively low employment/GDP elasticity, suggested by the relatively high levels of real salaries, we estimate that unemployment will not fall in 2017-2018, maintaining an annual average of 8.5%, which is slightly higher than the known average for the first 3 quarters of 2016 (see Figure 3.3). Therefore, improvement in private consumption in 2017 will not come from a sharp increase in new jobs but rather from an increase in real salaries, as

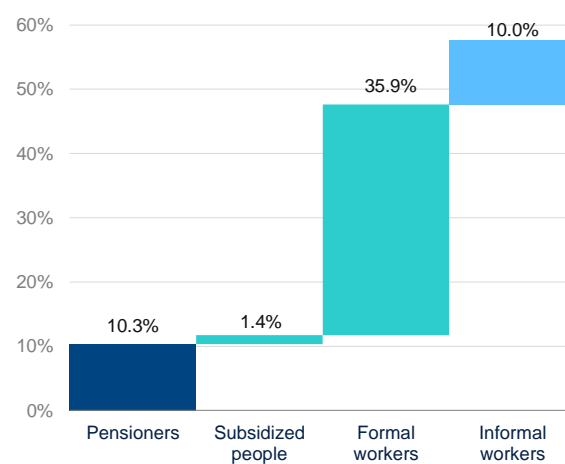
the total formal private sector wage bill represents almost 36% of total private consumption. Consumption will also be sustained by transfers to pensioners and beneficiaries of social programmes which will increase by around 40% Y/Y due to the Mobility Act which indexes them to past wage hikes and to the Historical Reparation Act which acknowledges past debt to pensioners (Figure 3.4).

Figure 3.3 Employment and participation in the labour market (%)



Source: BBVA Research and INDEC

Figure 3.4 Participation in Private Consumption (%)



Source: INDEC, SIPA social security and BBVA Research

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