9. The international outlook improves but domestic risks continue to lean towards the downside

As regards the external environment, two factors stand out, one related to the resolution of the imbalances in China and the other linked to US economic policies and the Federal Reserve's process of withdrawal of monetary stimulus measures. In the former case, the imbalances in China's economy show no signs of diminishing. Beyond the improved expectations of growth in the short term based on the resumption of stimulus measures, especially fiscal ones, medium-term risks increase, since the process of adjusting the growth model has come to a halt, and the financial weaknesses deriving from a recovery based on an increase in economic agents' indebtedness could become more pronounced. As we have repeatedly pointed out, a sharp adjustment of the Chinese economy would especially affect the economies of South America through the fall in exports to China and in commodity prices, as well as volatility in international markets.

Conversely, the risks associated with US economic (especially trade) policies are decreasing as the new administration seems to be looking at more moderate options for renegotiating NAFTA, while continuing to encounter obstacles to carrying out some of its policies on restricting immigration. However, we also mentioned at the beginning of this report the difficulty of passing measures on tax cuts or the plan for spending on infrastructure, which reduces the probability of a strong boost in the short term.

The deferral of investment projects due to doubts about the continuation of policies may bias growth to the downside

On the monetary side, we are already in a process of normalisation of monetary policy in the US, so we can expect an increase in the cost of financing globally. Communications policy will be the key to this process, to prevent mistakes like the famous "taper tantrum" (overreaction in 2013 by the bond market to the withdrawal of stimulus measures) in the USA. The tightening of financial conditions will depend not only on the policy rates set by the central banks but also, and in particular, on long-term interest rates. In this case, there are factors that continue to anchor the long section of the interest rate curve, such as the high degree of uncertainty, the scarcity of safe-haven assets and certain regulatory aspects.

The Argentine government has managed to negotiate successfully with the opposition in order to achieve many of its initiatives. However, there are still many challenges ahead which force it to negotiate continually with other parties, thus generating additional fiscal costs and a certain political attrition. Although expectations for the future remain optimistic, a slower exit from recession than estimated, or an upsurge in inflation, could be detrimental to the government's approval rating, affecting the results of the October mid-term elections and making it more complicated to strengthen the backing for the economic and political reforms that the government aspires to. Although they continue to be enthusiastic about the policy change in Argentina, a combination of several of these factors could affect foreign investors' expectations and create scepticism about the government's ability and room for manoeuvre to implement the reform plan. This could undermine the confidence and predictability needed for the promised investment plans to materialize. Although this scenario seemed to increase in probability during the first quarter of the year, given the conflicts with certain groups, such as the unions, opposition parties and other social organisations, in April the confidence and government image indicators began to improve sharply and therefore paving the way to a less complicated path to the midterm elections.

The markets have not punished Argentina for failing to fulfil the initial promise of fiscal consolidation of around 1% of GDP or more per year, giving a greater weight to Cambiemos' governance and continuance in power. Given Argentina's low level of indebtedness and prospects for growth, the sovereign debt risk premium has not risen, even in a more uncertain international environment after the new government in the United States took office. The S&P rating agency raised Argentina's sovereign debt credit rating from "B-" to "B" and gave it a stable outlook taking into account the improvements seen in the country's economic situation after the reforms which have already been carried out by the government. Nevertheless, if, in the medium term, an effective reduction in the state's weight in the economy does not materialise and the expected increase in investment levels is not consolidated, there could be an end to market complacency and Argentina's financing cost could be driven up to levels which may cast doubts on debt sustainability.

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