1. Summary

GDP growth continued to increase worldwide, to rates of around 1% per quarter, exceeding the 0.8% average since 2011. Overall, our forecasts for growth in 2017-18 have been revised only marginally. The best starts to the year have occurred in the Eurozone and especially China (where growth of 6.3% and 5.8% in 2017 and 2018 respectively is expected, around 0.5 percentage points more than three months ago), while the rates for the Latin American countries are slightly more negative this year. In the US, we continue to predict growth of 2.3% this year and 2.4% in 2018, supported by a boost in investment. As a result, expected worldwide growth is 3.3% for 2017 and 3.4% for 2018, which, in both cases, is one tenth of a percentage point higher than our previous forecasts. This acceleration has been driven by a generalised improvement in confidence levels, coupled with advances in world trade, stimulated particularly by monetary and fiscal stimulus measures in China. The performance of developed countries continues to be especially strong, with the consolidation of recovery in the US and with Europe growing above its potential. In contrast, Latin America will emerge from this year from the recession, although growth will be moderate. As regards the financial markets, over the last few months they have remained calm, recording low volatility in spite of the high uncertainty. In this context, the central banks are gradually moving forward with the monetary policy normalization process and the Fed, which leads the process, retains its gradual exit message.

In Argentina, the data from the 2016 national accounts confirm that the economy had begun to grow rather tepidly in Q3 and increased the growth rate to 0.5% Q/Q in the last quarter of the year. 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, to reach an accumulated growth of 2.8% in 2017, as we forecast in January. In spite of a certain reduction 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. The slight improvement in private consumption will offset this slower growth in capital stock, while the contribution from the external sector will continue to be negative, at -0.6% of GDP.

We expect the inflation rate (Buenos Aires City official index) to reach 22.4% year on year in December 2017. This is an increase on our previous forecast of 20.8%. We are also raising our forecast for INDEC official CPI for the Greater Buenos Aires to 19.5% y/y. Although this represents a deceleration compared to the 41% inflation of last year, which originated in the exchange rate and tariffs shocks, the monthly inflation data for the first quarter are slightly higher than expected due to downward stickiness in core inflation.

The Central Bank reacted to the latest inflation data by raising the monetary policy rate by 150 bp in April, which took the market by surprise as it expected a lower rise. The 2017 inflation target (12%/17%) continues to look difficult to achieve even after the hike in interest rates. While the fiscal deficit targets for 2017 announced last year were revised up (the primary deficit projected by the government for 2017 was raised from 3.3% to 4.2% in 2017) the inflation targets were maintained. Therefore, market expectations for inflation are not being corrected downwards, probably due to the impression that there is a lack of consistency between monetary and fiscal policy. Although we are expecting a downward trend for the monetary policy rate this year and next year, the Central Bank will remain cautious and any reduction in interest rates will be made more slowly.

The government decided to adopt a gradualist fiscal policy and, in 2016, less headway was made than expected due to political restrictions. The fiscal deficit remained almost constant in terms of GDP, in spite of extra income from the successful tax amnesty plan. Access to debt markets contributed to financing the deficit without major conflicts given that, additionally, one of the few solid points from the previous adminstration's legacy was the low level of public debt with the private sector. The Economy Minister, Nicolás Dujovne, announced quarterly targets for the fiscal deficit in 2017 and also targets for annual income, expenditure and deficit until 2019. He also introduced a new methodology for measuring the deficit which contributes to greater transparency. The targets look reachable and involve a gradual decrease to primary deficit of around 1 percentage point per year in order to reach 2.2% of GDP in 2019.

Although we expect a slight surplus in the balance of trade this year due, it will be lower than in 2016 due to a stronger rise in imports than in exports. The current account will continue to show a deficit in the medium term due to the negative balance on Real and Financial Services. In the medium term we expect that the trade surplus will be eroded as economic activity recovers, but that the current account deficit will remain stable at 3% of GDP.

The exchange rate will continue to strengthen in real terms, driven by capital inflows and the Central Bank's restrictive monetary policy which results in positive interest rates in real terms. The stronger exchange rate is sustainable in the medium term because the cost of capital for Argentina has fallen substantially, the majority of export taxes have been eliminated and there is abundant global liquidity to finance the domestic deficit. The country will continue to attract capital inflows as long as economic activity continues to recover and the government retains its target of gradual fiscal consolidation.

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