6. Without surprises in the budget proposal, the key fiscal debate will be between the Nation and the Provinces

2017 targets will be met, the focus is on the trend in the next few years

The aggregate primary result up to July suggests that 2017 targets will be comfortably met and that the primary deficit would be lower than 4.2% of estimated GDP. However, the total deficit will amount to 6.1% of GDP (higher than our former estimate of 5.9%), as the burden of debt interests is increasing at a higher than expected rate due to increased public borrowing seen since the opening of the markets the previous year and the Central Bank's reduction in funding to the Treasury.

The budget project for 2018 presented to Congress proposes a realistic macroeconomic scenario though it is slightly more optimistic than our own (see Table 6.1). The deficit reduction is based on adjusting primary spending mainly focused on energy and transport subsidies. There are no significant modifications in the indicators of fiscal proceeds in relation to GDP, from which it can be construed that the budget has been prepared without taking into account changes which will later be introduced in the tax reform to be announced after the October elections. The changes will have to be negotiated with the opposition, and it is very unlikely that there will be space for a far-reaching tax reform in the short term. In any event, the budget projection for future years may be taking for granted that any easing in tax pressure, which is currently at maximum levels, as a result of the reform would be offset with an improvement in tax collection efficiency and less tax evasion.

In coming years, the Budget Act is a statement of the Government's intent to continue to gradually bring down the deficit towards a primary surplus of 0.5% of GDP in 2024, which is quite a challenge in light of political restrictions and the current rigidity in public spending. The reduced need to finance the deficit will in turn tend to stabilise public debt indicators.

In addition to the Budget, the Congress was also sent the Fiscal Responsibility Act, aimed at improving the fiscal solvency of the provinces largely through guidelines for controlling the rise in provincial public spending. This project has already been approved by almost all the provincial administrations (22/24) and is the first step in the important forthcoming debate between the Nation and the Provinces. The Government wants to ease tax pressure on the private sector and bring down the weight of distortionary taxes such as the provincial tax on gross income. However, there is little leeway to bring down provincial taxes taking into account the possible losses in co-participation revenue from the pending judgement about the higher allocation of funds to Buenos Aires province and the virtual freezing of Social Security funds to offset the imbalances of the provincial retirement savings banks. This is taking place against a background in which the federal government needs the support of provincial governors in the Senate to approve key laws.

Table 6.1 Estimates Draft Budget Act

	2017	2018	2019	2020	2021
FX rate (average, ARS/USD)	16.7	19.3	20.4	21.2	21.9
CPI (average change y/y)	24.5	15.7	7.7	6.2	6.2
Exports (USD billion)	58.8	62.0	65.6	69.3	73.3
Imports (USD billion)	63.3	67.6	71.6	76.2	80.9
Trade balance (USD billion)	-4.5	-5.6	-6.0	-6.9	-7.6
Real GDP (% change y/y)	3.0	3.5	3.5	3.5	3.5
Private Consumption (% change y/y))	3.3	3.3	2.6	3.1	3.0
Public Consumption (% change y/y))	3.8	1.3	0.0	0.0	1.3
Investment (% change y/y))	10.1	12.0	10.1	8.4	7.4
Target fiscal primary result (% GDP)	-4.2	-3.2	-2.2	-1.2	-0.2
Target fiscal total result (% GDP)	-6.0	-5.2	-4.4	-3.3	-2.1

Source: BBVA Research with data from the Ministry of Finance

Table 6.2 Financial needs according to the Budget (% of GDP)

	% GDP	USD billion
SOURCES	**17,8%**	**114,0**
Indebtness	**17,6%**	**113,0**
CB advances	**4,6%**	**29,6**
Int. Organisms	**0,8%**	**4,9**
Treasury bonds	**8,2%**	**52,3**
Intra-public sector debt	**4,1%**	**26,2**
Others	**0,2%**	**1,0**
FINANCIAL NEEDS	**17,8%**	**114,0**
Debt payments	**10,4%**	**66,5**
CB advances	**3,5%**	**22,3**
Int. Organisms	**0,6%**	**3,6**
Treasury bonds	**5,2%**	**33,5**
Treasury bills	**3,5%**	**22,5**
Other	**1,7%**	**11,0**
Intra-public sector debt	**1,1%**	**7,1**
Financial investment	**1,9%**	**12,2**
Fiscal Deficit	**5,5%**	**35,2**

Source: BBVA Research and Ministry of Finance

Looking ahead to next year's financial needs, the government plans to refinance all the debt which is maturing that year and also issue new debt to cover the fiscal deficit. Based on the budget information, our estimates are that total net financial needs would amount to 5.3% of GDP and would be financed with transitory advances from the Central Bank (1.1%), disbursements from international bodies (0.2% of GDP), issue of public debt (2.9% of GDP) and new intra public sector funding (1.1% of GDP) (see Table 6.2). With these assumptions, the net issue of debt securities on the market would amount to USD 18.7 billion, although the total issue of debt securities could be in excess of USD 50 billion, taking into account the public debt amortised in 2018, a considerable part of which are short-term bills in dollars. Notwithstanding the above, and the above figure, there will not be so much pressure on the market to issue debt because part of the maturities are debt in public body portfolios.

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