6. Over-achievement in 2017 and pension benefit reform will facilitate fiscal targets in 2018

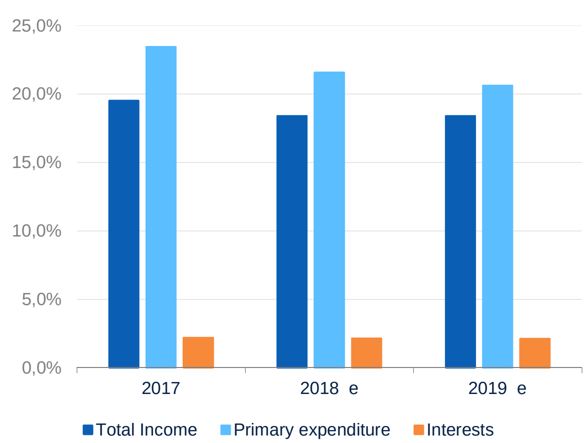
The cumulative primary fiscal deficit stood at 3.9% of GDP at December 2017, below the target for the primary balance of 4.2% of GDP anticipated for 2017 (Figure 6.1). Despite the seasonal rise in expenditure in December, and the bringing forward of 2018 outlays of ARS 25 bn and the reduction of floating debt, the balance was better than expected as, for the time since 2004, revenues (+22.6%) grew by more than expenditure (21.8%) and both did so below the year's average inflation level (25.7%). The smaller increase in tax revenues was due to a lower intake from regularisation under the tax amnesty compared to 2016 and the partial refund of 15% of the co-participation to provinces that had formerly been allocated to the National Social Security Administration. Although welfare payments (led by retirements) grew by 36.7% YoY in 2017, the contraction in subsidies to sectors of the economy (energy) of 22% and the falls in real terms of transfers to provinces and capital expenditure enabled a reduction of primary expenditure of 1.1% of GDP in 2017. Even so, the greater interest burden from the increase in borrowing meant that the overall deficit was 5.4% of GDP according to official estimates.

The fiscal pact with the provinces and the tax reform passed in December 2017 imply a sharp redistribution of tax revenues among the various different agents (social security and the provinces, among the provinces themselves, individuals vs. companies, etc.), yet since this involves only a very gradual tax reduction of 1.5% of GDP in five years, it will not produce any substantial diminishing of public revenue. The Fiscal Responsibility Act intended to enhance the fiscal solvency of the provinces (essentially via guidelines to control the expansion of provincial public expenditure) was also passed in Congress, which will allow a gradual reduction of distorting taxes such as Gross Income and Stamp in line with the aims of the tax reforms.

It we add into the mix the reduction of energy and transport subsidies scheduled for 2018, and the saving from the adjustment to the formula for calculating pension benefit mobility that was approved in December 2017, the public sector is highly likely to manage to achieve the deficit target of 3.2% for 2018 with some degree of comfort. The welfare benefit mobility system was set up in 2009 according to a formula which depended on two factors: variation in tax collection and wage rises, given that at that time no credible official inflation index existed. Although the variation in the mobility index (IM) depends on the economic cycle, from its inception up to the end of 2017 it had built up an increase that outstripped inflation, nominal GDP and wages in the registered private sector (Figure 6.2). IM-adjusted welfare benefits have topped 50% of primary expenditure to form the item that rose most to the detriment of other expenditure items. The reform of the index for making benefit adjustments has meant modifying the IM so that it moves in line with inflation, which will lead to a very sizeable saving that the government estimates to be some ARS 70 bn with respect to what was projected for 2018.

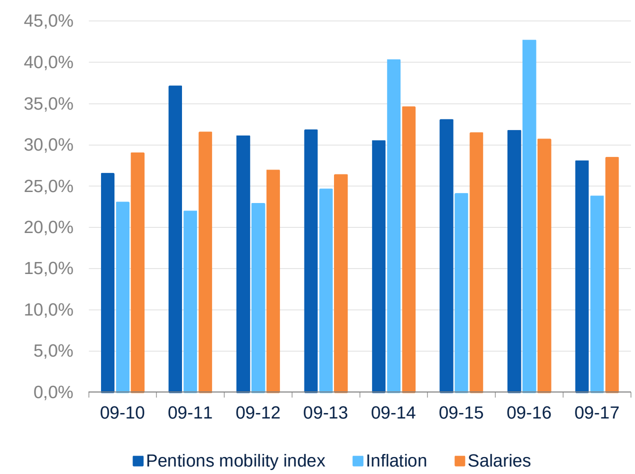
In 2019, a further reduction in primary expenditure is required of 1% of GDP to reach the target of 2.2% of GDP which is planned to be achieved via a final adjustment of energy rates and a freezing of certain items of current expenditure in real terms. In terms of medium term foreseeability, it was positive that in his presentation and when he announced the change in the inflation target, the Minister of the Treasury also presented the financial programme, with decreasing borrowing requirements for 2018 and 2019 and the schedule of a drop in central bank funding for the Treasury of around 0.5% of GDP per year to the point of this being reduced to just seigniorage in 2020. Thus in 2018 net borrowing requirements on account of central bank assistance for the Treasury (without including capital maturities) amount to USD 30 bn, which it is intended will mostly be placed in the domestic market. In January 2018, a USD 9 bn bond issue was carried out on the international market which means advance funding of around one third of the borrowing requirement for the year.

Figure 6.1 National public sector revenue and expenditure (% of GDP)



Source: BBVA Research with data from the Ministry of the Treasury

Figure 6.2 Benefit mobility index compared to inflation and wages (% var. YoY)



Source: BBVA Research, INDEC and the Ministry of the Treasury

DISCLAIMER

This document, prepared by BBVA Research Department, is informative in nature and contains data, opinions or estimates as at the date of its publication. These derive from the department's own research or are based on sources believed to be reliable, and have not been independently verified by BBVA. BBVA therefore makes no guarantee, express or implied, as to the document's accuracy, completeness or correctness.

Any estimates contained in this document have been made in accordance with generally accepted methods and are to be taken as such, i.e. as forecasts or projections. The historical evolution of economic variables (positive or negative) is no guarantee that they will evolve in the same way in the future.

The contents of this document are subject to change without prior notice for reasons of, for example, economic context or market fluctuations. BBVA does not give any undertaking to update any of the content or communicate such changes.

BBVA assumes no responsibility for any loss, direct or indirect, that may result from the use of this document or its contents.

Neither this document nor its contents constitute an offer, invitation or solicitation to acquire, divest or obtain any interest in assets or financial instruments, nor can they form the basis of any contract, commitment or decision of any kind.

In particular as regards investment in financial assets that may be related to the economic variables referred to in this document, readers should note that in no case should investment decisions be made based on the contents of this document; and that any persons or entities which may potentially offer them investment products are legally obliged to provide all the information they need to take these decisions.

BBVA | Research

This report has been produced by the Argentina Unit

Head Economist Argentina
Gloria Sorensen
gsorensen@bbva.com

Marcos Dal Bianco
marcos.dalbianco@bbva.com

Juan Manuel Manias
juan.manias@bbva.com

María Celeste González
celeste.gonzalez@bbva.com

Andrea Savignone
asavignone@bbva.com

Adriana Haring
aharing@bbva.com

Jorge Lamela
jorge.lamela@bbva.com

BBVA Research

Group Chief Economist
Jorge Sicilia Serrano

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Global Economic Situations
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Long term Global Modelling and Analysis
J. Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems And Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

International Coordination
Olga Cerqueira
olga.gouveia@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.com

Regulation
María Abascal
maria.abascal@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Turkey, China and Big Data
Álvaro Ortiz
Alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

China
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Perú
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

CONTACT DETAILS: BBVA Research ‑ BBVA Banco Francés: Reconquista 199, 1st floor. C1003ABC - Buenos Aires (Argentina).
Tel.: (+54) 11 4346 4000 / Fax: (+54) 11 4346 4416 - bbvaresearch@bbva.com www.bbvaresearch.com