

1. Summary

The better-than-expected results for the government in the October 2017 parliamentary elections dispelled doubts about the continuity of economic policy changes after 2019, stimulating more spirited investment in Argentina. The increased political capital allowed the government to announce a raft of prompt structural reforms, many already approved by Congress. At the same time optimism has swelled over the recovery of the world economy, and an upward revision of approaching 0.5pp for growth for Brazil and one of 1pp from 2019 for China point to a substantial improvement in external demand. Given this context, and also bearing in mind that the latest figures confirm that Argentina's economy is still growing at around 0.9% QoQ, **we now estimate a 3.3% rise in GDP in 2018 and 2019, which is a shade higher than was previously being forecast.**

2017 inflation closed at 24.8% YoY, which was well above initial expectations, owing to a bigger-than-expected impact from the correction of regulated prices and greater core inflation inertia. Faced with this fact and given the failure of analyst expectations to converge towards the target of 10% (+/-2%) for 2018, the Executive announced that it is postponing its goal of achieving 5% inflation by one year (to 2020). The target for 2018 will be 15%, with 10% (previously 5% +/-1.5%) for 2019. The prospect of an easing of monetary policy after modification of the targets, which the central bank corroborated by lowering the MPR by 150bp in January, prompted an upward revision of analyst expectations and a rapid depreciation in the exchange rate. **After taking account of the potential impact of a de-anchoring of expectations regarding wage bargaining and signs of a more dovish central bank, we are changing our forecast rise for the CPI to 18.5% for 2018 and 12.2% for 2019. We predict that the central bank will continue to pare down the monetary policy rate very gradually**, especially in the first four months of 2018, since the inflation figures will give no cause for optimism, until arriving at 21% by year end. The MPR will in any event stand at around 8% at the end of 2018 in real terms, which is still firmly positive.

The fiscal pact with the Provinces and the tax reform passed in December 2017 imply a sharp redistribution of tax revenues, 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 will enable a gradual reduction of distorting taxes such as that on gross income without any deterioration to provincial finances. The 2017 primary fiscal deficit was 3.9% of GDP and, since this was below target, it meant that 2018 expenditure could be brought forward. If we add into the mix the reduction of energy and transport subsidies and the saving from the adjustment to the formula for calculating pension benefits, **the public sector is highly likely to manage to achieve the deficit target of 3.2% for 2018 with some degree of comfort.**

More vigorous domestic demand, together with the real appreciation of the Argentine peso contributed to a sharp rise in imports in 2017 without any clear signs of recovery for exports yet. We forecast that, with the economy growing at close to its potential rate of 3%, imports will continue to rise at a sustained clip, but that the reforms to boost productivity

and a restoration of growth for Argentina's trading partners will lead to increased export buoyancy and a stabilisation of the trade deficit at around 1.5% of GDP. **Given the slow fiscal adjustment and that companies will continue to finance their expansion plans abroad, the current account deficit will remain high in the next few years up to 2020, averaging close on 5% of GDP.** Financing for this deficit will continue to flow, with the surplus supply of dollars remaining in place beyond occasional bouts of volatility, thereby giving rise to peso depreciation below the inflation rate, while, monetary policy, though looser, will buoy interest rates above expected inflation, underpinning the appeal of investments in pesos for non-residents.

This pattern underlines Argentina's vulnerability to any change in international conditions, and so it is crucial for the reforms that Macri's Government is pushing through to start bearing fruit in terms of improving productivity so that the financing of the current account is mostly channelled via foreign direct investment rather than through portfolio investments that are subject to sudden stops. There are likely to be major political limitations on forging ahead more swiftly with an agenda of supply-side reforms, but the government remains oriented toward its goal of bringing Argentina back onto the world stage to expand the size of the market and generate economies of scale

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.

The contents of this document are protected by intellectual property law. It is expressly prohibited to reproduce, process, distribute, publicly disseminate, make available, take extracts, reuse, forward or use the document in any way and by any means or process, except where it is legally permitted or expressly authorised by BBVA.

This report has been produced by the Argentina Unit

Head Economist Argentina

Gloria Sorensen
gsorensen@bbva.com

Marcos Dal Bianco
marcos.dalbiano@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.serrano@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