

# Argentina Economic Outlook

4Q20

October 2020

## Key points



**Global growth**, supported by resolute fiscal and monetary policy measures, **rebounded in the third quarter and is expected to continue doing so in the fourth quarter**, albeit at a slower rate, as the number of infections remains high.



**Recovery of global activity is expected to gain momentum in 2021**. The expected approval and distribution of effective vaccines and treatments against COVID-19 will allow for a progressive relaxation of social distancing measures over the next year, firstly in the major world economies and then in the rest.



**Argentina: New COVID-19 cases are plateauing in the AMBA but are increasing at worrying levels in several provinces**, some of which are showing signs of saturation in their healthcare systems. The approval of the pandemic management by the president has been eroded as social isolation has been extended.



**We expect a 13% fall in GDP in 2020**. Although activity is recovering from April lows, high frequency data shows a weak recovery in the second half of the year. Activity will grow by 5.5% in 2021, largely explained by statistical effect (i.e., driven by the mere normalization of economic activities).

## Key points



The unemployment rate reached 13.1% in 2Q20. This figure, which appears moderate, is explained by the fact that the economically active population fell to a historic low of 38.4%. This fall represents around 2.5 million fewer jobs compared to the beginning of the year. We expect an average unemployment rate of 14% for 2020 and 15.4% for 2021.



This year, the primary fiscal deficit would reach 8% of GDP, due to a sharp fall in revenue (resulting from the recession and the contraction of foreign trade) combined with a significant expansion of primary expenditure to lessen the impact of the pandemic. By 2021, we expect a deficit of 5.4% of GDP.



Money issuance remains the only source of financing for this deficit. Monetary assistance would exceed 8% of GDP in 2020. The Central Bank is conducting a process of "interest rate harmonization," so the relevant monetary policy rate is now the weighted average between LELIQ and REPOs (now at 34% per year). We expect an increase in this policy rate, up to 38% in 2020, in order to deal with the current monetary overhang in the economy. This rate would be subsequently raised toward 45% per year in 2021.

## Key points



The gap between the parallel and the official exchange rate surpassed 100% in October showing strong FX pressures in the economy. Despite this, and while we expect an acceleration in the monthly average depreciation in 4Q20, we have reduced our Dec-20 forecast from USD/ARS 90 to 86 because of the government's clear intention to avoid a steep devaluation. For 2021, we expect an exchange rate of USD/ARS 125 with an unchanged real exchange rate in the election year, but the balance of risks is skewed toward further depreciation.



The crawling peg of the exchange rate, frozen utilities' rates, social distancing and the deep recession have slowed inflation in 2020. We expect a 39% inflation for Dec-20, with a rise in 2021 to 50% due to the activity rebound, fiscal difficulties to further delay tariff adjustments and the impact of the current monetary overhang (combined with a mild monetary policy tightening).



The current account balance will show a surplus of 2.3% this year and 2.1% in 2021, as a result of the reduction in interest payments achieved by the debt restructuring and a better-than-expected trade surplus.



The debt restructuring ended with a 99% acceptance of private creditors. This exchange opens a 4-year window to stabilize the economy and restart growth. To achieve this, the government must agree on a new program with the IMF and give clearer signals of its multi-year economic plan.

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# Global Economic Outlook 4Q20

# Economic activity recovered rapidly in the third quarter, and is slowing in the fourth quarter due to the difficulty of controlling the pandemic

## RECENT DEVELOPMENTS IN THE WORLD ECONOMY

### Growth: 3Q20



Faster recovery than expected

### Economic stimuli



Growing and significant

### Growth: 4Q20



Signs of moderation

### Evolution of the pandemic

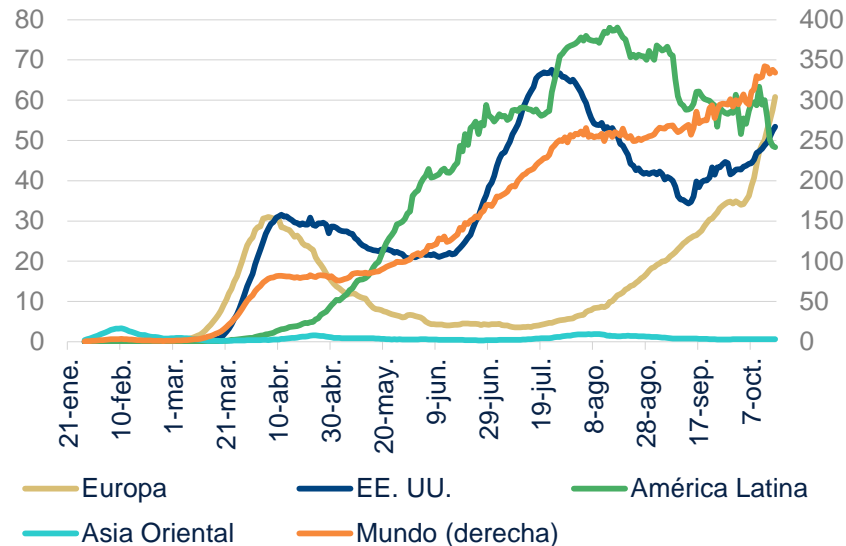


Infections on the rise in Europe and high in the Americas

# The pandemic is re-emerging in Europe, continues to worsen in the Americas and is under control in Eastern Asia

## DAILY CASES OF COVID-19 (\*)

(THOUSANDS OF PEOPLE, MOVING AVERAGE OVER THE LAST 7 DAYS)



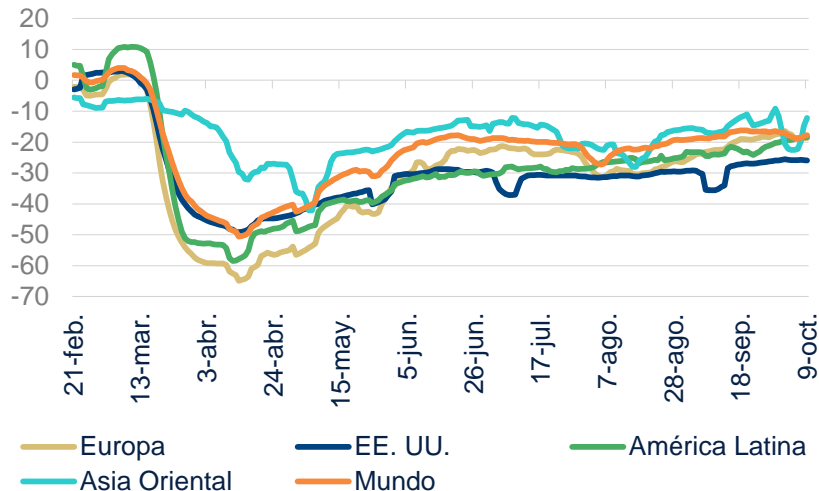
- Cases of COVID-19 worldwide have rebounded since September.
- **Europe:** infections on the rise, but with a relatively limited lethality so far.
- **United States:** after a respite, infections are back up in September.
- **LATAM:** infections are stable or falling, except in Argentina, where they are on the rise.
- **China** and other Asian countries: relatively under control.
- At least 10 **vaccines** are in the final phase of clinical evaluation, raising expectations that the virus will be controlled.

(\*) Europe: Germany, Spain, France, Italy, Portugal, the United Kingdom and Turkey. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Eastern Asia: China, South Korea, Japan and Singapore.

Source: BBVA Research based on data from Johns Hopkins University.

# New lockdown measures are less restrictive and more targeted than before

## MOBILITY TO THE WORKPLACE (\*) (HIGHER VALUES INDICATE GREATER MOBILITY)



(\*) The mobility indicator reflects the trends in mobility compared with the baseline period (January 3 through February 6). Average for the last 7 days. Europe: Germany, Spain, France, Italy, Portugal, the United Kingdom and Turkey. Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru and Uruguay. Eastern Asia: China, South Korea, Japan and Singapore.

Source: BBVA Research based on Google Mobility Reports.

### ■ Mobility is greater now than in the first few months of the pandemic:

- preference for selective, less restrictive lockdowns.
- high economic and social cost of severe lockdowns.

### ■ However, mobility remains below "normal" levels:

- official restrictions in many countries (increasingly in Europe).
- new habits adopted voluntarily, due to fear or inertia.

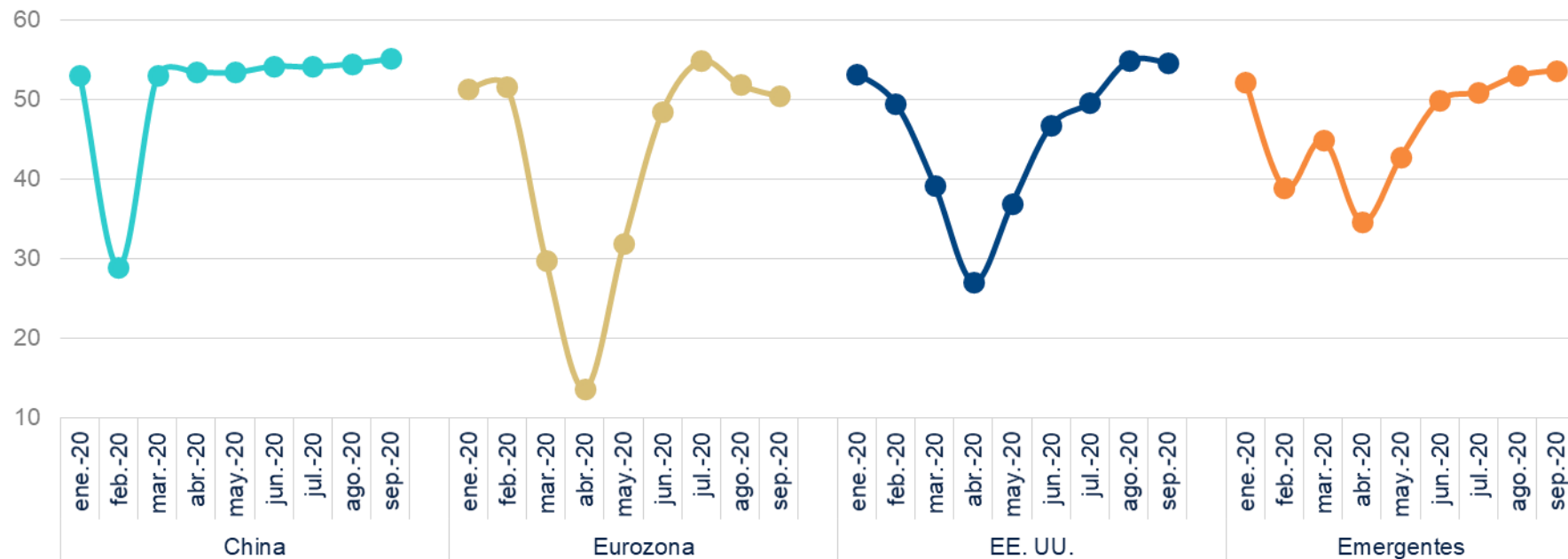
### ■ It will be difficult for mobility to normalize without an approved vaccine.



# Faster than expected recovery since April, but with increasing signs of slowdown

## PMI INDICATORS

(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



# The consolidation of the recovery will only come with a widespread vaccine or treatment

## ASSUMPTIONS BEHIND THE FORECASTS IN A HIGHLY UNCERTAIN ENVIRONMENT

### COVID-19



**Gradual improvement after the approval and distribution of a vaccine,** in the first half of 2021 for the major economies and in the second half for the others.

### Economic policy



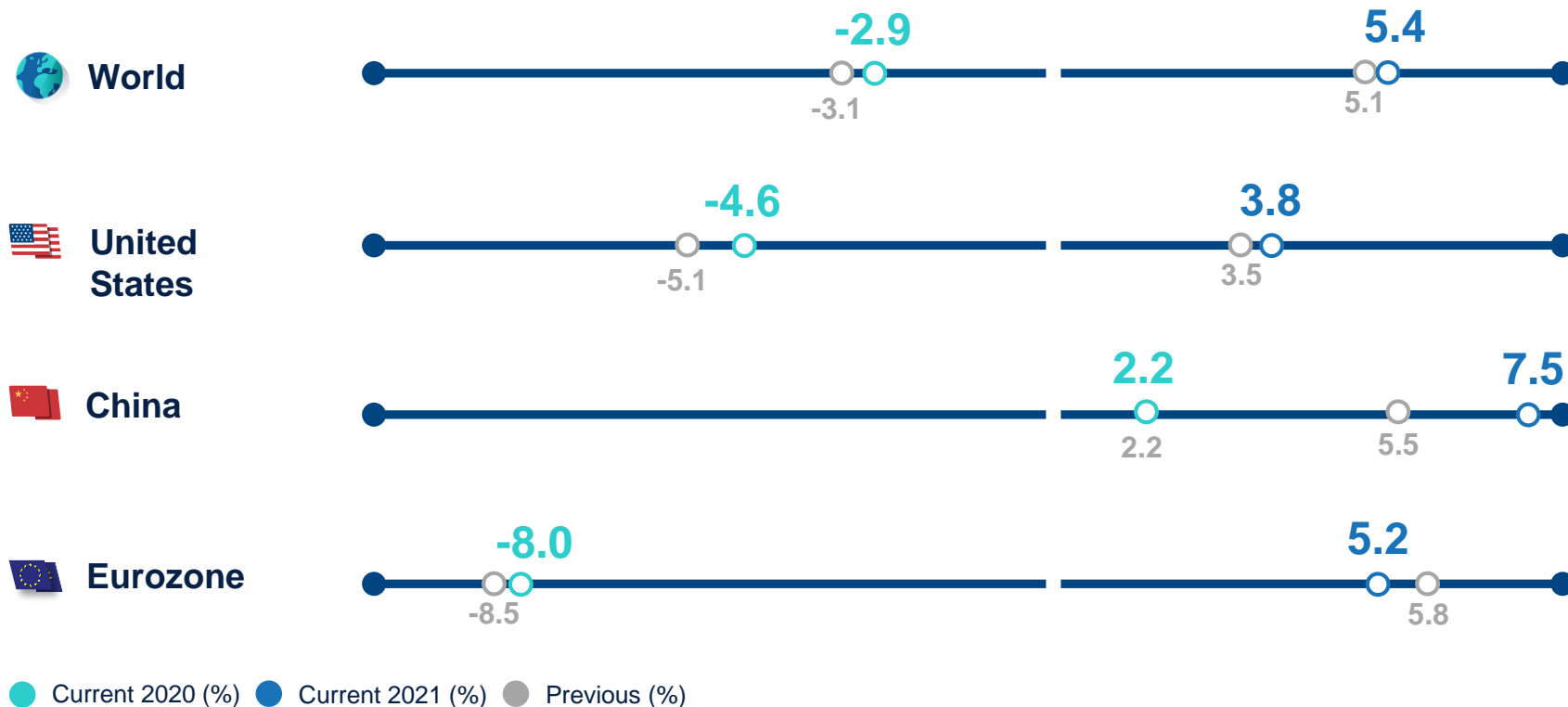
**The stimuli will remain at least until the recovery is consolidated.**

### Financial markets



**Gradual reduction of volatility and risk aversion throughout 2021.**

## Upward adjustment in global growth forecasts



## The risks in the central scenario go in both directions



### Positive risks

- Vaccines being distributed earlier than expected and/or new treatments favor:
  - a stronger rally in confidence.
  - increased risk taking.
- Additional fiscal and monetary stimuli.
- Greater global policy coordination.



### Negative risks

- Increased infections and poor efficacy of vaccines and treatments.
- Impact of the second wave of the pandemic:
  - corporate bankruptcies.
  - public debt sustainability.
- Financial stress, capital outflows from emerging economies.
- Geopolitical, political and social tensions.
- De-globalization.

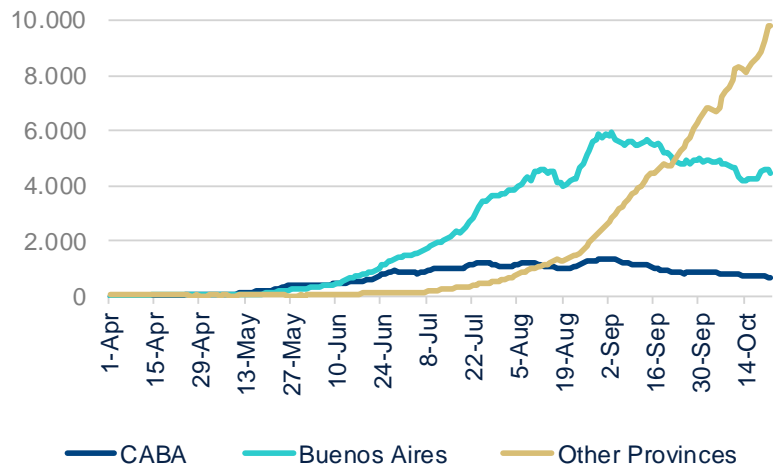
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# Argentina Economic Outlook 4Q20

# COVID-19 cases increased at different speeds and stricter lockdowns were reintroduced in some provinces

## NEW CASES BY JURISDICTION

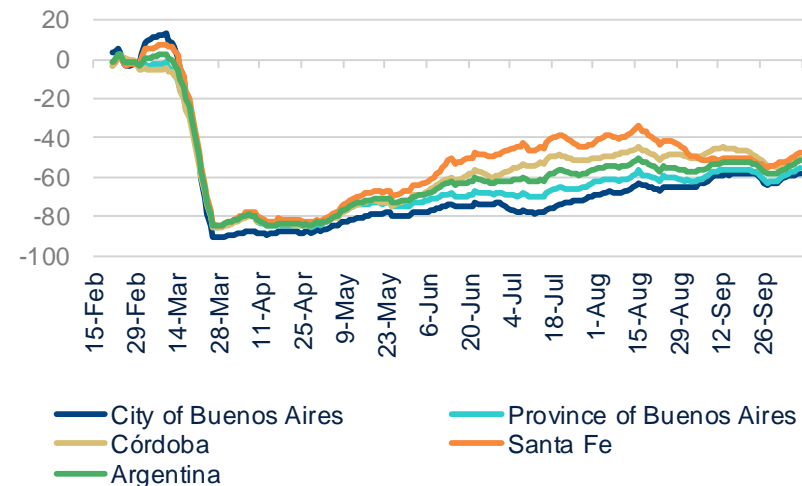
(CASES, 7-DAY MOVING AVERAGE)



Source: BBVA Research and the Argentine Ministry of Health.

## MOBILITY IN BUSINESSES AND RECREATION SPACES

(% CHANGE COMPARED TO THE AVERAGE FROM JAN 3 TO FEB 6)

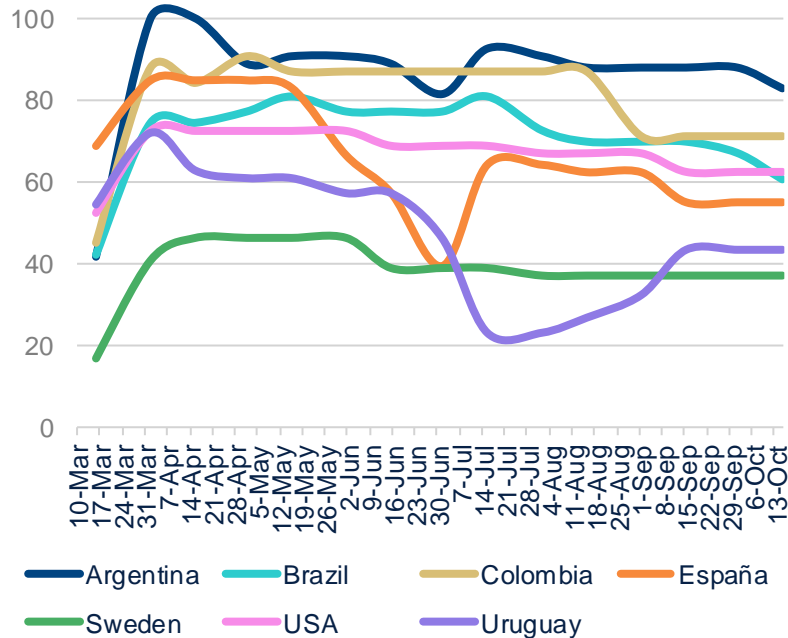


Source: Google.

Outbreaks moved from Buenos Aires to the rest of the Provinces. Occupation of ICU beds across the whole country has reached 64%, but the saturation of healthcare systems in provinces with over 80% ICU bed occupancy is concerning.

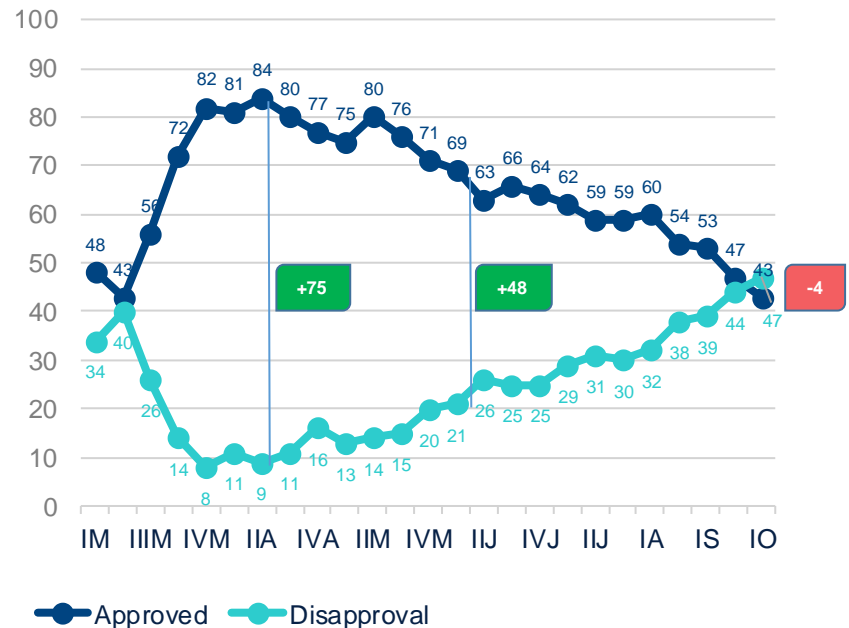
# The continuous rise in the number of infections is resulting in social distancing measures remaining strict

## SEVERITY OF SOCIAL DISTANCING MEASURES (OXFORD STRINGENCY INDEX, 100 = MOST SEVERE)



Source: BBVA Research and the University of Oxford.

## SOCIAL APPROVAL OF THE PRESIDENT'S MANAGEMENT OF THE CORONAVIRUS

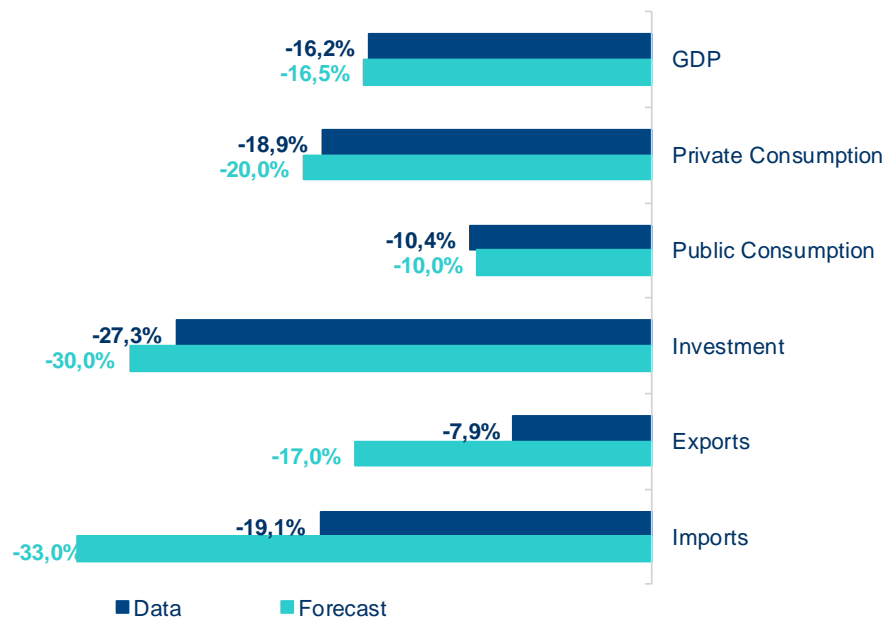


Source: BBVA Research & Poliarquía.

# The whole economy was affected by the shutdown in activities in 2Q20...

## GDP Q2 2020, BY COMPONENT

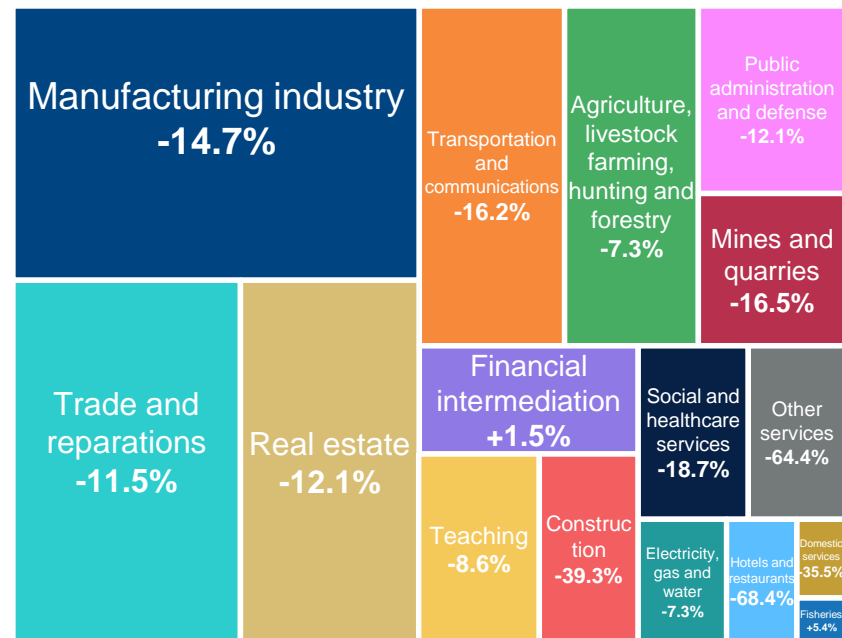
(Q/Q % CHANGE, S.A.)



Source: INDEC and BBVA Research.

## GDP Q2 2020, IMPACT PER SECTOR

(Q/Q % CHANGE, S.A.; IMPACT BY BOX SIZE)



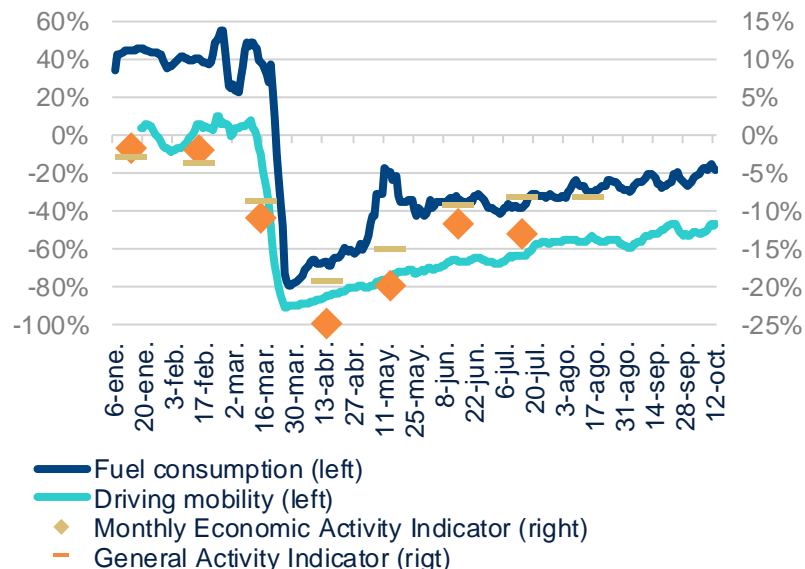
Source: INDEC and BBVA Research.



## ...and has been showing signs of a fatigued recovery since July

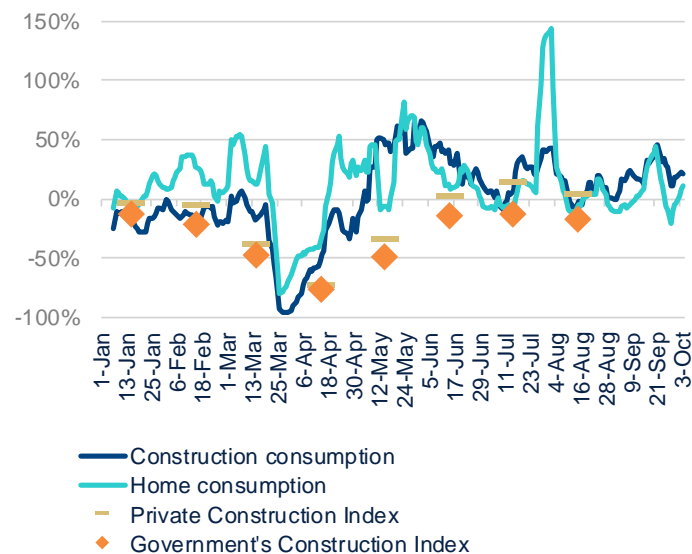
### FUEL CONSUMPTION<sup>1</sup>, MOBILITY AND ACTIVITY

(FUEL: Y/Y % CHANGE, 7-DAY MOVING AVERAGE; IGA: Y/Y % CHANGE IN REAL TERMS)



### CONSTRUCTION EXPENDITURE<sup>1</sup> AND SECTOR ACTIVITY

(CONSUMPTION: Y/Y % CHANGE, 7-DAY MOVING AVERAGE; SECTOR INDICATORS: Y/Y % CHANGE)

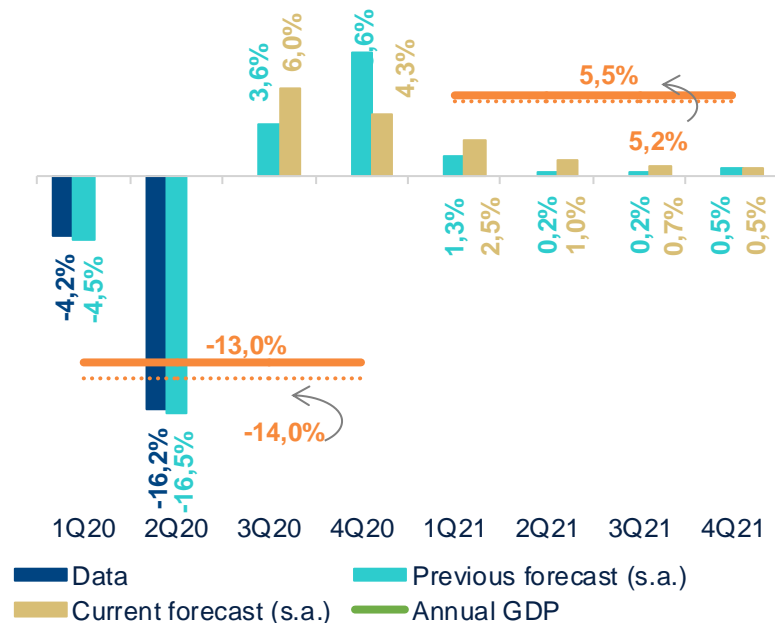


1: Fuel and construction expenditure are high frequency indicators based on spending in these areas by BBVA customers paying by card. Both have shown to be reliable when predicting short-term activity. \* Measures the level of activity of 11 companies representing the construction market in Argentina.

## 2020 will be the year of the COVID-19 crisis and 2021 the year of the weak recovery (mainly by the normalization of activities)

### GDP: CURRENT AND PREVIOUS FORECAST

(Q/Q % CHANGE S.A.; Y/Y % CHANGE IN REAL GDP)



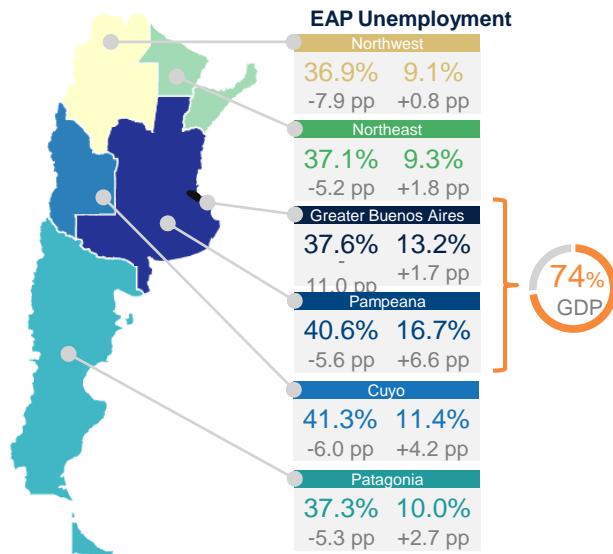
Source: BBVA Research based on data from INDEC.

- We adjusted our forecast from -14% to -13% for this year, given that data from 2Q20 were slightly better than expected and data from 1Q20 were revised upward.
- Our real-time consumption indicator shows that recovery began to plateau in 2H20.
- This is due to the combination of a fragmented ending of movement restrictions which has taken place at different speeds (and which will continue until the end of the year), and the impact of the surge in exchange-rate pressures following the debt settlement.
- In 2021, activity will be lackluster due to revenue that will be slow to recover, business bankruptcies, losses of markets and persistent unemployment.

# Employment plummeted together with activity, but the historic shrinkage of the labor force lowered the rise in the unemployment rate to 13.1%

## ACTIVITY AND UNEMPLOYMENT BY REGION

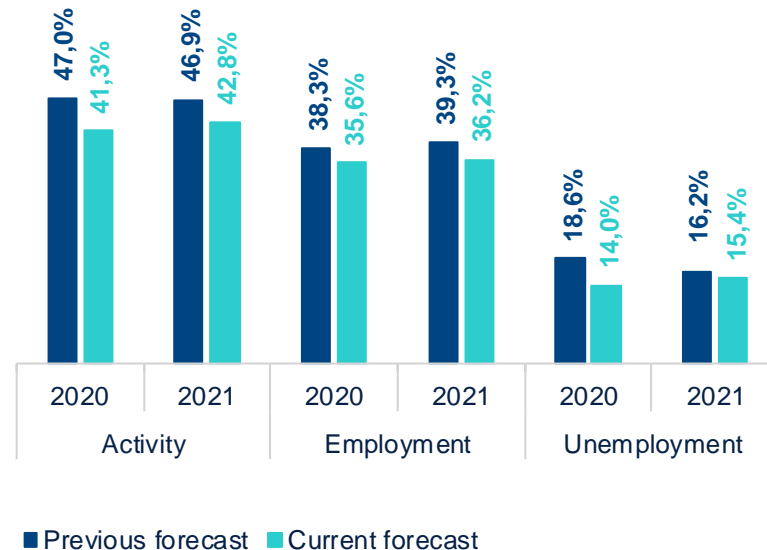
(OVERALL RATE IN %; Q/Q CHANGE IN PP)



Source: BBVA Research and INDEC.

## LABOR MARKET PROJECTION 2020–2022

(ANNUAL AVERAGE RATES)



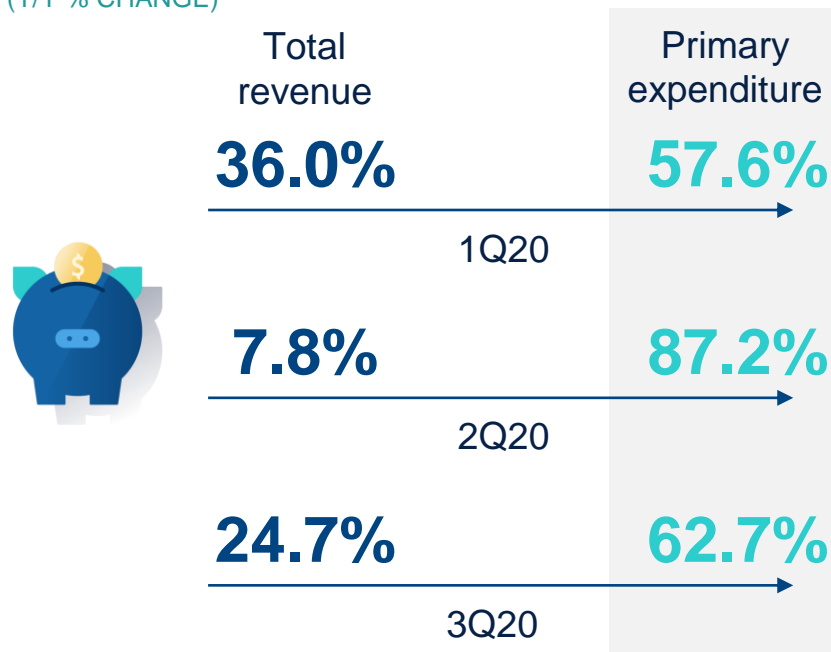
Source: BBVA Research and INDEC.

Both the economically active population (EAP) and employment plummeted in 2Q20 by an equivalent of 2.5 million people compared to 1Q20. If the labor force had remained at the same level as in 1Q20, the unemployment rate would have climbed to 29%.

# Government expenditure skyrocketed in 2Q20 to lessen the impact of the pandemic, while revenue fell as a result of the recession...

## EVOLUTION OF TOTAL REVENUE AND PRIMARY EXPENDITURE BY QUARTER

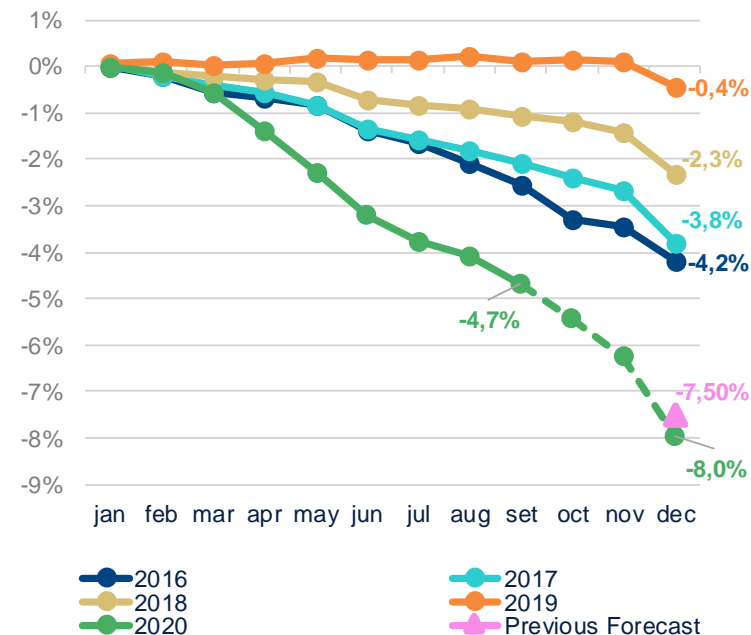
(Y/Y % CHANGE)



Source: BBVA Research based on data from the Ministry of Finance.

## CUMULATIVE FISCAL PRIMARY DEFICIT

(% of GDP)

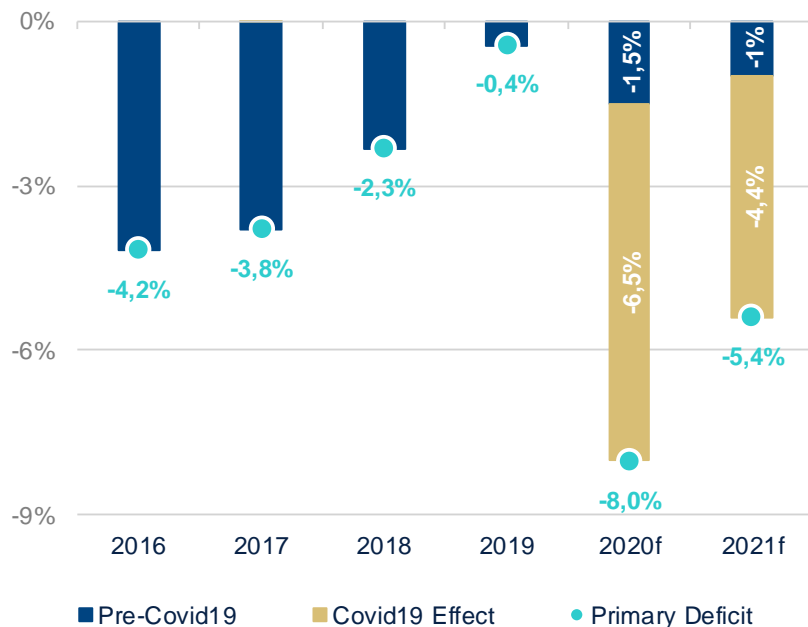


Source: BBVA Research based on data from the Ministry of Finance.

## ...and therefore the fiscal primary deficit in 2020 will be 8% of GDP...

### PRIMARY FISCAL BALANCE

(% OF GDP)

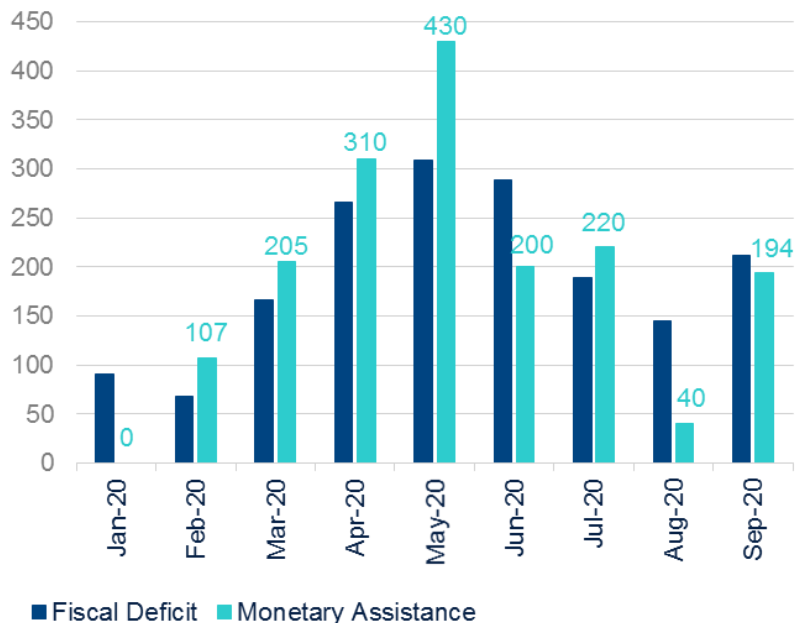


- The fiscal package to provide aid to those affected by COVID-19 represents 4% of GDP.
- While wages and pensions are growing more slowly than inflation, economic subsidies and transfers to provinces are the areas increasing the most.
- For 2021, we are predicting a (partial) withdrawal of COVID aid and an improvement in revenue caused by the recovery of economic activity. However, **the inertia of expenditure, accentuated by the mid-term elections, will result in a deficit of 5.4%.**

## ...which the Treasury can only finance by money issuance

### FISCAL DEFICIT AND MONETARY ASSISTANCE TO THE TREASURY

(ARS BILLION, PER MONTH)



Source: Ministry of Economy and BCRA.

### MONEY ISSUED TO ASSIST THE TREASURY

(% GDP, ROLLING 12-MONTH CUMULATIVE SUM)

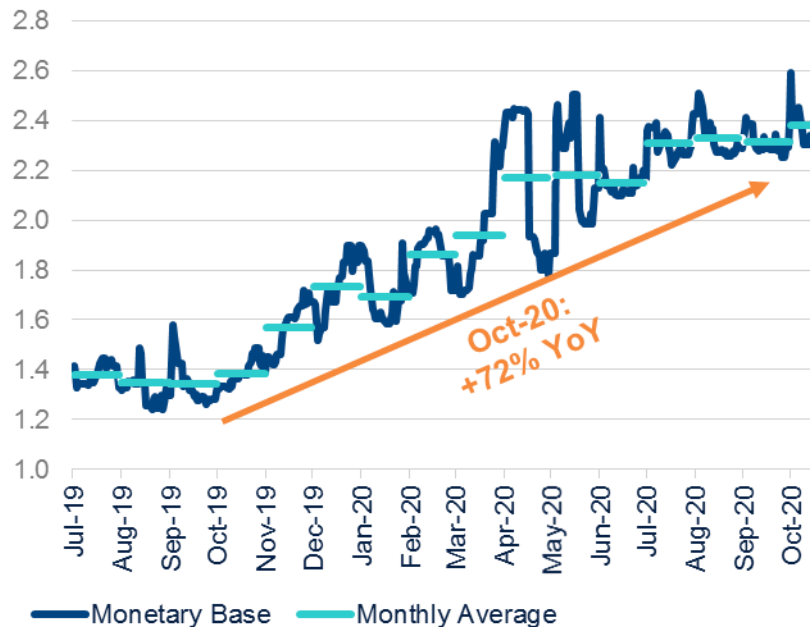


Source: BCRA and INDEC.

# The BCRA is trying to curb this monetary overhang through the issuance of its own securities (LELIQ and REPOs)

## MONETARY BASE

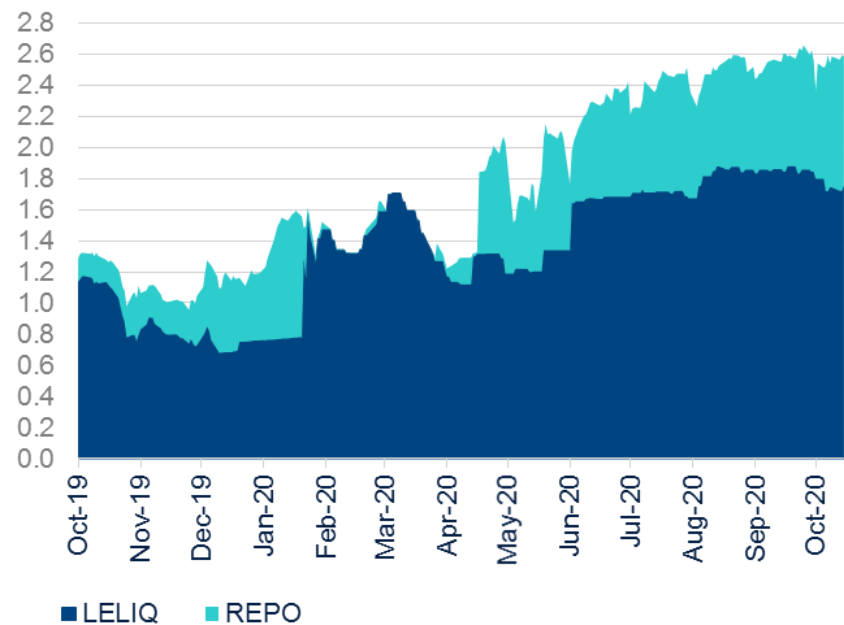
(ARS TRILLION)



Source: BCRA.

## COMPOSITION OF BCRA'S SECURITIES

(ARS TRILLION)

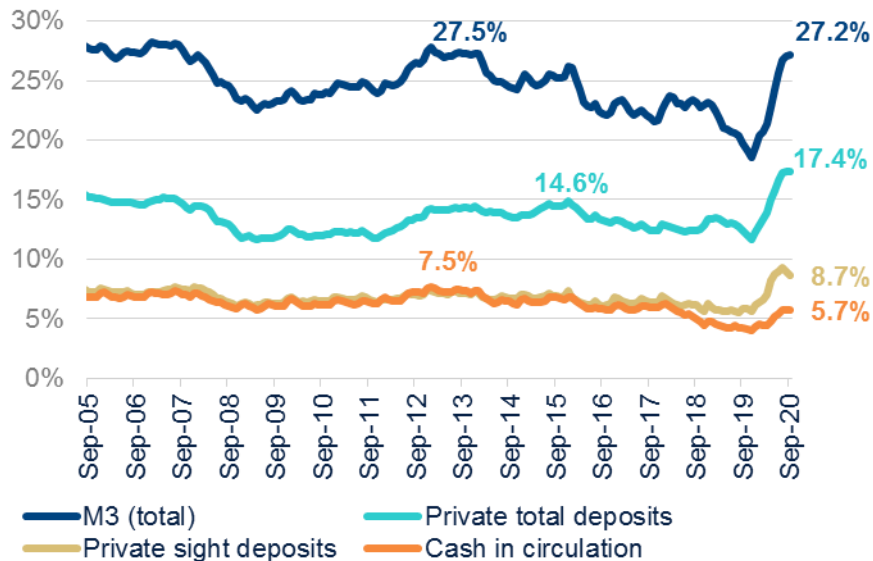


Source: BCRA.

## The current situation is characterized by the coexistence of an abundant amount of pesos and few dollars...

### MONETARY AGGREGATES IN ARS

(% OF GDP)

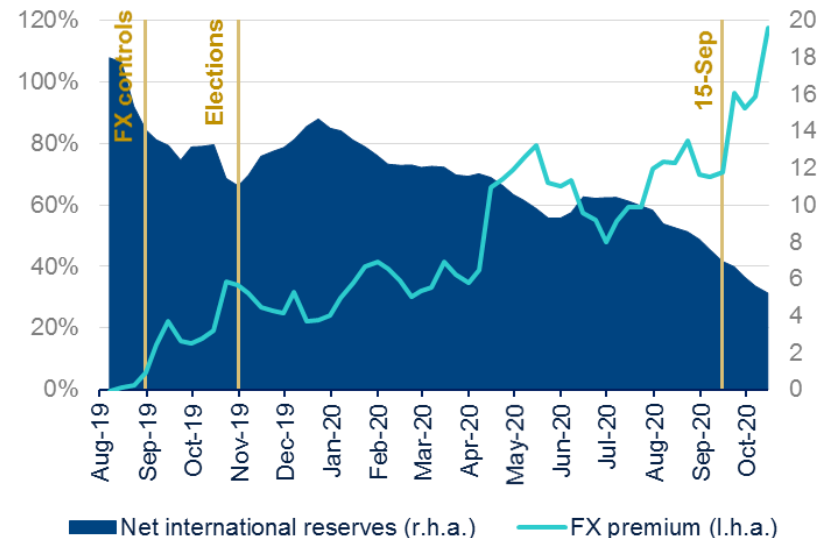


Source: BCRA.

Private sector deposits in pesos are reaching peaks since the Convertibility period.

### NET INTERNATIONAL RESERVES AND FX PREMIUM

(RESERVES IN USD BILLION; FX PREMIUM IN % WITH RESPECT TO THE OFFICIAL EXCHANGE RATE)



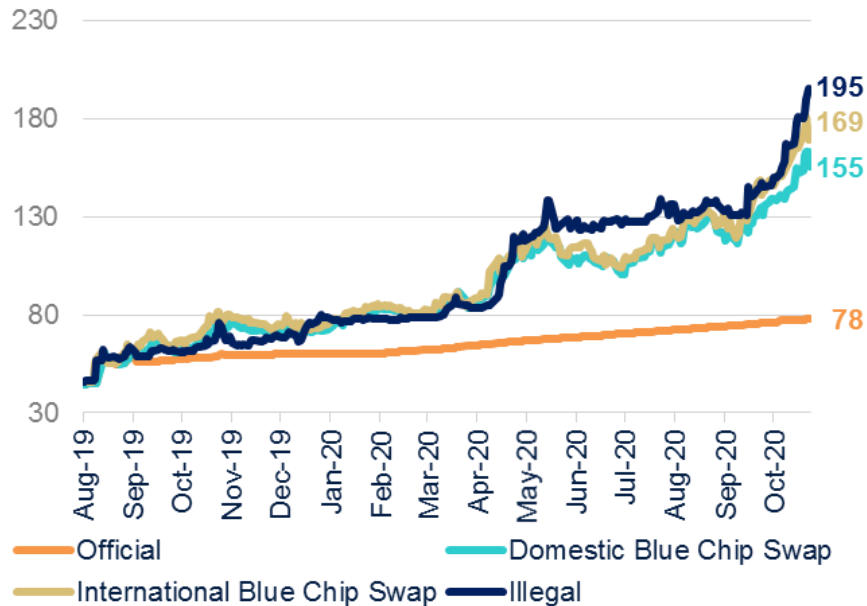
Source: BCRA.

The Central Bank is seeking to avoid further depreciation by using the available stock of reserves and by increasing restrictions on the foreign exchange market.



## ...which is leading to a significant increase in parallel exchange rates

### OFFICIAL AND PARALLEL EXCHANGE RATES (ARS/USD)

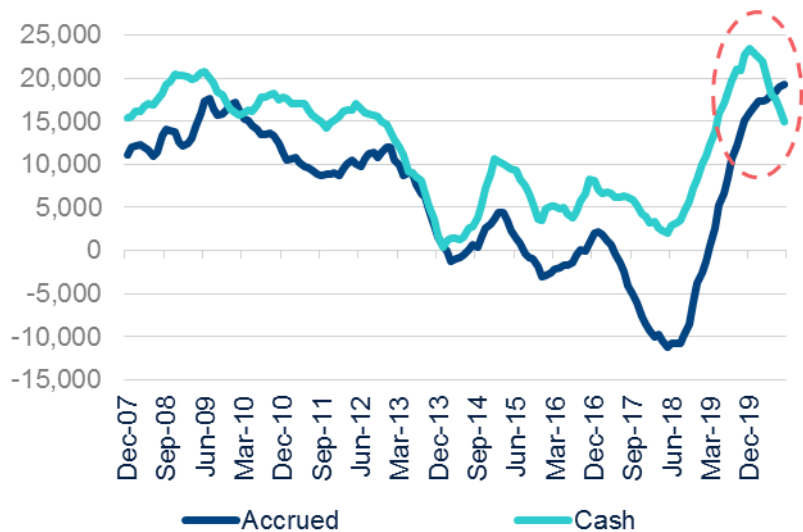


Source: BCRA.

- Parallel exchange rates are growing because of the monetary overhang in the system...
- ...and because of the absence of any clarification regarding future fiscal-monetary-exchange rate policies to overcome these imbalances.
- Following the announcement of the government's intention to delay a steep currency devaluation for as long as possible, we modified our ARS/USD exchange rate forecast to 86 for Dec-20 (down from 90).
- For Dec-21, we expect the exchange rate to reach ARS/USD 125, assuming that the Government is able to partially prevent a pronounced exchange rate adjustment due to the mid-term elections taking place this year.

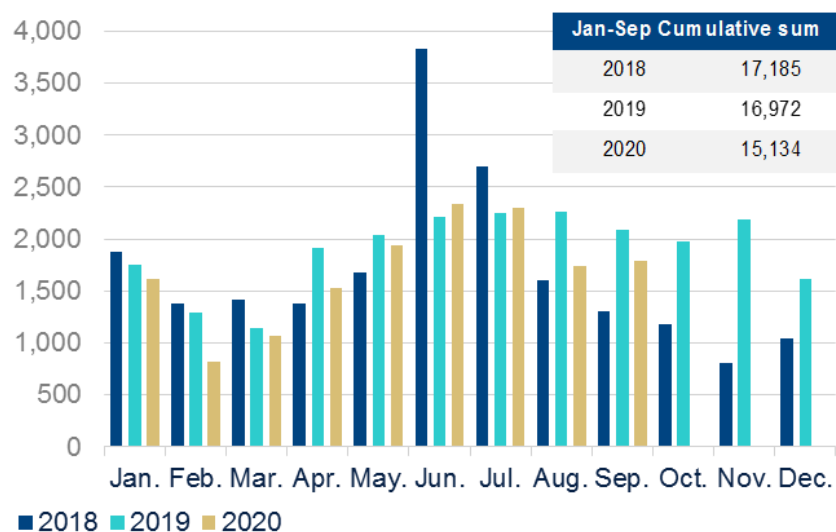
## The increase in the exchange rate gap is further reducing FX supply and boosting demand

### TRADE SURPLUS: CASH VERSUS ACCRUED (ROLLING 12-MONTH CUMULATIVE SUM; USD MILLION)



Source: BBVA Research, BCRA and INDEC.

### OILSEED AND GRAIN EXPORTERS: MONTHLY EXPORT SETTLEMENTS (USD MILLION)



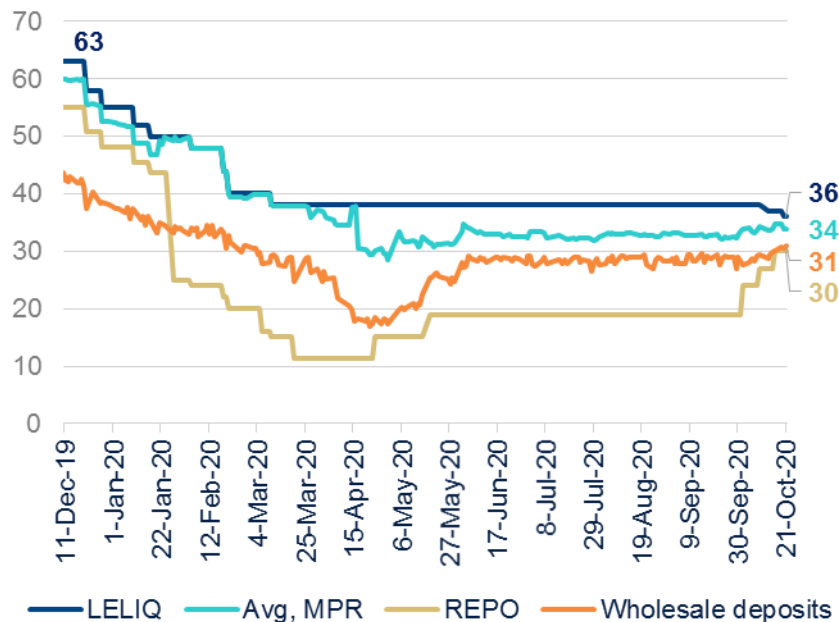
Source: CIARA.

The widening FX gap is providing importers with incentives to advance payments and repay hard currency debts, while exporters are delaying shipments as they expect a devaluation.

## As a result of this situation, the BCRA is conducting a “normalization” of interest rates, which seems insufficient to ease exchange-rate pressures

### MONETARY POLICY INTEREST RATES AND WHOLESALE DEPOSIT RATE

(% ANNUAL NOMINAL RATE)

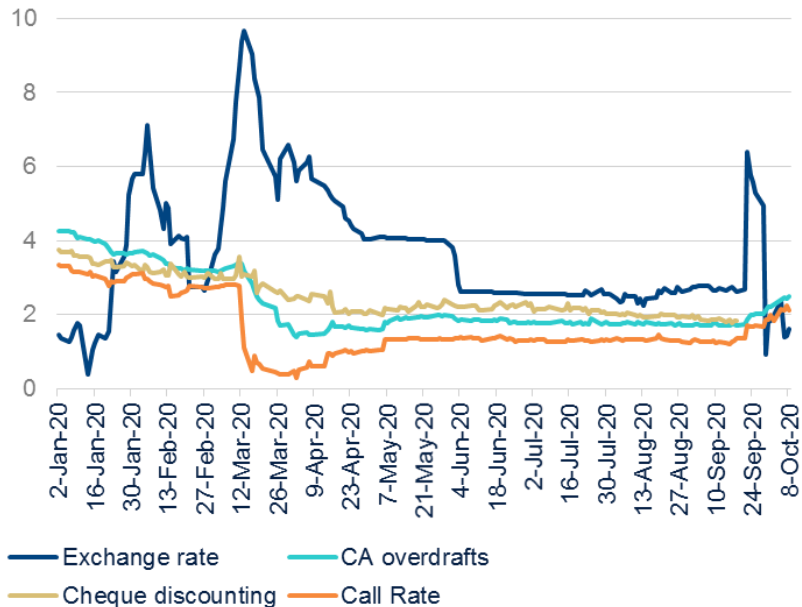


- In view of the gradual normalization of economic activities and the current FX pressures, the BCRA has begun a process of "interest-rate harmonization".
- The monetary authority raised the 1-day repo rate from 19% to 30%, but reduced the LELIQ rate from 38% to 36%, trying to keep the average quasifiscal cost almost constant.
- This is a step in the right direction, but is too-little, too-late, given the size of current monetary and FX pressures.

## The BCRA is also trying to normalize active rates in pesos, which have been too low since the beginning of the quarantine

### ACTIVE INTEREST RATES AND EXCHANGE RATE DEPRECIATION

(MONTHLY EFFECTIVE RATES IN %; MONTHLY EXCHANGE RATE CHANGE, 7-DAY MOVING AVERAGE)

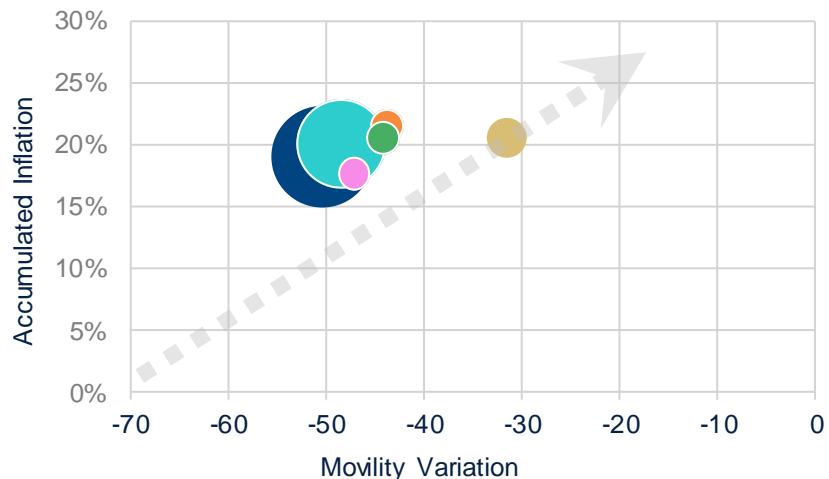


- The monthly depreciation of the official exchange rate has permanently exceeded the majority of the active interest rates since March.
- In view of the progressive easing of the lockdown, the BCRA seems to be seeking to gradually correct this situation, raising the average cost of loans in pesos and making the rate of changes in the value of the currency more volatile.

# Prices, also with restricted mobility

## INFLATION BY REGION AND MOBILITY

(% CHANGE ACCUMULATED JAN-SEP)

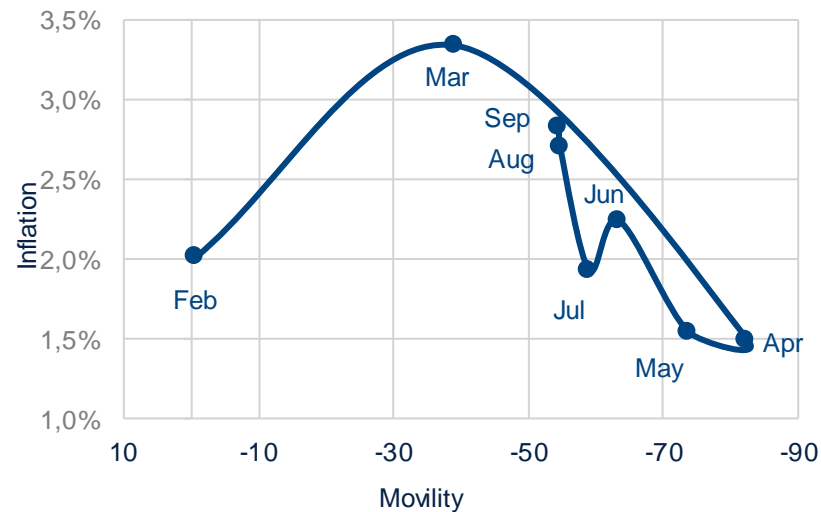


● GBA ● Pampeana ● Noroeste ● Noreste ● Cuyo ● Patagonia

Source: Google, INDEC and BBVA Research.

## INFLATION AND MOBILITY

(% CHANGE M/M)



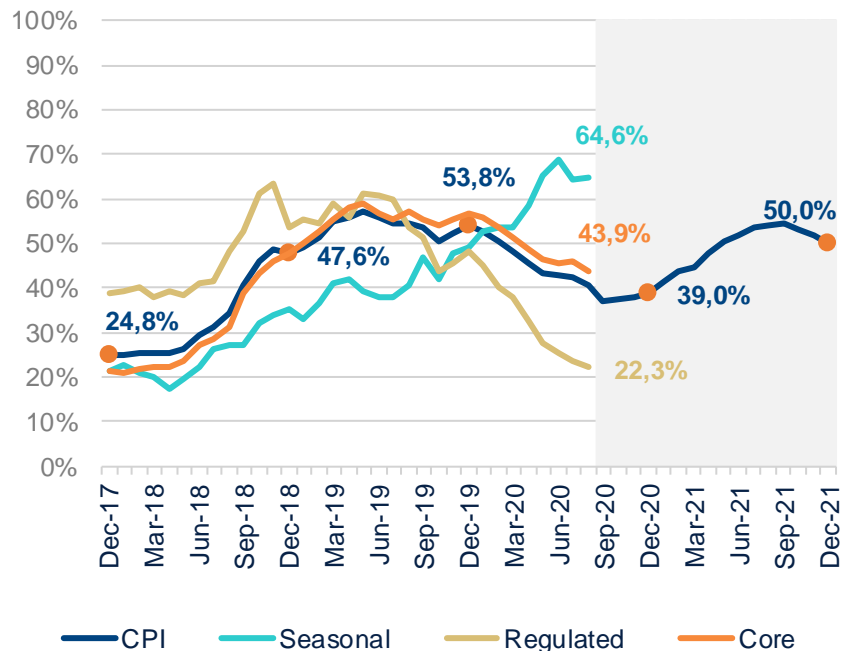
Source: Google, INDEC and BBVA Research.

We have found some evidence of a direct relationship between greater mobility following the end of lockdown and an acceleration in inflation.

# Inflation held back by lockdown, regulated prices and FX controls

## INFLATION, BY COMPONENTS

(% Y/Y)

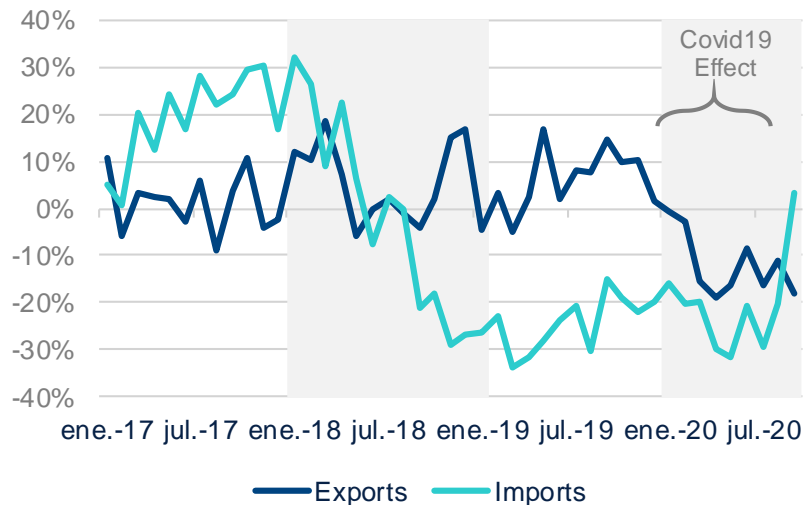


- We reduced 2020 inflation forecast to 39% (from 43%) in view of the latest data, which remained low due to the effects of recession, FX controls and tariff freezes.
- We maintain our baseline scenario that predicts an acceleration in the last quarter of the year due to an increase in the exchange rate.
- We are also maintaining our forecast of 50% inflation for 2021, with an upward bias. Processing the current monetary overhang is one of the most important challenges that the government has to face.

# The pandemic also hit Argentina's trade balance hard, as exports fell, but imports fell even further...

## EXPORTS AND IMPORTS

(Y/Y % CHANGE)

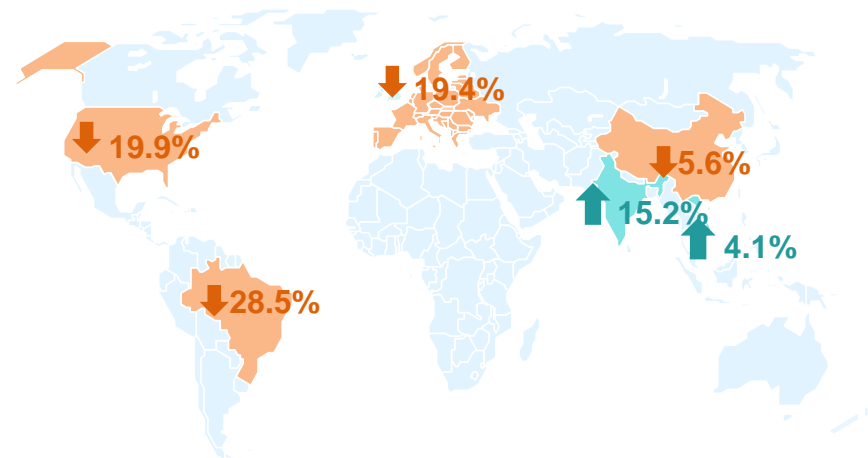


Source: INDEC

Exports will fall 12% in 2020 but grow in 2021 (+8.6%), while imports will fall another 18.8% this year (+16.2% in 2021).

## MAIN EXPORT DESTINATIONS

(Y/Y % CHANGE)



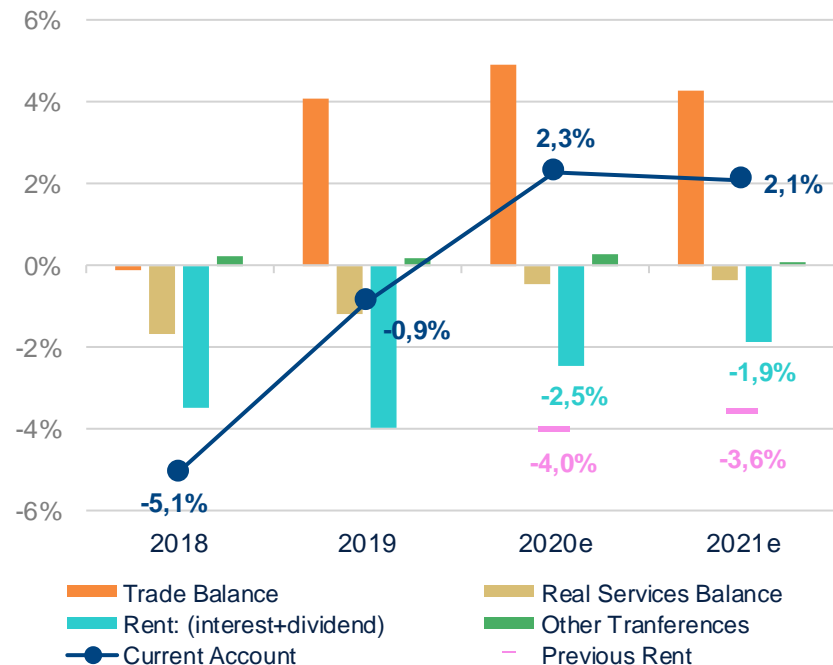
Source: INDEC

In 2020, placements are continuing to fall to Brazil, the USA and the EMU, and to a lesser extent to China. Exports to other Asian destinations are improving

## Debt restructuring eased the interest burden in the short term and allowed for further improvement of the current account

### CURRENT ACCOUNT, BY COMPONENT

(% of GDP)



Source: INDEC.

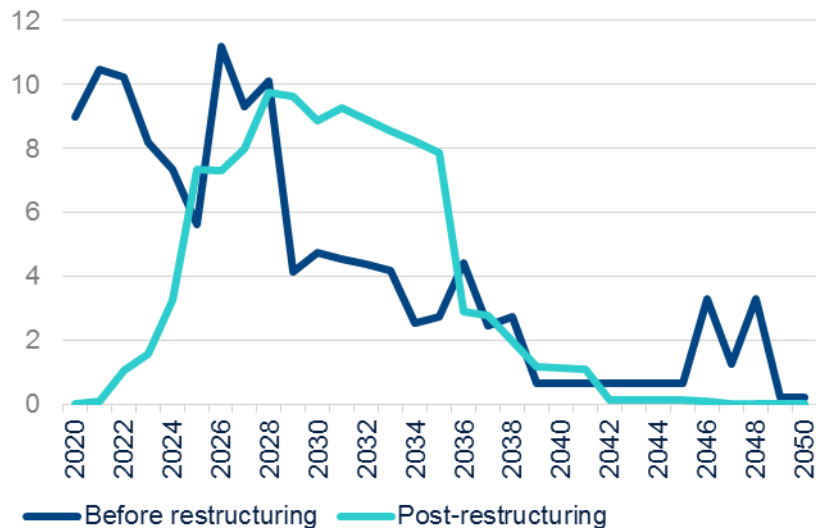
- In 2020, merchandise and services trade surplus led to a significant improvement in the external accounts.
- Moreover, debt restructuring allowed the interest burden to be eased by almost 1.5 pp each year.
- Our new current account forecast is now a surplus of 2.3% of GDP in 2020 and 2.1% of GDP the following year (formerly 0.7% and 1.0%, respectively).



## The debt restructuring cleared up short-term commitments... Will a new program with the IMF bring about the “macroeconomic plan” that the economy is needing?

### MATURITIES IN USD WITH PRIVATE CREDITORS

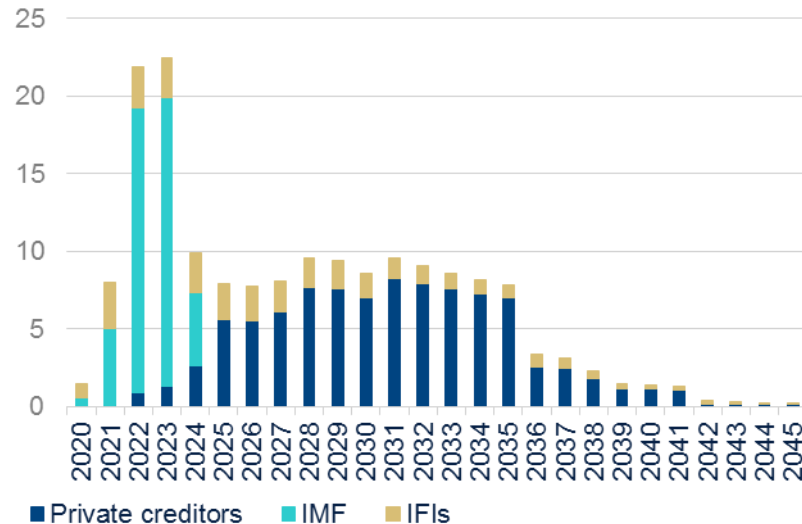
(USD BILLION, LOCAL AND FOREIGN LEGISLATION)



Source: BBVA Research.

### TOTAL FOREIGN CURRENCY MATURITIES

(USD BILLION)



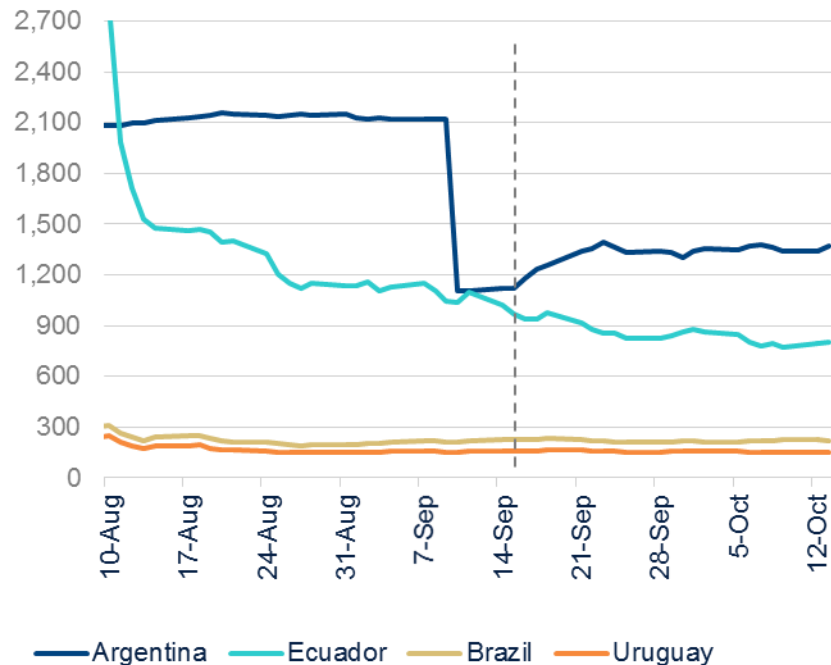
Source: BBVA Research.

The debt restructuring focused on clearing payments by 2024, through substantial coupon reduction and almost no capital haircuts. Negotiations are beginning with the IMF to refinance the existing SBA.

## The post-restructuring evolution of sovereign risk was not positive, signaling the need of a change of agenda

### COUNTRY RISK

(BASIS POINTS)



- In the short term, the government should implement an economic plan with clearer signals of fiscal consolidation, inflation reduction, exchange rate policy and investment stimulus.
- It must then move forward with crucial issues such as tariff regularization, the sustainability of the pension system and the efficiency of public spending.
- Boosting productivity growth is key to ensuring the sustainability of a considerable external surplus without the need for import contraction.
- Debt renegotiation has opened a four-year window to address the necessary reforms.

# Macroeconomic forecasts

ARGENTINA	2018	2019	2020f	2021f
GDP (% Y/Y)	-2.5	-2.2	-13.0	5.5
Inflation (% Y/Y, EOP)	47.6	53.8	39.0	50.0
Exchange rate (vs USD, EOP)	37.9	59.9	86.0	125.0
Monetary policy rate (% EOP)	59.3	58.5	38.0	45.0
Private consumption (% Y/Y)	-2.4	-6.5	-13.1	8.5
Public consumption (% Y/Y)	-3.3	-1.6	-10.0	-3.5
Investment (% Y/Y)	-5.7	-15.9	-32.5	14.3
Primary fiscal balance (% GDP)	-2.3	-0.4	-8.0	-5.4
Current account (% GDP)	-5.1	-0.8	2.3	2.1

\* As of Dec-19, the monetary policy rate results from the weighted average between the LELIQ rate and the REPO rate.

# Argentina Economic Outlook

4Q20

October 2020