Argentina Economic Outlook

3Q22

July 21, 2022

Creating Opportunities

Key messages. Global

Inflationary pressures

Global inflation remains at unusually high levels. Pressures have recently been reinforced by the impact of the war in Ukraine on commodity prices and continued supply-chain bottlenecks. Given the actions of central banks, the risk of significant second-round effects and de-anchoring of expectations is moderate, but growing.

Response of central banks

Central banks are accelerating the tightening of interest rates. Their recent tone suggests that they will not hesitate to do whatever it takes to control inflation in the medium to long term. The Fed will soon raise rates to restrictive levels, while in the eurozone, in an environment of less robust demand and risk of fragmentation, rates will converge to neutral levels.

Economic outlook

The world economy will slow down significantly, which will contribute to a decline in inflation, although levels will still remain well above target in the short term. In the eurozone, GDP is expected to fall in the coming quarters, primarily due to the disruptions created by the war, including energy shortages. The tightening of the monetary policy makes a (mild) recession likely in the U.S. The environment is very uncertain due to multiple coinciding shocks.

Risks

Further inflation persistence could trigger even more severe interest rate hikes, and thus a deeper and more generalized recession. Other risk factors include financial fragmentation in the eurozone, crises in the debt markets and emerging markets, the continuing of the pandemic (mainly in China), stagflation, social unrest, etc.

Key messages. Argentina

IMF Program

During 2Q22, deviations from the targets set with the IMF were stronger and faster than anticipated, which deteriorated the economic outlook. The relaxation of the targets for the coming quarters contributed to the de-anchoring of expectations and resulted in strong pressures on public debt in pesos, which had to be sustained by BCRA purchases.

Fiscal policy

The dynamics of the fiscal result so far this year point to a widening of the deficit with respect to 2021. This is mainly due to higher energy prices, which result in higher subsidies, while the government continues to delay the decision to correct the proportion of prices paid by users.

Monetary issuance

As a result of this higher deficit, money issuance to assist the Treasury already exceeds 1% of GDP, which is equivalent to the target set for the entire year with the IMF. In addition, the recent BCRA's massive bond purchases in the secondary market added another 1.3% of GDP to this issuance, exacerbating monetary, inflationary and exchange rate pressures on the economy.

Inflation

Rising global inflation due to the war and disruptions in global supply chains impacted inflation in Argentina, which had already been accelerating since late 2021. On top of this, the fiscal-monetary imbalance has deepened and there is no clear stabilization plan to face the acceleration of prices. This set of factors led us to increase our inflation forecast for 2022 to 95% for the year.

Key messages. Argentina

Exchange rate

Despite record high terms of trade, the BCRA has only managed to buy less than 30% of what it had purchased in 1H21. The usual shortage of agricultural exports in the third quarters is likely to trigger further foreign exchange restrictions by the Central Bank and an acceleration in the pace of exchange rate depreciation. We project that the official exchange rate will end the year close to $170/USD.

Interest rates

The BCRA will continue to raise interest rates to prevent them from losing further ground against inflation, but they will remain negative in real terms. We anticipate multiple monetary policy rate hikes, up to 70% before the end of the year.

External result

Despite record exports this year, which will reach USD 90 billion due to high commodity prices, the trade balance will only be USD 11 billion due to the substantial increase in energy imports (LNG) and high international freight costs. Thus, the current account will show a deficit of 0.1% of GDP because the contribution of trade is offset by the increase in the deficit of tourism and interest payments.

Economic activity

In this context, we project that economic activity will remain weak, as a result of the multiple capital controls, accelerating inflation that erodes wages, and the environment of macroeconomic uncertainty that damage investment. We have corrected our growth forecast from 3.5% to 2.5% for 2022.

BBVA Research

01

Global economic outlook 3Q22

Creating Opportunities

In a complex and uncertain environment, central banks have been forced to accelerate rate hikes in order to tackle inflation

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

COMMODITIES
Energy and food prices under heavy pressure due to war in Ukraine

SUPPLY DISRUPTIONS
Persistent bottlenecks due to war and covid mobility restrictions in China

DEMAND RESILIENCE
Robust employment and accumulated savings; weakness caused by covid in China

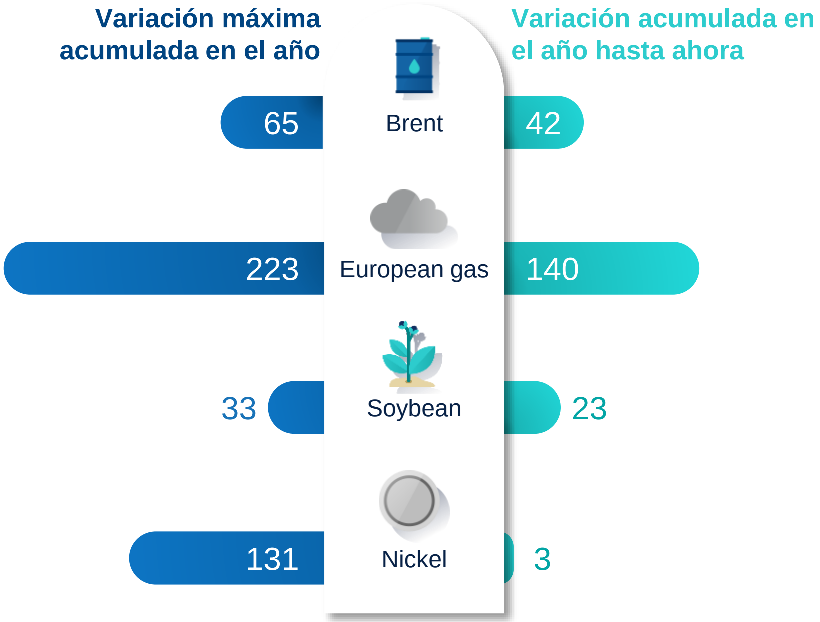
HIGH, PERSISTENT AND GENERALIZED INFLATION
Prices also pressured by incipient second-round effects and structural factors (such as de-globalization), with a risk of de-anchoring expectations.

MORE AGGRESSIVE CENTRAL BANKS AND FINANCIAL VOLATILITY
Stronger and earlier monetary tightening, particularly in the U.S., to reduce demand, which has kept financial volatility high.

Commodity prices have risen more than expected after the war, despite recent global slowdown concerns

COMMODITY PRICES

(ACCUMULATED PERCENTAGE VARIATION IN THE YEAR UP TO JULY 11, 2022)

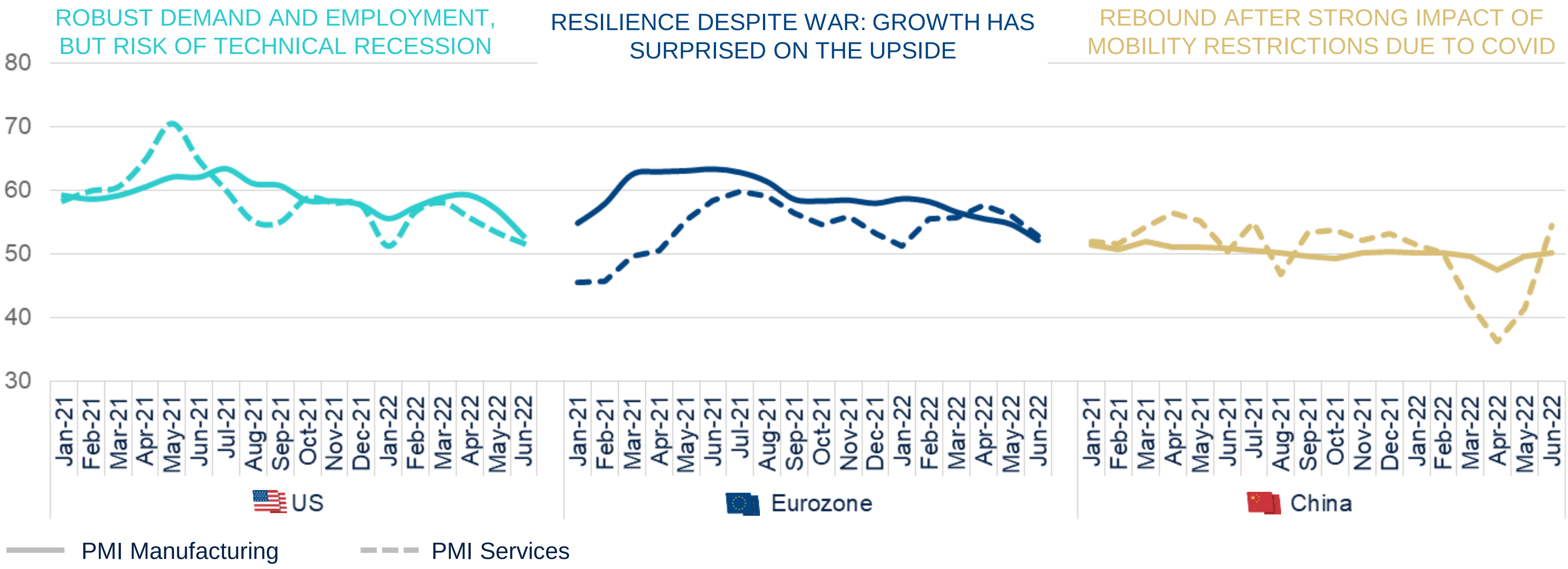


Source: BBVA Research based on data from Haver.

- War and sanctions have pressured commodity prices:
  - oil: affected by sanctions against Russia
  - gas: pressured by fears of supply restrictions b Russia
  - food: impacted by fertilizer prices and disruptions in Ukraine
  - metals: less direct exposure to the war, but pressured by energy transition
- The risk of a sharp global slowdown has recently triggered falls in commodity prices (but not in the gas price in Europe).

Growth is easing, but demand remains resilient given the high level of accumulated savings and the dynamism of both consumption and services

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

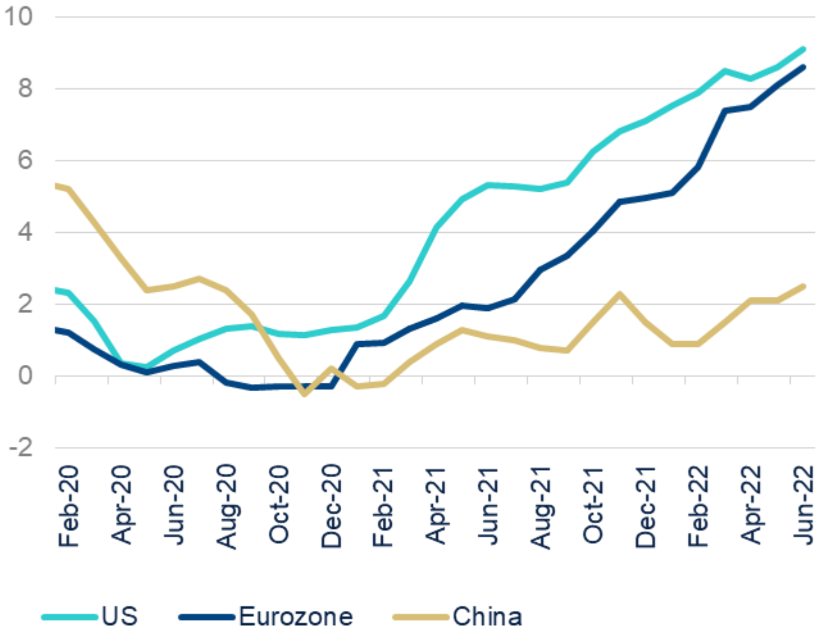


Source: BBVA Research based on data from Haver.

High, persistent and widespread inflationary pressures, largely due to supply-side and labor market-related factors

INFLATION: CPI

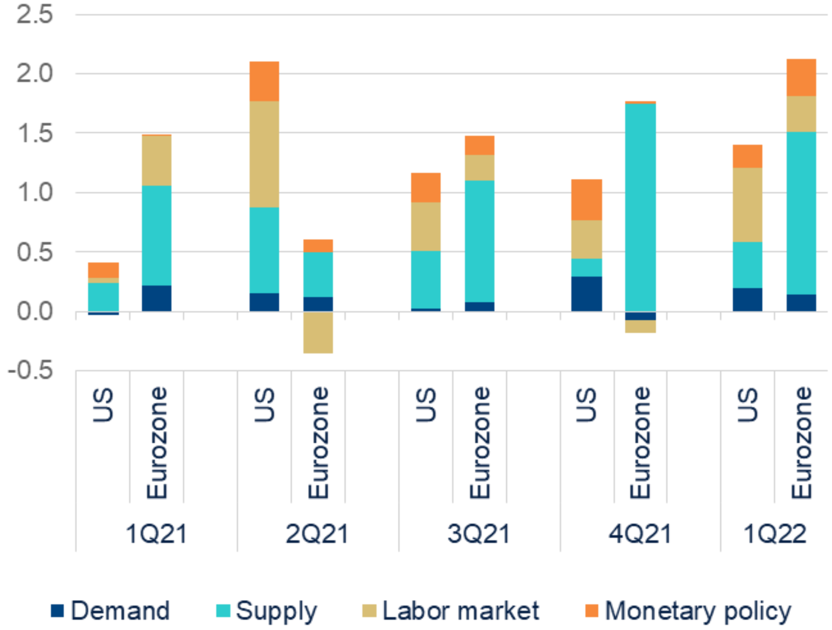
(Y/Y %)



Source: BBVA Research based on local statistics.

SHOCKS TO CORE INFLATION

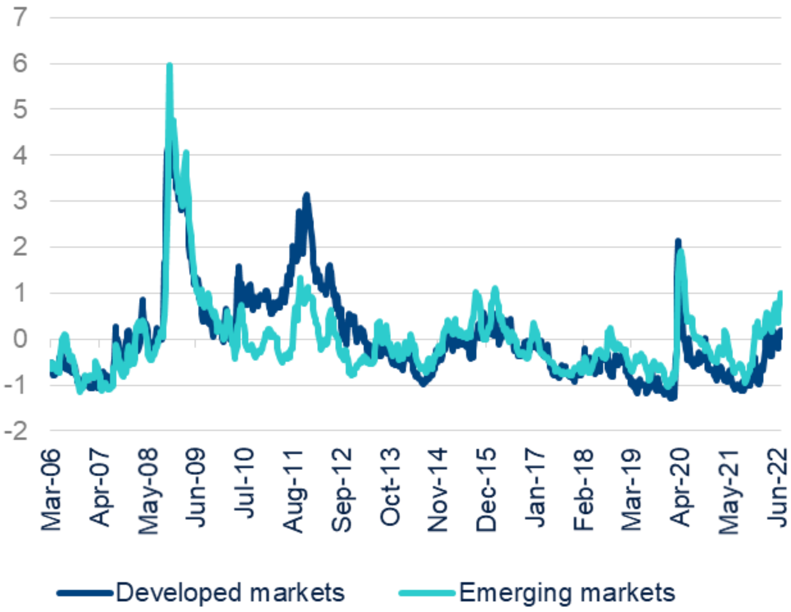
(PP)



Source: BBVA Research estimates using a SVAR model.

Central banks hawkish tone in response to rising inflation, in a context of activity slowdown, has increased financial volatility

BBVA RESEARCH FINANCIALTENSIONS INDEX
(INDEX: AVERAGE SINCE 2005 = 0)



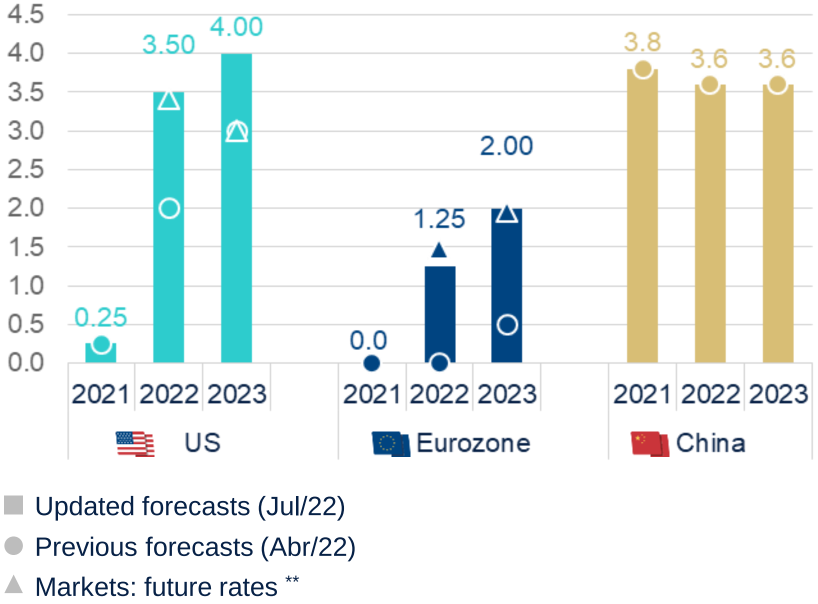
Source: BBVA Research.

- The Fed has raised rates to 1.75% (+150bp since March) and has indicated further significant adjustments in the coming months.
- The ECB has indicated that its rate hike cycle will begin this month and that it will address the risk of fragmentation with flexible PEPP reinvestment and a new instrument.
- Sovereign bond yields have risen sharply since March, although they have recently moderated due to cyclical risk.
- Stock markets have fallen, risk premia have moved higher and the dollar has appreciated.

Interest rates will rise more and sooner than expected; they are expected to reach restrictive levels in the US and be close to neutral in the Eurozone

MONETARY POLICY INTEREST RATES*

(%, END OF PERIOD)



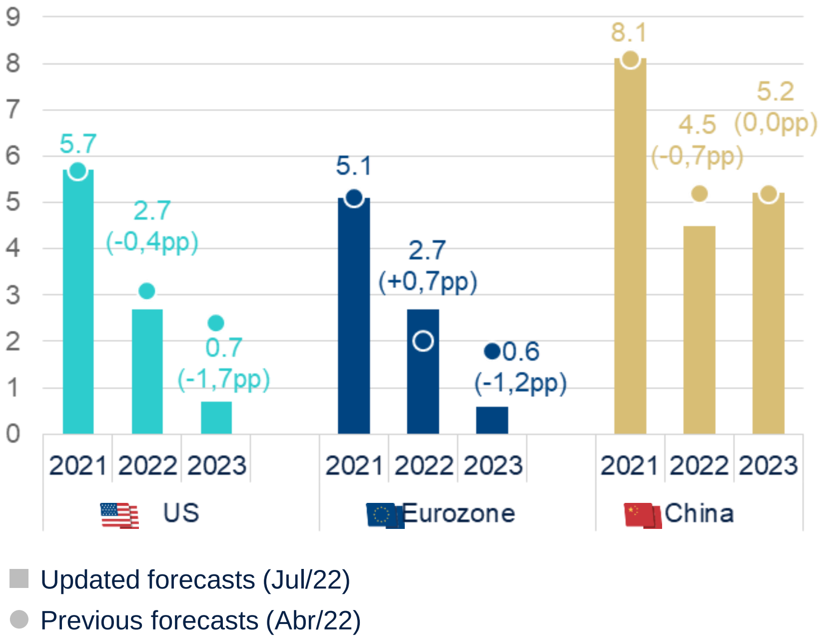
* In the case of the Eurozone, interest rates on refinancing operations.
** Data as of July 11.
Source: BBVA Research based on Bloomberg data.

- The Fed is expected to raise rates to 4.0%, above equilibrium levels (between 2% and 3%), while continuing to sell assets to reduce its balance sheet.
- The ECB is already starting its rate hike cycle, which will be less aggressive than the Fed's due to lower demand pressures and the risk of financial fragmentation.
- Unlike the US, fiscal policy in the Eurozone will focus on growth, through NGEU funds and the suspension of fiscal rules until 2023.
- In China, policies will continue to exhibit a moderately expansionary tone.

Global slowdown: after growing 6.2% in 2021, world GDP will grow 3.4% in 2022 and 2.5% in 2023 (respectively, 0.6pp and 1.1pp less than expected)

GDP: ANNUAL GROWTH IN REAL TERMS

(%)

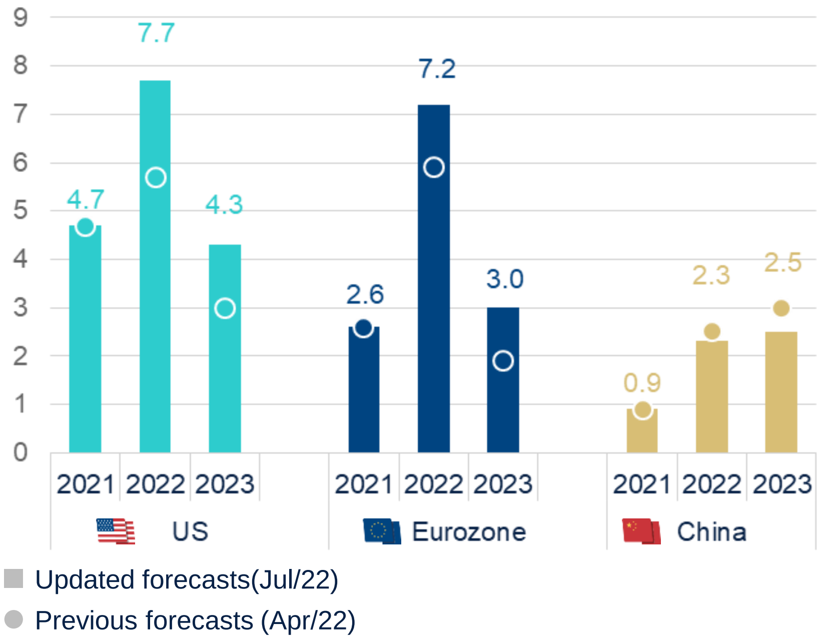


* Forecast change in parentheses.
Source: BBVA Research.

- Rising rates will likely push the US into a recession in 2023, which is expected to be mild given robust employment and sound household and financial system balance sheets.
- In the Eurozone, the impact of the war will be stronger in the coming quarters due to the expected gas restrictions, pushing GDP growth to slightly negative rates.
- In China, growth will recover from the impact of recent lockdowns, but the “zero-covid” policy remains as a potential problem.

Inflation to remain well above central bank targets, mainly in the short term

INFLATION:CPI
(Y/Y %, PERIOD AVERAGE)



Source: BBVA Research.

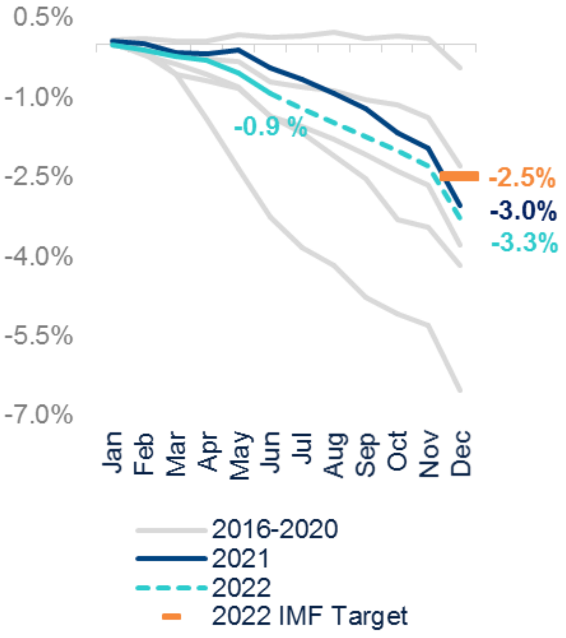
- Upward revision of inflation forecasts, mainly due to higher commodity prices.
- Inflation will eventually decline as current shocks lose strength and central banks continue to act
- Slowing demand will reduce the scope for significant wage increases, making a wage-price spiral unlikely.

02

Argentina economic outlook 3Q22

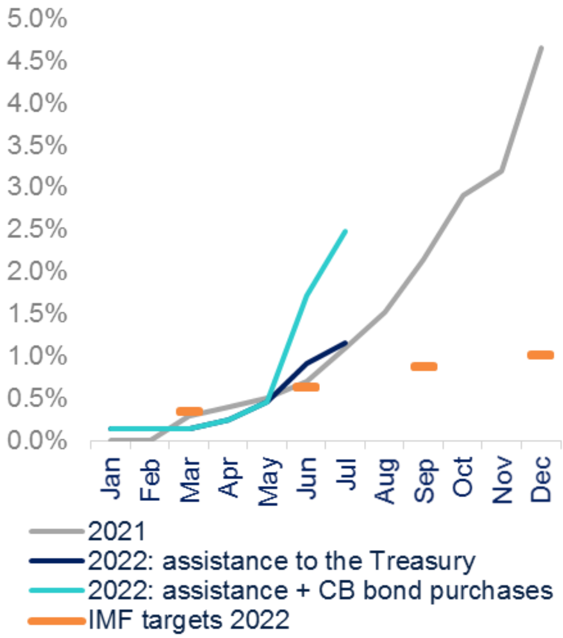
The deviations and recalibrations of the targets agreed on with the IMF triggered a sharp deterioration of expectations and the economic outlook...

CUMULATIVE PRIMARY FISCAL RESULT, BY YEAR (% GDP)



Source: BBVA Research, BCRA, IMF and the Ministry of Economy.

MONETARY ASSISTANCE TO THE TREASURY (% GDP)



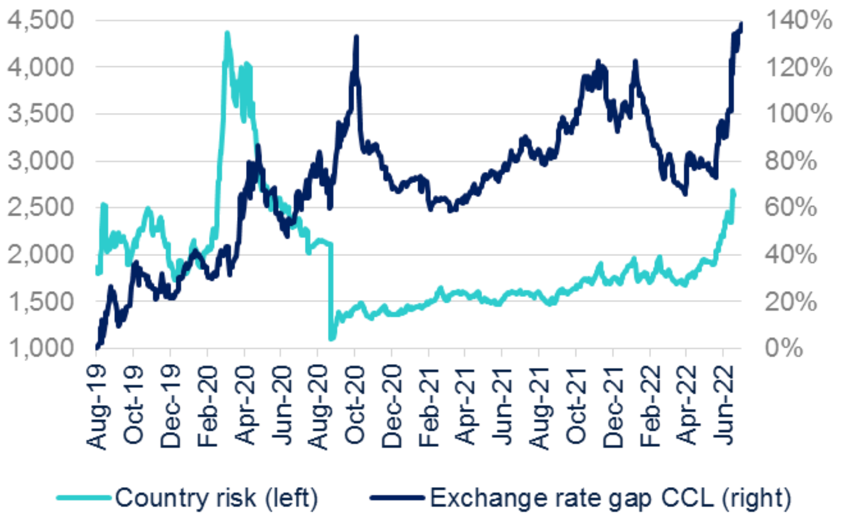
Source: BBVA Research, BCRA, IMF and INDEC.

NET INTERNATIONAL RESERVES (MILLIONS OF USD)

Source: BBVA Research and BCRA.

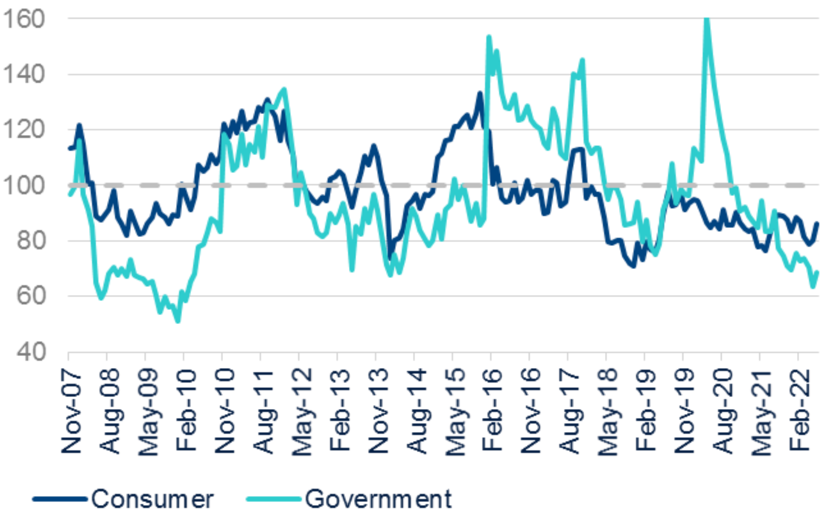
... aggravated by political tensions in the ruling coalition, which triggered an increase of uncertainty levels and risk perception

COUNTRY RISK AND EXCHANGE RATE GAP
(BASIS POINTS AND BLUE CHIP SWAP GAP VS. OFFICIAL)



Source: BCRA and JP Morgan.

CONFIDENCE INDICATORS
(BASE 100 = HISTORICAL AVERAGE)

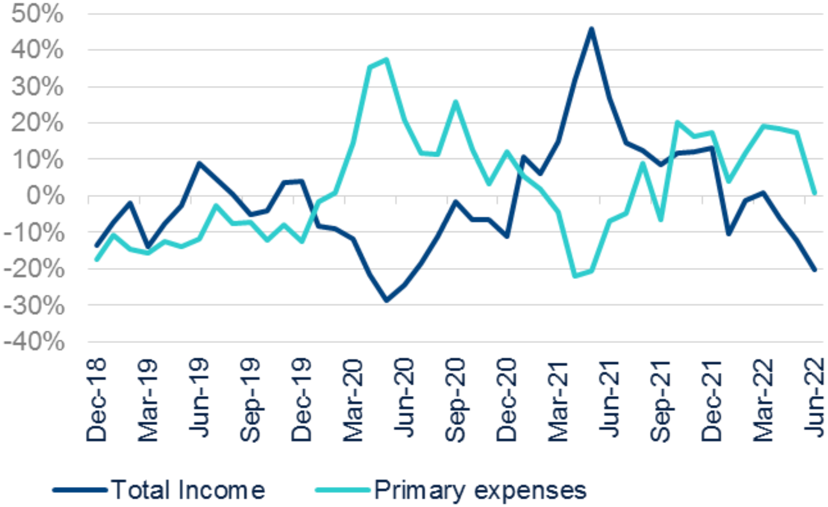


Source: BBVA Research and UTDT estimates.

In a fragile and deteriorated economic context, Minister of Economy Guzmán resigned suddenly at the beginning of July, generating greater uncertainty. His replacement is Silvina Batakis. We do not expect drastic changes in economic policies following her appointment, something that the Minister reaffirmed in her initial statements.

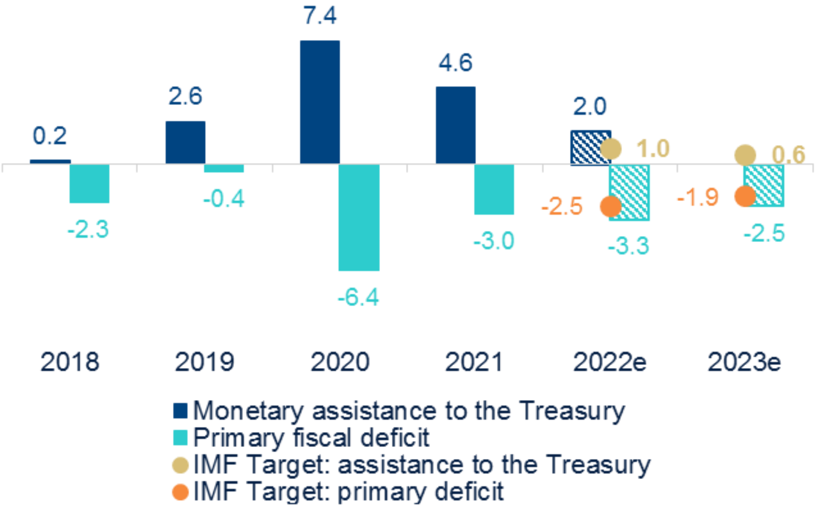
Recent fiscal dynamics point to a higher deficit than that of 2021, imposing a high floor on monetary issuance to finance it...

TAX REVENUES AND FISCAL EXPENDITURES
(% CHANGE Y/Y, IN REAL TERMS)



Source: BBVA Research and the Ministry of Economy.

FISCAL RESULT AND MONETARY ISSUANCE TO ASSIST THE TREASURY (% OF GDP)



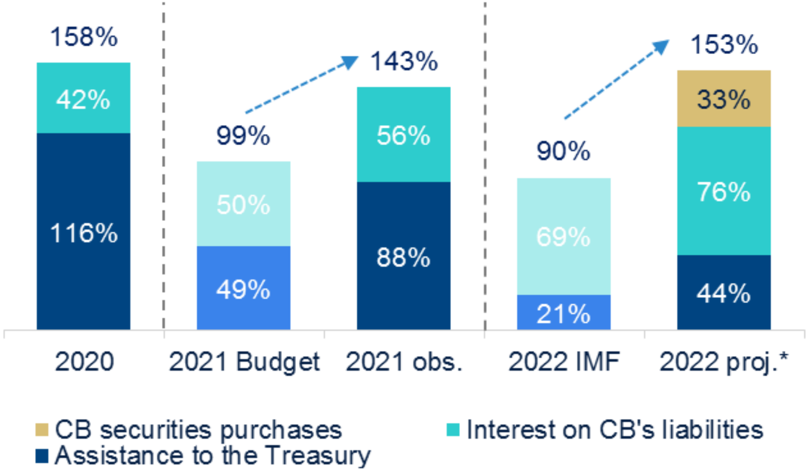
Source: estimates from BBVA Research, BCRA and the Ministry of Economy.

The dynamics of fiscal revenues and expenditures in the first half of the year, coupled with the fact that the second half of the year seasonally exhibits more deficit, lead to our forecast of 3.3% of GDP for the primary deficit, above the IMF target (2.5%). We believe that the IMF will be flexible in granting waivers during 2H22 given the global context.

...in addition, the BCRA must issue more pesos to pay interest on its liabilities and to support bond prices, adding increasing liquidity to the system…

SOURCE OF MONETARY EXPANSION

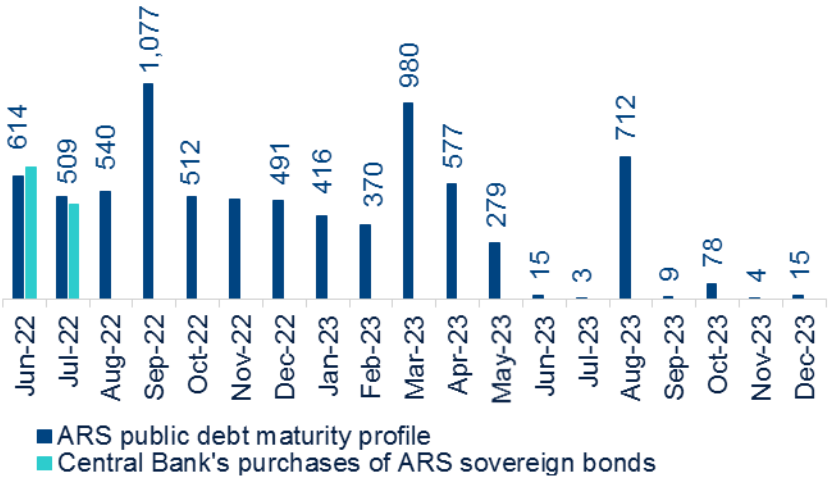
(IN % OF MONETARY BASE OF THE PREVIOUS YEAR)



*Note: BCRA bond purchases in the secondary market estimated as of July 1. Estimated maximum legal Treasury assistance for 2022.
Source: BCRA and BBVA Research.

MATURITIES OF PESO-DENOMINATED DEBT AND BCRA ISSUANCE FOR BOND REPURCHASES

(BILLIONS OF PESOS)

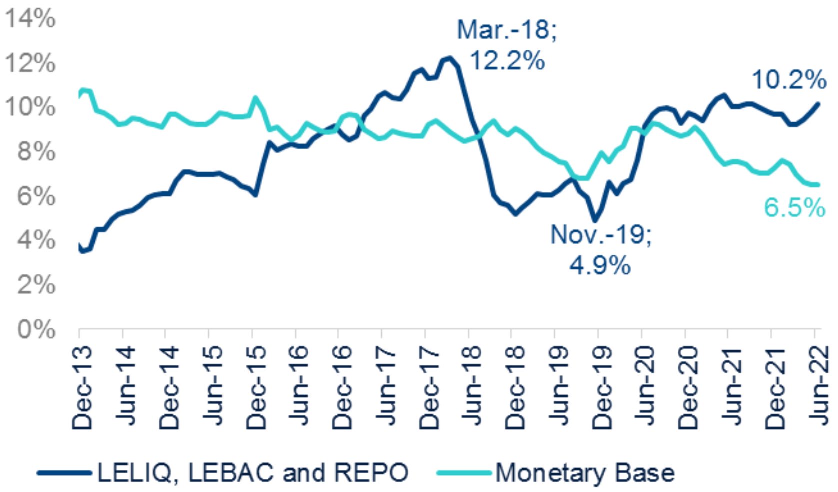


Source: BBVA Research, BCRA and the Ministry of Economy.

The combination of the aforementioned factors triggered uncertainty in the market and a sell-off of peso bonds during June and July. In response, the BCRA bought bonds in the secondary market to support its prices, issuing more than $1.1 trillion (1.3% of GDP) — equivalent to the peso debt maturities of June and July.

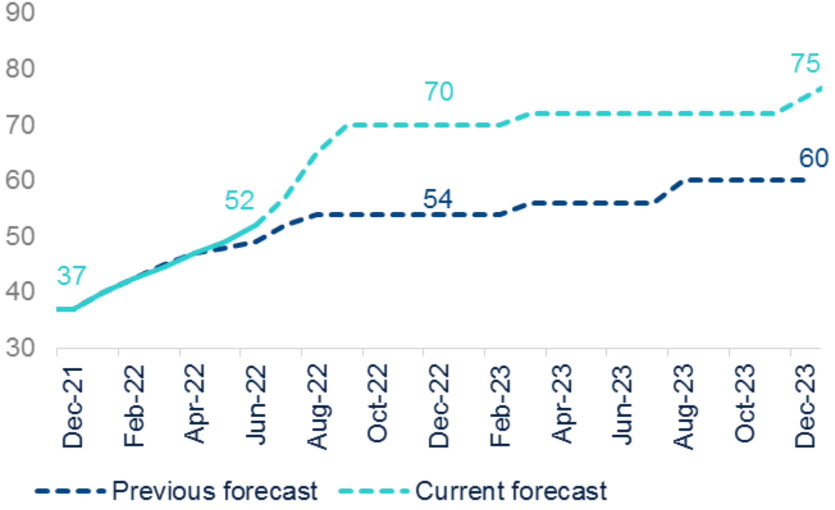
... most of which is sterilized through the BCRA's interest-bearing liabilities, a stock that limits its ability to raise interest rates

BCRA INTEREST-BEARING LIABILITIES (LELIQS, REPOS, LEBACS) AND MONETARY BASE (% OF GDP)



Source: BBVA Research, INDEC and BCRA.

MONETARY POLICY RATE (% ANNUAL NOMINAL RATE)

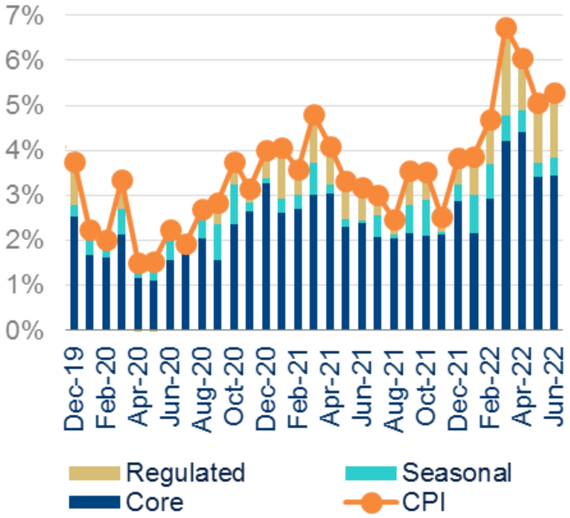


Source: BCRA and BBVA Research.

A large part of the money issuance to buy bonds in the secondary market was sterilized through BCRA’s bills, the stock of which exceeded 10% of GDP. These liabilities limit the BCRA's ability to raise interest rates above inflation. Thus, we foresee interest rate hikes in the coming months, but the Monetary Policy Rate will remain negative in real terms.

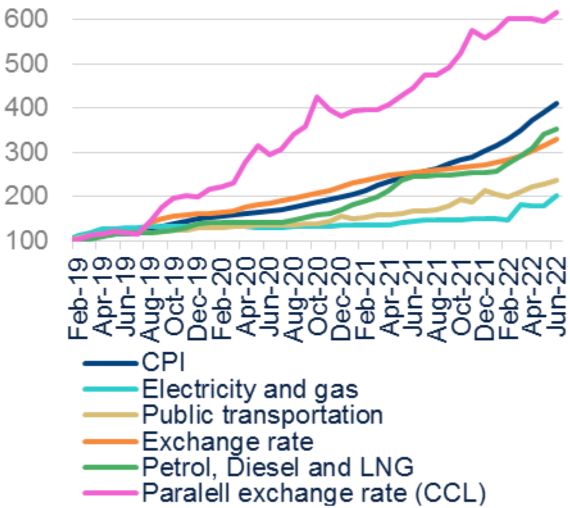
The growing excess of pesos, together with the absence of a stabilization plan to anchor expectations, imposes a high floor for inflation

MONTHLY INFLATION, BY COMPONENTS (VAR. % M/M)



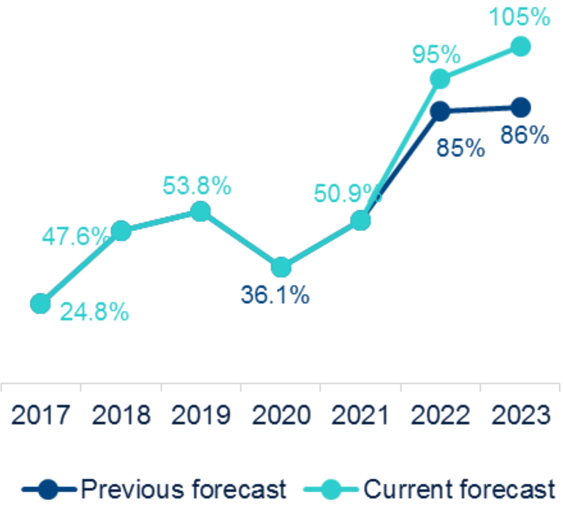
Source: BBVA Research and INDEC.

PRICE LEVEL AND EXCHANGE RATES (JAN-19 = 100)



Source: BBVA Research, INDEC, BCRA.

INFLATION (VAR. % Y/Y)

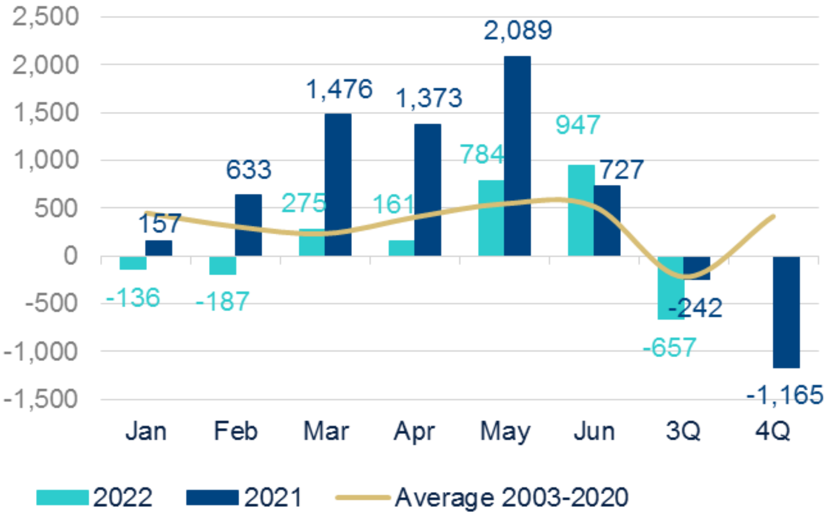


Source: BBVA Research and INDEC.

In addition, the government no longer has fiscal space to continue freezing utility prices, and the exchange market does not provide much margin to continue deepening the exchange rate real appreciation. Hence, these price distortions, coupled with an eventual regularization of both, anticipates that inflation will remain high for the next few years.

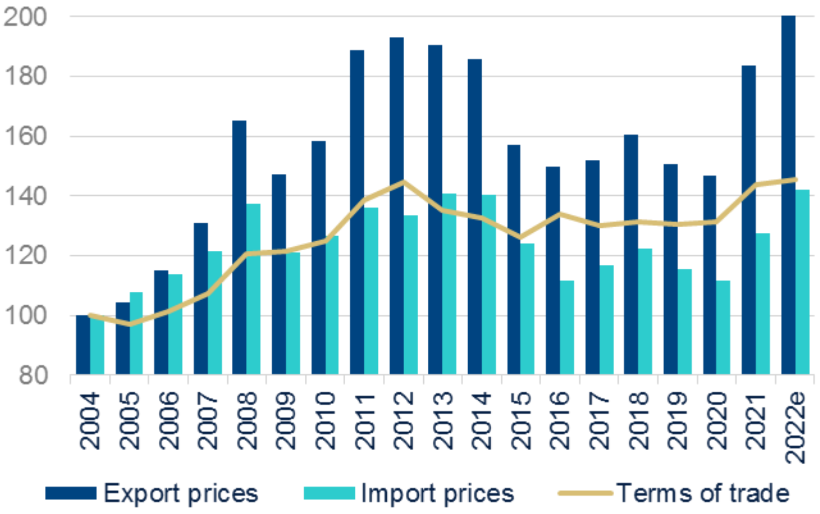
The Central Bank is struggling to purchase international reserves, despite record high terms of trade…

BCRA'S FX NET PURCHASES IN THE OFFICIAL MARKET, BY MONTH (MILLIONS OF USD)



Source: BBVA Research and BCRA.

TERMS OF TRADE (DEC-20 = 100)

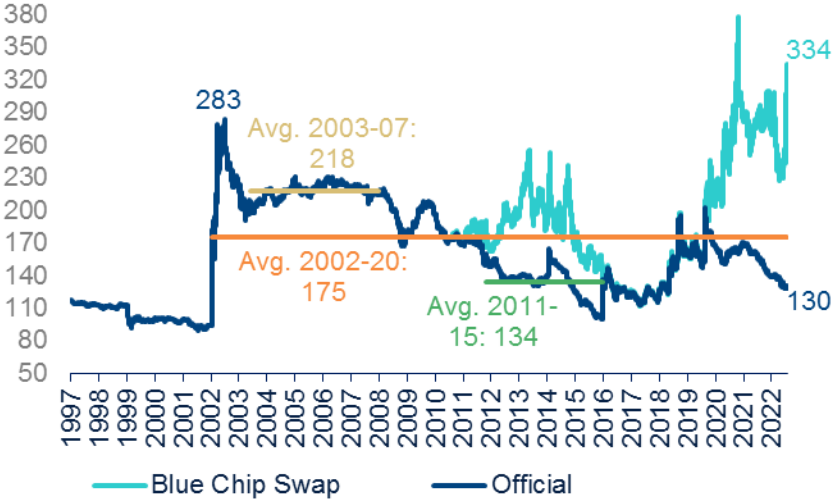


Source: BBVA Research, INDEC.

During the first half of the year, the BCRA purchased only 29% of the reserves it had acquired in 1H21, making it substantially more difficult to meet IMF targets in 2022. Third quarters tend to be the quarters with the lowest exports, so we expect this shortage of foreign currency to translate into more import restrictions and capital controls.

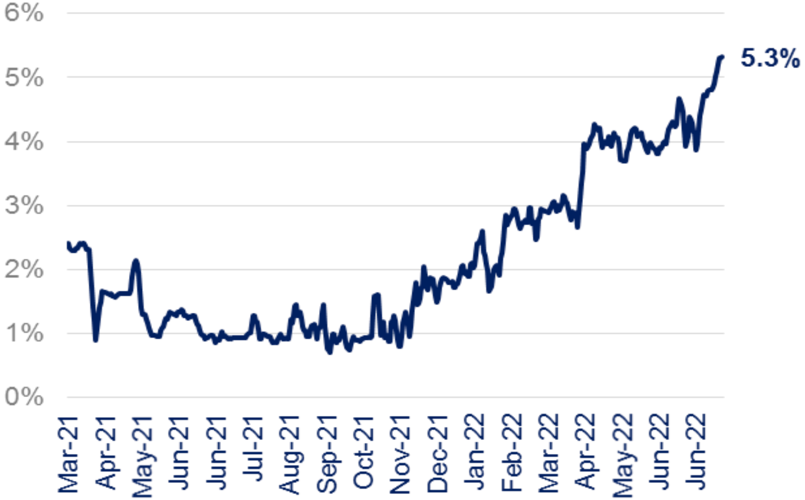
... due to the (increasing) exchange rate gap, which puts pressure on economic activity, leading the BCRA to accelerate the depreciation pace of the peso

REAL OFFICIAL AND PARALLEL EXCHANGE RATE (CCL) (PESOS PER DOLLAR, AT TODAY'S PRICES)



Source: BBVA Research and BCRA.

CRAWLING PEG OF THE OFFICIAL EXCHANGE RATE (MONTHLY- EQUIVALENT D/D VAR., 7-DAY MOVING AVERAGE)

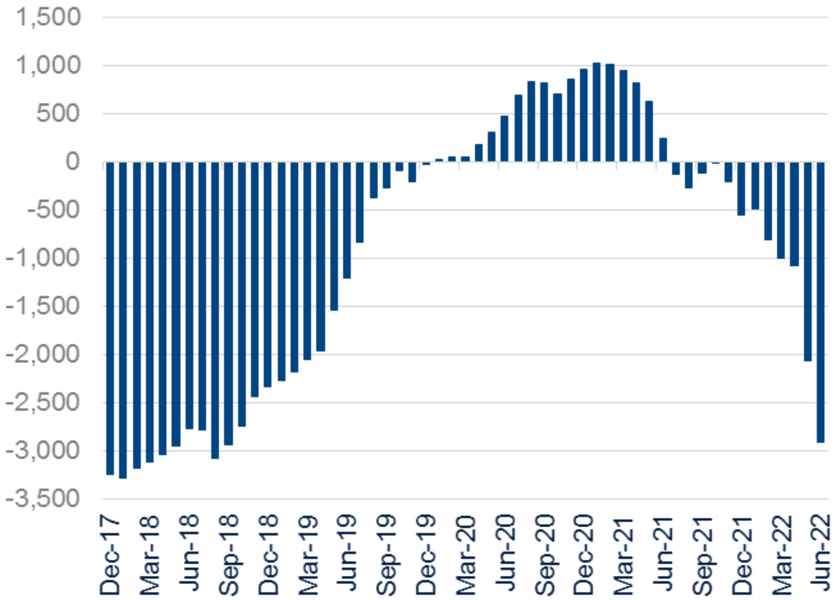


Source: BBVA Research and BCRA.

In view of the scarcity of reserves and a third quarter of seasonally low exports, the BCRA is accelerating the pace of exchange rate depreciation, although it remains below inflation. We project that it will end the year at 170 pesos per dollar (with a balance of risks skewed towards more depreciation).

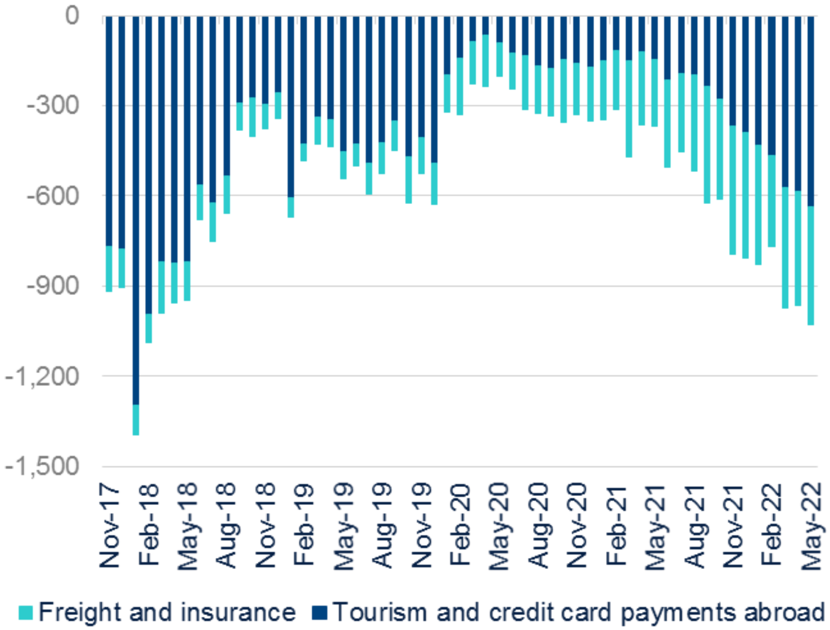
In addition, energy imports are soaring, coupled with very expensive international freight prices and growing outbound tourism...

ENERGY BALANCE (EXPO - IMPO)
(12M ACCUM., IN MILLIONS OF USD)



Source: BBVA Research and INDEC.

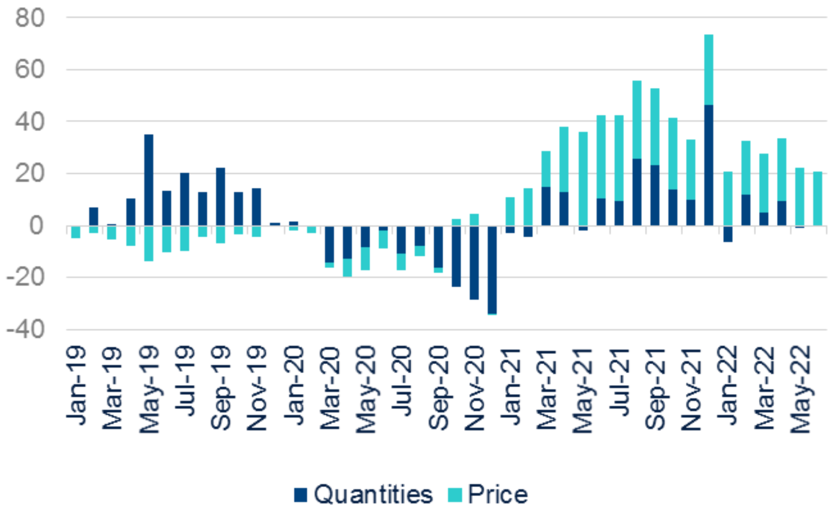
EXTERNAL PAYMENTS: TOURISM, CREDIT CARD PAYMENTS AND FREIGHTS (MILLIONS OF USD)



Source: BBVA Research and BCRA.

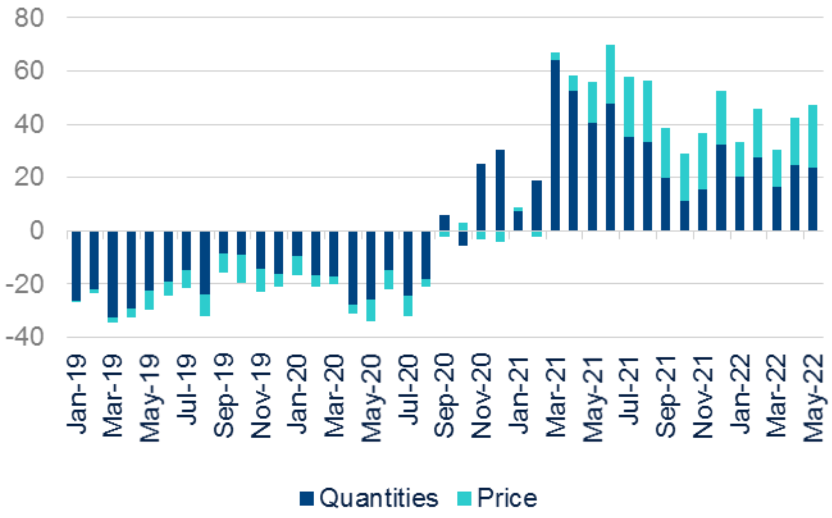
... which erode the trade balance, sustained mainly by agricultural export prices (which we expect to remain relatively high)

EXPORTS: PRICE AND QUANTITY
(VAR. % Y/Y)



Source: BBVA Research and INDEC.

IMPORTS: PRICE AND QUANTITY
(VAR. % Y/Y)

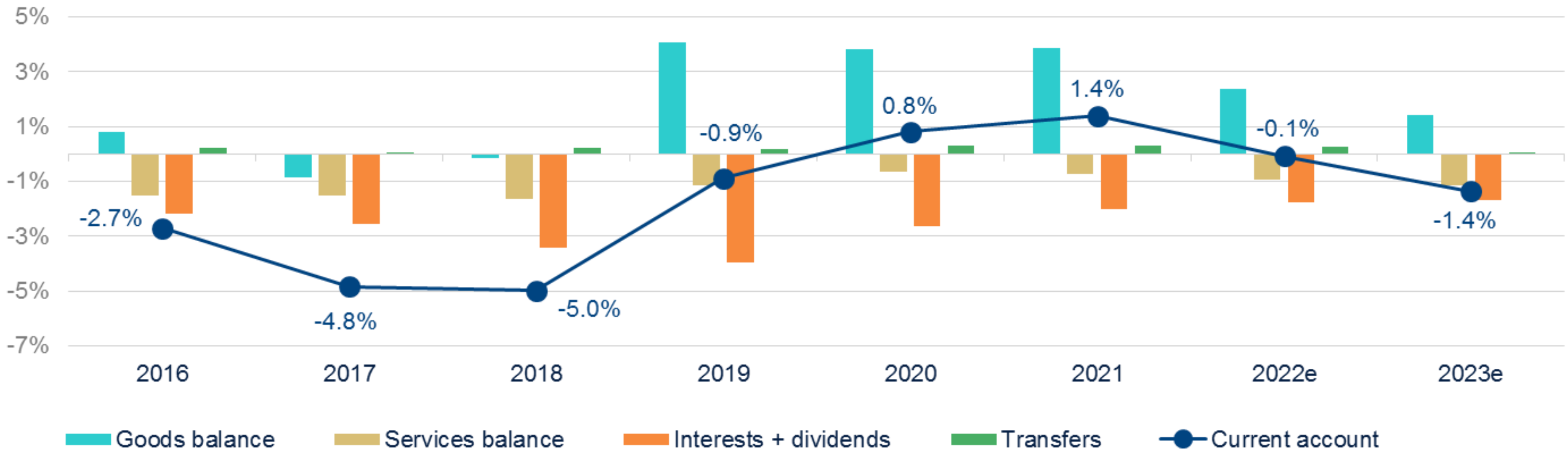


Source: BBVA Research and INDEC.

Record commodity prices underpin exports—which we expect to reach levels close to USD 90 billion— and the trade balance will reach a surplus around USD 11 billion (with a balance of risks skewed towards a lower level due to high energy imports).

As a result, the current account balance will show a value close to equilibrium, due to the deficit in the services account and interest payments

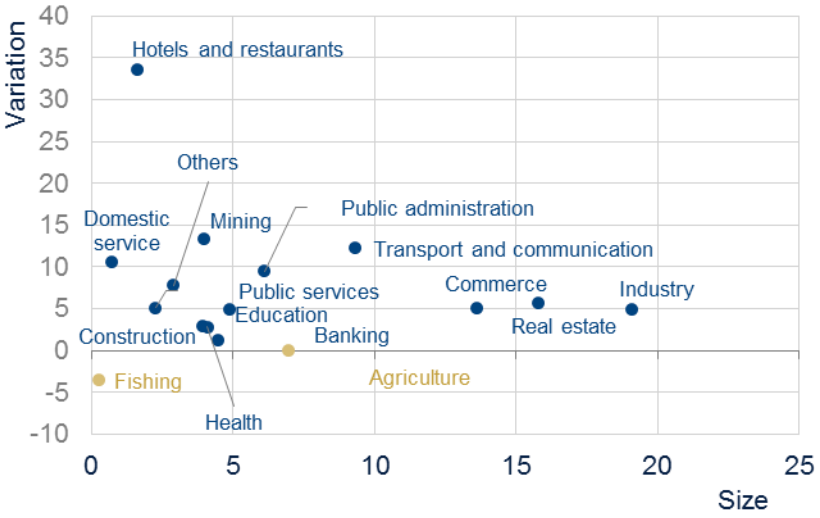
CURRENT ACCOUNT AND COMPONENTS
(% GDP)



Source: BBVA Research and INDEC.

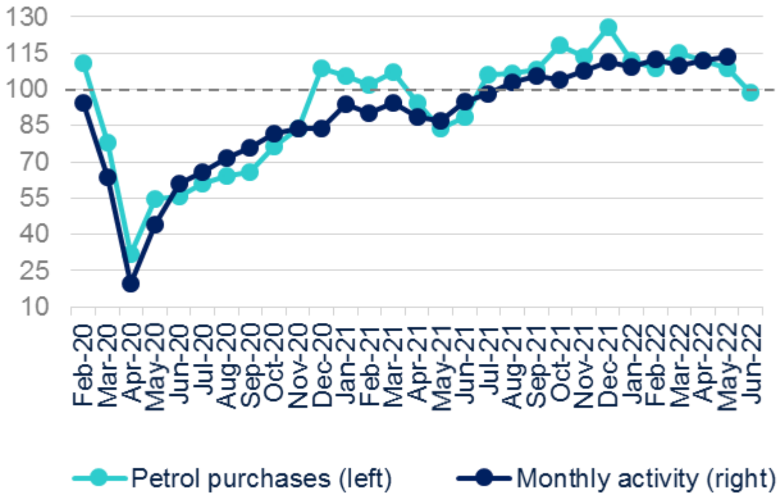
The accumulation of imbalances and the deterioration of expectations are affecting GDP, which will slow down more than expected in the coming quarters

ACTIVITY BY SECTOR
(SIZE AND GROWTH, VAR. % Y/Y)



Source: BBVA Research and INDEC.

FUEL CONSUMPTION AND ECONOMIC ACTIVITY
(AVG. BASE 2019 = 100; CONSUMPTION IN REAL TERMS; ACTIVITY MEASURED WITHOUT SEASONALITY)

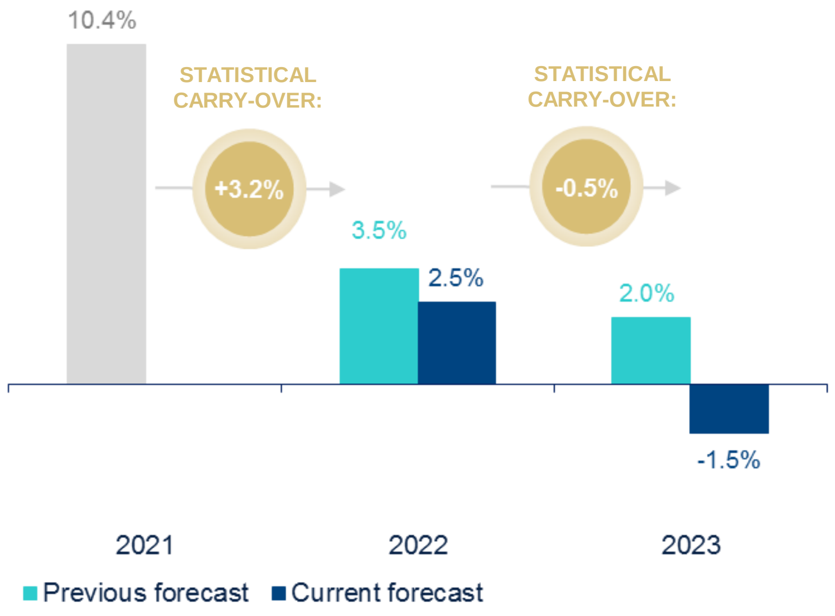


Source: BBVA Research and INDEC.

As of 1Q22, most sectors had already reached the pre-pandemic level, but the recovery is uneven and the high-frequency data shows weakening momentum.

... which leads us to adjust our GDP growth forecast downward

GDP GROWTH AND STATISTICAL CARRYOVER
(Y/Y VAR.)



Source: BBVA Research and INDEC.

We are lowering the 2022 growth forecast because:

- There is poor consumption growth due to erosion of real wages (caused by higher inflation)
- Private investment barely sustains the replacement level, given the environment of uncertainty and high inflation

In 2023, activity will fall because:

- Consumption and investment will slow down due to acceleration of inflation.
- There will be lower contribution from the external sector.
- Negative contribution from 2022 carry-over.

Forecasts

	2019	2020	2021	2022f	2023f
Gross Domestic Product (% YoY)	-2.0	-9.9	10.4	2.5	-1.5
Inflation (% YoY eop)	53.8	36.1	50.9	95.0	105.0
Exchange Rate (vs USD eop)	59.9	82.6	101.9	170.0	316.0
Monetary Policy Rate (% eop)	58.5	37.1	36.7	70.0	75.0
Private Consumption (% YoY)	-6.1	-13.7	10.0	4.3	-1.4
Public Consumption (% YoY)	-6.4	-1.9	7.1	4.2	1.3
Private Investment (% YoY)	-16.0	-13.0	33.4	0.7	-3.8
Primary Fiscal Balance (excl. SDRs, % GDP)	-0.4	-6.4	-3.0	-3.3	-2.5
Current Account Balance (% GDP)	-0.9	0.8	1.4	-0.1	-1.4

Source: BBVA Research.

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Argentina Economic Outlook

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Creating Opportunities