Argentina Economic Outlook

December 2022

Creating Opportunities

Main messages – Global

Economic activity

Economic activity is expected to lose steam over 2023. Global growth is forecast to reach 2.3% in 2023 after having grown 6.3% in 2021 and around 3.3% in 2022. Aggressive monetary tightening coupled with still significant price pressures, amid a war in Ukraine and increasing hurdles to free-trade, will likely weaken labor markets and private consumption, which have been holding up relatively well so far. Uncertainty is high and risks are tilted to the downside: a sharper-than-expected activity deceleration could pave the way for a global recession.

Inflation

The ongoing easing of commodity prices and bottlenecks reinforces the prospects that inflation will slow down ahead, favored by positive base effects. In the US, actually, inflation is already falling. Although, in the Eurozone, price pressures continue to build, inflation is still expected to soon peak. Still, inflation will remain well above targets, at least throughout 2023.

Monetary policy

The interest-rate hiking cycle is likely to come to an end in early 2023, both in the US and the EZ. Policy rates are forecast to converge to around 5% in the former and 2.75% in the latter. However, there will be scarce room for monetary easing till the end of 2023. Moreover, a quantitative tightening is set to remain in place in the US and to be launched next year in the EZ.

Financial volatility

Declining global liquidity, high interest rates and dollar strength could continue spurring volatility and significant corrections in financial markets. Stress episodes, such as those recently observed in the UK and in crypto markets, and even a financial crisis could emerge ahead, specially if inflation and interest rates end up being higher than expected.

Main messages – Argentina

Fiscal policy

The new Minister of Economy has been successful in curbing the fiscal deficit and the IMF's target for 2022 could be met. This was ultimately achieved thanks to extraordinary measures on the revenue side (such as a jump in export duties due to a differential exchange rate to the soybean exports and its byproducts) and by postponing expenditures. However, in 2023 – an election year – meeting the primary fiscal deficit target of 1.9% of GDP will be a tougher challenge.

Monetary assistance

Thanks to the containment of the fiscal deficit, the Central Bank halted monetary assistance to the Ministry of Finance since July. However, it has been intervening in the secondary market of government securities to support bond prices. Since October, it has already issued more than $400 billion to purchase public bonds in local currency.

Public debt

The peso debt market is showing signs of saturation, and the government is finding it difficult to obtain net financing from this source. Therefore, we believe that it will need to continue relying on the BCRA’s monetary issuance in December to cover the year-end deficit.

Inflation

Inflation is advancing at an average monthly rate higher than 6% and we expect it to end the year at 99%. Despite some signs of a slowdown in the margin, we forecast that inflation next year will grow at a similar pace to this year (105% YoY), as utility prices will need to be corrected and the exchange rate has no leeway to move slower than the general price level.

Main messages – Argentina

Exchange rate

The official exchange rate is crawling at an average monthly rate of around 6.5%, slightly above inflation. As the government is seeking to avoid, at all costs, any significant jump of the official rate, we believe that it will continue to employ multiple exchange rates (like the "soy dollar" scheme or through sector-specific taxes) and will adjust import controls accordingly.

Interest rates

The BCRA has already aligned interest rates with current and expected inflation, and we believe it will maintain this "equilibrium" in the coming months. It will not raise interest rates above inflation, in order to contain the growth of its interest-bearing liabilities (which already reached historically high levels).

External sector

The drought has been diminishing wheat harvest yields and the discount time for soy has already begun. This is one of the main sources of risk for 2023, that could scuttle the government's plan to stop the exchange rate from depreciating further. Thanks to the new edition of the "soy dollar" scheme, we expect that the government will be close to meeting the reserves target agreed with the IMF.

Economic activity

Economic activity performed better than expected in 2022 and is likely to close the year with annual growth of around 5%. The main driver was consumption, which picked up amid the price instability, aided also by the recovery of those sectors most affected by the pandemic (such as tourism and restaurants) and an industrial sector that was not forced to slow down due to a lack of fuel, as had been expected after the increase in energy prices due to the Russia-Ukraine war.

BBVA Research

01

Global Economic Outlook December 2022

A sharp growth deceleration, with (mild) recessions in the US and the EZ, is likely in 2023 as interest rates and inflation will remain at high levels

BBVA RESEARCH BASELINE SCENARIO: MAIN ASSUMPTIONS AND IMPACTS

GROWTH TO SLOW DOWN SIGNIFICANTLY

Global growth to ease from 6.3% in 2021 to 3.3% (+0.1pp) in 2022, 2.3% (-0.1pp) in 2023, and to bounce back to 3.3% in 2024.

Energy prices to soon push the EZ into a recession, but gas shortages are not expected.

A mild recession by the mid-23 is likely in the US.

Growth to remain relatively weak, despite a likely recovery in China.

MONETARY TIGHTENING: STILL NOT OVER

Policy rates will continue to raise, but likely at a more gradual pace as inflation/growth lose steam.

Once they peak in 1Q23, rates are likely to remain unchanged at least till the end of 2023.

Rate increases will be complemented by quantitative tightening

Pro-growth measures to remain in place in China.

INFLATION TO EASE WHILE REMAINING HIGH

Inflation expected to slow as commodities prices and bottlenecks continue easing.

Wages are likely to grow more than in the past, but less than inflation.

Large second-round effects to be prevented.

Monetary tightening to reign in on expectations.

FINANCIAL VOLATILITY TO REMAIN IN PLACE

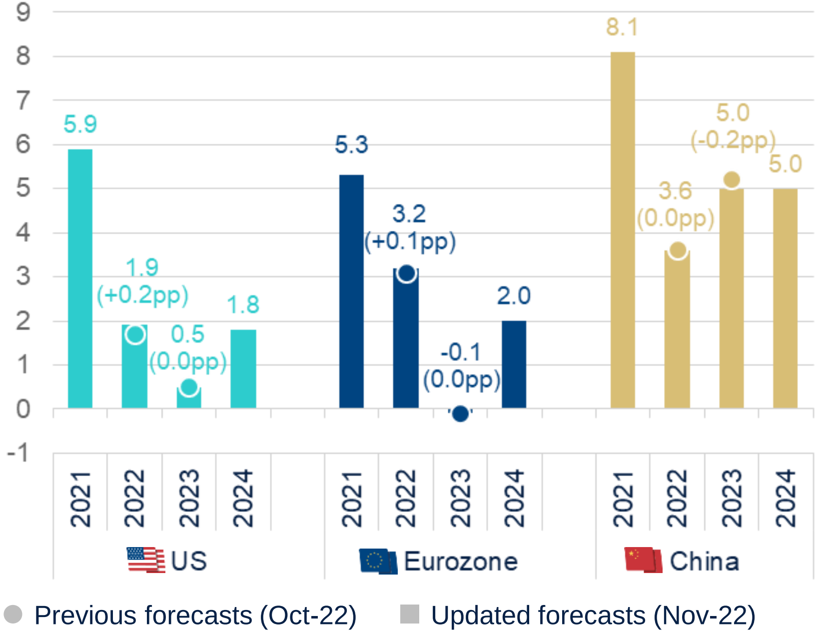
Inflation easing to take some pressure off central banks.

But lower global liquidity and high interest rates to continue supporting the USD and bond yields.

Volatility is set to remain relatively high and stress episodes should not be ruled out.

Growth to stagnate before going back to potential levels in 2024 in the US and the Eurozone

GDP: ANNUAL GROWTH IN REAL TERMS (*)
(%)

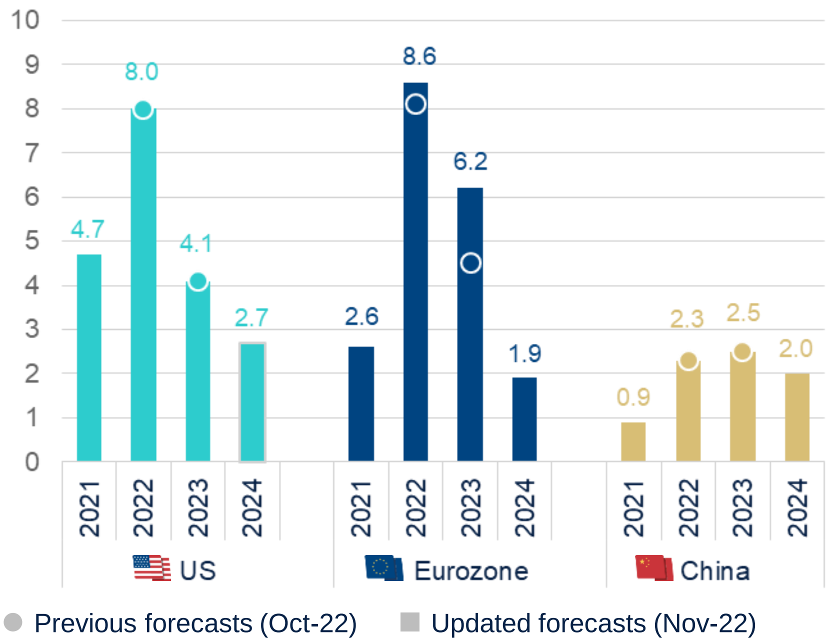


(*) Forecast change in parentheses.
Source: BBVA Research.

- 2022 GDP forecasts revised slightly up in US and EZ, in line with upward 3Q22 surprises.
- Deceleration prospects remain broadly unchanged: monetary tightening and price pressures will eventually hit harder labor markets and private consumption.
- A mild recession is likely over the next few quarters in the EZ, although gas shortages are not anticipated, and by mid-2023 in the US.
- In China, growth is still expected to recover, supported by infrastructure investment, but 2023 GDP forecast has been revised down.
- The recent measures to ease covid policies and support to the real estate sector are insufficient to significantly reduce concerns about weak growth.

Inflation will decline more quickly in the US than in the EZ, at least in 2023, as the shock imposed by the war will continue affecting mainly the latter

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

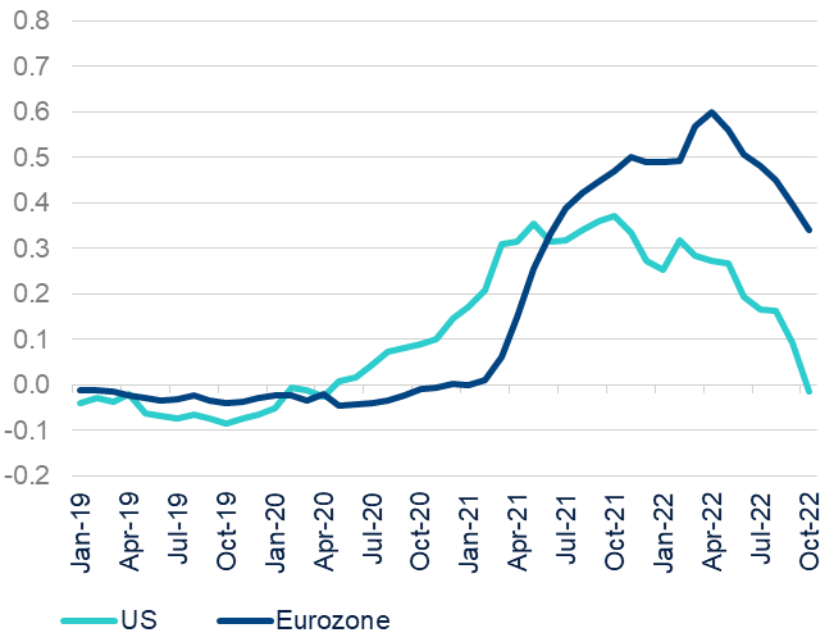


Source: BBVA Research.

- Inflation is set to continue slowing in the US as ongoing shocks wane and demand weakens, but it will be above the 2% target for some time.
- In the EZ, inflation is likely to soon peak, but forecasts have been revised up as the effects of more widespread price revisions, higher wage growth (to be around 4% ahead) and a weaker euro offset lower than expected energy prices.
- Inflation expectations are expected to remain broadly anchored both in the US and in the EZ.
- In China, inflation will continue at low levels largely on declining commodity prices, increasing imports from Russia and subdued demand.
- Inflation forecasts still have an upward bias.

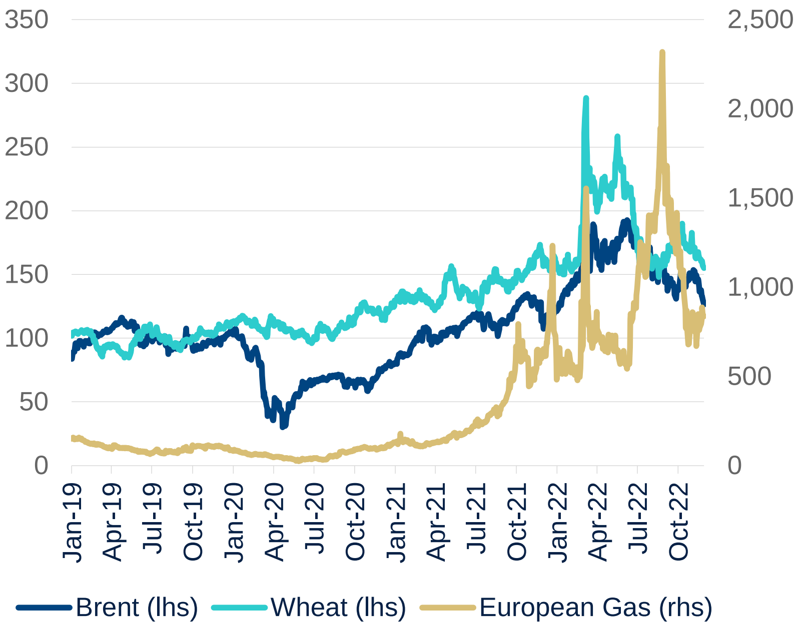
Growth slowing has contributed to easing bottlenecks and commodity prices; gas prices have fallen on high reserves and saving measures in the EU

BBVA RESEARCH BOTTLENECK INDEX
(INDEX: AVERAGE SINCE 2003 = 0)



Source: BBVA Research

COMMODITY PRICES
(INDEX: 2019 AVERAGE = 100)

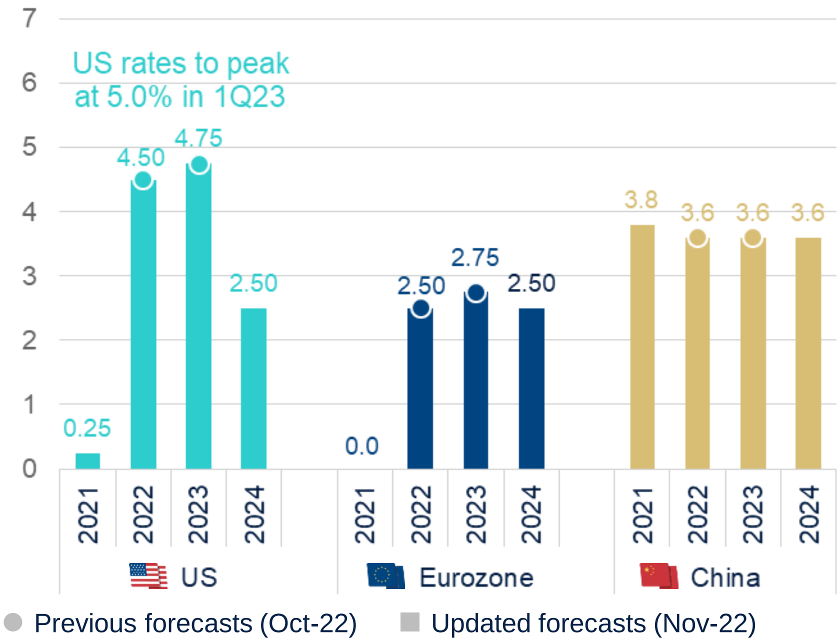


Source: BBVA Research based on data from Bloomberg

The interest-rate hiking cycle is likely to come to an end in early 2023 in the US and the EZ, but there will be scarce room for monetary easing before 2024

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)



(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- The Fed and the ECB will continue raising rates, but probably at a softer pace than in the last few months: policy rates to reach 5.0% in the US and 2.75% (with an upside bias) in the EZ in 1Q23.
- A long pause is likely afterwards: inflation above targets should prevent rate cuts before Dec/23.
- Although rate hiking cycles should be soon over, a quantitative tightening is set to remain in place in the US and to soon start in the EZ.
- A non-expansionary fiscal policy is likely in the US, but not necessarily in the EZ.
- In China, controlled inflation will allow policy rates to remain low, but significant monetary stimulus are not anticipated.

Risks: multiple factors, such as long-lasting inflation or new war-related shocks, could trigger a global recession or a financial crisis

MAIN SHORT-TERM RISKS TO THE WORLD ECONOMY

PERSISTENT INFLATION AND HIGHER RATES

UKRAINE WAR AND GEOPOLITICS

HARD-LANDING IN CHINA

SOCIAL TENSIONS AND POPULISM

GLOBAL RECESSION

Growth in G3 economies could weaken more than expected, pushing emerging markets and the global economy into a recession. In particular, if inflation refrains from easing significantly (due to new supply shocks or monetary policy mismanagement, for example), a stagflation scenario could also emerge.

FINANCIAL CRISIS

Declining global liquidity, higher Fed rates, financial volatility and a strong USD could trigger sharp corrections and financial turmoil. Risks are higher in some segments: leveraged loans, high yield debt markets, shadow banking, dollar indebted agents and EM countries, real estate in some DMs, etc.

BBVA Research

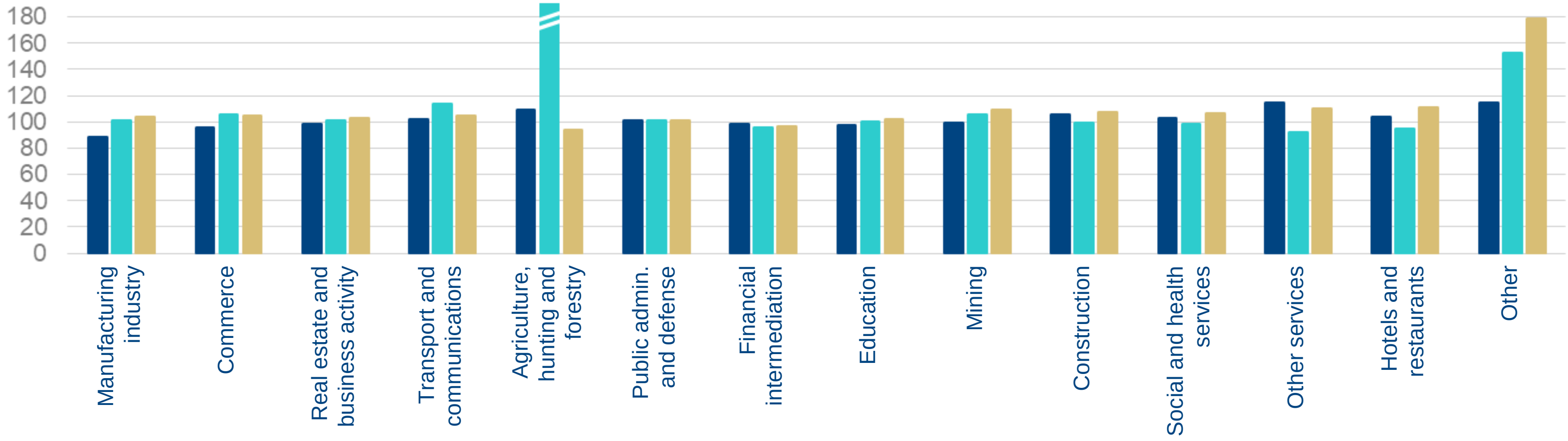
02

Argentina – Economic Outlook
December 2022

Economic activity: the main sectors performed better than expected during 3Q22, which improved the GDP growth forecast for 2022 to 5%...

TREND IN ECONOMIC ACTIVITY BY SECTOR

(BASE 4Q21 = 100; RELATIVE WEIGHT AS A % OF GDP)



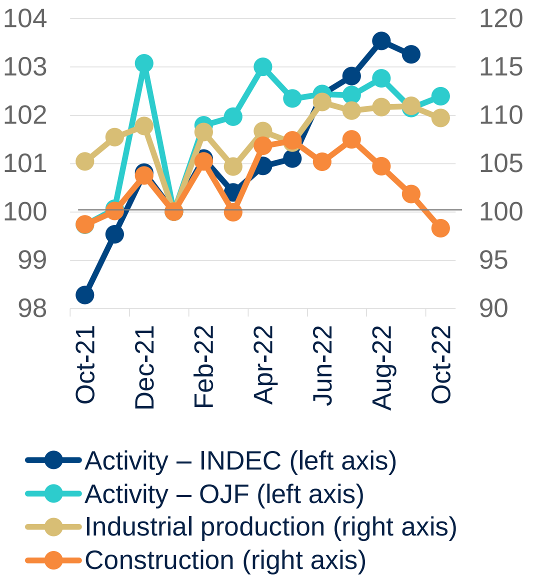
Relative weight	21.0%	15.6%	12.4%	8.9%	8.7%	5.3%	4.4%	4.3%	4.2%	3.7%	3.6%	3.6%	1.8%	2.6%

Source: BBVA Research and INDEC.

... however, there are signs of a slowdown in late 2022, that will extend into 2023

GENERAL ACTIVITY, INDUSTRIAL PRODUCTION AND CONSTRUCTION

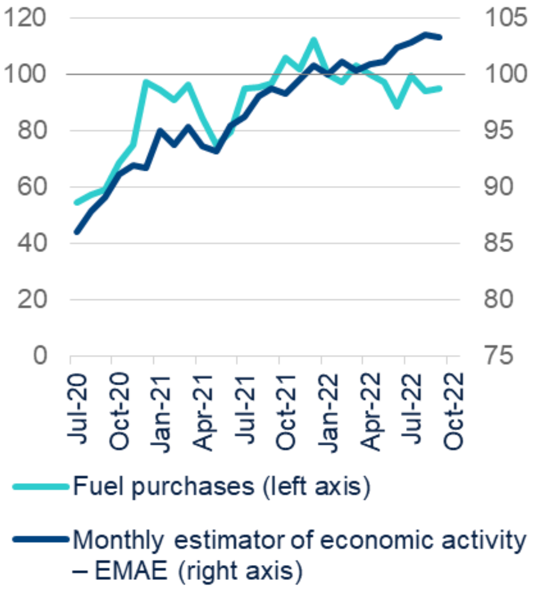
(JANUARY 2022 = 100)



Source: BBVA Research, OJF & Asociados and INDEC.

FUEL PURCHASES WITH BBVA CARDS AND ECONOMIC ACTIVITY

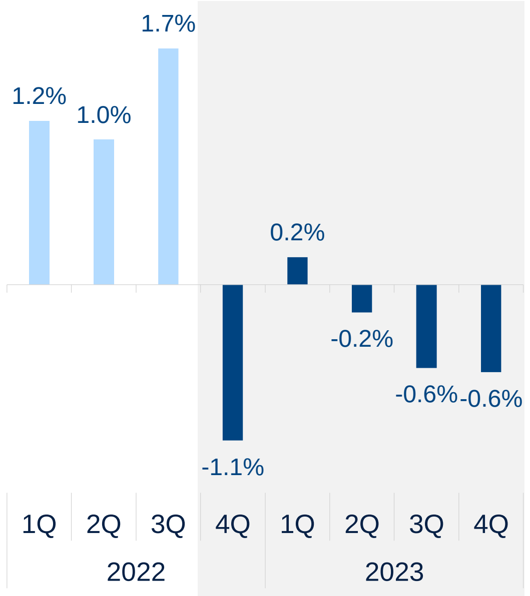
(JANUARY 2022 = 100; PURCHASES IN AMOUNTS)



Source: BBVA Research and INDEC.

QUARTERLY GDP FORECAST

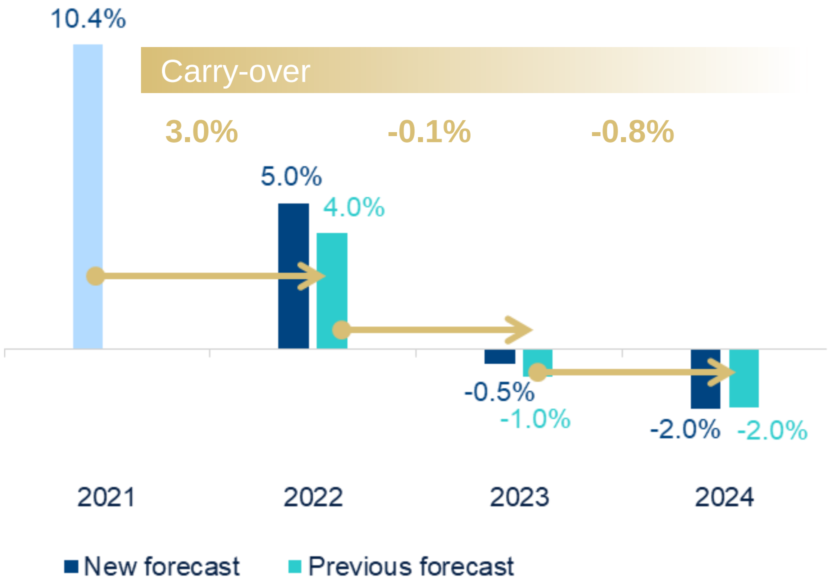
(CHG. % CHG. Q/Q; SERIES NOT SEASONALLY ADJUSTED; CONSTANT ARS)



Source: BBVA Research and INDEC.

Macroeconomic imbalances were curbed after the change of Finance Minister, but the challenge to contain them in 2023 will be tougher

ECONOMIC GROWTH AND STATISTICAL CARRY-OVER
(% Y/Y CHG.)

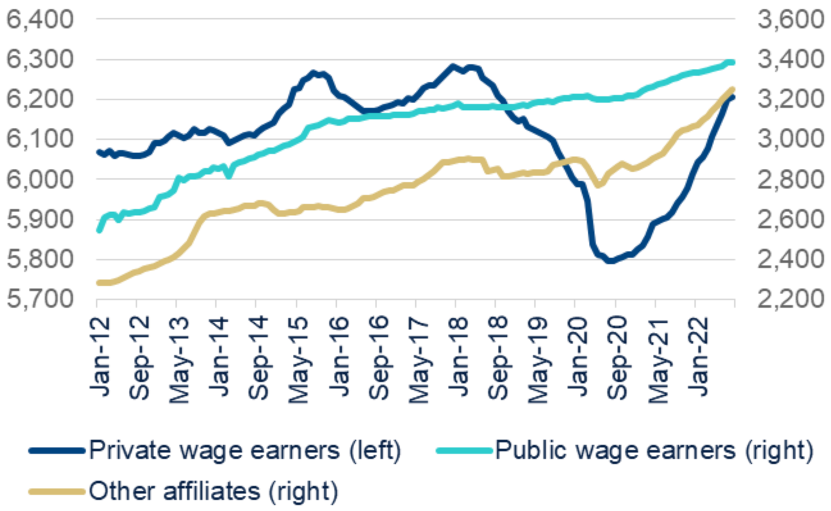


Source: BBVA Research and INDEC.

- Economic activity will end the year above expectations, due to greater dynamism within the sectors that contribute the most to GDP, thus leading to higher growth forecasts.
- However, the economy is beginning to slow in 4Q22 as a result of high inflation, a complex exchange rate policy, a tightening of import restrictions and the prevailing uncertainty and lack of confidence, which has dampened investment.
- This environment will persist throughout 2023, exacerbated by the drought in the agricultural sector (which could threaten foreign currency inflows from exports) and tensions in the local debt market. This scenario could well cause economic activity to slump next year.

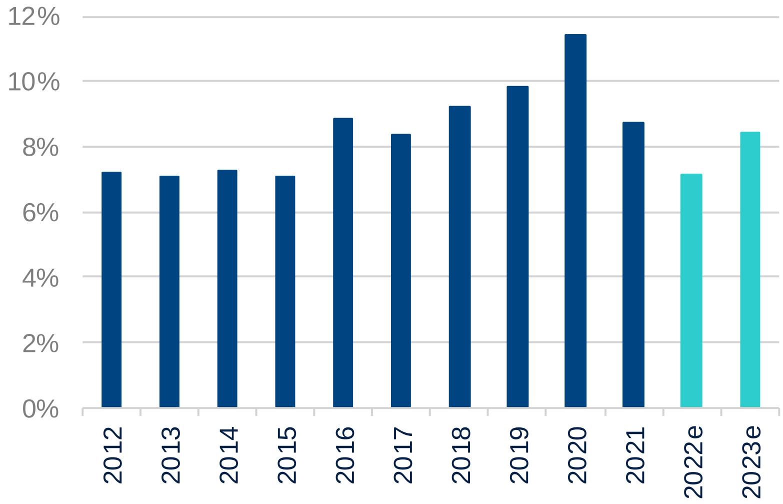
Informal jobs and public sector workers have continued to increase, while formal salaried employment is growing but has not yet reached its previous peak

REGISTERED SALARIED WORKERS
(THOUSANDS)



Source: BBVA Research and INDEC.

UNEMPLOYMENT RATE
(% OF THE TOTAL LABOR FORCE)

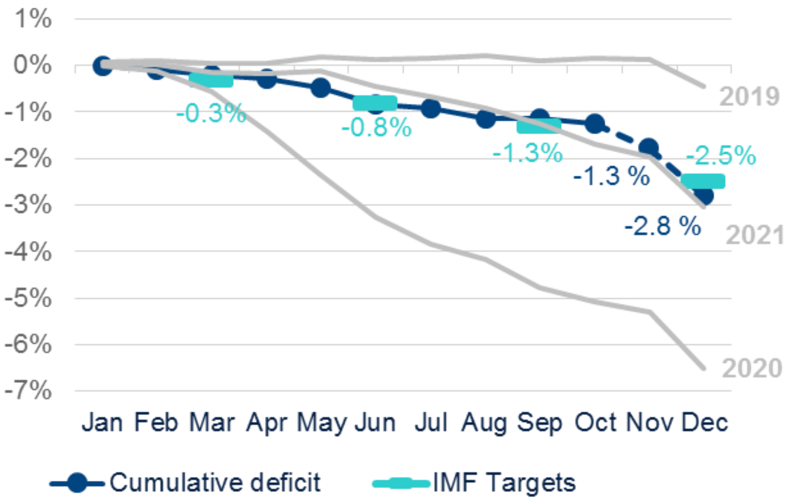


Source: BBVA Research and INDEC.

The labor market remains weak due to the prevalence of informal work and the relatively low likelihood of generating formal employment given the rather vulnerable macroeconomic environment.

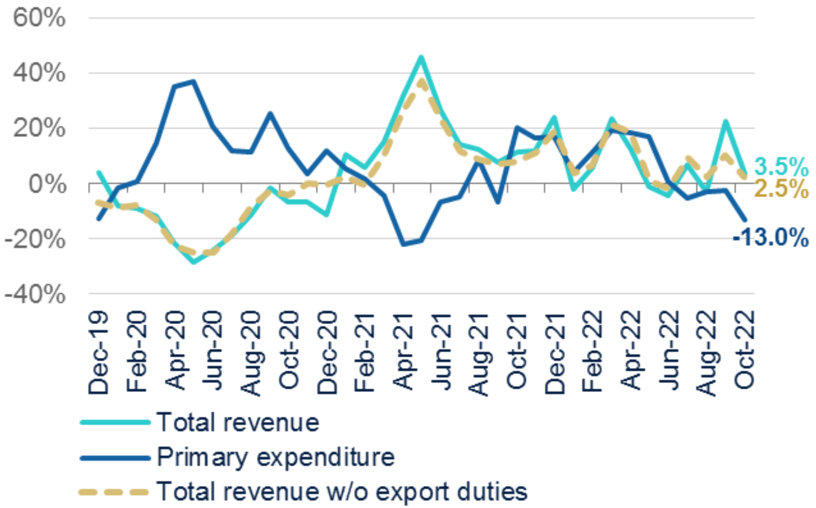
The deterioration of the fiscal deficit has slowed since August, thanks to expenditure-control measures and certain improvements in government revenue...

PRIMARY FISCAL BALANCE
(CUMULATIVE ANNUAL, % GDP)



Note: BBVA forecasts for November and December 2022 fiscal deficit.
Source: BBVA Research and Ministry of Economy.

FISCAL REVENUE AND EXPENDITURE
(% CHANGE Y/Y IN REAL TERMS)

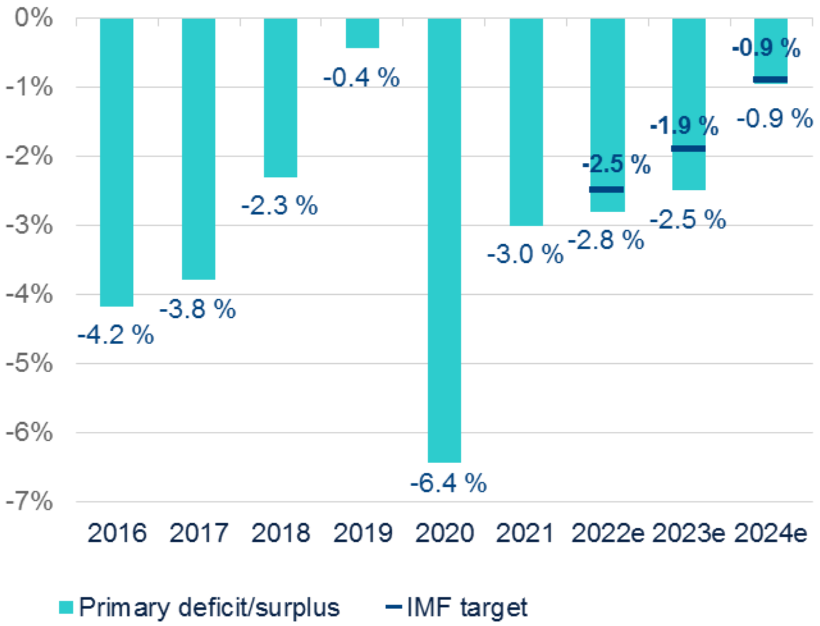


Source: BBVA Research and Ministry of Economy.

Export duties boosted fiscal revenues in September, while in October the government collected a sizable amount in corporate income tax receipts. Meanwhile, expenditure made it four months of real year-on-year decline, even though the delays in tariff corrections kept subsidy expenditure high, as inflation erodes social spending in real terms.

... as a result, the fiscal deficit could end the year in line with the annual target agreed upon with the IMF

PRIMARY FISCAL BALANCE
(% OF GDP)

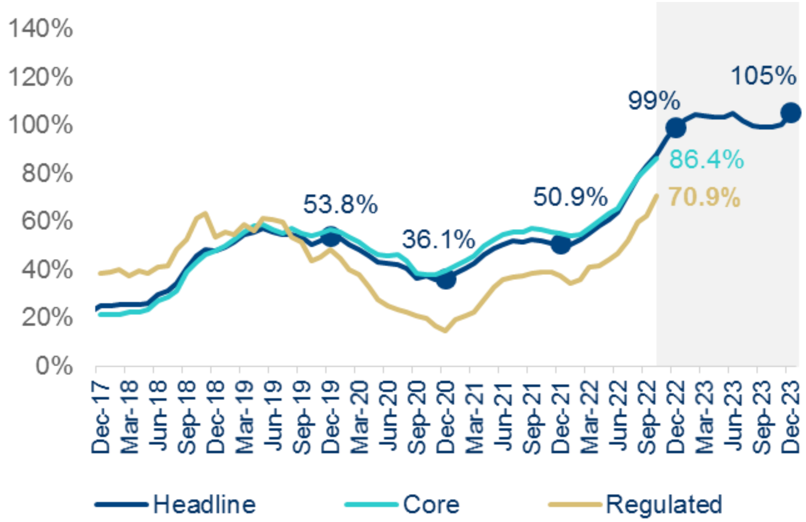


Source: BBVA Research and Ministry of Economy.

- The fiscal balance showed a deterioration with respect to 2021 during the first half of the year. However, since August the government has been successful in reversing this dynamic and the deficit target of 2.5% of GDP for 2022 now looks attainable.
- This fiscal adjustment was explained by “one-offs”: an extraordinary improvement in export duties thanks to the “soy dollar” scheme and a temporary brake on Treasury payments.
- The government will find it hard to meet the fiscal target for 2023 (-1.9% of GDP), as it is an election year and usually the public spending is very difficult to control.

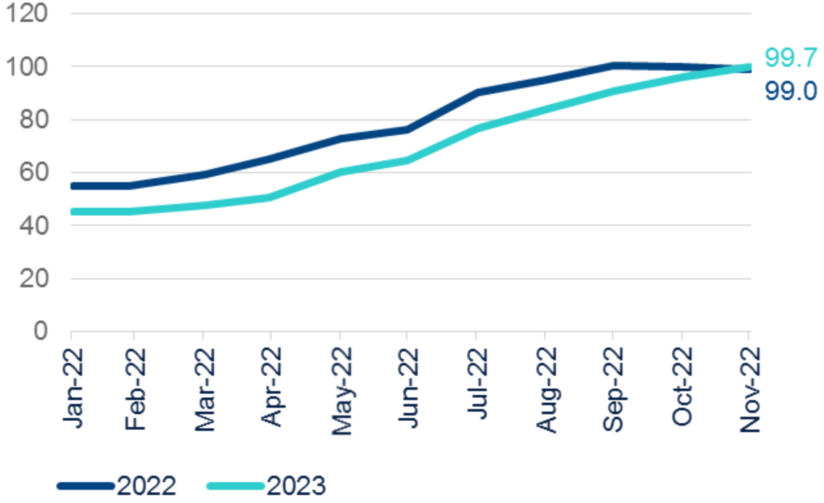
Inflation advanced at an average rate of 6.5% in the last quarter and we forecast that it will end 2022 at 99% YoY

INFLATION, BY COMPONENT
(Y/Y VAR.)



Source: BBVA Research and INDEC.

INFLATION EXPECTATIONS: PROFESSIONAL ANALYSTS (% Y/Y VAR.)

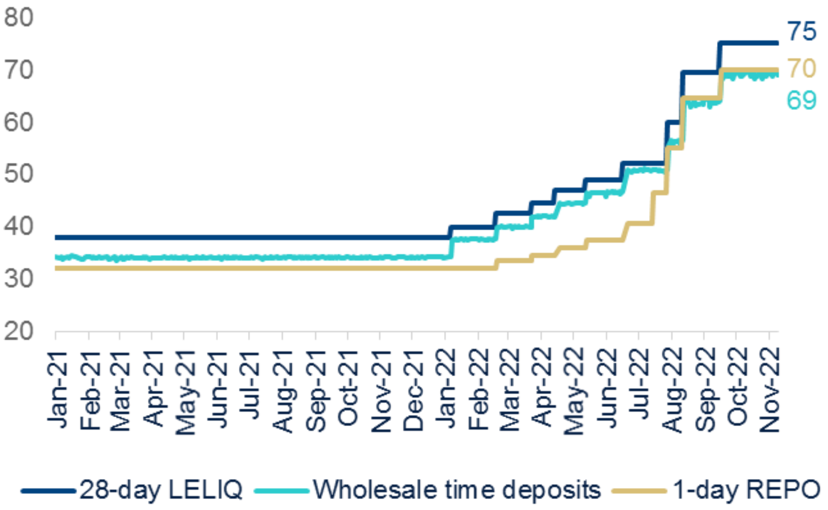


Source: BBVA Research and BCRA.

We expect inflation to remain at similar levels in 2023, closing at 105% annually. The possible slowdown in prices caused by the slower pace of monetary issuance would be offset by a correction of utility tariffs and an official exchange rate that we expect will move in line with the general price level.

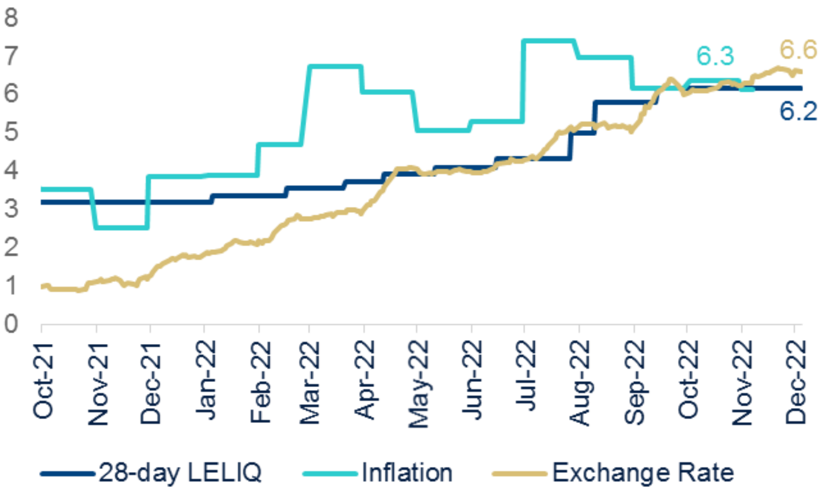
The government hiked interest rates to align them with current and expected inflation

INTEREST RATES
(IN %, ANNUAL RATES)



Source: BBVA Research and BCRA.

MONTHLY INTEREST RATE, INFLATION AND CHANGE IN THE OFFICIAL EXCHANGE RATE
(% CHG., M/M)

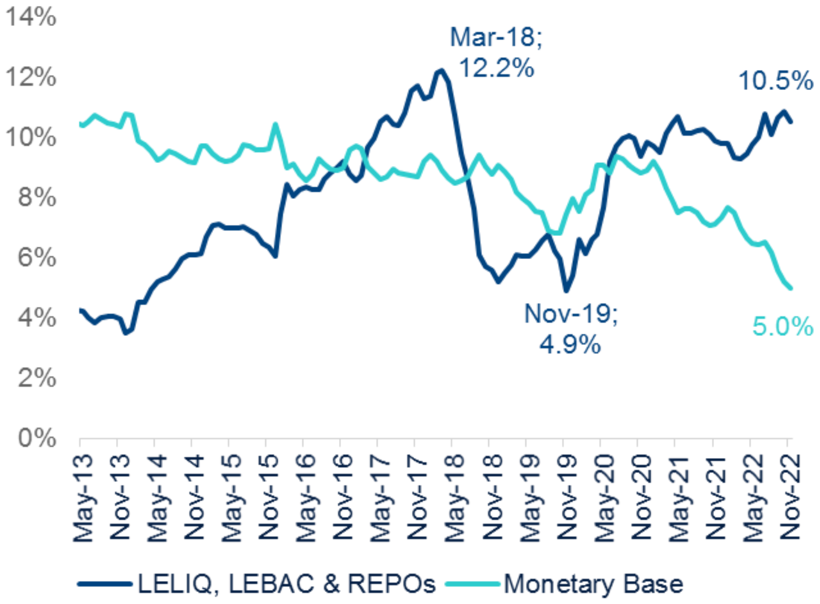


Source: BBVA Research, INDEC and BCRA.

Moving forward, we believe that the central bank's decisions will seek to maintain this "delicate balance" between interest rates and inflation, so as to keep real interest rates at "neutral" levels, but without applying a contractionary monetary policy.

The BCRA's considerable stock of interest-bearing liabilities generates high levels of money issuance and makes it harder to manage monetary policy

INTEREST-BEARING LIABILITIES OF THE BCRA AND MONETARY BASE
(% of GDP)



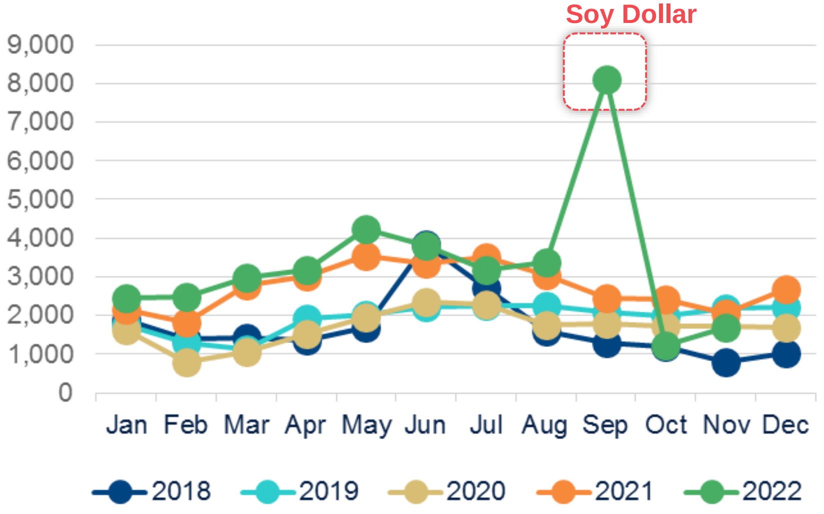
Source: BBVA Research and BCRA.

- The BCRA's interest-bearing liabilities amount to more than 10% of GDP, a high proportion in historical terms, which generates a significant interest burden (approx. 10% of the monetary base per month).
- It places a significant constraint on monetary policy and also represents a potential source of risk. A reduction in monetary assistance to the Treasury is crucial to guarantee the sustainability of these liabilities.
- These interest payments generate a level of monetary issuance that put a high floor for inflation next year.

After the heavy buying of reserves in September, the BCRA became a net seller of foreign currency, forcing it to implement a new “soy dollar” scheme

FOREIGN CURRENCY SETTLEMENTS BY SOYBEAN AND GRAIN EXPORTERS

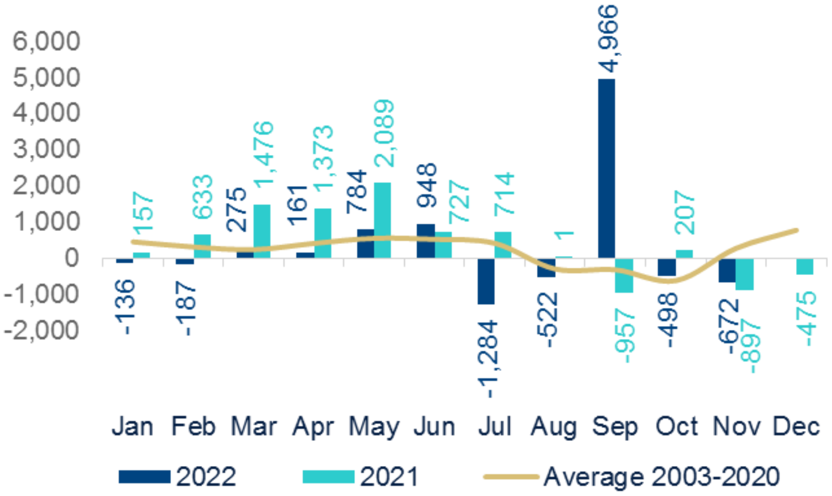
(IN MILLIONS OF USD)



Source: BBVA Research and Cámara de Exportadores.

BCRA FOREIGN EXCHANGE NET PURCHASES IN THE OFFICIAL MARKET

(IN MILLIONS OF USD)

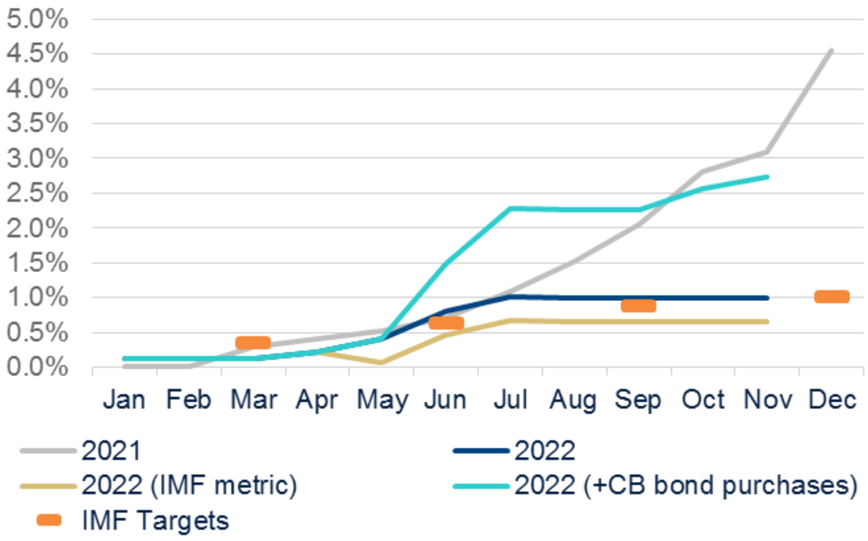


Source: BBVA Research and Ministry of Economy.

In September, the settlement of exports for the soybean complex reached a record of USD 8.2 bn. However, this value then dropped to USD 1.2 bn and 1.7 bn in Oct and Nov. Faced with the need to replenish its stock of reserves, the government repeated the strategy by setting a special exchange rate of ARS 230/USD effective December 2022 (while the official exchange rate is at around ARS 170).

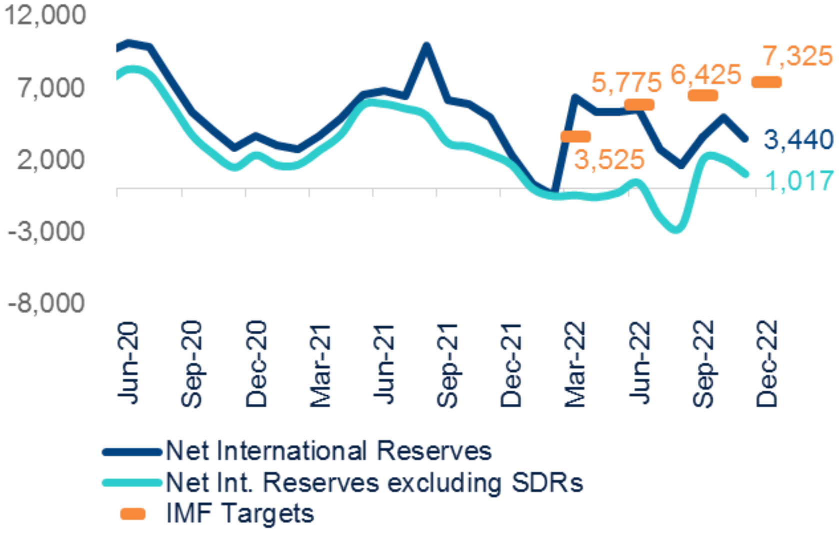
Thanks to this new edition of the "soy dollar", the government could move closer to meeting its 4Q reserves target with the IMF

MONEY ISSUED TO ASSIST THE TREASURY
(% OF GDP)



Source: BBVA Research, BCRA and IMF.

NET INTERNATIONAL RESERVES
(USD MILLIONS)

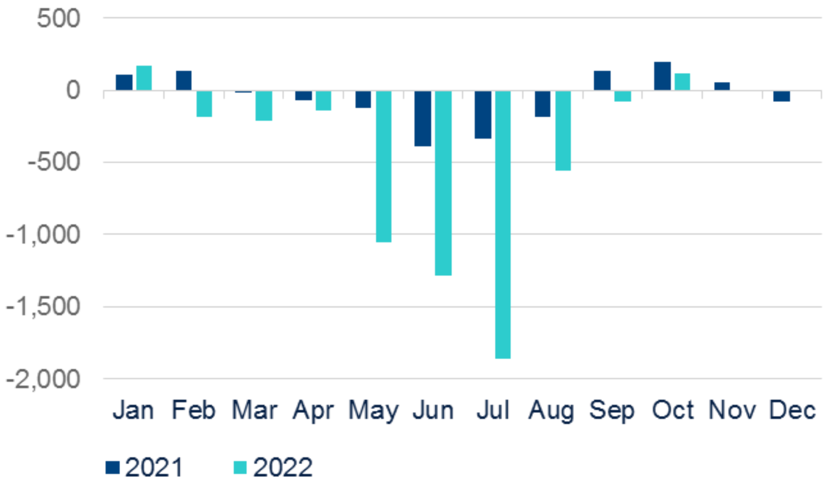


Source: BBVA Research, BCRA and IMF.

The IMF announced that the 3Q targets were met. The annual reserves target was lowered by USD 800 million. However, the 4Q reserves and monetary issuance targets will be harder to achieve. The government will seek to achieve them with the "soy dollar", which will increase purchases of USD by the BCRA and reduce the fiscal deficit in December 2022 thanks to the export duties collected.

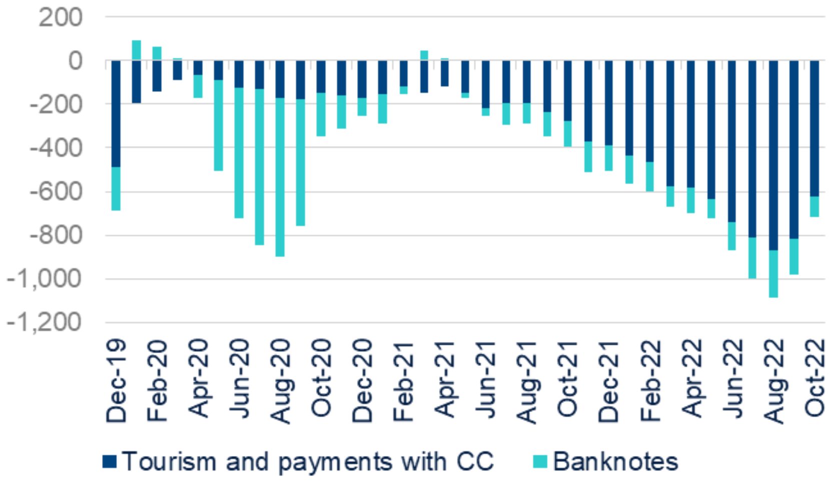
After navigating the worst months of the energy deficit, foreign currency outflows for fuels have fallen, though demand due to tourism remains high

ENERGY BALANCE: NET EXPORTS
(IN MILLIONS OF USD)



Source: BBVA Research and INDEC

FOREIGN EXCHANGE OUTFLOWS DUE TO TOURISM, CREDIT CARDS (CC) AND SAVING PURPOSES
(IN MILLIONS OF USD)

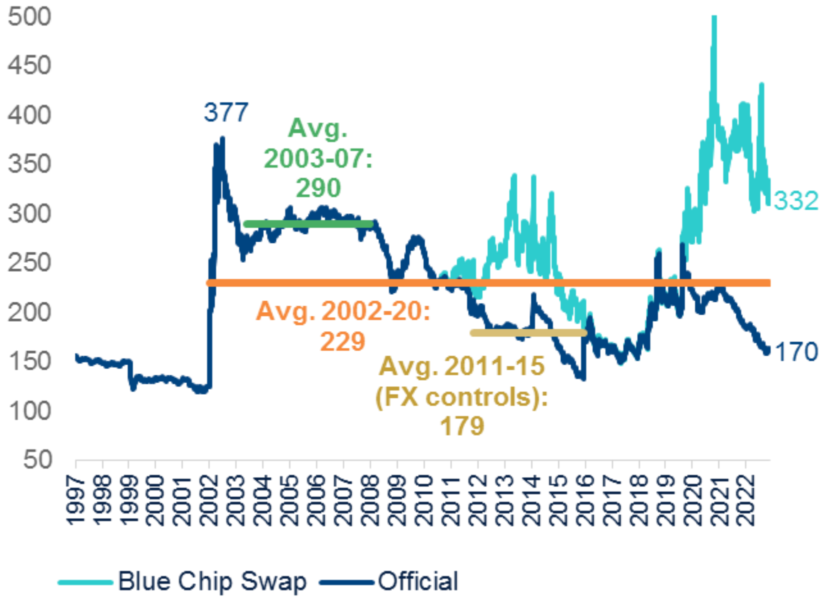


Source: BBVA Research and BCRA.

The energy balance will remain neutral or slightly positive until 2Q23. Meanwhile, the exchange rate gap near 100% is driving demand for dollars for international tourism. This has led to the creation of a new tax on the purchase of foreign currency for tourism (a 25% withholding tax in addition to the existing levies), thus generating a new implicit exchange rate.

The government introduced differential exchange rates and new import controls to avoid further devaluation of the official exchange rate

OFFICIAL AND PARALLEL EXCHANGE RATES IN REAL TERMS
(PESOS PER DOLLAR, AT TODAY'S PRICES)

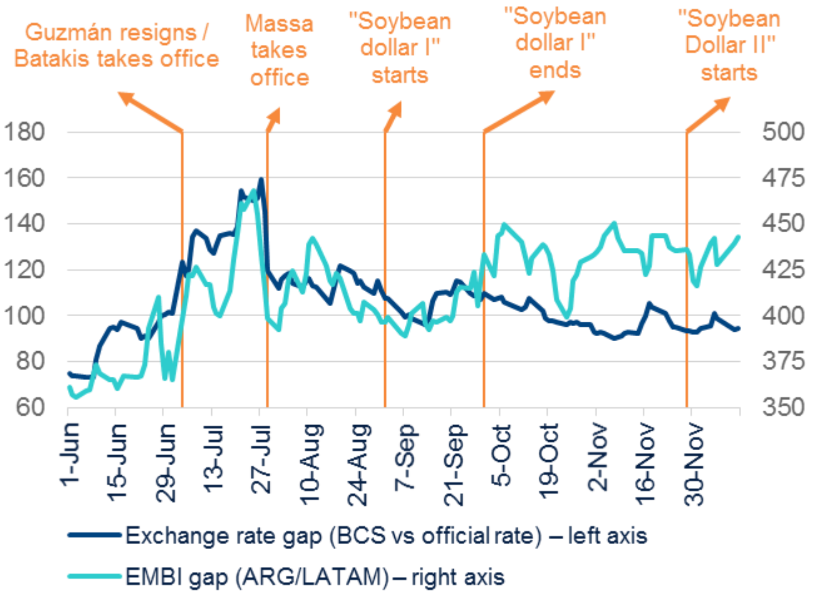


Source: BBVA Research, INDEC and BCRA.

- For example, it implemented a temporary depreciated exchange rate for the soybean complex in September and December, as well as taxes on the purchase of foreign currency for tourism and foreign artists.
- The official exchange rate is crawling at a rate of around 6.5% per month, slightly above inflation, although the global appreciation of the dollar has been making the Argentine peso less competitive in effective terms.
- We expect the government to maintain this strategy, avoiding any abrupt increase in the official rate through multiple exchange rates and adjusting import controls accordingly.
- We maintain our exchange rate projection of ARS 173/USD for Dec-22 and 320 for Dec-23.

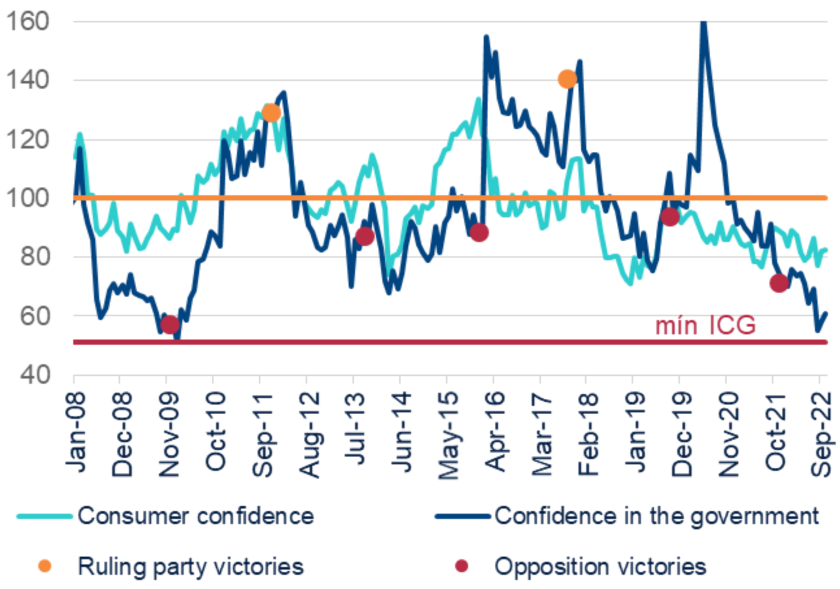
Due to the “palliative” economic measures rolled out, risk remains high and confidence in the government’s ability to resolve the imbalances remains very low

FINANCIAL RISK INDICATORS
(FX GAP: %; EMBI GAP: B.P.)



Source: BBVA Research and Haver.

CONFIDENCE INDICATORS
(HISTORICAL AVERAGE = 100)

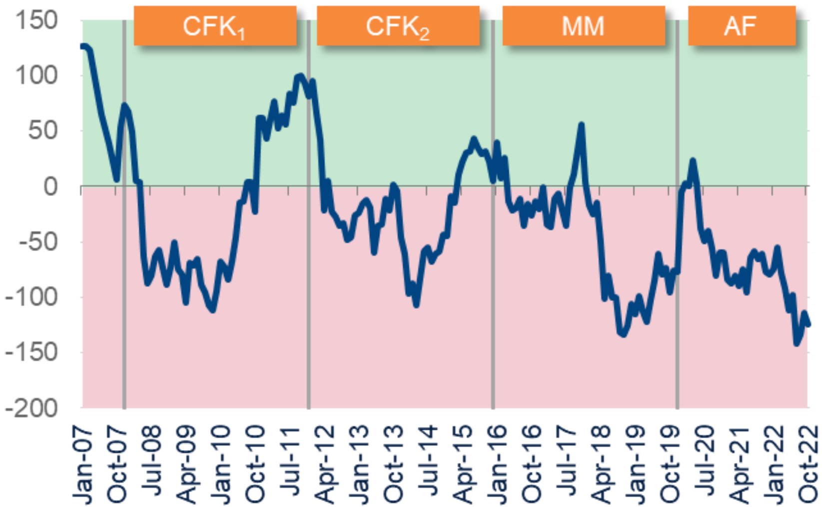


Note: The dots point the moment of elections in the Province of Buenos Aires.

Source: BBVA Research and UTDT.

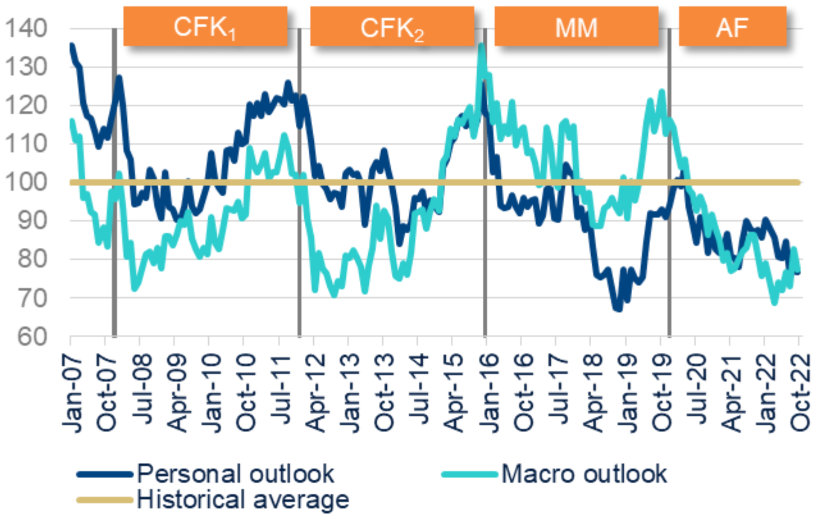
The 2023 presidential elections will take place against a backdrop of public pessimism regarding both politics and the economy

PUBLIC CONFIDENCE INDEX
(VALUES > 0 INDICATE OPTIMISM AND VALUES < 0 PESSIMISM)



Source: BBVA Research and Poliarquía Consultores.

CONSUMER CONFIDENCE ACCORDING TO PERSONAL SITUATION AND MACROECONOMIC PROSPECTS

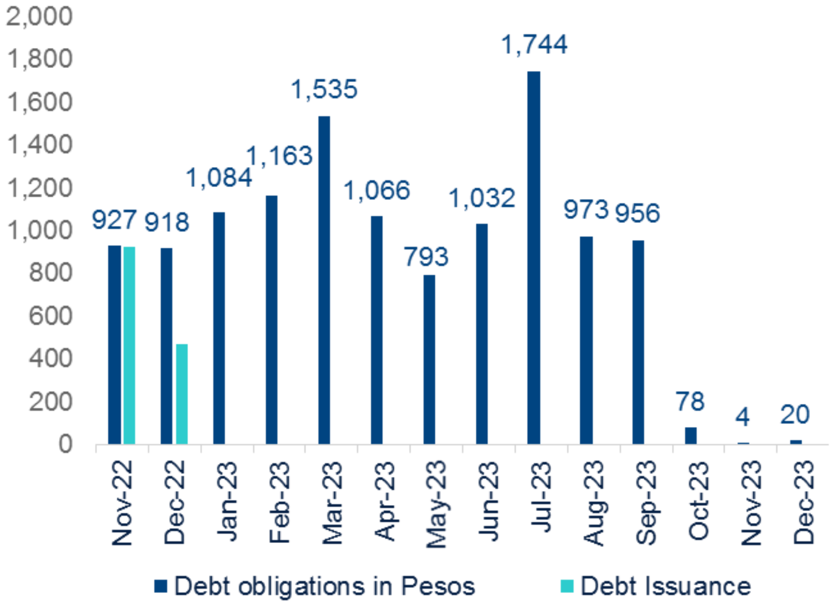


Source: BBVA Research and Universidad Torcuato Di Tella.

Public confidence and the prospects for improvement in terms of both the personal and national economy are now at a 15-year low, meaning that resolute policies must be taken to come up with a plan to stabilize the macroeconomic situation and restore confidence in the short term.

Risks for 2023 (I): insufficient roll-over of peso-denominated debt maturities

PUBLIC DEBT MATURITY PROFILE IN PESOS AND NEW DEBT ISSUANCE, PER MONTH
(ARS BILLION)

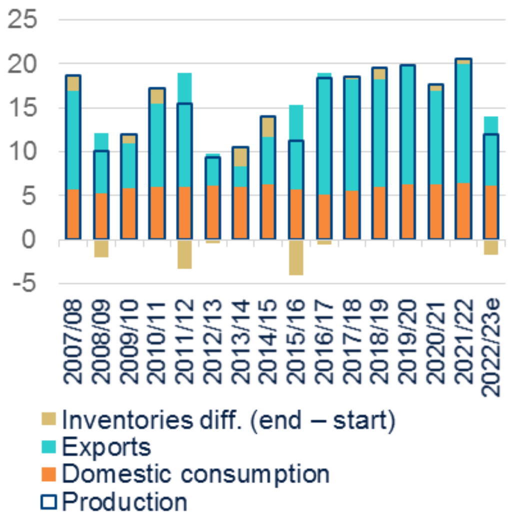


Source: BBVA Research, BCRA and Ministry of Economy.

- There are sizable maturities of peso-denominated debt due in 2023, as the market seems reluctant to refinance payments beyond July of next year. The first major challenge will take place next March.
- Notably, at least 50% of the maturities through to December 2023 are in the hands of public creditors. Several voluntary exchanges will take place in the coming months to refinance these securities.
- The shorter-term maturities are largely in the hands of private counterparties, while the longer-term maturities tend to be held by public creditors.

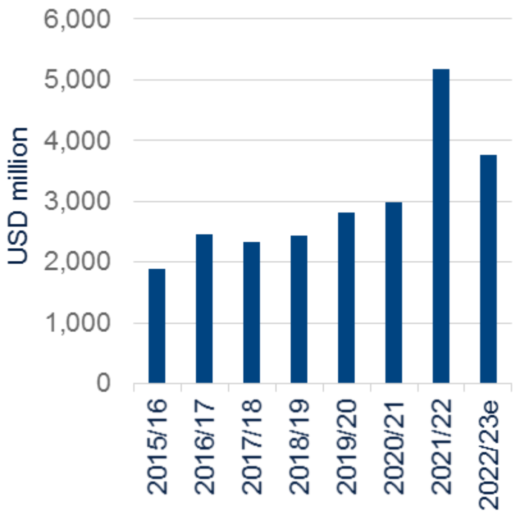
Risks for 2023 (II): due to the drought, estimated wheat harvest has fallen and the discount time period for corn and soy is underway

WHEAT OUTPUT
(MILLIONS OF METRIC TONS)



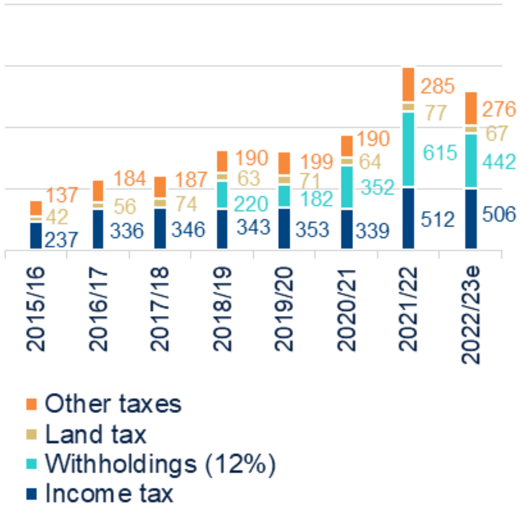
Source: USDA, BCBA and BBVA Research.

WHEAT EXPORTS
(USD MILLION)



Source: BCBA HAVER and BBVA Research.

FISCAL CONTRIBUTION OF WHEAT
(USD MILLION)



Source: BCBA and BBVA Research.

The bulk of the harvest takes place in December, although the drought is severe and output is likely to be the lowest since 2015. Prices for agricultural commodities remain high due to the ongoing war in Europe and adverse weather events. The possible easing of China's zero-COVID policy would boost the agricultural package, particularly soy and corn.

Table of Macroeconomic Forecasts

	2020	2021	2022f	2023f	2024f
Gross Domestic Product (% YoY)	-9.9	10.4	5.0	-0.5	-2.0
Inflation (% YoY eop)	36.1	50.9	99.0	105.0	115.0
Exchange Rate (vs USD eop)	82.6	101.9	173.0	320.0	705.0
Monetary Policy Rate (% eop)	37.1	36.7	76.0	82.0	78.0
Private Consumption (% YoY)	-13.7	10.0	9.4	-0.2	-4.4
Public Consumption (% YoY)	-1.9	7.1	2.6	-1.3	-5.1
Private Investment (% YoY)	-13.0	33.4	14.1	-2.5	7.0
Primary Fiscal Balance (% GDP)	-6.4	-3.0	-2.8	-2.5	-0.9
Current Account Balance (% GDP)	0.8	1.4	-0.7	-1.3	-1.8

Source: BBVA Research.

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Argentina Economic Outlook

December 2022

Creating Opportunities