BBVA Research

Argentina Economic Outlook

March 2023

Creating Opportunities

Main messages – Global economy

Recent developments

Supply shocks have eased while demand has remained resilient, triggering upward growth surprises and reducing the odds of a recession in the short run. Headline inflation has fallen, but core figures remain sticky. After a temporary decoupling, markets are now in line with central banks' indications that interest rates still have some room to rise and the easing cycle will take some time to unfold; financial volatility has increased, but remains contained.

Growth outlook

Global growth is forecasted to reach 2.8% in 2023 (0.5pp higher than the previous forecast) and 3.3% in 2024 (unchanged forecast), after having reached 3.2% in 2022. Positive incoming data and lower energy prices favor an upward revision in 2023 GDP estimation in the US and, mainly, in the Eurozone, while the easing of covid restrictions supports a sharper recovery in China. Still, a growth slowdown is likely ahead amid higher inflation and interest rates.

Inflation and rates outlook

Persistent core inflation and robust labor markets will force central banks to deliver higher than expected policy rates and no rate cuts before 2024. Inflation is expected to decline gradually as supply shocks wane and demand weakens, but it will remain above the 2% target in both the US and the Eurozone at least until the end of 2024.

Risks

The main risk is that inflation proves to be more persistent than expected, due to tight labor markets, second-round effects, a demand-driven recovery in China, war disruptions, etc., triggering further monetary tightening, and then, potentially, a recession, stagflation or, even, financial instability.

Main messages - Argentina

Political outlook

The busy electoral calendar will lead the way to a 2023 with a complex economic situation and low levels of government approval. Candidates have yet to be officially announced, but it is expected that provincial elections, that take place before the main national vote, will provide an early glimpse of the results for the Presidential elections, which will be held in the second half of the year.

Economic activity

GDP grew 5.2% in 2022, driven by consumption and sectors that are still recovering from 2020, such as industry (mainly automotive) and mining. On the other hand, agriculture was hit by the most severe drought of the last decades. We expect a GDP fall of 2.5% in 2023 due to the impact of the drought and the persistence and deepening of macroeconomic imbalances.

External sector

The exceptionally severe drought will result in a 35% lower harvest compared to last year, which will slash USD 17 billion of agricultural exports. This will be partially offset by the better performance of the energy sector due to lower gas imports and higher oil exports, which will contribute with USD3 bn.

Inflation

Inflation was 94.8% in 2022 and monthly inflation accelerated in January and February. We expect it to swing around 6% MoM for the rest of the year, resulting in a 105% inflation in 2023. There could be an acceleration to 115% in 2024 due to the implementation of an economic program aimed at correcting the current macroeconomic imbalances, carried out by the government that will take office in Dec-23.

Main messages - Argentina

IMF

The annual targets agreed with the IMF for 2022 were met. The primary fiscal balance amounted to 2,4% of GDP and, thanks to differential exchange rates for soybean exporters, the reserve accumulation goal was also achieved. In 2023, due to the effect of the drought the target for international reserves will be relaxed, but the fiscal goal still remains unchanged (although it is very challenging).

Exchange rate

The official exchange rate is moving slightly below inflation in the first two months of the year. The Government is fully invested in avoiding a jump in this parity. Given that the drought will limit the CB's firepower to do so, we estimate that the Government will continue to resort to multiple exchange rates (like the "soybean dollar" or through specific sectoral taxes) and tighten import controls.

Interest rates

The Central Bank (CB) kept interest rates aligned with current and expected inflation. It would maintain this "balance" in the coming months. We do not expect rate hikes that could have real anti-inflationary effects, because they would boost the growth of the CB's interest-bearing liabilities, which would put a higher floor on monetary issuance due to interest payments on these instruments.

Public debt

The Government has mitigated the rollover risk in the local currency debt market through voluntary swaps, extending maturities to 2024-25. In addition, the government started a consolidation process of the USD-denominated National debt in the hands of several public entities, to concentrate it in the Ministry of Economy and the Central Bank. This measure will provide some funding to finance fiscal needs this year and some room to curb FX pressures in parallel markets until the elections.

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Global Economic Outlook March 2023

Creating Opportunities

BBVA Research baseline scenario: interest rates will be higher for longer to ease demand and slowdown inflation

BBVA RESEARCH BASELINE SCENARIO: MAIN ASSUMPTIONS AND FEATURES

COMMODITIES AND BOTTLENECKS

Commodity prices to remain under 2022 levels, but China's demand and supply issues will limit downward corrections and favor rebound of oil prices in 2H23.

Supply bottlenecks to continue normalizing.

EUROPEAN GAS

Prices assumed to remain somewhat higher than ongoing levels, mainly from mid-2023.

Gas reserves to be enough to prevent shortages, even under relatively unfavorable scenarios.

FINANCIAL AND MONETARY CONDITIONS

More restrictive monetary policy, also through monetary tightening programs.

A strong dollar, higher sovereign yields and modest capital inflows into riskier assets are expected.

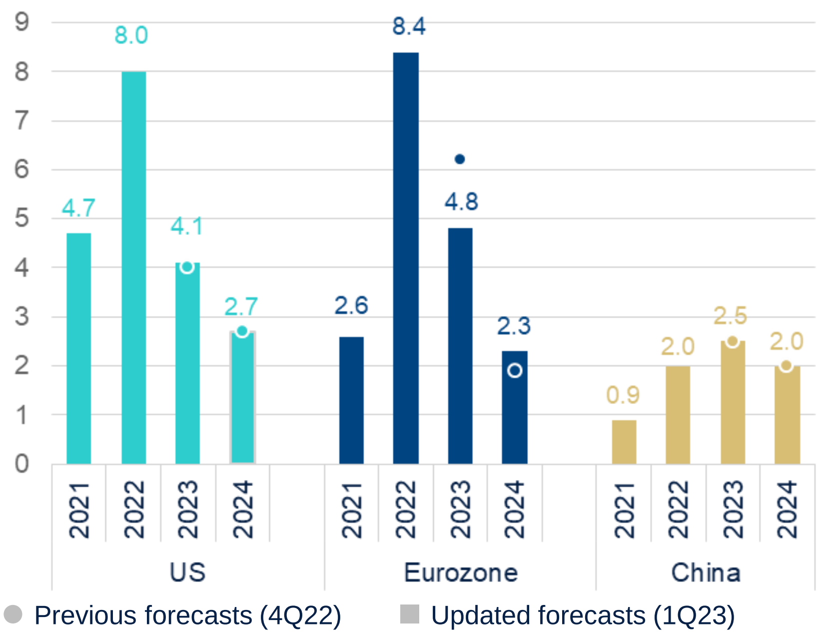
ACTIVITY AND PRICES

Monetary tightening will pave the way for demand deceleration.

Price and wage pressures will gradually ease and price and wage spirals will be avoided.

Inflation will continue trending downwards, but slower demand deceleration will prevent it from converging to the target over the next two years

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

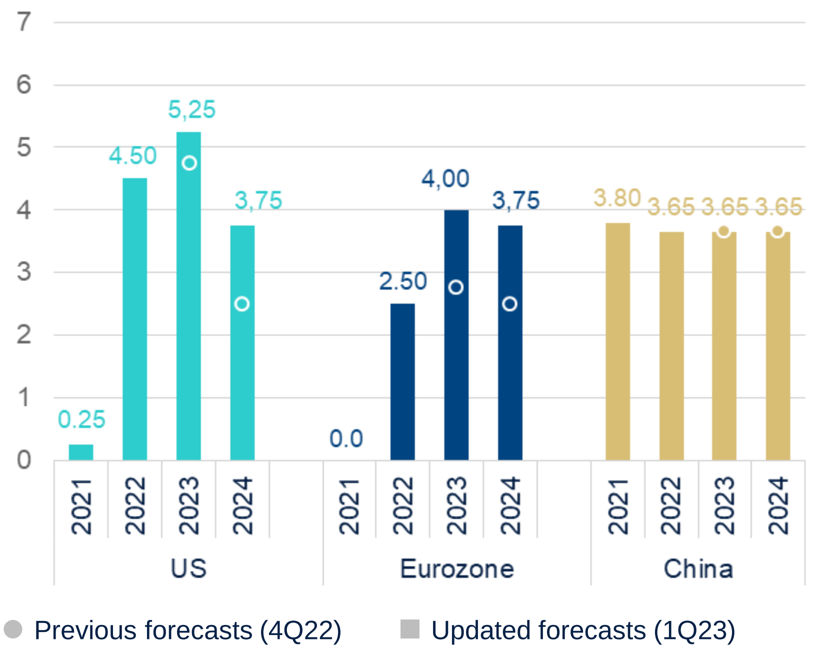


Source: BBVA Research.

- Downward surprises in headline inflation pave the way for lower-than-expected price pressures in the short-run both in the US and the EZ.
- Still, sticky core prices amid more resilient labor markets as well as scarcer room for further falls in energy prices will keep inflation high for longer than expected.
- Inflation will probably remain under control in China, but the risk is that higher domestic demand coupled with the impact of protectionist measures more than offset the effects from the supply normalization, which would add to inflation pressures.

Central banks will remain focused on inflation: interest rates will rise more and will be kept higher for longer than expected

MONETARY POLICY INTEREST RATES (*)
(%, END OF PERIOD)

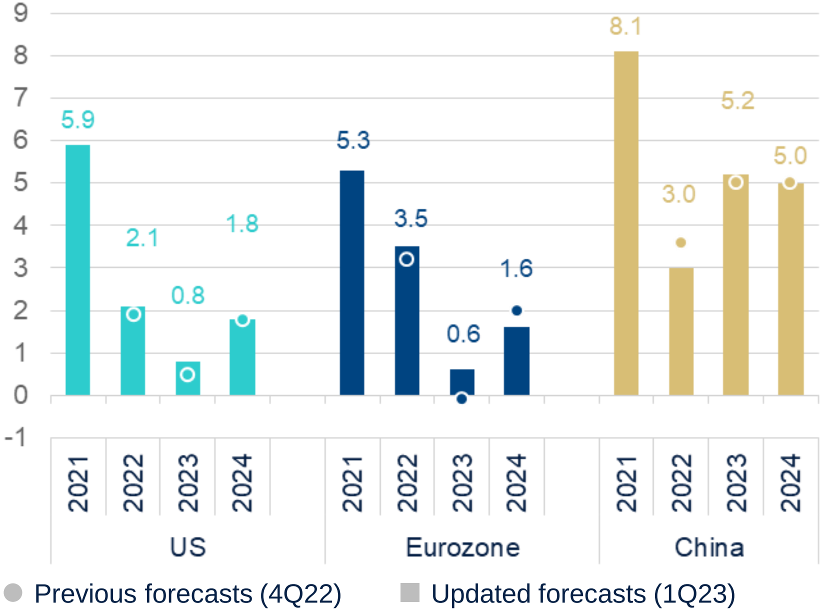


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- Terminal interest rates will be higher than expected, but uncertainty is large due to the volatile inflation dynamics, the unexpected resiliency of demand and doubts about the power of monetary policy in this context.
- One option is to accelerate quantitative tightening in exchange for smaller additional rate hikes, but that entails financial instability risks.
- The most likely is that rates soon reach 5.25%-5.50% in the US and 4.00%-4.25% in the euro zone.
- High rates can be expected for longer, given the slow process of disinflation.

Better growth prospects for 2023: a softer deceleration in both the US and the Eurozone, and a stronger rebound in China

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



(*) Previous forecasts: 0.5% in 2023 and 1.8% in 2024 in the US, -0.1% in 2023 and 2.0% in 2024 in the Eurozone, 5.0% en 2023 and 5.0% in 2024 in China.
Source: BBVA Research.

- Global GDP is expected to grow 2.8% (0.5pp higher than forecast) in 2023 and 3.3% (0.0pp) in 2024, after having grown 3.2% in 2022.
- 2023 forecasts have been revised up in the US and the EZ on positive incoming data (resilient demand) and lower energy prices, and GDP also in China as the reopening will support consumption and supply-side normalization, while policy stimuli will back investment.
- Deceleration prospects remain in place due to monetary tightening and high inflation, but some factors (private sector's balance sheets, NGEU in Europe) will be supportive and a deep recession will likely be avoided.

In an uncertainty context, the main risk is that sticky inflation requires extra monetary tightening, triggering a recession or financial instability

MAIN RISKS

MORE PERSISTENT INFLATION AND TIGHTER MONETARY POLICY:

- stronger demand (tight labor markets, fiscal stimulus, etc.)
- demand-driven Chinese recovery
- higher energy prices on the war or other factors
- wage-price spirals

→

GLOBAL RECESSION OR STAGFLATION

FINANCIAL INSTABILITY

MAIN UNCERTAINTIES

GEOPOLITICAL TENSIONS

US-CHINA RIVALRY (DEGLOBALIZATION, ETC)

ENERGY TRANSITION AND CLIMATE CHANGE

SOCIAL TENSIONS AND POPULISM

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Argentina – Economic Outlook Q1 2023

Creating Opportunities

Navigating a political 2023, in a context of macroeconomic instability and low levels of public approval of the current government

ELECTORAL CALENDAR
(DISTRICTS WITH CONFIRMED DATES)

April — Neuquén / Río Negro

May — Misiones / Jujuy
La Pampa / Salta
San Juan / Tucumán

June — San Luis / Córdoba
National: announcement of candidates

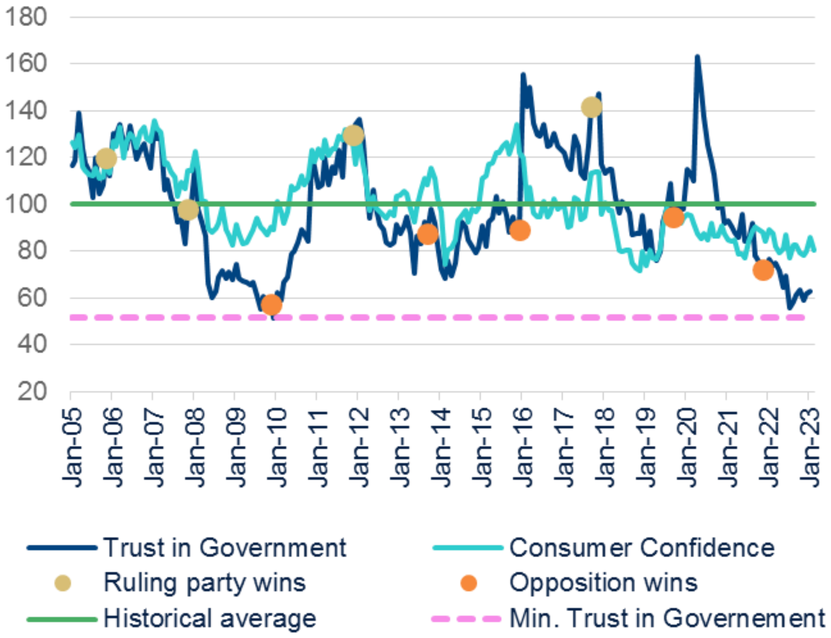
August — National: Primary elections

September — Chaco / Mendoza

October — National: Presidential elections
BA City / Prov. of Buenos Aires / Catamarca

November — National: 'Ballotage' (2nd round)

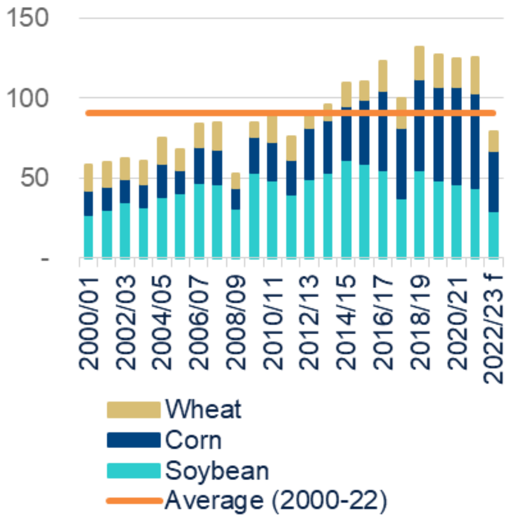
CONFIDENCE INDICATORS AND ELECTORAL RESULTS (BASE 100 = HISTORIC AVERAGE)



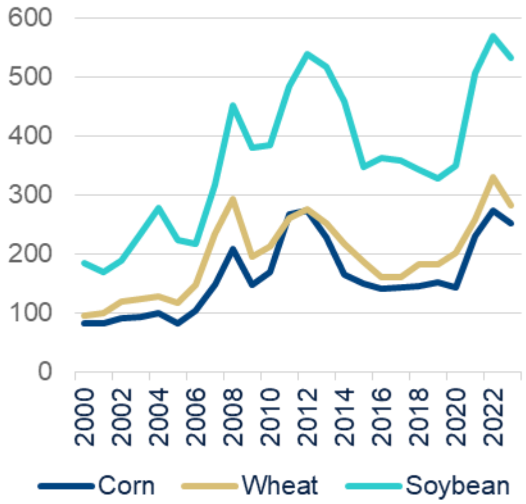
Note: Points are placed on the timeline on the dates of elections in the Province of Buenos Aires.
Source: BBVA Research and UTDT.

The drought is far more severe than expected, and crop forecasts are still worsening...

AGRICULTURAL PRODUCTION
(MILLIONS OF TONS)

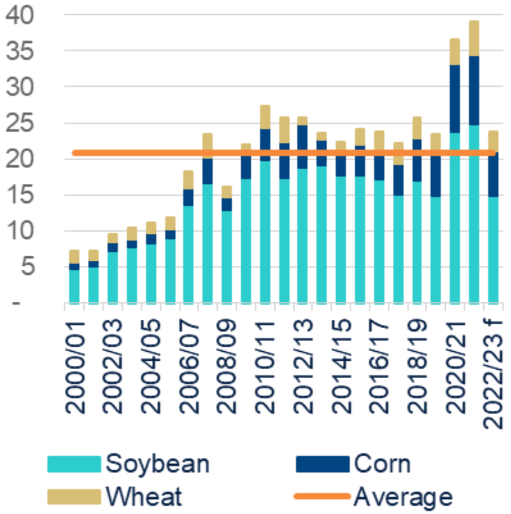


INTERNATIONAL PRICES
(USD PER TON, ANNUAL AVERAGE)



Source: BBVA Research, Ministry of Agriculture and Buenos Aires Grain Exchange, Rosario Stock Exchange and USDA.

EXPORTS
(MILLIONS OF USD)



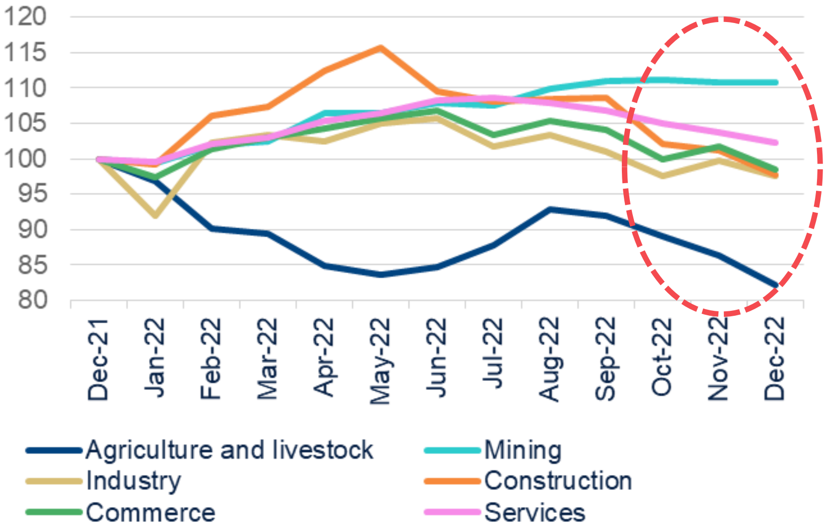
Source: BBVA Research and Haver

Soybean, corn and wheat production will fall by more than 35% in the 2022/23 season (compared to 2021/22), although international prices sustain exports at the 2003-2021 average.

… which, together with the economic activity decline at the end of 2022, led us to reduced our 2023 GDP growth forecast to -2.5%

ECONOMIC ACTIVITY

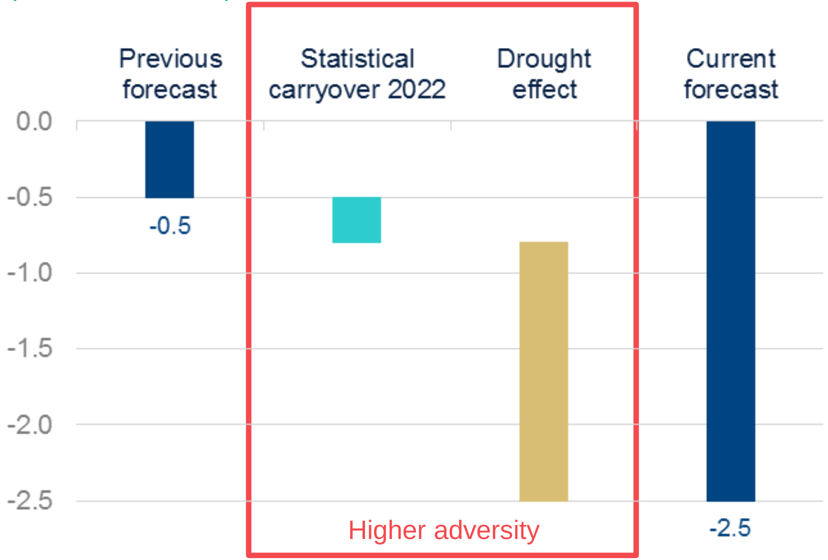
(BASE 100 = DEC'21; SEASONALLY ADJUSTED)



Source: BBVA Research and INDEC.

NEW GDP GROWTH FORECAST 2023

(ANNUAL % VAR.)

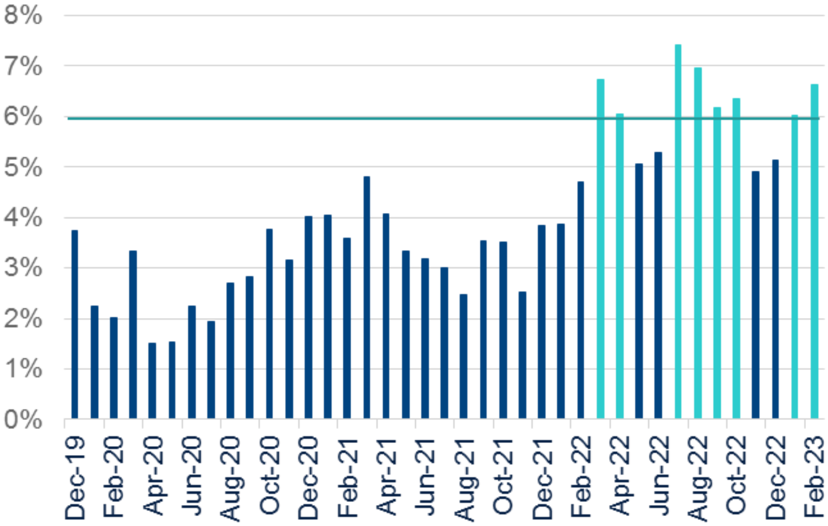


Source: BBVA Research and INDEC.

Tighter import restrictions complicate industrial production and disrupt payments. In addition, high inflation will continue to erode real wages, placing downward pressure on private consumption and hurting activity, which is already experiencing the effects of the drought. Activity is set to fall 2.5% in 2023.

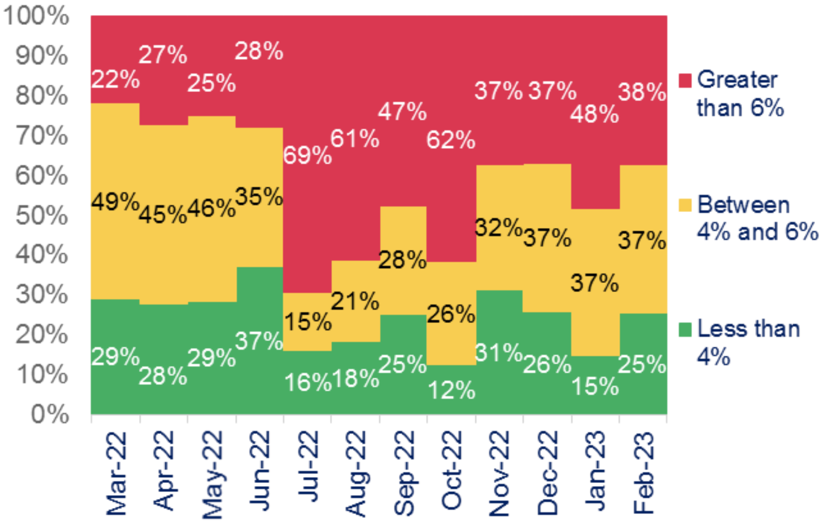
Inflation has averaged 6.2% a month since July-22, with no signs of a substantial slowdown in the coming months

MONTHLY INFLATION
(M/M %)



Source: BBVA Research and INDEC.

MONTHLY VARIATION OF ITEMS WITHIN THE CPI
(AS % OF CPI-BA BASKET, ACCORDING TO M/M % CHANGE)

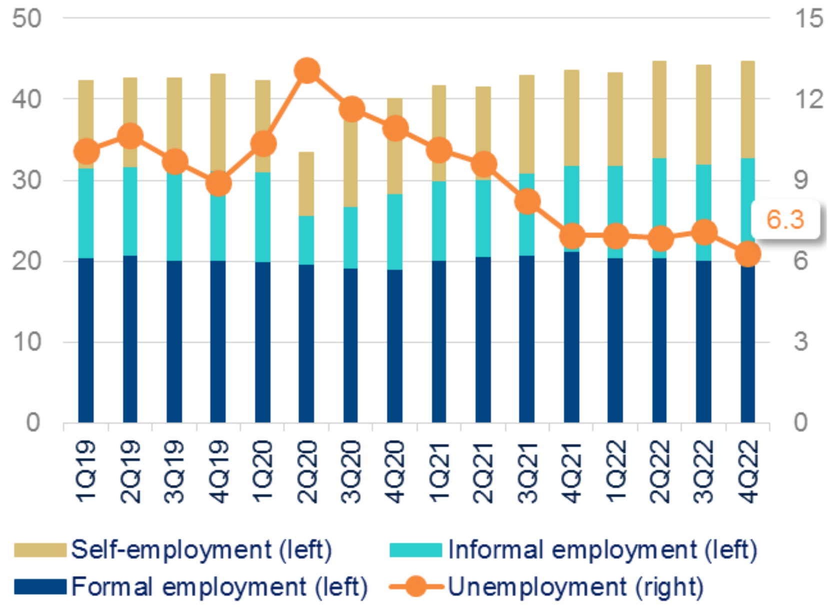


Source: BBVA Research and Department of Statistics of the City of Buenos Aires.

Monthly inflation accelerated in January and February, reaching a year-on-year value of 102.5%. The monetary imbalance is the main factor for the highest annual inflation in 31 years and the CB's balance sheet (with soaring interest-bearing liabilities) constrains the margin for a tight monetary policy to reduce it.

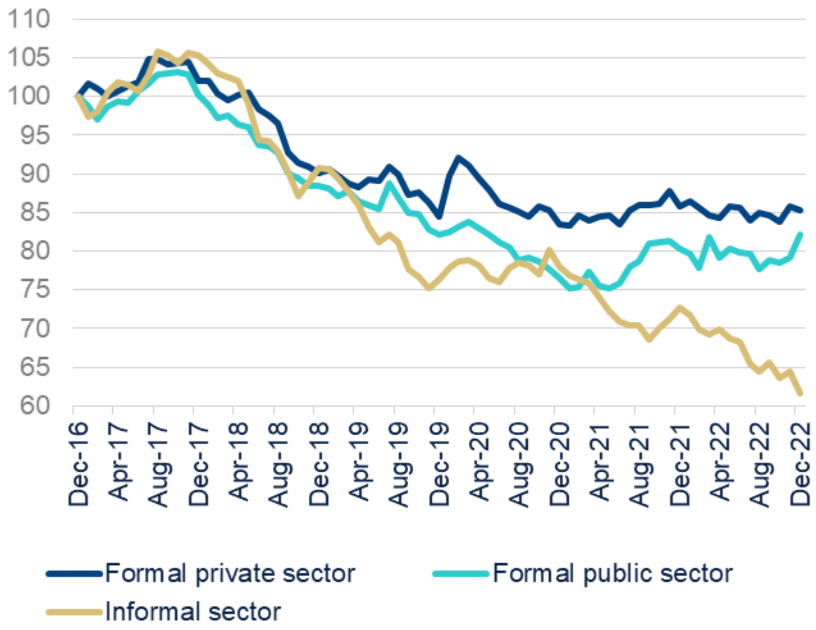
Unemployment is narrowing at the cost of lower real wages in both the formal and informal sector

MAIN LABOR MARKET INDICATORS
(%)



Source: BBVA Research and Ministry of Employment.

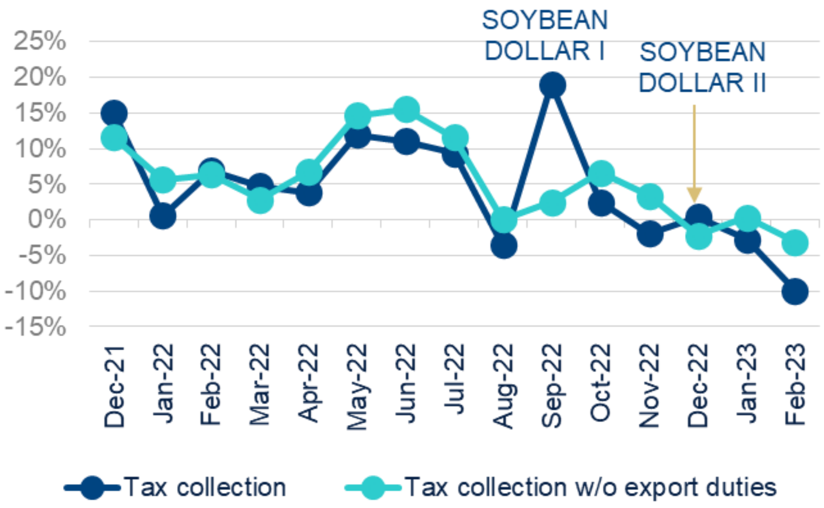
REAL WAGES, BY TYPE OF EMPLOYMENT
(BASE 100 = DEC '16)



Source: BBVA Research, BCRA and INDEC.

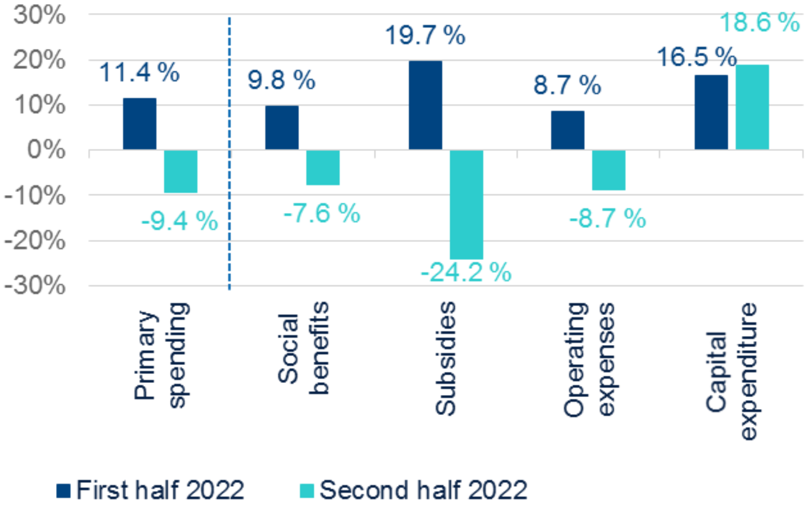
The Government met the 2022 IMF fiscal target thanks to a postponement in expenditures and higher tax collection from the soybean exports...

TOTAL TAX COLLECTION
(Y/Y % IN REAL TERMS)



Source: BBVA Research and Ministry of Economy.

PRIMARY FISCAL EXPENDITURE
(Y/Y % IN REAL TERMS)



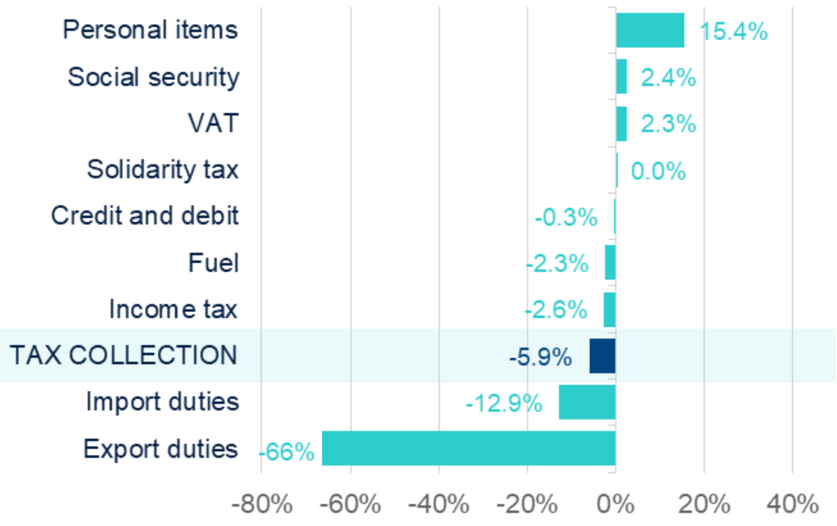
Source: BBVA Research and Ministry of Economy.

Minister Massa has partially contained the fiscal deficit through an early collection of taxes and soybean export duties, reduction of subsidies and a public workforce freezing. However, he resorted to money printing in order to avoid a deeper adjustment.

… which makes it more challenging to achieve the 2023 fiscal target, as the drought will also subtract 0.5% of GDP from the tax collection

TAX COLLECTION: JAN-FEB 2023

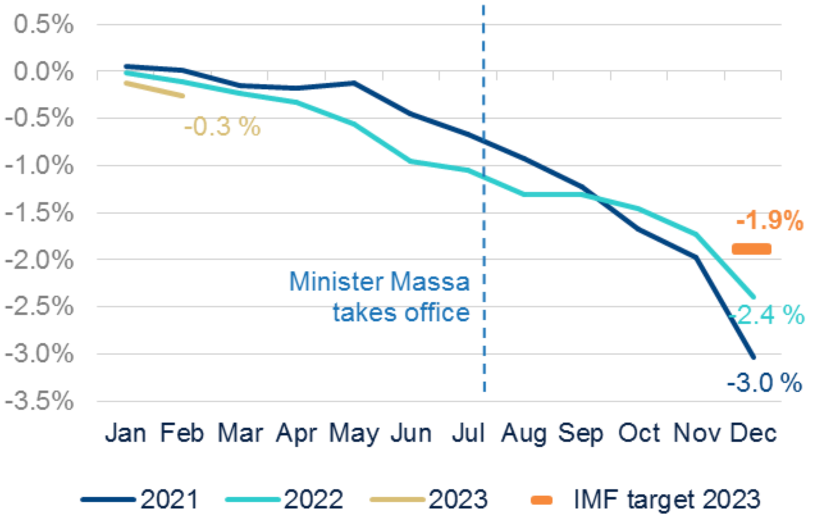
(YoY % IN REAL TERMS)



Source: BBVA Research and Ministry of Economy.

PRIMARY FISCAL BALANCE

(% of GDP)

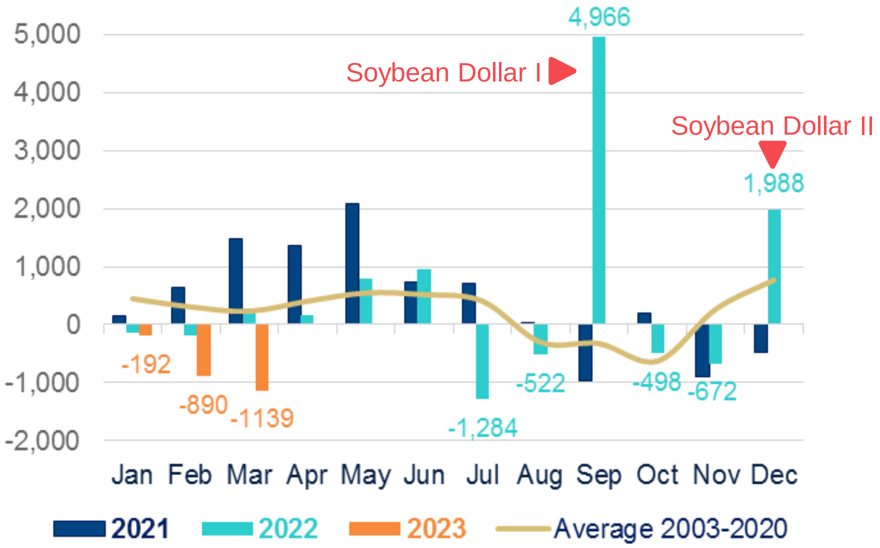


Source: BBVA Research and Ministry of Economy.

Revenues fell 6.9% YoY in real terms in the first two months of 2023, mainly due to lower export duties, while expenditures increased by 1.3% YoY in real terms, reversing the trend of late 2022. We expect a faster convergence to fiscal equilibrium from 2024 onwards.

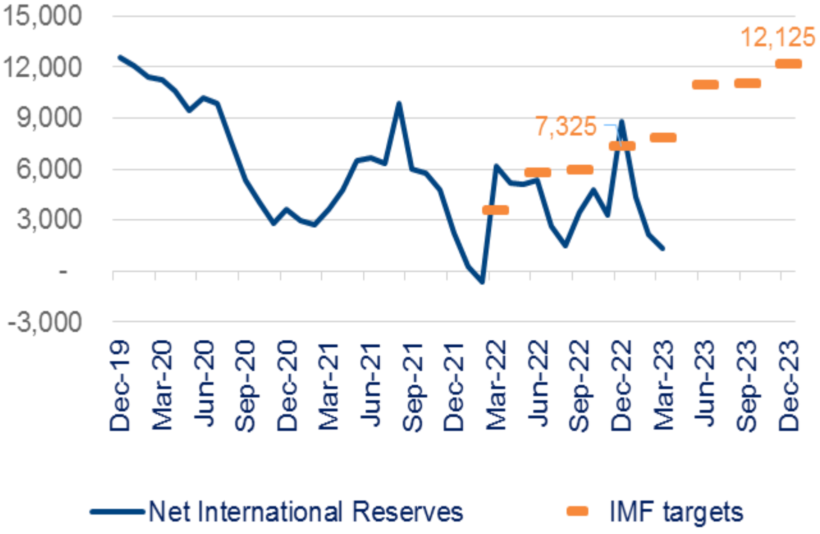
The Government resorted to multiple exchange rates and import controls to curb the FX depreciation without larger CB reserves losses

BCRA'S FX NET PURCHASES ON THE OFFICIAL MARKET (MILLIONS OF USD)



Source: BBVA Research and BCRA.

NET INTERNATIONAL RESERVES (MILLIONS OF USD)

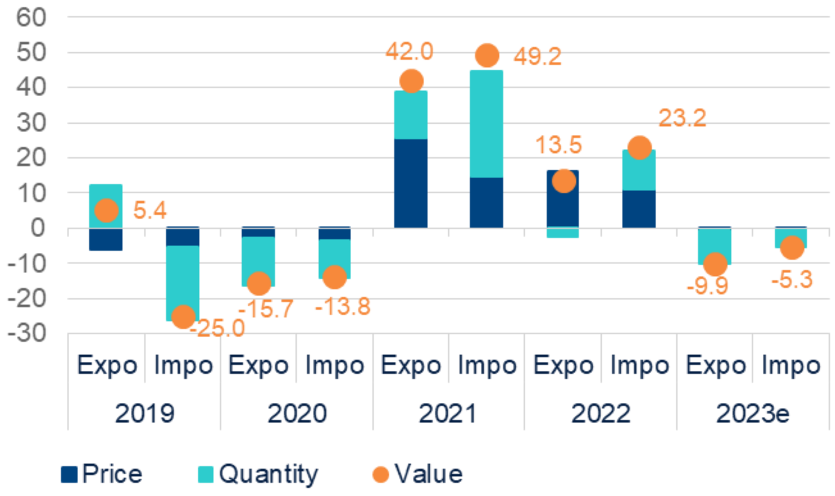


Source: BBVA Research and BCRA.

The establishment of a differential exchange rate for the soybean exports in Sep-22 and Dec-22 allowed the CB to avoid larger reserve losses in the official FX market in 2022. We expect another soybean differential FX to take place in the coming months. The multiplicity of exchange rates and the tight import restrictions would be intensified to avoid a sharp depreciation in 2023.

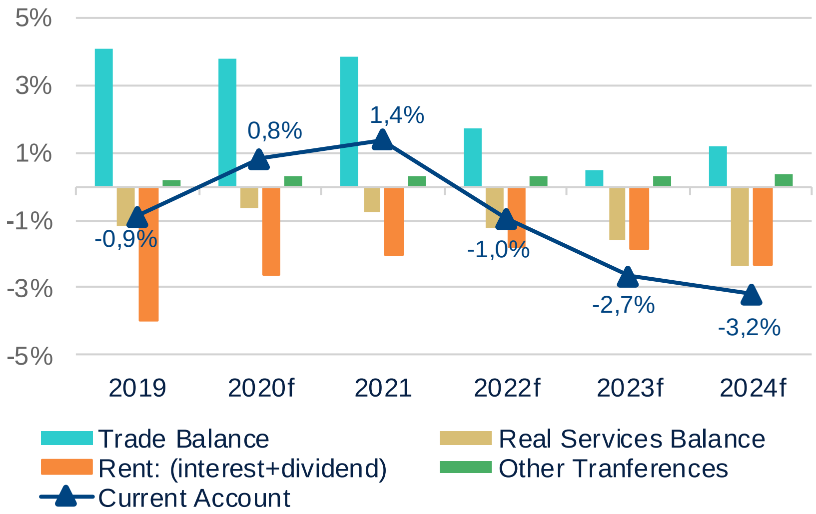
The drought will have a strong adverse impact on the external balance in 2023, although it will be partially offset by an improvement in the energy balance

FOREIGN TRADE: PRICE, QUANTITY AND VALUE
(% Y/Y CHG.



Source: BBVA Research and INDEC.

CURRENT ACCOUNT AND COMPONENTS
(% GDP)

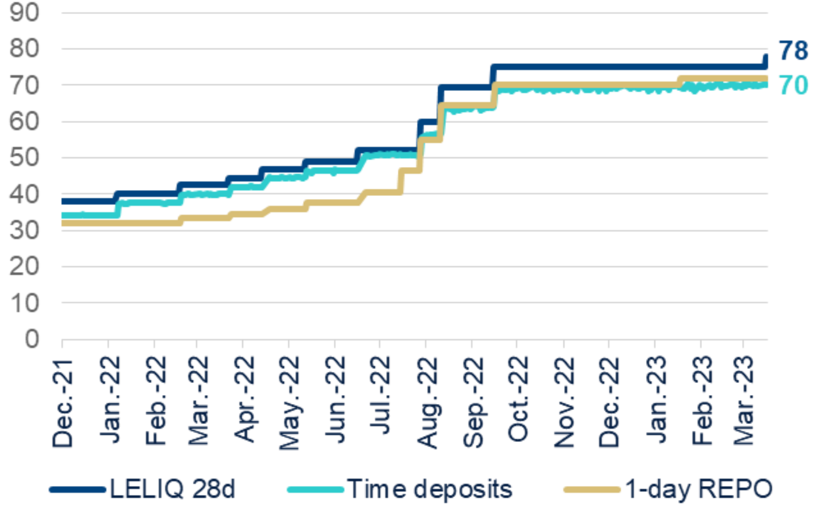


Source: BBVA Research and INDEC.

Exports will fall to USD 79.6 billion in 2023 and imports to USD 77.1 billion. Quantities will be significantly reduced (exports due to the drought and imports due to lower gas needs) but prices will remain unchanged. The lower contribution of trade and the wider deficit of services and interests will hurt the current account balance.

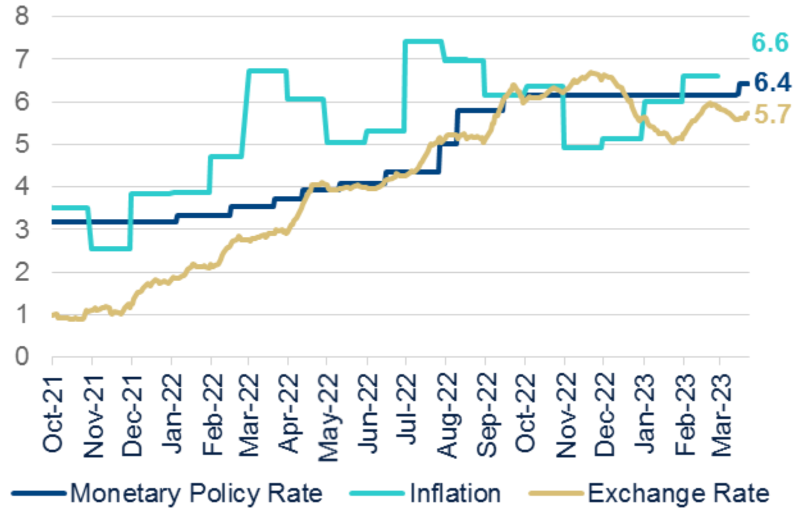
The monetary policy rate and the depreciation pace of the official exchange rate are in line with inflation

INTEREST RATES
(% ANNUAL RATES)



Source: BBVA Research and BCRA.

MONTHLY INTEREST RATES, INFLATION AND EXCHANGE RATE VARIATION (EXCHANGE RATE: DAILY % CHANGE AVERAGED OVER A MONTHLY PERIOD; 20-DAY MA)

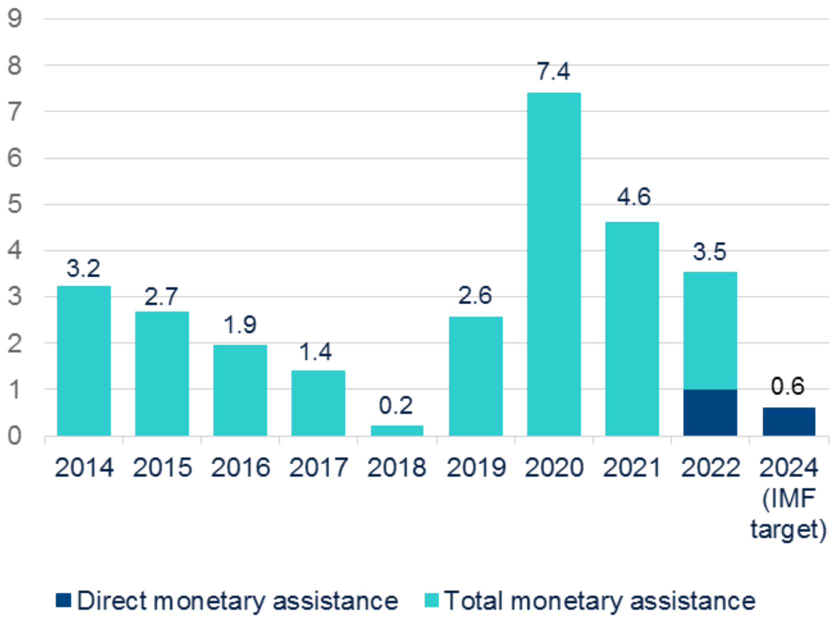


Source: BBVA Research, BCRA and INDEC.

Since September 2022, the CB has aligned the monthly inflation rate with the monetary policy rate (28-day LELIQ) and the depreciation of the official exchange rate. The government will seek to maintain this balance in the coming quarters. However, these real interest rate levels are still not enough to drive inflation down.

Monetary issuance to assist the Treasury was reduced in 2022, but still remains at high levels, generating exchange rate and inflationary pressures

MONETARY ISSUANCE TO FINANCE THE TREASURY
(% GDP)



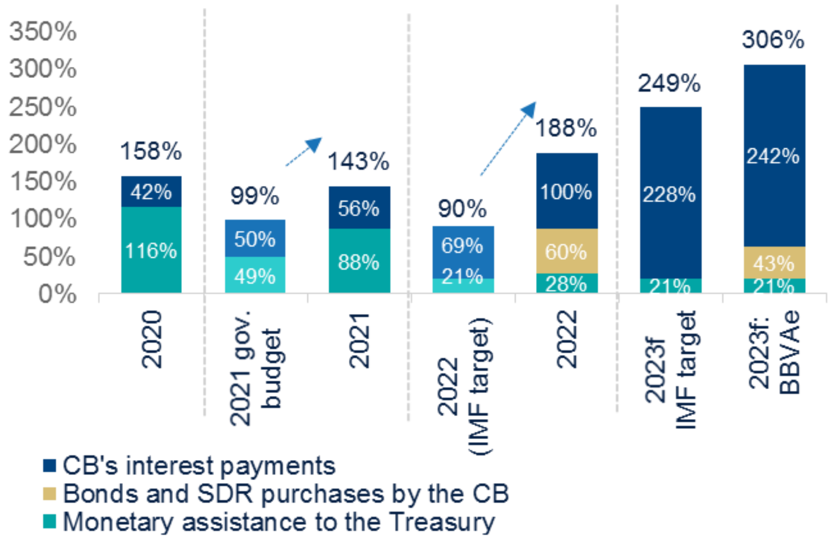
Source: BBVA Research and BCRA.

- Direct monetary assistance from the CB to the Treasury was held under 1% of GDP in 2022, to comply with the IMF annual target.
- But the Government resorted to alternative mechanisms to finance the remaining fiscal needs with indirect money issuance: the CB purchased sovereign bonds in the secondary market (for more than 2% of GDP). This fueled exchange rate and inflationary pressures during 2022.
- The monetary assistance target for 2023 is 0.6% of GDP. The Government may as well meet it, but the CB will keep buying government securities outside this limit.

Monetary injections triggered a leap in the central bank's interest-bearing liabilities, which constrains the monetary policy room for maneuver

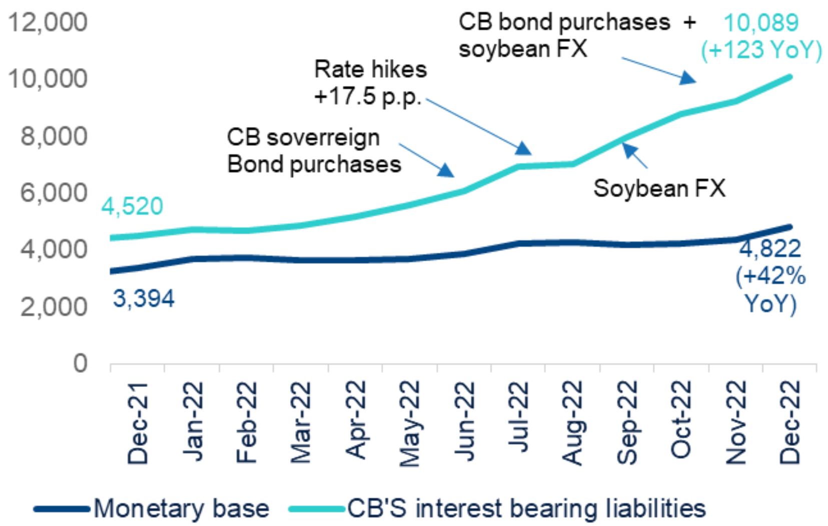
EXPANSIONARY FACTORS OF THE MONETARY BASE

(AS % OF PREVIOUS YEAR-END MONETARY BASE)



Source: BBVA Research and Ministry of Economy.

INTEREST-BEARING LIABILITIES OF THE BCRA AND MONETARY BASE (ARS BILLION)

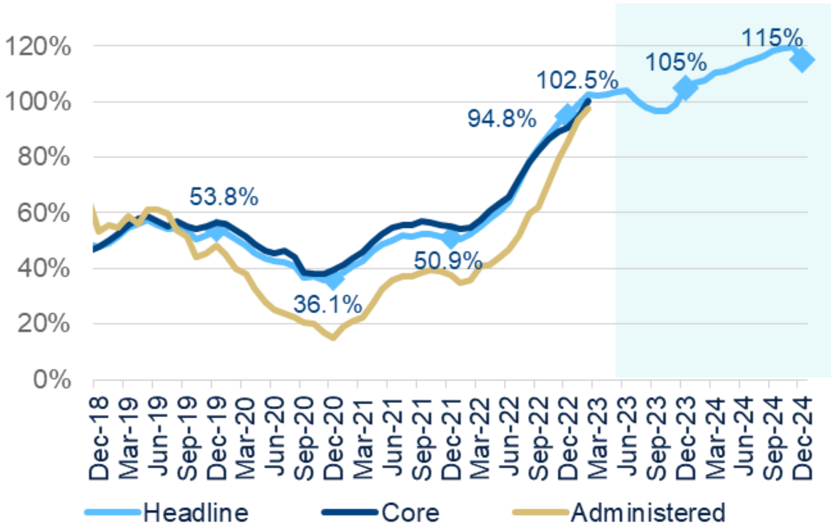


Source: BBVA Research and Ministry of Economy.

The CBs bond purchases in the secondary market and the acquisition of dollars at a higher exchange rate (due to the "soybean dollar") caused large injections of pesos, which the CB partially sterilized through LELIQs and REPOs. This stock rose to almost 10% of GDP and money issuance accelerated due to interest payments, which constrains the CB's ability to increase interest rates.

Inflation will keep accelerating in 2023 and 2024, although the drivers of these accelerations will not be the same

INFLATION, BY COMPONENT
(% Y/Y)



Source: BBVA Research and INDEC.

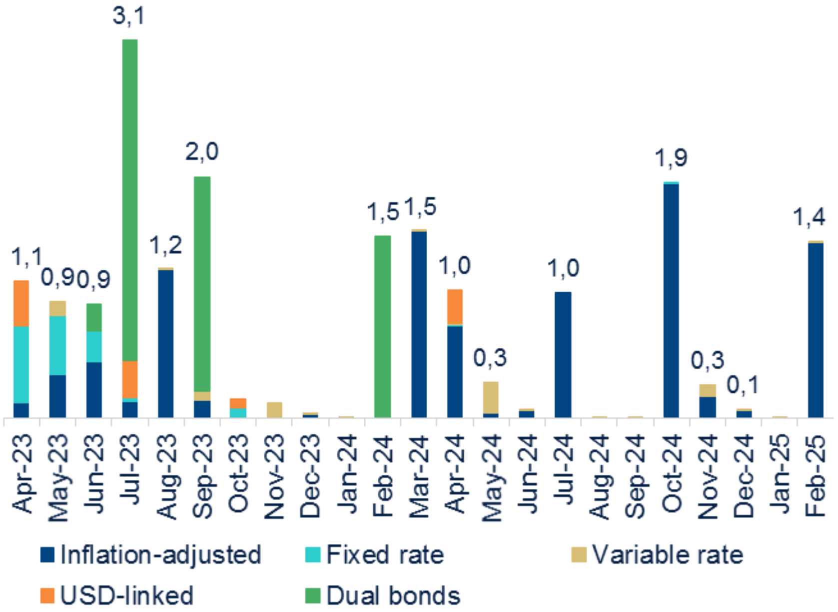
PRICES THAT COULD DRIVE INFLATION MOVING FORWARD (ACC. VARIATION FROM DEC ’21 TO FEB ’23)

Source: BBVA Research, BCRA and INDEC.

The monetary issuance to assist the Treasury, the interest payments on CB liabilities, the high inflationary inertia at 6% MoM and the exchange rate volatility resulting from the drought (with the exchange rate premium > 100%) will explain the 2023 inflationary acceleration. The correction of the exchange rate and utility prices would explain the acceleration in 2024.

March's local currency voluntary debt exchange postponed maturities from 2Q23 to 2024 and 2025

DEBT MATURITY PROFILE IN PESOS
(BY TYPE OF ASSET, ARS TRILLION)

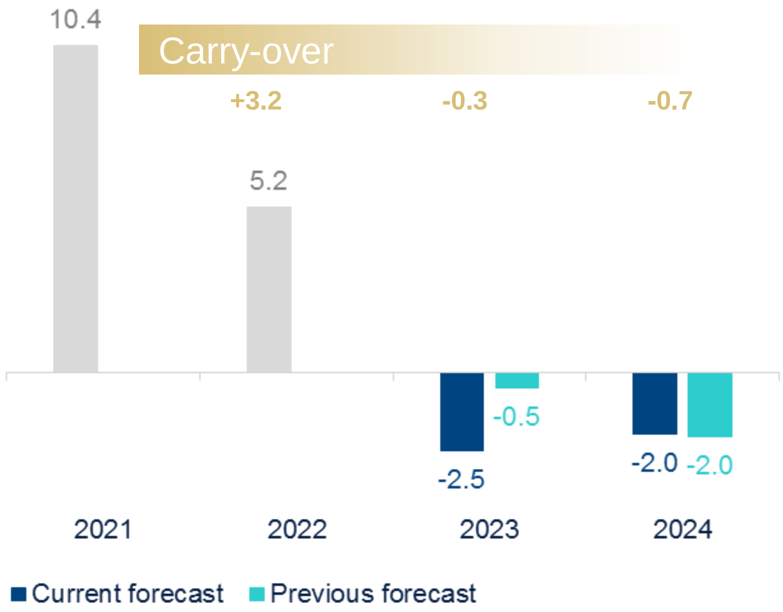


Source: BBVA Research and Ministry of Economy.

- Local currency maturities with private creditors are $4.5 trillion in 2023, approximately 85% of the monetary base (5.8% of GDP).
- With the recent local currency debt swap, 57% of the March-June 2023 maturities were postponed to 2024 and 2025. However, there are still maturities (close to $1 trillion per month) in 2Q23.
- The Government will have to resort to this type of swap again, towards the end of June, in order to reduce 3Q23 maturities, which are still highly concentrated before the elections.

2024: the challenge of correcting macroeconomic imbalances in an adverse context

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



Source: BBVA Research and INDEC.

- Government's approval ratings require a strong change in expectations, regarding the solution of economic problems, to recover.
- Potential exchange rate and tariff corrections will put upward pressures on prices, with an inflation level already above 100%. The reduction of the fiscal deficit will affect public works and social spending in a context of low investment and high vulnerability (poverty above 35%, indigence around 10% of the population and labor informality around 50%). Real wages will fall once again.
- This outlook sets up a very problematic start to 2024 for activity, and we estimate that GDP will contract by 2%.

Table of Macroeconomic Forecasts

	2020	2021	2022	2023f	2024f
Gross Domestic Product (% YoY)	-9.9	10.4	5.2	-2.5	-2.0
Inflation (% YoY eop)	36.1	50.9	94.8	105.0	115.0
Exchange Rate (vs USD eop)	82.6	101.9	172.9	355.0	826.0
Monetary Policy Rate (% eop)	37.1	36.7	78.0	85.0	78.0
Private Consumption (% YoY)	-13.7	10.0	9.4	-3.3	-4.4
Public Consumption (% YoY)	-1.9	7.1	1.8	-2.2	-5.2
Private Investment (% YoY)	-13.0	33.4	10.9	-11.7	7.6
Primary Fiscal Balance (% GDP)	-6.4	-3.0	-2.4	-2.6	-0.9
Current Account Balance (% GDP)	0.8	1.4	-0.7	-2.7	-3.2

Source: BBVA Research.

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Argentina Economic Outlook

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Creating Opportunities