BBVA Research

Argentina Economic Outlook

October 2023

Creating Opportunities

Main messages. Global

Recent developments

The global economy is slowing down at different paces across regions. Still, even though rate tightening cycles seem to be over, persistent inflation amid tight labor markets paved the way for the Fed and the ECB to maintain a hawkish tone, while leaving doors open for further hikes, if inflation proves to be more persistent than expected.

Growth outlook

A soft-landing is expected, with global growth declining from 3.5% in 2021 to 2.9% in 2023 and 3.0% in 2024. In the US, resilient domestic demand paves the way for higher growth forecasts and makes a recession unlikely. In China, growth prospects deteriorated significantly and risks augmented, but expansionary measures are expected to support confidence and prevent a hard-landing. In the Eurozone, a timid GDP expansion, slightly below previous forecasts, is now anticipated.

Inflation and rates outlook

Inflation is likely to continue slowing ahead, allowing the Fed and the ECB to skip further rate hikes over the next few months. Still, it will continue above targets, and upward risks will remain alive, making rate cuts unlikely in the short-run and favoring a reduction of central bank balances.

Risks

Recession and financial instability episodes driven by persistent inflation (on second-round effects, higher oil prices, etc) and contractionary monetary policy are still possible. A sharper deceleration of China, geopolitical tensions and US presidential elections are also a source of risks.

Main messages. Argentina

Political outlook

The most voted candidate in the primary elections was Javier Milei of “La Libertad Avanza”, who had been placed 3rd in the polls. This surprising result leaves the general elections on October 22 wide open, in view of the small differences between the 3 main parties and the flow of new votes expected given the high abstention rate in the primaries.

Exchange market

The need to halt the fall in reserves led the BCRA to force a 22% jump in the FX rate on the Monday after the primaries. The government announced that it will maintain this new parity (ARS/USD 350) until October, but the immediate pass-through to prices has already eliminated the "gain" in exchange rate competitiveness, so we expect further depreciations to leave the FX rate in Dec-23 at ARS/USD 630 (monthly average).

Inflation

Inflation should then reach 200% in 2023, with monthly increases above single digits in the last four months. Inflation will remain elevated during the first months of 2024 as corrections in regulated prices and the FX rate are expected from Dec-23. It would only start to decelerate in 2H24, accumulating 155% in the year (if the incoming government pursues a successful stabilization plan).

Economic activity

The latest economic activity data were better than expected, but the exchange rate jump in August and soaring inflation will deteriorate economic conditions in 2H23. We maintain the 3.5% GDP decline forecast for 2023 and worsen the contraction forecast for 2024 to 2.5%.

Main messages. Argentina

Fiscal Result

After the PASO, the government pushed through a package of measures that increased primary expenditure above our pre-election spending acceleration forecasts, so we are revising our primary fiscal deficit estimate upward from 2.6% to 2.8% of GDP. Next year the government will implement a fiscal adjustment and the primary deficit would be close to 1% of GDP.

Monetary sector

Given this increase in fiscal deficit, we expect monetary issuance to continue accelerating for the rest of the year, accentuating the current FX rate and inflationary pressures in the economy. Direct monetary issuance to assist the treasury and indirect monetary issuance (via BCRA bond purchases in the secondary market) will exceed 4% of GDP in 2023 (up 0.5 p.p. compared to 2022).

External sector

Good prospects for the external accounts in 2024. The trade balance will improve in 2024 due to the real depreciation of the peso, due to the recovery of agriculture, once the post-drought situation has normalized, and due to the expected good performance of the energy sector, which is expected to achieve an energy trade surplus. This will reverse the trade deficit of 2023 and significantly reduce the current account deficit.

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Global Economic Outlook October 2023

Creating Opportunities

Global growth is likely to soft land while monetary policy will remain restrictive for a longer than usual period to help inflation ease towards targets

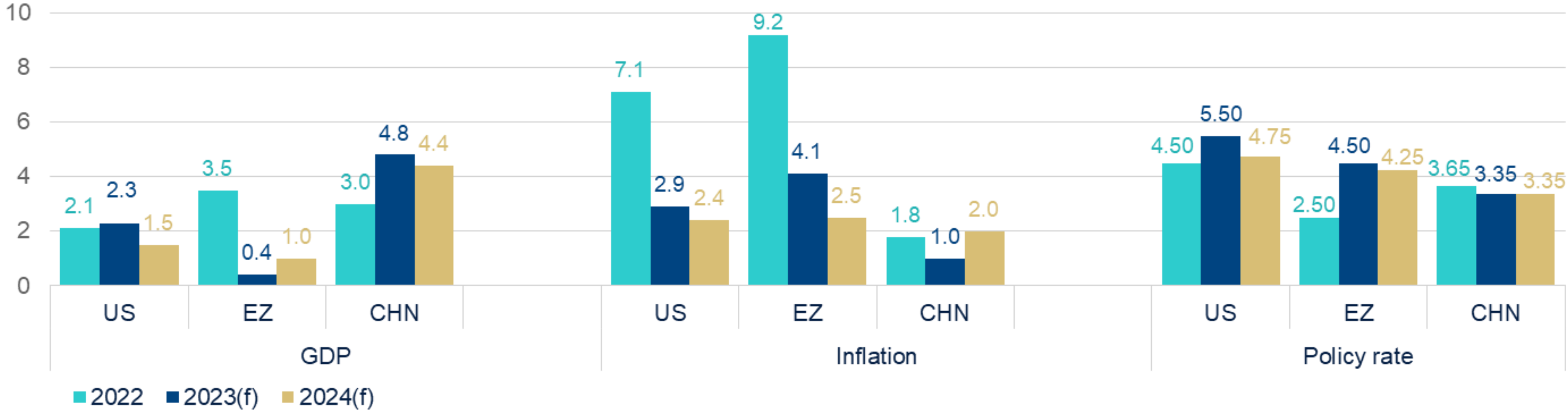
BBVA RESEARCH BASELINE SCENARIO: GDP GROWTH, INFLATION AND POLICY INTEREST RATES (*)

(GDP GROWTH: %, INFLATION: YOY %, EOP, POLICY INTEREST RATES: %, EOP)

Global growth: from 3.5% in 2022 to 2.9% (+0.0pp) in 2023 and 3.0% (+0.1pp) in 2024

Inflation will remain high, but will trend down as demand weakens and given no extra supply shocks

Monetary tightening cycle is likely over in the US and the EZ, but rate cuts are not around the corner

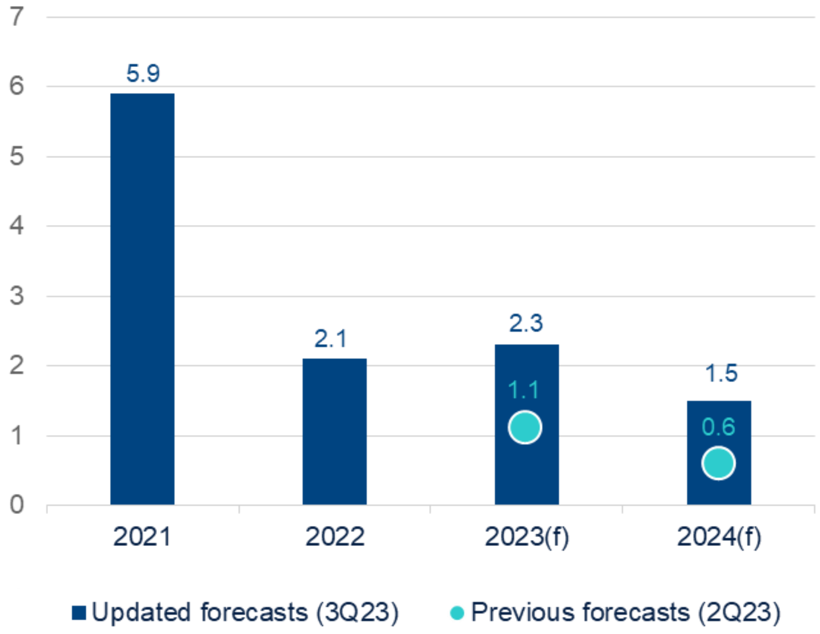


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

US: growth resilience signs make a recession unlikely ahead, postponing the prospects for the beginning of the easing cycle to mid-2024

US: GDP GROWTH

(%)

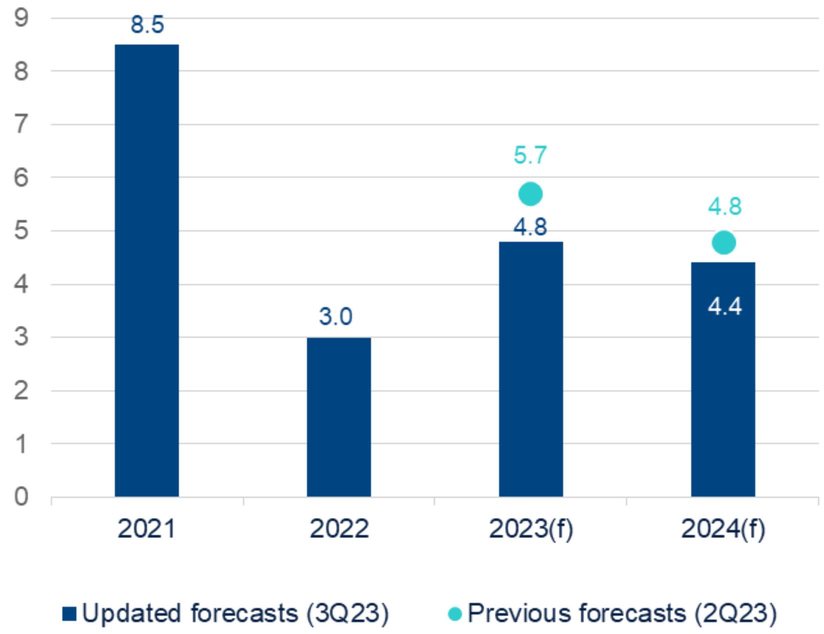


(f): forecast.
Source: BBVA Research

- GDP forecasts revised up on robust domestic demand: solid consumption and resilient investment (boosted by housing market recovery as well as IRA and CHIPS acts).
- Inflation expected to reach 2.9% in Dec/23 and 2.4% in Dec/24; upside risks are still relevant.
- Fed: inflation improvement will prevent extra rate rises (but a hike is still possible in 4Q23); an easing cycle from Jun/24 is likely to take rates to 4.75% in Dec/24.
- Risks: a recession or financial stress on tight monetary conditions and persistent inflation, presidential elections.

China: prospects deteriorated significantly and risks increased given increasing structural challenges, but a gradual growth slowdown is still likely

CHINA: GDP GROWTH
(%)

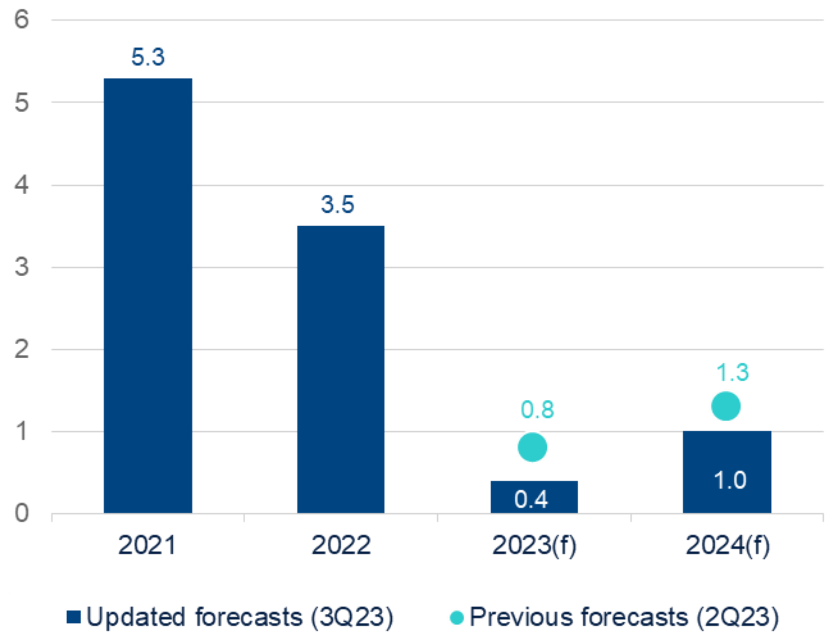


(f): forecast.
Source: BBVA Research

- Generalized deceleration on weak confidence, real estate crunch, 2021 “regulatory storms” and global slowdown.
- Still, the most likely scenario is that further targeted monetary, fiscal and regulatory measures sustain growth and drive inflation up.
- Although a soft-landing is still expected, GDP forecasts have been revised down on incoming data and a costly (but controlled) addressing of real estate imbalances.
- Structural challenges: balance-sheet recession and deflation, US-China confrontation, middle-income trap, unfavorable demographics, etc.

Eurozone: persistent inflation, despite weaker GDP growth, is likely to force the ECB to maintain policy rates at restrictive levels for long

EUROZONE: GDP GROWTH
(%)



(f): forecast.
Source: BBVA Research

- Growth revised down on incoming data amid a deceleration of China, whose effects will be mostly offset by higher US growth.
- Fiscal policy is still supportive, but will likely become more targeted and less expansionary onwards.
- Average inflation forecasts revised up: 5.7% in 2023, 3.0% in 2024 on service stickiness, rebound in oil prices.
- ECB: rates are likely to remain at current levels until Dec/24; increasing focus on liquidity reduction measures.
- Risks: higher energy prices, more persistent inflation, stagflation, China's deceleration.

Risks: the soft-landing scenario could be potentially derailed by problems in China and the effects of the still high inflation and interest rates

MAIN RISKS

Recession and financial stress on tight monetary conditions

- mainly under more persistent inflation (on labor tightness, second-round effects, higher energy prices, etc.)

A hard-landing in China

- due to real estate problems, low confidence, US-China confrontation, deflation, etc.
- potential financial spillovers

MAIN UNCERTAINTIES

- **Geopolitical and political tensions**
- **US-China rivalry and deglobalization**
- **Climate change and energy transition**
- **Social tensions and populism**

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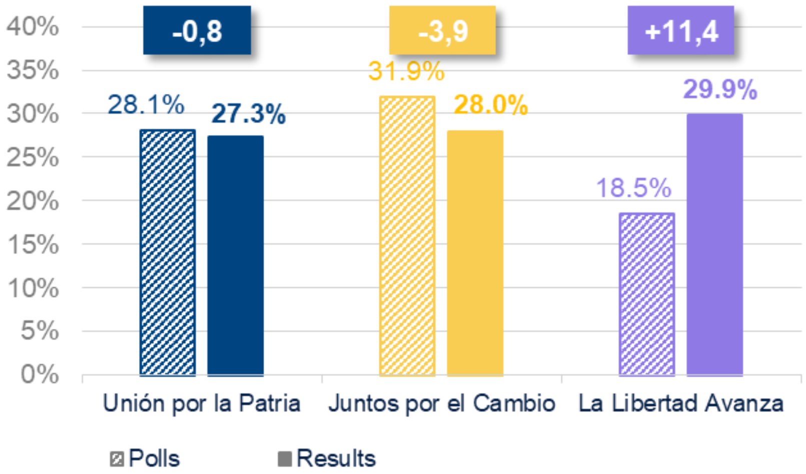
02

Argentina Economic Outlook
October 2023

Creating Opportunities

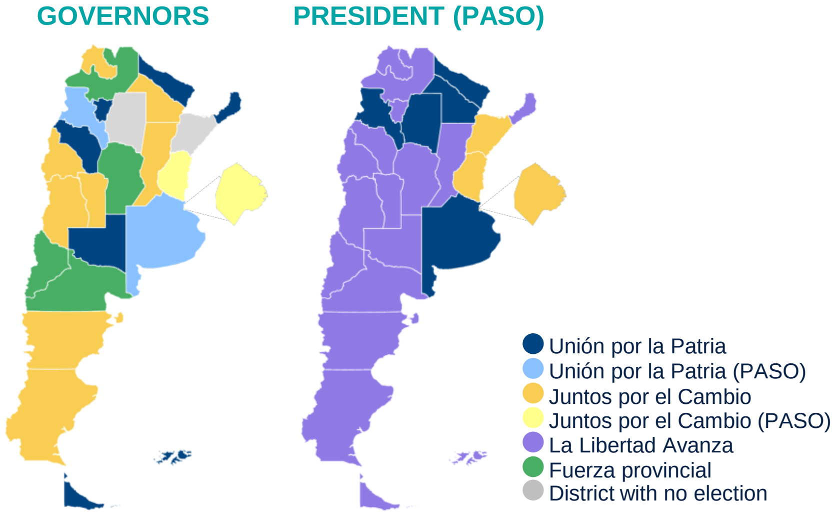
Neither the polls nor the results in the provincial elections anticipated the results of the primary elections...

POLLS VS. PASO* ELECTION RESULTS



*PASO: primary, open, simultaneous and compulsory elections (Primarias, Abiertas, Simultáneas y Obligatorias).
Source: Ministry of the Interior and BBVA Research.

PROVINCIAL ELECTIONS AND PRESIDENTIAL PASO*

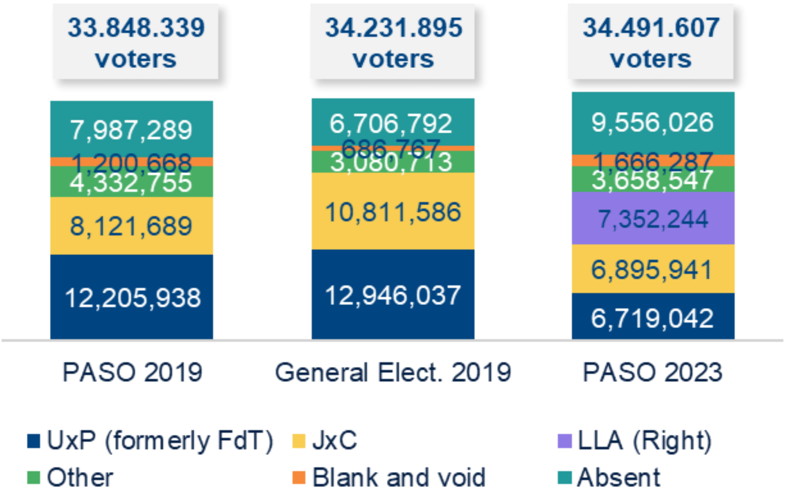


*PASO: primary, open, simultaneous and compulsory elections (Primarias, Abiertas, Simultáneas y Obligatorias).
Source: Ministry of the Interior, Provincial electoral chambers and BBVA Research.

The polls underestimated the intention to vote for Javier Milei by more than 11 pp. In the elections held at provincial level before the PASO on August 13 (46% of the electoral roll) the representatives of the libertarian platform represented only 3.8% of the total number of voters.

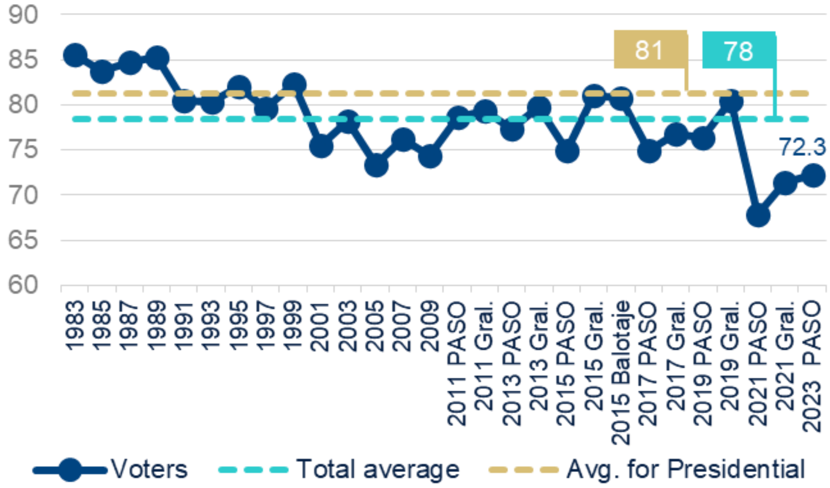
… which has left the electoral outcome open and increased uncertainty…

PROVINCIAL ELECTIONS 2019 AND 2023
(NUMBER OF VOTERS)



Source: Ministry of the Interior and BBVA Research.

ELECTORAL TURNOUT
(AS A % OF THE ELECTORAL ROLL)

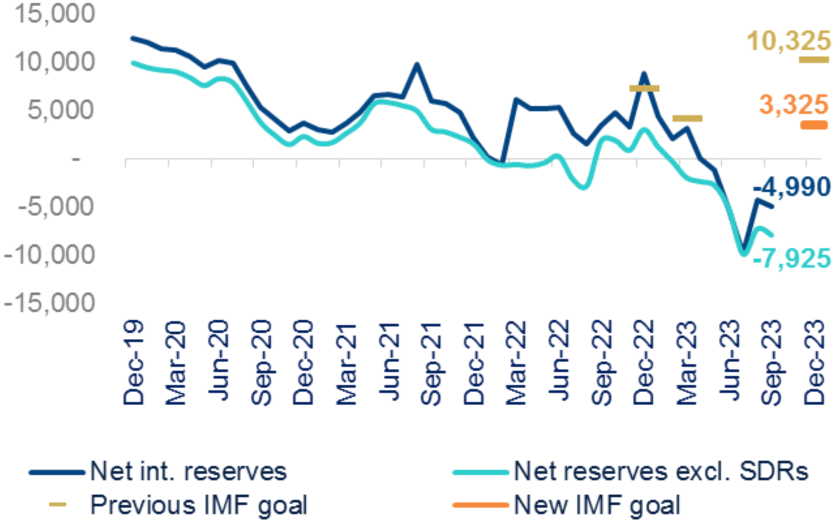


Source: Ministry of the Interior and BBVA Research.

The difference in votes between the three candidates is narrow. The final result remains uncertain since there could be between 2 and 4 million new voters in the general elections who did not vote in the primaries, to which must be added the distribution of votes from parties that did not reach the minimum threshold of 1.5% of votes in that instance (about 745 thousand votes).

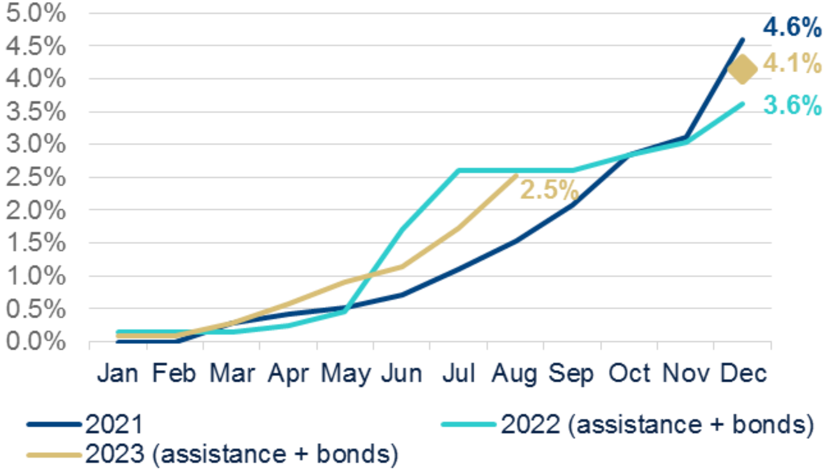
… in an already deteriorated economic scenario, with depleted reserves and accelerating monetary issuance to assist the Treasury

NET INTERNATIONAL RESERVES
(MILLIONS OF USD)



Source: BBVA Research, IMF and BCRA.

MONEY ISSUED TO SUPPORT THE NATIONAL TREASURY
(% GDP)

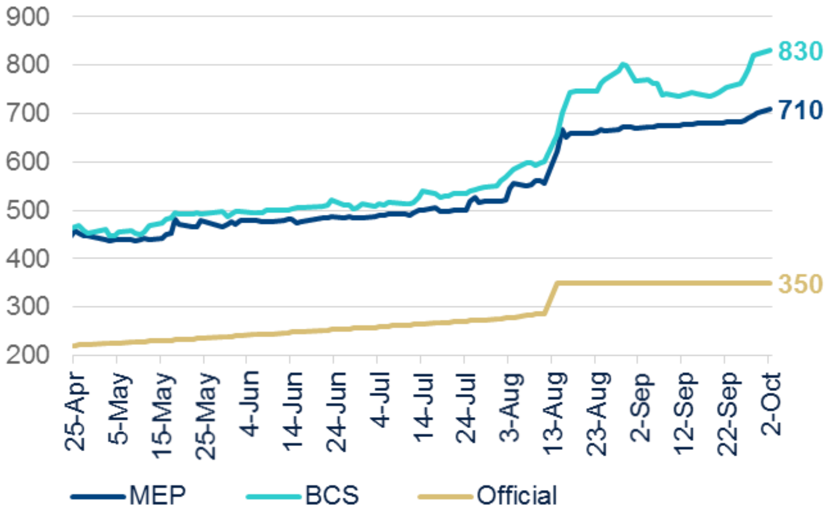


Source: BBVA Research, IMF and BCRA.

Net international reserves have been in negative territory since the beginning of the year. This low level of reserves, together with high monetary issuance to assist the Treasury (which has accelerated even further since June), creates a combination that generates continuous and growing exchange rate and inflationary pressures.

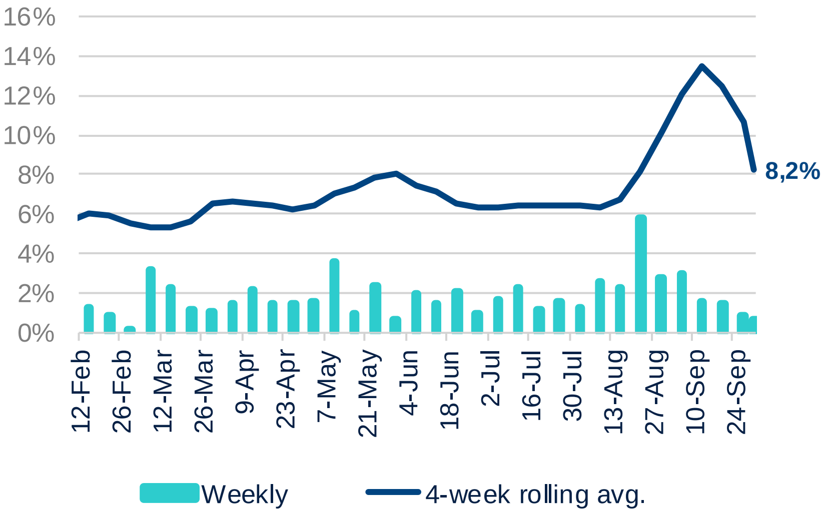
After the primary elections, the official exchange rate jumped (the parallel rates also reacted in the same way)

TRENDS IN DIFFERENT EXCHANGE RATES (ARS/USD)



Source: BBVA Research and BCRA.

HIGH-FREQUENCY INFLATION INDICATORS (WEEKLY % CHANGE AND 4-WEEK ROLLING AVERAGE)



Source: SEIDO/Alphacast and BBVA Research.

The 27% devaluation during August was agreed with the IMF in order to increase reserves, but the lack of a plan to anchor expectations, together with the electoral uncertainty, also boosted parallel exchange rates (the gap did not narrow) and prices reacted strongly. The Government stated that it would keep the exchange rate at 350 until the end of October.

… but the exchange rate correction has been quickly diluted by the rapid pass-through to prices

REAL EXCHANGE RATE: OFFICIAL VS. PARALLEL

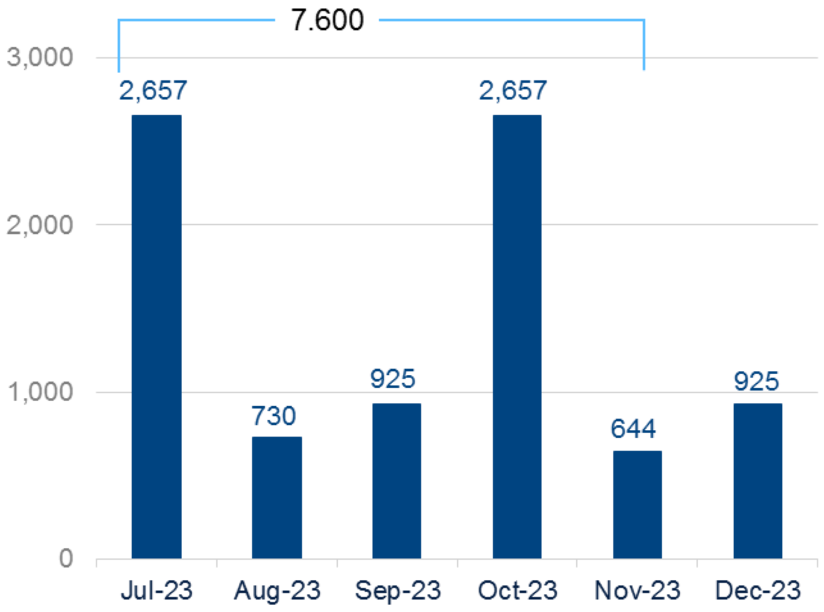
(ARS/USD, AT CONSTANT PRICES FROM 02/OCT/23)

Source: INDEC, BCRA and BBVA Research.

In order to contain the inflation caused by the exchange rate adjustment after the primary elections, the BCRA halted the exchange rate since then, quickly "erasing" in real terms the effect of the depreciation. Therefore, we expect a new exchange rate jump after October elections and an additional adjustment in December implemented by the new government.

The IMF approved a new disbursement in August, and the next review will take place in November

MONTHLY DEBT OBLIGATIONS WITH THE IMF
(MILLIONS OF USD)

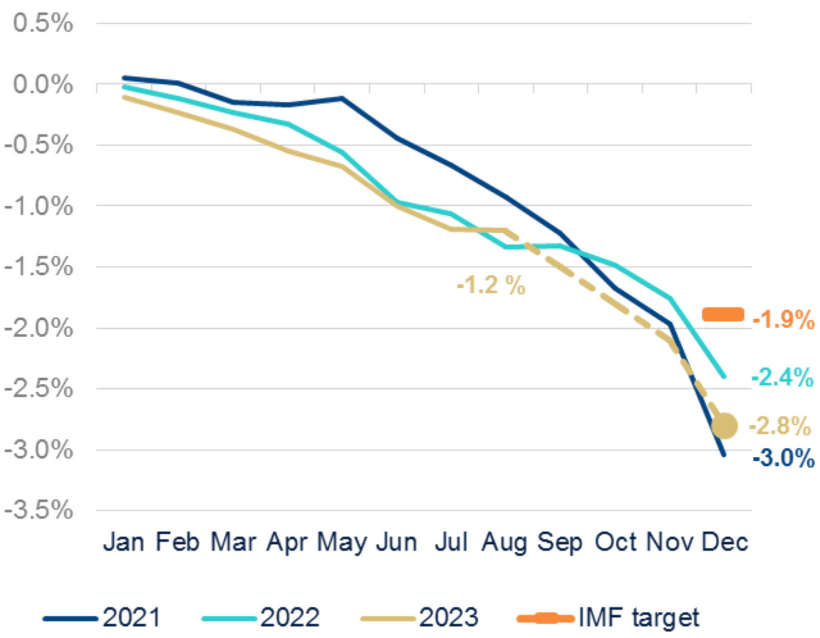


Source: BCRA, IMF and BBVA Research.

- The Government reached an with the IMF, for which a disbursement of USD 7.3 billion was made last August.
- This amount is sufficient to cover payments to the IMF between July and November, the month in which the next target review is due to take place.
- The next discussion with the multilateral organization will probably take place with the new president of Argentina.
- Therefore, a new recalibration of the program (which today the government is again failing to comply with) is expected in December.

The fiscal deficit perspectives deteriorated after the PASO due to new spending measures, making the necessary adjustment more difficult for 2024

CUMULATIVE PRIMARY FISCAL RESULT
(% GDP)

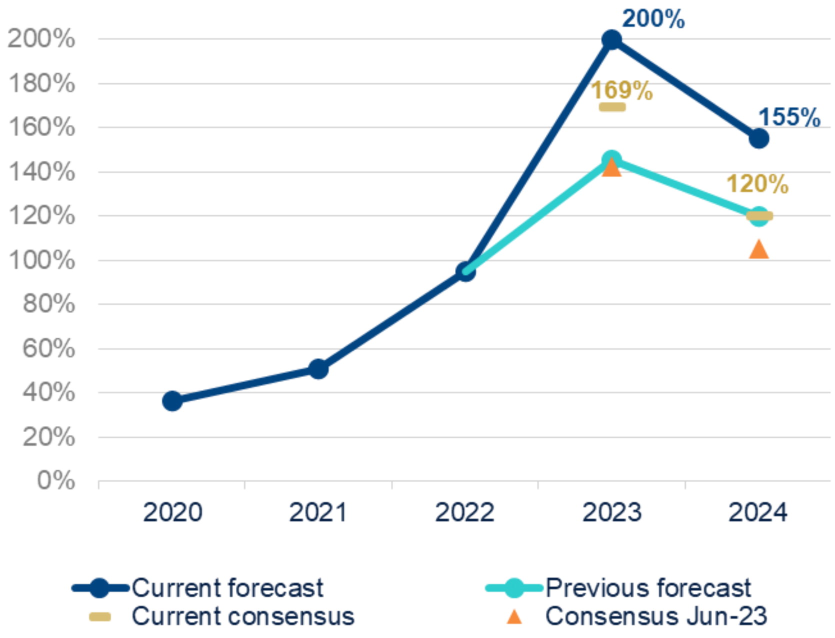


Source: Ministry of Economy and BBVA Research.

- Tax revenues were negatively affected by the drought, but marginally increased due to the PAIS tax (broadening of the taxable base) and VAT (defensive consumption in the face of uncertainty).
- The adjustment in expenditure in 2023 is due to the reduction of social expenditure and the reduction of subsidies. However, the electoral measures recently implemented by the government will have a fiscal cost of 1% of GDP. The government continues to announce expansionary policies that further deteriorate the result that will end at -2.8% of GDP.
- For 2024 we forecast a deficit of 1% of GDP. We expect that a fiscal adjustment during the first year of the next administration (whoever wins the election) will be unavoidable.

As a consequence, we are raising our inflation forecast to 200% by 2023 and 155% by 2024

INFLATION OBSERVED AND EXPECTED BY BBVA AND THE MARKET CONSENSUS (Y/Y CHANGE %)

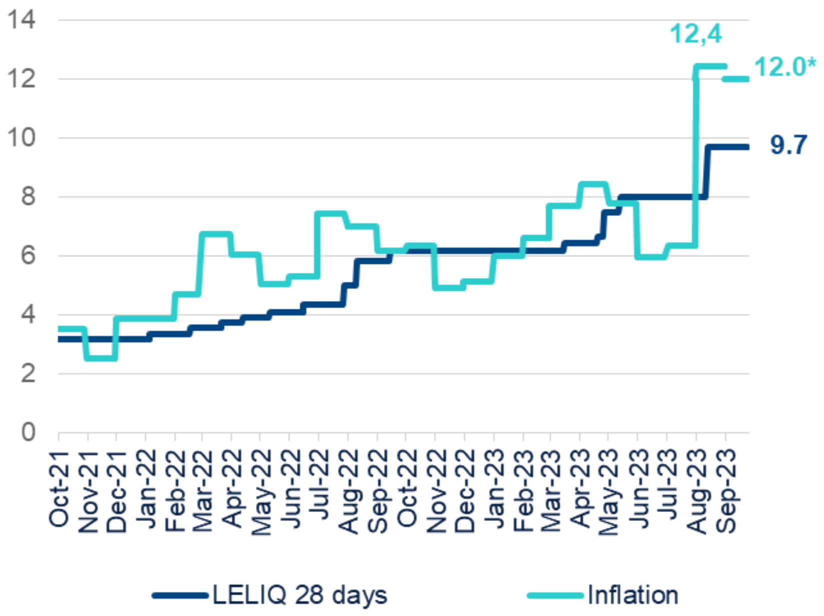


Source: BBVA Research and BCRA.

- The August devaluation, since it was not part of a comprehensive plan, will only accelerate the economy's inflation level during the second half of the year.
- We expect double-digit average monthly inflation for the remainder of the year.
- We anticipate that the exchange rate will move again post-election and then a further correction in December. This will accelerate prices in November and December 2023.
- In addition, relative price corrections are expected to keep inflation high in 1H24.
- The government that takes office will probably launch a stabilization plan, but its effects will not be felt until the second half of 2024.

Against this backdrop of high inflation for the rest of the year, we project several consecutive interest rate hikes until December

MONTHLY INFLATION AND EFFECTIVE MONTHLY INTEREST RATE OF THE LELIQ (%)

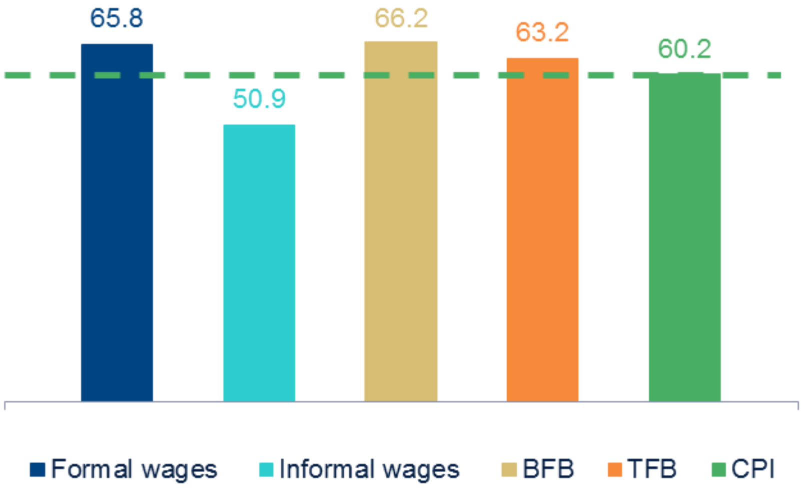


BBVA Research's September inflation forecast.
Source: BBVA Research, INDEC and BCRA.

- We forecast that the LELIQ interest rate will gradually rise to 138% in December, in the context of inflation averaging double digits per month, which will force the BCRA to take containment actions.
- In any case, we believe it will be very difficult for the interest rate to offset the price acceleration expected for 4Q23 and the first half of 2024.
- From mid-2024 onwards, if the government intends to embark on a stabilization plan, it will likely seek to foster a positive real interest rate environment to lower inflation.

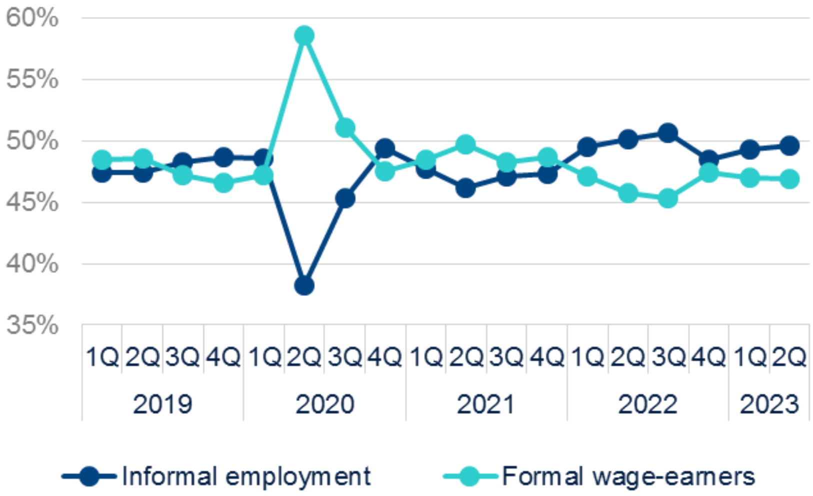
High inflation and the informality of the labor market caused a great deterioration in the socioeconomic conditions...

WAGES, BASIC FOOD BASKETS AND INFLATION
(CUMULATIVE % CHG. YTD, JULY 2023)



BFB: Basic Food Basket (Indigence Line).
TFB: Total Food Basket (Poverty Line).
Source: INDEC and BBVA Research.

FORMAL AND INFORMAL EMPLOYMENT
(% OF THE TOTAL LABOR FORCE)



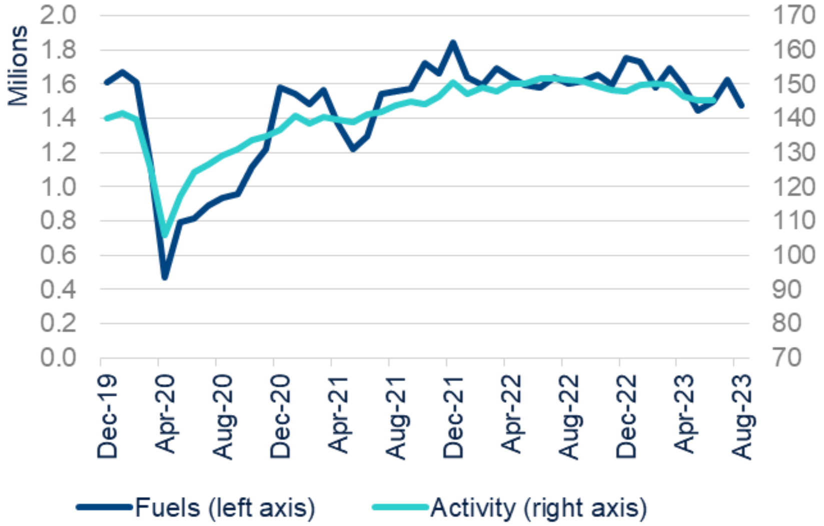
Source: INDEC and BBVA Research.

The acceleration of inflation is increasingly eroding incomes, further damaging the situation of the most vulnerable sectors. The proportion of informal workers rose again in 2Q23 and continues its upward trend, contrary to the situation of formal workers, who have greater protection against the loss of their real wages.

…which, together with the drought and import restrictions, negatively affect activity and punish (due to carry-over) growth in 2024

ECONOMIC ACTIVITY AND EXPENDITURE IN FUEL WITH BBVA CARDS

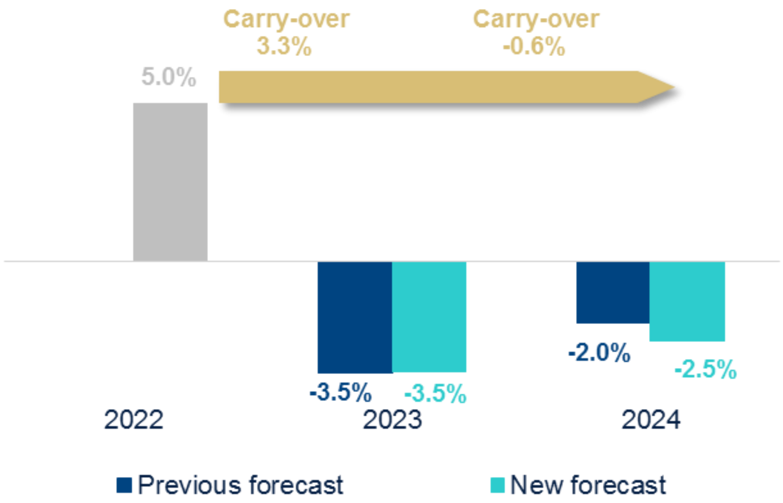
(ACTIVITY BASED ON 100=2004; CONSUMPTION IN QUANTITIES)



Source: INDEC and BBVA Research.

GROSS DOMESTIC PRODUCT

(% YOY)

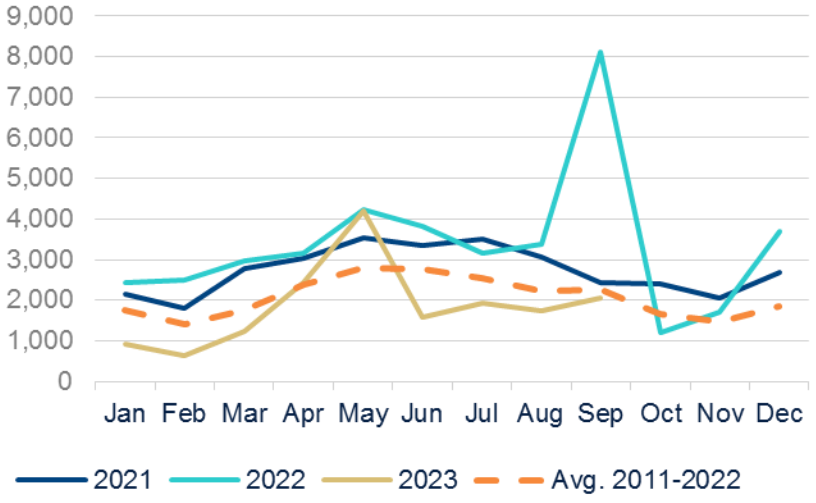


Source: INDEC and BBVA Research.

Although activity performed better than expected in the first half of the year, the severity of the drought pushed it into negative territory (-1.9% YtD accum.). Recent sectoral indicators show recessionary signs for the second half of the year. We maintain the 2023 GDP decline forecast at -3.5% and modify the 2024 forecast from -2% to -2.5%.

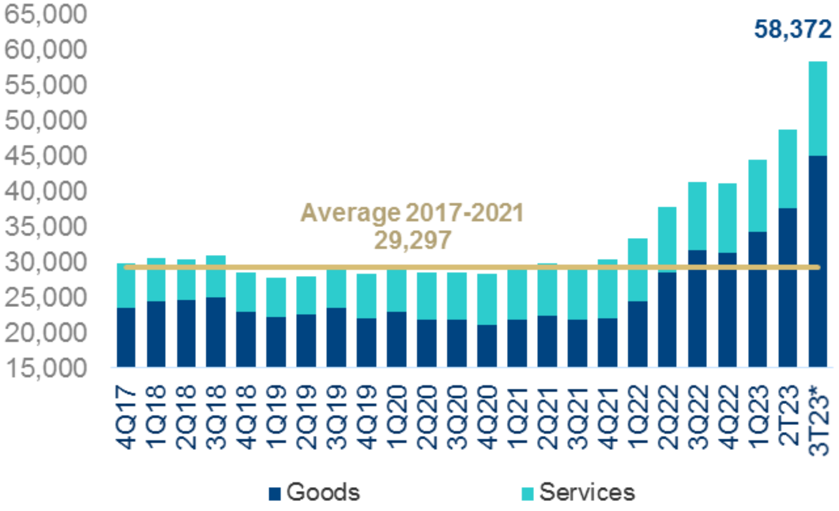
During 2023, the external sector accumulated imbalances, both on the export and import sides

CEREALS AND OILSEEDS EXPORTS
(MILLIONS OF USD)



Source: CIARACEC and BBVA Research.

IMPORTERS' COMMERCIAL DEBT (GOODS AND SERVICES) (MILLIONS OF USD)

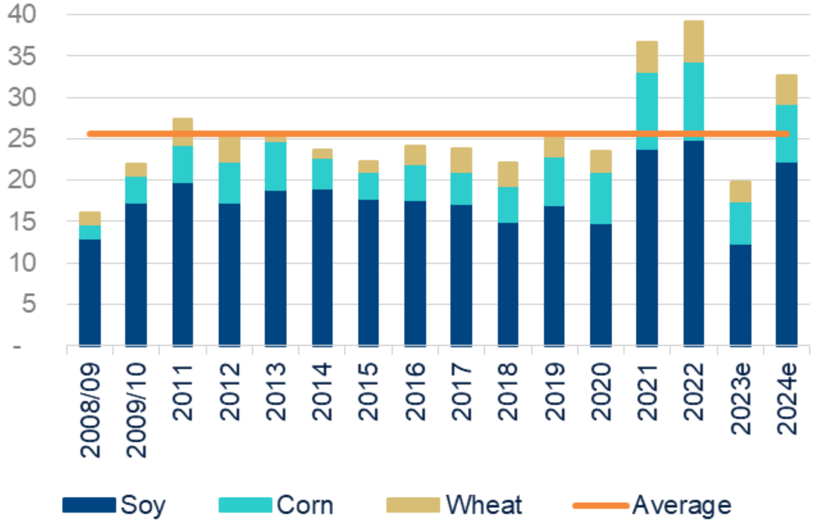


Source: INDEC, BCRA and BBVA Research.

Increasing restrictions on access to the official exchange market due to lower liquidation of exports (as a result of the drought) accelerated the accumulation of importers' commercial debt.

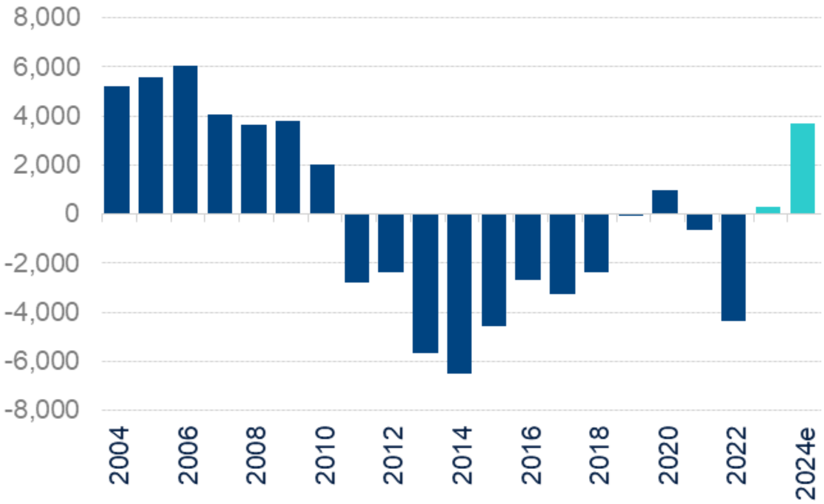
In 2024, the good outlook for agricultural exports and the energy trade balance will improve the external accounts of Argentina

AGRICULTURAL EXPORTS: MAIN PRODUCTS
(BILLIONS OF USD)



Source: USDA, Rosario Stock Exchange and BBVA Research.

TRADE BALANCE OF THE ENERGY SECTOR
(MILLIONS OF USD)



Source: INDEC, Ministry of Energy and BBVA Research.

Everything indicates that the drought will be reversed in 2024 and this will increase the exportable supply of the agricultural sector. With the opening of the gas pipeline and progress in other infrastructure works, it will not only be possible to replace energy imports but also to increase oil exports and reach a trade surplus in the energy balance in 2024.

Table of Macroeconomic Forecasts

	2020	2021	2022	2023e	2024e
GDP (% y/y)	-9.9	10.7	5.0	-3.5	-2.5
Inflation (% y/y, EOP)	36.1	50.9	94.8	200	155
Exchange Rate (vs. USD eop, Dec. avg.)	82.6	101.9	172.9	630	1,493
Monetary policy rate (% EOP)	37.1	36.7	75.0	138	60
Private consumption (% y/y)	-12.2	10.4	9.7	0.3	-3.4
Public consumption (% y/y)	-2.0	6.3	1.9	2.5	-5.3
Investment (% y/y)	-13.1	33.8	11.1	0.4	11.7
Primary Fiscal Result (% GDP)	-6.4	-3.0	-2.4	-2.8	-1.0
Financial Fiscal Result (% of GDP)	-8.4	-4.5	-4.2	-4.7	-3.3
Current account (% GDP)	0.7	1.4	-0.7	-3.5	-1.1
Public Debt (% GDP)	103.8	80.6	85.0	114.8	90.7

Source: BBVA Research.

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