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# Argentina Economic Outlook

December 2023

Creating Opportunities

# Main messages. Global

**Recent developments**

Growth and inflation have been trending downwards, favored by the recent tightening of monetary conditions. The moderation of commodity prices is also allowing inflation to ease, while providing some support to growth. Still expansive fiscal policy and resilient labor markets are backing activity, but making the disinflation process more difficult. Markets have exhibited a positive tone lately, but remain subject to volatility, especially considering that uncertainty remains very high.

**Growth outlook**

A further deceleration of the global economy is likely moving forward, as monetary conditions will remain tight, fiscal policy will eventually become less expansive, labor markets will continue losing steam and excess savings are set to decline further. However, a deep recession will likely be avoided. Global growth is forecasted to decline from 3.4% in 2022 to around 3.0% in both 2023 and 2024.

**Inflation and rates outlook**

Inflation is also expected to keep easing, continuing its slow convergence to the targets. That will provide some relief to central banks, which are unlikely, however, to embark on interest rate cutting cycles before the middle of 2024: the Fed and the ECB are expected to revise rates gradually down from Jun/24 and Sep/24, respectively, while they continue to reduce liquidity levels.

**Risks**

Recession and financial stress episodes are still possible given tight monetary conditions, high inflation and growth deceleration. Geopolitical uncertainty is also a source of concern, particularly after the beginning of the Israel-Hamas conflict. Another risk is a hard-landing in China.

# Key points. Argentina

**Political outlook**

Decisive victory for Javier Milei in the runoff. The society expressed in favor of a change and the “La Libertad Avanza” candidate will be the next Argentine president, after winning 55.7% of the votes against the official candidate Sergio Massa. The alliance with Mauricio Macri and his teams gives the new government a degree of moderation and greater ability to rule the country.

**Exchange Market**

We expect rapid progress toward the normalization of the FX market after the change of government, with a liberalization of restrictions for trade flows of goods and services that would trigger a depreciation of the FX rate up to 800 ARS/USD on 31 December 23. From 2Q24, the contribution of exports from the recovery of the agricultural sector would allow the removal of more capital controls, to finish 2024 without an FX rate gap.

**Inflation**

The correction of the FX rate and transportation and energy prices will drive a sharp acceleration in inflation in the first few months of 2024 until a peak is reached in April/May. Then, with the launching of a stabilization plan, we expect inflation to begin a downward monthly trajectory to end up increasing 155% in the year.

**Economic activity**

The 2H23 data show a smaller contraction than expected, due to a strong surge in electoral expenditure, so we cut our GDP variation forecast for 2023 to -3% (previously -3.5%). However, in view of the depth and speed of the adjustments announced by the elected government we have increased the expected contraction to -4% for 2024 (-2.5% previously).

# Key points. Argentina

**Fiscal Result**

Milei has stated that he will seek to achieve fiscal equilibrium with a sharp cut in expenditure (subsidies, public works, etc.) on top of an overhaul of the State and will have, as additional help, the improvement in export taxes due to the end of the drought (~1% of GDP). As a result, we expect a sharp correction of the primary deficit from 3.2% of GDP at the end of 2023 to 0.8% of GDP in 2024.

**Monetary sector**

As a result of the ambitious fiscal consolidation, we expect a significant reduction in monetary issuance to assist the treasury, but without a substantial adjustment in the interest rate, so it will remain negative in real terms while the FX rate and utility prices are adjusted in the 1H2024. Then, within the framework of the abovementioned stabilization plan, the interest rate will become positive in real terms.

**External sector**

In 2024 there will be a significant contribution of dollars from exports due to the recovery of agriculture and the expected energy surplus for next year. However, these inflows must be managed very well to meet external commitments (debt with importers and public debt obligations) as well as to achieve a recomposition of international reserves.

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# 01

# Global Situation December 2023

Creating Opportunities

# A soft landing of both growth and inflation is likely to pave the way for cautious rate-cutting cycles, which are closer now but are not imminent yet

## BBVA RESEARCH BASELINE SCENARIO

### Growth and inflation slowdown

Growth and inflation will ease on extra demand weakening, given no extra supply shocks, but risks are still significant

### Cautious central banks

Fed and ECB rates have peaked but are unlikely to be cut before Jun/24; anyway, quantitative tightening will continue

### Financial volatility

Volatility will remain in place on high interest rates, still hawkish central banks and large uncertainty

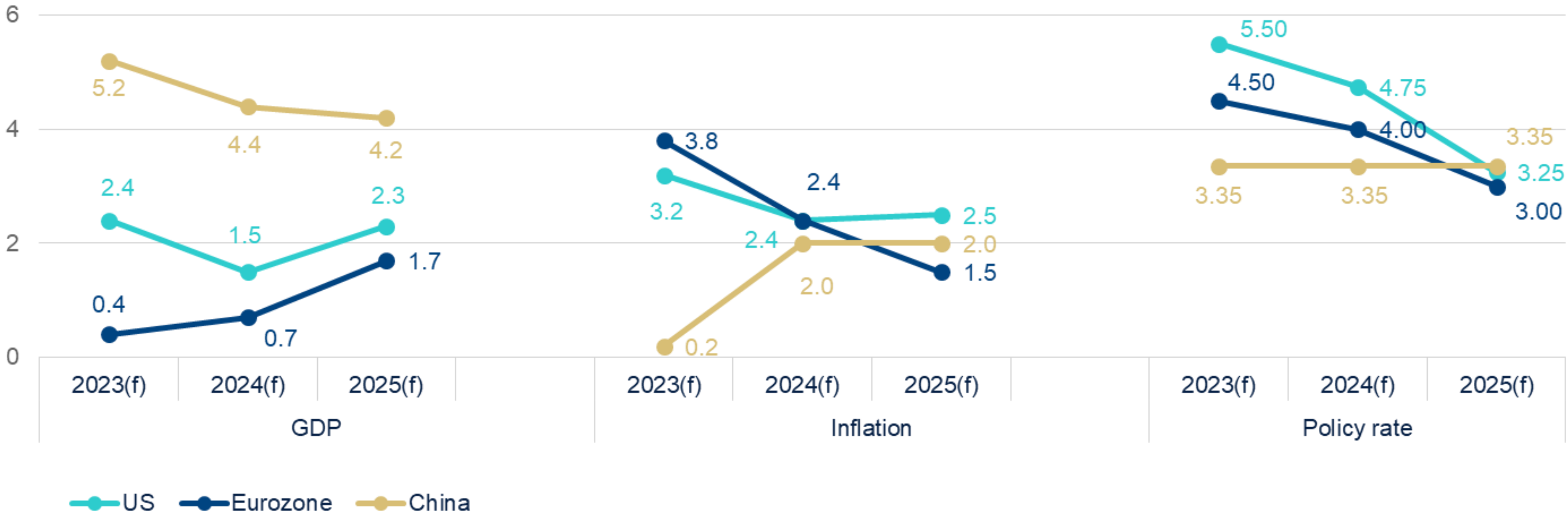
### Geopolitical tensions

Rising risks, but large economic effects are not assumed; Middle-East conflict to have limited impact on energy prices

# Global growth will be relatively low, while inflation and policy rates will decline without converging to pre-pandemic (ultra-low) levels over the next two years

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

(GDP GROWTH: %; INFLATION: YOY %, END OF PERIOD, POLICY INTEREST RATES: %, END OF PERIOD)




(*) Global GDP growth is forecast to ease from 3.4% in 2022 to around 3.0% (+0.1pp) in 2023, 3.0% (0.0pp) in 2024 and 3.3% in 2025, below the 2000-2022 average (3.6%).

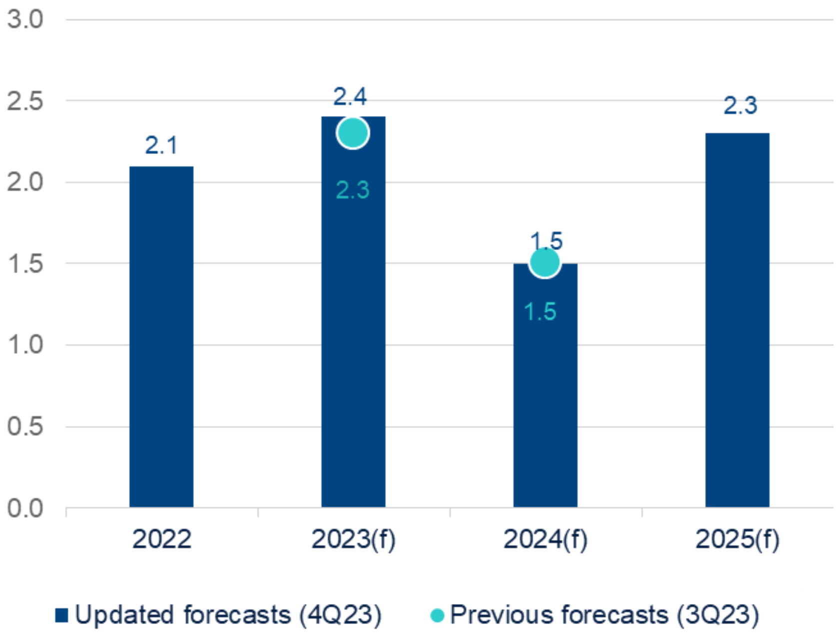
(**) In the case of the Eurozone, interest rates on refinancing operations.

(f): forecasts

Source: BBVA Research based on Bloomberg data.

# US: solid domestic demand supports 2023 growth; high interest rates (despite eventual rate cuts from June) likely to weigh more on growth in 2024

## US: GDP GROWTH
(%)



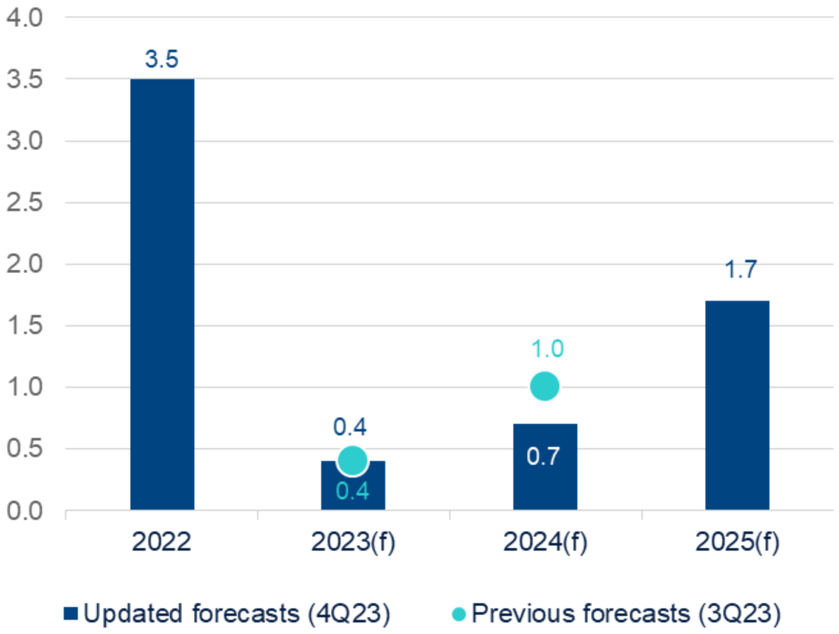

(f): forecast.
Source: BBVA Research

- 2023 growth revised up, despite moderation signs: consumption backed by still significant excess savings and strong labor markets; manufacturing is benefiting from bottleneck normalization.
- Growth to ease in 2024 mainly on the lagged effect of the recent monetary tightening.
- Inflation to keep falling as labor markets come into a better balance.
- Fed: the most likely is a pause with gradual cuts from Jun/24; fears of incomplete convergence to the 2% target to prevent earlier cuts.
- Risks: recession or financial stress on high rates, presidential elections and expansive fiscal stance.

# Eurozone: milder growth and lower inflation favor a reduction of ECB policy rates from September, somewhat earlier than previously expected

## EUROZONE: GDP GROWTH

(%)

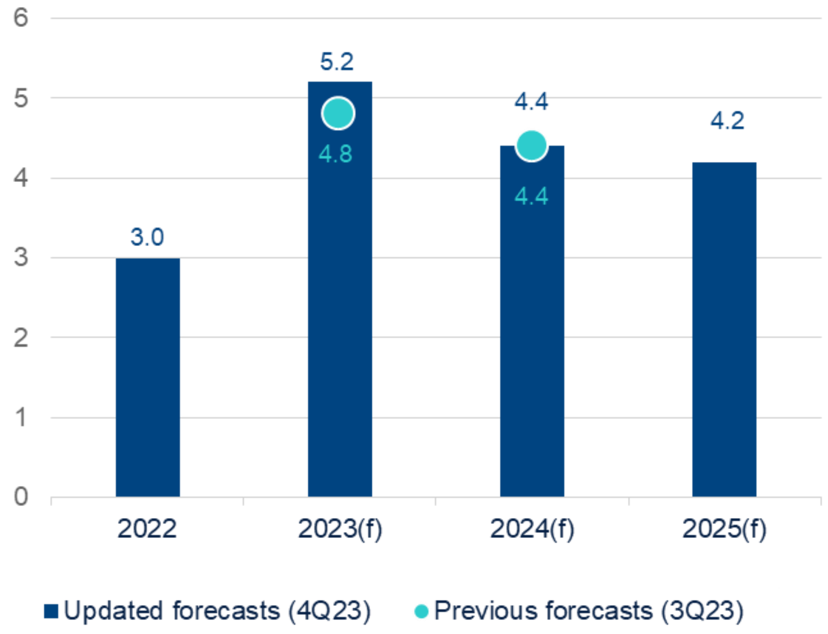



(f): forecast.
Source: BBVA Research

- GDP forecasts: unchanged in 2023 but revised down in 2024; recent data suggest a (minor) recession in 2H23.
- Inflation forecasts revised down: pressures from energy prices, fiscal policy and labor markets to be offset by sharper core disinflation, in line with incoming data.
- ECB: rate cuts from Sep/24, when the disinflation process will be clearer; balance sheet reduction will continue, with focus on PEPP reinvestment and new operational framework.
- Risks: stagflation and competitiveness problems on high energy prices, sovereign debt tensions.

# China: recent data reinforce the view that a hard-landing will likely be avoided, but growth is set to ease in 2024-25 as structural challenges remain in place

**CHINA: GDP GROWTH**
(%)




(f): forecast.
Source: BBVA Research

- 2023 GDP was revised upwards in line with incoming data showing that demand improved somewhat after series of stimulus policies were adopted to avoid a hard-landing.
- Growth is likely to weaken ahead and hard-lading is still a risk as real estate tensions, large local government debt and other structural problems (middle-income trap, ageing, US confrontation etc.) remain in place.
- Inflation remains close to zero, but is forecast to converge to 2% on more supportive policies and some confidence improvement.
- Risks: sharp growth deceleration, deflation and balance-sheet recession, geopolitical tensions.

# Risks: tensions in the Middle-East add to the concerns about the potential consequences of high inflation and interest rates and a hard-landing in China

## Inflation and high interest rate risks

Higher energy prices on **Middle-East or Ukraine conflicts**

Strong demand on **public spending** (scarce fiscal consolidation)

Strong demand on **private spending** (labor tightness, etc.)

## Financial tensions risks

**Risk-off** and financial volatility

Tensions in **sovereign debt markets**

Tensions in **private debt markets**

## Growth deceleration risks

**Stagflation**, mainly in the EZ and other energy net-importers

**Recession**, including (but not only) in the US

**Hard-landing in China**, with balance-sheet recession and deflation risks

# Uncertainty on series of economic, political, geopolitical and climate factors

| Economic uncertainty | Political uncertainty | Geopolitical uncertainty | Climate uncertainty |
|---|---|---|---|
| **Inflation** and macro policy mix | **US presidential** elections | **Israel-Hamas** conflict | **El Niño effects** mainly on S. America |
| **Monetary tightening** impact, neutral level | **Political tensions** in DMs and EMs | **Ukraine-Russia** war | **Climate disruptions** and weather shocks |
| **Fiscal consolidation** | **Populism** and social unrest | **US-China rivalry:** deglobalization, Taiwan | **Energy transition** policies |

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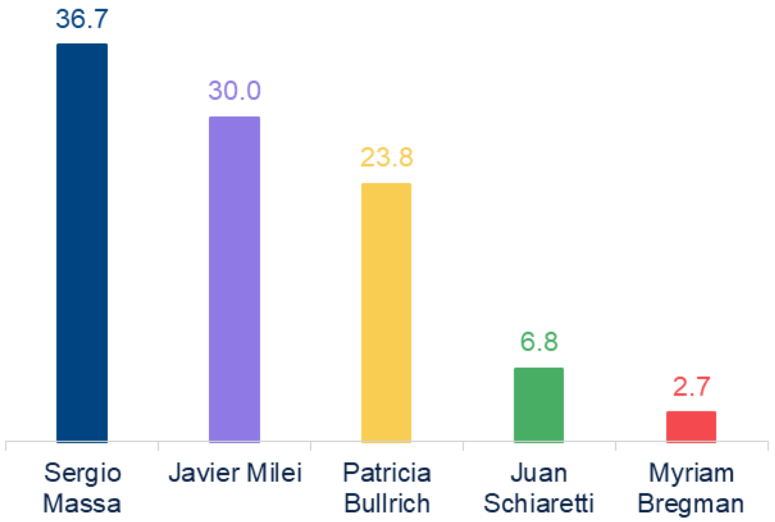
02

# Argentina Outlook
December 2023

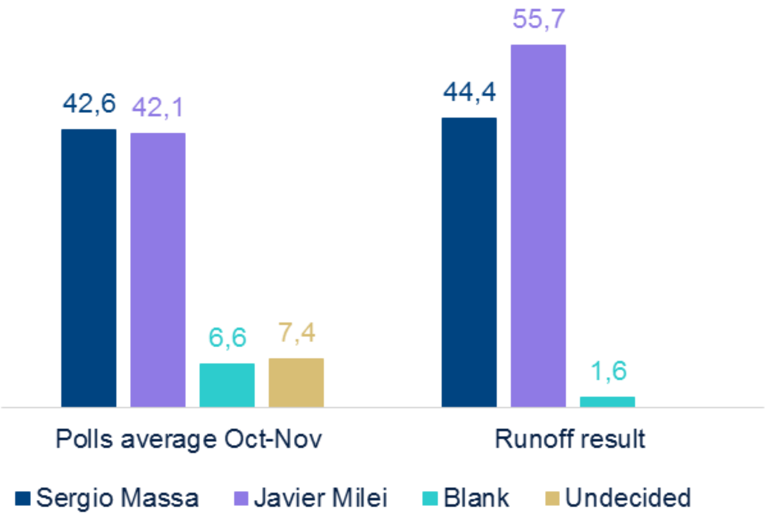
# With a resounding victory in the runoff, Javier Milei was elected President of Argentina for the next four years

## GENERAL ELECTION RESULT (1ST ROUND)
(IN % OF AFFIRMATIVE VOTES)




Source: Ministry of the Interior and BBVA Research.

## POLLS VS RUNOFF RESULTS
(IN %)

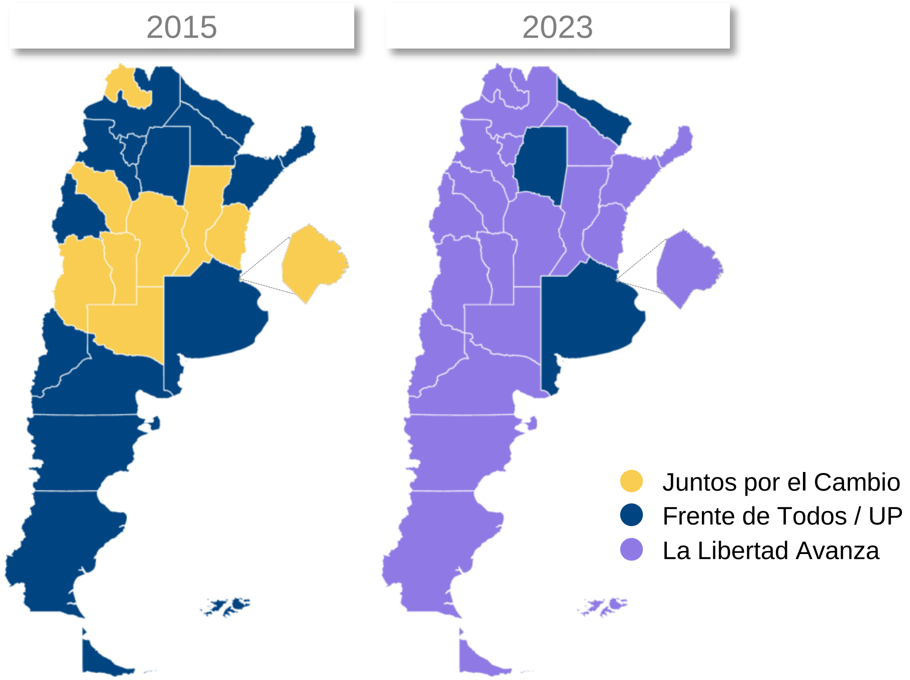



Source: Ministry of Interior, various pollsters and BBVA Research.

As in the primary election, Milei's victory was the big surprise compared with the polls' predictions. In the general election it was Massa who came first, rising 10 pp compared with the primary elections. However, in the runoff Milei impressed with the resounding nature of his victory which, again, had not been anticipated by the polls (let alone the difference with Massa).

# Milei's success was categorical due to its transversality and broad territorial support, which is unusual for a runoff

## RUN-OFF RESULTS 2015 VERSUS 2023

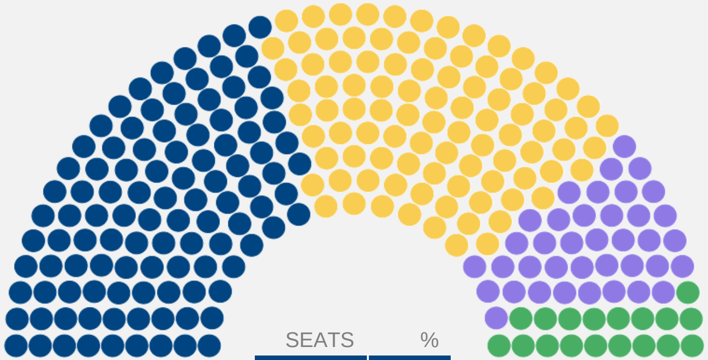



Source: Ministry of the Interior and BBVA Research.

- The support that Javier Milei obtained was unusual because he achieved victory in 21 of the country's 24 districts. Even in the Province of Buenos Aires, with the significant relative weight of the traditionally Peronist Greater Buenos Aires, Massa's advantage was barely 1.4 percentage points.
- The growth in the number of votes for Milei was surprising, even in Peronist strongholds such as Chaco, Tucumán, San Luis and La Rioja.
- The only previous runoff experience was in 2015, when Mauricio Macri won the election over Daniel Scioli. But Milei's victory stands apart for the greater level of support with which he will assume the Presidency.

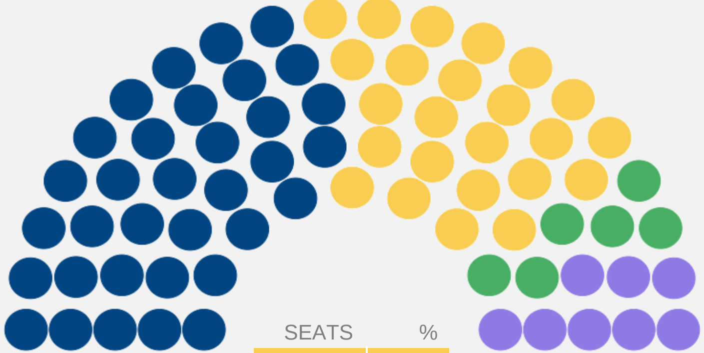
# However, he will face a fragmented Congress that means he will constantly need to negotiate to pass laws...

## LOWER HOUSE
MEMBERS: 257 – QUORUM: 129



| SEATS | % |
|---|---|
| 107 | 41,6 |
| 94 | 36,6 |
| 37 | 14,4 |
| 19 | 7,4 |

## SENATE
MEMBERS: 72 – QUORUM: 36



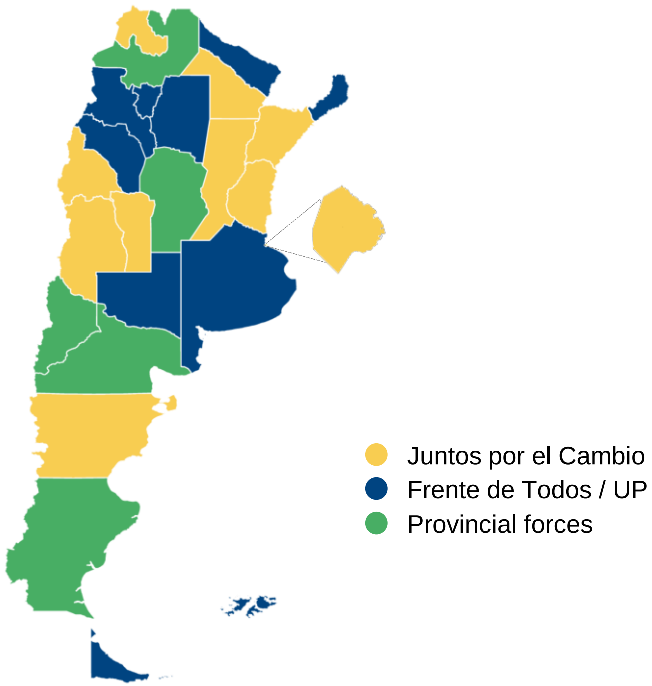
| SEATS | % |
|---|---|
| 34 | 47,2 |
| 24 | 33,2 |
| 8 | 11,1 |
| 6 | 8,3 |

Juntos por el Cambio · Frente de Todos / UP · La Libertad Avanza · Other parties

Milei's victory is more personal than partisan, since he has not managed to achieve clear representation in the Congress. It remains to be seen whether the libertarian party will be strengthened by the PRO (the hardline wing of Juntos por el Cambio), how Juntos por el Cambio will be reconfigured and how Peronism will reinvent itself after the worst defeat in its history.

# …and with a significant jurisdictional segmentation given that he will govern alongside provincial leaders of different political parties

## GOVERNMENTS BY POLITICAL SPACE

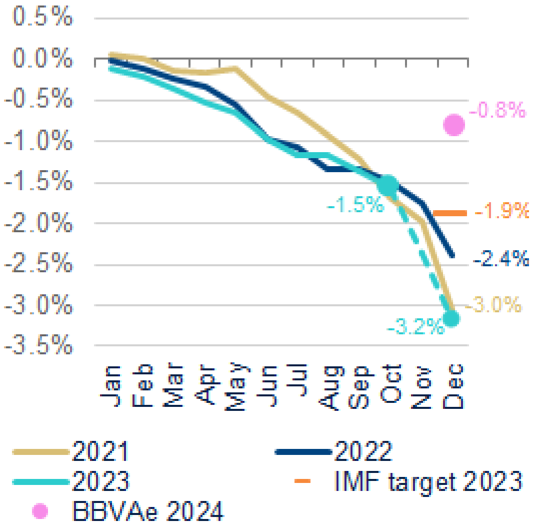



Source: Ministry of the Interior and BBVA Research.

- The long electoral process has resulted in a government with significant support from society, but with a need to form alliances given the lack of territorial support (LLA has no provincial government, nor any relevant municipal government) and its minority position in both houses of congress.
- Furthermore, this weakness provides, for now, an important component of moderation and control due to the alliance with Mauricio Macri and his teams, who help keep in check the radicalism of some of the ideas proposed by Milei in the campaign and offer technical skills to deal with the necessary reforms.

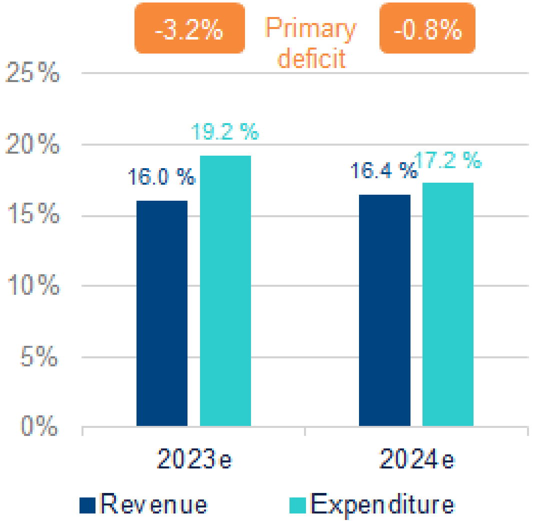
# The acceleration of the fiscal deterioration in 2H23 as a result of electoral expenditure makes the essential and urgent adjustment for 2024 more challenging...

## CUMULATIVE PRIMARY FISCAL RESULT (% of GDP)



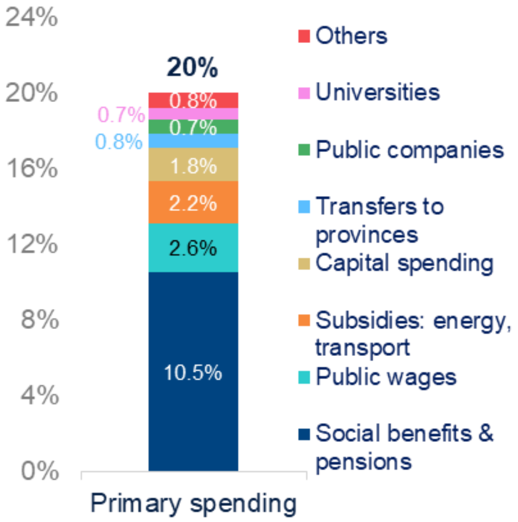

Source: Ministry of Economy and BBVA Research.

## FISCAL REVENUES AND PRIMARY EXPENDITURE (% GDP)




Source: BBVA Research forecasts.

## COMPOSITION OF FISCAL EXPENDITURES (% GDP, cum. 12-month as of Sep23)

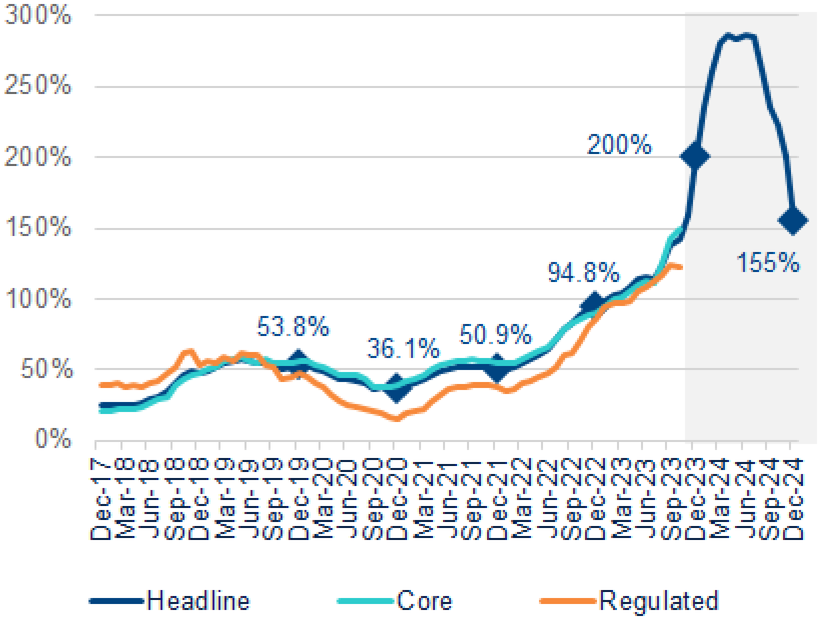



Source: Ministry of Economy and BBVA Research.

Fiscal consolidation in 2024 will be focused on reducing subsidies (energy and transportation) and capital expenditure, postponing the cut in social benefits given the fragile socioeconomic situation. There will also be an improvement in revenues of ~1% of GDP due to the recovery of agricultural exports. We expect a primary deficit of 0.8% of GDP in 2024.

# …because monetary issuance is the only source of financing for the deficit and puts a high floor to the inflationary process

## INFLATION, BY COMPONENT
(VAR. % Y/Y)

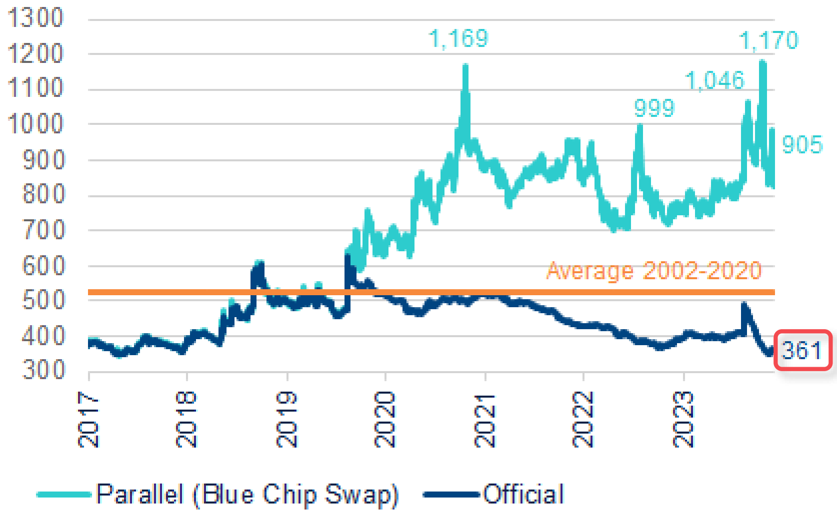



Source: INDEC and BBVA Research.

- Due to the expected adjustments in the FX rate and utility prices, inflation will accelerate sharply in the coming months.
- After the correction of relative prices, a stabilization plan must be implemented to reverse the price escalation, leaving inflation at 155% annually in 2024 and at 50% in 2025.
- The most likely scenario is the establishment of some type of FX peg, in a scenario without monetary issuance for the Treasury, to reduce inflation quickly and thus be able to show the results that the electorate demands.

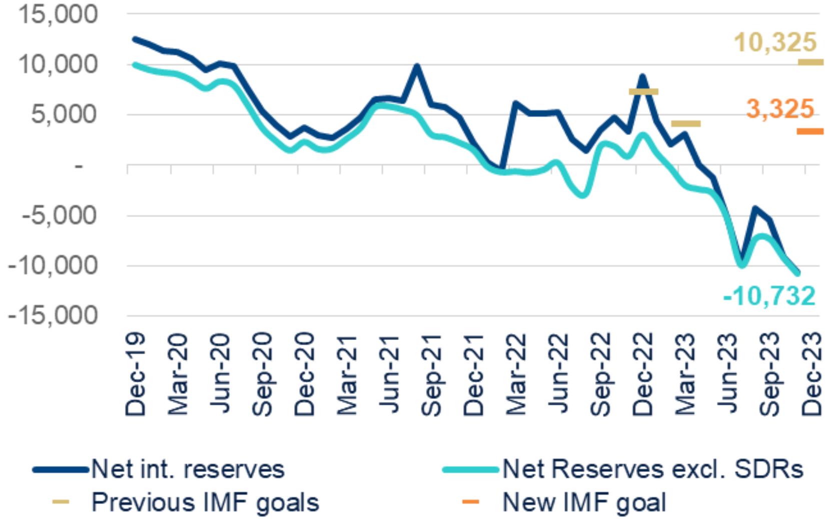
# A very overvalued official exchange rate, due to the inflationary acceleration, in a scenario of negative net international reserves...

## REAL EXCHANGE RATE: OFFICIAL VS PARALLEL
(ARS/USD AT CONSTANT PRICES OF 1/DEC/23)




Source: BCRA, Alphacast and BBVA Research.

## NET INTERNATIONAL RESERVES
(MILLIONS OF USD)

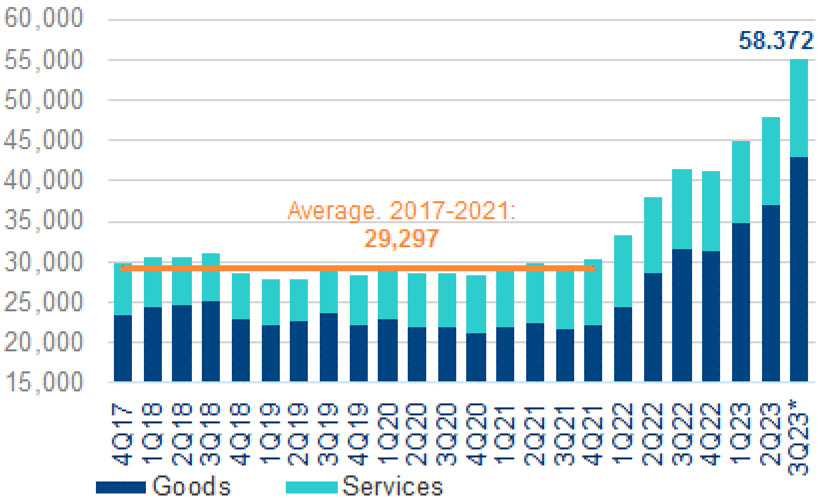



Source: BCRA and BBVA Research.

The failed devaluation after the PASO, which was quickly passed on to prices due to the absence of a comprehensive economic plan, aggravated the dynamics of international reserves that the Government tried to moderate with more restrictions on the official and parallel FX markets.

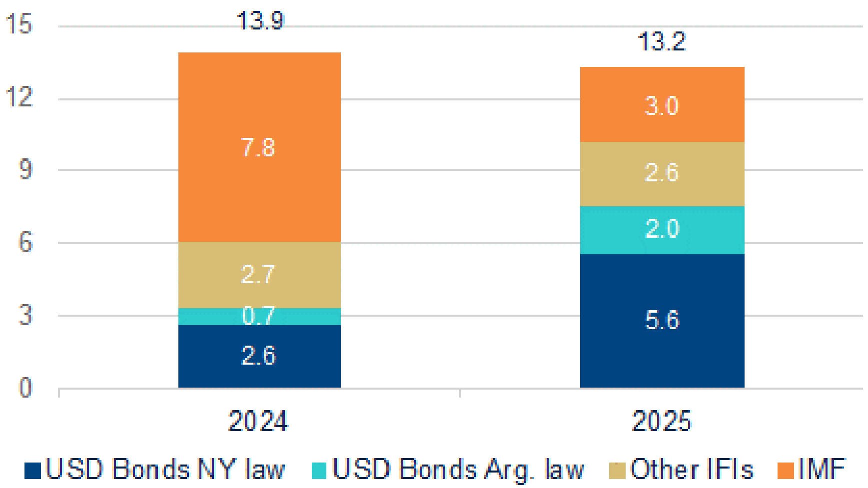
# …combined with strong FX demands coming from commercial debt and public debt obligations…

## COMMERCIAL DEBT FOR IMPORTS OF GOODS AND SERVICES (MILLIONS OF USD)




Source: INDEC, BCRA and BBVA Research.

## PUBLIC DEBT OBLIGATIONS IN FOREIGN CURRENCY (BILLIONS OF USD)

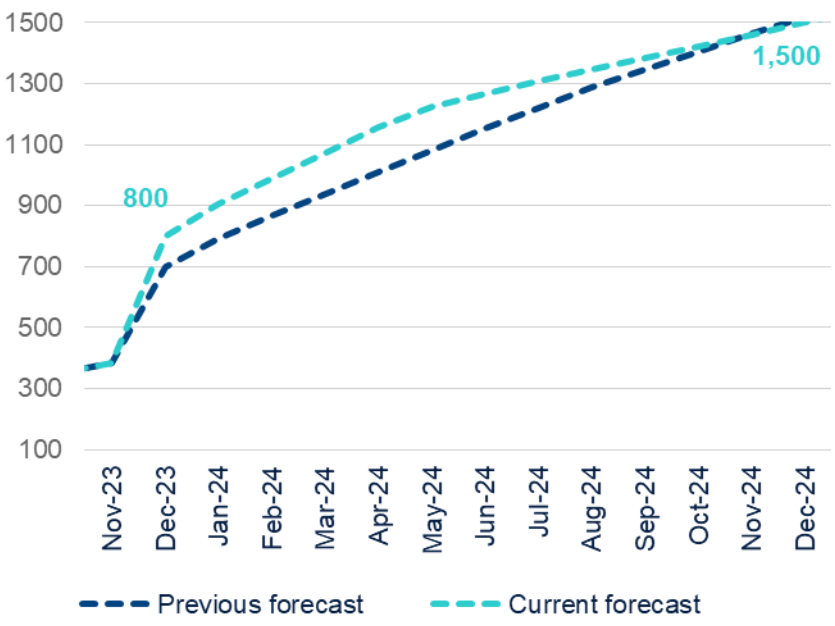



Source: Ministry of Economy and BBVA Research.

A rapid liberalization of capital controls would imply a significant depreciation of the FX rate. However, the liberalization of accumulated dividend payments, debts for delayed imports and the formation of external assets would have to wait until a second stage of Milei’s plan, since he already stated that it would be difficult to completely remove the FX controls immediately.

# …entail strong pressure on the FX rate, in order to ease restrictions on trade flows and accumulate international reserves

## OFFICIAL EXCHANGE RATE
(PESOS / USD)

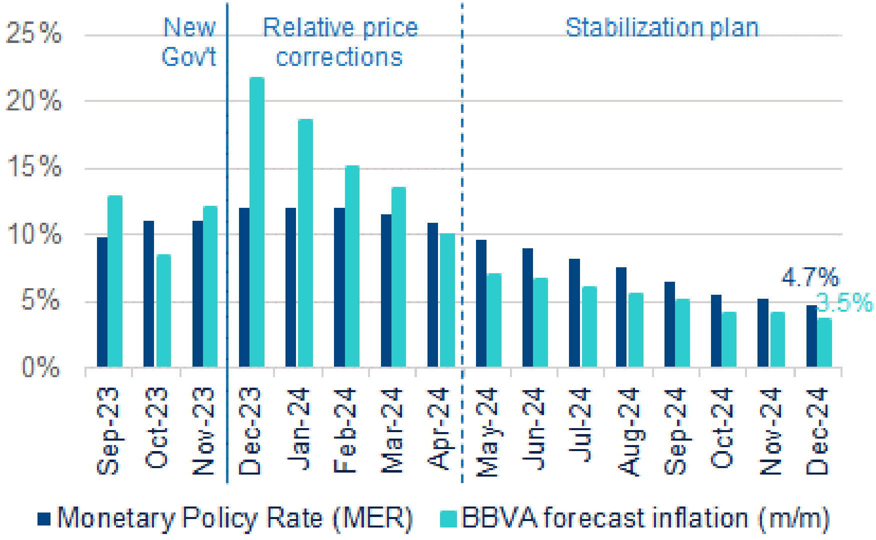



Source: BCRA and BBVA Research.

- We expect a correction of the official FX rate to around USD/ARS 800 at the end of 2023. This adjustment would imply a relatively undervalued currency (+40% compared to the average of the last 20 years), which would allow a relaxation of import restrictions in the short term.
- Then, we expect a second round of liberalization of capital controls by April, when the inflow of foreign currency from the soybean and corn harvest begins.
- The downturn in economic activity and improvements in exports provide room for the FX rate to grow by less than inflation in 2024, and close the year at around USD/ARS 1,500.

# The interest rate will not be able to match inflation at the start of the new government, but the trend would reverse in the second half of 2024

## BBVA RESEARCH BASELINE SCENARIO: MONTHLY INFLATION AND MONTHLY EFFECTIVE INTEREST RATE

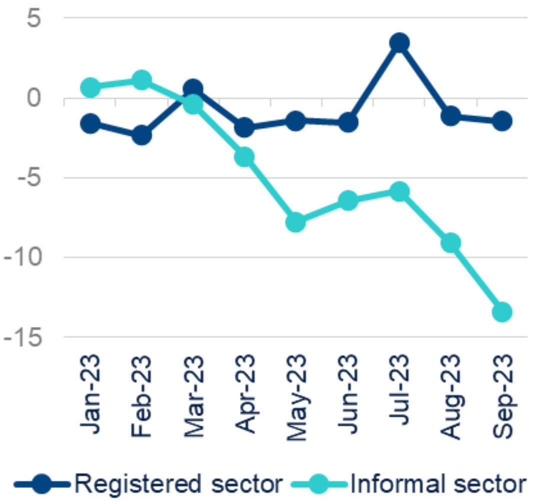



Source: BCRA, Alphacast and BBVA Research.

- The interest rates will probably not offset inflation during the first months of the next year.
- Thus, this environment of negative real rates will contribute to the reduction of the Central Bank's interest-bearing liabilities as a % of GDP.
- Under our baseline scenario, after a first stage of adjustment of relative prices (FX and utility prices) the government would launch an stabilization plan to reduce inflation during the 2H24, and interest rates would turn positive in real terms.

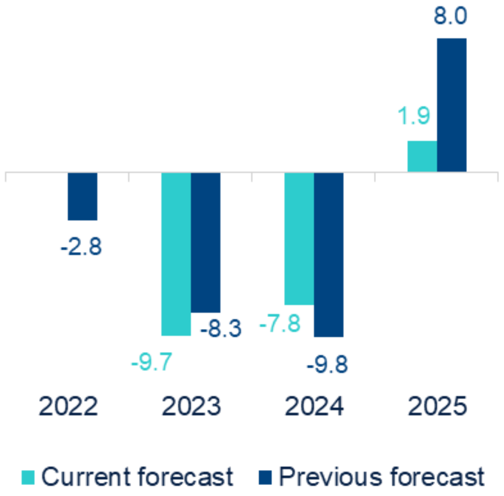
# As a result of the acceleration in inflation, real wages will continue to erode in a deteriorated labor market

## REAL WAGES: 2023
(% CHG. Y/Y)



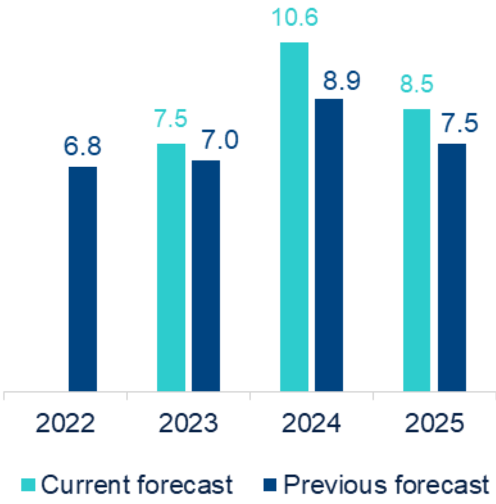

Source: BBVA Research and INDEC.

## REAL WAGES
(% CHG. Y/Y)




Source: BBVA Research, FIEL and INDEC.

## LABOR MARKET FORECASTS
(IN %)

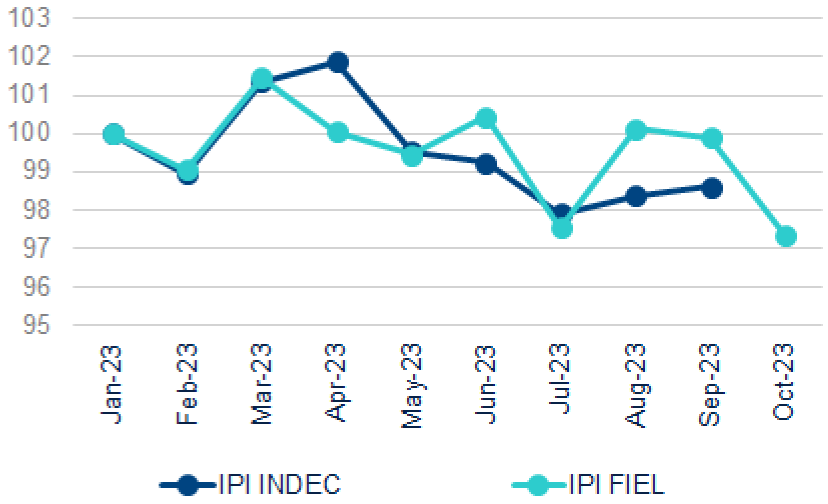



Source: BBVA Research and INDEC.

Informal workers have been severely harmed by the deterioration of real incomes. At the end of 2Q23, labor informality had climbed to 49.6% and we expect it to remain at around 50% during the coming months until economic activity starts to recover (after the downturn expected for 1H24).

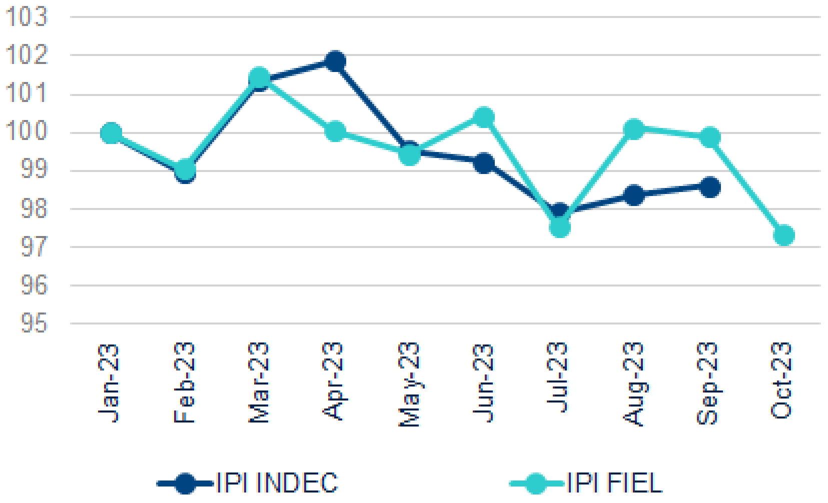
# Activity performed better than expected in 2H23 due to the electoral fiscal stimulus and increased private consumption as a "protection" against inflation...

## INDUSTRIAL OUTPUT INDEX (IPI)
(JAN'23 = 100; SA SERIES)




Source: BBVA Research, FIEL and INDEC.

## PURCHASES IN SUPERMARKETS AND SELF-SERVICE WHOLESALERS (QTY. TRANSACTIONS; JAN'23 = 100; S.A.)

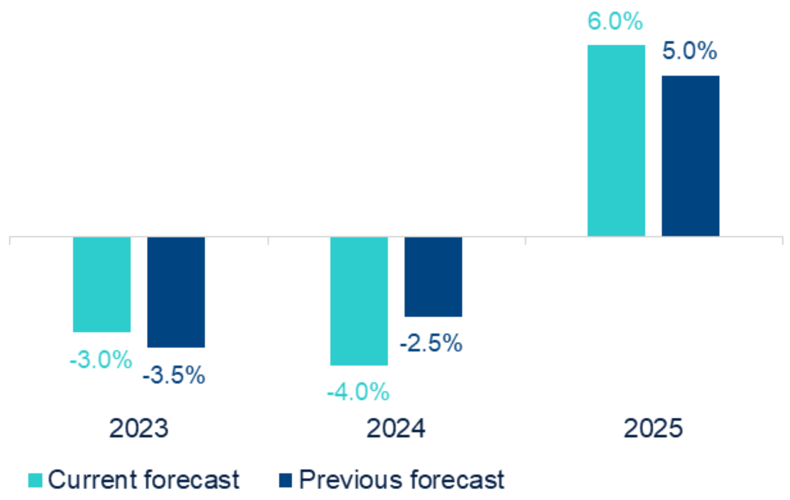



Source: BBVA Research and INDEC.

The expansionary fiscal policy measures during the electoral campaign in a context of accelerating inflation boosted the growth of private consumption. In turn, companies' profit margins remain high, while imports did not slow down in line with the drop in exports, which sustained industrial activity.

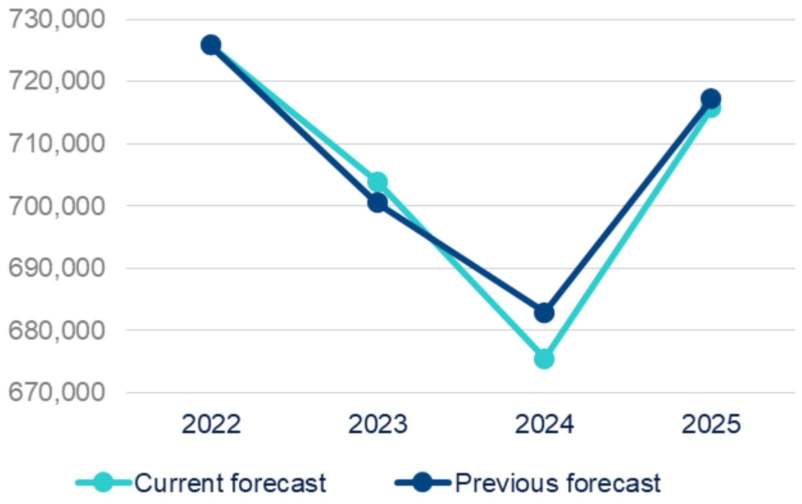
# ...so we cut the fall in GDP in 2023 but increase the decline in 2024 due to a stronger expected adjustment

## GDP GROWTH FORECAST
(% Y/Y CHG; CONSTANT ARS)




Source: BBVA Research and INDEC.

## GDP LEVEL FORECAST
(IN CONSTANT ARS MILLION)




Source: BBVA Research and INDEC.

In 2024, activity will contract in light of the adjustments that Milei announced during his campaign and plans to carry out with the aim of adressing the country's macroeconomic imbalances. This rapid correction will stimulate investment that, coupled with the improvement of the external sector, could pave the way to a more sustainable growth path from 2025.

# In conclusion, Milei will apply a shock policy but without its most extreme aspects...

Javier Milei assumes the Presidency accompanied by the PRO wing of Juntos por el Cambio (Macri and Bullrich), which softens his most extreme positions.

Milei and his team propose that the current monetary and fiscal imbalance must be tackled immediately: “There is no scope for gradualism”. They need to bolster their ability to govern achieving quick economic results in the short term.

FX controls will be removed as soon as possible, but not entirely. First, foreign trade flows of goods and services would be made more flexible along with the payment of maturing debt. The access to FX market for the commercial debt, dividends and other financial flows would have to wait until a second stage during 2024.

The correction of relative prices and the various imbalances will impact the economic activity, causing it to fall by more than expected.

Once the corrections have been made and the stock of Leliqs has been reduced in real terms, a stabilization plan can be implemented, which will probably be based on an exchange rate anchor.

Although the task is very challenging, the encouraging signs of moderation and positive reception for political and technical teams from other political forces are to some extent auspicious.

# …and will require skill to gain political support for his measures

## WHAT COULD MILEI DO WITH SCARCE POLITICAL SUPPORT?

- Remove capital controls.
- Partially liberalize foreign trade.
- Reduce public expenditures (2-4% GDP).
- Deregulate the financial sector.

## WHAT WOULD MILEI NOT BE ABLE TO DO WITHOUT POLITICAL SUPPORT?

- Dollarize.
- Remove or apply taxes (except for taxes on foreign trade).
- Structural reforms: labor market, pensions, tax system.
- Privatize key public companies.

# Table of macroeconomic forecasts

| | 2022 | 2023e | 2024e | 2025e |
|---|---|---|---|---|
| GDP (% y/y) | 5.0 | -3.0 | -4.0 | 6.0 |
| Inflation (% y/y, EOP) | 94.8 | 200 | 155 | 50 |
| Exchange Rate (vs USD Dec. avg.) | 172.9 | 700 | 1483 | 2031 |
| Exchange Rate (vs USD 31/Dec.) | 177.1 | 800 | 1500 | 2058 |
| Monetary policy rate (% EOP) | 75.0 | 144 | 56 | 43 |
| Private consumption (% y/y) | 9.7 | 1.5 | -0.1 | 3.1 |
| Public consumption (% y/y) | 1.9 | 4.9 | -1.0 | 1.8 |
| Investment (% y/y) | 11.1 | 1.4 | 12.7 | 36.6 |
| Primary Fiscal Result (% GDP) | -2.4 | -3.2 | -0.8 | -0.5 |
| Financial Fiscal Result (% GDP) | -4.2 | -5.1 | -3.0 | -2.8 |
| Current account (% GDP) | -0.7 | -3.6 | -1.2 | -2.1 |
| Government debt (% GDP) | 85.0 | 116.2 | 89.4 | 77.5 |

Source: BBVA Research.

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# Argentina Economic Outlook

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Creating Opportunities