Argentina
Economic Outlook

3Q20

July 2020
Key points

- The global environment continues to be marked by the spread of the COVID-19 pandemic, which has been contained through different health policy strategies, most successfully so far in Asia and Europe. Global growth has been adjusted downward from -2.4% to -3.2%.

- The Argentinean economy has been damaged more than expected by the pandemic and by the measures taken to curb it, so we have adjusted GDP growth for 2020 downward to -14% from -11%. By 2021 we expect a 5.2% rebound, relatively low given the magnitude of the previous drop.

- Unemployment is expected to rise to 18.6% in 2020, with the greatest impact being on the informal sector and on the activities that are least capable of adapting to digitization. Between 1.5 and 2 million jobs could be lost this year, more than half of which are informal.

- The fiscal deficit will reach 7.5% of GDP as a result of weak tax revenues caused by the recession, while primary expenditure will continue to rise to mitigate the contractionary impact of the lockdown.

- As the only way to finance the public deficit is monetary issuance, a major monetary overhang is growing. Thus, the Central Bank of Argentina (BCRA) will have to deal with it in 2H20, probably raising the policy rate to 40% by December 2020 (previous forecast: 35%).
Key points

- The Argentine peso appreciated by 9% in the year, and as the trade surplus is the only source of US dollars for the country, we expect further depreciation in the exchange rate in the 2H20. **We have raised the December 2020 forecast for ARS/USD from 86 to 90 and for December 2021 from 110 to 120.**

- Inflation is being kept in check by the sharp recession, the frozen utility prices and exchange-rate restrictions. Nevertheless, **we maintain our forecast for 2020 at 47% due to the higher depreciation expected in the coming months.** For 2021, we have increased our forecast to 50% due to the expected lagged impact of the current monetary overhang.

- **We are at a crucial stage in the debt restructuring saga.** The government made an offer that is acceptable to a more significant number of creditors, which **could obtain around 50% consent (in an optimistic scenario).** But it has yet to convince the majority bondholders’ committee. We believe that the Government will improve this latest offer to garner the consent of that group and move toward the acceptance threshold needed to trigger the CACs and swap all eligible bonds.

- The post-pandemic challenges are very significant, because they involve not only stabilizing measures but also necessary structural reforms. Although the economic environment is dominated by debt negotiation and the pandemic, it is essential for the Government to announce a consistent economic plan which can help to better anchor expectations coupled with structural reforms that increase Argentina's productivity and potential growth.
Global environment 3Q20
Pandemic continues to spread, particularly in the Americas and South Asia, despite the drop in infections in Europe and East Asia

China’s approach (shock and an immediate and short lockdown to eradicate the virus), which was expected to be the model for other regions, is not being repeated in other countries.

Europe has brought down the number of cases very significantly with a view to living with the virus at tolerable levels, but because it has not fully eliminated the virus, a complete return to normal economic activity looks to be more challenging.

Other regions (USA, LatAm and India, among others) are at earlier stages of the pandemic and have adopted a variety of strategies.
Despite being at different stages of the pandemic and having different policies to tackle it, national economies have started lifting lockdowns.

COMMUTING INDICATOR (*)
(HIGHER VALUES INDICATE GREATER MOBILITY: 0 = PRE-COVID MOBILITY; -1 = TOTAL ABSENCE OF MOBILITY)

(*) The mobility indicator reflects the trends in mobility compared with the baseline period (January 3 through February 6). Current situation: Average for the last 7 days through to June 29. Minimum since February: Lowest seven-day moving average since the beginning of February.
Source: BBVA Research based on Google Mobility Reports.
Activity indicators suggest economy will take time to return to normal

RETAIL SALES AND INDUSTRIAL OUTPUT (*)
(INDICES: DECEMBER 2019 = 100, SEASONALLY ADJUSTED DATA)

(*) In the case of the Eurozone, industrial output data for May represent the (weighted) average monthly growth of Germany, Spain, France and Italy. As regards emerging countries, the data reflect the simple average of the data for Mexico, Brazil, Russia, Singapore and Turkey. In this case, the June data include the partial information available.
Source: BBVA Research based on data from Haver
Growth forecasts for 2020 have been adjusted downward and for 2021 upward, with higher cumulative product losses in the two-year period.

**United States**
- Current 2020 (%): -7
- Current 2021 (%): 3.5
- Previous (%): 2

**China**
- Current 2020 (%): -8.5
- Current 2021 (%): 5.8
- Previous (%): 1

**Eurozone**
- Current 2020 (%): -11
- Current 2021 (%): 5.8
- Previous (%): 2.2

**World**
- Current 2020 (%): -3.1
- Current 2021 (%): 5.1
- Previous (%): -2.4

GDP growth: forecasts
Source: BBVA Research
Weak global demand will keep the price of oil in check, helping to offset potential supply pressures

**OIL (BRENT) AND INFLATION**
*(OIL: (DOLLARS PER BARREL, ANNUAL AVERAGE; INFLATION: YOY %, EOP)*

Source: BBVA Research
Argentina Economic Outlook 3Q20
The COVID-19 had an initial limited impact, but is currently increasing in the most populated areas...

NEW DAILY INFECTED IN ARGENTINA
(# OF CASES)

RETAIL MOBILITY RATES (% DAILY CHANGE, 7D AVERAGE, BASELINE = DAILY AVERAGE BETWEEN JANUARY 3 AND FEBRUARY 6)

The number of infections has not yet peaked, and the Government is trying to flatten the curve, with the strictest lockdown in the Buenos Aires Metropolitan Area (AMBA) and some cities in the rest of the country.
... where almost 50% of Argentina’s GDP is concentrated

- Intensive care bed occupancy rate for all types of illness is growing rapidly in the AMBA, reaching 60%.
- Concerns about overloading the health system (mainly in the AMBA) prompted the Government to impose stricter and more extensive social distancing measures.
- Strategy of extending the lockdown and restricting non-essential activities has born acceptable results so far in terms of infections but has had a high cost in economic terms.
- Exiting the crisis will therefore take place at various speeds depending on how early and extensively the lockdown is relaxed.

Source: Argentine National Institute of Statistics and Censuses (INDEC), Google and BBVA Research
Overall drop in activity, which is only moderate in some sectors…

MONTHLY ECONOMIC ACTIVITY ESTIMATOR (EMAE)
(CUMULATIVE YOY % CHANGE)

Source: BBVA Research based on data from INDEC

BBVA RESEARCH DAILY CONSUMPTION INDICATOR
(CARD CONSUMPTION, YOY %, 7D MOV. AVERAGE)

Source: BBVA Research
…of an economy that is going through its third year of recession

After the higher than expected 4.8% seasonally adjusted drop in 1Q20, and given the highly negative figures for 2Q20, in the midst of the lockdown, we estimate that GDP will plummet by 16.5% (seasonally adjusted) in 2Q20 followed by a modest 3.6% growth (seasonally adjusted) in 3Q20.

High frequency data show that the decline in consumption decelerated in June, in line with our view.

Recovery will be weak in 2021, depending on the macro vulnerability and idle production resources resulting from the quarantine. Propensity to consume will be affected by new habits acquired during the pandemic.

COMPARISON OF RECESSIONS
(100 = GDP AT THE BEGINNING OF RECESSION)

Source: BBVA Research based on data from INDEC.
Sharp decline in 2020 followed by an “statistical” recovery in 2021

- Extension of the total lockdown throughout July led us to adjust the expected drop in activity.
- Healthcare strategy has had acceptable results so far in terms of infection and death rates, but at a high price in economic terms.
- We forecast 5.2% growth for next year, with a strong carry-over effect of (3.7 pp) from 2020, but performance will be lackluster.
- Risks: the balance is skewed downward by the likelihood of a second outbreak in the AMBA or along the border with Brazil.

GDP: CURRENT AND PREVIOUS FORECAST
(QUARTERLY % CHANGE (SEASONALLY ADJUSTED); YOY % CHANGE REAL GDP)

Source: BBVA Research based on data from INDEC
Collapse in activity will lead to unemployment, affecting the most vulnerable sectors

**IMPACT OF UNEMPLOYMENT PER LABOR SECTOR (AMOUNTS IN THOUSANDS)**

- Private sector employees: -422
- Public sector employees: -45
- Self-employed workers: -278
- Other enrolled workers: -119
- Informal workers: -1,181

**UNEMPLOYMENT: CURRENT AND PREVIOUS FORECAST (ANNUAL UNEMPLOYMENT RATE)**

- 2019: 9.8%
- 2020: 18.6% (COVID-19 effect: 10.4%)
- 2021: 16.2% (COVID-19 effect: 6.4%)
- 2022: 13.6% (COVID-19 effect: 4.5%)

Source: BBVA Research based on data from Ministry of Labor and INDEC
Pandemic widens fiscal deficit: recession causes tax revenues to shrink, while lockdown measures spark a surge in primary expenditure

In 1H20, tax revenue fell by 14% YOY in real terms. As of May, the fiscal deficit was already 2.3% of GDP.
Ramifications of COVID were worse than expected, severely eroding the fiscal balance

Despite the limited fiscal room, the primary deficit in 2020 as % of GDP will be the worst in the last 45 years.

The countercyclical measures accumulated a fiscal cost of 2.9% of GDP until now, and are estimated to cost around 4% of GDP in 2020.

Since the debt market is closed off to the country, this imbalance is being financed through money creation.

The BCRA’s monetary assistance to the Treasury could reach up to 8.4% of GDP in the year, of which some 4 pp of GDP remain for 2H20.

Source: Ministry of Finance
Money issuance is the only source of financing available to the Treasury in the current context...

**MONETARY BASE**
(ARS BILLION)

**MONETARY ASSISTANCE TO THE TREASURY**
(12M CUMULATIVE, % GDP)

Source: BCRA.
Source: BCRA and INDEC.
… the BCRA seeks to absorb part of this issuance, taking its interest-bearing liabilities to worryingly high levels.

**MARKET AND MONETARY POLICY RATES**  
(% ANNUAL NOMINAL RATE)

**BCRA'S INTEREST-BEARING LIABILITIES AND NET INTERNATIONAL RESERVES**  
(% OF GDP)

*Note: All BCRA securities are included: Repos, LELIQ, LEBAC, NOBAC and NOCOM.  
Source: BBVA Research, BCRA and INDEC*
It is expected that significant money creation will still be needed over the rest of the year, generating a significant monetary overhang.

There will still be a need to create money amounting to at least 5.5% of GDP over the 2H20.

Throughout 2020, the monetary financing for the Treasury and interests on BCRA’s liabilities will sum nearly ARS 3 trillion (10.7% of GDP), representing 177% of the monetary base stock as of December 2019.

It will be crucial to redress this monetary overhang once the health crisis has been overcome.

The risk of inflation accelerating will be high by the end of the quarantine.
Monetary shock caused parallel exchange rates to shoot up, while the BCRA intervened to slow the depreciation of the official rate.
Wider FX premium encouraged the usual over-invoicing of imports and under-invoicing of exports, increasing the pressures on the official market.
Prices also “under lockdown”, for now

Low monthly inflation figures in recent months due to severe recession, frozen utility prices, FX controls.

We expect inflation to accelerate in the coming months because of the expected exchange rate jump that will probably occur in 2H20.

Monetary normalization following the pandemic crisis is the biggest challenge, given the risk of price acceleration in 2021.

Source: INDEC and BBVA Research
Non-virtuous adjustment of the trade balance continues, leading to a mild current account surplus

Less trade: exports drop by 21% YOY and imports by 29% YOY. The 2020 trade surplus will reach USD 16.7 billion.

Trade balance is barely enough to cover interest payments and other transfers.
Government made progress in normalizing the debt in ARS while restructuring US dollar bonds with private creditors. IMF pending

**COMPOSITION OF GROSS PUBLIC DEBT**
(USD BILLION)

- Debt w/ other public agencies: 323
- IFIS and IMF: 130.3
- Private creditors: 73.4

**COMPOSITION OF DEBT WITH PRIVATE CREDITORS AND HOW IT IS HANDLED BY THE GOVERNMENT**
(USD BILLION)

- ARS (26.0): refinancing in local market, honor maturities
- Letes USD (3.9): Exchange for ARS bonds
- Argentine-law bonds (65.5): current offer, in negotiation
- Foreign-law bonds (13.7): reprofiled until 31/12/20, “same treatment as foreign law”
- Others (10.1)

Source: BBVA Research and Ministry of Economy
Restructuring of USD bonds under foreign legislation: closer to a deal, but not yet there

**NET PRESENT VALUE OF THE RESTRUCTURING OFFERS BY THE ARGENTINE GOVERNMENT, PER BOND TO BE SWAPPED (Cents on the USD par value)**

<table>
<thead>
<tr>
<th>Original bond</th>
<th>Exit yield: 10%</th>
<th>Exit yield: 12%</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Current offer</td>
<td>Initial offer</td>
</tr>
<tr>
<td>Discount (swaps)</td>
<td>59.5</td>
<td>42.9</td>
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<tr>
<td>Par (swaps)</td>
<td>51.4</td>
<td>41.6</td>
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<tr>
<td>Global 2020–23</td>
<td>53.9</td>
<td>41.5</td>
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<tr>
<td>Global 2026–36</td>
<td>52.5</td>
<td>38.0</td>
</tr>
<tr>
<td>Global 2046–2117</td>
<td>51.6</td>
<td>38.3</td>
</tr>
<tr>
<td>Avg.</td>
<td>53.3</td>
<td>39.8</td>
</tr>
</tbody>
</table>

- Argentine government substantially improved its initial offer, coming closer to an agreement with the main creditors.
- The latest offer expires on August 4.
- It has already reached deals with some bondholders. But further improvements to the offer would be needed to reach an agreement with the main creditors’ committee.
- We believe that the Government will improve the offer in this sense, to achieve a majority swap during the July-August period.

Source: BBVA Research based on data from Ministry of Economy
Crisis spotlighted vulnerabilities of the Argentine economy

- Government has not yet announced an economic plan.
- Impact of the crisis further diverting the path of fiscal consolidation; progress must be made in the pension reform, tariff regularization and public spending efficiency.
- Increasing productivity is a priority to ensure the sustainability of the trade surplus without needing to cut imports.
- Limited trade openness and high labor costs accentuate the profile of low added value exports.

Source: BBVA Research and Ministry of Economy
# Macroeconomic forecasts

<table>
<thead>
<tr>
<th>ARGENTINA</th>
<th>2018</th>
<th>2019</th>
<th>2020f</th>
<th>2021f</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Base 2004 (% YOY)</td>
<td>-2.5</td>
<td>-2.2</td>
<td>-14.0</td>
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<tr>
<td>Inflation (% YOY, EOP)</td>
<td>47.6</td>
<td>53.8</td>
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<td>Exchange rate (vs USD, EOP)</td>
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<td>59.9</td>
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<td>Monetary policy rate (%, EOP)</td>
<td>59.3</td>
<td>55.0</td>
<td>40.0</td>
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<td>Private consumption (% YOY)</td>
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<td>Public consumption (% YOY)</td>
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<td>-2.6</td>
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<td>Investment (% YOY)</td>
<td>-5.7</td>
<td>-15.9</td>
<td>-34.5</td>
<td>15.6</td>
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<td>Primary fiscal balance(% of GDP)</td>
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<td>-0.4</td>
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<td>-3.5</td>
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<tr>
<td>Current account (% of GDP)</td>
<td>-5.1</td>
<td>-0.8</td>
<td>0.7</td>
<td>1.0</td>
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</table>
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