

Santiago Resico
Economist
sresico@tpcgco.com
+54 11 4898 6615

February 26, 2024

Provinces – Argentina

Provinces Strategy Flash

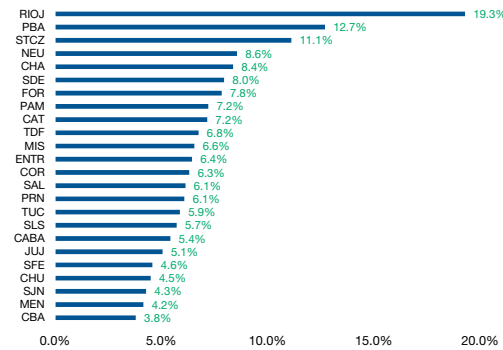
PBA suffers yet another blow to its fiscal position

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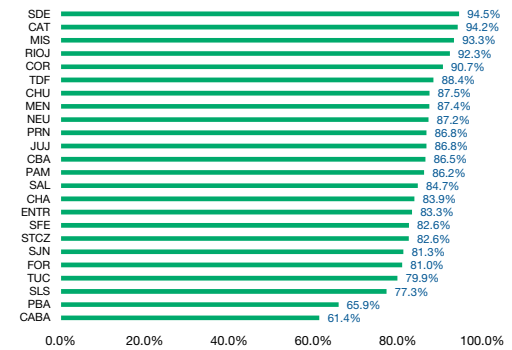
Earlier today, the national government eliminated PBA's Fiscal Strengthening fund, in a move that strains the province's fiscal position even further. This fund has been a controversial issue since its creation. Originated in 2020, amidst the COVID crisis, the national administration decided to take away a portion of the City of Buenos Aires coparticipation revenues, granting them to the province of Buenos Aires. This decision came on the back of police and security force strikes against PBA governor, Mr. Kiciloff, demanding for improved wages, and the fund was created to satisfy these claims, that is, to pay for operating expenditures of the province. The funds totaled nearly 3.5% of the revenues of the province in 2023, which represents around ARS250bn (USD846mn at the 2023 average official FX). The news could not have come at a worse time for the province, as just last week it phased in the newly created Municipal Strengthening Fund, which, as its name suggests, provides additional freely available funds for the PBA munis. This fund is bound to total ARS116bn (1.6% of revenues), with the first payment made on the 15th of February, while the rest of the fund is bound to be disbursed in 3 other installments, 30% before the 30th of April, 30% before the 31st of July and 30% before the 30th of October of the current year. In addition, the province must face, by the end of this week, the payment of its Eurobonds, having to service USD235mn in interest and USD118mn in amortization payments.

Figure 1: The news compound with massive cuts in discretionary transfers

Discr. Transfers as % of revenues | 2023



Real Cut in Disc. Transfers Jan-24 | %yoy



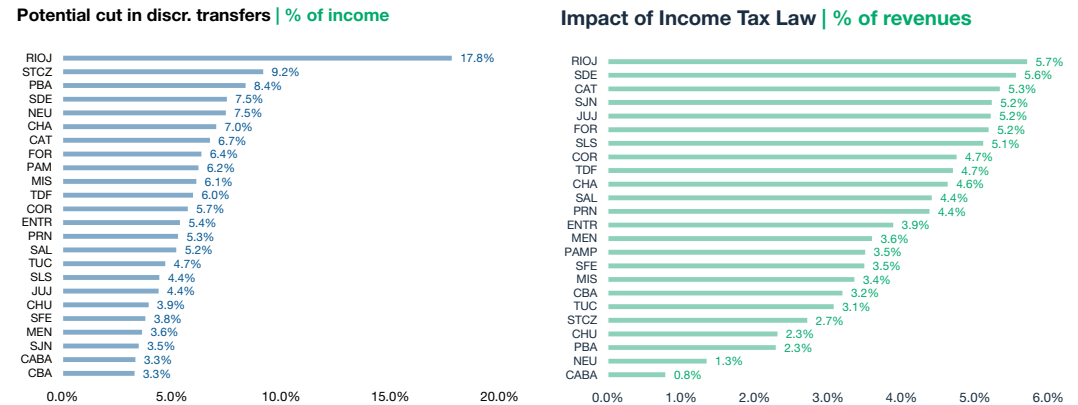
Source: TPCG Research based on Finance Ministry.

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This news compounded with an enlarging series of measures that are detrimental to the health of PBA's fiscal position, including a heavy trim in discretionary transfers, making them increasingly credit negative. While the latest news weighs heavily on the PBA's fiscal position, the administration is trying to get the entire provincial space in line with its austerity program, as it needs the entire balance of the consolidated public sector to be hawkish, to cleanse the fiscal position of the national government and to tame inflationary pressures going forward. In this context, discretionary transfers to provinces in January collapsed in real terms, shrinking by -79%yoy. While the effect was not even throughout the space, extrapolating the current reduction in transfers vs the relative weight of these in each of the province's balances, we find the most affected regions to be La Rioja (-17.8% of income sources) Santa Cruz (-9.2%) and PBA (-8.4%). This adds up with the income tax law, instated in 2023, which will also dent provincial balances. In addition, the jury is still out regarding the effect of the cuts in fiduciary funds and activity levels in provincial income. Compounding the mentioned factors above, in a scenario where the hostility

between the province and the national government continues, PBA is bound to lose 2.3% of its revenues due to the income tax law, 3.5% of its revenues due to the cuts in the Fiscal Strengthening fund, and another 8.4% due to cuts in discretionary transfers, if Mr. Milei does not decide to cut them off completely, as the province only suffered a -66% drop in real terms in January.

Figure 2: All of the major provincial income sources are bound to suffer



Source: TPCG Research based on Finance Ministry.

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In this context, we believe the composition of provincial income suggests provinces are bound to suffer the brunt of the national government's adjustment plan, portraying a bleak outlook going forward. Dissecting the composition of provincial income, the three main sources of revenue the provinces receive include: (i) Automatic Government transfers, originating from the Copa scheme and fiduciary funds, (ii) discretionary government transfers, and (iii) provincial tax revenues. We believe all three will suffer significant strain going forward. On automatic transfers, the national government is bent on trimming fiduciary funds, which support a significant portion of the provincial salary mass, including teachers and security forces, leaving the provinces to handle inflated payrolls, which they cannot fund, on their own. In addition, even if the National government does have some revenue lines indexed, such as export taxes, most coparticipable taxes are not, and are very sensitive to activity metrics, which have been suffering massively since December, meaning whatever the provinces are bound to receive from the copa scheme will be depressed relative to inflation. On the discretionary transfers side, as discussed above, the administration has the ability, and intention, to cut off a significant portion of them, while provincial revenues are also heavily reliant on activity levels, which will be hammered during 1H24. Furthermore, in relative terms, the provinces are bound to suffer some balance sheet effects, which will bloat their debt services in USD in relation to their ARS income sources, at least until inflation, and then tax revenues, catch up to the official FX devaluation. All in all, with all income sources bound to suffer significantly, most provinces will be faced with the unpleasant task of dialing back expenditure. While there have been some movements in that direction since the start of the year, it will come down to each governor to choose which lines to trim, in a context where the provinces have picked a row with the national government, one it is not certain they can win. For an in-depth view of the current state of the dispute between the national government and the provinces, please [click here](#).

TPCG Analysts & Staff

Research

Juan Manuel Pazos	Chief Economist	jmpazos@tpcgco.com	+54 11 4898-6606
Paula La Greca	Corporate Research Analyst	plagreca@tpcgco.com	+54 11 4898-6638
Santiago Resico	Economist	sresico@tpcgco.com	+54 11 4898-6615
Camila Sanchez Lauria	Research Analyst	csanchezlauria@tpcgco.com	+54 11 6616-9512

Sales & Trading

Juan Manuel Truppia	Head of Sales & Trading	jmtruppia@tpcgco.com	+54 11 4898-6659
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Institutional Sales

Lucia Rodriguez Pardina	S&T Director	lrodriguezpardina@tpcgco.com	+54 11 4898-6614
Agustina Guadalupe	Sales	aguadalupe@tpcgco.com	+54 11 4898-6682
Maria Pilar Hurtado	Sales	mhurtado@tpcgco.com	+54 11 4898-6616
Juan Ignacio Vergara	Sales	jivergara@tpcgco.com	+54 11 4898-1936
Santiago Baibiene	Sales	sbaibiene@tpcgco.com	+54 11 4898-6648
Pedro Nollmann	Sales	pnollmann@tpcgco.com	+54 11 4898-6617
María Ruiz de Castroviejo Salas	Sales	mruidecastroviejo@tpcgco.com	+54 11 4898-6643
Santiago Jauregui	Sales	sjauregui@tpcgco.com	+598 9933-9495
Victoria Faynbloch	Desk Analyst	vfaynbloch@tpcgco.com	+54 11 4898-6635

Trading

Felipe Freire	Trader	ffreire@tpcgco.com	+54 11 4898-1921
Homero Fernandez Bianco	Trader	hfbianco@tpcgco.com	+54 11 4898-6667
Andres Robertson	Trader	arobertson@tpcgco.com	+54 11 4898-6693

Corporate Finance

José Ramos	Head of Corporate Finance	jramos@tpcgco.com	+54 11 4898-6645
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Corporate Sales

Camila Martinez	Corporate Sales Director	cmartinez@tpcgco.com	+54 11 4898-6621
Fernando Depierre	Corporate Sales	fdepierre@tpcgco.com	+54 11 4898-6636
Sol Silvestrini	Corporate Sales	ssilvestrini@tpcgco.com	+54 11 4898-6641
Nicolas Iglesias	Corporate Sales	niglesias@tpcgco.com	+54 11 4898-6612

Capital markets

Nicolás Alperín	DCM	nalperin@tpcgco.com	+54 11 4898-6604
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Wealth Management

Josefina Guerrero	Private Wealth Management Specialist	jguerrero@tpcgco.com	+54 9 11 6556 2401
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Asset Management

Ileana Aiello	Portfolio Manager	iaiello@tpcgco.com	+54 11 4898-6611
Claudio Achaerandio	Portfolio Manager	cachaerandio@tpcgco.com	+54 11 4898-6618

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