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Strategy – Argentina

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Argentina Strategy Flash

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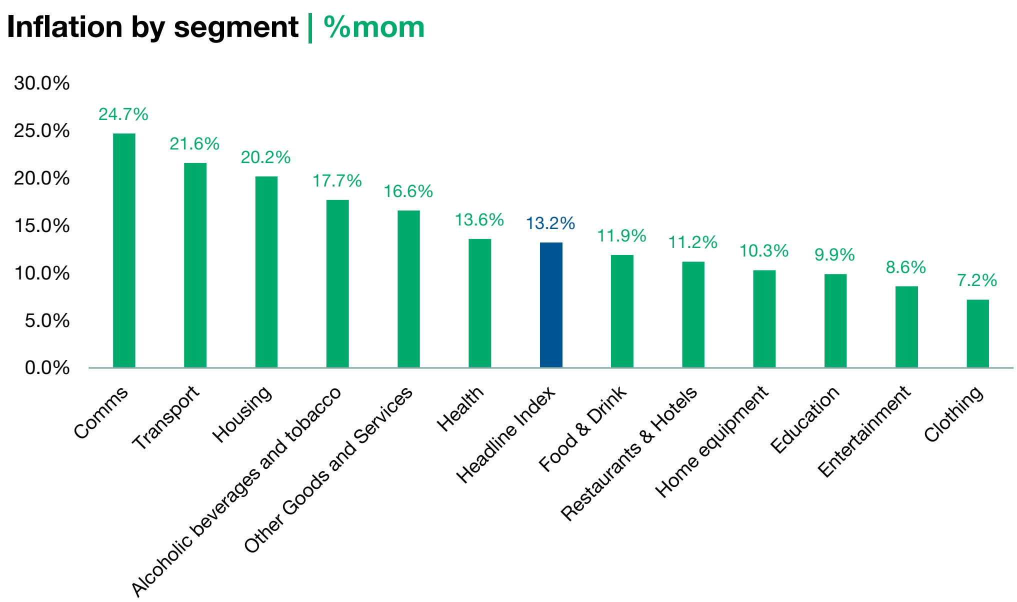
Figure 1: Regulated prices drove the February print



Source: TPCG Research based on Indec

The print was primarily driven by the Regulated subsection of the index, which clocked in at +21.1%mom in February.

The print was primarily driven by the Regulated subsection of the index, which clocked in at +21.1%mom in February. Regulated prices saw a significant surge during February and were the main driver behind the monthly increase. In turn, this rise can be explained by the start of the administration's plan to phase out energy subsidies, as last month was the first to experience some of the expected tariff increases in water, natural gas, and electricity. Furthermore, the increase in public transportation resulted in a significant hike in the segment, as the government also moved forward to reduce subsidies on that front as well, amidst the start of its rift with the provincial governors. In addition, this compounded with an increase in the telco subsection, bloating the regulated index. In this context, while the regulated index clocked in at +21.1%mom, Comms came in at +24.7%mom, Transport at +21.6%mom and Housing, Water Electricity, and Gas at +20.2%mom surpassing the headline index by a wide margin. Excluding the hike in Regulated prices, the price increases in the rest of the subsections were nearly consistent with a one-digit print, on behalf of the high contribution of the segment to headline CPI. However, the phasing out of subsidies had a very heterogeneous impact throughout regions. While in the Gran Buenos Aires area, the measure was very significant, as most subsidies were concentrated there, and therefore the phasing out had a major impact on prices, the effect on the rest of the regions was half of that in GBA, on behalf of these areas receiving less subsidies, and therefore facing less abrupt hikes in prices. This generated a strong dispersion in the CPI print, with the headline index variation for GBA coming in 3.14pp over the rest of the region's average, explained almost exclusively to the high sensitivity the area has to reductions in subsidies. In GBA, Regulated prices contributed 4.54pp of the monthly print, while, on average, in the rest of the regions the subsections' contribution came in at 2.40pp.

Figure 2: The effect of subsidy cuts hit harder in the GBA area

%mom	National	GBA	Pampas	Northeast	Northwest	Cuyo	Patagonia
Headline Index	13.2	15	11.9	10.9	11.7	13.5	11.3
Food & Drink	11.9	13.4	11.2	8.7	9.4	12	9.7
Alcoholic beverages and tobacco	17.7	18.6	17.2	16.3	15.3	15.7	19.8
Clothing	7.2	6.7	7.3	10.8	6.6	8.3	9.2
Housing	20.2	22.9	15	13.2	27.4	28.8	14.7
Home equipment	10.3	10	10.9	9	10.6	10.2	10.6
Health	13.6	15	12.9	13	11.6	11.9	12.4
Transport	21.6	32.8	13.9	13.2	17.3	15.3	11.2
Comms	24.7	25	25.7	23.2	20.7	22.8	24.2
Entertainment	8.6	8.7	8	10.4	8.4	9.8	8.3
Education	9.9	14.9	2.3	24.3	2.1	4.9	8.2
Restaurants & Hotels	11.2	9.9	11.9	10.5	12.9	15.1	10.9
Other Goods and Services	16.6	14.8	17.3	14.3	18.3	22	22

Contribution to montlhy print, in pp	GBA	Pampas	Northeast	Northwest	Cuyo	Patagonia
Headline Index	15.0	11.9	10.9	11.7	13.5	11.3
Food & Drink	3.8	3.7	3.5	3.7	4.0	3.1
Alcoholic beverages and tobacco	0.5	0.5	0.5	0.4	0.4	0.5
Clothing	0.6	0.7	1.0	0.7	0.8	1.1
Housing	1.4	0.7	0.8	1.3	1.6	0.9
Home equipment	0.7	0.7	0.7	0.7	0.7	0.8
Health	1.4	1.2	0.8	0.9	1.1	0.7
Transport	3.4	1.6	1.4	1.4	2.1	1.9
Comms	0.5	0.5	0.5	0.4	0.4	0.5
Entertainment	0.7	0.6	0.6	0.4	0.6	0.6
Education	0.3	0.0	0.1	0.0	0.1	0.1
Restaurants & Hotels	1.2	1.0	0.5	1.1	1.1	0.6
Other Goods and Services	0.6	0.6	0.5	0.7	0.8	0.7

Source: TPCG Research based on Indec

While regulated prices experienced a strong surge, the lower-than-expected headline print was explained by the softness of the Core and Seasonal components of the index.

While regulated prices experienced a strong surge, the lower-than-expected headline print was explained by the softness of the Core and Seasonal components of the index. These two subsections clocked in at +8.7%mom and +12.3%mom, respectively, surprising on the downside, and were the main driver behind the solid print. We find two drivers behind the relative weakness of the core indicator, which came 0.9pp under the headline index. The first is the massive drop in activity levels, which is hammering down consumption. High-frequency activity indicators suggest that the economy is deaccelerating significantly, albeit at different paces. Retail sales of key consumption goods are dropping at a pace of roughly -6-7%, while retail sales of non-essentials are falling at a pace of -13-15%. Durable goods purchases are faring even worse, weakening at a -20% pace since December, while construction and heavy-duty industries are receding by -30%. With demand weakening significantly, it is no surprise that goods prices are unable to maintain the inflationary inertia, while services do continue to show additional momentum. The former clocked in at +11.9%mom, while the latter did at +17.6%. In our view, this signals that businesses are being unable to pass through the price increases in services to goods, responding to the weakened condition of the demand. Furthermore, the fact that the passthrough from goods to services is limited also suggests the passthrough from the December devaluation is also coming to an end. The fall in activity levels has reduced the sensitivity of prices to increases in both services and the FX significantly, which is a piece of auspicious news for the administration, as the cost of performing an FX correction in the current scenario seems to be falling significantly, requiring less sacrifice on the inflationary front in the near future.

Figure 3: Activity levels are anchoring core components

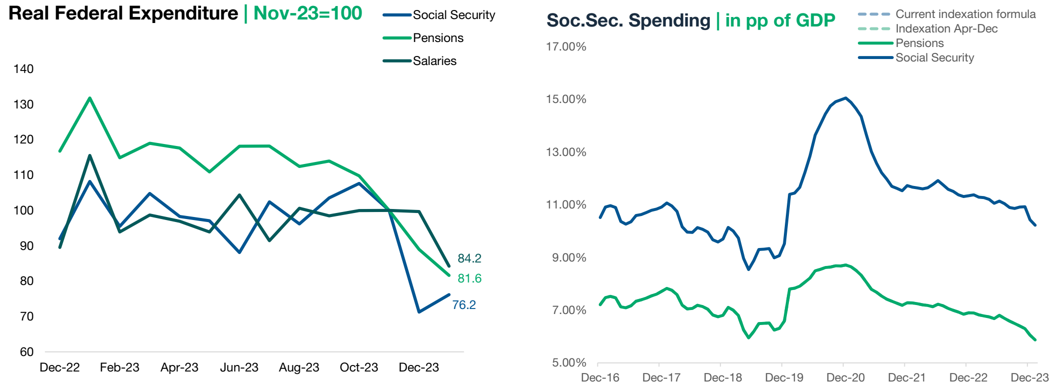
	%yoy						%mom SA					
	1H23	3Q23	4Q23	dec-23	jan-24	feb-24	1H23	3Q23	4Q23	dec-23	jan-24	feb-24
Overall Activity												
Economic Activity Indicator	-2.0%	-0.8%	-1.5%	-4.5%	-	-	-0.4%	2.5%	-1.9%	-3.1%	-	-
Industry												
IPI (Fiel)	-0.7%	-1.8%	-2.0%	-5.6%	-6.3%	-	0.4%	-1.4%	-2.9%	-4.0%	-0.9%	-
IPI (Indec)	1.3%	-3.5%	-5.9%	-12.8%	-12.4%	-	0.0%	-2.9%	-4.6%	-6.7%	1.4%	-
Construction												
ISAC	-2.1%	-4.4%	-3.3%	-12.2%	-21.7%	-	0.8%	-2.8%	-5.5%	-9.4%	-10.2%	-
Cement Sales	0.9%	-5.4%	-8.0%	-13.3%	-20.0%	-	0.9%	-5.0%	-7.5%	-3.6%	-1.8%	-
Construya Index	-8.2%	-9.9%	-4.9%	-17.4%	-35.2%	-25.6%	3.0%	-3.7%	-4.8%	-14.8%	-18.1%	6.8%
Consumption												
Car Registration	12.2%	4.2%	12.1%	-5.8%	-32.7%	-	1.3%	-3.1%	1.1%	-8.9%	-34.5%	-
Car Sales	14.1%	12.1%	-6.1%	-25.2%	-27.9%	10.3%	3.8%	-5.6%	-10.2%	-21.3%	-0.9%	63.1%
Shopping Sales	12.8%	14.9%	10.5%	-0.4%	-	-	6.5%	-14.1%	-10.6%	-13.1%	-	-
Supermarket Sales	1.4%	2.0%	-0.8%	-6.6%	-	-	0.0%	2.2%	-3.0%	-6.3%	-	-
Consumer Confidence	1.1%	20.2%	24.1%	10.9%	-7.6%	-0.4%	2.5%	4.8%	2.3%	-14.0%	-12.4%	4.7%
VAT	7.8%	16.4%	2.6%	0.2%	8.3%	1.2%	1.8%	1.6%	-8.2%	-0.8%	5.3%	-4.4%
Debits and Credits Tax	1.5%	-0.5%	0.6%	-13.2%	-16.1%	-4.1%	0.3%	-2.3%	-2.1%	-13.2%	-3.9%	12.8%
Fuel sales	5.8%	2.3%	3.8%	0.0%	-6.1%	-	2.2%	-5.2%	-2.6%	-7.4%	-0.1%	-

Source: TPCG Research based on Indec, FIEL, ACCARA, AFIP, CONSTRUYA, Di Tella University, Economy Ministry

Going forward, further deacceleration of monthly inflation in March will largely depend on a weak Core component, as Seasonal prices are bound to surge, while Regulated prices should continue to experience significant increases.

Going forward, further deacceleration of monthly inflation in March will largely depend on a weak Core component, as Seasonal prices are bound to surge, while Regulated prices should continue to experience significant increases. While the path of inflation up to now has been a steady descent since December, March comes as the first test to the continuous monthly deacceleration. This mainly comes on the back of March being a month with a strong seasonal component, segment which has been mostly depressed since the start of the year. In addition to a hard seasonal print, the administration is continuing to implement its subsidy phase-out, which means further hikes in electricity, gas, and water tariffs. In conjunction, these two subsections should put a significant strain on the Headline index. Still, March's monthly print could come below February's, but this will largely rely on Core prices to continue depressed. We expect this to be the case, as we find the administration's policy bias to be consistent with weaker activity levels. In that sense, the government confirmed that it used the same fiscal strategy in February as it did in January, meaning that the bias of the fiscal policy will continue to be severely hawkish, as the administration compresses outlays by relying on brute force. In addition, the administration is keeping salary negotiations in check, not allowing for significant recoveries in real wages. This compounds with the now-known fact that even with the increases envisaged by the current Soc.Sec indexation formula, which will yield a 27.18% increase in pensions and plans, in real terms Soc.Sec outlays will drop by -25.8% relative to Nov-23, marking an extremely hawkish income policy bias by the administration. This policy mix is consistent with a further weakening of activity levels going forward, which should allow the core component to remain soft. Finally, the fact that the administration is planning on sticking to the current 2% monthly crawling peg in the FX market means that it will allow to keep tradeable prices anchored. So, all in all, we believe the policy bias of the government is consistent with March's monthly inflation coming below February's. However, the softness of the Core component might not be enough to keep the monthly gauge from exceeding February's, which is what is currently priced in market expectations.

Figure 4: The administration's hawkish bias supports desinflation

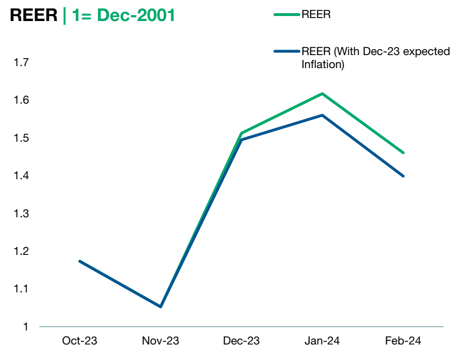


Source: TPCG Research based on the Treasury

We find the weaker-than-expected print is providing some assistance to an appreciating REER. However, it does not look enough to make current levels sustainable.

We find the weaker-than-expected print is providing some assistance to an appreciating REER. However, it does not look enough to make current levels sustainable. The fact that inflation is clocking systematically under market expectations gives the administration some maneuvering room in the REER department. Initially, market estimates envisaged that by March, the REER would be back to its pre-devaluation level. However, with inflation surprising on the downside, REER levels are +4.2% weaker than initially foreseen. This provides the administration with an extra buffer to weather the storm. We find current REER levels to be adequate. However, Services prices have been accelerating significantly, and February's print confirms that the acceleration is surpassing comfortably the increase in goods prices. This, compounded with the robust performance of the FX makes services prices in USD increasingly expensive. The key issue the administration will run into is the fact that the FX appreciation is currently sitting on its toolbox to combat inflation, as it has been an important asset to tame price pressures, especially paired with the recession. The consistency issue here is that, if the administration plans to correct the FX framework and establish a REER to accumulate NIR, then it cannot use the FX to combat inflation, as current REER levels are not consistent with NIR accumulation, once import arrears are factored in. The administration cannot simultaneously use the FX to anchor tradeable prices with an appreciation while correcting the REER to net reserve accumulation levels. And while seasonal flows will be very kind to the FX framework during 1H24, the administration must design a plan to avoid a skip in the FX in 2H24, when agri-flows dry up and are unable to support the currency. Such a scenario could turn into a headache for the administration, as it could spark new inflationary pressures, which could jeopardize the government's crucial objective of taming the CPI index, which has massive political importance.

Figure 5: The administration still has to look into REER sustainability



		In today's ARS	Deval/Reval to reach	Capital Controls
Official FX (Feb-24 Average)		834.6	-	YES
BCS (Feb-24 Average)		1178.5	-29.2%	YES
Average REER under Mr. Fernandez	Official FX	777.6	7.3%	YES
	BCS	1543.8	-45.9%	
Weakest REER under Mr. Fernandez	Official FX	882.6	-5.4%	YES
	BCS	2002.9	-58.3%	
Average REER under Mr. Macri	Official FX	675.3	23.6%	NO
Average REER under CFK (II)	Official FX	568.7	46.8%	YES
	BCS	881.0	-5.3%	
Average REER under CFK (I)	Official FX	770.4	8.3%	NO
Average REER under Mr. Kirchner	Official FX	1114.5	-25.1%	NO
Average REER under Mr. Duhalde	Official FX	1369.5	-39.1%	Mild
Average REER under the "Convertibilidad"	Official FX	610.1	36.8%	NO
Average REER in 1970-80's (Macro Instability)	Official FX	831.3	0.4%	YES
	BCS	1119.2	-25.4%	

Source: TPCG Research based on the BCRA

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