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WARLIKE CONFLICTS CAN HINDER GLOBAL RECOVERY

Fulfilling -for the first time- one of his pre-election promises, President Trump decided in only a few days, to bet heavily on defense issues. War concerns have lastly thus moved to the forefront. This was the main reason why global markets failed to celebrate the signs of a synchronized recovery of the global economy.

Because of these and other reasons the dollar depreciated, the US bonds rose, and the same happened with gold and oil. The soybean fell because of the great South American crops. There were ups and downs in the stock markets. The most profitable assets since the election of Trump have been the oil and the stock exchanges of Argentina and Europe. The most punished, slightly, have been soy, the euro and the yen. The risk of emerging bonds is now slightly lower than at the beginning of the Trump era.

There are several threats that could invalidate The Economist's optimistic forecast about the synchronized recovery of the global economy. First and foremost, a worsening situation in the Middle East or with North Korea. Second, but important, a ballotage in France between Marie Le Pen and Jean-Luc Melenchon. Third, for Trump to carry out some of its strong protectionism projects or to fulfill its promises of an infrastructure boom, pressing an already tense job market, with unemployment at 4.5%, and for the Fed to respond by accelerating the increase of the interest rate.

Economic conditions are given for a faster growth cycle of the global economy, closer to 4% than 3%. Threats are bellicose or political (France, corruption in Brazil), not economic. This would help the Argentine economy to also approach 4% growth this year. These days are complex and caution is advisable.

Regional panorama: in search of lost growth in Latin America

The region lost, five years ago, the pace of growth it had maintained since 2002. There is no super-cycle of raw materials any more. Pacific countries are ahead of a more recessive Atlantic. The country risk level is heterogeneous in the region. The Alliance for the Pacific is presented less strongly by the lack of American interest in the project. Mercosur is in the process of re-launching, once again.

Brazil leaves moderately two very bad years. It continues with low inflation and the fiscal adjustment is in course. Its level of competitiveness lags behind and has been further complicated by corruption scandals.

As for the rest of the main countries, Mexico is attentive by the protectionist policy of Trump and the growth is moderate with a stable dollar. Colombia, in the March of the complex peace process, continues with good growth and direct foreign investment. Chile is rethinking its model of growth towards a greater diversification of exports, with a university system and pension funds that are being questioned. Peru, the star of the region, is still a poor country of us$ 8000 per capita but with interesting potential. Ecuador opted for political continuity and the rise of oil poses a good scenario. Bolivia continues with a good growth rate and the dollar is very stable, without tensions between Santa Cruz and La Paz, which is positive. Uruguay has slowed its growth pace but pulp projects can boost the economy. Paraguay remains firm in its agricultural model based on soy and meat although populist and feudal positions are debated. Venezuela is on the edge of political tension with an enormous influx of emigrants and near economic collapse, characterized by a compromised supply of goods and inflation, which continues growing, and is about hyperinflation.

In short, there is currently a lot of heterogeneity among the countries of the region, but with favorable results for those who have followed rational pro-growth policies.

Internal panorama: The economy trends to a moderate growth with a "taste" of draw

The Argentine economy is crossing an external shock related to a marked decrease in the demand for exports. This imbalance must be offset by a rise in consumption and investment. The delay in consumption has continued in the first quarter and the future of investment is associated with the political electoral cycle.

The indicators of activity are not very encouraging although technically the recession has been overcome. The public work contributes to the investment and has been strengthened. Gross investment is at a level of 15% of GDP, well below the average for emerging countries. Direct foreign investment is not very significant.

Inflation is easing but the government must compensate for the imbalance of the first quarter due to, among other things, the increase in tariffs. The government continues with the policies of control of prices and purchases in quotas, institutions inherited from the previous government. Core inflation continues to be a concern and efforts are being made to mitigate with a higher interest rate.

The fiscal deficit continues without further developments. Money laundering has been very abundant and expresses confidence in the government. The amount of us$ 116 billion, a record figure in the international comparison, and has a positive impact on the activity of some sectors such as real estate.

As for the outlook on the exchange rate, the consensus is a gradual rise of the dollar up to 18 pesos by the end of the year.

In the labor and social front, the popular demands continue despite the moderate recovery of jobs. The poverty rate is still high and stands at 30%. Despite the government's social restraint and dialogue with the unions, on April 6 we had the first general strike. The estimated cost of it was us$ 1 billion.

For the next months a moderate rebound in the industry is expected. The harvest has good prospects although the floods can generate an estimated loss of us$ 5,000 million.

The tension between the interest rate and the level of activity will be a classic in these campaign months. 2017 has a taste of draw; we still expect growth.

Internal panorama: Industry expects to reverse an adverse 2016

The engines of growth in 2017 for the economy in general will be, among others, public works, agriculture and energy production. The industry will accompany but at a slower rate. The government forecast a growth of 3% for the manufacturing industry.

The industrial sector is facing a weak recovery, in search of sustained growth if competitiveness is restored. Almost all branches fell in 2016. The biggest lag was in durable consumer goods and the smallest drop in non-durable consumer goods and capital goods. The decline in GDP by sector was led by base metals, steel, automotive, non-metallic minerals and construction.

Installed industrial capacity is now 60%; this level is equivalent to the exit of the crisis in 2001. The high interest rate affects the financing of the investment and generates impacts in the payment chain and in the productive process, especially of SMEs.

There is a debate between openness and greater protection; a classic debate. The items with the largest increases in imported quantities were consumer goods and passenger car vehicles. There are sensitive sectors such as textiles, footwear and IT that are threatened by import flows.

The activity this year will depend on the international context, basically on the recovery of Brazil and the response of household consumption to the new relative prices. The recovery of the industry occurs within the demanding framework of recent costs. It is key to improve credit, business and tax for the industry to recover. For the consolidation of the government's growth model, it is essential that the industrial sector recovers its dynamism while increasing its competitiveness.

Internal panorama: Direct foreign investment is still far from potential

Foreign direct investment (FDI) in 2016 was approximately $6 billion and is estimated to reach us$ 8 billion by 2017. This investment is marginal for GDP growth but implies a foreign exchange income and a demonstration effect for the rest of the productive system. US investment leadership is still present and the FDI novelty -primarily commodity oriented- is China.

Local obstacles have inertia in our country. The lack of systemic competitiveness is manifested in the ranking of WEF where Argentina occupies the 104th position. There are issues in which progress is being made, but legal insecurity and the lack of clearer regulatory frameworks are factors that still influence the delay of FDI. The lower flow of trade in exports and imports also influences the lower FDI.

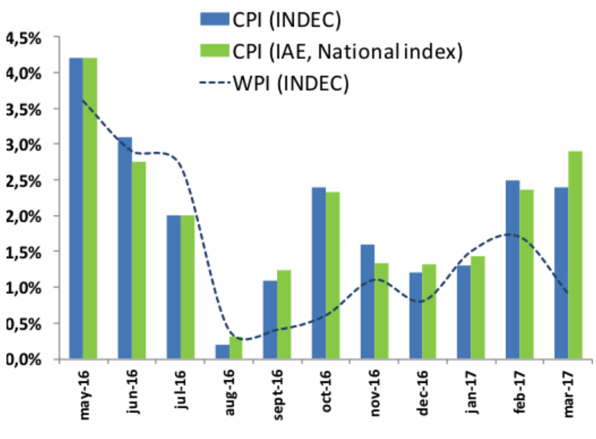
The election year generates uncertainty. If the ruling party won, it would give FDI more encouragement. The quasi-recessionary situation of recent years does not stimulate projects and in some sectors the exchange rate lag can be detrimental. With strong investor potential, among others, are the mining sector, conventional energy, shale gas and shale oil, renewable energy and modern services.

As reforms are tackled, FDI will consolidate, more in line with what happened in the 1990s. The recent meeting of the WEF in Buenos Aires rescues the relevance of each pillar of the competitiveness index as a key element of the control panel.

Prices

The first quarter showed a price growth higher than expected. Increases in electricity rates and fees in education kept prices rising above 2% MoM. In March, prices rose 2.4% in the AMBA and accumulated 6.3% so far this year. At the national level, the increase was somewhat higher (2.9%). However, in annual terms it continues to decline and stands at 31.2%. Although retail inflation accelerates, wholesale prices showed lower growth. In March, they increased by 0.9% MoM and stay below 20% in annual terms. The cost of construction slowed with a growth of 1.1% contained by the null increase in the cost of labor. In March, the first peers

Figure 1: Monthly inflation



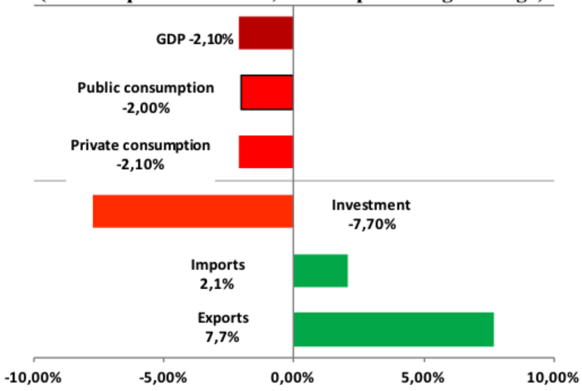
Source: INDEC and IAE.

were closed with salary increases of 20%, below expected inflation. For the coming months, inflation is expected to decline slightly, 1.9% in April and 1.6% in May, while annual inflation is forecast at 21.2% in December. Real wages will not recover significantly this year.

Economic activity

Data for the fourth quarter of 2016 showed a 2.1% decline in real GDP, ending the year at -2.3%. In seasonally-adjusted terms, however, it grew 0.5% for the second consecutive quarter, thus emerging from the "technical" recession. GDP per capita in dollars, on the other hand, grew almost 20% and finished at US$ 12,500. The beginning of 2017 showed an aggregate activity growth of 1.1% YoY on January, although regressing in seasonally adjusted terms. The good performance of industrial production at the end of 2016 was forgotten and the first months of 2017 show a strong decline. In annual terms, industrial activity fell by 6% in February. Automotive production continues to recede although sales to dealers continue on positive ground. Good data emerged in the steel industry and in the construction sector with an annual growth of 23.5% and 11.2%, respectively, in March. Retail sales remain negative; In March fell 4.4% YoY and accumulated -3.7% in the first quarter. The exit from the recession seems to be taking longer than anticipated because of the difficult situation of the industrial sector. Although construction has already reacted and the steel industry as well, the great unknown are consumption and investment, that still do not respond. The momentum of construction and the agricultural sector will begin to be shown in the second quarter.

Figure 2: Components of GDP
(Fourth quarter of 2016, annual percentage change)



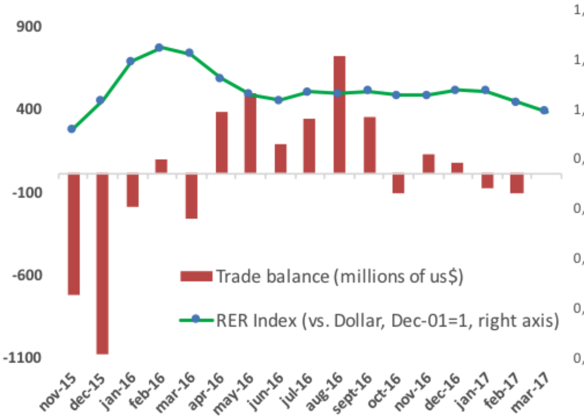
Source: INDEC.

Fiscal sector

In the second month of the year the fiscal deficit appeared again. The primary deficit grew 61% YoY and the financial result was a 46% more negative than in February 2016. In March, the improvement in tax revenues in real terms is explained by the contribution of money laundering. Tax collection registered an annual increase of 54% YoY. However, if the extraordinary income from money laundering was discounted, the increase was 32%, in line with annual inflation. Taxes linked to economic activity such as VAT grew 22.7% annual, below inflation. Money laundering ended at US$ 116.8 billion. It was the highest in Argentinian history and, in terms of GDP, it was the highest in the world as well (1.2% of GDP). Despite the deficit growth, the government will continue to boost public spending in order to finally pull the economy out of recession. However, in order to meet fiscal targets, it will be important to control primary expenditures as the economy is not yet arising, and extra money from bleaching will no longer be present.

External sector

Figure 3: Real Exchange Rate (RER) and Trade balance



Source: INDEC, BCRA, BLS and IAE.

Beyond the present war conflicts and their possible impact on the world economy, the Fed increased the rate by 0.25% to a range of 0.75 and 1 percent. Markets reacted positively, with increases in share prices, gold and other commodities. The US economy grew only 1.6% in 2016 (the worst performance in 5 years) although there was a rebound in the last quarter. In Europe, the UK formally initiated the Brexit process and begins to negotiate a free trade agreement with the EU. As for the Argentine economy, the trade balance in February showed a deficit of US $ 122 million due to the contraction of exports (-6.2% YoY) driven by Primary Products, which fell 14.5%. Despite the improvement in trade with Brazil (grew 18.3% YoY in March), the Argentine trade deficit reached US$ 703 million (the highest value for a month in March since 2006). The appreciation of the TCR continues and the indicator is already below the levels of the convertibility. For the coming months, the agricultural sector is expected to boost exports, which depend more on the recovery of Brazilian demand. Exchange appreciation will continue to push the trade deficit through growth in imports, particularly of consumer goods.

Monetary and Financial Sector

To face the acceleration of domestic prices and inflationary expectations, the BCRA tightened monetary policy. The monetary base contracted 7% MoM in real terms and the benchmark interest rate increased 1.5%, from 24.75% to 26.25%. Exchange rate policy continues with its nominal anchor role. In March, the nominal wholesale exchange rate averaged $15,524, which meant a 0.5% fall compared to February. International reserves grew by US$ 1,566 million in the first two weeks of April and already exceed US$ 52 billion. The Merval reached in the first days of April a new historical record when exceeded 20,800 bp, boosted by the success of money laundering and the improvement in credit rating by S&P. For the coming months, the Central Bank is expected to maintain a clear anti-inflationary bias in its policy, thus ensuring that the disinflation process continues towards its target. The priority in monetary policy is undoubtedly inflation, at least in the short term.