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Argentina’s Economic Outlook

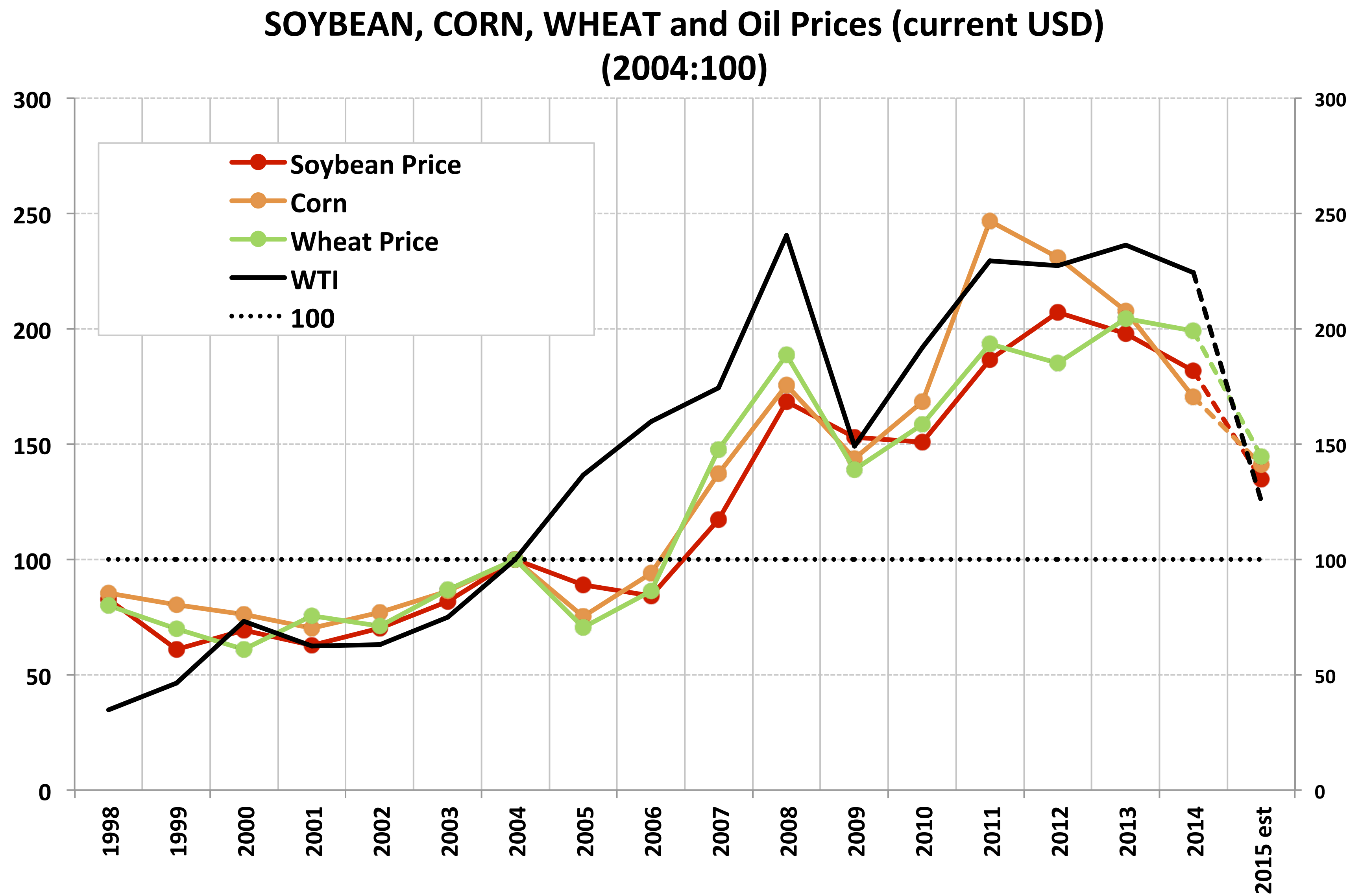
Unstable scenarios ahead

Juan Luis Bour

Council of the Americas

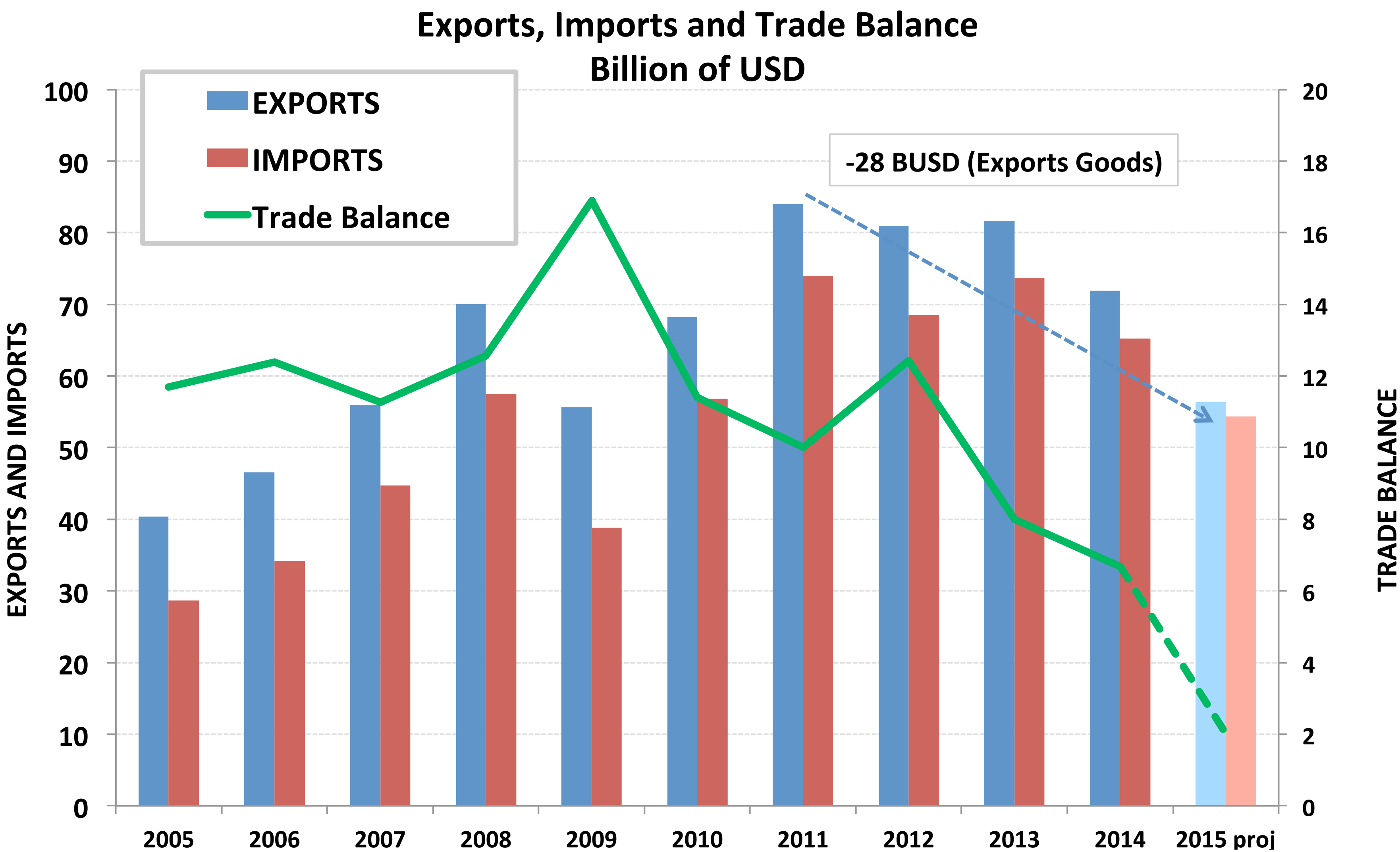
New York, April 23rd, 2015

Head winds from Brazil and low commodity prices
(with impact on trade and manufacturing production)

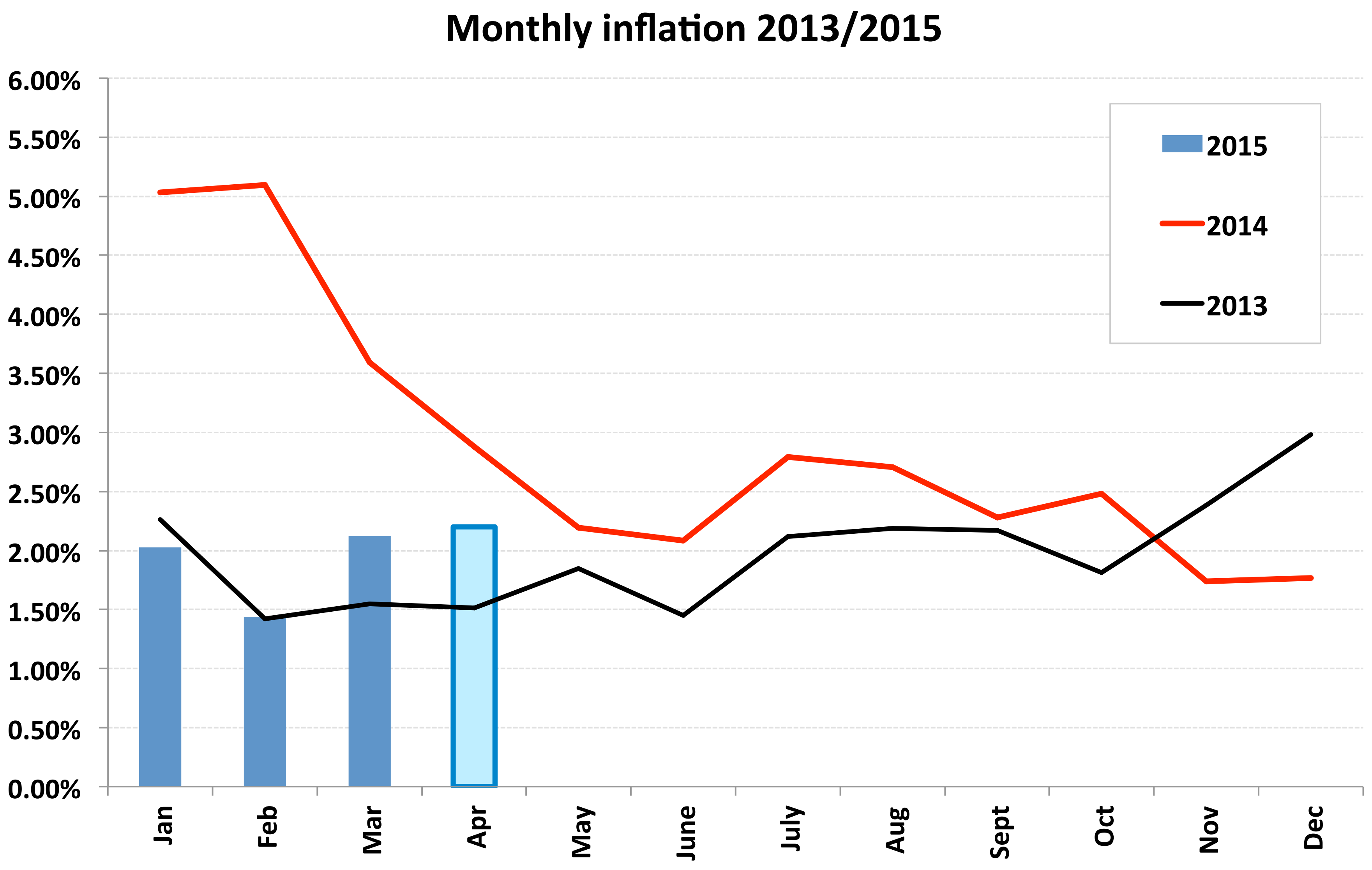


Exports (value) down 28 BUSD in 4 years

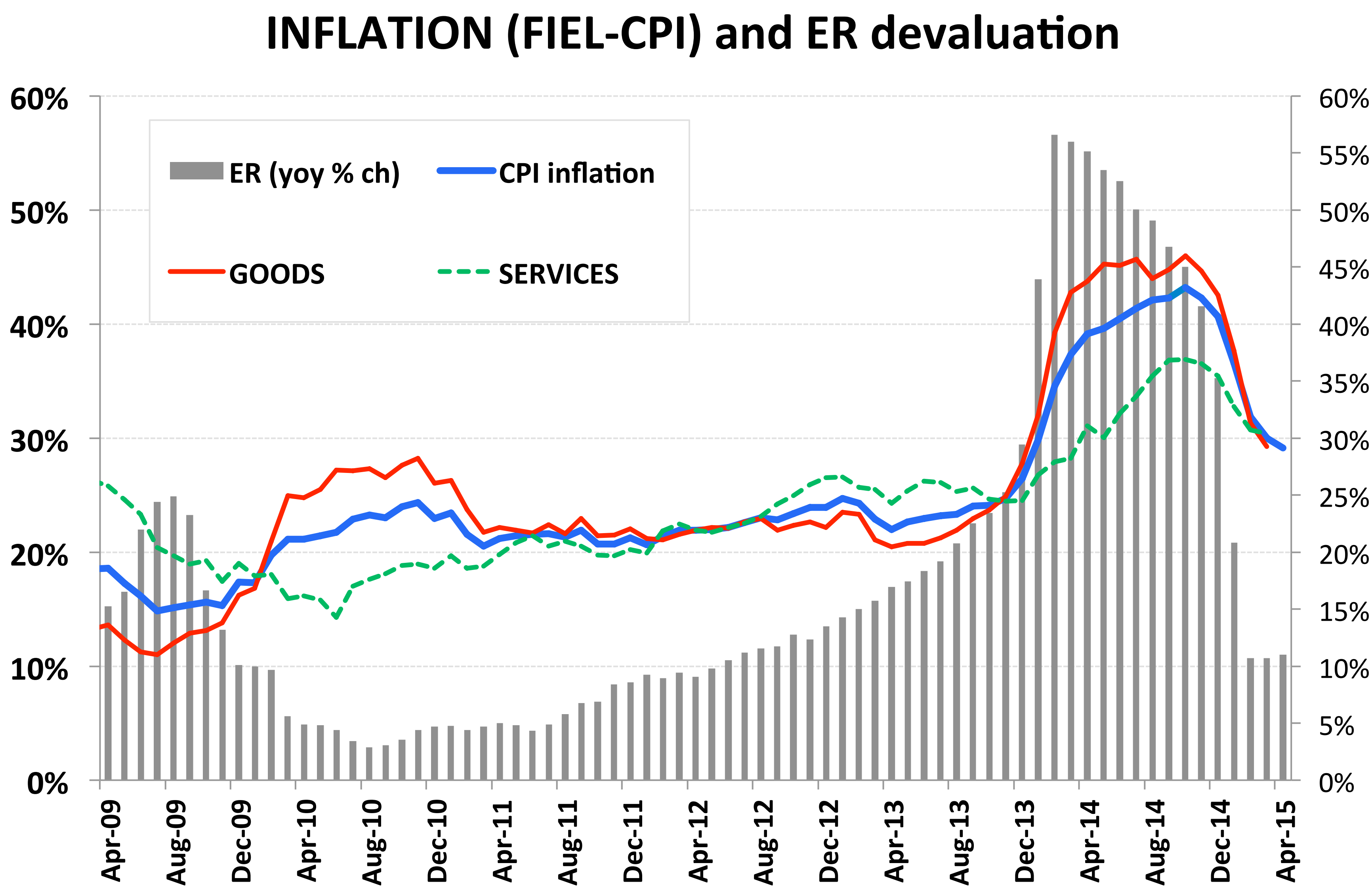
(33% in value, 21% in volume)



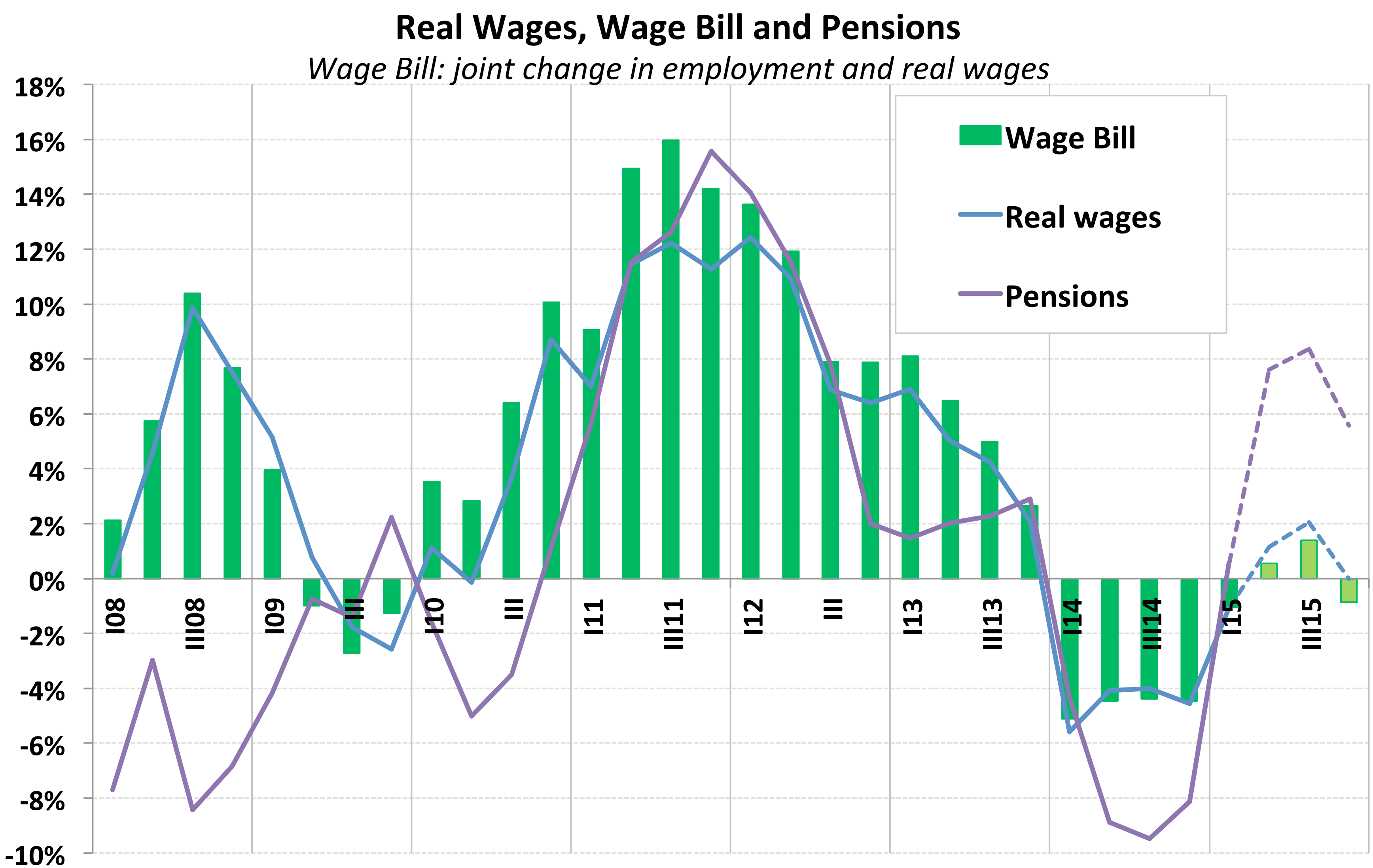
*Inflation: in spite of strong repression (tariffs, regulated prices and ER) monthly inflation crawling above 2% (=**deceleration is over**)*



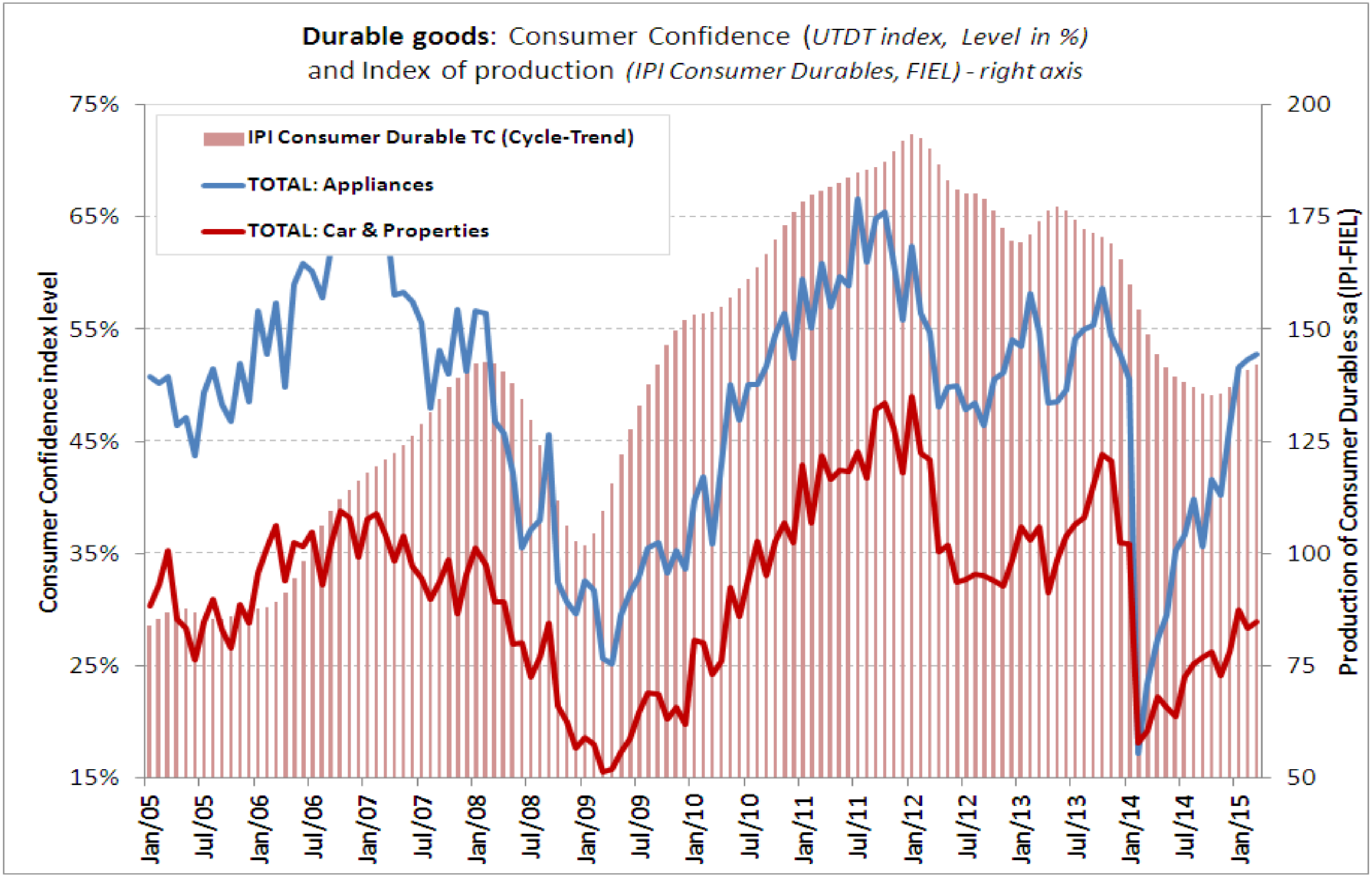
Inflation in tradable goods and ER devaluation



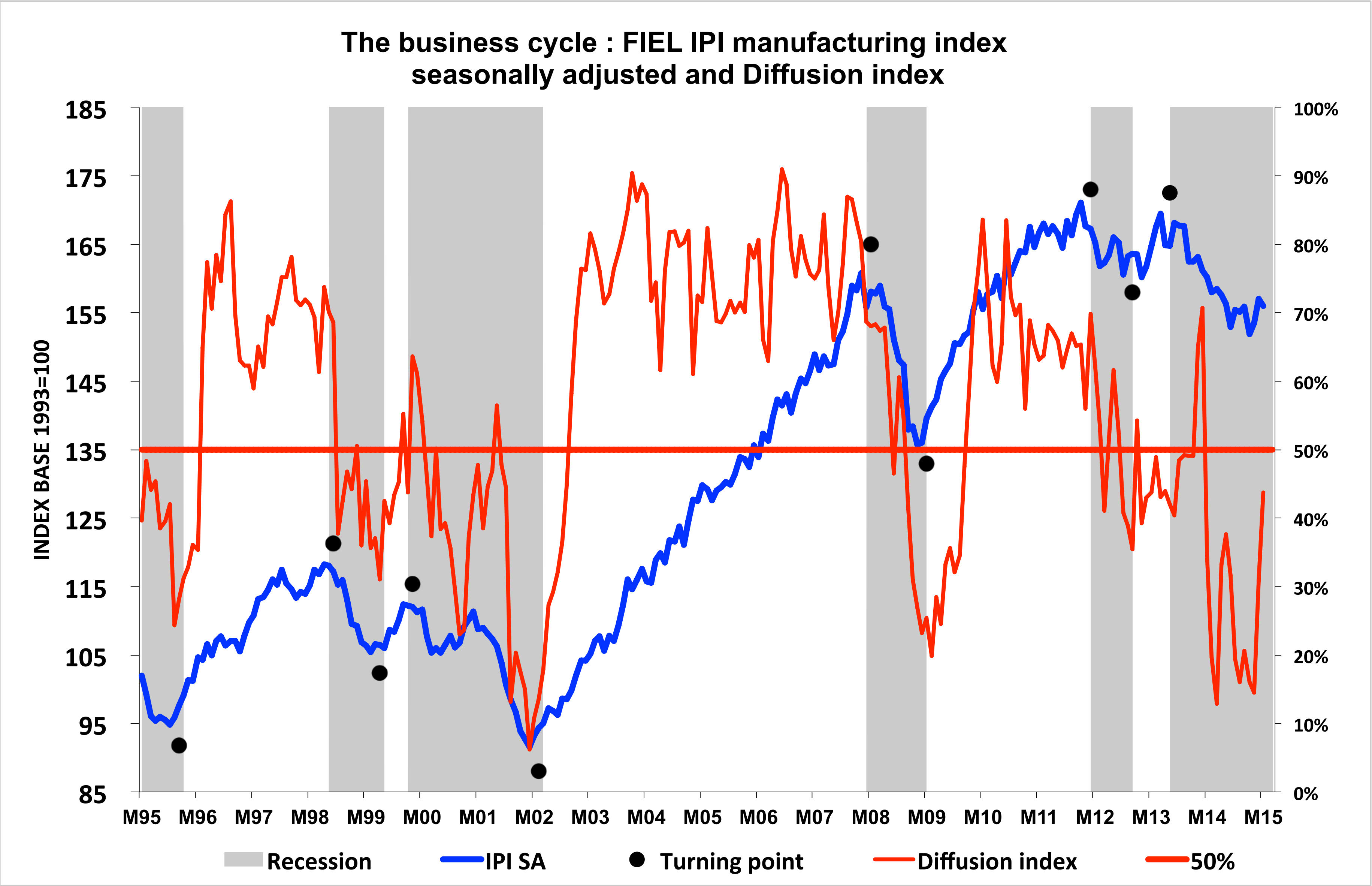
Expected recovery in real incomes in Q2 & Q3
*(lagged dynamic of wages and pensions) – **But Q4 looks different (inflation up)***



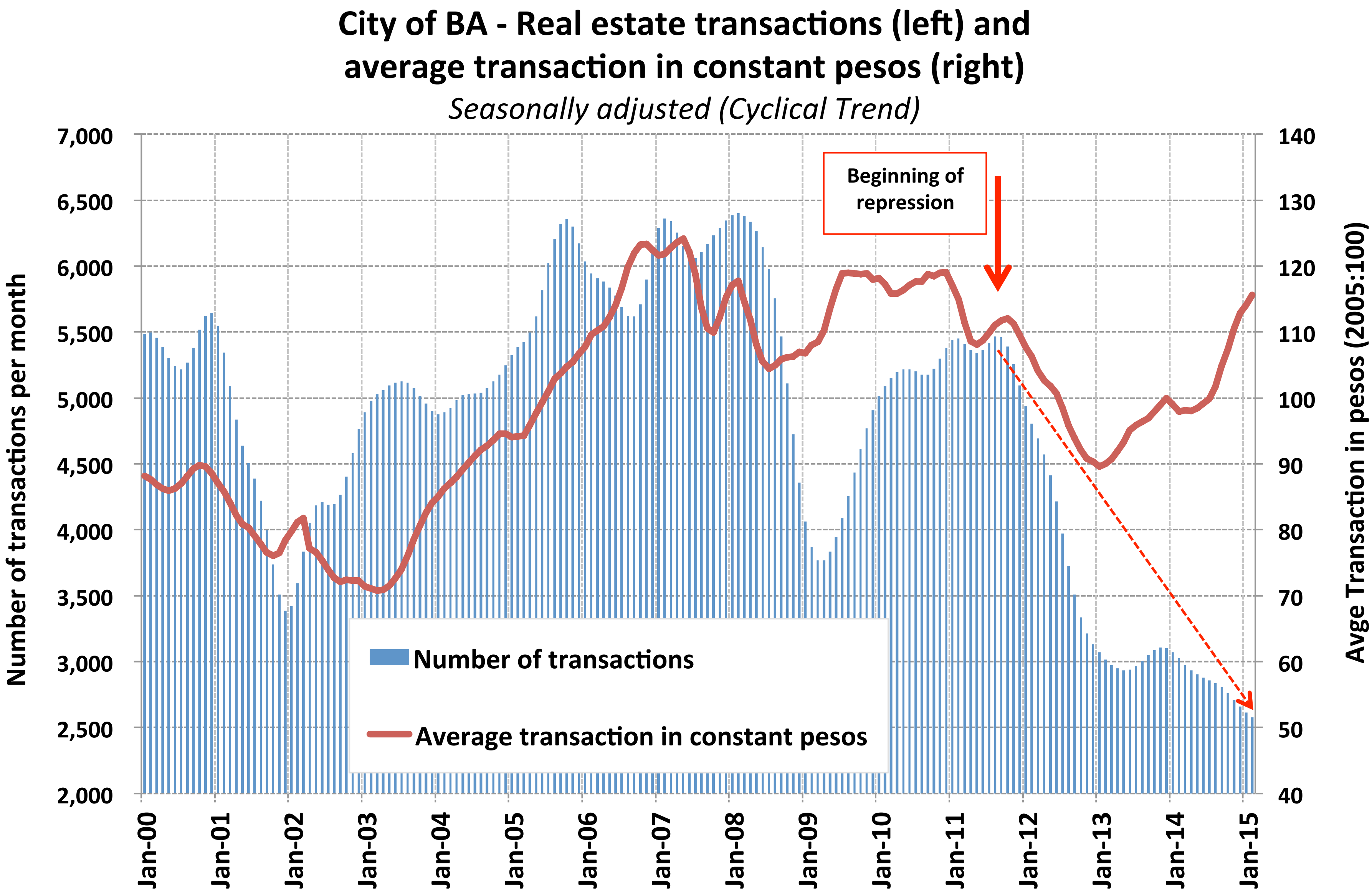
Consumer confidence is rebounding (just for small appliances – strong credit subsidy and change in real incomes)



Manufacturing: close to a turning point (for how long?)



Deepening recession in real estate: transactions down 55% (since generalization of repression in real estate and financial markets)

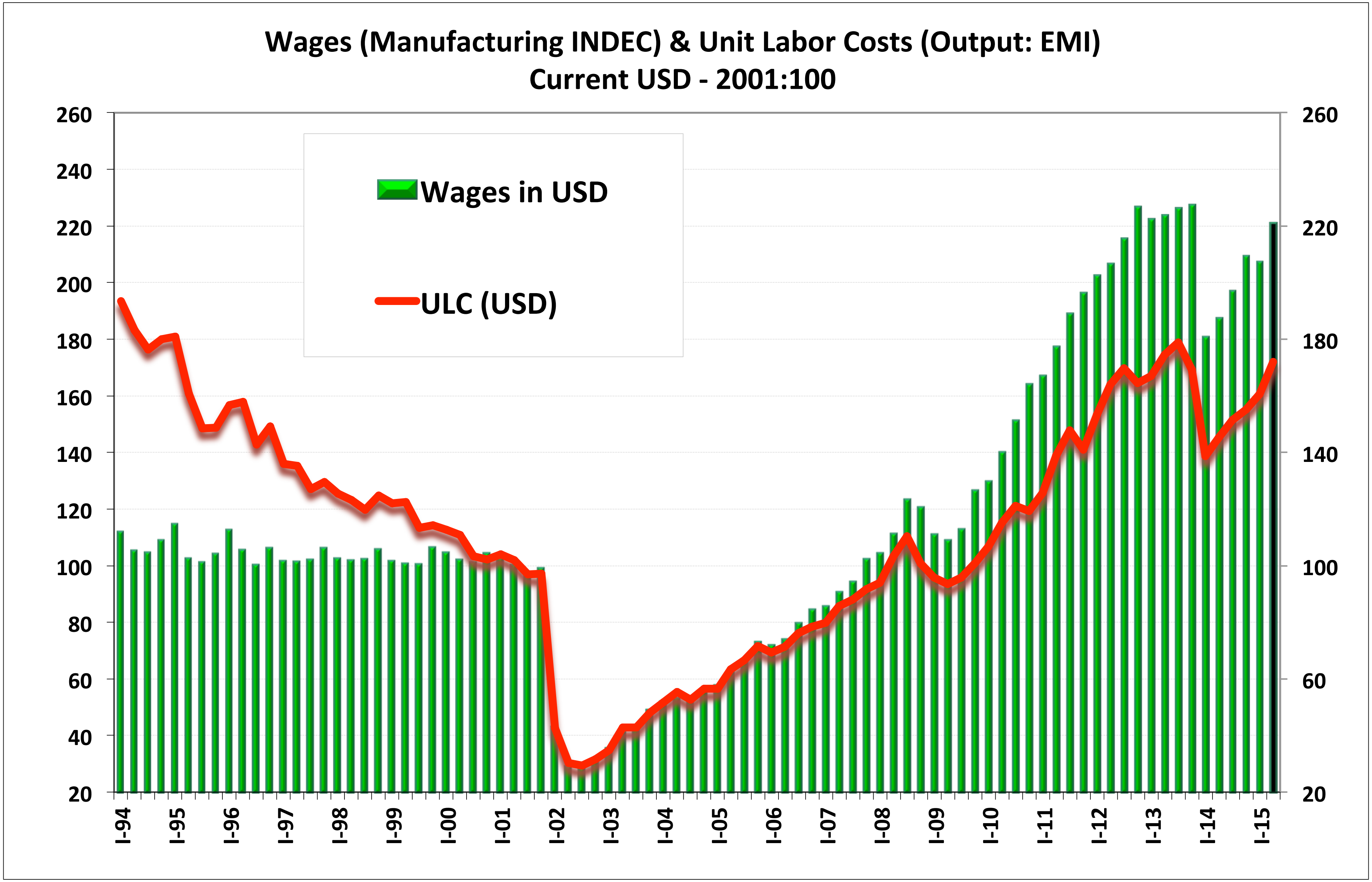


Overstaffing: Employment growth (totally) driven by the public sector

Changes in private and public employment

Year	**Private employment**		**Public Employment**	
	level (eop)	*Yoy % change (average)*	*level (eop)*	*Yoy % change (average)*
1990	**100.0**		**100.0**	
2000	**124.5**	*2.2%*	**94.3**	*-0.6%*
2010	**147.7**	*1.7%*	**127.6**	*3.1%*
2015	**147.6**	*0.0%*	**156.7**	*4.2%*

The dual of ER appreciation: Unit Labor Costs follow an explosive path



Macro outlook: short term

Variable	Unit	2004-07 K1	2008-11 K2	2012-15 K3	2015
GDP growth	*average, Yoy % ch*	8.83	4.04	-0.10	-1.3
Investment/GDP	*average*	20.4	22.5	20.4	18.8
Exports (Goods, USD) Yoy % change	*average, Yoy % ch*	17.0	12.5	-9.1	-22.0
Imports (Goods, USD) YoY% change	*average, Yoy % ch*	35.0	18.2	-7.0	-18.0
Inflation	*average*	10.5	20.6	29.0	30
Real ER (2001:1.0)	*average*	2.06	1.54	1.21	1.08
Wages (Private Formal) in USD	*average*	470	876	1406	1494
Wages (Private Formal) Blue USD	*average*	*470*	*862*	*965*	*999*
Reserves (gross)	*average*	27725	48625	34490	20400
Current account	*average*	2.4	0.9	-1.0	-2.0
Fiscal balance (% of GDP)	*average*	1.3	-1.4	-4.9	-7.0
Loans Private Sector/GDP	*eop*	8.3%	10.3%	12.9%	12.8%

SOURCE: FIEL

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Argentina’s Economic Outlook

Frankenstein’s undoing: Energy Subsidies

Fernando Navajas

Council of the Americas

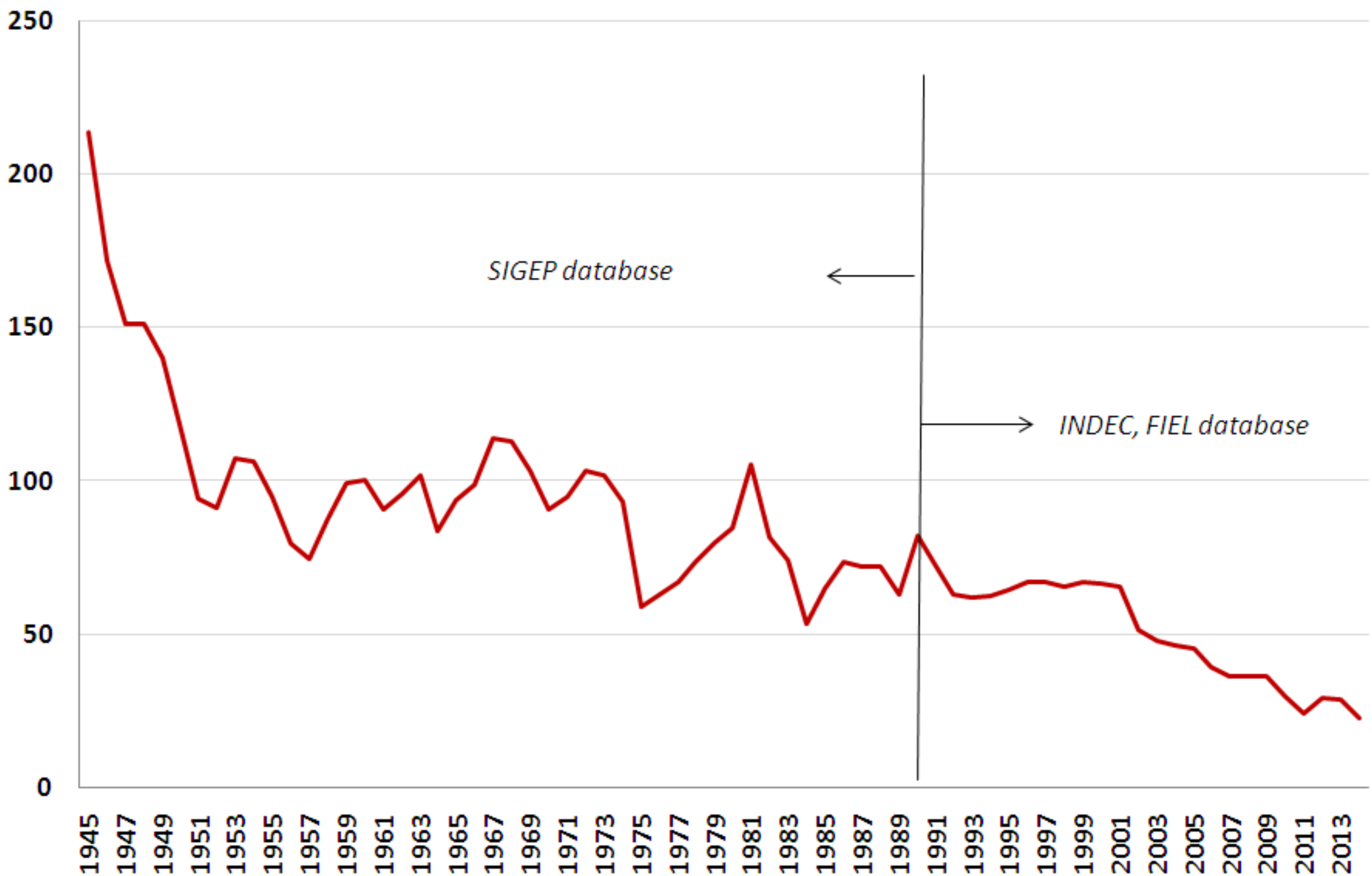
New York, April 23rd, 2015

Introducing Frankenstein

- After the largest induced drop (in recorded history) of prices of natural gas and electricity, subsidies soared with large fiscal and external impacts
  - The “nuts” argument was that this would spur growth. It did exactly the opposite.
- Supplying both sectors “costed ” in 2014 about 10 billion dollars each, with demand “paying” only 4 billion in natural gas and 2 billion in electricity. This added up to more than 3% of GDP.
  - About 50% of this goes to households and 70% of this (i.e. 35%) goes to non-poor families.
- But costs of supply are expressed in dollars , while demand prices are in pesos. A 30% real devaluation adds about 5 billion dollars to the previous figure.
  - Lower import prices (net of higher domestic prices to producers) in 2015 help a bit but do not change this landscape.
- Purposed legacy: Removing subsidies will be costly in terms of incidence, price stability and political costs in the short run.

Argentina: Real electricity prices for households 1945-2014

(1960=100)

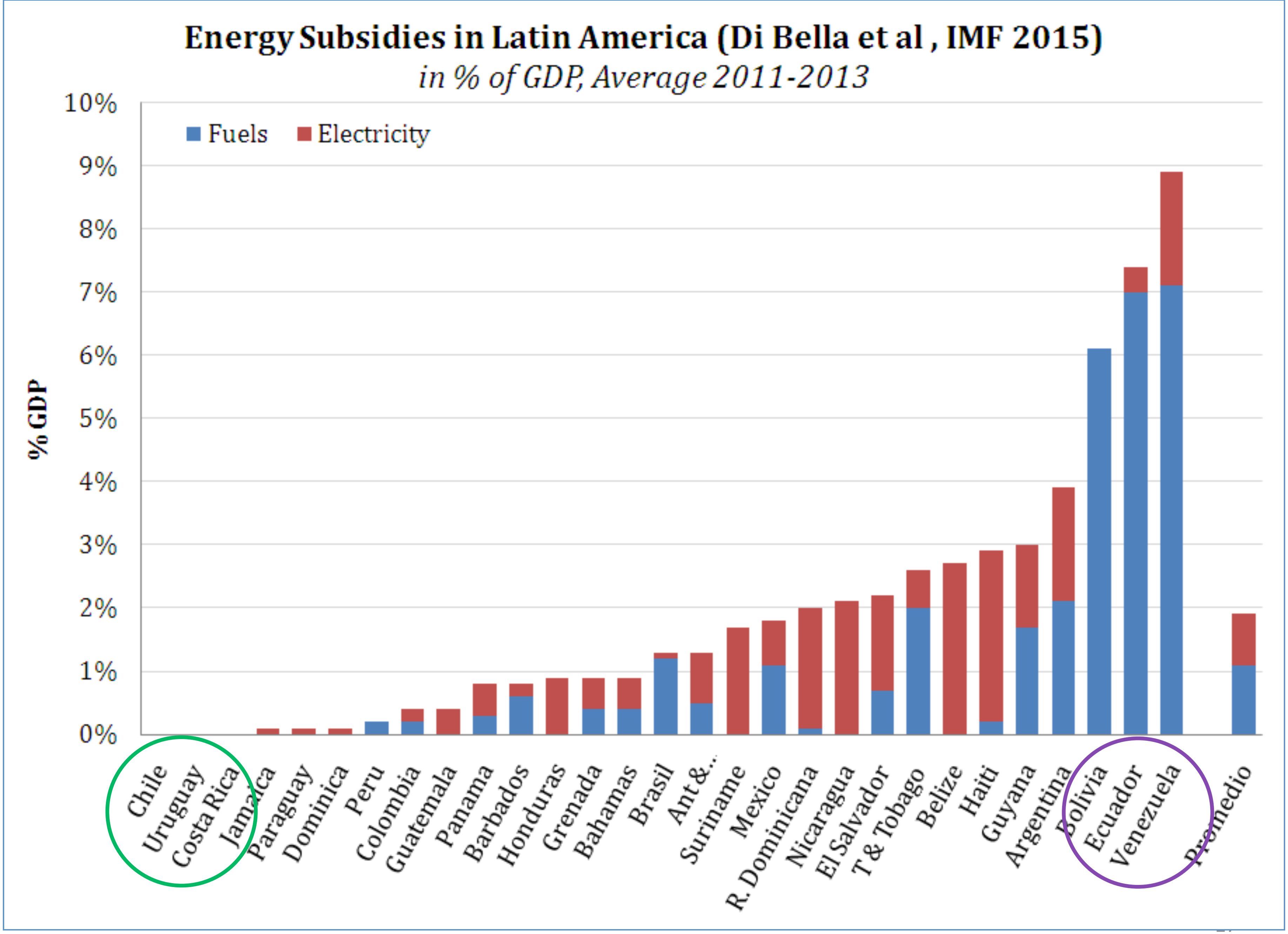


10 Episodes of downfalls in real electricity prices for households 1945-2015

Residential customers prices deflated by the CPI

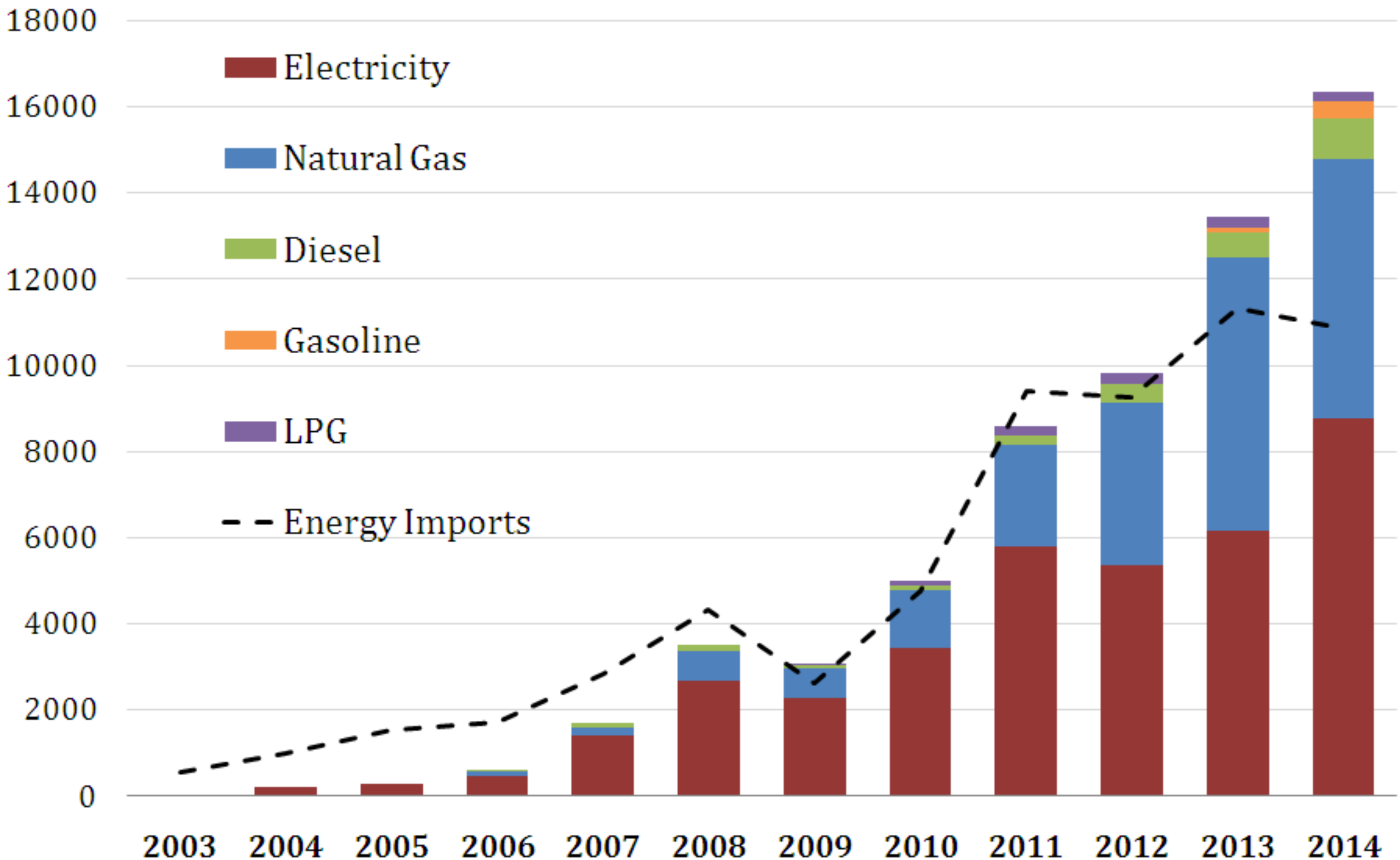
Period	Years duration	Size of Drop	Adjustment in 1st year of reversal	Correction of drop in 1st year of reversal
1945-52	7	51.3%	17.4%	16.5%
1953-57	4	30.7%	18.1%	40.9%
1960-61	1	9.2%	5.4%	53.3%
1963-64	1	18.1%	12.3%	55.7%
1967-70	3	20.2%	4.4%	17.4%
1973-75	2	42.6%	6.4%	8.6%
1981-84	3	49.2%	21.8%	22.5%
1986-89	3	14.1%	30.0%	182.8%
1990-94	4	23.7%	2.7%	8.7%
2001-15	14	73.0%	?	?

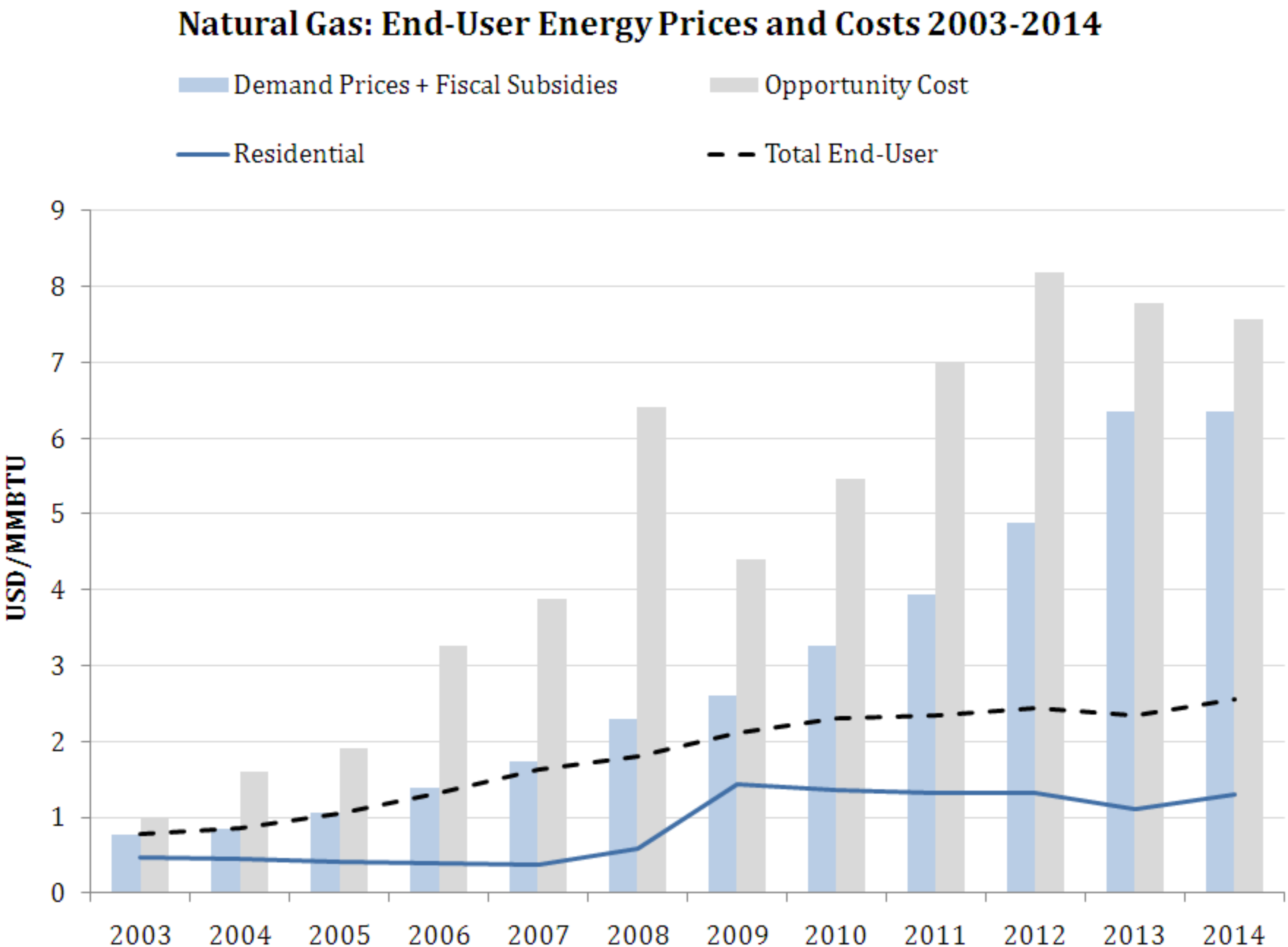
Source: Navajas (2015)

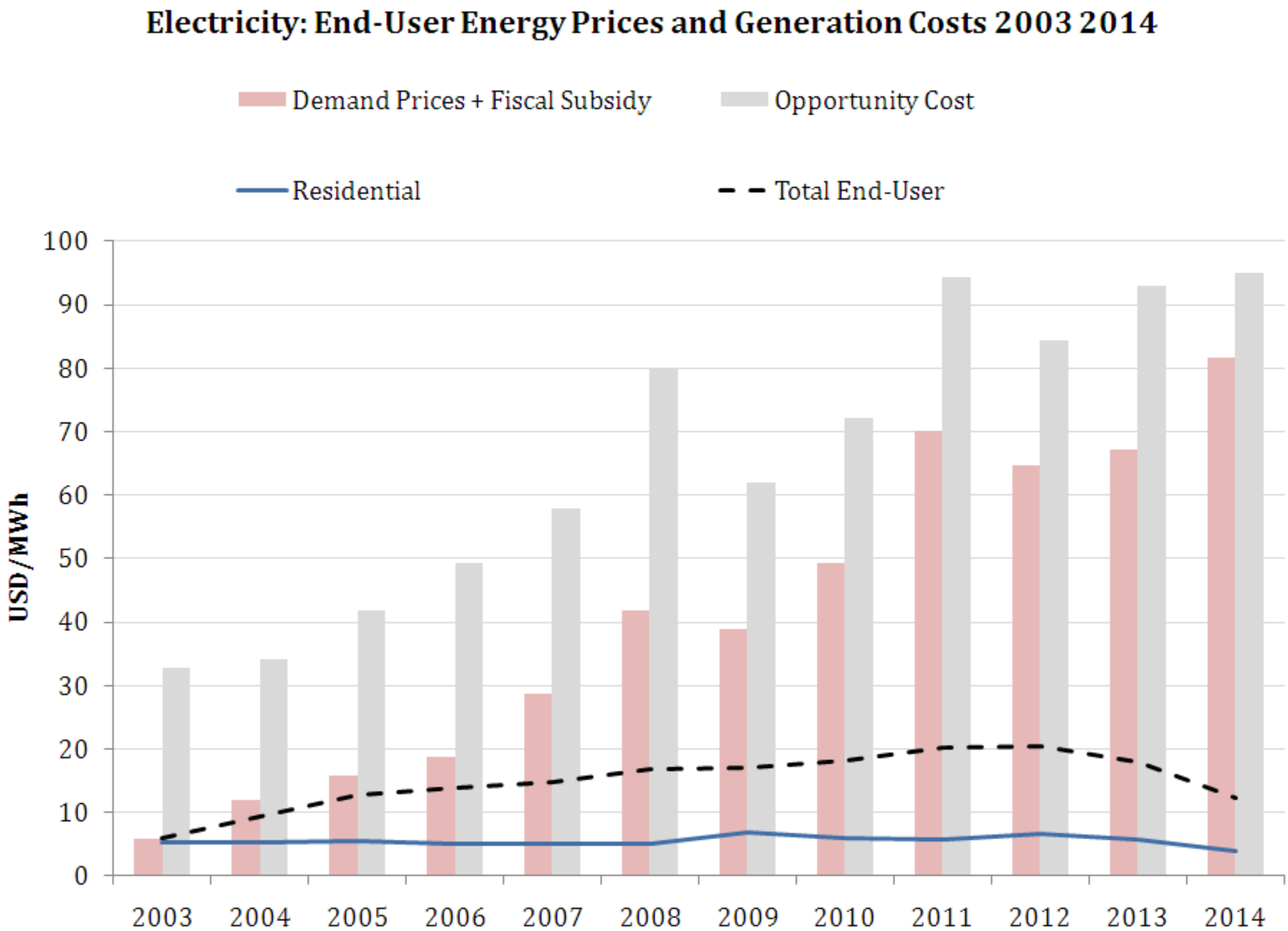

Energy Subsidies in Latin America (Di Bella et al , IMF 2015)
in % of GDP, Average 2011-2013
Fuels
Electricity
% GDP
10%
9%
8%
7%
6%
5%
4%
3%
2%
1%
0%
Chile
Uruguay
Costa Rica
Jamaica
Paraguay
Dominica
Peru
Colombia
Guatemala
Panama
Barbados
Honduras
Grenada
Bahamas
Brasil
Ant &...
Suriname
Mexico
R. Dominicana
Nicaragua
El Salvador
T & Tobago
Belize
Haiti
Guyana
Argentina
Bolivia
Ecuador
Venezuela
Promedio

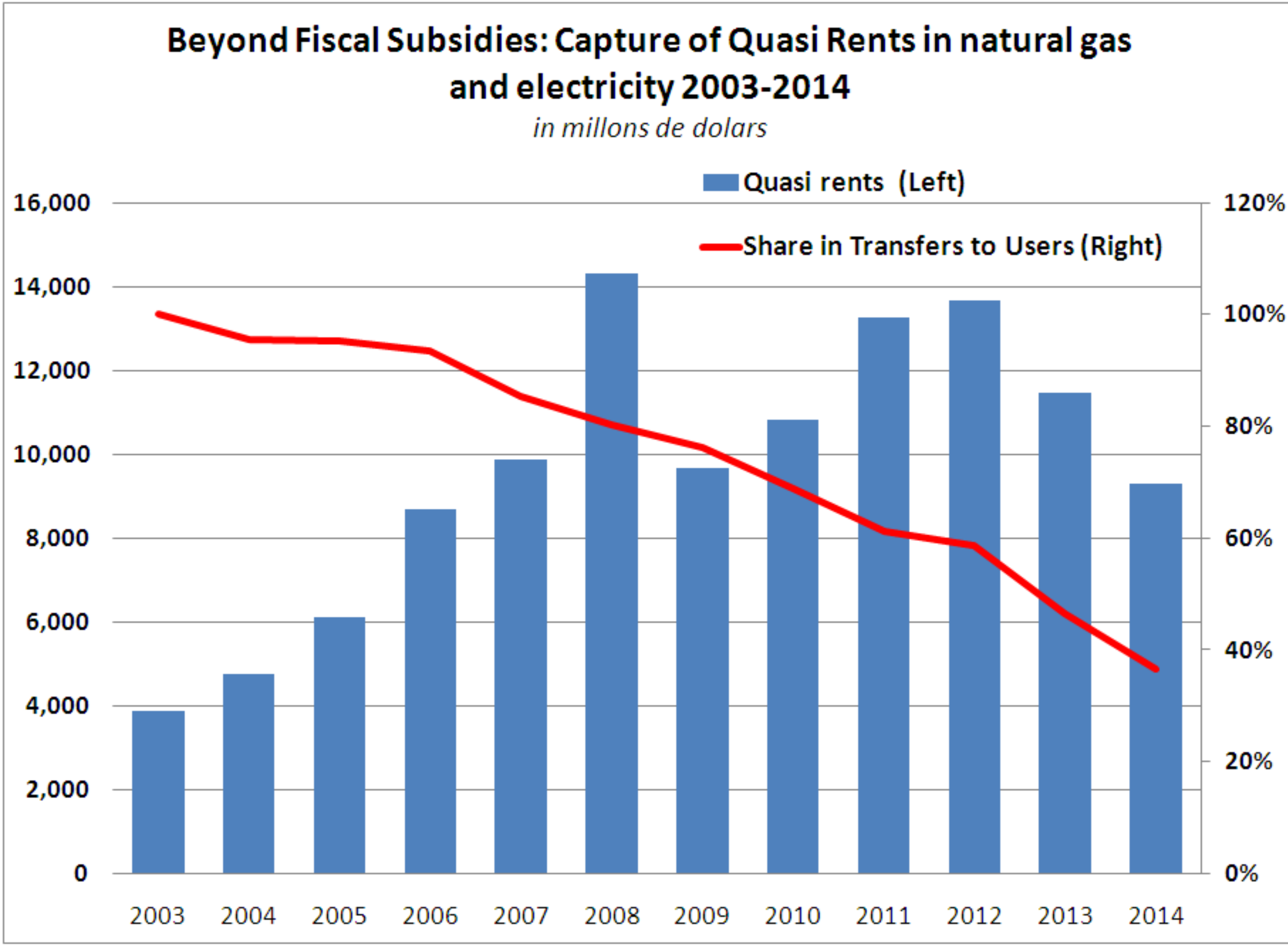
Argentina: Energy Subsidies 2003-2014

in millones of USD




Natural Gas: End-User Energy Prices and Costs 2003-2014
Demand Prices + Fiscal Subsidies
Opportunity Cost
Residential
Total End-User
USD/MMBTU
0
1
2
3
4
5
6
7
8
9
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Electricity: End-User Energy Prices and Generation Costs 2003 2014
Demand Prices + Fiscal Subsidy
Opportunity Cost
Residential
Total End-User
USD/MWh
100
90
80
70
60
50
40
30
20
10
0
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014


Beyond Fiscal Subsidies: Capture of Quasi Rents in natural gas and electricity 2003-2014
in millons de dolars
Quasi rents (Left)
Share in Transfers to Users (Right)
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
120%
100%
80%
60%
40%
20%
0%
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

Argentina: Energy subsidies across households 2003-2014

Distribution of natural gas subsidies and electricity subsidies across households between 2003-2014					
Decile	Natural Gas		Electricity		Total
1	3.5%		6.7%		5.0%
2	5.8%		8.1%		6.9%
3	7.1%		9.6%		8.3%
4	8.4%		9.4%		8.9%
5	10.0%		9.8%		9.9%
6	11.9%		10.5%		11.2%
7	12.6%	**83.6%**	10.7%	**75.6%**	11.7%
8	13.8%		10.8%		12.3%
9	13.8%		11.4%		12.6%
10	13.2%		13.0%		13.1%

Source: Hancevic, Cont and Navajas (2015)

Argentina: Parameters Behind Energy Subsidies in Natural Gas

average values for 2004 and 2014

parameters	units	values	
		2004	*2014*
Supply prices			
Bolivia	USD MMBTU	1.6	10.1
LNG	USD MMBTU		14.8
"Old Gas"	USD MMBTU	0.7	2.4
"New Gas"	USD MMBTU		7.5
Shares			
Imports in Supply	%	2.4	28.5
LNG in Imports	%	0	50.9
New Gas in Domestic Supply	%	0	29.3
Average prices			
Supply	USD MMBTU	0.7	6.3
Demand	USD MMBTU	0.8	2.6
Opprtunity Cost (Supply Long Run)	USD MMBTU	1.2	7.6
Consumption	MMBTU	$1.23*10^9$	$1.60*10^9$
Exchange rate	ARS/USD	2.96	8.14
Fiscal Subsidy	millons USD	0	6031
at zero imports	millons USD		2130
Economic Subsidy	millones USD	494	7990
at zero imports	millons USD		7990

Argentina: Parameters Behind Energy Subsidies in Electricity

average values for 2004 and 2014

parameter	units	values	
		2004	*2014*
Input prices for thermal generation			
Liquid Fuels	USD m3	207.3	733.2
Natural Gas	USD m3	0.04	0.11
Input-Output Coefficients			
Liquid Fuels	m3/MWh	0.16	0.20
Natural Gas	m3/MWh	168.1	205.5
Share			
Fuels in Thermal Generation	%	9.5	25.4
Variable Cost of Thermal Generation			
Liquid Fuels	USD/MWh	27.9	146.7
Natural Gas	USD/MWh	6.1	23.1
Prices			
Energy	USD/MWh	8.1	54.5
Residual	USD/MWh	3.9	25.1
Supply	USD/MWh	12.0	79.6
Demand	USD/MWh	9.4	12.2
Opprtunity Cost (Supply Long Run)	USD/MWh	32.8	95.0
Consumption	MWh	88.6*10^6	127.6*10^6
Exchange rate	ARS/USD	2.96	8.14
Fiscal Subsidy	millones USD	230	8603
Economic Subsidy	millones USD	2076	10568

Macroeconomics of subsidy reform

- ¿What impact on inflation of eliminating subsidies?
  - 2 effects: “Impact effect” vs. “Fiscal stabilization effect”.
  - Which dominates in the short run?
- A price equation where inflation depends on money (deficit, i.e. subsidies) and shocks in the exchange rate, wages and energy prices.
  - Simulation with coefficients “imported” from past history (70s,80s)
- Results: Even without exchange rate or wage adjustments, a sharp elimination of subsidies raises inflation in the short run (by 11% yoy) and reduces by the end of 2016.
  - Thus, sharp subsidy reduction requires a comprehensive stabilization framework.

Impact effect vs. Fiscal stabilization effect of eliminating energy subsidies

$$\dot{p}_t = \alpha'_1 \dot{e}_t + \boxed{\alpha'_2 \dot{p}_{d_t}} + \alpha_3 \dot{w}_t + \alpha_0 \frac{v}{Y_{t-1}}(G_t - T_t) + \boxed{\frac{vX_t}{Y_{t-1}}\left(p_{s_{t-1}} - p_{d_{t-1}}\right)}$$

Inflation

Δ Energy prices

Devaluation

Δ Wages

Déficit & money emission

Deficit & money emission by subsidies

Dismantling Frankenstein

- Context suggests a gradual adjustment towards well designed energy policy
  - Historic evidence on energy price cycles is not much in favor of a shock terapy
  - Fiscal stabilization effects will not dominate in the short run over impact effects.
  - Incidence of large adjustments will create social and political problems
- Still, the million dollar question remains: Is there a reform package that can be accepted by society and motivate large investments?
- The answer is yes. The design and details will emerge soon.
- Some central ingredients:
  - Clear long run or end-point conditions that restore economic rationale, supported by new institutional environment inspired in rule-driven and market driven mechanisms for price formation.
  - Smooth but steady transition towards regional (border) prices of energy.
  - Mitigation mechanisms that reorganize focalized subsidies at a much lower level.

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Argentina's Economic Outlook

Challenges and opportunities for the next administration

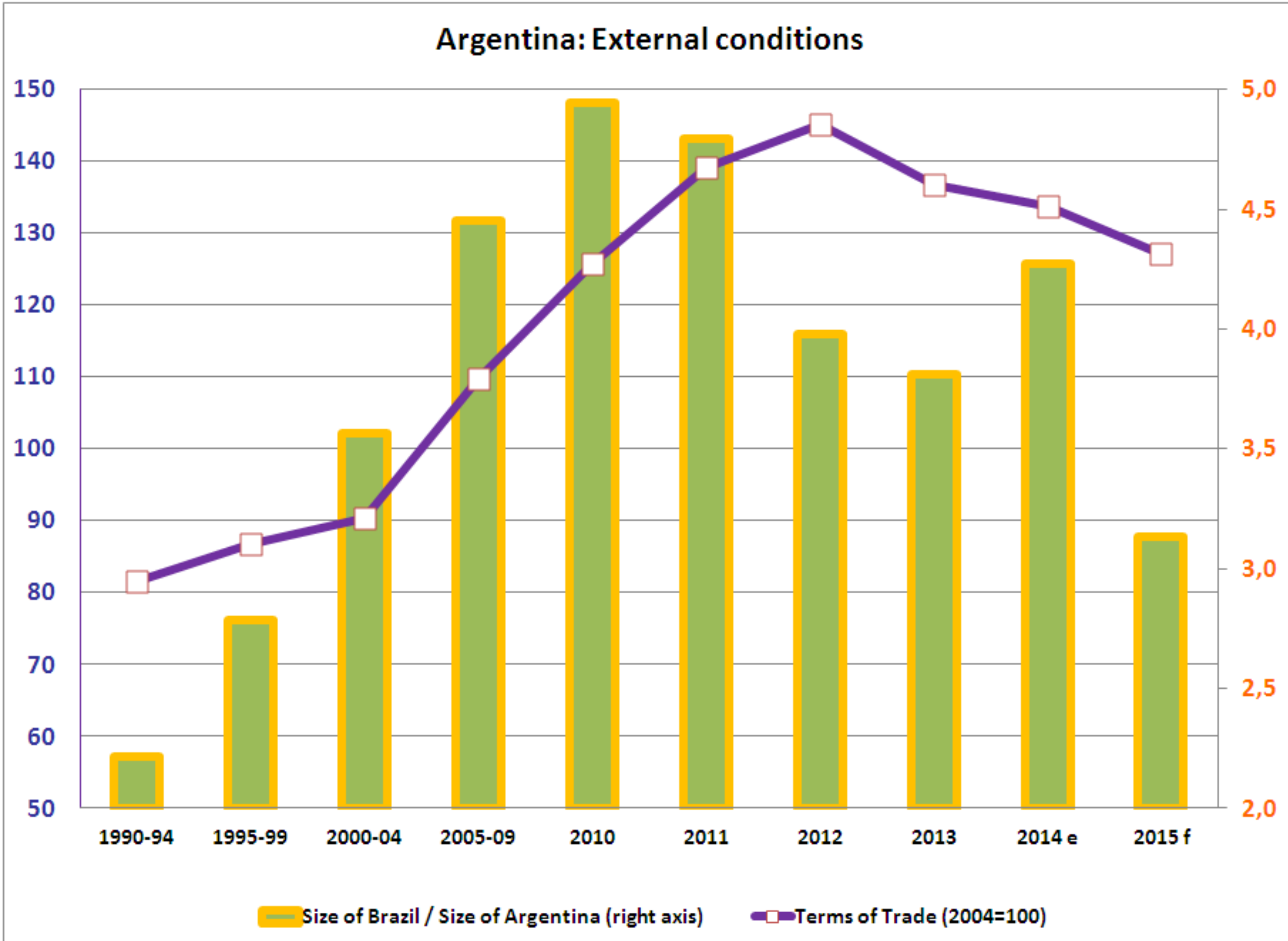
Daniel Artana

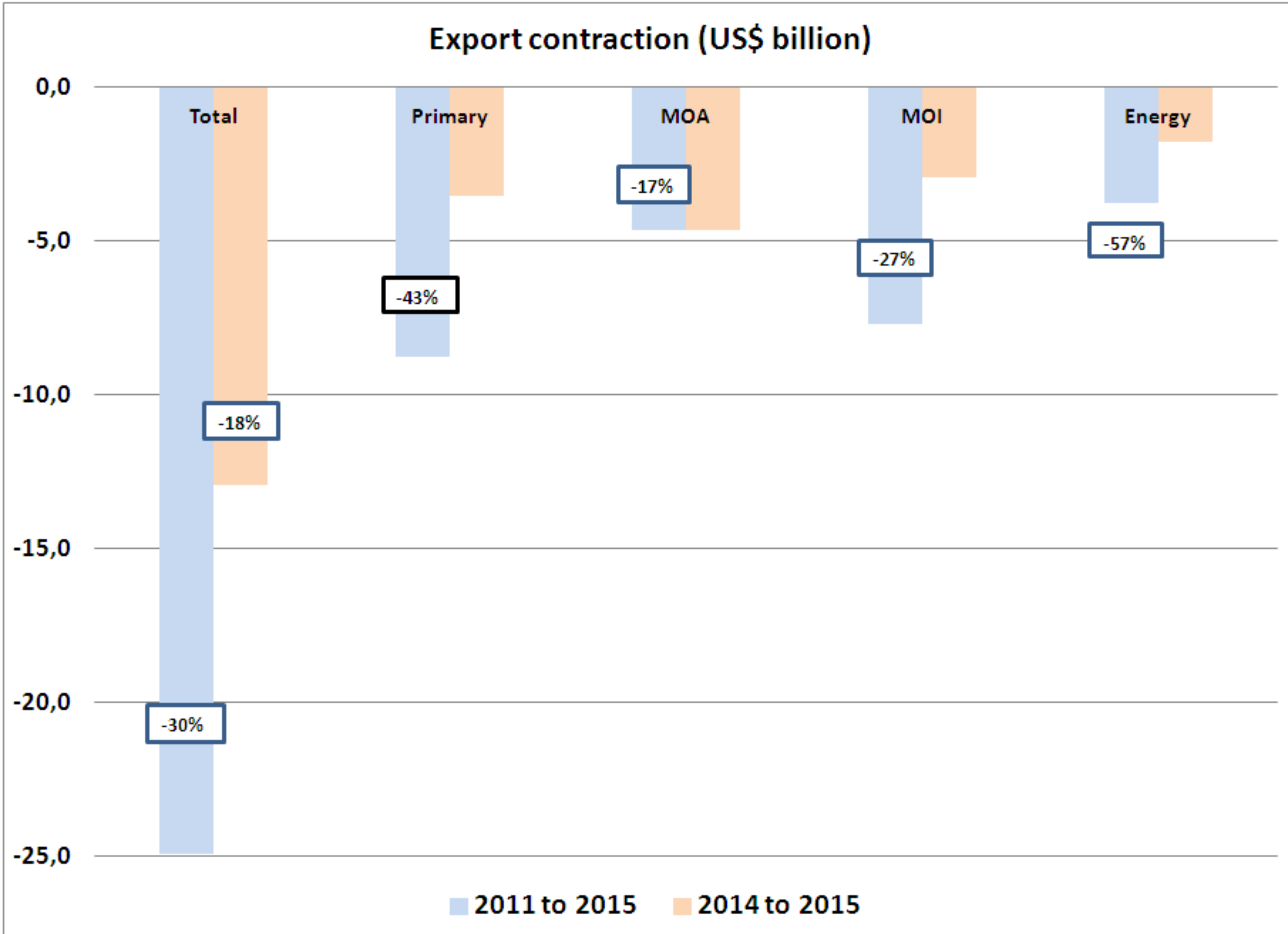
Council of the Americas

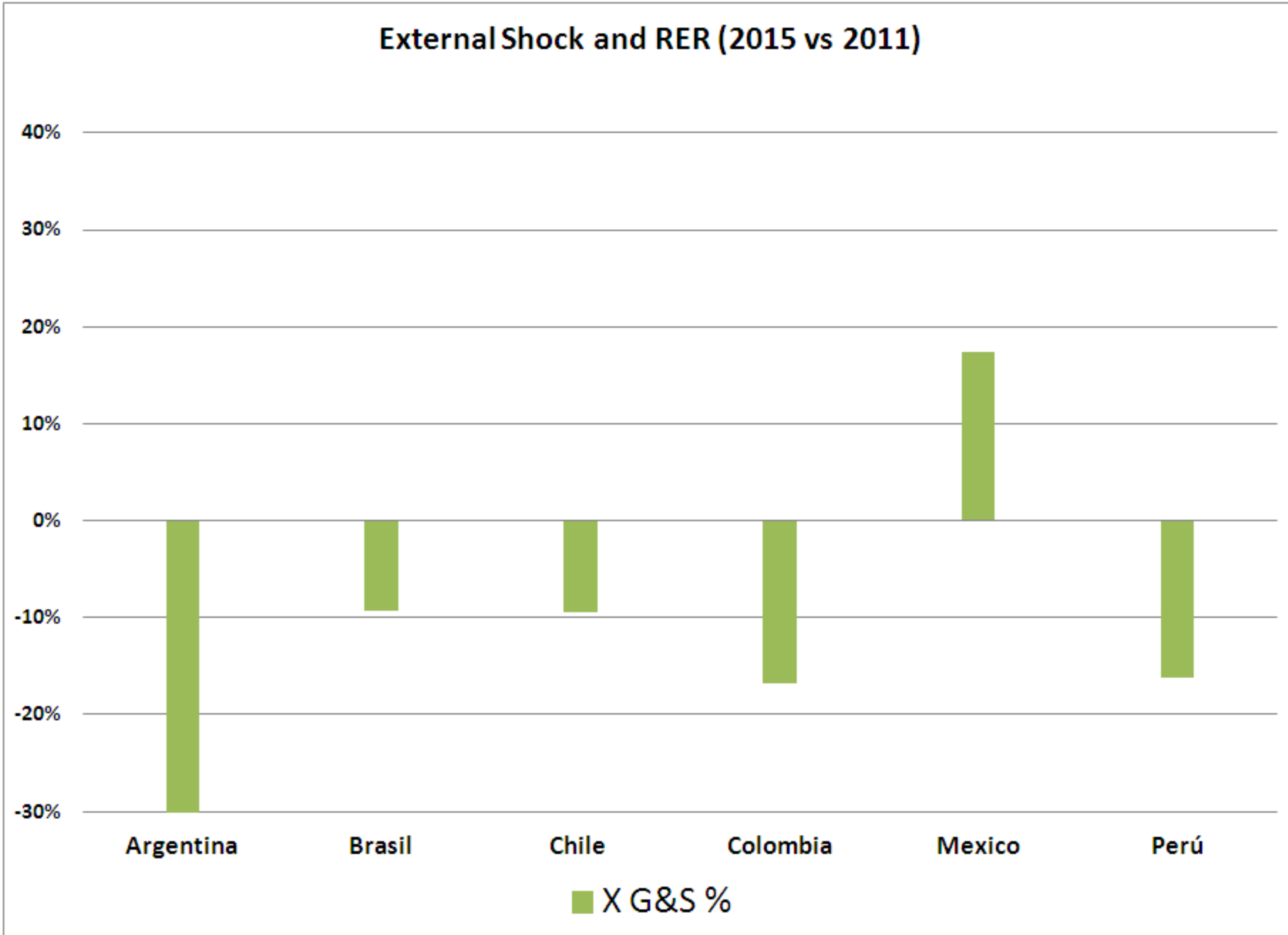
New York, April 23rd, 2015

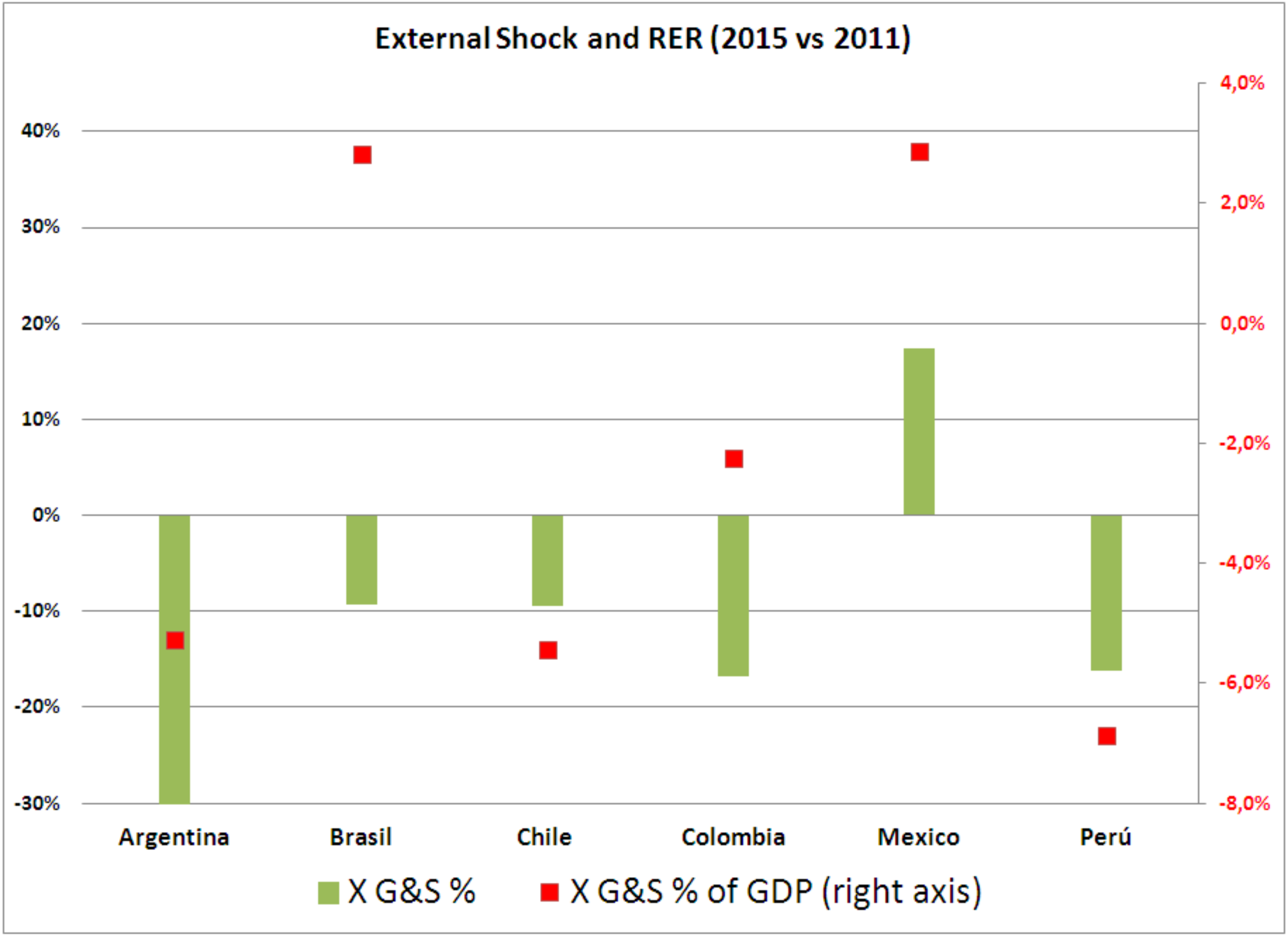
The challenges

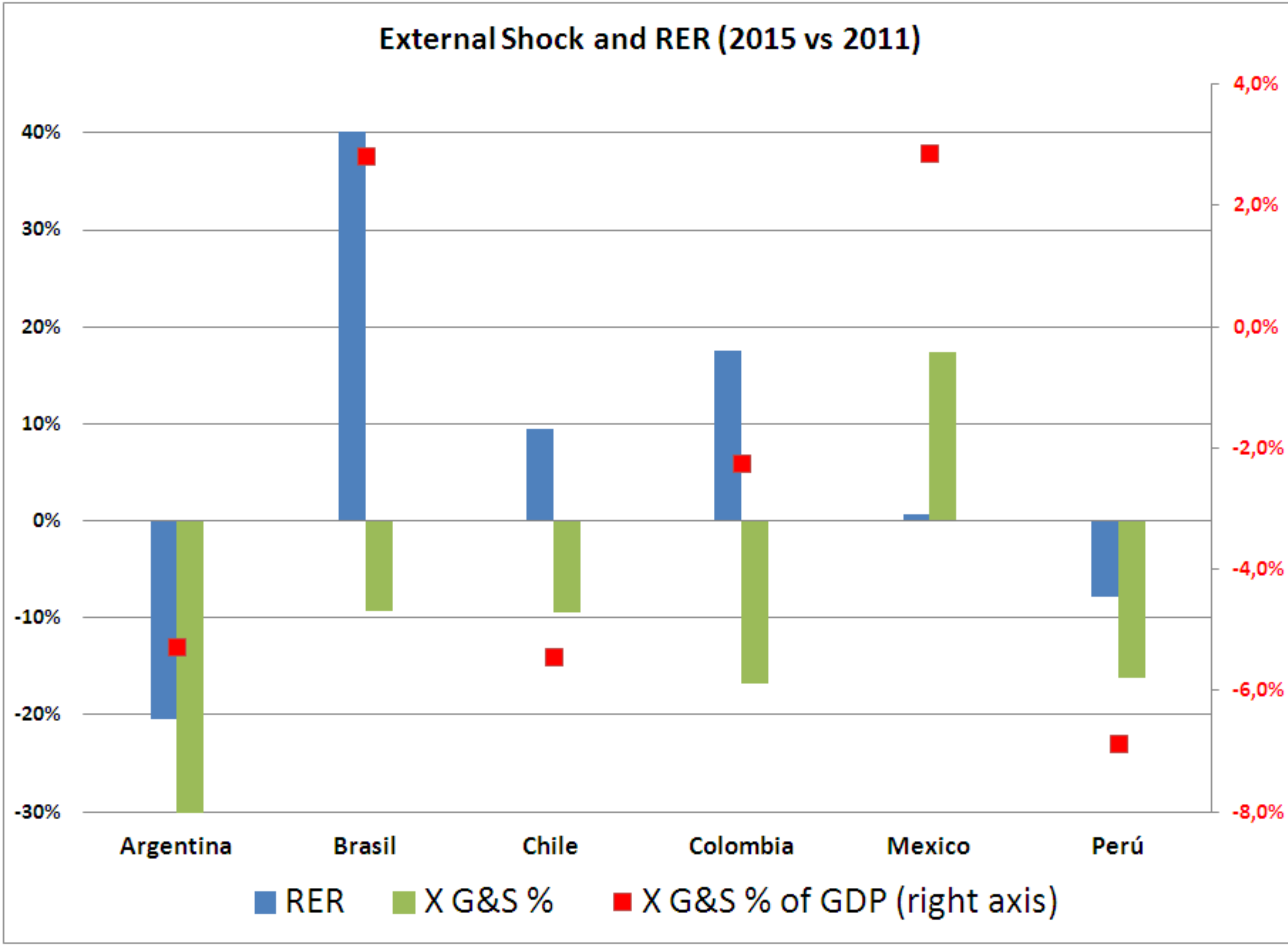
- Overvalued currency
- High Fiscal Deficit
- Low energy prices
- High inflation
- Low foreign reserves

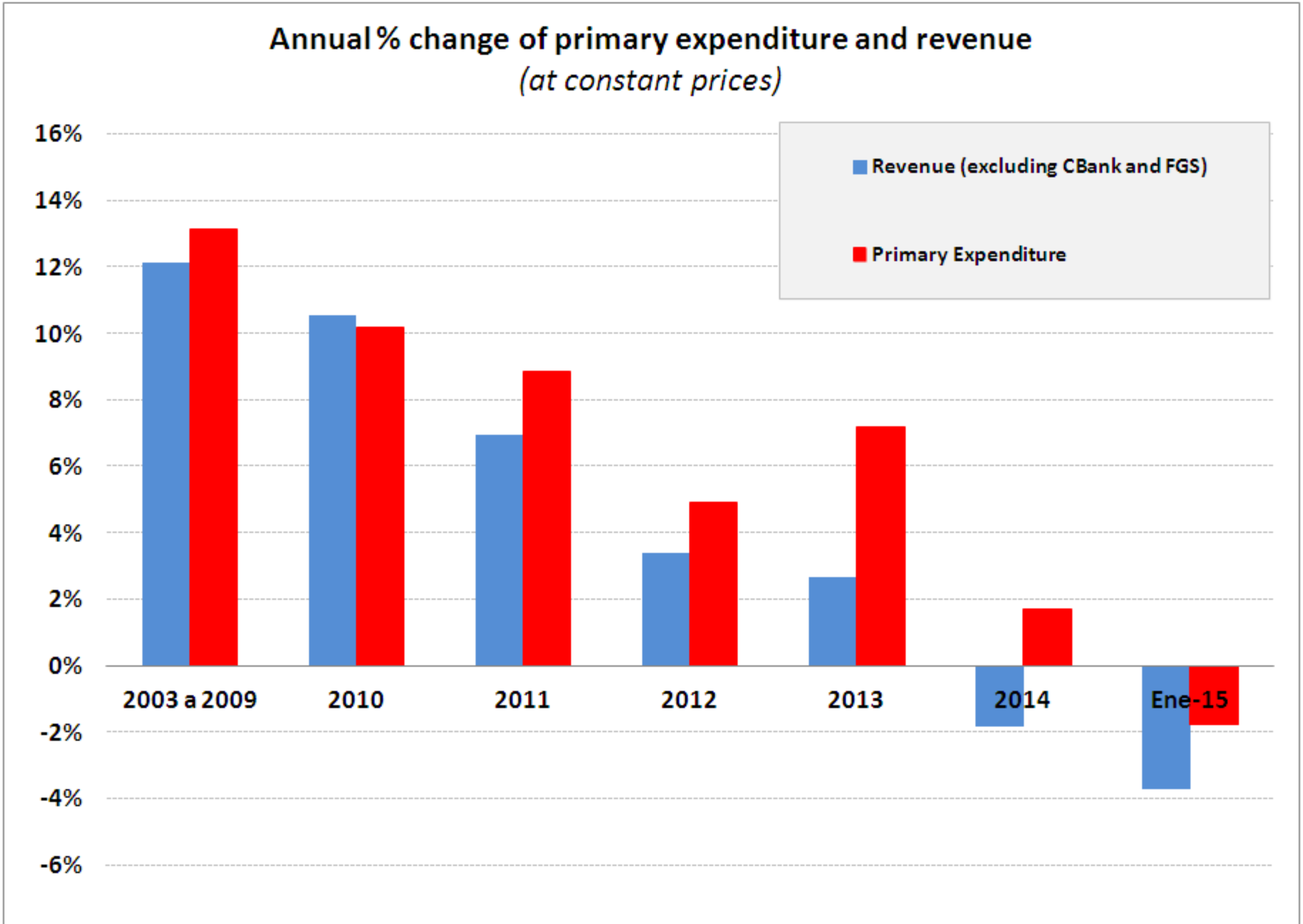

Argentina: External conditions
150
140
130
120
110
100
90
80
70
60
50
5,0
4,5
4,0
3,5
3,0
2,5
2,0
1990-94
1995-99
2000-04
2005-09
2010
2011
2012
2013
2014 e
2015 f
Size of Brazil / Size of Argentina (right axis)
Terms of Trade (2004=100)

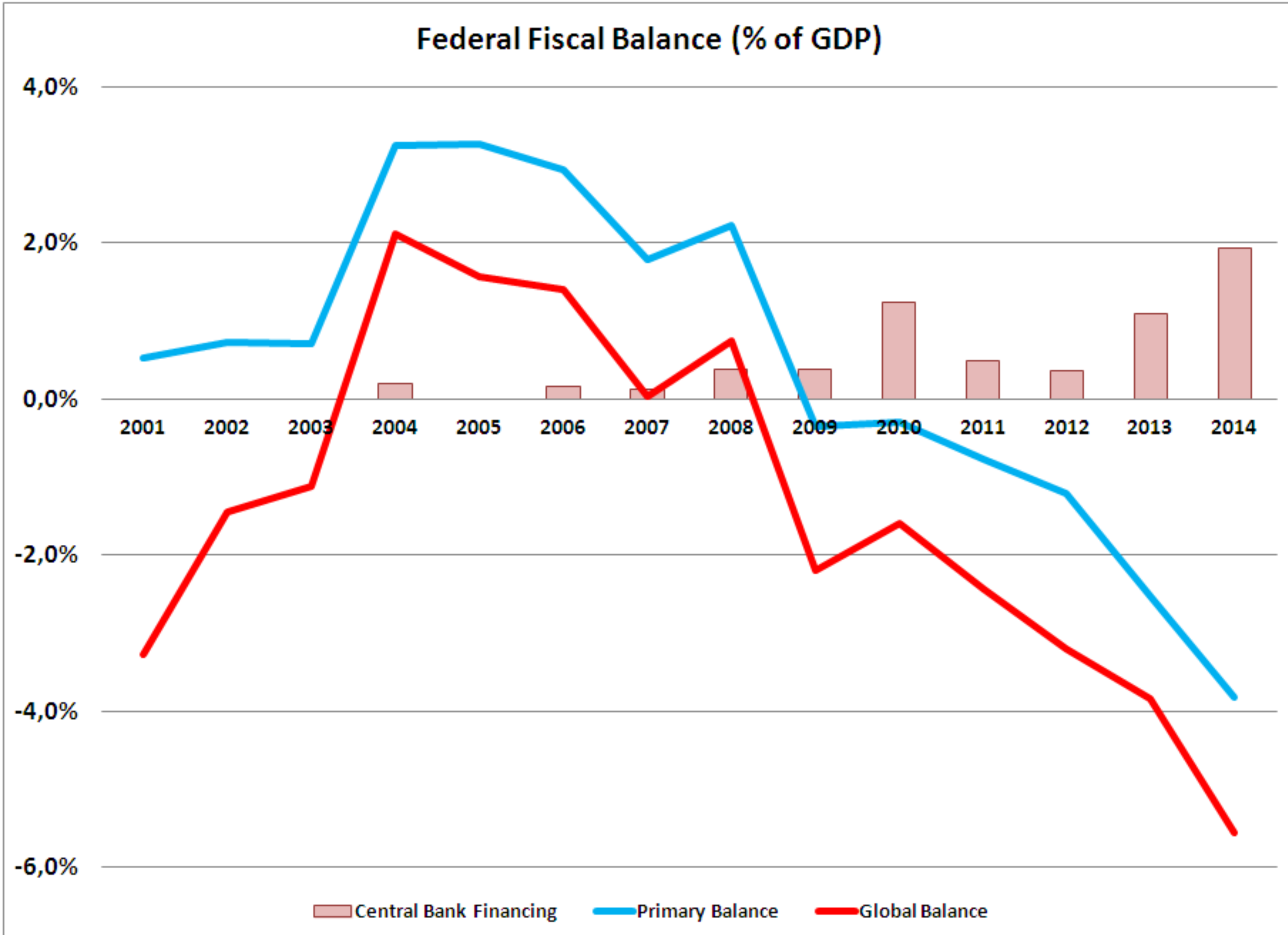

Export contraction (US$ billion)
0,0
-5,0
-10,0
-15,0
-20,0
-25,0
Total
Primary
MOA
MOI
Energy
-30%
-18%
-43%
-17%
-27%
-57%
2011 to 2015
2014 to 2015


External Shock and RER (2015 vs 2011)
40%
30%
20%
10%
0%
-10%
-20%
-30%
Argentina
Brasil
Chile
Colombia
Mexico
Perú
X G&S %

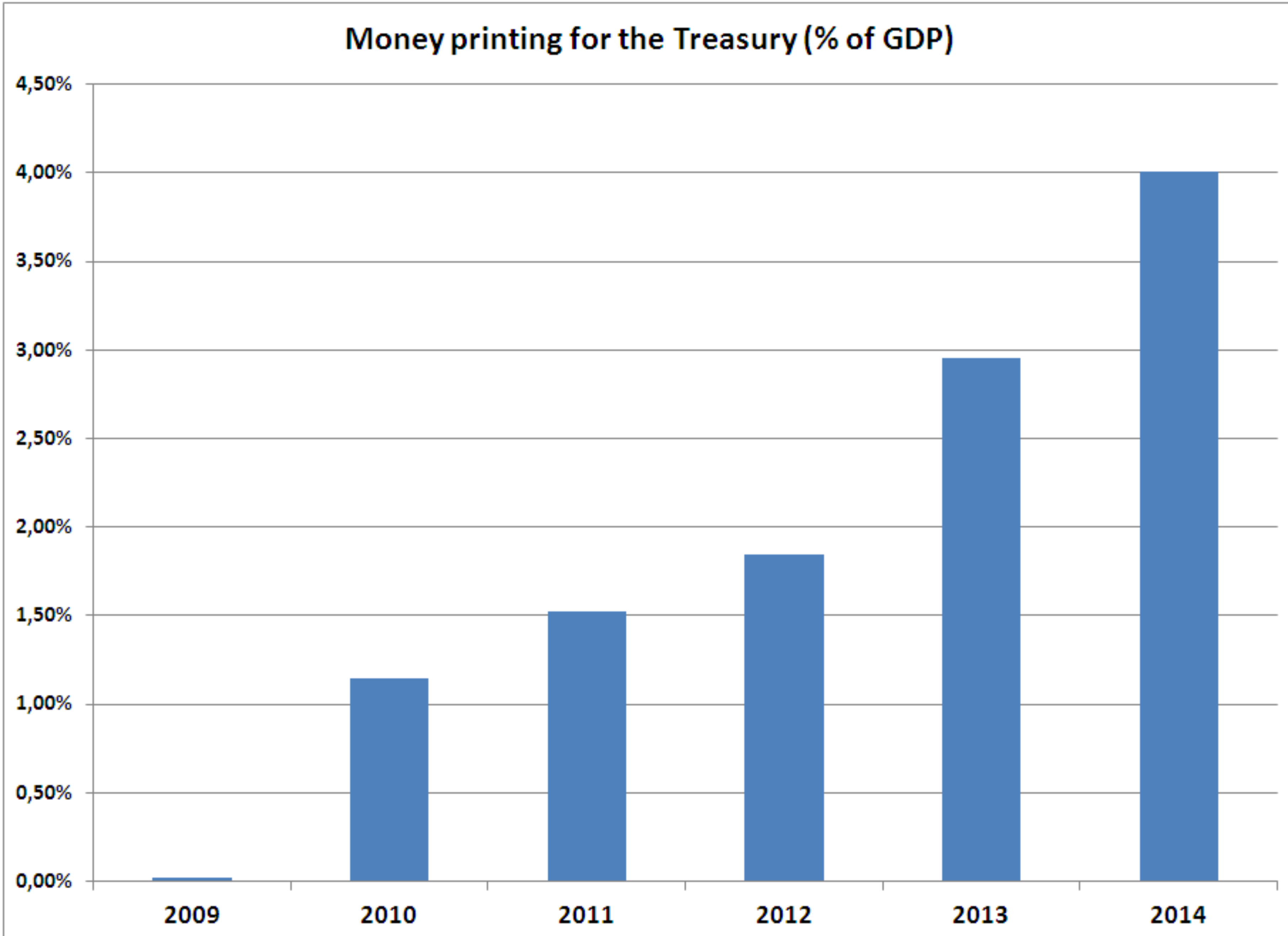

External Shock and RER (2015 vs 2011)
40%
30%
20%
10%
0%
-10%
-20%
-30%
4,0%
2,0%
0,0%
-2,0%
-4,0%
-6,0%
-8,0%
Argentina
Brasil
Chile
Colombia
Mexico
Perú
X G&S %
X G&S % of GDP (right axis)

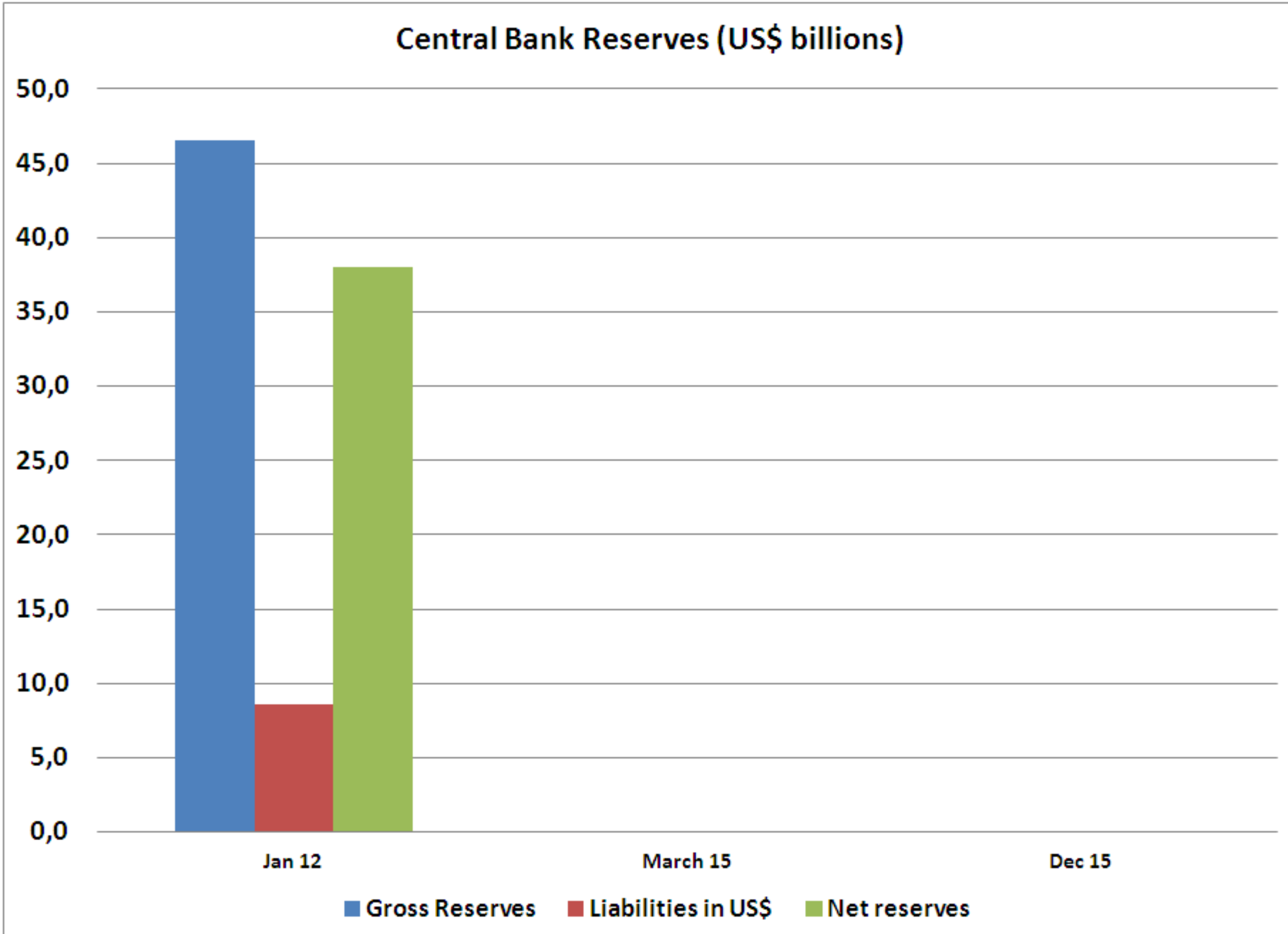

External Shock and RER (2015 vs 2011)
40%
30%
20%
10%
0%
-10%
-20%
-30%
4,0%
2,0%
0,0%
-2,0%
-4,0%
-6,0%
-8,0%
Argentina
Brasil
Chile
Colombia
Mexico
Perú
RER
X G&S %
X G&S % of GDP (right axis)

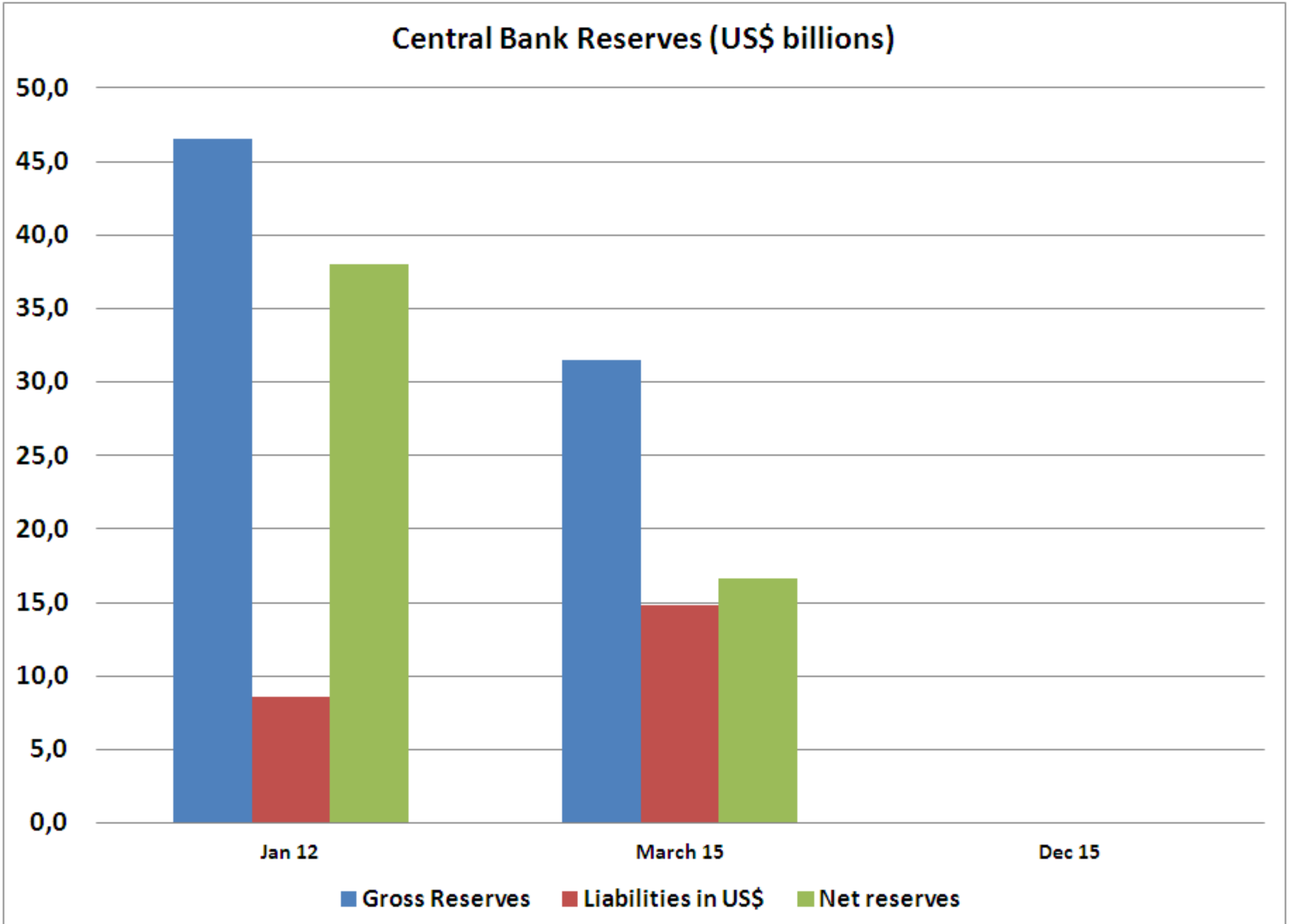

Annual % change of primary expenditure and revenue
(at constant prices)
Revenue (excluding CBank and FGS)
Primary Expenditure
16%
14%
12%
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
2003 a 2009
2010
2011
2012
2013
2014
Ene-15

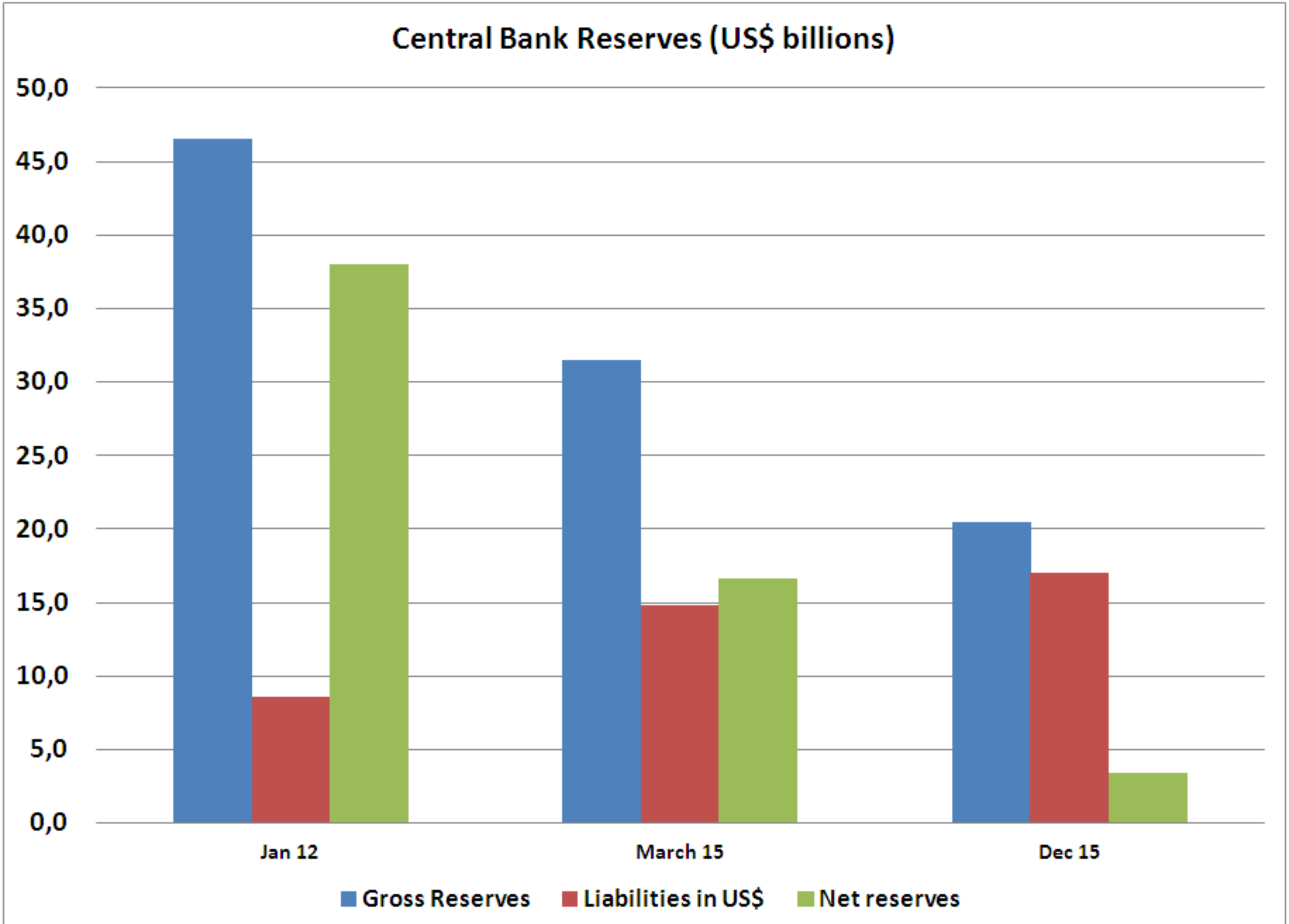


Federal Fiscal Balance (% of GDP)
4,0%
2,0%
0,0%
-2,0%
-4,0%
-6,0%
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
Central Bank Financing
Primary Balance
Global Balance


Money printing for the Treasury (% of GDP)
4,50%
4,00%
3,50%
3,00%
2,50%
2,00%
1,50%
1,00%
0,50%
0,00%
2009
2010
2011
2012
2013
2014


Central Bank Reserves (US$ billions)
50,0
45,0
40,0
35,0
30,0
25,0
20,0
15,0
10,0
5,0
0,0
Jan 12
March 15
Dec 15
Gross Reserves
Liabilities in US$
Net reserves


Central Bank Reserves (US$ billions)
50,0
45,0
40,0
35,0
30,0
25,0
20,0
15,0
10,0
5,0
0,0
Jan 12
March 15
Dec 15
Gross Reserves
Liabilities in US$
Net reserves



Central Bank Reserves (US$ billions)
50,0
45,0
40,0
35,0
30,0
25,0
20,0
15,0
10,0
5,0
0,0
Jan 12
March 15
Dec 15
Gross Reserves
Liabilities in US$
Net reserves

The opportunities ahead

- Large non-conventional gas and oil resources
- Output gap
- Relatively low public debt
- Getting back to “normal”

The Global Competitiveness Index 2013-2014

	GCI 2013-2014		GCI 2012-2013	
Country/Economy	Rank	Score	Rank	Change
Chile	34	4.61	33	-1
Panama	40	4.50	40	0
Costa Rica	54	4.35	57	3
Mexico	55	4.34	53	-2
Brazil	56	4.33	48	-8
Peru	61	4.25	61	0
Colombia	69	4.19	69	0
Ecuador	71	4.18	86	15
Uruguay	85	4.05	74	-11
Guatemala	86	4.04	83	-3
El Salvador	97	3.84	101	4
Bolivia	98	3.84	104	6
Nicaragua	99	3.84	108	9
Argentina	104	3.76	94	-10
Dominican Republic	105	3.76	105	0
Honduras	111	3.70	90	-21
Paraguay	119	3.61	116	-3
Venezuela	134	3.35	126	-8

- **Ranking out of 148 countries.**
- **Looks at 12 indicators of competitiviness**
- **Average of Brazil, Chile, Colombia, Mexico, Peru & Uruguay is 60**