

The Macri Administration: *Into the second part of the Presidential Term*



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1. Executive Summary

The end of President Mauricio Macri's second year in government finds him stronger: with a consolidated leadership as shown by the results of the legislative election held last October 22, the improved economic activity in 2017, the continuous political and economic measures implemented and the support shown by world leaders.

The governing party, *Cambiamos*, had a resounding victory in the recent elections on a national level, with 41% of the votes, consolidating its position as the country's leading political force and garnering a comfortable advantage over the traditional Peronist party. Mauricio Macri achieved a historical feat, for the first time in the last 32 years, leading a non-Peronist party to win the elections in the five most important districts of Argentina that represent two thirds of the nationwide votes.

The reaffirmation of the citizen vote to *Cambiamos* transcends even more because the former President Cristina Fernández de Kirchner has participated in the elections as candidate of the political party *Unidad Ciudadana*, losing in the province of Buenos Aires and obtaining as a political party only 21% of the votes nationwide. The society has ratified with its vote the search for transparency and professionalization of public management, both promoted by the current government. It should be noted that the strategic positions of the current administration are occupied by successful people from the private sector who turned to politics.

The electoral result partly reflects the economic achievements of the current administration on a domestic and international level. During its first 2 years of office, the Macri administration managed to unify the exchange market, lift controls on the purchase and sale of foreign currency, exit the default and return to international financial debt and equity markets, reduce annual inflation from around 40% to 20%, and emerge from a recession - achieving a 1.6% growth in GDP in the first semester of 2017.

Driven by voter support for the direction taken by the country's leadership, and by a rising positive image, President Macri has announced a series of structural reforms tailored to improve the country's competitiveness and growth. The government projects a 3.5% growth in GDP for the year 2018, a new drop in inflation -to an estimated annual 15%, an exchange rate of \$21ARS to the USD, and a reduction in the fiscal deficit to 3.2%.

This report discusses in more detail the main events that occurred in the first two years of Macri's mandate and the outlook for the second part of it (2018-2019).

Highlights of the 2nd year

Sector-Specific

- Plan for the operation of the Vaca Muerta oilfield.
- Opening-up of lemon exports to the US market.
- Opening-up of new air routes and arrival of low-cost airlines to the country.
- Construction of the Atucha III Nuclear Power Plant, with a generating capacity serving over one million people.
- Launch of the RenovAr 2 renewable energy plan, attracting offers of almost 8 times greater than the volumes required.
- Announcement of the first segment of competitive bidding for Public-Private Partnerships.

Foreign Policy

- Bilateral agreement with numerous countries and high-level meetings with international leaders.
- Fast-track process to join the Organization for Economic Cooperation and Development.
- Designation of Argentina as the host for the G-20 summit in 2018.
- Commencement of the IMF audit of national public accounts.

Domestic Policy

- Reduction of subsidies for electricity and an increase in jobs and investments in the electricity sector.
- Zero tolerance policy toward cases of corruption.
- Launch of the labor, tax and social security reform plan.
- Reactivation of personal loans through the launch of the U.V. A. mortgage loans (Unit of measurement created by the Argentine Central Bank -BCRA- to reactivate mortgage loans).
- Expansion of the capital market.

Normalization of economic imbalances

- Effective monetary policy created by the Central Bank to safeguard the value of the Argentine peso and reduce inflation.
- Increase of Central Bank reserves.
- Reduction of the unemployment rate from 9.3% to 8.7%.
- Reactivation of the economy.
- Reduction of the fiscal deficit from 5.4% of the GDP in 2015 to 4.2% in 2017.

2. Sector-Specific actions and outlook

Sector leaders of PwC Argentina highlighted the outlook and the following sector-specific actions.

2.1 Agriculture

Argentina has achieved a new record grain production during the 2016/17 campaign, after having completed its first crop production cycle during the Macri Administration. This record-high was mainly fueled by corn production, which again surpassed its latest record high. This occurred because of increased technology for farmlands, which resulted in higher productivity per hectare, as well as crop rotation from soybean to corn and wheat. Projections for the agricultural sector remain attractive as it is clearly one of the economic sectors that is better positioned to receive more foreign direct investment, particularly once restrictions on the purchase of land by foreigners has been removed. Current tax reforms are under discussion in Congress to reduce the tax burden (particularly, a reduction in turnover tax charged by provinces) and would also help to achieve a strategic goal for the agricultural sector: to add value in origin and thus industrialize and export commodities with more added value, especially incorporating technology and labor by Argentine workers.

The international landscape poses significant challenges for the agricultural producers, mainly due to tariffs imposed by the Trump Administration on Argentine biofuel, which currently does not have an alternative market until the European Union implements the resolution adopted by the World Trade Organization. Access to foreign markets for Argentine products should remain an area of focus for both our Foreign Affairs and Agricultural Ministries. In a rapidly growing Asian population that is eager to improve its diet with more proteins, a key liaison to Asia would help to link Argentine agricultural production to meet this rapidly growing demand for protein and provide good opportunities for our local pork, poultry and beef industries.

2.2 Infrastructure

Infrastructure is an important priority for this government given the significant lack of infrastructure that the country has. Under this landscape, the government boosted the enactment of the Law of Public-Private Participation (PPP) Agreements, which, together with its regulation published in February 2017, is the path the government would like to promote in relation to public works and infrastructure in general.

A list of 60 priority projects spread out across the country and of national importance has been published, which the government intends to implement via PPP; the projects represent investment of over US\$ 26 billion for the next 5 years. These projects are in diverse fields of Energy & Mining, Transportation, Telecommunications, Water, Sanitation & Housing, as well as Health, Education & Justice. In November 2017, the government officially launched the first stage of the Public-Private Participation Plan focused on road infrastructure, with the first 16 projects expected to be assigned during the first quarter of 2018.

2.3 Telecommunications

During the second year of the administration of Mauricio Macri, progress has been made in the modernization and development of telecommunications. Through decree 1340/16, the Government took a new step toward converging telecommunications by authorizing telephone companies to offer pay TV throughout the country in 2018. This will enable any operator to offer fixed and mobile telephony, Internet and pay TV (4Play), allowing greater competition and encouraging investment. Furthermore, the government aim to incorporate 2 million people who currently do not have internet access, improve bandwidth, expand the spectrum twofold, and accelerate investments to incorporate 5G.

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2.4 Energy

The Argentine energy sector continues to offer significant opportunities for investors. In 2016 the government launched the RenovAR plan to attract over US\$ 15 billion in investments to increase renewable energies to 20% of the energy matrix by the year 2025 (they currently account for 2%). Round 1, carried out in 2016, was highly successful and has attracted offers representing over 6 times the volumes required by the government. In October 2017 the government launched Round 2, attracting offers almost 8 times greater than the volumes required (9400 MW vs 1200 MW).

In the oil segment, important investments continued in Vaca Muerta, one of the largest oil and shale gas areas in the world, and very significant investments are expected to continue in the years ahead. The gas price incentive plan launched by the government and the cooperation agreement between the province, trade unions and private companies have enabled cost reductions and contributed to attracting investments. Additionally, as from October 2017 the country began to determine its oil prices in line with the international market, putting an end to the price regulation established in recent years.

2.5 Mining

The mining sector faces a number of opportunities and challenges in the second year. Early measures implemented by the Macri administration, including the lifting of foreign exchange controls and the elimination of withholdings on mining exports, enhanced competitiveness and development of the sector.

The Macri administration needs to portray consistency between provinces to improve the attractiveness of investment and assuage investor uncertainty. To that end, the Argentine government wants to unify mining regulations under a proposed federal law that would permit mines to operate throughout the country; the government plans to send its mining bill to Congress early next year after reaching consensus with Provincial administrations.

Despite challenges, there are opportunities to revive previously discontinued large projects, such as Potasio Rio Colorado and Pascua-Lama. Furthermore, there are new investments in exploration, including the development of lithium projects in Argentina's northern salt flats.

2.6 Financial services

One of the main objectives of the Central Bank during 2017 was to reduce the rate of inflation, aiming at a one-digit inflation target for the year 2019. As an anti-inflationary monetary policy, the Argentine Central Bank has issued high-interest rate bills (Lebacs), reducing money in circulation and consequently financial institutions have been led to invest in these as opposed to other financial instruments.

As the inflation rate continues to drop and tends to converge with the Central Bank's expectations, so will the LEBAC real interest rates. This reduction in interest rates will gradually make these bills less attractive and will motivate financial institutions to develop new products. This challenge will go hand in hand with the need to increase the average term for deposits in order to develop long-term products. The access to financial services is low in Argentina. The private credit for enterprises represents 15% of the GDP, whereas in Europe it represents 95% and in the US, 190%. The financial market is thus expected to grow and to develop new products, while offering new opportunities.

The Financial System continues to offer fertile ground for the digitization of operations, the increase in banking levels, financial inclusion and efficiency in the cost structure of financial institutions. The items on the agenda are: (i) deepening access to credit, which shows improvements through long-term U.V.A. instruments (especially mortgage loans); and (ii) financial innovation boosted by mobile technologies, web platforms and the relationship between traditional banking and FinTech within a framework of regulatory barriers that should be reviewed.

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3. Domestic Affairs

Boosted by the recent electoral victory and a rising positive image, President Macri has announced a series of structural reforms that he sent to the National Congress he deemed necessary to improve the country's growth and competitiveness.

The reforms announced by government propose a medium-term economic, fiscal and labor plan, granting predictability for citizens and investors and gradually modifying the significant imbalances inherited from previous administrations.

Main reforms announced by Government

Labor reform: The labor reform seeks to improve the competitiveness of Argentine manpower compared with its neighboring countries by reducing associated costs.

- Reduction of labor costs: gradual reduction of employer contributions paid by companies for their employees.
- Negotiation of sector agreements by industry to lower specific labor costs of each sector.
- Formalization of labor with the aim of reducing informal employment (which currently accounts for 33.7% of salaried employees): Full exemption from fines for employers that transform informal jobs into formal ones.
- Ius variandi: Changes in employee work terms and conditions (time, place, activity). An Hour bank: remuneration of overtime with work hours.
- Elimination of solidary responsibility of companies in the case of subcontracting of certain activities (cleaning, security, cafeteria service, transport, among others).

Tax Reform: Bring the level of taxation in line with other Latin American and OECD member countries.

- Reduce the current tax burden from 41% to 33% of the GDP in 6 years
- Main tax reductions announced:
- Use of check tax charges as payment for Income Tax.
- Gradual reduction of the income tax applied to retained earnings reinvested by companies (35% to 25%).
- Elimination of the tax on the transfer of real estate.
- Early refund of VAT for investments.
- Reduction of provincial taxes through an agreement with the provinces: Gross Revenue Tax, Stamp tax.

Reform of the Capital Market Law: The reform of this law seeks to develop the capital markets, leveraging and accompanying country growth.

- Elimination of the tax on closed mutual investment funds;
- Authorization for private banks and international investment banks to operate in the country from abroad;
- Limit the power of the National Securities Commission (CNV) to intervene in the affairs of publicly traded companies, including its veto power.
- Restrict the power of the CNV to separate the administrative bodies of publicly traded companies.
- Elimination of barriers on the issue of Negotiable Bonds by the Board of Directors of companies.

Social Security Reform: The reform aims to eliminate certain imbalances that make the current social security system inoperable to reduce the fiscal deficit:

- Changes in the calculation of retirement/pension payment adjustments. The inflation rate will be used instead of a formula based on GDP's growth.
- Elimination of privileged retirement benefits awarded to certain officers of the Executive and the Judiciary power.
- Increase of the retirement age.

Reduction of the Fiscal Deficit:

- The Government will seek to reduce the primary fiscal deficit from the current 4.2 to 3.2 of the GDP in 2018 and to 2.2% by 2019 - the last year of its term.
- The government reforms referred to envisage a reduction in subsidies and in public works spending (through a move toward public-private partnerships) to achieve the proposed objectives.



President Mauricio Macri and Minister of Finance Nicolas Dujovne

Solid and independent institutions

During the first part of his mandate, President Macri has centered the actions of his administration on returning independence from the Executive branch to the country's institutions. The attainment of this goal can be seen in the actions and measures taken by the Argentine Central Bank, the Judiciary, and the Federal Administration (AFIP). These organisms have freedom of action - without pressure from the Executive - to take the measures they deem best for the country.

Additionally, the NGO Transparency International issued a report indicating that Argentina has made progress in the field of transparency and the fight against corruption, including the enactment of the Public Information Access Act and the Repentance Law.

With regard to the BCRA and the AFIP, both these organisms act with total independence and implement measures in line with the powers vested in them by their respective regulations, despite the fact that these may on occasion be opposed to the vision of the Executive branch.

4. International Affairs

In the second year of his mandate, the reinsertion of Argentina in world affairs has been a priority of President Macri's agenda. Argentina's foreign relations had a clear focus on economic issues, specifically on attracting investments based on the recovery of international confidence and strengthening political and economic ties with countries where relations were virtually frozen.

Bilateral Relations

During the first two years of office of President Mauricio Macri, several high-ranked world leaders have visited the country, showing their support for the President and his economic policy. During his first year in government, Macri hosted visits by former Italian Prime Minister Matteo Renzi; former French President Francois Hollande; former President of the United States of America Barack Obama; Canadian Prime Minister Justin Trudeau; Japanese Prime Minister Shinzo Abe; and former UN Secretary General Ban Ki-Moon.

During the second year of Macri's administration, he continued to host renowned international leaders. In June 2017, German Prime Minister Angela Merkel met with Macri in Buenos Aires, marking the first official visit by a German leader in 15 years. During her stay in Argentina, Merkel praised the measures taken by the new government, in terms of reforms implemented and international cooperation, and supported the country's inclusion in the OECD (Organization for Economic Cooperation and Development). In August 2017, Macri hosted a visit by Vice President of the United States Mike Pence, with whom he talked of increasing mutually beneficial bilateral trade. One of the Argentine Government's achievements in terms of bilateral trade has been the definitive authorization for lemon exports to the US after a 16-year ban.

Another significant visit in the economic sphere was that of World Bank President Jim Yong Kim, who highlighted that the Argentine economy has taken a promising path and anticipated that the international agency will grant funding



Macri - Angela Merkel (Germany)

of up to US\$ 2 billion next year, to be distributed between the public and private sectors.

Additionally, President Macri has made progress in the negotiation of multiple cooperation, investment, employment and trade agreements with various developed countries that are considered world powers, such as Spain, Italy, the Netherlands, Japan and China. Conversations with the Association of Southeast Asian Nations (ASEAN) have also been accelerated for the development of a trade agreement with the Mercosur, which would imply cooperation between two blocks made up by emerging economies with high growth rates.

Private Sector

With regard to the private sector, the Macri administration has placed significant emphasis on regaining investor confidence. In 2016 the Argentina Business and Investment Forum was organized, with the participation of over 2,000 business

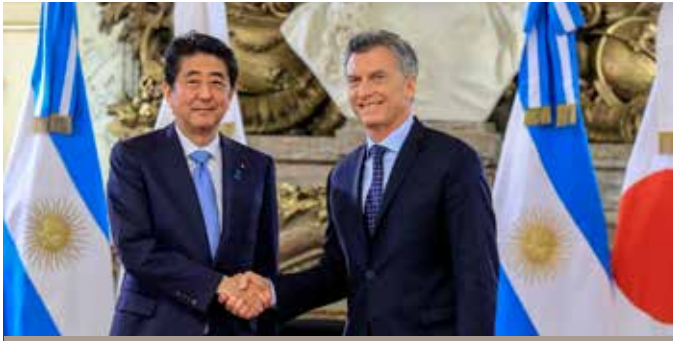
executives, investors and politicians from 67 different countries, inviting them to take part in the country's new economic phase to grant new dynamism to the productive sectors.

As a result of the commitment shown by Macri with this vision for a new country, various foreign companies have announced interest in investing locally, for a total of more than US\$ 74 billion.

Additionally, after ten years of absence, Argentina took part once again in the World Economic Forum at Davos, where officers of the Macri administration used the opportunity to meet with leading global politicians and business people to coordinate cross-border investments and trade relations.

G20 and Mercosur

The designation of Argentina as chair of the G-20 for 2018 endorses the country's achievements in terms of foreign policy and will allow it to once again form part of the international business forum, with



Macri - Shinzo Abe (Japan)



Macri - Michelle Bachelet (Chile)



Macri - Justin Trudeau (Canada)



Macri - François Hollande (France)



Macri - Enrique Peña Nieto (Mexico)



Macri - Donald Trump (USA)

a potential to promote initiatives that are aligned with the country's interests.

With regard to regional relations, the Macri administration is focused on negotiating a free trade agreement between Mercosur - the economic block made up by Argentina, Brazil, Uruguay and Paraguay - and the European Union. This will allow the country to significantly increase beef exports and restore the local biodiesel market and could trigger European investments, giving the country a chance to access decisive capital assets for a much-needed industrial boost.

The Argentine government expects to close this agreement by the end of the year

IMF

The IMF audit of the Argentine economy under the framework of the well-known article IV (regular annual inspection of all IMF member countries) took place in October 2017. This is viewed by the Government as a core issue for the future years of its term. After a decade with no IMF audit, this is a clear signal to the world that the country is on the right path in terms of economic and fiscal policy.

The recovery of IMF confidence will grant Argentina access to funding at lower interest rates.

Emerging market rating

The government estimates that because of all the corrections implemented and of the reforms and changes announced in 2018 it will receive an emerging market rating (the country is currently rated as a frontier market) by investment bank Morgan Stanley, with the consequent inclusion in the MSCI index. This rating would allow the country to leverage its growth and development by opening access to credit for business at lower interest rates, favoring foreign capital inflows in view of the number of institutional and financial funds that replicate this market / index.

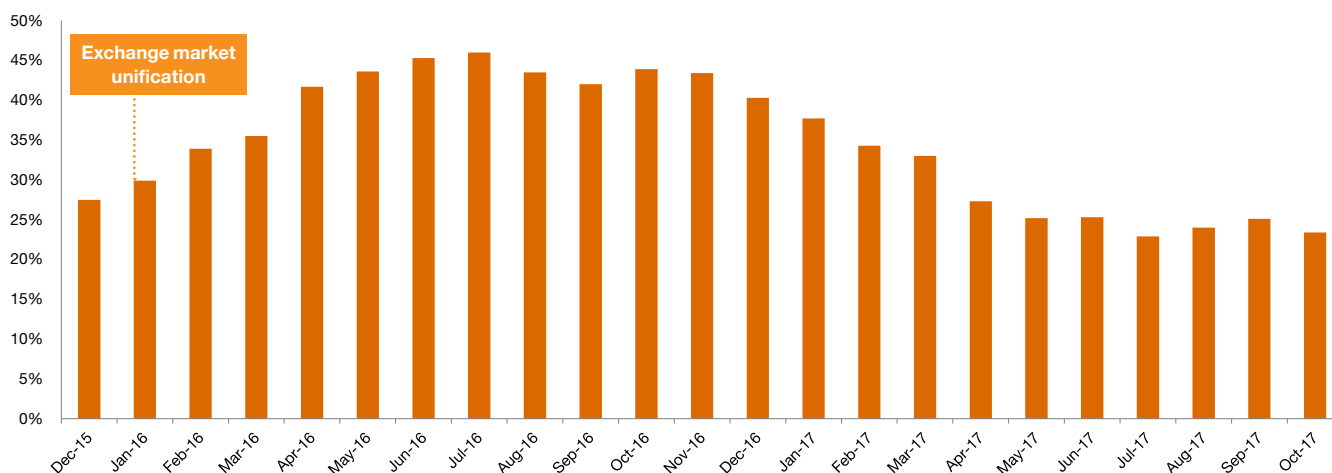
5. Normalizing economic imbalances



Federico Sturzenegger at IDEA's 2016 annual conference in Buenos Aires

Macri's government continues to combat the major macroeconomic imbalances inherited from the previous administration. As noted by President Macri in his inaugural speech in 2015, the reduction of inflation, the fiscal deficit and poverty are the priorities and major objectives of his executive mandate. Success in achieving these three goals will lead to the growth and development of Argentina. Inflation is expected to be slightly above 20% by the end of 2017, although exceeding the initial 17% inflation target for the year, but significantly below the 41% inflation recorded in 2016. Central Bank President Federico Sturzenegger declared the government's inflationary goal as 15%, continuing the downward trend since the present government took office, and close to the maximum one-digit target inflation rate for 2019. To achieve this inflationary target, the Central Bank, as an autarchic agency, will continue with its restrictive monetary policy, maintaining high interest rates in the face of a change in the decline in inflation.

Inflation in Argentina during Macri's presidency (Consumers Prices Index LTM)



Source: CPI Congress

As a result of the progressive normalization of existing imbalances, the Argentine economy showed a recovery in 2017, according to data published by the INDEC (Statistics and Census Institute). The GDP grew 1.6% in the first semester compared with the same period of 2016, at a rate of 0.4% during the first quarter and 2.7% during the second. In September, the Monthly Economic Activity Evolution index (EMAE) reported a growth for a seventh consecutive month, compared with the same month of the previous year. This indicator showed a cumulative growth of 2.5% for the first nine months of the year continuing its upward trend that reflects a consolidated recovery of the local economy. This change has taken momentum in the second and third quarter when some sectors started to show stronger performances. The agriculture and construction sectors have taken the lead and have been promoting different industrial blocks. Thus, manufacturing activity as a whole has been growing since May on a year over year basis and increased 1.5% in the first nine months of the year after having fallen for fifteen consecutive months in its year over year comparison.

Additionally, according to the latest Permanent Household Survey (EPH) published by the INDEC, employment is beginning to recover, in line with the upturn in economic activity. Unemployment fell to 8.7% in the second semester of 2017, versus 9.3%

for the same period of the previous year, which means that in the span of one year 57,000 people found employment.

When looking at foreign trade, exports are starting to recover after having been primarily affected by the poor economic performance of Brazil, the main trade partner with Argentina, together with lower international commodity prices. On the other hand, the economic activity rebound led to imports growing at a faster rate. This will lead to a negative trade balance for 2017 and is a variable to monitor in the years to come as the exports need to gain competitiveness through means other than the exchange rate.

Aware of this, the government has focused on reducing costs by improving infrastructure through the investment in public works and has sent to Congress different bills to reform the tax system, reduce labor costs and improve the efficiency of capital markets. In the meantime, it has signed agreements with the trade unions and industry chambers within different economic sectors - such as the energy sector, construction, automotive area and SMEs, among others - to reduce specific costs and improve productivity.

On the fiscal side, the government will meet its primary deficit target, 4.2% for all of 2017, as it did last year. The public sector has significantly modified its pattern of financing: up to 2015, its main source was financing through the Central Bank, whereas from 2016,

funding has come mainly through borrowing in the capital markets. The current administration still faces the challenge of meeting the fiscal deficit reduction target of 2.2% of the GDP in 2019.

Argentina has maintained its stance of obtaining funding through the issue of bonds on the capital markets. In January 2017, the government placed US\$ 7 billion worth in bonds, with a significant interest rate reduction, obtaining an average 6.3% annual rate, below the 7.2% it had attained in 2016. In June 2017, for the first time in the history of the country, Argentina issued a 100-year USD bond on the international market for US\$ 2.75 billion, reflecting long-term investor confidence in the country. In November this year, Argentina returned to the European market with the placement of three bonds totaling 2.75 billion euros, including the first 30-year bond ever placed by the country in that currency. Once again, this shows investor confidence in the policies implemented by the national government.

As a result of this, during the second year of Macri's term, the Central Bank continued to increase its reserves, which are currently at a level of US\$ 55 billion, historical record to date, which allows the government to safeguard the exchange market against sudden fluctuations and pay foreign debt commitments.



6. What we expect at PwC?

The ruling party's recent electoral victory confirms the path the country is taking and is a vote of confidence for the government to implement structural reforms directed at solving fundamental problems such as the high poverty level, extensive informal employment and economy, the country's high tax burden, and the lack of infrastructure that effects Argentina's competitiveness.

In addition to the planned reforms, progress made in lawsuits against corruption, added to the independence and economic self-sufficiency shown by the Central Bank, the AFIP, and the Judiciary, provide a framework of legal security for investors and for the country's citizenry.

While there are challenges that still lie ahead for the Argentina economy, the business community and stakeholders agree that the Government has taken steps in the right direction to recover the macroeconomic balances and to set the foundations for a robust economic growth based on investment toward the development of the country.

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