The Macri Administration:
Into the Second Year

December 2016
Contents

1. Executive summary........................................................................................................................................3

2. Sector-specific actions and perspectives..................................................................................................4
   2.1 Agriculture........................................................................................................................................4
   2.2 Infrastructure.....................................................................................................................................4
   2.3 Telecommunications.........................................................................................................................4
   2.4 Energy ...............................................................................................................................................5
   2.5 Mining .............................................................................................................................................5
   2.6 Financial services ..............................................................................................................................5

3. International affairs ..................................................................................................................................6

4. Domestic affairs .........................................................................................................................................7

5. Normalizing economic imbalances ...........................................................................................................8

6. What we expect at PwC ..........................................................................................................................11

Contacts

If you wish to obtain information and/or learn how we can help, please contact us

Santiago Mignone
Country Senior Partner
santiago.mignone@ar.pwc.com
Tel.: +54 11 4850-4563

Jorge C. Bacher
Partner | Deals
jorge.c.bacher@ar.pwc.com
Tel.: +54 11 4850-6814

Ignacio Aquino
Partner | Deals
ignacio.aquino@ar.pwc.com
Tel.: +54 11 4850-6816

Federico Hourbeigt
Manager | Corporate Finance
federico.hourbeigt@ar.pwc.com
Tel.: +54 11 4850-4672

Eric Krasnow
Senior Analyst | Corporate Finance
eric.krasnow@ar.pwc.com
Tel.: +54 11 4850-0000 ext. 6176
1. Executive summary

In its first year, President Mauricio Macri’s administration implemented major domestic and international initiatives. Achievements include a unified money exchange rate market, a return to capital markets, normalized domestic institutions, strengthened relationships with international organizations and governments and an improved political culture in Congress.

Despite these successes, the year is ending with more difficulties than expected by government officials. First, foreign and domestic investments have not materialized as originally anticipated. Second, poverty levels remain high, implying the need for government support and subsidies to boost consumption and improve living standards. With mid-terms approaching in October 2017, it is likely that such government support will increase in the short-term.

For 2017, the Argentine government predicts GDP (est. USD 550 billion in 2016) growth of 3.5%, inflation of 17%, a USD/ARS exchange rate of 18 and a government deficit of 4.2%.

The fact that President Macri and his leadership team are taking actions to manage this complex situation and achieve the administration’s macroeconomic goals is positively viewed by the business community and other stakeholders. This report discusses the main events that occurred in the second semester of 2016, and prospects for 2017.

Highlights of the first-year

**Sector-specific**
- Elimination of export tariffs on agricultural products, reduction of tariffs on soy.
- USD 16 billion infrastructure program with associated social impact.
- Passing of Public-Private Partnership bill to attract long-term infrastructure investments.
- Launch of Renewable Energy Plan that is expected to attract USD 15 billion in investment.

**Foreign Policy**
- Leadership position in MERCOSUR/EU trade talks.
- Observer status in the Pacific Alliance.
- Fast-track process to join the Organization for Economic Cooperation and Development.
- Ratified bid to host the 2018 G20 Summit.
- Bilateral agreements with numerous countries, and high-level meetings with international leaders, including U.S. President Barack Obama, French President François Hollande, German Chancellor Angela Merkel, Canadian Prime Minister Justin Trudeau, Japanese Prime Minister Shinzo Abe and Mexican President Enrique Peña Nieto, among others.

**Domestic Policy**
- Removal of IMF censure on INDEC, Argentina’s statistic agency.
- Major impact of Tax Amnesty Law that will inject tens of billions of USD into the economy.
- Agreement with business and union leaders to curb layoffs until March 2017.
- High-level anti-corruption cases prosecuted in courts.
- Completed gas and electricity tariff review, process of normalization in utilities industry.
- Law passed to incentivize small-medium businesses by providing credits.
- Judicial reform, improving institutional independence, justice and human rights.

**Normalizing economic imbalances**
- Liberation of foreign exchange controls, Argentine Peso put on managed-float.
- Settled negotiations with debt default holdouts, followed by a return to capital markets and multiple bond sales.
- Bolstering of Central Bank reserves through various measures.
- Central Bank emphasis on using monetary policy, primarily interest rates, to reduce inflation.
2. Sector-specific actions and perspectives

The following sector-specific actions and perspectives were highlighted by PwC Argentina's sector leaders.

### 2.1 Agriculture

The agriculture sector in Argentina faced a few setbacks in the second semester. First, high inflation rates in the country reduced the initial impact of the sector’s improved competitiveness that was generated by the liberation of foreign exchange controls and the elimination of export tariffs. Second, due to fiscal restrictions, the government did not advance with its planned gradual elimination of soybean tariffs for the next season. Third, the sector’s future became more uncertain with the victory of United States President-elect Donald Trump. A series of important questions for the Argentine agricultural sector have arisen as a result: 1) What will the impact of potential U.S. trade restrictions be on international agriculture commodity prices; especially pertaining to China, the main recipient of Argentine grains and oils, 2) Will Trump’s energy policy, through the elimination of subsidies to American blenders that import biofuel, impact the export of Argentine biofuel and 3) Will the measures of economic openness announced by the Obama administration that would favor the export of lemons and Argentine beef to the U.S. market be effectively implemented?

### 2.2 Infrastructure

The infrastructure sector had some positive results in the second semester. In November, the Public-Private Partnership (PPP) bill was sanctioned by Argentina’s Senate. The bill is set to attract long-term investments in infrastructure from the private sector by providing guarantees to hedge the risks associated with the public sector. In addition, there are ongoing and significant discussions in Congress to reform Argentina’s Income Tax Law; these will continue into the next year, seeing as many questions from Congressional members and tax experts remain.

On November 30th the Argentine Senate enacted the National Public Administration Budget bill and approved a reform to the Financial Administration Law, which limits the Executive Branch’s discretion and power to reallocate budget items. The budget contemplates GDP growth of 3.5%, inflation of 17%, USD/ARS exchange rate of 18 and a fiscal deficit of 4.2% in 2017, and includes an ambitious public works plan. Lastly, on December 6th, Argentina was excluded from the Programme for International Student Association (PISA) test run by the OECD; there are still no reliable statistics and assessments for students in the country.

### 2.3 Telecommunications

The Macri administration has continued to gradually improve the quality of mobile communications and internet access in the country in the second semester. The Plan of Mobile Internet Access (PAIM), launched in July, is expected to result in the replacement of 1 million mobile devices by the end of 2016. In addition, the Convergent Communications law, which aims to extend the right to communication and quality for all Argentines, is in the last stage of drafting. The regulatory framework for licenses of Virtual Mobile Operators (VMO's) is also in development. The administration has also begun implementing communication tools that better productivity in the sector, and the rearrangement of some bands of the radio spectrum is in the final stage. Major agenda items for the sector include regulatory changes and the need for investment.
2.4 Energy

In May, Macri launched Plan RenovAr, a decade-long plan to attract USD 15 billion in renewable energy investments. The first phase of the bidding process was encouraging; the Argentine government received offers for more than 6,000 MW, and granted contracts to build 1,100 MW (700 MW in wind and 400 MW in solar), with estimated investments of USD 1.8 billion. The next bidding process will be in May 2017. Financing is now the main challenge most companies face.

Currently, the Macri administration is articulating a plan to have local oil prices converge with international prices – this could happen by mid-2017. In addition, the government is articulating a strategic plan to allow investors to develop the Vaca Muerta Shale fields, one of the largest oil and gas shale fields in the world. This plan includes negotiations to make oil worker contracts more flexible and to reduce taxes and royalties. Big international players are coming to the country to explore opportunities to invest in oil and gas shale fields.

A main challenge in the second semester was related to gas and electricity tariffs. In mid-August, Argentina’s Supreme Court annulled the increases in residential natural-gas prices the Macri administration made in the first semester. Public hearings have since taken place in the gas sector and are being completed in the areas of electricity distribution and transmission; these will trigger tariff adjustments.

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 liberation of foreign exchange controls and the elimination of the withholdings on mining exports, enhanced the competitiveness and development of the sector.

The Macri administration needs to portray consistency between provinces to improve the investment attractiveness and assuage investor uncertainty. To that end, the Argentine government wants to unify mining regulations under a proposed federal law that would permit open-pit mines to operate throughout the country; the government plans to send its mining bill to Congress early next year. In this context, concern resulted from recent Congressional discussions about whether or not export duties on mining products should be reestablished as a way to finance an income tax cut for middle income workers and other tax allowances.

Despite these challenges, there are opportunities to re-stimulate large projects that were previously discontinued, such as Potacio Río Colorado and Lama. Furthermore, there are new investments to explore, including the development of lithium projects in Argentina’s northern salt pans.

2.6 Financial services

The Macri administration has continued the process of deregulating commissions for financial institutions into the second year. This is necessary to create sustainable business in a context of decreasing rates and spreads and inelastic costs. There also remains a great opportunity for the industry through regulatory changes that will allow the country to deepen processes of digitalization, improve application of new technologies conducive to better operational efficiency, increase banking levels and facilitate financial inclusion.

In addition, the sector is likely to improve in the second year as a result of the Tax Amnesty Law, which has increased deposits by nearly USD 7.2 billion in Argentine bank accounts as of November 21st. This repatriation of cash has resulted in reactivated financial flows and enables the possibility of new applications of funds that the Central Bank can regulate. The emphasis the Central Bank has on reducing inflation and making cash available is also a positive sign for the sector.

There are various challenges and questions for the financial services sector into the second year. First is the effect of United States President-elect Trump, and the question of how high interest rates in the United States will impact the local market. Another is the tension that remains between reference rates that continued to decline at a slower pace and those rates’ impact on economic activity. Third is that the demand for credit has not yet demonstrated signs of economic growth.
In the second semester, President Macri continued his major initiatives to improve relationships in Latin America and around the globe. Regionally, the administration took steps towards strengthening Mercosur, a trade bloc that counts Argentina, Brazil, Paraguay and Uruguay as its member states (Venezuela was suspended from Mercosur on December 1st). In October, President Macri met with his Brazilian and Uruguayan counterparts, Michel Temer and Tabare Vazquez, respectively, to discuss strategies to use Mercosur as a platform to open Europe, China and the world.

The European Union has taken note of Argentina’s leadership. After a meeting with Macri in August, European Parliament President Martin Shultz stated that the EU is looking to establish links with the region through Argentina. In early November, an EU parliament delegation of 14 lawmakers arrived to Buenos Aires to boost Mercosur/EU trade talks create a framework that involves interests from business leaders, farmers and unions, among others.

Also in the second semester, the Macri administration hosted high-ranking international figures. On November 17th, Canadian Prime Minister Justin Trudeau met with Macri in Buenos Aires – the two discussed their goals on a range of issues, such as: strengthening trade, collaborating on polar research, promoting human rights and combating protectionism. Three days later, President Macri hosted Japanese Prime Minister Shinzo Abe – the first instance in 57 years that a Japanese Prime Minister visited Argentina – along with a delegation of leading Japanese business leaders. Macri and Abe signed a tax pact for increased economic exchanges, and spoke of expanding bilateral trade and investment. The above meetings, in addition to those of United States President Barack Obama, Secretary of State John Kerry and Treasury Secretary Jack Lew, were especially significant in terms of foreign policy.

Regionally, the Macri administration has taken a lead in promoting the sciences and environmental protection. On September 1st, Argentina’s Congress ratified the Paris Climate Change Accord, on November 23rd, Argentina and the U.K. signed an accord to promote joint work in scientific research and an active exchange of scientists and, in August, the U.S. and Argentina organized the first ever bilateral Ocean and Data Management meeting in the country. Argentina and the U.S. have continued to partner on global challenges, such as peacekeeping, refugees, the defense of human rights, and to reach agreements on the economic front to help small businesses and entrepreneurship. This cooperation may continue into the future – on a phone call with Macri, President-elect Trump said the two countries will have their closest relationship in history.

The Macri administration is also building relationships with new partners. In early November, Argentina and Qatar agreed to create a billion-dollar joint fund to carry out infrastructure works in addition to bilateral promotion and protection agreements. And, in September, Argentina’s defense minister Julio Martinez travelled to Russia in order to expand bilateral strategic cooperation in defense issues, such as the supply of hardware and equipment.

In the private sector, the Macri administration has taken great strides to promote trade build investor confidence in Argentina. From September 12th to the 15th, nearly 2,000 executives, investors and political figures from dozens of countries attended the Argentina Business and Investment Forum. At the conference, General Electric pledged USD 10 billion in Argentina over the next decade, including USD 900 million to build thermal power plants and a USD 288 million loan to Aerolineas Argentinas to finance the purchase of 7 airplanes. Also at the forum, Siemens AF stated its goal to provide financing for USD 5.6 billion in infrastructure, energy and transportation projects. Further demonstrating investment interest in the country, the U.S. Ex-Im Bank said it would begin offering financing in Argentina for the first time since 2002, and that it was willing to finance all possible export/import projects at the lowest possible rates to support the country.
Despite having a minority position in Congress, Macri’s political party has managed substantial accomplishments and reforms through compromise and the creation of coalitions with opposition members.

The June 29th Tax Amnesty Law, which aimed to increase government revenue, stimulate local investment and settle ongoing debts with pensioners, had positive results in the second semester. According to Finance Minister Alfonso Prat-Gay, as of November 21st, Argentine citizens had declared USD 21.9 billion in hidden savings, and had deposited nearly USD 7.2 billion in special bank accounts. The Law expires in March, 2017.

President Macri’s year-long efforts to strengthen the national statistics agency INDEC and produce reliable and trustworthy data also resulted in positive results in the second semester; on November 9th, the International Monetary Fund officially removed its Declaration of Censure on INDEC.

One of the main challenges for the Macri administration heading into the second semester was unemployment, which rose to 9.3 percent in the second quarter, before falling to 8.5 percent in the third, due to lower activities in certain sectors and the dismissal of government employees without specific positions. On November 23rd, the Argentine government reached an agreement with business and CGT (General Confederation of Labor) union leaders to prevent layoffs until March 2017, thus reassuring workers that the government is committed to creating new jobs and preserving existing ones. The Organization for Economic Cooperation and Development estimates that unemployment will fall during 2017, when the full impact of the Macri administration’s reforms will be felt.

As discussed, another challenge for the administration is related to gas and electricity tariffs. In mid-August, Argentina’s Supreme Court annulled the increases in residential natural-gas prices the Macri administration made in the first semester, ruling that the government must hold public hearings before implementing any rate increase. Public hearings have since taken place in the gas sector and are being completed in the areas of electricity distribution and transmission; these will trigger tariff adjustments.

In addition, there are ongoing and significant discussions between the two main political parties in Congress relating to reforming Argentina’s Income Tax Law. These will extend into the second year.

President Macri’s administration has also continued its push to combat drug traffickers in the country. From a security standpoint, Macri is adding radars and better equipping security forces on Argentina’s borders. The Argentine Congress is also looking to criminalize the misuse of chemical precursors to make synthetic drugs.
Curbing inflation remains a top priority for the government. In a speech at the 52nd annual IDEA Colloquium on October 14th, Central Bank President Federico Sturzenegger shared his goal to lower the inflation rate to between 12 and 17 percent in 2017, 8 and 12 percent in 2018 and 5 percent in 2019. Sturzenegger emphasized his position that the Central Bank will use the interest rate as the main tool of their monetary policy, and will not touch the exchange rate as to preserve the value of the Argentine peso.
In November, monthly inflation was 1.6 percent, down from 2.4 percent in October. The high inflation rate of 2016 has resulted in consequences for consumers and businesses. One such effect has been high interest rates on loans, which makes credits unaffordable for many companies. Amid expectations that inflation will begin to slow, Argentina’s main state-run bank, Banco Nacion, lowered its interest rates for loans to businesses, a move that will help put credit back within reach. In addition, Banco Nacion has also set aside USD 330 million for loans to small and medium businesses at a discounted rate of 15%.

To show its confidence that inflation would decline in line with its expectations, the Central Bank has also dropped its benchmark interest rates by 150 basis points in November, to 25.25 percent. In addition, the Central Bank has continued to bolster reserves into the second semester. For the first time in three years, reserves grew to almost USD 40 billion, before dropping to USD 37 billion, a significant increase from the USD 24 billion held by the Central Bank in December 2015, when Argentina was on the brink of a balance of payment crisis.

Argentina has also furthered its strong return to capital markets. On October 4th, the country sold USD 2.8 billion of debt. The deal was priced at a yield of 4% for a bond that matures in 2022 and 5.125% for one that comes due in 2027.
The Macri Administration: Into the Second Year

December 2016
6. What we expect at PwC

The year of 2016 is ending with more significant challenges than the government had originally anticipated, such initial expectations were discussed in our previous reports. Foreign and domestic investments have not yet materialized as planned, and poverty (now measured accurately as government statistics are significantly more reliable) remains high for almost 30% of the population, implying the need for government support and subsidies to boost consumption and improve living standards. As stated earlier, Congress will face mid-term elections in 2017.

On the other hand, bold decisions taken by the Macri administration, including unifying the money exchange rate market, settling negotiations with debt default holdouts, normalizing domestic institutions and others, combined with a sound democratic attitude in Congress that enabled the passing of significant legislation, provide substance for the Argentine government’s intended macroeconomic policies. The business community and other stakeholders believe that the economic indicators of 2017 will be better than those of 2016, and that the path towards growth and development will become evident.
©2016 In Argentina, the member firms of the global network of PricewaterhouseCoopers International Limited are Price Waterhouse & Co. S.R.L, Price Waterhouse & Co. Asesores de Empresas S.R.L. and PwC Legal S.R.L, each of which, either separately or jointly, are identified as PwC Argentina.