Argentina: From Bad to Worse?

*By Arturo C. Porzecanski**

Argentina’s new Economy Minister, Silvina Batakis

Argentina’s mismanagement of fiscal, monetary, and exchange-rate policies – and its business-unfriendly, interventionist policies destructive of investor confidence – have delivered an increasingly unpopular mix of economic stagnation and accelerating inflation. While the government most likely will muddle through until the next national elections in October 2023, there is a non-negligible risk that remaining public confidence could collapse and lead to uncontrolled inflation, deepening recession, social unrest, and even the resignation of President Alberto Fernández.

- By early 2021, the Argentine economy had already recovered from the 15 percent drop in real GDP caused by the pandemic in the second quarter of 2020. That was a relatively easy feat because the economy was already in a recession; real GDP in the first quarter of 2020 stood 11 percent below that in the fourth quarter of 2017. So far this year, the pace of economic activity has remained below that 2017 peak, and it has started to drop some more, with the latest consensus forecast projecting GDP declines in the second and third quarters, followed by stagnation in the fourth trimester.
- Inflation has accelerated from a yearly average pace of under 50 percent in 2020 and 2021 to an annualized rate of 85 percent in the first half of this year. This month’s inflation rate may well have three digits once annualized. To slow down inflation, the government has resorted to price controls on staples sold by supermarkets; import and capital controls to prevent the currency from devaluing faster; export quotas on beef, corn, and wheat to keep domestic supplies higher and prices lower; and hefty subsidies to state-owned and private companies that supply

electricity, gasoline, natural gas, mass transit, and water and sewer services to consumers. As a result, the headline inflation rate is underestimated by at least 10 percentage points, while the subsidies are keeping the fiscal deficit about 4 percent of GDP wider than otherwise.

By now Argentina wasn't supposed to be in such lamentable economic shape. Barely four months ago, the government and the International Monetary Fund (IMF) completed negotiations on a $44 billion loan under an Extended Fund Facility (EFF). The country was granted an up-front disbursement of almost $10 billion, plus $4 billion more in late June.

- The IMF program has three main targets for this year. The first is a modestly narrower fiscal deficit – 2.5 percent of GDP rather than last year's 3 percent (measured excluding interest payments on the public debt). The second calls for a nearly $6 billion accumulation of central bank net international reserves, which would take the year-end total to over $8 billion. And the third requires a reduction in central bank financing of the government's budget deficit, to the equivalent of 1 percent of GDP from 3.7 percent in 2021.
- The program's rather modest fiscal and monetary objectives are based on optimistic assumptions, however, and its structural reforms fall way short of what is required to spark confidence and a sustainable economic recovery. Populist economic measures – advocated mainly by the Peronist faction led by Vice President Cristina Kirchner – have greatly harmed the country's business and investment climate.
- It is an open secret in Argentina that the main purpose of the IMF loan is really to help the government avoid defaulting on the $44 billion the Fund previously loaned (in 2018-19) to President Mauricio Macri's administration. That loan is scheduled for repayment in full between September 2021 and mid-2024, and the present government had made it plain to the IMF that it had no means to do so absent a reprofiling or a *quid pro quo*. Therefore, in Argentina, the new IMF loan is widely understood to be a fig leaf over what is an indirect debt rescheduling on an installment plan – and it is characterized as a debt refinancing by the government itself.

Even the mild conditionality attached to the new IMF loan has already proven difficult to meet and has claimed its first significant victim –Economy Minister and Fernández ally Martín Guzmán resigned on July 2. His replacement is Silvina Batakis, a heterodox Peronist economist handpicked by Cristina Kirchner.

- *All indications are that the government missed the IMF targets for end-June, especially once discounting any window dressing, and that, failing to take restrictive fiscal and monetary measures soon, it will miss the goals for the full year. Argentina's financial markets have been reacting badly. The stock market index has been trailing far behind inflation; the government's dollar-denominated bonds have plunged to distressed levels, mostly below 25 cents on the dollar; and the Argentine peso, whose value is set artificially by the central bank under a rationing system, trades in parallel (but legal) and black markets at less than half its official value.*
- *Social and political tensions are on the rise, largely because wages and pensions are incapable of keeping up with inflation. On July 9, Independence Day celebrations were marred by nationwide*

protests against the government, though at least they were peaceful. On July 13, farmers staged a one-day strike to complain against punishing taxes, damaging currency controls, and a scarcity of diesel fuel that has hit them during the harvest season. New Economy Minister Batakis will need to walk a fine line between introducing unpopular corrective measures to break the inflation spiral – restrictive fiscal and monetary policies, in particular – and pleasing political masters who seem to be persuaded that a muddling-through scenario of tightening controls and ignoring market realities is still viable. A miscalculation could lead to triple-digit inflation, widespread social unrest, and the early exit of President Alberto Fernández.

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