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Argentina and the IMF Face Renewed Disappointment

By Arturo Porzecanski on July 8, 2022

IMAGE CREDIT

In recent months, economic and financial conditions in Argentina have taken a sharp turn for the worse, so much so that Martín Guzmán, minister of the economy for the past two-and-a-half years, resigned last weekend rather than continue enduring withering criticism from many quarters, including from within the ruling Peronist coalition.

Inflation has accelerated from an annualized rate of under 50 percent in the fourth quarter of 2021 to 80 percent in the first quarter of 2022 and an estimated 90 percent from April to June of this year. Meanwhile, economic activity has leveled off, from an annualized and seasonally adjusted GDP growth rate of 7½ percent in the final quarter of last year to 3½ percent in the first quarter of 2022 and projected zero growth or a contraction in the second quarter.

Argentina's main stock market index, the S&P Merval, is up about 10 percent from end-2021, meaning share values have fallen by around 25 percent year-to-date once adjusted for inflation. The government's dollar-denominated bonds have plunged to levels – mostly below 30 cents per dollar – not seen since mid-2020, when Argentina last defaulted on, and restructured, that portion of its foreign debt. 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 nearly half its official value.

By now Argentina wasn't supposed to be in grave economic and financial distress. Barely four months ago, the government and the staff of the International Monetary Fund (IMF) completed negotiations on a nearly $44 billion loan under an Extended Fund Facility (EFF) – the IMF's largest-ever under that credit window. Upon its approval in March by the legislative and executive branches of government in Argentina, as well as by the Fund's board of directors, the country was granted an up-front disbursement of $9.7 billion. The loan and its economic program were supposed to boost confidence and bolster the business and investment climate in Argentina.

About ten days ago, Argentina received a second shot in the arm worth $4 billion as a reward for having met its end-March IMF performance objectives. The main targets for this year are three. The first is a modestly narrower fiscal deficit, measured excluding interest payments on public debt: 2.5 percent of GDP rather than last year's 3 percent. 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.

Governments usually apply for the IMF's EFF when they face serious medium-term balance-of-payments problems because of structural weaknesses that require time to address. The funds drawn can be repaid within 5-10 years rather than 3-5 years under the IMF's classic Stand-By Arrangement (SBA), the emergency loan window through which the bulk of IMF assistance is provided. Therefore, the typical EFF program complements ambitious quarterly fiscal and monetary targets with comprehensive policy and institutional reforms to correct underlying economic imbalances.

Argentina's new IMF program, however, includes rather modest fiscal and monetary objectives based on optimistic assumptions, and its agenda of structural reforms falls way short of what is required to spark confidence and a sustainable economic recovery. A raft of populist economic measures, including government interventions that have caused major distortions in key markets (e.g., costly subsidies to keep utility rates low), in a context of pervasive institutional and political weaknesses (due to bitter divisions within the ruling coalition), have done great damage to the business and investment climate – before and during the COVID-19 pandemic.

Examples of the timid reform measures contemplated by Argentina's EFF include pledges to (a) avoid additional taxes on financial transactions; (b) publish an investor relations presentation twice per year; (c) prepare a study outlining options to strengthen the sustainability of the pension system; and (d) conduct and release an external audit on 2020 COVID-19 spending. It is no wonder analysts have characterized this EFF as "IMF light."

Truth be told, the IMF was in a weak bargaining position. During 2018-19, the Fund disbursed $44 billion to Argentina through an SBA in support of the economic policies of the prior administration, led by President Mauricio Macri. Repayments of that loan started to fall due in September of last year, and the scheduled payments exceed $17 billion this year, surpass $18 billion in 2023 and only taper off in 2024 at under $5 billion.

The current government of Argentina had long ago made it known that its fiscal savings in dollars were close to nil; there was no political will to adopt major budget cuts; and there was no intention of enacting the kind of investor-friendly policies that might enable the government to raise in financial markets even a portion of what it owes the IMF. Therefore, the IMF was on notice that unless it granted a new loan so Argentina could repay its old loan, the government would default.

This explains not just why the EFF is light on conditionality, but also why the new loan is identical – nearly down to the penny – to what Argentina owes the Fund. Given that by long-standing IMF policy its SBA and EFF loans are not eligible for a reprofiling, the institution had faced a momentous choice: either lend Argentina the money to remain current on its obligations or suffer the consequences of Argentina's likely default – an ugly prospect with potentially painful reputational and financial costs for the IMF, given its huge exposure to that country.

Despite its lack of ambition, however, there is mounting evidence that in politically unstable and financially fragile Argentina, the EFF is already falling off track. It was one thing for the authorities and the IMF staff to agree in late February on quarterly performance targets attainable by end-March, but it was quite another to set goals for end-June through end-December – never mind for 2023-24 – in the absence of Argentina's political will to make unpopular sacrifices by ditching populist economic policies.

On the fiscal front, for example, preliminary figures for January-June show that government spending excluding debt-service costs jumped 72 percent relative to the first half of 2021. That leap exceeded the 58 percent cumulative increase in consumer prices between the first half of 2021 and the first half of 2022, evidencing a lack of spending restraint. Moreover, the fiscal deficit during January-May, measured excluding interest payments on public debt, was a multiple of that posted in the first five months of 2021, likewise evidencing no deficit moderation. Therefore, Argentina probably missed its end-June fiscal target and will only be able to reach its forthcoming quarterly goals if fiscal policy turns firmly restrictive.

The IMF program's two other targets are also looking hard to achieve. The envisioned accumulation of central bank net international reserves by end-June probably was not realized, and any progress on this front would require a marked tightening of monetary policy combined with an accelerated devaluation of the official exchange rate, which has lagged badly behind inflation and market realities. And the planned reduction in central bank financing of the government's budget deficit, which is also unlikely to have been attained as of end-June, cannot be accomplished in the months ahead until fiscal, monetary and exchange-rate policies turn restrictive. That combination is the only one that could enable the government to fund a smaller fiscal deficit by selling bonds to willing investors – rather than by leaning heavily on central bank loans.

The replacement minister of economy is Silvina Batakis, a heterodox economist who managed the finances of the Province of Buenos Aires during 2011-2015 and has held other government posts at the municipal, provincial and national levels. She was appointed by President Alberto Fernández under pressure from Vice President Cristina Kirchner, whereas her predecessor was close to the president and regularly chastised by Kirchner for attempting to dial down populist economic policies and for borrowing anew from the IMF.

Chances are that Batakis will try to salvage Argentina's program with the IMF by taking some corrective economic measures here and there. However, it is doubtful she will have the inclination or political support to deal forcefully with the fiscal, monetary and exchange-rate policy deficiencies that are at the root of Argentina's economic and financial fragility. Therefore, disagreements over objectives, and disappointments over outcomes, will feed the traditionally contentious relationship between Argentina and the IMF, keeping local financial assets, like stocks, bonds and property, depressed.

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