Argentina: The Downside of Gradualism

*By Arturo C. Porzecanski**


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President Mauricio Macri made a surprise announcement on May 8 that his government would seek financial support from the IMF to enable the country to "avoid a crisis like the ones we have faced before in our history" – essentially, an admission that time may be up for his policy of gradualism in dealing with the legacy of populism. Sources in his administration expressed confidence that Argentina could obtain some $30 billion in "precautionary" loans at low interest rates and with few strings attached as an alternative to more borrowing in the international capital markets at higher and rising rates. His finance minister, Nicolás Dujovne, and other members of the economic team departed Buenos Aires for Washington, DC, that same evening to formalize the request at IMF headquarters and to meet with a top Trump administration official at the U.S. Treasury. After an initial round of friendly conversations, the parties agreed to meet again starting on May 14 to initiate a negotiation process that they acknowledged would take several weeks.

- Macri blamed downward pressure on the Argentine peso (despite drastic hikes in short-term interest rates and the sale of one-tenth of hard-currency official reserves), on tighter monetary conditions and on volatility abroad at a time when the government must still raise money internationally to finance its large fiscal deficit. "The problem that we have today is that we are one of the countries in the world that most depends on external finance, as a result of the enormous public spending that we inherited and are restoring order to," the President stated.
- The decision to turn to the IMF surprised observers because it came at an unusually early point in the country's financial cycle. Argentina's central bank still has about $55 billion in

international reserves, the equivalent of some 10 months of imports, or three times the amount of foreign-currency government debt maturing in 2018. Also, foreign investors by no means have slammed the door on Argentina's face, though admittedly the government probably could not sell another 100-year dollar bond like it did last June, raising $2.75 billion from die-hard optimists. Argentina in the past, like most other countries, has generally turned to the IMF only in desperation once they were unwelcomed by Wall Street and their vaults were almost bare.

- The onus placed by Macri on deteriorating financial conditions abroad was also surprising. After all, the U.S. Federal Reserve has barely begun its monetary tightening process: the overnight fed funds rate, currently around 1.7 percent per annum, is still below U.S. inflation of 2.1 percent, so it has yet to enter positive territory. Moreover, U.S. bond yields now in the vicinity of 3 percent for 10-year Treasuries, are up from 2.3 percent a year ago but have merely bounced back to a level they were at as of end-2013. And the financial markets' "fear" index VIX, a measure of expectations implied by options on the S&P 500 index, has fluctuated in the teens, which while higher than last year's mostly single digits, remains very far from the range of 30 to 80 seen during prior episodes of extreme risk aversion in the financial markets.

President Macri's announcement did not have the favorable intended effect on confidence and market behavior, as evidenced by the peso remaining under downward pressure in the three business days that followed. Despite renewed central bank intervention to boost the currency, it now takes almost 24 pesos to buy a U.S. dollar when it took fewer than 16 pesos to do so a year ago – a loss of about one-third in the currency's purchasing power. One reason is that Macri's blaming adverse developments abroad for his currency's woes rings hollow with investors, given how very slowly his administration has moved to reduce a fiscal deficit running above 6 percent of GDP since 2015; how much debt (around $100 billion) he has taken on in just a couple of years; and how timid his central bank has been in its attempt to bring down inflation running at about 2 percent per month. And the other reason is that it quickly became apparent that any loan from the IMF will come with strict conditionality attached, because Argentina's request was routed to the Fund's regular, "stand-by" window – and not to its easier-access, precautionary lending window for highly creditworthy borrowers. The Fund spelled out its economic policy advice for Argentina in its December 2017 "Staff Report for the 2017 Article IV Consultation," and it calls for a more assertive reduction in the fiscal deficit, especially by cutting government spending, and for supply-side reforms it called "indispensable" to support economic growth, raise labor productivity, attract private investment, and enhance the country's competitiveness. These are all recommendations that fly in the face of President Macri's gradualist approach to defusing the economic minefield left behind by his populist predecessor, Cristina Fernández Kirchner, and will therefore paint his government into a politically fragile corner. We are witnessing the demise of Macri's cherished – and popular – gradualism.

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