Turning the page



The victory of Mauricio Macri raises hopes of economic recovery in Argentina and normalization of trade with Brazil.

Solange Monteiro

THE ELECTION OF Mauricio Macri to lead Argentina as of December 10 puts an end to 12 years of Kirchner dominance of the country's politics and to the exhausted economic policies of outgoing President Cristina Kirchner. The success of the candidate of the Republican Proposal (PRO), although by a narrower margin than expected, represented a choice to end exchange controls—a topic that dominated the debates before the second round. Established in 2011 to stem the outflow of capital, the controls have depressed the economy's growth, which has stagnated.

Argentina has paid dearly for previous foreign currency constraints, and new President Macri will take over a country in a very difficult environment. If he succeeds in his stated reforms, Macri will have to tame the inflationary pressure stemming from a necessary currency devaluation and the correction of controlled prices; inflation this year is estimated at 25%. Macri will also face a primary fiscal deficit estimated at 4–6% of GDP and an elevated tax burden of 30% of GDP so he must urgently review subsidies and the prices of public utilities. "Macri will have to work various policy instruments together, including a wage bargaining system that can moderate the strength of trade union demands and an active monetary policy, which will depend on the central bank being in tune with his proposals," says Fabio Giambiagi, an economist with Brazil's National Development Bank. He points out that the central bank governor will have to resign and a new board of directors be appointed, "something that can take anywhere from weeks to months."

At a recent event sponsored by the Go Associates consulting firm, Giambiagi expressed cautious optimism about Argentina's short-term



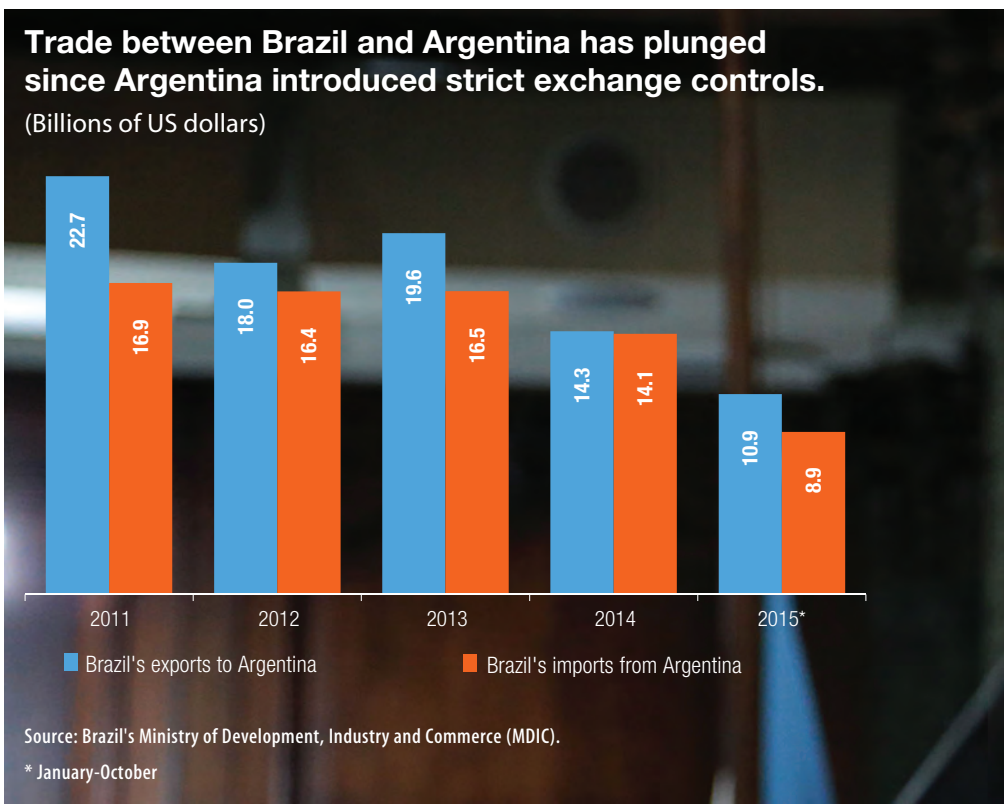
The prospects for president-elect Mauricio Macri are daunting.

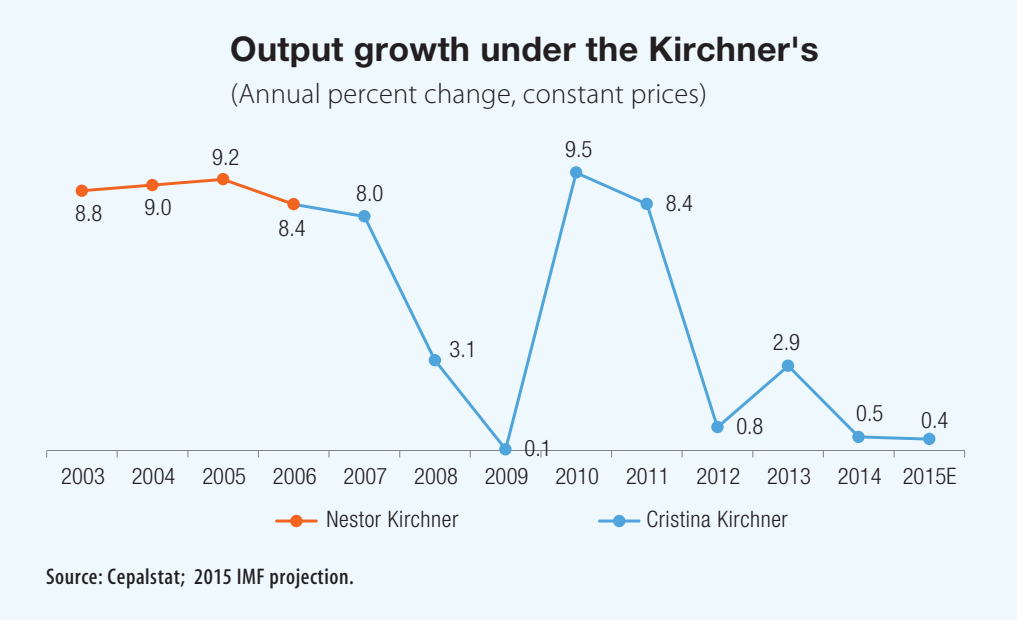
future. He believes that the Macri administration is cohesive, and if the new government can give consistent signals, even without immediate results it may restore some confidence in the markets and society, making Argentina a more attractive place to invest. He also thinks Brazil should trust the new Argentinian administration: "Brazil has had trade problems with Argentina, and it is hard not to respond to the barbarity of the trade controls Argentina imposed. But today it is interesting that China is the most influential country in our neighbor." Giambiagi suggests that it would be good for Brazil to cooperate to mitigate the foreign currency restrictions that hinder the Argentina's recovery in the short term. Since "Argentine's reserves are vanishing, while Brazil has US$270 billion," he suggests that Brazil lend,

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for example, US$5 billion for one or two years with the necessary guarantees, because "that would make economic, strategic and diplomatic sense."

According to Ambassador Regis Arslanian, who was Brazil's representative to Mercosur until 2012, Argentina needs about US$12 billion in reserves, which is a significant obstacle for resumption of Argentina-Brazil bilateral trade





Source: Cepalstat; 2015 IMF projection.

in the short term. The ambassador is optimistic about the possibility that, with Macri's leadership in Argentina, Mercosur will make progress in negotiating trade agreements with the European Union and the United States. The agreement with the EU will be discussed at the next Mercosur summit on December 21 in Asuncion, "which will also mark Argentina's position on the membership of Venezuela in the bloc, with important implications for Brazil, which may be isolated," Arslanian says. The ambassador argues that Brazil and Argentina should become allies on issues like agriculture, which are vital for both countries, during the December WTO ministerial meeting in Nairobi.

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While Macri needs to move promptly to establish policies on many fronts this year, Argentine analysts consider it most important for the government to build up domestic support, since PRO is a minority in Congress and part of society is still polarized around the Peronist party. "If Macri decides to deal with all the evils at once, he will jeopardize his own legitimacy and that of his government," said Matias Kulfas, who was general manager of the Argentine Central Bank in 2012–13. Bernardo Kosacoff, professor at Buenos Aires and Torcuato Di Tella Universities, has confidence that the new president will be successful. "There is consensus on the priority issues, perhaps much more than at any other time in Argentina," he said, indicating that could help support structural changes and mitigate the uncertainties that always accompany the beginning of a new administration.



Argentina: First interview

Matias Kulfas: "We need a managed float"

Matias Kulfas, now director of the Idear Desarrollo consultancy, was general manager of the Argentine Central Bank in 2012 and 2013 and director of the Banco de La Nacion Argentina from 2008 through 2012.

Adjustment path

President Macri's economic team must have calculated that the end of exchange controls would result in the exchange rate overshooting and then stabilizing, with the exchange rate devaluing by 40–50%. But it is necessary to take into account certain factors. One is the unexpected victory of his party in the province of Buenos Aires, which has the highest GDP in the country but significant pockets of poverty and marginalization. The shock of a very large exchange devaluation could generate social problems in a region now managed by the PRO, and the president needs to avoid short-term governability problems. Another factor is that exiting exchange controls depends on discussion of a new social pact because a large devaluation shock carries a risk of accelerating devaluation and prices and consequently a risk of reaction by the trade unions, which will defend the purchasing power of wages. Argentina does not have a good history of transition between exchange controls and a free float. In 2002, for example, we had a great inflationary surge. We need a managed float; the risk of not managing the float is high. Financial and exchange rate instability can bring about unemployment and a major recession. But I think that President Macri is less concerned with rising unemployment. His scheme seems to be to return to a more orthodox policy, with tougher and tighter monetary policy. Unlike Brazil, in the past 12 years Argentina has lived with negative real interest rates, which reduce savings and boost consumption. Now, the policy should be more restrictive, to improve relations with the international financial system to attract a fresh supply of US dollars.

Congress and society: Support?

President Macri has generated a lot of expectations in a number of different sectors, but he has no majority in Congress; his strength does not exceed 25%. Macri was the candidate of those who wanted to turn the page for Argentina, but that does not mean all fall into his political space. If he decides to deal with all the evils at once, he will jeopardize his own legitimacy and that of his government.

Trade liberalization

There is concern because in recent years many Argentine industries—such as footwear, textiles, and metalworking—have fared well and managed to grow, thanks to controls on imports, and they would struggle with competition from other countries. Without an exchange rate that is appreciated by about 50%, industry … will contract, losing market share and generating unemployment. On the other hand, the exports of the agro-industrial sector were affected by the unfavorable exchange rate, and the tax burden—35% since 2007—needs to be reduced. Producers have inventories of at least US$8.5 billion waiting for devaluation and tax cuts, which would ensure greater profitability, and more dollars for the government. But if in the short term that means relief, in the long term we cannot expect international commodity prices to be high enough to generate a new production boom.

Brazil and Mercosur

I think that Macri will bet on Mercosur, and Brazil is its historical ally. It will be necessary to strengthen this relationship. But I also think the new administration will be more open, including to countries aiming at the Pacific region.



Argentina: Second interview

Bernardo Kosacoff: "There is consensus on priority issues"

Professor at the Torcuato di Tella and Buenos Aires Universities, Kosacoff was director of the UN Economic Commission for Latin America and the Caribbean from 2002 to 2010, and chairman of the Economic and Social Development Institute (IDES) from 1999 to 2002.

Adjustment path

Removal of exchange controls will depend fundamentally and simultaneously on changes in the monetary and fiscal fronts and the ability to obtain additional financing, to give the country room to manage its macroeconomic policy. Even with little public debt, Argentina is the country in the region that, after Venezuela, pays the highest interest rate due to lack of international reserves. Normalization of Argentina's access to international credit markets will allow it to better manage exchange rate policy. The withdrawal of controls on foreign currency requires delicate management that takes into account the impact not only on domestic prices but also on wages and incomes. On the fiscal front, public utility rates should be adjusted gradually to avoid a sharp decline in peoples' purchasing power and should include support for utilities rates to meet the needs of the poorest population. Such a move could pave the way for improving public spending and reducing the tax burden, since in many sectors—principally electricity—these subsidies are not necessarily associated with improvement in either the competitiveness of the economy or income redistribution.

Points in favor

Argentina has low debt, both public and private, and low payments of interest and principal in 2016. At the same time, the private sector, which has been cautious in recent years, has created a very robust countercyclical fund of nearly US$400 billion, 80% of GDP, that awaits the return of the economy to normality. On the demand side, between 2000 and 2011, Argentina nearly doubled the size of its domestic market; although that has stagnated in the last four years, there is great potential for it to resume growth.

Congress and society: Support?

Admittedly, the presidential election outcome was close but there is consensus on priority issues, much more than at any other time in Argentina. The long-term structural issues cannot be resolved in the first quarter, but it is possible to improve the investment climate. Macri has invited people for his government who are focused on reducing unemployment and income inequality. In this sense, it seems he breaks the image of a fundamentalist government that believes in the total market capacity and is seeking measures to generate growth as well as inclusion.

Brazil and foreign trade

Macri said his priority is to strengthen the bond between Argentina and Brazil. We acknowledge the impact of Chinese imports in recent years, but today society and the productive sectors agree on the diagnosis that we need to reassess our business relationship with China. To open foreign trade, we must take into account the sectors most vulnerable to trade openness, but I think the president will have a positive attitude to generate complementary policies. Argentina's priority is to expand its offerings and its capacity to generate dollars through exports, despite the current context of slow global trade, and I am highly optimistic that this is possible.