

The rebuilding of Argentina

So far Argentinians deeply approve of new President Macri's openness to the world and his decisive actions on the exchange rate and utilities rates. However, anxiety about inflation and unemployment, and the slowdown in the economies of trading partners, will put his administration to the test, particularly during legislative elections in 2017.

Nilson Brandão

AFTER TWELVE YEARS of the dominance of left-leaning kirchnerism in Argentine politics—presidents Nestor Kirchner (2003-2007) and Cristina Kirchner (2008-2015)—, the country appears now to be moving to a stage that is more market-friendly as it seeks access to international capital markets to finance its growth. But though the election of Mauricio Macri has opened new perspectives, there are still concerns about persistently high inflation and unemployment, as well as the economic



slowdown in two of Argentina's main trading partners, Brazil and China.

In mid-March *La Nación* newspaper reported that 69% of Argentinians approve of the Macri government and 29% disapprove. In other words, after its first 100 days, more than two-thirds of Argentina supported the new administration and the measures adopted by the current president, who won the election with a margin of only 3%, and supporters include some who had voted for other candidates. But the polls also revealed anxiety about inflation and unemployment, which raises the question of how long demand for short-term results and gradual policies to rebalance the economy in the medium term can coexist.

So far the Macri administration has ended exchange rate controls, adjusted public utility rates, lowered the tax on exports to encourage production especially of agricultural commodities, resumed negotiations with holders of Argentina's bonds who did not participate in the 2005 and 2010 debt restructuring, and made advances in foreign policy.

Back to the markets

Emblematic were this year's visits to Argentina of three world leaders: Matteo Renzi, Prime Minister of Italy; French President François Hollande; and recently US President, Barack Obama. Obama's visit was particularly significant given the anti-Americanism of previous years.

To show the world a new Argentina, in January, Macri traveled to Davos, Switzerland, for the World Economic Forum, accompanied by opposition leader Sergio Massa. The purpose was



President Mauricio Macri

to demonstrate domestic political conciliation in favor of the changes underway, and to remind the world of the existence and importance of Argentina, which for at least 10 years had not been present in Davos.

"In Argentina we are seeing a moment in which there is a normal democratic transition from the two great political factions, which are radicalism and Peronism," according to Marcos Azambuja, who for six years was Brazil's Ambassador to Argentina. Azambuja believes both Brazil and Argentina are at a difficult juncture. "Both countries are not having a brilliant time. Economically, leadership has gone to the Pacific coast," the ambassador said citing the economic performance of Chile, Colombia, Peru, and Mexico. "These countries have found a formula, a better economic model," he said during the seminar on "The New Government of Argentina: Lessons for Brazil," conducted by the Brazilian Institute of Economics (IBRE) in March.

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The International Monetary Fund *Outlook for Latin America and the Caribbean* published in January heightens the contrast: it projects that output for the region will decline by 0.3%, mainly because of the negative performance of Venezuela (–8%), Brazil (–3.5%), and Argentina (–1%), relieved somewhat by growth in Peru (3.3%), Colombia (2.7%), Mexico (2.6 %), and Chile (2.1%). Chile, Colombia, and Peru, the IMF notes, are continuing a relatively orderly adjustment process, “in which a combination of sharp devaluation of the currency, gradual fiscal consolidation, and accommodative monetary policies [has] avoided economic contraction.” Those three countries, the IMF said, have “sound economic policies, credible institutions, sound financial markets, and favorable costs of external debt.” Mexico’s growth reflects a stronger US economy.

In describing Brazil’s problems, the IMF cited the worsening political scene, macroeconomic weaknesses, and “major scandal,” as well as rising unemployment and inflation. Brazil, the report said, continues to “postpone the adoption of a credible fiscal strategy to keep public debt on a

sustainable path,” which has caused international rating agencies to downgrade Brazil’s risk rating.

The IMF believes, on the other hand, that Argentina is at the “beginning of an important transition to correct macroeconomic imbalances and microeconomic distortions.” Before Macri was inaugurated, the IMF highlighted as significant steps forward “elimination of restrictions on the foreign exchange market, abolition of various restrictions on international trade, announcement of the main guidelines of the new macroeconomic policy, and partial removal of energy subsidies.” It noted, however, that although expectations have improved, adjustment must be careful to avoid recession in 2016.

Argentine economist Guillermo Rozenwurcel pointed out that for five decades his country has been on a volatile course that he calls “crash and go.” Rozenwurcel listed, as “legacies” the country must deal, with the progressive deterioration of external and fiscal balances, annual inflation above 25%, and a fall in GDP per capita from about US\$15,000 to US\$13,600.

The need for patience

“There are pent-up demands and a desire for improvements in Argentina. ... There is support [for the new administration], but it is linked to more or less rapid results,” Rozenwurcel said, adding, “Patience is very short.” He warned of the risk of a sudden change from excessive hope to exaggerated pessimism.

The results of the February Ifo-FGV Latin America Economic Survey support the perception that prospects have improved. The Expectations

Indicator for Argentina jumped from 94 points in December to 166 points in January. The assessment is that people and corporations approved the initial actions of the Macri administration and there is “great optimism” about the country’s economic outlook. In contrast, opinion about Argentina’s current situation improved only a little, from 50 to 52 points, which is still “unfavorable.”

Domestically, the Macri administration has already moved to greater transparency. In the week before the Obama visit, even having only a minority in the House, the administration pushed through the House of Representatives by a vote of 165 to 86 a draft law that would facilitate payment to creditors that were left out of previous restructurings—the “holdouts.” According to Rozenwurcel, “That was very significant not only from the point of view of the progress of the debt negotiation, but also from a political point of view,” Rozenwurcel said. The opposition lent support to the draft law.

“This opens up a positive perspective on governability,” Rozenwurcel said, “which was in doubt because the government’s party only has a minority in the House of Representatives.” The government is proposing to repay the debt at a 25% discount. To move forward the proposal must still be approved by the Senate, where there is still a significant number of supporters of former president Kirchner. The government considers agreement on the debt to be crucial if Argentina is to access foreign credit; the country was shut out of the international market in June 2014.

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Marcos Azambuja

Economist Fabio Giambiagi of the Brazilian Development Bank believes the ability to dialogue with different stakeholders has been instrumental for Macri to establish bridges and build consensus—an example Brazilian politicians should follow: “The Argentine president is dialoguing on three different fronts: Peronists interested in leaving behind the old government legacy, the group of Sergio Massa; the block of governors that converged to Macri and favor governability; and the traditional parliamentary leadership that cultivates dialogue,” Giambiagi explained.

In general, Icatu Seguros economist Victoria Werneck said, it is expected that if Argentina had a more friendly relationship with the market, that would, among other things, open access to international financial markets, reduce capital costs, make it possible to refinance public debt at lower cost, attract foreign direct investment, and perhaps “become more successful in negotiating international agreements.” In her opinion, “Macri is considering what the rest of the world thinks about Argentina.”

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José Augusto de Castro

Argentina urgently needs foreign capital and foreign exchange, and the outlook is promising. Despite the inauspicious recession in Brazil and significant slowdown in China’s economic growth, says José Augusto de Castro, president of the Foreign Trade Association of Brazil (AEB), “my expectations for the economy of Argentina are good because the recent changes to eliminate the tax on exports of soybeans, wheat, corn, sorghum, and meat will generate more dollars and stimulate an increase of the planted area, which will generate more dollars, rebuild foreign exchange reserves, and increase the power of imports, in the medium term benefiting Brazilian exports of manufactured goods to Argentina.”

The peso devaluation also makes Argentine products more competitive, which again stimulates increases in the production and export of agribusiness commodities. Although imports will cost more, that will not have much impact

on the decision to import because there is little local production of manufactured goods. Castro explains that “As a result of these measures, Argentina has been negotiating its debt with foreign bond holders and is returning to the international financial market. Thus the crisis of lack of foreign exchange is being eased, which will allow elimination of its barriers on imports.”

The AEB estimates that Brazilian exports to Argentina this year will reach US\$14.7 billion, up 15% from 2015, and imports from Argentina will amount to US\$9.2 billion, 10.9% less than last year, resulting in a favorable trade surplus for Brazil of US\$5.5 billion. Brazil will buy less from its neighbor due to its domestic recession and devaluation of the Brazilian real. Rozenwurcel lamented that “These projections appear realistic and for us Argentineans cause concern because we need more foreign exchange to recover.”

In coming months, despite the encouragement of Argentine exports, devaluation and public tariff increases will keep inflation high, especially in the second half of 2016. In the opinion of Roberto Iglesias, Director of the Center for Studies in Integration and Development (CINDES), “Inflation is something that Macri really needs to take care of and that to me is the dilemma in the short term. It wears out any president. In my view, though, he has still respect because people know, in most cases, that he is correcting distortions, problems that the previous government left.” Recognizing that Argentine will have legislative elections in 2017, it is likely that the government is already working on policies to keep the economy stable and address remaining bottleneck. 