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## **ARGENTINA UPDATE: Economic and Political Overview** *June 2018*

### **ECONOMIC UPDATE**

- **The Argentine peso has suffered weeks of turmoil in the foreign exchange markets.** In mid-May, the government halted a currency run following a period of volatility. The peso had depreciated significantly—about a fifth of its value against a strengthening U.S. dollar—as higher U.S. Treasury yields led investors to sell assets in emerging markets. Argentina’s Central Bank responded by selling reserves and hiking interest rates to 40%, and the government also committed to narrowing the primary fiscal deficit to 2.7 percent of gross domestic product from a previous target of 3.2 percent, appeasing investor criticism that it hasn’t cut spending fast enough. **As the currency crisis deepened, the Macri Administration turned to the International Monetary Fund (IMF) in early May to ensure financing** (at a lower rate than offered by the market).
- **On June 7, Argentina reached a loan agreement in principle with the IMF) to provide a US\$50 billion credit line over the next three years.** As part of the program, Argentina will accelerate reduction of its fiscal deficit to reach a primary surplus by 2021. Macri Administration officials described the IMF loan as a “preventive” move aimed at avoiding a more serious crisis. The IMF Executive Board must vote to approve the agreement at its next meeting on June 20 before an initial US\$15 billion disbursement. **Investors welcomed the size of the package, seeing the IMF’s second biggest ever credit line in cash terms as a strong show of support for the Macri Administration.**
- **As part of the agreement, the Central Bank will also receive greater autonomy to adjust interest rates and to set its own inflation targets.** This marks a major shift away from the control over the Central Bank that was initially imposed by former President Cristina Fernández de Kirchner (2007-15) and a continuation of the Macri Administration’s effort to reduce the use of Central Bank funds to finance the deficit. The Central Bank also announced **higher inflation targets for the next three years:** 17% in 2019 (up from 10%), 13% in 2020 (up from 5%), and 9% in 2021.
- **Treasury Minister Nicolás Dujovne said on June 7 that the government had adjusted its growth forecast downward to 1.5% for 2018,** a significant reduction from its forecast of 3.5% GDP growth last September. The downward adjustment was provoked by lower agricultural output due to a drought, but also took into account

the impact of tighter fiscal policy on reducing consumer demand, and the impact of the currency slide on reducing investor confidence.

- **On June 14, following a resumed selloff of the peso that left it at a record low, Federico Sturzenegger resigned as the head of the Central Bank. He will be replaced by Finance Minister Luis Caputo, who is widely respected by investors. Newly empowered Minister Dujovne, who also oversees coordination of spending cuts across the cabinet, will lead consolidated Finance and Treasury Ministries.** In a press conference on June 15, Dujovne said that the disbursement of funds from the IMF will help to take pressure off the peso and strengthen the Central Bank's reserves.
- Eliminating the fiscal deficit lies at the heart of Macri's economic program. His commitment to a "gradualist" agenda—because of social and political opposition to more vigorous spending cuts—will remain but at an accelerated pace.

## POLITICAL UPDATE

- **The decision to request a loan from the IMF was politically risky;** the institution is unpopular due to its perceived role in the country's 2001-02 financial crisis. Approximately 55% of respondents in an M&F poll released on May 27 disagreed with the decision to seek an IMF loan, while 75% believed the deal would fail to adequately address Argentina's economic problems. **However, there are signs that the IMF brand is less politically toxic than in the past,** and IMF Managing Director Christine Lagarde has shown political sensitivity in insisting that the program is "owned and designed by Argentina" and "will protect the most vulnerable in the population."
- **President Macri is likely to face increasing political pressure from labor groups due to utility price hikes and belt-tightening measures.** The General Workers' Confederation (CGT) has announced that it will stage a general strike on June 25.
- **President Macri's popular approval stood at 41% in a poll released on June 5 by Poliarquía polling firm,** indicating a recovery of five of the nine points that had been lost during the currency run in early May.
- **In response to President Macri's commitment to unpopular fiscal cuts, the Peronist opposition in Congress may become a more difficult legislative partner,** thereby complicating his prospects for reelection in October 2019. While the President's coalition Cambiemos does not have a majority in Congress, it benefits from the fragmentation of the opposition. **President Macri remains the strongest candidate for the 2019 election given the lack of strong opponent.**

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