

April 4, 2024

## Will the latest attempt to reform Argentina's economy finally succeed?

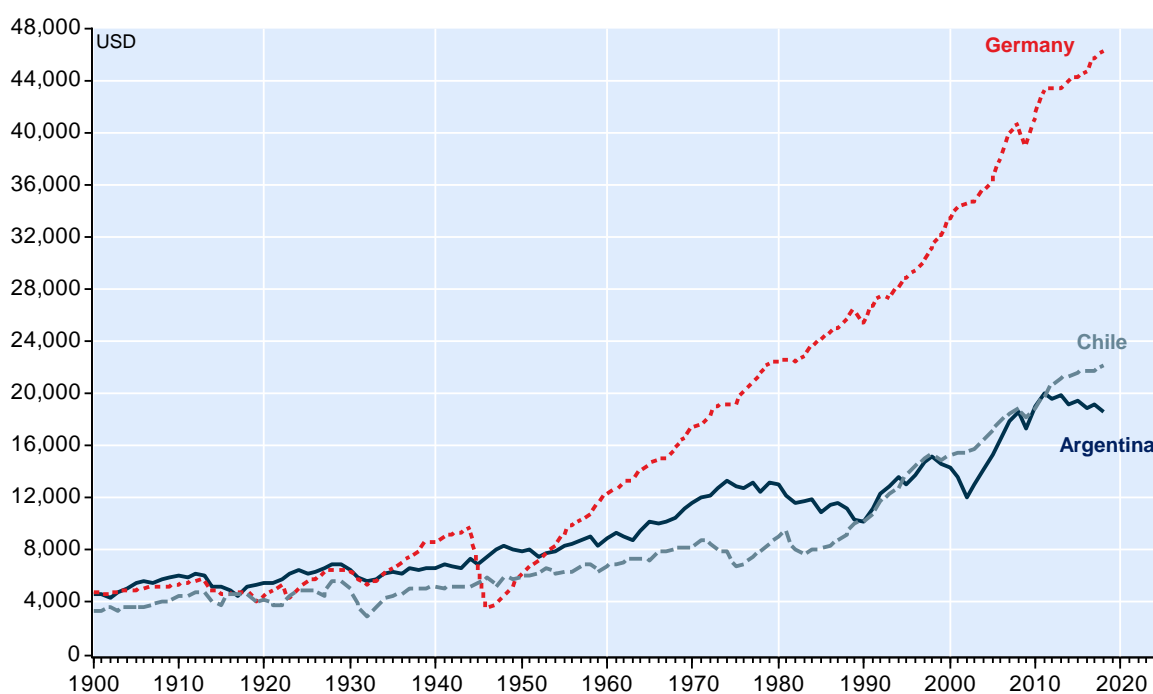
By Angelo Katsoras

### Introduction

A century ago, Argentina was among the richest countries in the world, with a per capita income that surpassed Germany's. However, its fortunes have since taken a turn for the worse. Today, Germany's GDP per capita is several times that of Argentina. Even neighbouring Chile's GDP per capita exceeds Argentina's by about a fifth (see chart below). Argentina's financial instability is highlighted by the fact that, since gaining independence from Spain in 1816, it has defaulted on its debt nine times, including three times since 2000.

### Argentina's long economic losing streak

Real per capita GDP: (1900 to 2018)



NBF Economics and Strategy (data via [University of Groningen](#))

Disillusioned by decades of financial crises, voters surprised pollsters by electing Javier Milei as president last November. He takes power at a time when Argentina is in the midst of yet another inflationary crisis fueled in large part by governments that for years have printed money to finance spending. Argentina's total debt-to-GDP ratio is expected to rise to 89.5% this year from 84.7% in 2022, according to the IMF. About 55% (\$263 billion) is denominated in foreign currency.<sup>1</sup>

Largely due to the short-term effects of the new government's reforms, the IMF revised its 2024 economic growth projection for Argentina from +2.8% to -2.8%. The Institute of International Finance predicts that annual inflation will rise to about 300% by mid-year.<sup>2</sup> However, the IMF did state that, if these reforms are implemented properly, they could set the stage for more-stable, long-term growth.

President Milei is in a race against time. While he currently has a mandate for change, the longer it takes to tackle the hyperinflation crisis and turn the economy around, the greater the chances that his approval ratings will drop significantly. And thus limit his ability to advance his reform agenda.

<sup>1</sup> Argentina country report, International Monetary Fund, August 2023

<sup>2</sup> "Milei's Austerity Is Devastating Argentina," Foreign Policy, March 5, 2024

### Policies enacted by President Milei so far

Just days after his inauguration on December 10, Milei used his executive authority to implement a series of radical measures. These included phasing out annual subsidies equivalent to 0.7% of GDP,<sup>3</sup> reducing the number of government ministries from 18 to 9, suspending all new public works contracts, and devaluing the peso by more than 50% in order to boost exports and reduce imports<sup>4</sup>

The government claims that these measures allowed Argentina to post its first monthly budget surpluses (January and February) in 12 years and to increase its foreign currency reserves from \$21 billion to \$27 billion.<sup>5</sup>

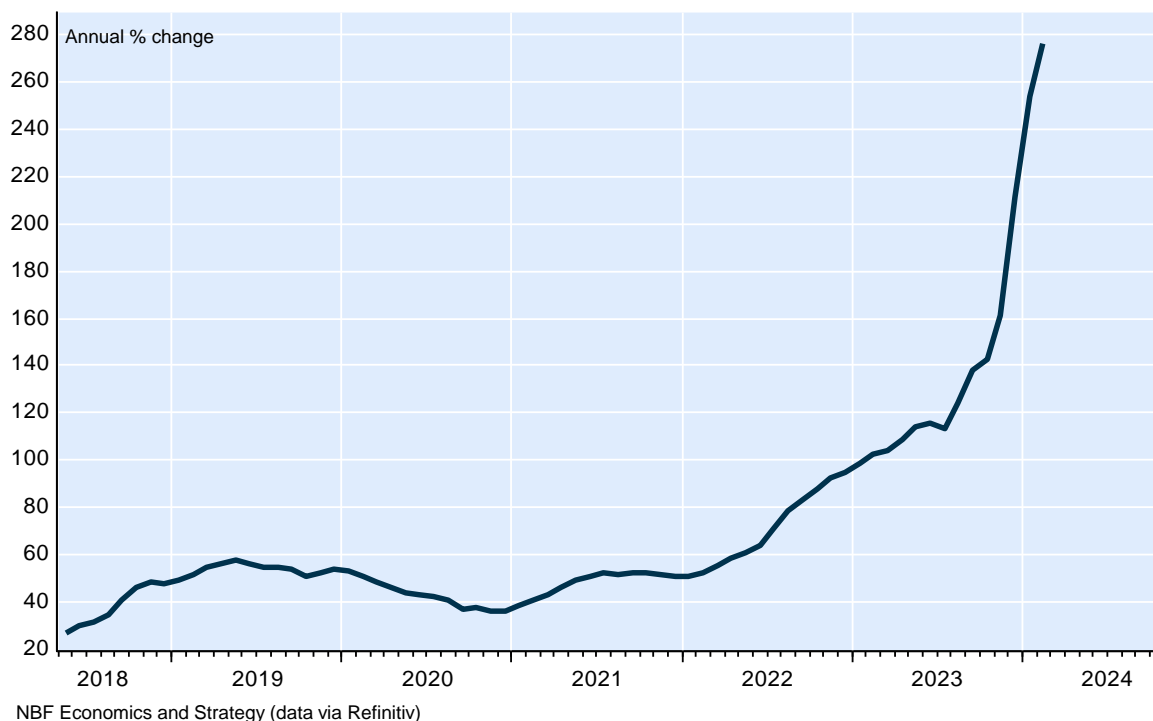
The IMF has welcomed these actions and recently approved a new \$4.7-billion loan disbursement, which raised the total amount lent to Argentina to \$40.6 billion.

But it is important to note the painful short-term costs of these measures. These include not fully indexing pensions to inflation and cutting subsidies for public transportation and energy. Some of Argentina's regional governments have warned that bus and subway fares will rise by as much as 360% in the coming months.<sup>6</sup>

While monthly inflation has been slowing recently (from 25% in December to 13% in February), annual inflation still sits at over 276%, the highest in the world.<sup>7</sup> To put this into perspective, it only took an annual inflation in the 8% range to destabilize the politics of most industrialized countries.

### Argentina's massive inflation challenge

Annual % change in CPI



Inflation has been driven primarily by a significant depreciation of the currency, a trend that has been particularly pronounced since President Milei took office last November. As we've discussed previously, a significant percentage of this depreciation can be attributed to the government's decision to devalue the currency by more than 50% in an effort to reduce the budget deficit. The government's move also brought the official exchange rate closer to the lower black-market rate.

<sup>3</sup> "What Javier Milei could learn from Peru's economic successes," The Economist, February 22, 2024

<sup>4</sup> "Success and Setbacks: 100 Days of Argentina's Milei," Agence France-Presse, March 19, 2024

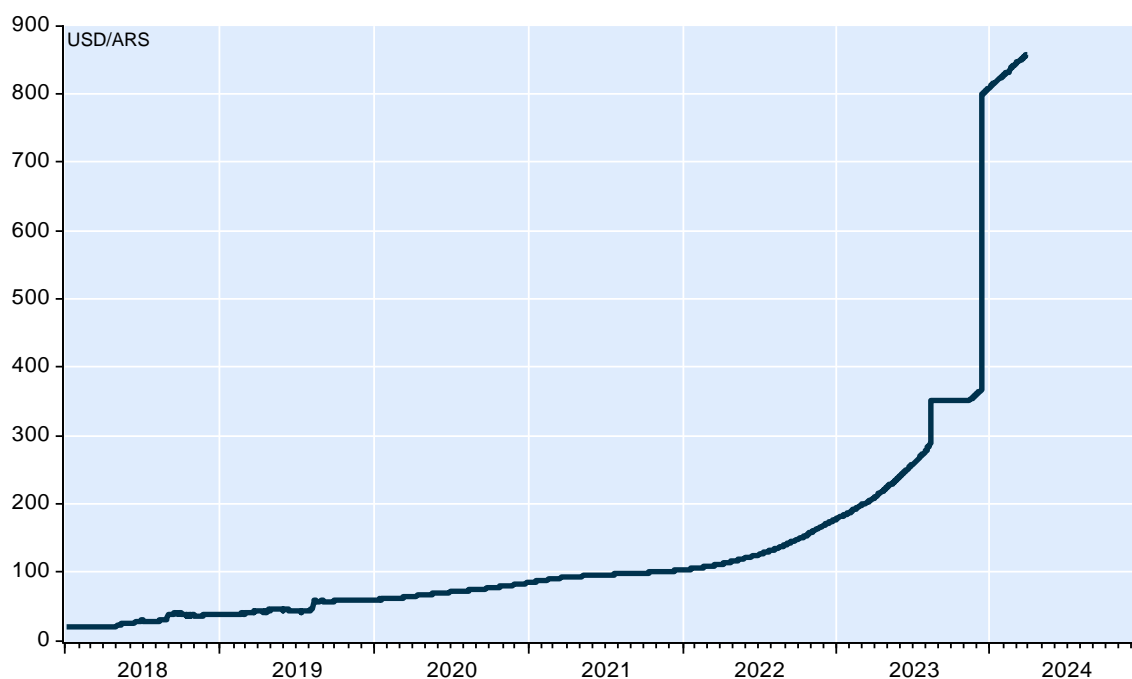
<sup>5</sup> "Argentina's Milei warns lawmakers he will make reforms 'with or without' them," Agence France-Presse, March 3, 2024

<sup>6</sup> "How Javier Milei is trying to curb Argentina's 250% inflation," Financial Times, February 14, 2024

<sup>7</sup> "Argentina's 100 days of shock treatment," The Globe and Mail, March 19, 2024

## Argentina's freefalling currency

Argentinian Pesos per U.S. dollars



NBF Economics and Strategy (data via Refinitiv)

## President Milei runs into congressional gridlock

Milei is caught between a rock and a hard place. On the one hand, he rose in popularity by attacking the political establishment. On the other hand, he needs the support of a significant part of this very establishment to further his legislative agenda. His Freedom Advances party controls only 40 of the 257 seats in the Chamber of Deputies and only 7 of the 72 seats in the Senate.<sup>8</sup>

To date, the President has lacked the savvy required to navigate this political landscape. Indeed, many people believe he has made his task even more difficult by leveling corruption accusations against certain politicians and threatening further funding cuts to provinces that resist his agenda. Some provincial governors reacted by pressuring their federal representatives to oppose his policies.

This tension played a large role in the Milei administration's failure to win congressional approval for key pieces of legislation. For starters, last December, he had to withdraw a bill with 664 articles that included such measures as allowing the privatization of numerous state-owned companies and lowering export taxes.

Then on March 14, the Senate voted against his second attempt at economic reform by presidential decree, which allows the government to bypass Congress under "exceptional circumstances". The reform package contained measures to amend or revoke over 300 laws in a broad range of areas, including rent controls, export caps, the privatization of state-run companies, and the loosening of labour laws.

The decree package must now go to the lower house of Congress, where a simple majority can overturn it.<sup>9</sup> (Congress doesn't have to approve a decree for it to go into effect, but they can vote it down.) While Milei's predecessors have issued many decrees over the past 20 years, this is the first presidential edict in recent memory to be voted down by the Senate. This is indicative of the level of political tension that exists between the opposing sides.

If Milei wants any part of the package to survive, he will have to reach an agreement with Congress. The success of these negotiations will not only determine the fate of these measures, it will largely define his ability to advance other parts of his agenda.

<sup>8</sup>"Gauging the Outlook for Energy Reforms in Argentina," Stratfor, March 18, 2024

<sup>9</sup>"Argentina Senate rejects economic 'mega decree' in blow for Milei," Reuters, March 14, 2024

## Milei's fate likely to rest on public opinion

While Milei's approval ratings remain fairly high, there is reason for concern. A poll released at the end of February put his rating at 52%, higher than any other national politician. However, this was down from 57% in January.<sup>10</sup>



The big question is whether Milei can continue to maintain this level of approval over the long term. For that to happen, people need to understand that there may be significant immediate economic costs to setting Argentina back on the path to long-term prosperity. The more his support falters, the harder it will be to pass reforms.

## Agriculture and energy sectors to play key role in success or failure of reforms

### Agriculture

Argentina is hoping that agriculture, which accounts for more than half of its exports, will help pull the country out of its economic doldrums. It is one of the world's leading exporters of soybeans and corn, and a major supplier of wheat and meat. Argentina is endowed with very fertile soil, relatively limited fertilizer needs, a good climate and has low transportation costs.<sup>11</sup>

However, this sector has long been held back by caps and taxes on agricultural exports. Milei has vowed to reduce and eventually eliminate these barriers.

A 50% devaluation of the peso has already made it more attractive for farmers to export their produce as they get more pesos for overseas sales, which are denominated mostly in dollars.

### Oil and gas sectors

Argentina is also blessed with significant energy resources, including having the world's second-largest reserves of shale gas and fourth-largest of shale oil.<sup>12</sup> However, much like agriculture, the energy sector has been held back by exports controls and a chaotic business landscape.

Efforts to lower caps and taxes on energy and agricultural exports were stalled when the Senate rejected the presidential decree package encompassing these reforms. The energy and agriculture sectors hope that any revised decree package to emerge from the lower house will still include these measures.

<sup>10</sup> "Milei pierde imagen positiva y aprobación de gestión, aunque se mantiene como el dirigente más valorado," LA NACION, February 27, 2024

<sup>11</sup> "Global markets watch Argentina's export taxes," The Western Produce, December 18, 2023

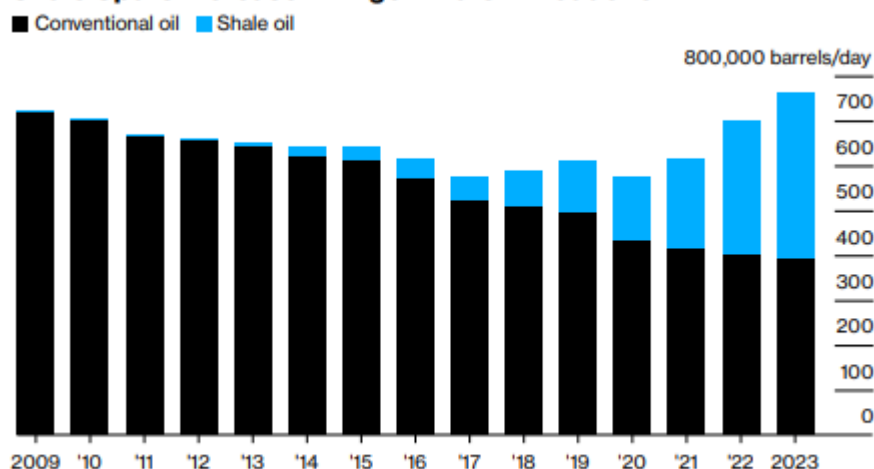
<sup>12</sup> International Energy Agency

### Some good news for oil and gas

Last July, the government finally managed to complete a long-promised pipeline connecting a massive shale gas deposit in central-western Argentina to the province of Buenos Aires. The government reports that the new pipeline saved Argentina \$1.7 billion last year and anticipates a further \$4 billion in savings in 2024 by eliminating the need to import liquefied natural gas and piped gas from Bolivia.<sup>13</sup>

Another positive development is that Argentina's oil production, which had been declining for many years, has reversed course thanks to an increase in shale output. Rystad Energy, a consultancy firm, recently said that with the right policy measures in place, Argentina could potentially triple its current shale oil production to over 1 million barrels per day by 2030.<sup>14</sup>

#### Shale Spurs Increase in Argentina Oil Production



Source: Argentine Energy Secretariat

Source: "Milei's Plan to Free Argentina's Oil Market Slows in Congress," Bloomberg, January 26, 2024

According to reports from the Argentine press, the country recorded an energy trade deficit of \$4.4 billion in 2022 (i.e., difference between total exports and total imports). In 2023, Argentina's energy trade was roughly balanced. For the current year, projections indicate that Argentina is on track to have an energy trade surplus of \$3.5 billion. If these projections come to fruition, it would mark the first time in over a decade that the energy sector has posted a trade surplus. The sector would therefore no longer be a drain on the country's foreign exchange.<sup>15</sup>

### Argentina's lithium sector

Argentina currently ranks as the world's fourth-largest producer of lithium and second-largest in terms of proven reserves.<sup>16</sup> It has three active lithium mines with an additional 38 at various stages of development. Government data show lithium exports reached \$369 million from January to May, up 84% from the same period a year earlier.<sup>17</sup>

### What dollarization entails and whether Milei will pursue it

To dollarize, the government would have to convert all legal contracts, bank accounts, and corporate and government assets and liabilities into dollars. This would require establishing the market value of the peso, which would mean floating the currency and lifting capital controls prior to conversion.

Transitioning to a dollarized economy offers the potential to reduce borrowing costs and enforce fiscal responsibility by giving up the ability to print more money. However, there are significant challenges involved in choosing this path. This includes the central bank having to hold sufficient dollar reserves not only to purchase all the local currency in circulation but also to

<sup>13</sup> "Argentina hits milestone on path to gas export bonanza," Financial Times, July 18, 2023

<sup>14</sup> "Argentina's Vaca Muerta shale patch could produce 1 million bpd in 2030, but hurdles remain," Rystad Energy, May 31, 2023

<sup>15</sup> "Argentine energy sector expected to be major contributor of foreign currency in 2024," Buenos Aires Herald, November 14, 2023

<sup>16</sup> "Argentina could be epicenter of new stage of lithium supply," S&P Global, August 14, 2023

<sup>17</sup> "Argentina's growing lithium industry hits export records," Bloomberg, June 17, 2023





protect banks from a run on deposits. Dollarization would also force the country to adopt the monetary policy of the United States, regardless of whether their cycles are synchronized.

While Milei has long supported dollarization, he seems to have backed away from this position since his election victory. However, he maintains that that it could still be an option one day.

### **Conclusion: Argentina's narrow path to success**

- The massive challenges facing Argentina, underscored by hyperinflation and significant currency devaluation, cast a shadow of doubt over the president's ability to steer the economy towards sustained growth and stability. This skepticism also stems from the failures of many of his predecessors. The question is whether Milei can overcome the odds stacked against him. His narrow path to success will depend on his ability to achieve the following objectives.
- Successfully passing a revised decree package would mark a significant victory and speak to Milei's ability to learn from past mistakes in his approach to negotiating with the opposition.
- Reforms included in the new decree package would make it easier for the agriculture, energy and lithium sectors to increase production and exports, and thereby bring more foreign currency into the country.
- Swinging from an energy trade deficit to an energy trade surplus would mean less outflows of foreign currency. This, in turn, would help stabilize the peso and make it easier for the government to service its foreign dollar-dominated debt.
- Reducing inflation and stabilizing the currency would go a long way towards helping the economy heal and maintaining public support for Milei.
- Milei's approval ratings continue to hover at around 50%, which suggests that he still enjoys substantial public support. This level of popularity would make the opposition more inclined to negotiate and compromise.

**Bottomline: While we remain very cautious about Milei's ability to turn the economy around, the above goals provide a clear framework by which to assess his progress.**



## Economics and Strategy

### Montreal Office

514-879-2529

#### Stéfane Marion

*Chief Economist and Strategist*  
stefane.marion@nbc.ca

#### Kyle Dahms

*Economist*  
kyle.dahms@nbc.ca

#### Alexandra Ducharme

*Economist*  
alexandra.ducharme@nbc.ca

#### Matthieu Arseneau

*Deputy Chief Economist*  
matthieu.arseneau@nbc.ca

#### Daren King, CFA

*Economist*  
daren.king@nbc.ca

#### Angelo Katsoras

*Geopolitical Analyst*  
angelo.katsoras@nbc.ca

#### Jocelyn Paquet

*Economist*  
jocelyn.paquet@nbc.ca

### Toronto Office

416-869-8598

#### Warren Lovely

*Chief Rates and Public Sector Strategist*  
warren.lovely@nbc.ca

#### Taylor Schleich

*Rates Strategist*  
taylor.schleich@nbc.ca

### General

This Report was prepared by National Bank Financial, Inc. (NBF), (a Canadian investment dealer, member of IIROC), an indirect wholly owned subsidiary of National Bank of Canada. National Bank of Canada is a public company listed on the Toronto Stock Exchange.

The particulars contained herein were obtained from sources which we believe to be reliable but are not guaranteed by us and may be incomplete and may be subject to change without notice. The information is current as of the date of this document. Neither the author nor NBF assumes any obligation to update the information or advise on further developments relating to the topics or securities discussed. The opinions expressed are based upon the author(s) analysis and interpretation of these particulars and are not to be construed as a solicitation or offer to buy or sell the securities mentioned herein, and nothing in this Report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances. In all cases, investors should conduct their own investigation and analysis of such information before taking or omitting to take any action in relation to securities or markets that are analyzed in this Report. The Report alone is not intended to form the basis for an investment decision, or to replace any due diligence or analytical work required by you in making an investment decision.

This Report is for distribution only under such circumstances as may be permitted by applicable law. This Report is not directed at you if NBF or any affiliate distributing this Report is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that NBF is permitted to provide this Report to you under relevant legislation and regulations.

National Bank of Canada Financial Markets is a trade name used by National Bank Financial and National Bank of Canada Financial Inc.

### Canadian Residents

NBF or its affiliates may engage in any trading strategies described herein for their own account or on a discretionary basis on behalf of certain clients and as market conditions change, may amend or change investment strategy including full and complete divestment. The trading interests of NBF and its affiliates may also be contrary to any opinions expressed in this Report.

NBF or its affiliates often act as financial advisor, agent or underwriter for certain issuers mentioned herein and may receive remuneration for its services. As well NBF and its affiliates and/or their officers, directors, representatives, associates, may have a position in the securities mentioned herein and may make purchases and/or sales of these securities from time to time in the open market or otherwise. NBF and its affiliates may make a market in securities mentioned in this Report. This Report may not be independent of the proprietary interests of NBF and its affiliates.

This Report is not considered a research product under Canadian law and regulation, and consequently is not governed by Canadian rules applicable to the publication and distribution of research Reports, including relevant restrictions or disclosures required to be included in research Reports.



### UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

### U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. ("NBCFI") which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

### HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited ("NBCFMA") which is licensed by the Securities and Futures Commission ("SFC") to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong ("SFO")). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates' businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.

### Copyright

This Report may not be reproduced in whole or in part, or further distributed or published or referred to in any manner whatsoever, nor may the information, opinions or conclusions contained in it be referred to without in each case the prior express written consent of NBF.