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Milei in and Kirchnerism out. Our first impressions

Before giving our first impressions on the prospects of Javier Milei's future government, it is crucial not to lose sight of a transcendent issue. Although it may seem obvious, these presidential elections not only entail the triumph of Javier Milei but also the defeat of Kirchnerism. Kirchnerism governed for 16 of the last 20 years in Argentina, potentially missing the best historical opportunity for emerging economies. Latin America, with some exceptions, took advantage of the favorable international context to grow, reduce poverty, decrease debt, increase reserves, and strengthen the independence of its Central Banks. Argentina governed by Kirchnerism may have foregone a historic opportunity. Therefore, the first impression of yesterday's presidential election is that not only did Javier Milei win, but Kirchnerism also lost.

Next, a few brief lines about the most relevant points to consider for the first months of the new government.

The need for a stabilization plan. Inflationary inertia in recent months has reached 8% monthly, being optimistic. The macroeconomic debacle left by the Fernandez government and the economic policies of Massa is brutal. The official exchange rate is significantly overvalued, and relative prices are completely misaligned. In any stabilization plan and macroeconomic correction program, inflation is likely to rise before it falls. Even the best-designed stabilization plans have a high probability of failure. Hyperinflation in Argentina today is a looming threat due to the fiscal hole of 3.5 points of GDP financed entirely by money printing. A sudden devaluation of the official exchange rate without a consistent plan can be the spark that ignites the hyperinflationary fire. The first step in a stabilization plan should be fiscal adjustment.

The magnitude of the fiscal adjustment. Argentina does not have deep domestic capital markets to finance its fiscal deficit. Recurrent inflation and contract ruptures prevent the country from funding its fiscal deficit domestically. With international debt markets closed for the country, the only source of financing is the Central Bank through the inflation tax. Hence, the crucial importance of reducing the fiscal deficit to stabilize the economy. The new government will assume office with a fiscal deficit of 3.5% of GDP, a result of the fiscal debacle of the outgoing government, exacerbated by Massa in the last months to win the election. Milei and his team must focus on cutting expenses before reducing taxes. Lowering taxes will be pointless if the fiscal gap is not reduced first. Pension payments have been declining for the past four years as a percentage of the GDP, making it challenging to cut them further. The main areas where the new government should focus its attention are subsidies for public services (around 2.3% of GDP), transfers to provinces (0.7% of GDP), public investment (1.7% of GDP), and, above all, new expenses that emerged during COVID and never went away, such as IFE, ATP, Alimentar, Potenciar Trabajo, etc. (2% of GDP). Fiscal adjustment won't be easy; the FX devaluation will help, but it won't be sufficient. In political terms, managing the economy with a 43% poverty rate won't be easy. However, it's not all bad news—successful stabilization plans quickly revive economic activity a few months after the adjustment, mainly because they provide certainty and reduce the inflation tax.

Dollarization is a bad and dangerous idea. Dollarization is not only a very bad idea but also appears impractical in this situation. Some names being considered for the Ministry of Economy, such as Federico Sturzenegger and other economists from PRO, have publicly expressed their opposition to dollarization and support the exploration of schemes similar to successful neighboring countries like Peru, Chile, Uruguay, Colombia, or Brazil. We believe that this approach is the right one. However, in recent weeks, Milei has continued to advocate for dollarization as a short-term goal. The statements made in these days and the appointment of economic teams will be crucial. Beyond the advisability of dollarization, feasibility comes first. Dollarization requires a minimum of USD 47 billion (monetary base + interest-bearing liabilities + negative reserves) at the current exchange rate. Even with a significant dilution and prior

devaluation (at an exchange rate of 1,500), USD 32 billion would be needed. With capital markets closed and the IMF against dollarization, obtaining such funds today seems absolutely improbable. We also think that Emilio Ocampo's plan is unlikely to be practicable. In conclusion, a substantial devaluation as a means to facilitate dollarization may lead to the worst-case scenario. A sudden devaluation might not be enough to achieve dollarization and could potentially result in the country experiencing hyperinflation, the onset of which is known but not the exit. Potential hyperinflation would be very detrimental to Milei's governance.

Governability. In the last few decades, Argentina experienced significant economic instability, but at the same time, it maintained political stability. We can position our country in the opposite quadrant of what happened in Peru. The stability in the political system was mainly explained by bipartisanship. Bipartisanship in Latin America has, a priori, two qualities. Firstly, it aids governability. An administration with a parliamentary minority has a higher likelihood of being removed by Congress, as we have seen in the cases of Peru or Ecuador in recent years. Secondly, parliamentary majorities or consensus are a necessary condition for reforms. Milei's victory a priori breaks with bipartisanship and generates greater uncertainty regarding governability guarantees. But only a priori. Macri's support will be crucial for governability. The victory by a wide margin over Massa also provides him with greater governability, at least initially. It will be crucial for Milei to maintain a discourse and actions aimed at building a coalition government, in line with what he has been demonstrating in recent months.

Sovereign Bonds. Stocks and bonds are responding favorably to the results. We believe this is fundamentally due to three factors. Firstly, the defeat of Kirchnerism. Secondly, the wide margin of victory, which provides greater governability. Lastly, Milei's discourse, heavily focused on extending bridges of governability and incorporating PRO teams into his government. We favor sovereign bonds ([see here for a complete analysis](#)). We think the key for the coming days will be getting to know the economic teams and seeing if the President-elect keeps dollarization on the short-term agenda, which would not be welcomed for the economy or the bonds, in our humble opinion. The schemes of fixed exchange rates without fiscal discipline end in unsustainable currency appreciation and debt defaults (Argentina 2001 or current Ecuador).

In the medium term, expectations are encouraging. The agro-industrial sector is already the main driver of foreign exchange generation. Next year should see an exportable surplus of USD 20,000 million, significantly above the current year, which was heavily impacted by drought. The hydrocarbons sector is another major player that will drive the external sector. The gas pipeline will reduce imports to zero, and exports (Vaca Muerta) will leave the country with a growing exportable surplus of unconventional oil. Looking further into the future, the export sector has a lot of additional potential with mining. Finally, we believe that the global context will work in our favor; the cycle of Fed interest rate hikes has come to an end, bringing good news for emerging markets. **In the medium term, Argentina has a positive story to tell, but that story is yet to be written. The short term, as we well know, will be very complex.**

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