



Argentine president Mauricio Macri during a state visit to Brazil. Image: Agencia Brasil do Fotografias/Flickr

## **A critical year for Argentina**

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In late January, Argentine government officials finally had some encouraging data that a long hoped-for economic rebound might actually be materializing. Figures from the national statistics agency INDEC showed that month-on-month economic activity went up 1.4 percent between October and November, the second straight month of increase. An internal government document leaked to Clarín in January estimated that growth had increased by close to one percent in the last quarter of 2016. While this was a far cry from the optimistic scenario painted by former Finance Minister Alfonso Prat-Gay, who was sacked last December, the numbers are feeding a narrative by the government of President Mauricio

Macri that the Argentine economy is on a clear path to recovery. According to Minister of Production Francisco Cabrera, “all the conditions are in place for Argentina to grow between 3.5 and five percent” in 2017.

The numbers may be exaggerated, but with elections taking place in October 2017 to renew a third of the Senate and half the House, the Macri government has every reason to emphasize the positive. The economy shrank during Macri’s first year in office—by 1.8 percent, according to the International Monetary Fund (IMF), or as much as 2.3 percent, according to World Bank figures. Inflation is widely estimated at 40 percent although the rate of increase has begun to slow. Approximately a third of Argentines live in poverty, but the rate among children 14 years old and younger is a scandalous 47.5 percent, according to the IMF. Macri eliminated expensive, across-the-board subsidies for natural gas and electricity, maintaining a safety net for poor households even while price increases hit the middle class hard.

Yet polls suggest that the Argentine public overall has been willing thus far to grant Macri the benefit of the doubt in moving to overcome distortions inherited from twelve years of kirchnerismo. The Argentine Congress, in which Macri’s coalition holds a minority of seats, came together to approve a deal ending the country’s deadlock with holders of Argentine bonds following the 2001 default, thereby restoring the country’s access to international capital markets. Macri also gets credit (how much depends on whom you ask) for rebuilding the credibility of the statistics agency, INDEC; unifying the exchange rate (leading to a sharp devaluation which has contributed to the spiraling inflation); ending foreign exchange controls; and lifting agricultural tariffs to foster exports. According to the polling agency Poliarquía, the president ended the year with a 55 percent approval rating, one of the highest in Latin America. According to the same poll, over half of Argentines believe that things will improve this year.

The real question, however, is whether that optimism is well-founded and if so, how quickly improvements will be felt. The public’s tolerance for short-term pain in the interest of long-term gain is undoubtedly finite, particularly as various segments of peronismo jockey for position in advance of October’s elections. And for all the progress in getting economic fundamentals right, Argentina is still—like all emerging markets—highly vulnerable to global trends. The “headwinds” include what the World Bank euphemistically referred to as “policy uncertainty in the United States”—a thinly-veiled reference to the rising protectionism of the administration of President Donald Trump. Argentina, along with South America in general, has been spared the U.S. broadsides against Mexico and NAFTA. But the Trump administration lost no time in suspending imports of Argentine lemons, quickly overturning one of the concrete results of President Barack Obama’s visit to Buenos Aires in March 2016. The Macri administration had hoped to also renew beef exports, something that seems highly unlikely for now.

More consequential for Argentina in Macri’s second year is Brazil, the destination for 20 percent of Argentina’s exports overall and fully 50 percent of its manufacturing exports. Brazil’s deep recession continued in 2016 as the country struggled with a massive corruption scandal and related political instability. Brazil’s economy contracted by 3.5 percent last year and is expected to grow only 0.2 percent in 2017, according to the IMF. Macri and Brazilian President Michel Temer are now looking to revamp the rules of Mercosur to facilitate trade and loosen the straightjacket vis-à-vis those outside the bloc, particularly the countries of the Pacific Alliance. Indeed, one consequence of the Trump

administration's "America First" policies may be to strengthen moves toward trade integration in South America, and between it and the economies of Asia as well as Canada and Europe.

In light of the October elections, Macri's second year in office may see only incremental efforts to deal with ongoing structural issues such as the fiscal deficit, including by reforming the pension system and raising the retirement age. As noted by an economist from the Argentine think tank CIPPEC, "deficits never go down" in an election year. Moreover, the Peronist General Confederation of Labor (CGT) has ramped up the pressure, calling for a general strike on March 7 to protest a 17 percent cap on wage increases proposed by the Macri government. A critical question is whether domestic and foreign investment—the kind that generates jobs and linkages to other sectors of the economy—will materialize in 2017 in ways that have a palpable impact on employment and growth. In 2016, foreign investors largely sat on their hands, generating approximately \$1.8 billion in new investment in the first nine months against promises of some four times that amount. Foreign interest in Argentina's energy sector—the vast oil and gas fields of Vaca Muerta—is real and growing. But a clear and present danger, in addition to the penalties Trump has threatened against U.S. companies seen as sending jobs abroad, is that the domestic and international private sectors wait to see whether the size of Macri's coalition increases in the October elections and thus whether the reform process will deepen or die on the vine.

Elections in 2016 in Argentina, Brazil, and Peru brought to power centrist or center-right governments that embraced free market principles long advocated by the United States as well as Washington-based international financial institutions. The victories of Macri, Temer, and Pedro Pablo Kuczynski in Peru were taken as evidence that Latin America was turning away from governments of the populist as well as moderate left. What happens in Argentina, long a poster-child of Latin American populism, could well indicate the strength of that trend. This year is a critical one not only for Macri but also the vision of enlightened capitalism he and others represent.

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