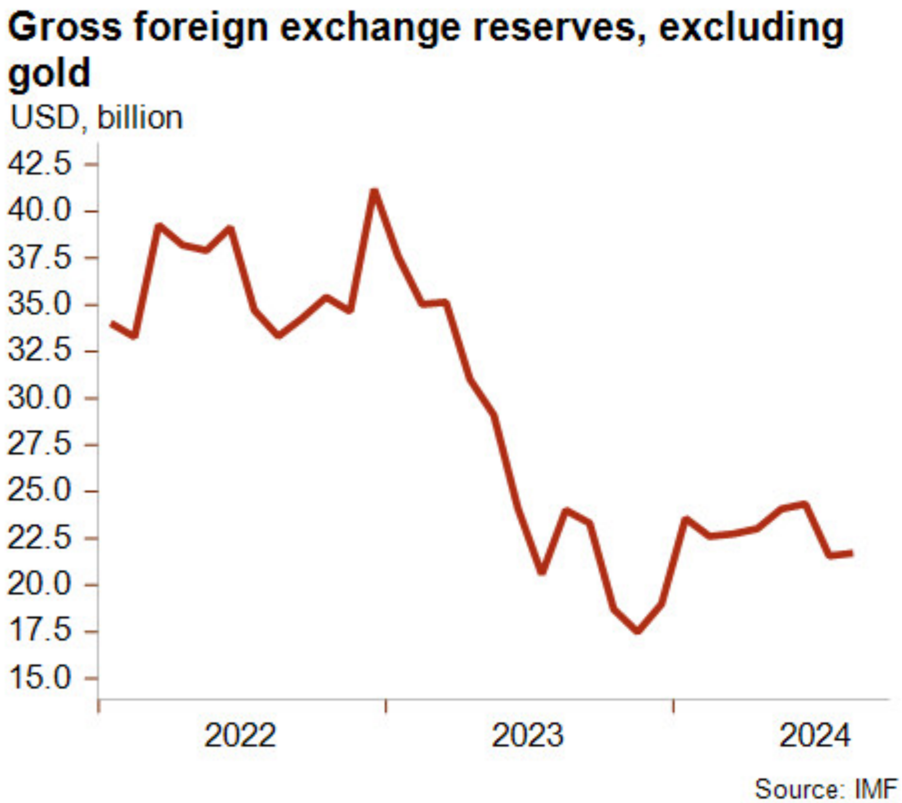
Argentina: President Milei achieved impressive reforms after ten months in office, but the country's liquidity remains poor | Credendo

Event

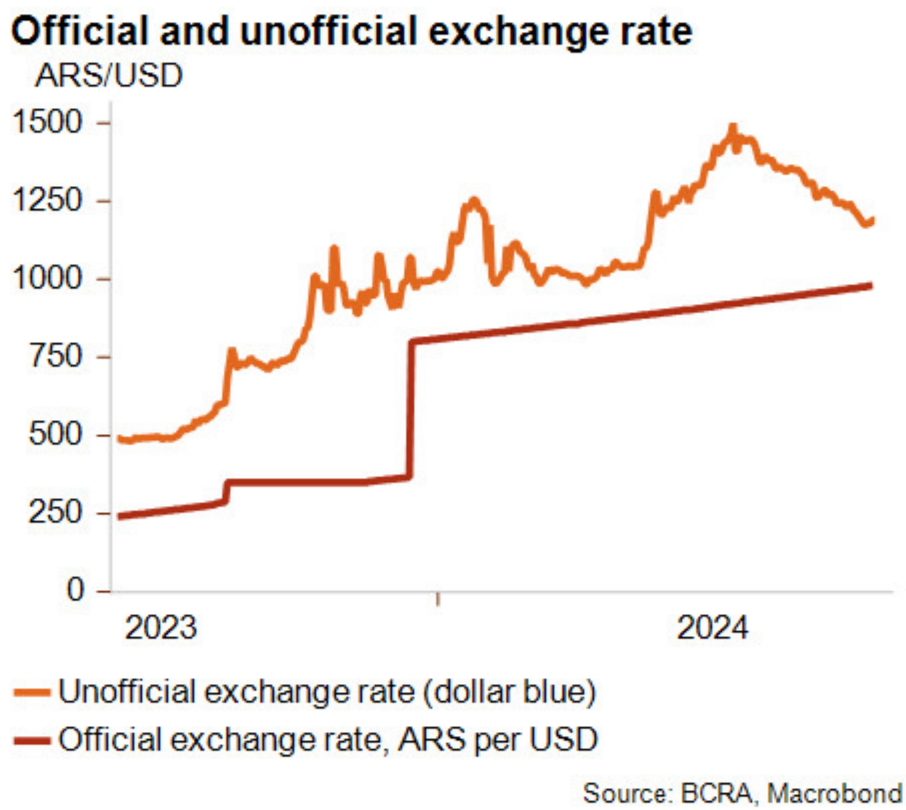
Within ten months of office, President Milei, has enacted impressive reforms. The previously derailed IMF programme is back on track and the wide fiscal deficit (which averaged -10% of GDP between 2020-2023) is narrowing to an expected -3.3% of GDP this year. In the end of June, President Milei also achieved his first legislative victory with the approval of the Bases Law (though in a much diluted version), an important milestone given his lack of congressional majority. Additional reforms are essential to restore fiscal balance and improve South America's second largest economy on a lasting basis. However, the administration faces challenges due to the fragile social situation and a severe economic recession forecast at -3.5% for 2024. Furthermore, Milei regularly shows significant resistance to (popular) bills proposed by the congressional opposition (which would increase public spending) by vetoing them and keeping his pledge for fiscal responsibility, leading to bouts of unrest and decreasing his approval ratings.

Impact

Despite impressive reforms, Argentina still faces a poor liquidity situation. Gross foreign exchange reserves have only modestly increased since the beginning of the year (see graph below), when usable reserves were virtually depleted. The country remains shut out of financial markets and short-term external debt levels are very high. Furthermore, despite the initial promises to eliminate currency controls by mid-2024, multiple controls remain in place. Foreign exchange controls are unlikely to be removed any time soon, as President Milei announced last week he was not ready to lift them yet.



The official exchange rate also remains under significant pressure despite the large devaluation of last year. The parallel market is more than 20% higher (see graph below) than the official exchange rate. Even though the gap is significantly smaller than in 2023, it still poses a risk for (another) currency crisis or a large devaluation, which would affect the difficult business environment (category G/G).



Looking ahead, there is a mixed bag of risks and opportunities. On the downside, there is a 71% probability that a La Niña weather pattern will develop by November, increasing to 80% by the end of 2024, and potentially lasting until February 2025. La Niña typically causes droughts in wheat-growing regions of Argentina, which can damage crops and significantly reduce current account revenues. In the past, during most La Niña years, Argentina's current account revenues decreased significantly and pressurised the country's liquidity (though macroeconomic unorthodox policies blurred the picture). Moreover, decreasing approval ratings and unrest could pressurise President Milei and halt or even backtrack reforms. On the upside, a new IMF programme could provide much-needed liquidity relief as the current one ends next month. However, negotiations with the IMF have yet to begin. In this context, the outlook for political risk ratings (7/7) is stable.

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