Argentina heading to stagflation

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With the measures adopted by the Argentine government, the country is heading towards stagflation, as President Milei anticipated. With the aggravating factor that it does so in the context of a very weak global economy.

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Obsessed with achieving a primary fiscal surplus of 2 points by 2024, minister Caputo ordered a fiscal adjustment of 5.2% of GDP. This percentage would be achieved with a 2.9% reduction in expenditure and a 2.2% increase in revenue (this adjustment is stronger than the one requested by the Fund, which, in the face of a primary deficit of 3%, proposed to bring it to zero by 2025). At the same time, it ordered a devaluation of 118% and a monthly adjustment (crawling peg) of the exchange rate of 2% and freed the prices of goods and services traded in the domestic market.

The role of Congress

The minister's scheme is to increase income through the replacement of export duties on non-agricultural sectors (20% of these sales can be settled in the CCL) and income tax on the 4th Category, plus increased PAIS tax on imports and withholdings on exports. The reduction in expenses is achieved with the extension of the 2023 Budget, thus liquefying the state's liabilities (public salaries, debts with suppliers, retirements and pensions), plus the repeal of the law that imposes retirement mobility. Some of these measures included in the so-called Omnibus Law will require the approval of Congress. Hence, Caputo threatened that if this law is not approved, the adjustment on expenses and rates would be greater, and the responsibility would fall on the legislators.

In addition, the package of measures replaces the SIRA with a new system that will not require prior approval and the issuance of a bond (BOPREAL), which importers can subscribe in pesos, and which is settled at maturity in dollars. With it, they will be able to pay debts with their foreign suppliers (this is the first time that the Central Bank issues debt in foreign currency, which may be a first step towards dollarization).

A desired stagflation

The devaluation had an immediate pass-through to prices. Inflation in December was 25.5% (29.7 in

food) closing 2023 with an increase of 211.4%, the highest rate since 1990. Increases in the order of 18-20% are expected for January and February when increases in public tariffs (gas, electricity, water, transport) weigh in. The doubling of the amount of the AUH and the 50% increase in the Food Card do not compensate for the increases in the cost of living.

The acceleration of inflation had a rapid impact on public salaries, pensions and popular incomes, while lowering the interest rate also liquefied the funds of savers. This is reflected in lower domestic consumption. Economic activity is falling, and recession is the order of the day. Various estimates indicate that GDP fell by 2.3% in 2023 and project a further fall of between 2.5 and 4% this year. Two consecutive years of falling GDP have totally discouraged investment, dragging private sector activity down, deepening the recession, which in turn explains the reduction in imports. Lower activity can cause the unemployment rate to climb to 8-9%.

This year, exports will be important, and there may be a greater inflow of speculative financial capital. Added together, they cannot necessarily offset the fall, so the economy will tend to stagnate while inflation is estimated on average at 250% for the whole year. It is nothing more than a desire for stagflation, as the President opportunely announced.

Market solution

The Central Bank is determined to absorb pesos from the market and liquefy them via the lowering of the interest rate, while buying foreign currency to rebuild the balance sheet of the institution. But since the only tool available to increase reserves is the trade surplus, it not only needs exports to grow, but also imports to fall, therefore less consumption and investment. Thus, domestic demand, which had been falling since the last quarter of 2023, has now had that decline accelerated.

The government's entire tightening policy is focused on fighting high inflation with a market solution, hence the induced recession. That is, demand will fall so much that companies will finally begin to liquidate stocks and lower prices, which is what happened in recent years with Cavallo and negative inflation.

A less-than-optimistic world

In its latest "World Economic Outlook" report, the World Bank set a bleak outlook, stating that: "Without a major course correction, the decade of the 2020s will go down in history as a time of wasted opportunities for the global economy." While he noted that "the global economy is in better shape than it was a year ago, the risk of a global recession has diminished, especially given the strength of the U.S. economy." At the same time, it added, as a contradictory tendency, "... that the slowdown in the Chinese economy is greater than expected."

The agency projects that global growth will remain weak, slowing to 2.4% this year and the third consecutive slowdown. Monetary policies, tight credit conditions, and low global trade and investment are expected to weigh on growth. It points out that the main difficulties are the suffocation of debts for the middle and low developing countries and the difficulties of the poor population in accessing basic foodstuffs. It does not mention our country as an example, but it is more than evident.

Just a certainty

In this context, it is difficult to make projections, if the situation left by the previous government was already complex, the first month of the Milei government made it even more complex and deepened the crisis. What will be the recession floor for the market solution to start operating? How much will the drop in activity impact tax collection? Making BOPREAL's tenders successful depends on a minimum exchange rate gap of 40%. If the gap continues to grow, will it force a new devaluation? Will a new devaluation relaunch the inflationary spiral? What will the flow of foreign currency be like? How much will the slowdown in the Chinese economy impact the demand for our products and how much will the good harvests in Brazil, the United States and our country put pressure on prices?

Nothing is certain. Only that the package of measures constitutes a full-line attack on working people. The extraordinary breadth of the CGT's call for a general strike and rally in front of the National Congress on the 24th reaffirms this certainty. As well as that 2024 will be a year of high social conflict. Of strong disputes that will unfold in parliament, in the courts and in the streets. Once again, the coin is still in the air.

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