An economy on the mend

The election of Mauricio Macri and arrival of a new government in late 2015 seems to have initiated a turnaround in Argentina. The past 15 years have been marked by an economic crisis, a sovereign debt default, and unorthodox economic policies that strained the international relations of the South American nation. The new reform-minded administration was quick to put in place a series of policies, including:

- Lifting most capital and currency controls, prompting a material devaluation of the peso;
- Removing heavy government subsidies on public services and pushing to reform the tax code;
- Solving the outstanding issue with international bondholders from the country’s early 2000 default;
- Returning to international diplomatic and trade cooperation and global markets;
- Largely eliminating export and import restrictions and duties on agricultural goods;
- Overhauling the national institute of statistics after official statistics had been discredited (and censured by the IMF).

These changes have raised expectations of brighter medium term prospects for the country.

From an economic perspective, many of these reforms took a toll on the Argentine economy in 2016. GDP contracted by 2.3% and inflation soared to approximately 40%, largely driven by the currency devaluation. Yet, this difficult patch should be short-lived with the IMF predicting GDP growth of 2.2% in 2017.1 A combination of lower inflation, a cyclical recovery, higher demand from the tax amnesty policy and low valuations could help drive demand for local assets this year.

Figure 1: Argentinean optimism abounds

Source: BlackRock Investment Institute, Thomson Reuters, as of 4/24/2017.
Notes: The leading index assigns a factor of expected growth based on survey and economic data.2 Index returns are for illustrative purposes only. Index performance returns do not reflect any management fees, transaction costs or expenses. Indexes are unmanaged and one cannot invest directly in an index. Past performance does not guarantee future results.
Return to global financial markets

One essential change attracting investor interest is the return of Argentina to global financial markets. After 14 years away, changes to capital and currency controls have allowed the country to return to the international bond market, and led to its inclusion in the flagship JP Morgan GBI-EM Index earlier this year. Market participants are also anticipating Argentina’s re-inclusion in the near future into MSCI’s flagship emerging markets equity index, which could be a positive catalyst for future inflows (2016 has seen about $82mm of inflows into Argentinian ETPs).

However, risks remain. A key one: the stability of political support for the ruling party, particularly in the face of unpopular reforms (such as subsidy cuts) and rising inflation. In that regard, the legislative elections in the fall will be key in gauging support for President Macri’s reform program. In addition, fixing the country’s fiscal deficit is a challenge that investors will closely be watching.

Figure 2: A lurking risk: Argentina fiscal balance

Notes: The Estimates for 2017 are from Oxford Economics.

Conclusion

Argentina is still far from achieving macroeconomic stability. Although a heavy policy agenda means greater uncertainty, the combination of sound economic policies, a rebound in investments, and an improving external environment could signal a change in the direction for the South American country.

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Footnotes:
2) Source: IMF, Bloomberg, INDEC, as of 3/31/2017
3) Source: MSCI, as of 3/20/2017
4) Source: BlackRock, as of 4/21/2017
5) Notes: The leading index is based on the combination of 10 variables derived from economic data and consumer services. The index provides a factor that can be used to infer future changes in an economy.

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