

## ECONOMICS: LATIN AMERICA PERSPECTIVES

# ARGENTINA: THE POLITICAL OUTLOOK BECOMES CLEARER

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The ruling coalition's strong showing in midterm elections delivers a hard blow to the Peronist opposition and boosts President Mauricio Macri's reelection chances in 2019. It should also clear the way for more investment.

Argentina's ruling Cambiemos coalition scored a significant victory in the midterm elections on October 22, winning 14 of the country's 24 electoral districts, including the five largest. Cambiemos won 42% of the votes at the national level, consolidating its position as the main political force in the country. While the coalition fell short of controlling either chamber of Congress, it is closer to being able to build a legislative majority, especially in the lower house (*Display 1*).

Cambiemos's biggest win was in the province of Buenos Aires, where its candidate Esteban Bullrich beat former President Cristina Fernandez de Kirchner. Kirchner had won by a razor-thin margin in the primary elections held in July. Some 38% of registered voters live in this province, and it's traditionally been a Peronist stronghold.

The latest results dimmed Kirchner's aura of invincibility and suggests that the population doesn't want to go back to the Kirchnerist ways. Other Peronist candidates, including former interior minister Florencio Randazzo and former cabinet chief Sergio Massa, also did poorly.

Cambiemos also won in the province of Salta, where young governor and moderate Peronist José Urtubey had been considered a possible presidential candidate. After the elections, he acknowledged that his presidential aspirations may have to wait.

Not surprisingly, the media responded to the results by playing up the possibility of President Macri's reelection in 2019. Macri's improved fortunes should make it easier for Cambiemos to negotiate with provincial governors, many of whom depend on federal funds to underwrite provincial spending. Macri has been quick to take advantage of the situation. Directly after the election he called for a meeting with all provincial governors to establish "a grand national accord" to put forth crucial structural reforms.

With increased political capital in hand, Macri is expected to push for more aggressive reforms. That will likely include gradual fiscal tightening, as Macri remains a gradualist at heart. On the tax front, we could see a reduction in corporate income taxes and an expansion of the income tax base. Look for gradual spending cuts as well, with the government continuing to

Display 1  
Congressional Composition After  
October 22 Elections

	Lower House	Senate
Cambiemos	107	24
Kirchnerist	67	23
Peronist	38	10
Massist	22	—
Leftist	4	—
Other	19	15
Total	257	72
Simple Majority	129	37

As of October 26, 2017  
Source: Local newspapers and AB

slash various subsidies. Macri's team also recognizes the need to expand credit to boost growth. That means capital-market reform should also find its way onto the policy agenda.

A strengthened Cambiemos and the bump in Macri's reelection chances should be good news for domestic and external investment. Many investors were holding off on making decisions before the elections. Now that the results are known, that may change.

## Fighting Inflation

Monthly inflation has averaged 1.82% since January, according to recent data.

That represents an annual inflation rate of more than 24%, ensuring that the central bank will miss its 17% inflation target for the year. To avoid a hit to its credibility, the bank hiked the target seven-day repo rate by 150 basis points after the elections. On an annualized basis, the real expected policy rate is now close to the 10% mark, roughly three times higher than it is in Brazil (*Display 2*).

The message is clear: monetary policy will be tightened until inflation moves closer to the central bank's target. And with voters giving their support to the government and some data showing early signs of economic growth, the central bank should have the cover to maintain its aggressive posture.

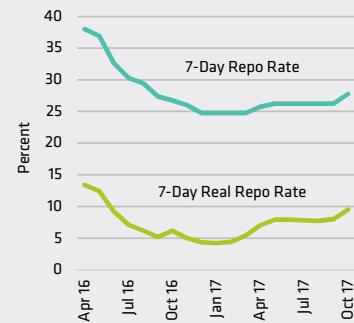
Meanwhile, we expect the government to slowly roll out a fiscal consolidation strategy. The combination of gradually

tighter fiscal policy and very strict upfront monetary policy makes local-currency instruments, especially those that carry floating-interest-rate exposure, attractive.

As it gradually adjusts policy, the government should be able to keep financing its imbalances with foreign inflows. For now, Argentina represents an attractive convergence play within the emerging-market universe. ■

## Display 2 Tight(er) Monetary Policy

Nominal and Inflation-Adjusted Policy Rates



Through October 26, 2017

Source: Banco Central de la República Argentina and Haver Analytics

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