



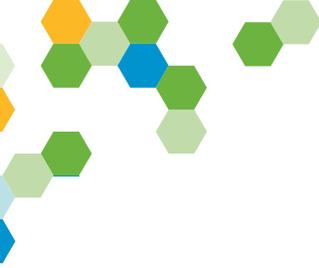
SPECIAL REPORT

Comments on Macri's first Budget

Buenos Aires, January 2017

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1. INTRODUCTION

Despite governing Argentina since December 2015, the current administration was only this year able to launch their first income and expenditure forecast. In this report we take a look at government lines, as revealed in the bill approved by Congress, the implementation of which will begin in the days ahead.

2. CONTEXT

Interestingly enough, Mauricio Macri was only recently able to launch the first budget prepared by his own political space this year, even though he became president on 10 December 2015. How can this be? Law 24156 of the Financial Administration Act obliges National Executive Power to submit its income and expenditure forecast before 15 September in the year prior to its implementation¹, almost three months before an eventual change of government. Thus, in 2016, the current administration had to make do with the budget that was prepared and approved in Congress under the force commanded by ex-president Cristina Kirchner.

Nevertheless, this particularity did not restrict Macri's decision-making, nor that of his officials. Another Argentinian peculiarity allowed him to discretionarily reallocate budgets without agreement from Congress: the so-called "Superpowers". With Argentina submerged in a deep political, economic and institutional crisis, Congress had decided to concede some of its authority to executive power in 2001, so that they could make the speedy decisions that the situation merited (hence the nickname "Superpowers" given to the executive by the press).

Among these issues – as previously mentioned– was the restructuring of the budget, as included in the said Financial Administration Act.² This power is in the Chief of Staff's hands – a minister acting as cabinet coordinator– who is designated and can be removed by the president by decree, without Parliament's endorsement. This article allowed this official –Marcos Peña– to reallocate funds of at least \$5 billion during the course of last year.

¹ Article 26. "National Executive Power will present the draft bill for the general budget to the National chamber of deputies before 15 September of the previous year"

² Article 37. "The Chief of Staff can stipulate any budget reallocation he deems necessary within the approved total for each budget bill, to include changes involving current expenditure, capital expenditure, financial applications and distribution of the final objectives".

“The Argentinian gross domestic product resembles an electrocardiogram with a series of very sharp highs and lows”

Despite not limiting the authorities of the current administration to allocate funds to one area or another, the absence of a budget prepared by themselves deprived Argentinians of the government's macroeconomic forecasts for its first administrative year. How much will the GDP grow? What will the dollar value be, which is a sensitive indicator for the local economy? Will reduction of the public debt inherited by the previous administration be gradual or drastic? If gradual, how will it be financed? And what about inflation, one of the biggest scourges of recent years? This information, along with others will be outlined in the first budget prepared by the “macrista” administration for 2017.

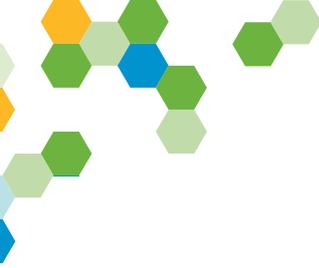
3. GROWTH OF GDP

In Argentina, statistics have been a sensitive subject for years: in 2007, ex-president Néstor Kirchner's government intervened in the organisation responsible for calculations. Such interference by the executive in an organisation which should have a certain amount of independence called any one of the economic indicators into question. Monthly inflation indexes offered the most profane evidence that statistics had been tampered with, that previous administrations had attempted to hide: whilst

private consultants estimated annual price increases of around 25 %, INDEC (National Institute of Statistics and Census of Argentina) set the same rate at less than 10 %. The immediate consequence was not the standardisation of the institute, but the legal persecution of the consultants who were banned from communicating their indicators.

Having accomplished this caveat, the Argentinian gross domestic product – the amount of goods and services that the country produces – resembles an electrocardiogram with a series of very sharp highs and lows. In 2015, the last year of Cristina Kirchner's mandate, this indicator showed a 2.1 % growth in GDP. This estimate carries some credibility as the organisation made it public during Macri's administration, who had already started a process of institutional standardization.

Nevertheless, 2016 was clearly a year of recession which closed with an approximate 2.5 % fall in GDP. The economy would recover in the second semester, according to the government's optimistic claims, but this did not become a reality. Various officials claimed that this decline was the fault of the previous administration, arguing that inherited macroeconomic instability cannot be resolved from one day to the next. But



“The local economy is “dollarized”. What does this mean? That local prices have a strong relationship with the value of the dollar”

they also use Brazil's situation as a backup: Argentina's main commercial partner had been through a year of recession through political instability.

In contrast, the 2017 budget forecasts a growth of around 3.5 % of GDP, driven by increased consumption (+ 3.5 % against - 0.9 % in 2016) and a rise in investment (+ 14.4 % against - 3.5 % in 2016). Taking 2016's activity into account, there would be a rebound of almost 6 % (of - 2.5 to 3.5 %). If this forecast is fulfilled, the odd-numbered years of the 2015–2017 triennium will show expansion (2015: + 2.1 %; 2017: + 3.5 %), while the even-numbered year (2016: -2.5 %) will contract. An electrocardiogram of a patient under observation.

4. VALUE OF THE DOLLAR

The dollar is a sensitive indicator for the Argentinian economy. Following successive devaluations of their local currency, Argentinians are devoted to the North American currency and incurable tendency to take refuge in it as a store of value. This explains

why Argentina is the country with the largest quantity of dollar bills per capita on average, outside of the United States.^{3,4}

The local economy is “dollarized”. What does this mean? That local prices have a strong relationship with the value of the dollar- During the nineties for example – when with one peso you could buy one dollar– a coffee in a Buenos Aires bar was worth \$1.50, today the same coffee – with the American dollar valued at around 16 pesos– costs about 24 pesos (or rather, \$1.50 x 16 pesos).

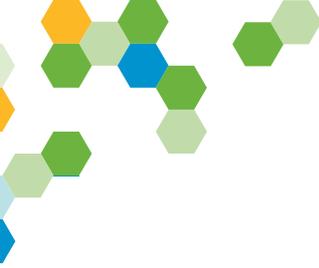
This is a purely local phenomenon which directly impacts inflation. If the value of the dollar increases (however small the increase), the price of goods and services will also rise irrespective of whether consumption is in this currency or not. The difference in comparison to neighbouring countries is remarkable. For example, Brazil saw a 48 % devaluation in 2015, with inflation at 10 %. Such a difference between these indicators would be unthinkable in Argentina.

Table 1. Estimators

ESTIMATORS	
GDP	+3,5 %
INFLATION	17 %
AVERAGE DOLLAR VALUE	18 pesos
BUDGET DEFICIT	4,2 %

³ United States Federal Reserve: <https://www.federalreserve.gov/pubs/ifdp/2012/1058/ifdp1058.pdf>

⁴ Bloomberg article: <https://www.bloomberg.com/news/articles/2013-05-15/argentinians-hold-more-than-50-billion-in-u-dot-s-dot-currency-dot-heres-how-we-know>



“Argentina’s high inflation will take away any comparative advantage over potential competitors in the region”

The 2017 budget thus envisages an average of rate 18 pesos to the dollar. This means that the currency would be valued at around 16 pesos in January, rising to 20 pesos by the end of the year. As elections will take place in August – internal primaries– and in October – general elections–, the lion’s share of currency depreciation will take place after Argentini-ans have been to the polls in an attempt to minimise any possible effect on voting intentions towards the government.

In contrast to European countries that have the euro, different rates in the local currencies of the various countries in the region will make them more or less competitive in relation to each other. If one country in the region devalues its currency (in other words, more pesos can be bought with the same number of dollars), it automatically becomes a cheaper market for dollars another and thus,

more attractive for investors. Nevertheless, Argentina’s high inflation (which will be discussed later in this article) will take away any comparative advantage over potential competitors in the region.

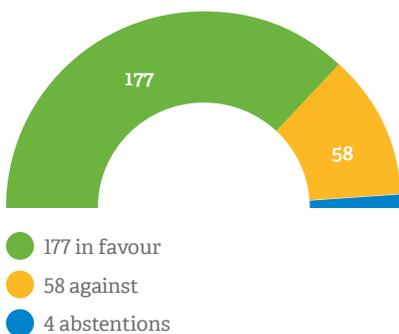
5. REDUCTION OF PUBLIC DEBT AND ITS FINANCING

One of the enigmas unveiled in the 2017 budget is the decision that it should take in relation to public spending which, according to estimates by administration officials, hit the astronomical figure of 7 % of GDP in 2015. The administration’s intention for this year was to continue with the restraint and expenditure that began in 2016, when the deficit was at 4.8 % of GDP.

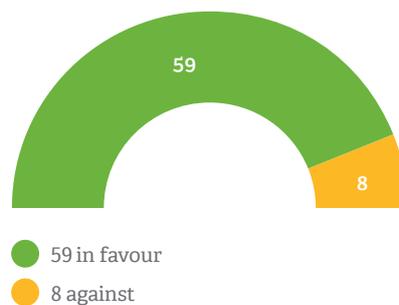
President Macri was presented with two campaigns that proposed how to reduce it. There were those that reiterated the importance of a gradual reduction, which would not immediately harm the administration’s image or potential voting intentions for the ruling party in the face of legislative elections. And there were also those that insisted on taking shock measures, drastically adjusting expenditure and assuming the political costs in short-term, while the government was still enjoying the so-called “honeymoon” with the people, having only recently taken up its duties.

Figure 1. Votes in the two Chambers

Chamber of Deputies:



Chamber of Senate:



“Dujovne reiterated the need to reduce the tax deficit on several occasions”

“Gradualism” prevailed: this year’s deficit which was originally forecast at 3.3 % of GDP, was now expected to be 4.2 %. One of the main instigators of this stance, the departing Finance Minister, Alfonso Prat Gay, explained the decision: reducing the deficit to 3.3 % of GDP was a strong adjustment and would kill the fledgling economic recovery that we are now experiencing.” According to this budget, expenditure would continue to be gradually reduced: it will be 3 % in 2018 and 1.5 % in 2019, the last year of president Macri’s mandate.

However, those that support the theory that shock measures would achieve better and faster results received some good news in December: Nicolás Dujovne, an orthodox economist with media presence, replaced Prat as head of the finance ministry. In his weekly slot of a television programme, Dujovne reiterated the need to reduce the tax deficit on several occasions and also confessed in his presentation press conference: “we will try to reduce the deficit by the 4.2 % that we had planned”.

He took his first measures with this intention in mind: elimination of the 5 % refund on VAT (21 %) valid for debit card purchases – the measurement intended

to discourage the use of cash had a fiscal cost of 500 million dollars– and restricted the incorporation of new State employees.

Methods to finance the deficit are significantly different from Cristina Kirchner’s government: “this is not that different to a Kirchnerist budget: we financed the debt by omission and they do it with public debt”, speculated Juan Manuel Abal Medina, who was chief of staff – the same post held today by Marcos Peña– from 2011 to 2013. This administration took on a debt of more than fifty billion dollars in 2016 (an exorbitant 9 % of GDP), part of which was used to settle other matured debts, but some money was also allocated to cover current expenditure and to fulfil the objectives of “gradualism”.

6. INFLATION:

The general increase in the price of goods and services is a structural problem in Argentina. Inflation has been under two digits for only 14 of the last 70 years; or rather, only one out of every five years –on average– can be considered as non-inflationary. Of these 14 years, nine were consecutive –from 1993 to 2001 inclusive–, so Argentina is used to living with this scourge. The longest spate ran from 1970 to 1992

“According to an IMF study, in 2015, Argentina ranked in the top three countries with highest inflation, only behind Venezuela and the Ukraine”

without interruption and with a maximum hyperinflation point in 1989 (3.079 % annual) and 1990 (2.314 % annual)⁵.

The situation is still as severe now as it was then. According to an IMF study, in 2015, Argentina ranked (with 26.9 %) in the top three countries with highest inflation, only behind Venezuela (273.7 %) and the Ukraine (43.3 %)⁶. And in 2016 – with a change of government – was no exception: annual inflation closed at 40.1 %

What is the reason for such disparate macroeconomic imbalance? Most analysts agree that one of the main causes is the excessive government spending discussed in the section referring to budget deficit. When the state cannot sustain itself with taxes collected – something that happens often in Argentina – it covers expenditure by issuing more banknotes. And as everybody knows, an increased money supply will almost inevitably result in price increases.

The government has set an inflationary target of around 17 % for 2017. The bar has been set high, it should reduce the rate to below half of that of 2016 (40 %), in an electoral year when the ruling party

will avoid making big cuts to prevent repercussions at the polls. Nevertheless, the majority of private consultants believe that the rate will be somewhere between 20 % and 25 %, and that the 17 % forecast by the government is an attempt to strengthen expectations.

Negotiations for parity will be fundamental to reach this objective, which are the agreements for salary increases reached by syndicates and employees in each sector – usually during the first semester of the year – to compensate for the loss of purchasing power that salaries are subjected to with inflation. There is a constant race in Argentina in which salaries are successively chasing inflation, following a year where the price of goods and services increases – for example, by 40 % –, syndicates propose a similar increase so that salaries are not undervalued. The challenge that the current administration faces is to set this salary adjustment – despite inflation of around 40 % – at somewhere around 25 %.

In addition, the consultants' estimates are more linked to the price of the dollar as mentioned: if at the end of 2017

⁵ Consumer Price Index in Argentina, Wikipedia: https://es.wikipedia.org/wiki/Anexo:Evoluci%C3%B3n_del_%C3%8Dndice_de_Precios_al_Consumidor_en_Argentina

⁶ Article in El Tribuno: <http://www.tribuno.info/argentina-el-podio-los-paises-mayor-inflacion-n671852>

the North American currency is valued at 20 pesos (or rather, a devaluation close to 25 % if you take into account that today one dollar costs 16 pesos), it's unlikely that price increases will stay below 20 %.

7. CONCLUSIONS

Until 2015, Argentina's budget did not comply with required budget standards: the forecasted rate of inflation did not become reality, the value of the dollar foreseen for the four years after the Bill's approval were exceeded in the parallel market before December of the following year, and income and expenditure were underestimated in order to discretionarily reallocate resources. In addition, it was impossible to know in advance the main economic indicators that would be forecast by government in power. In Parliamentary debate, the most common phrase reiterated by legislators was that the dispute in Congress was pointless because the budget was a "sketch".

The previous administration's decision to conceal its true forecasts had an indispensable ally: the aforementioned "Superpowers". That delegation of powers reserved for an emergency situation in the event of extraordinary

circumstances, became somewhat ordinary. In 2006, legislators close to Néstor Kirchner's government – which was in power at the time – approved the permanent transfer of their powers to the Executive domain.

This budget sets a maximum for the reallocation of lines and envisages that this percentage will gradually decrease. In 2017, executive power will not be able to reallocate more than 7.5 % of total general expenditure. This percentage is reduced to 5 % for 2018. The intention of the ruling party is that Macri's presidency finalises in 2019 with the authority to reallocate 2.5 % of total expenditure, without the endorsement of Congress.

The cycle is completed without the need further clarification: in 2020 there will be no reason for executive power to carry on using these funds without Parliamentary agreement. For this to happen, it will once again be imperative that the legislation allows a new government to modify – with the agreement of Congress – its first budget on coming into power and not have to accept an income and expenditure forecast prepared by a previous administration and approved by a previous Parliament membership.

“The intention of the ruling party is that Macri's presidency finalises in 2019 with the authority to reallocate 2.5 % of total expenditure”

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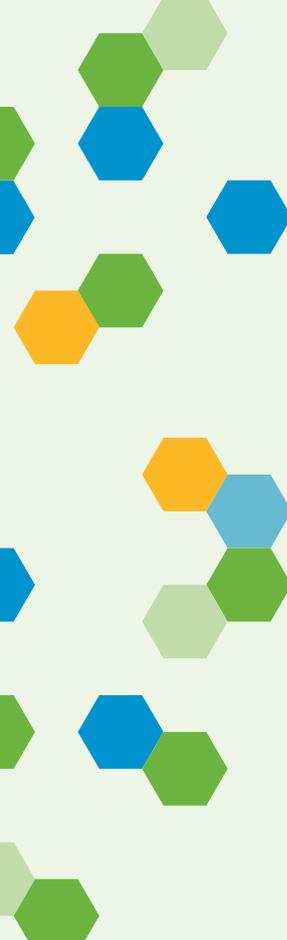
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