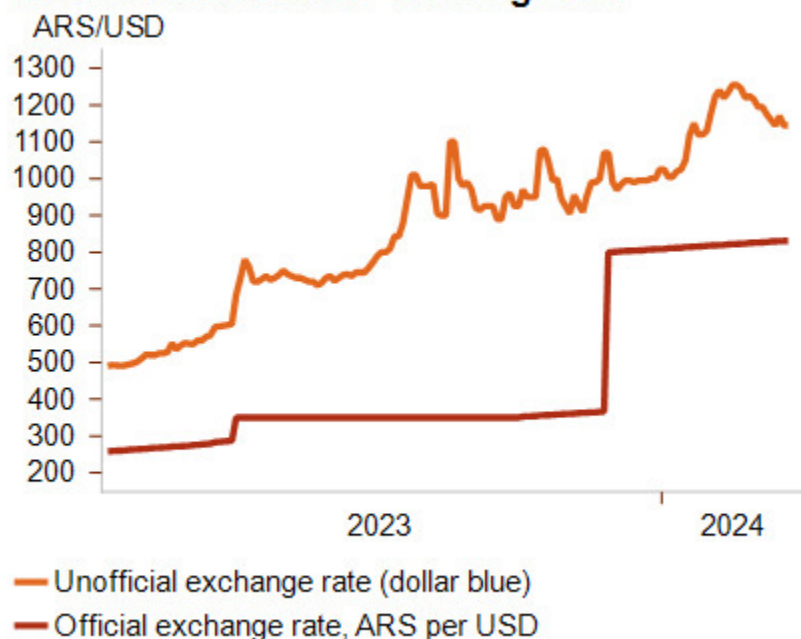


Argentina: Downgrade of ST political risk to category 7/7 | Credendo

President Milei took important steps to reform the ailing economy

In November 2023, [liberal presidential candidate Javier Milei](#) won the elections with a landslide, which provided him with a strong mandate for his “shock therapy” to cure the ailing economy. When Milei took office mid-December, he took important steps to liberalise the economy and improve the liquidity situation. Notably, a new and transparent import system was put in place for imports dating after 12 December 2023, replacing the cumbersome and untransparent system of administrative import controls, wherein the Central Bank of Argentina had a large level of discretion. The Argentine peso devaluated with 55% and a crawling peg was instated. Following the mid-December devaluation, the exchange market reacted relatively calmly (see graph below), seemingly showing confidence in the reforms.

Official and unofficial exchange rate



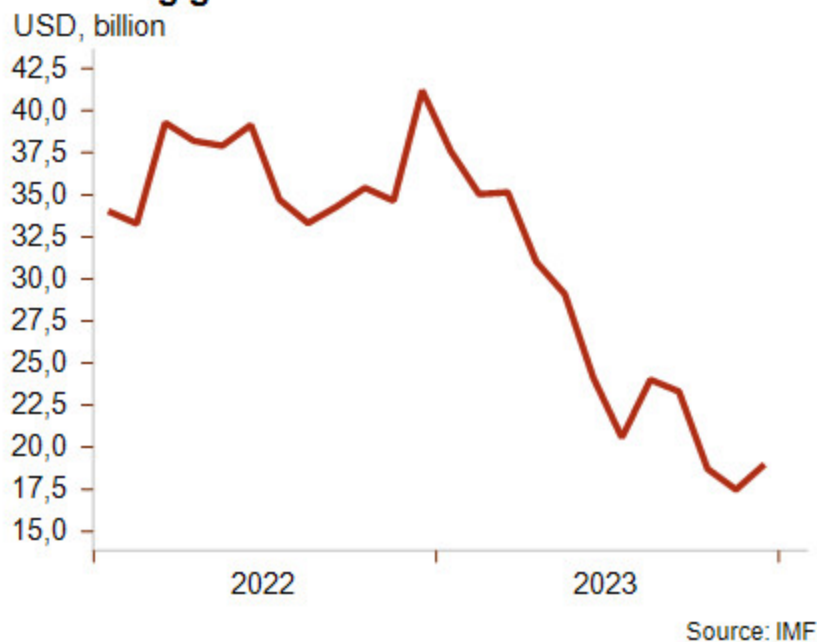
Source: BCRA, Macrobond

However, Milei inherited a very dire liquidity situation

The Peronist government left a very dire liquidity situation, which cannot only be blamed on the severe drought of last year. The previous Peronist government enacted a large spending spree and very unorthodox policy measures, while maintaining a highly overvalued exchange rate to win support for their (failed) presidential bid in their last months in office. As a consequence, the IMF programme went severely off track at the end of last year, halting the vital liquidity disbursements. Furthermore, imports remained strong due to stockpiling, amid a high foreign exchange gap (150%-200%) and imports supported by expansionary policies. As a result, the current account deficit of 2023 stood at a wide -10% of GDP (instead of -0.6% of GDP forecast by the IMF WEO in October 2023). As the government used a fifth of its foreign exchange reserves to bolster the

parallel exchange market and an undisclosed amount to defend its official exchange market, the liquid foreign exchange reserves skydived (see graph below) and were exhausted. In the meantime, import financing – highly encouraged by the previous government – ballooned (ST commercial external debt stood at 60 billion USD, double the historical average). Hence, the government of Milei was left with a huge backlog of short-term commercial external debt and depleted foreign exchange reserves. Recently, the payment experience of Credendo also seriously deteriorated.

Argentina: Gross foreign exchange reserves, excluding gold



Harsh rebalancing in the cards

The good news is that Milei managed to very quickly put the IMF programme back on rails with an ambitious stabilisation programme and by securing a vital liquidity disbursement in the end of January. Looking ahead, rebalancing will be hard. The expected current account surplus of 1% of GDP in 2024 will only very limitedly increase liquidity and keep the net foreign exchange reserves (excluding swap lines with the BIS and China) into negative territory in the coming year. According to the IMF, the gross external financing needs exceed external financing sources in 2024, while the external financing gap is expected to be financed by IMF disbursements (mainly the disbursement of the end of January). If a larger gap occurs, it will be difficult to find additional financing. The current IMF programme (that is mainly used to pay back IMF debt) will stop in November 2024. A new IMF programme is not on the table, as there is very little appetite from the IMF, and Argentina is already IMF's largest creditor (the current loan is already very high at about 1000% of quota, while normally a country can borrow up to 435% of its quota). China might also show little appetite given Milei's sympathy towards the USA or might only lend in renminbi for Chinese exporters, with untransparent conditions attached to these loans. Lastly, the access to the financial markets is not expected to be restored until at least late 2025.

Large downside risks loom

On the domestic front, the necessary fiscal adjustment is unprecedented, while the feasibility to

enact reforms is becoming more and more difficult. The judiciary already suspended some important reforms. On 7 February, a major setback occurred in the Congress, where the President's party has less than 15% of congressional seats. Milei's proposed reforms bill was revoked despite the original reform bill was already seriously watered down in January. Though important reforms are still expected to be pushed through, it is possible that Milei will not sufficiently improve the fiscal balance (and risk the IMF programme going off track). Moreover, given the delicate social situation (40% of Argentinians live in poverty), large strikes and unrest are ongoing against Milei's reforms. Hence, it is possible that he will have to seriously backtrack, or even leave office, likely paving the way for another Peronist government. On top of that, since mid-January, the parallel exchange rate shot up by 25% and the gap with the official rate widened above 50%. Hence, a new severe devaluation is highly likely before April, as otherwise farmers could hoard agricultural harvests. Nevertheless, another devaluation might not restore market confidence given Argentina's history in erratic policy-making and deep macroeconomic imbalances. Moreover, a devaluation would weigh on inflation and therefore on social unrest. Hence, the exchange rate might remain under pressure. Lastly, a likely return of the La Niña weather pattern, causing droughts in Argentina, in the second half of 2024 could hurt exports, while the development of the lithium and copper sectors could lead to higher imports than currently anticipated in 2024, given the high but uncertain imports component in the early stages of mining projects. On the external front, a further slowdown in trading partners (such as China), lower commodity export prices and a deterioration in global financial conditions are also downside risks.

Given the severe deterioration of the liquidity situation, the quick deterioration of Credendo's payment experience and large downside risks, Credendo decided to downgrade Argentina's ST political risk rating to category 7.

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