

Argentina: elections and reforms

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The Cambiemos administration, led by President Macri, will begin its third year of office strengthened by the result of the mid-term elections last Sunday. The ruling party won 41% of the votes for national deputies and won 13 of the 24 Argentine provinces, including the city of Buenos Aires and the four central provinces where more than 66% of the population and 75% of GDP are concentrated. In senate election in the largest and hardest-fought constituency, the province of Buenos Aires, the ruling party beat former President Cristina Kirchner's party by 4 points with 41.4% of the votes. These results clear up the economic scenario for the coming years, since they allow for the extension of the timeframe within which the current rules, which favour a more stable macroeconomic situation and a more pro-market atmosphere will prevail.

Since the beginning of its mandate, the Macri administration has focused on reordering the macroeconomy, correcting distortions in relative prices, regularising the country's payments situation and lifting exchange restrictions to attract investment and encourage economic and employment growth. These policies are bearing fruit and have contributed to the good electoral result, since the economy is growing at around 4% YoY, while confidence indicators have recovered strongly and lending to the private sector is expanding at 48% YoY, well above inflation, which is still at 23.8%. In the short term, the government will have to maintain its austere monetary policy until it brings inflation down another notch and it converges with the Central Bank's targets of achieving single digits in 2019. In addition, in 2018, after two years of low consolidation, progress will be made on reducing primary expenditure by 1pp of GDP, which will enable the primary fiscal deficit target (3.2% of GDP) to be met and ensure access to funding.

However, to enable sustainable growth without external strangulation, it is crucial to continue expanding the rate of investment, which is among the lowest in the region: 19.5% of GDP. This involves addressing economic issues affecting competitiveness as well as issues related to institutional quality, in addition to electoral reform and the modernisation of the judicial system.

With regard to improvements in competitiveness, it is necessary to reduce the heavy weight of the State in the economy, to move forward with the modernisation of the public sector and with deregulation. A substantial reduction in the high tax pressure on the private sector depends fundamentally on controlling the expansion of national and provincial public expenditure and on obtaining alternative sources of stable revenue that will eliminate the most distorting taxes. This involves discussing the provincial fiscal responsibility law and the reform of federal tax revenue sharing. Although Cambiemos will still have no majority in either Chamber, it will have the biggest minority of Deputies and will reach 33% of the seats in the Senate. It will have to continue to negotiate with the opposition to obtain the approval of these key laws, but from a position of greater strength.

Greater encouragement for investment will also require tackling the problems of low labour productivity and the insertion of Argentina in the world. While a comprehensive labour reform has been ruled out, sectoral agreements with which the government plans to move forward will involve negotiation with unions and companies in which each sector needs to cut the other some slack. Further opening of the economy with the

signing of trade agreements will bring with it a large scale advantage to domestic production, but its impact on less competitive sectors must also be considered.

Despite these difficulties, the government's greater political capital after the elections and the expansion of the horizon to implement reforms to a possible second term, gives Argentina a unique opportunity to solve the problems that have historically hampered the achievement of its development potential, and which are now at the centre of the government's reform agenda. The starting point is an economy that is badly damaged after years of bad policies and with a very small financial system, so the margin for improvement is substantial.

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