



The Argentine Paradox

Lost in the global era?

Buenos Aires, 2016

Today's conversation

1

- After growing at 6% annually between 2003-13, growth was 0.5% in 2014 and 1,5% in 2015. Consumption and Gov. expenditure increased, but industry production, investment, exports and private jobs decreased
- Huge economic imbalances accumulated (fiscal, inflation, current account, forex rate and utility prices) that need to be eliminated or reduced

2

- This is the result of another populist project that enjoyed a positive international context and created some growth and prosperity but at a significant macroeconomic cost, increasing State intervention and discretion, imposing forex & tariffs controls and deteriorating property rights

3

- The new government will have to restore confidence and introduce sound economic policies to reduce econ imbalances, increase investment, growth, competitiveness and international confidence, while improving conditions to the 25% of the population in poverty
- In an international context that is becoming less favorable due to the appreciation of the USD, commodity prices downturn, slowdown in China, stagnation & crisis in Brazil and a probable increase in USD interest rates
- Or he may go home early, which is common for non-peronist presidents

The hangover after another populist party, high commodity prices and accelerated global growth ...



... and maybe not even the Pope can save them this time



The Argentine Pendulum



Populism – Peronism

- Domestic demand growth oriented
- Monetary and fiscal expansion with large macro imbalances
- High salaries
- Strong government economic intervention
- Nationalistic & Protectionist
- Overvalued forex rate

Neoliberalism

- Private investment and export oriented
- Sound macroeconomics
- Friendly government to private activity
- Integrated to the world

The pendulum in historical perspective

1870 – 1929

**Ag export &
FDI based
growth**

**Global
economic
crisis**

**From an
oligarchic
republic to
gradual
opening of the
political
representation**

1930 – 1989

**Import
Substitution
Industria-
lization**

**End of the true
democracy,
Peronism,
unstable
political
systems**

**1982-89
Debt
Crisis**

1990 – 2001

**Washington
consensus
reforms &
convertibility**

**Back to
democracy
under major
economic
and social
pressure**

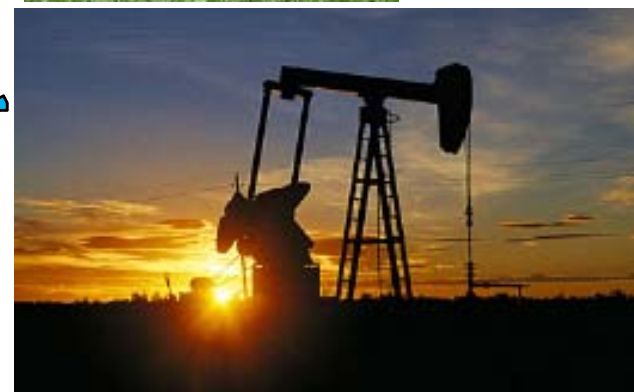
**2001-02
Debt &
Forex
Crisis**

2002 – 2015

**Return to
“ISI & true
Peronism”**

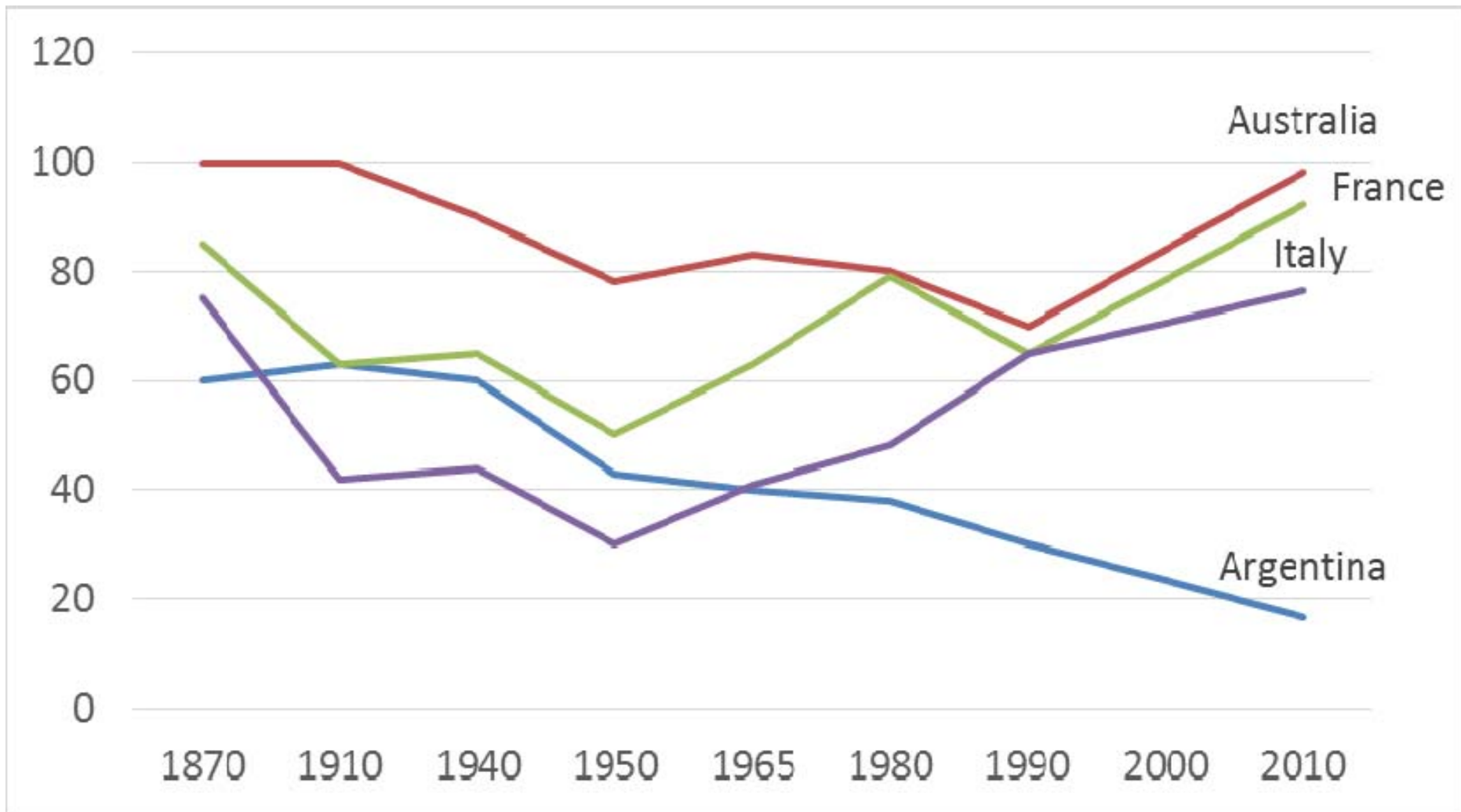
**Hiper
presidential
populist
project ...
gone or just
a break?**

Argentina: a land of multiple resources



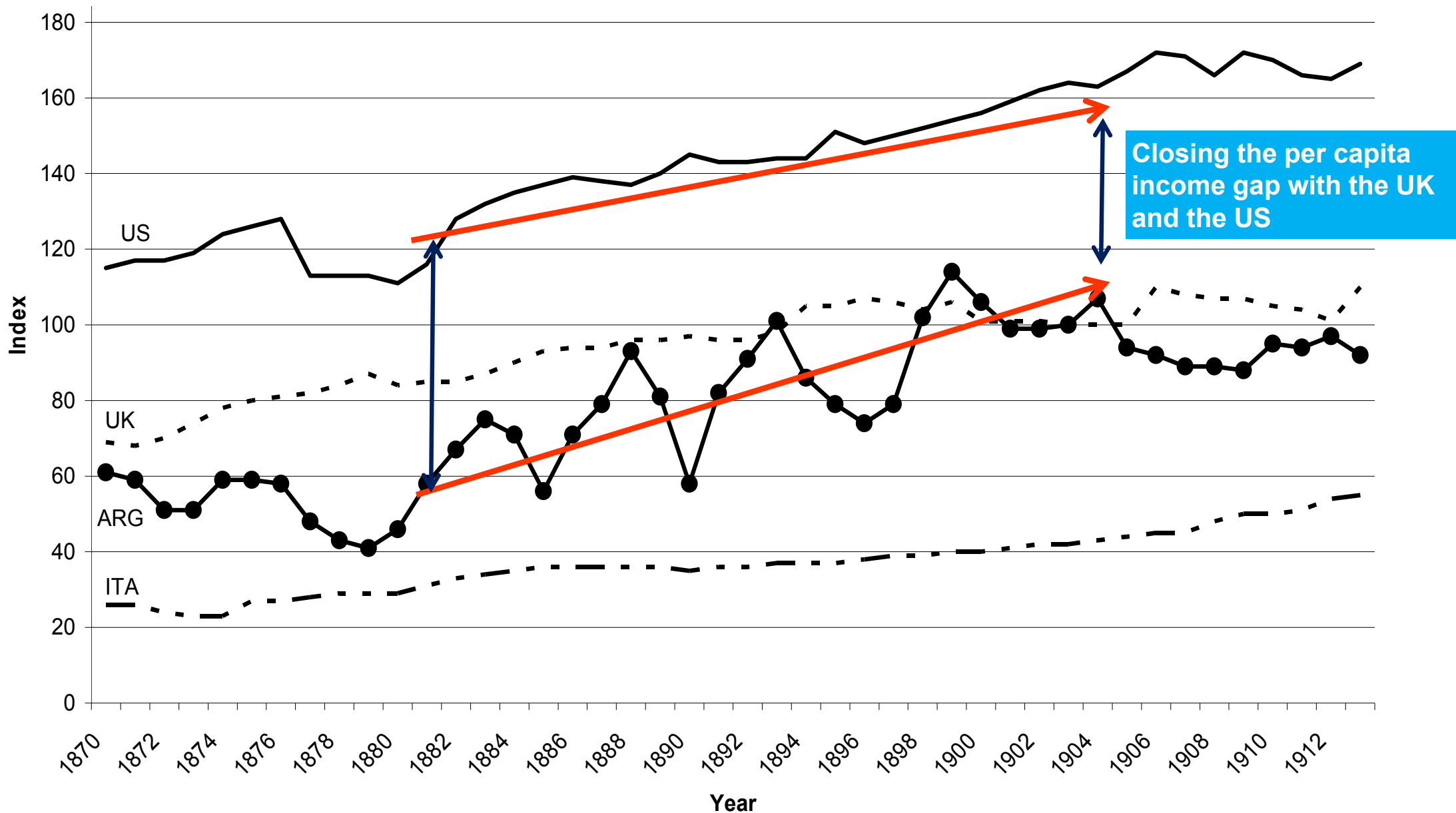
But disappointing economic and development performance

Income per capita as percentage of the USA

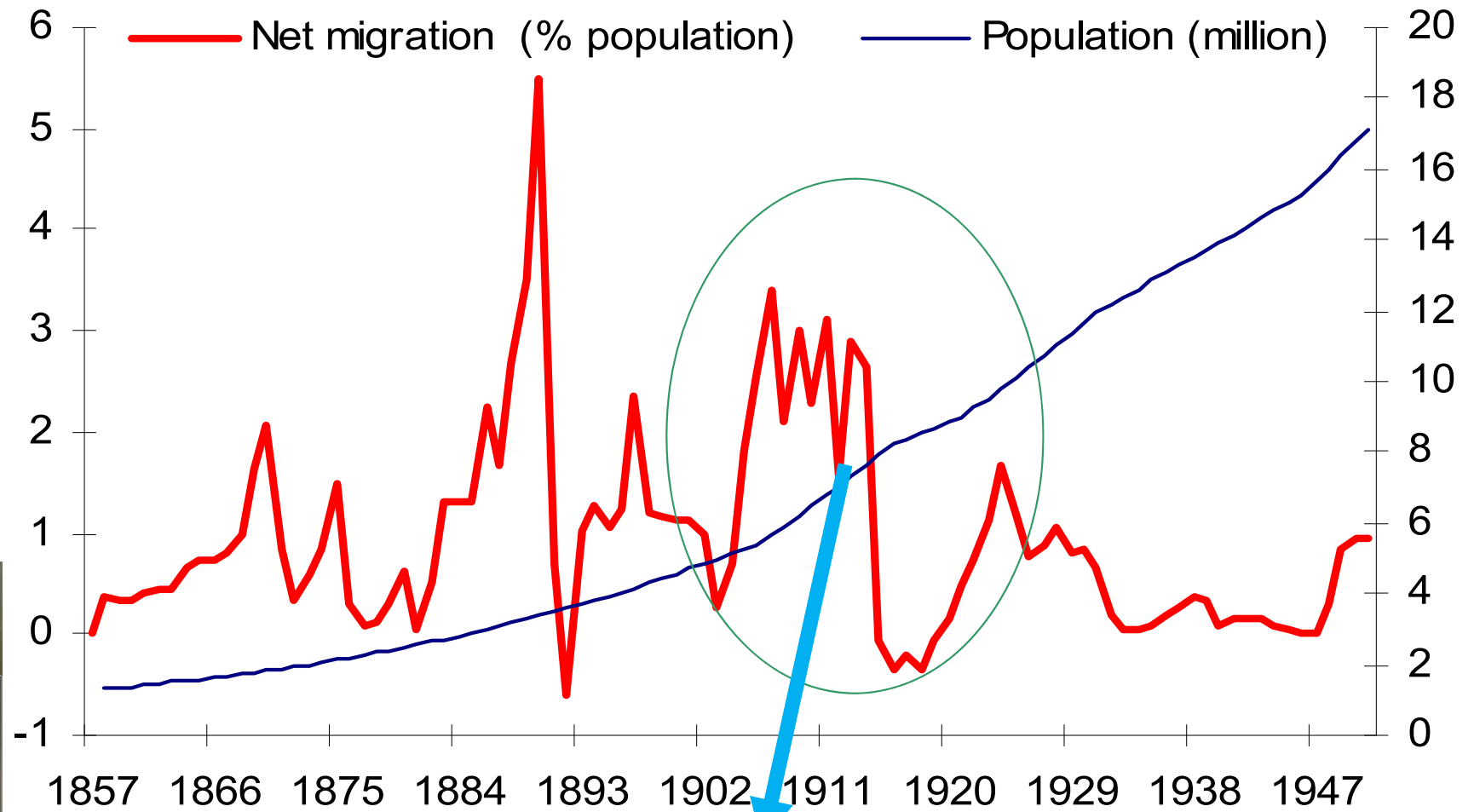


Annual wage 1870 - 1913

UK real wage in 1905 = 100



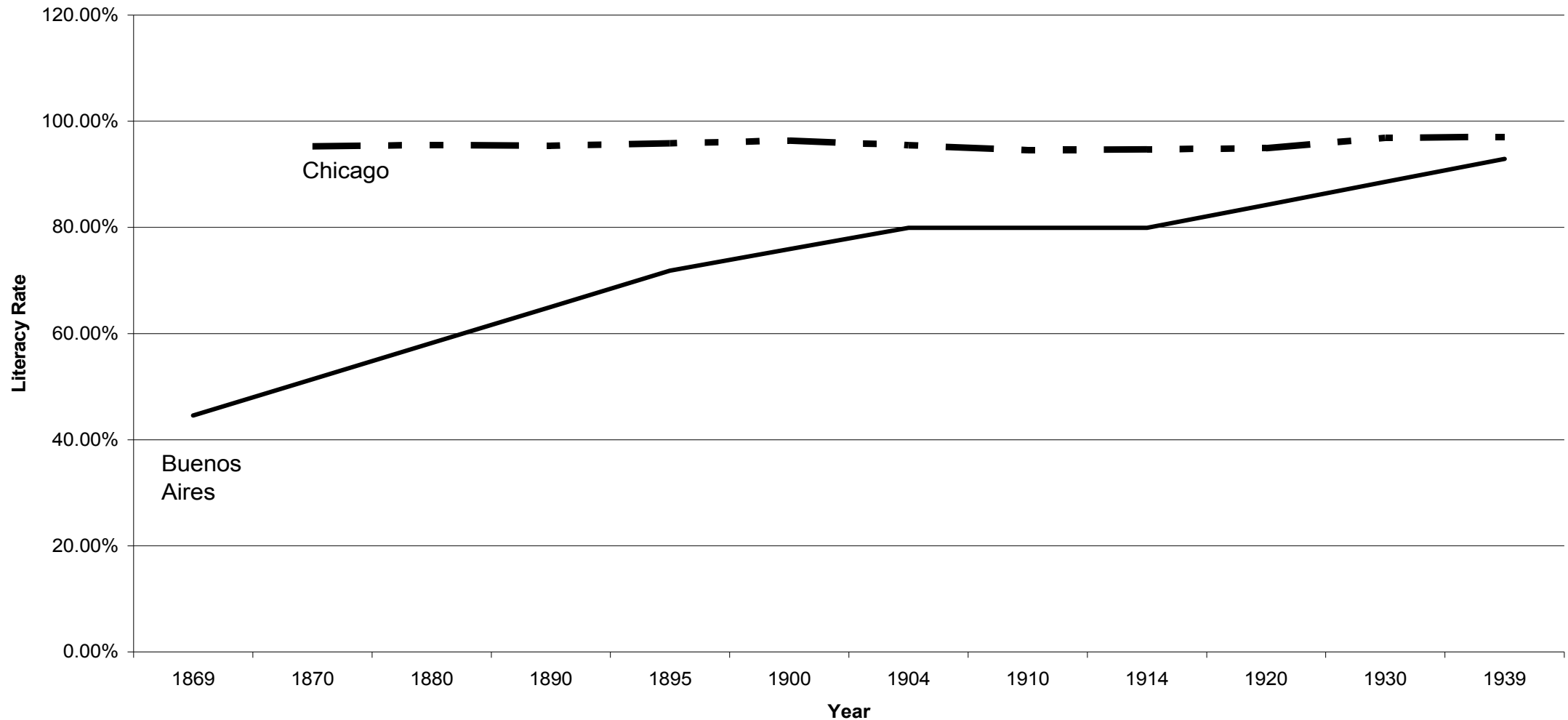
Friendly invasion: From 1860 to 1950 Argentina received millions of immigrants



- By 1910's about half of the population were immigrants
- Most of them were Italians and Spaniards, but there were also Lebanese, Syrian, Jews, Irish, French and Germans
- Immigrants brought modern agriculture, industry, and commercial & investment networks in Europe

Government invested heavily in public education

Literacy Rates in Buenos Aires and Chicago, 1869 - 1939



Sources: Data for Chicago from the U.S. Census IPUMS (Integrated Public Use Microdata Series) at www.ipums.org. Data for Buenos Aires from Primer Censo Nacional (1869), Segundo Censo Nacional (1895), Censo General de la Ciudad de Buenos Aires (1904), Tercer Censo Nacional (1914) Tomo III, and Cuarto Censo General de la Ciudad de Buenos Aires (1939)

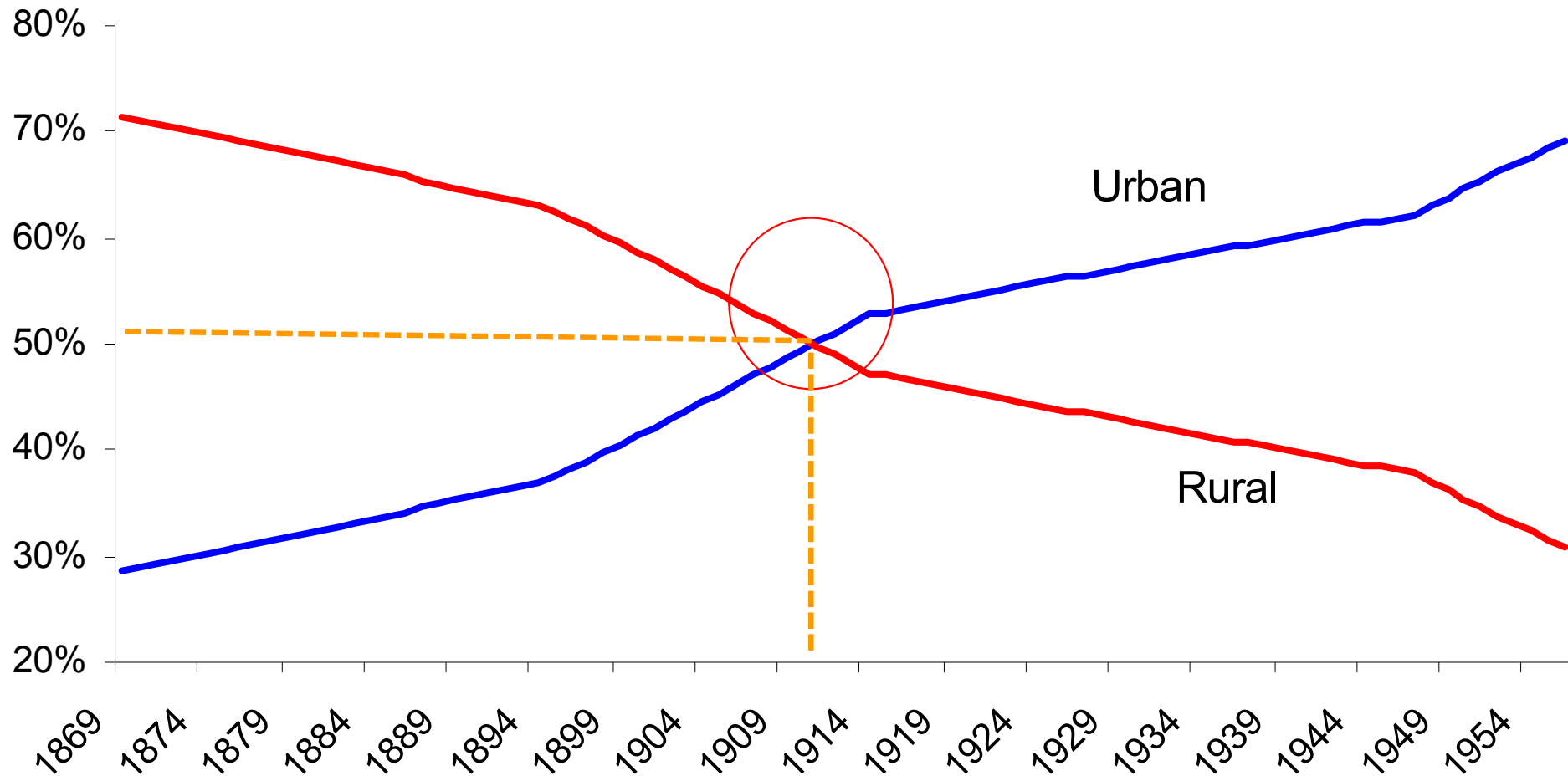
From 1900 to 1929 economic growth exceeded demographic expansion, resulting in a significant increase in per capita income

	Conservative 1900 - 1915	Radicals 1916 - 1929
Real GDP Growth	5.0	5.0
Real GDP per capita Growth	1.4	2.3
Consumer Price Inflation	2.5	2.0
Investment / GDP	24.5	16.1
M3 / GDP	48.1	50.8
Public Expenditure / GDP	13.1	10.5
Public Deficit / GDP	2.8	1.4
Exports & Imports / GDP	21.6	20.1

- Impressive growth
- Low inflation
- High investment rates
- Low public expenditure and deficit
- Open economy
- Land expansion, high capital and infrastructure investment, and labor force expansion explain most of the growth

**Then, what
happened
after 1929?**

There was a significant urbanization. First, caused by foreign immigration and, second, by rural migration to the cities due to the downturn in agriculture prices, exports and production during the crisis



In 1930s population became mostly urban, employed in industry and services, with no democratic representation, no labor rights or social welfare



How do you rule in a country with an unequal income distribution, whose economy has traditionally being based on natural resources, which are concentrated in few hands?

In the 1930s the global economic crisis and increased protectionism put an end to agricultural exports and inflows of foreign capital. The export oriented growth model was over.

	Conservative		
	Conservative	Radicals	Coalition
	1900 - 1915	1916 - 1929	1930 - 1942
Real GDP Growth	5.0	5.0	1.8
Real GDP per capita Growth	1.4	2.3	0.1
Consumer Price Inflation	2.5	2.0	0.5
Investment / GDP	24.5	16.1	14.4
M3 / GDP	48.1	50.8	52.8
Public Expenditure / GDP	13.1	10.5	17.9
Public Deficit / GDP	2.8	1.4	3.2
Exports & Imports / GDP	21.6	20.1	13.8

- **Moderate growth**
- **Low inflation**
- **Low investment rates**
- **Higher public expenditure and deficit**
- **Closed economy**

What would you do?

The end of the liberal-conservative era



- During the conservative and liberal period, income per capita growth was impressive while there was increasing demand for argentine exports, which collapsed with the 1930's crisis
- Conservatives did not understand the role of industry in development, failed to develop incentives to promote domestic industries, even when there were some modest projects proposed by the more progressive conservatives
- A few economist and politicians reacted well to the 30's crisis and implemented wise policies to reduce international exposure and to promote industry. They had more ambitious projects, but the traditional conservative leaders saw these measures as temporary and did not see the long term need for industrial development
- Worse, conservatives were not ready to share power or social wellbeing with the new urban middle class and the new industrialist. They failed to develop a "Party of Ideas" and leadership that could persuade a popular base and win elections. Ironically, they failed to adapt to their own success.

Peron and Populism

Objectives: Nationalism, Industrialization & Social Welfare

- Economic independence: trade, capital, manufactures, energy and technology
- Social welfare: full employment & high real salaries in the industry sector

Peron's strategy: ISI + State intervention

- Promotion of new industries by Import Substitution Industrialization (tariffs, quotas, licenses)
- SOBanks and financial policies to provide cheap capital to strategic industries & consumption
- Nationalization of foreign firms (independence, cheap inputs & employment)
- Development of infrastructure and heavy industry mainly by SOEs (cheap inputs & employment)
- Growth driven by consumption (high real wages, employment, social benefits, low food cost, subsidies and overvalued forex rate)



Peron's political power

- Coalition of unions and industry
- Nationalist militaries
- Support from social welfare politicians & the Catholic Church
- Demagogy & propaganda, The Evita Foundation
- Tough on opposition and free press



How do you finance this?

- Taxes? On farmers, industry or Households?
- Debt? Foreign or Domestic debt? Who is saving? Who is lending?
- Central Bank monetary expansion?
- Private equity? National or FDI?

Antagonism Braden or Peron: Braden, and the US, misjudged people's feelings and ended helping Peron to win and isolate from US influence



Peronist industry and technology projects: The Graciela, first designed and manufactured car in Argentina



Family Sedan

Sport Convertible



Peronist industry and technology projects: The CM1 and CM2 the first two, and last, diesel-electric locomotives designed and manufactured in Argentina



Peronist defense industry and technology projects: The Pulqui II, almost one of the first supersonic fighters in history



Evita, the mother of the poor: an nice looking actress from a working class family with great energy, charisma and ambition



Peronist propaganda: Evita, the reason of my life are the poor



Fundacion Eva Peron: social welfare with a “personal” touch



A strong hero, a beautiful girl, an epic project. But ain't a great story without a great song



<https://www.youtube.com/watch?v=tayldJvpbHY>

Peronist education: Peron is good, we vote Peron



EL LUCHADOR MARAVILLOSO

Los hombres que necesitaban trabajar para vivir, no recibían lo que merecían por su esfuerzo.

Los viejecitos sin familia, no encontraban quiénes les dieran cariño.

Los niños pobres debían ganar su comida.

Así era de triste la vida en nuestra Patria.

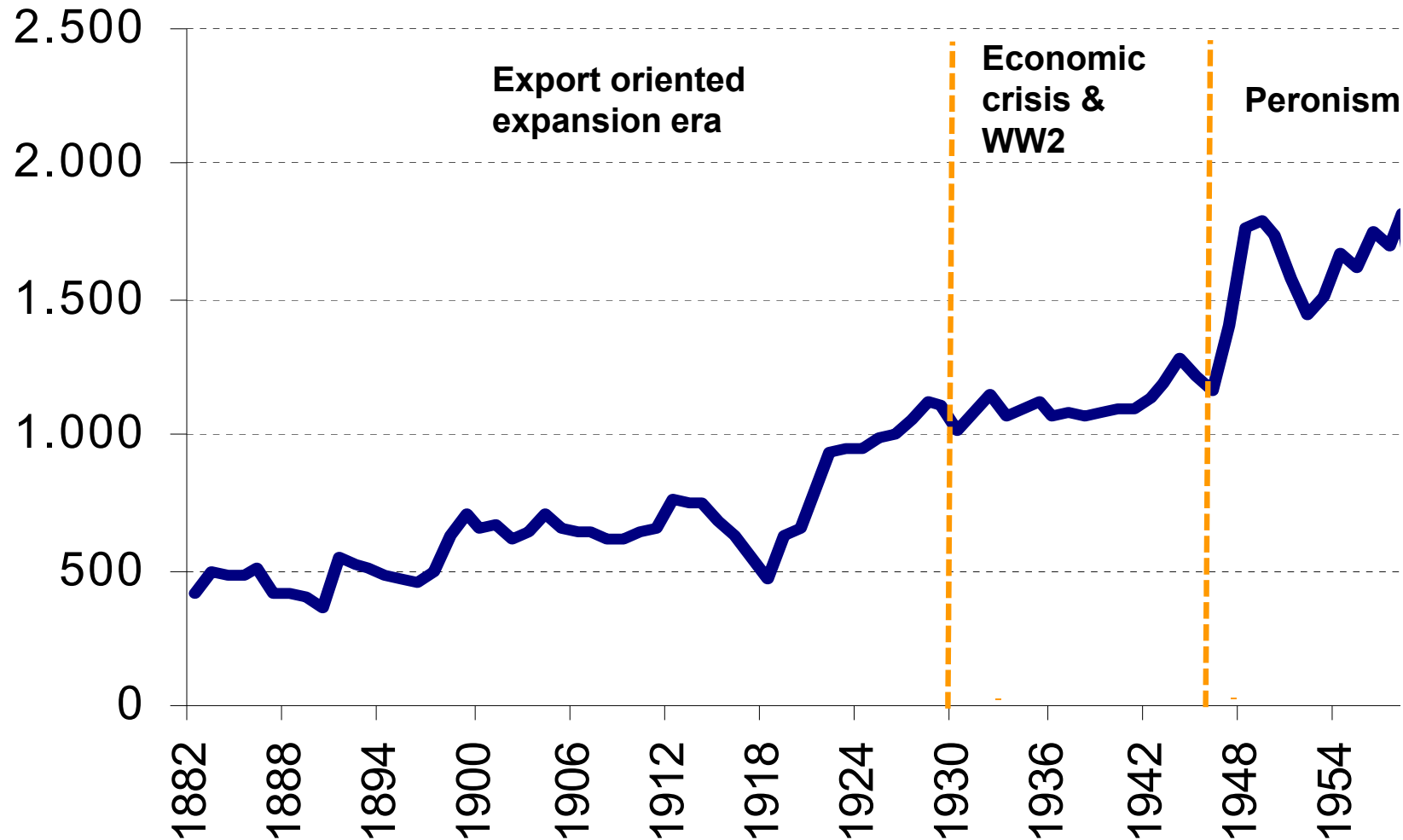
Viendo tanta injusticia, un hombre que la amaba más que a su vida, juró salvarla.

Luchó valerosamente, sin descanso, hasta cumplir su promesa.

Ese patriota, ese luchador maravilloso que hizo a nuestra Patria Libre, Justa y Soberana se llama: ¡Juan Perón!

After a decade without real increases in wage, they reached a record during the Peron's government

Real wage evolution 1880-1955




Peron, a decade and half a century in perspective

	Ag export period 1900 - 1929	Conservative Coalition 1930 - 1942	Peron 1943 - 1955
Real GDP Growth	5.0	1.8	3.7
Real GDP per capita Growth	1.8	0.1	1.7
Consumer Price Inflation	2.2	0.5	16.7
Investment / GDP	20.3	14.4	16.7
M3 / GDP	49.4	52.8	50.0
Public Expenditure / GDP	11.8	17.9	28.8
Public Deficit / GDP	2.1	3.2	8.1
Exports & Imports / GDP	20.8	13.8	7.5

- After the disappointing years of the global crisis and WW2, growth increased. Investment also increased, but not as much as in 1900-29
- Consumption and public expenditure were the main drivers of growth, investment remained behind, resulting in fiscal deficit and high inflation
- Exports were neglected, causing severe forex constraints when high commodity prices ended in 1949
- In 1953 Peron attempted to correct major inconsistencies: increased farm incomes, attracted FDI, restrained monetary expansion and wages
- His personalist style, increasing authoritarianism and negotiations with Standard Oil alienated some militaries, which finally overturn the government

Ruling against the ghost of Peron turned to be a mission impossible and a political chaos. Military and semi-legitimate constitutional governments alternated unable to gain stable political and social support

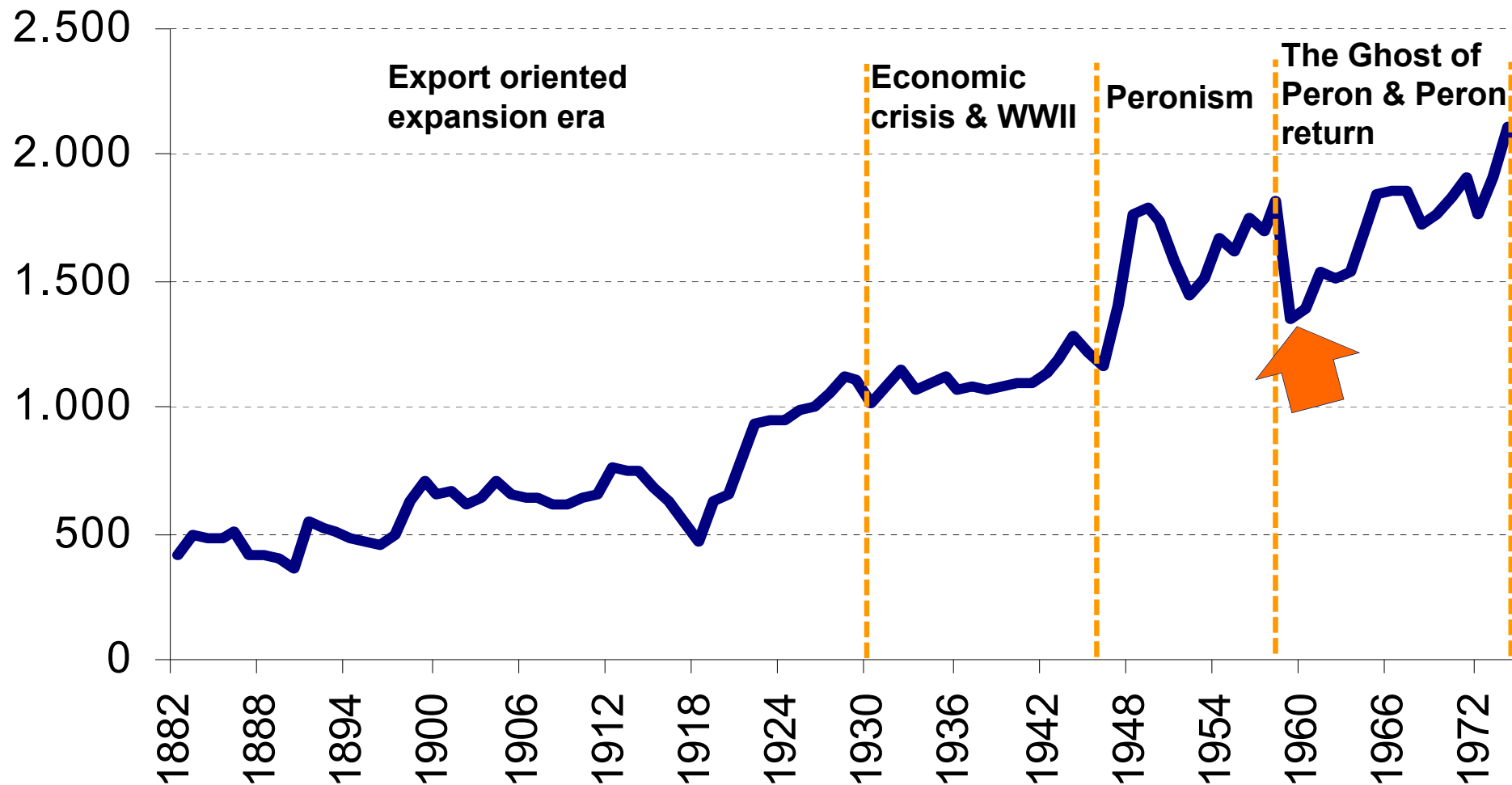


**15 presidents
in 18 years,
about a 1 year
term by
president.
Only 3 lasted
about 4 years.**





1955	Eduardo Lonardi (Military)
1955/1958	Pedro Eugenio Aramburu (Military)
1958/1962	Arturo Frondizi (Constitutional)
1962/1963	José María Guido (Constitutional)
1963/1966	Arturo Illia (Constitutional)
1966/1970	Juan Carlos Onganía (Military)
1970/1971	Roberto Levingston (Military)
1971/1973	Alejandro Lanusse (Military)
1973	Héctor Cámpora (Constitutional)
1973	Raúl Lastiri (Constitutional)
1973	Juan Perón (Constitutional)
1973/1976	María Estela Martínez de Perón (Constitutional)
1976/1981	Jorge Videla (Military)
1981/1982	Leopoldo Galtieri (Military)
1982/1983	Reynaldo Bignone (Military)

After Peron, economic adjustment hit hard on real wages, which recovered after a few years. However, workers did not forget the good peronist years

Real wage evolution 1880-1973

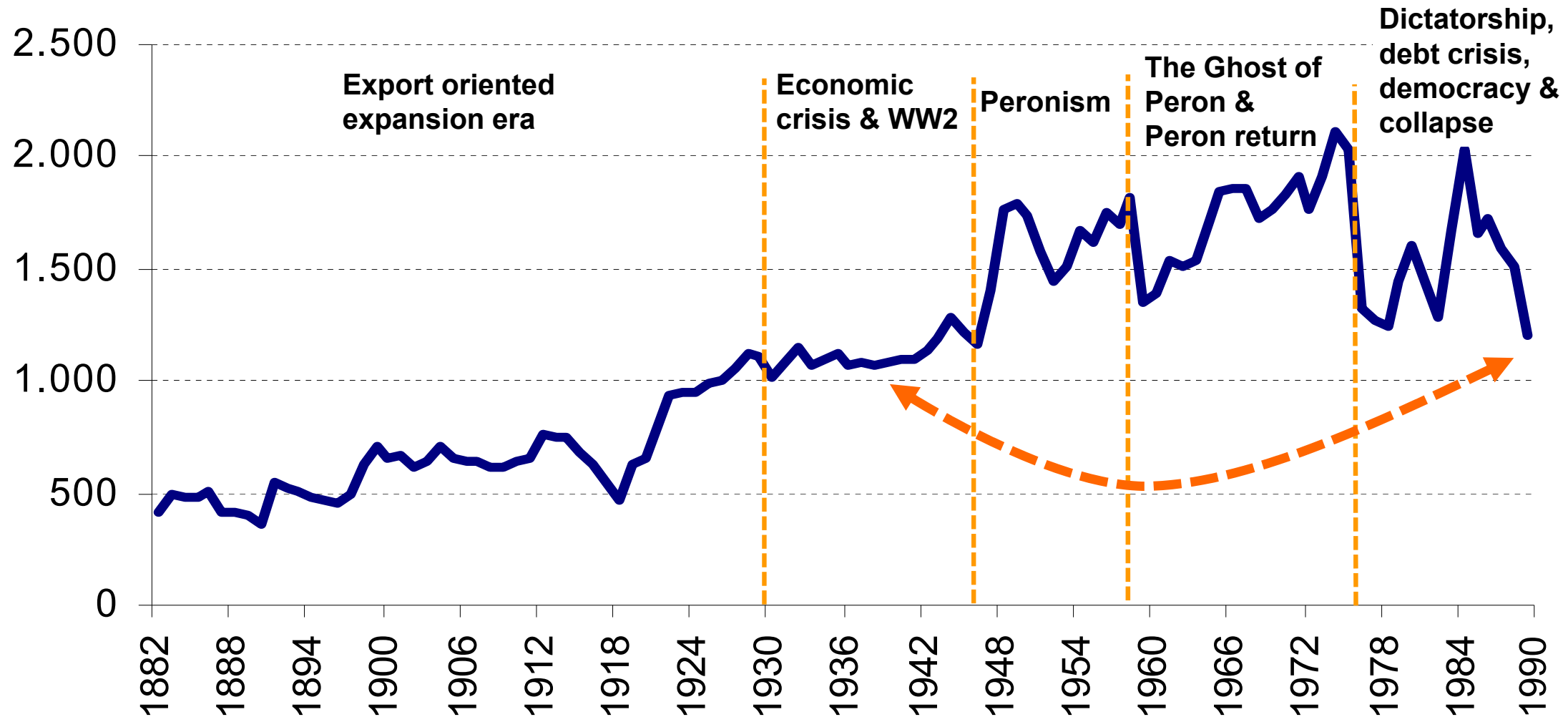


From ruling against the ghost of Peron to democracy and collapse

	The Ghost					
	of Peron	Peron II	Military	Democracy & collapse		
	<u>1956 - 72</u>	<u>1973 - 76</u>	<u>1977 - 82</u>	<u>1983 - 88</u>	<u>1989 - 90</u>	
Real GDP growth	3.9	2.1	0.5	1.2	-3.1	
Per capita real GDP growth	2.3	0.5	-1.1	-0.2	-4.3	
Consumer price inflation	30.5	178	147	368	2,697	
Investment / GDP	22.7	25.0	26.5	20.0	16.2	
M3 / GDP	27.3	28.3	29.7	16.6	7.5	
Public expenditure / GDP	25.0	27.7	29.0	29.5	23.5	
Public deficit / GDP	3.7	11.4	12.1	9.3	4.3	
(Exports + Imports) / GDP	6.4	6.0	9.1	8.5	9.8	

- After Peron growth returned, but was always fragile because of inflation, public deficit and frequent forex currency constrains.
- It was politically unsustainable. Peronism was proscribed and governments were not representative nor legitimate.
- Peron II tried to recreate the populist policies, but it only aggravated imbalances without clear gains and became economic and politically unstable after Peron died
- 76-83 dictatorship increased foreign debt, public deficit, overvalued the ARS and opened the economy destroying part of the local industry. It Fall after 1982's foreign debt crisis and Malvinas war.
- The rest of the 80's were wasted trying to manage foreign debt burden, fiscal deficit and unprofitable and inefficient SOEs. At least, democracy was consolidated.

In 1989, after years of poor economic management, political instability and recurrent crisis, real wages were almost back to the 1930's level
Real wage evolution 1880-1990



The 1989 picture



- Average per capita GDP growth 1975-89: 0%
- Average fiscal and quasi-fiscal deficit 1975-89: 10 %
- Inflation rate in 89: 5,000 %
- GDP growth in 89: -7 %
- Inefficient, overemployed & bankrupted SOEs
- Average presidential tenure of the last 40 years: 2 years

**What would
you do to
change this?**

The end of the ISI, Peronist and anti-Peronist years



- The industrialization project was ambitious and achieved some impressive results. Argentina was the most industrialized country of Latam, with a large urban workers population and the highest incomes.
- However, there were several macroeconomic inconsistencies and unbalances. Too much government expenditure, fiscal deficit, monetary expansion and inflation.
- There was also too much Government intervention, discretion, unstable institutions, expropriations of savings and distributive conflicts that discouraged saving and investment.
- Exports depended on farm products, whose production, investment and technology adoption were neglected causing balance of payments instability.
- In some cases subsidies and overprotection created inefficient industries and lack of incentives to improve.
- To govern against the “love for Peron” was impossible. Resulted in weak, unstable and sometimes violent and repressive governments.
- The accumulated unbalances, easy money and high debts during the 70’s followed by the interest rate increases of the 80’s caused the complete collapse of the system.

Only another peronist could change history



Structural reform of the 90's: Elements of the Washington Consensus

1- Government budget & debt stability

- Fiscal Discipline & Debt restructuring
- Tax reform broadening the tax base and reducing marginal tax rates
- Privatization of SOEs and SOBs
- Redirection of public expenditure towards health, education and infrastructure

- 
- Restore fiscal and public debt stability
 - Focus government expenditure on productivity

2 - Private sector incentives

- Secure property rights
- Deregulation

- 
- Private sectors is more efficient and dynamic
 - Attract private investment

3 - Trade integration

- Unified and competitive exchange rate
- Trade liberalization

- 
- Focus on competitive industries
 - Enjoy global efficiency & growth

4 - Financial integration

- Eliminate barriers to FDI
- Financial liberalization

- 
- Increase financial markets depth & efficiency
 - Enjoy global capital

Washington consensus policies with an Argentine touch

Reduced inflation & monetary instability

- Central Bank not able to print money freely by the Convertibility Act
- Fixed exchange rate & currency board regime: 1 Peso = 1 USD

Reduced fiscal deficit

- Transferred public services to local governments (education and health)
- Increased taxes (VAT) and created new taxes (tax on financial transfers)
- Foreign debt restructuring (Brady Plan)
- Massive privatizations: Oil, telecom, railroads, ports, steel, power generation & distribution, petrochem, banks and shipyards

Deregulation & liberalization

- Import duties were cut to an average level of 15%, well below 1970's 75% and 1980's 30%, and eliminated export taxes
- Open to capital flows
- Pension fund reform. The State no longer pension fund monopoly

Washington consensus policies with an Argentine touch: the hidden traps

Convertibility

- The fixed exchange rate caused OVERVALUATION by time and LOSS of COMPETITIVENESS in an open economy.
- Government lost ability to use monetary policy in a downturn.

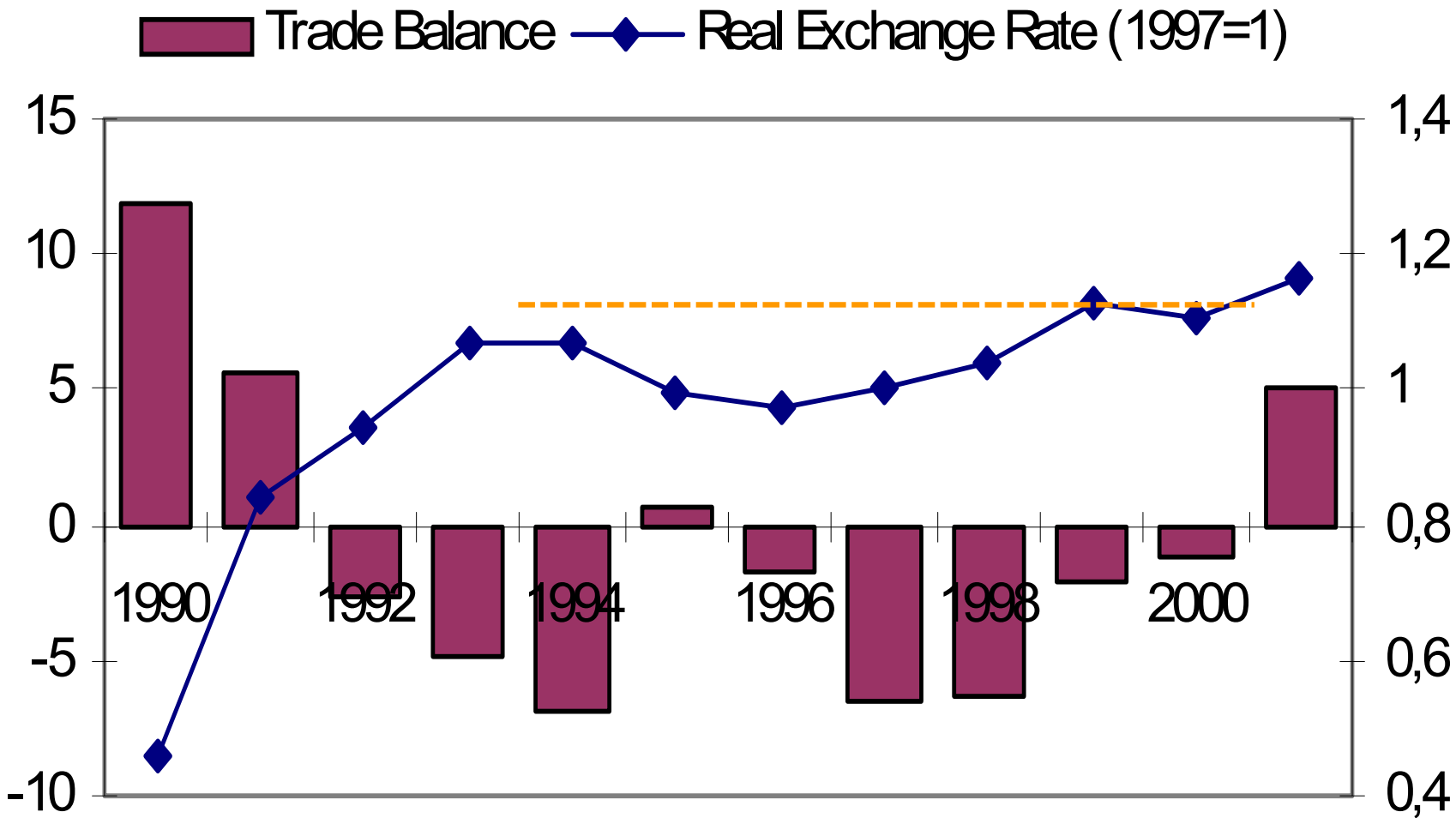
Fiscal deficit

- Several expenditures were not reduced, were simply TRANSFERRED to the provinces
- Introduction of private pension funds created a DEFICIT in the public social security system, and consequently in the fiscal budget

Privatization & employment

- Privatizations caused significant UNEMPLOYMENT
- While the private sector was LOOSING COMPETITIVENESS due to convertibility and REDUCING INVESTMENT due to increasing unbalances

Through time, the exchange rate appreciated 100% compared to the 80's. Domestic companies loose competitiveness and the trade balance deteriorated

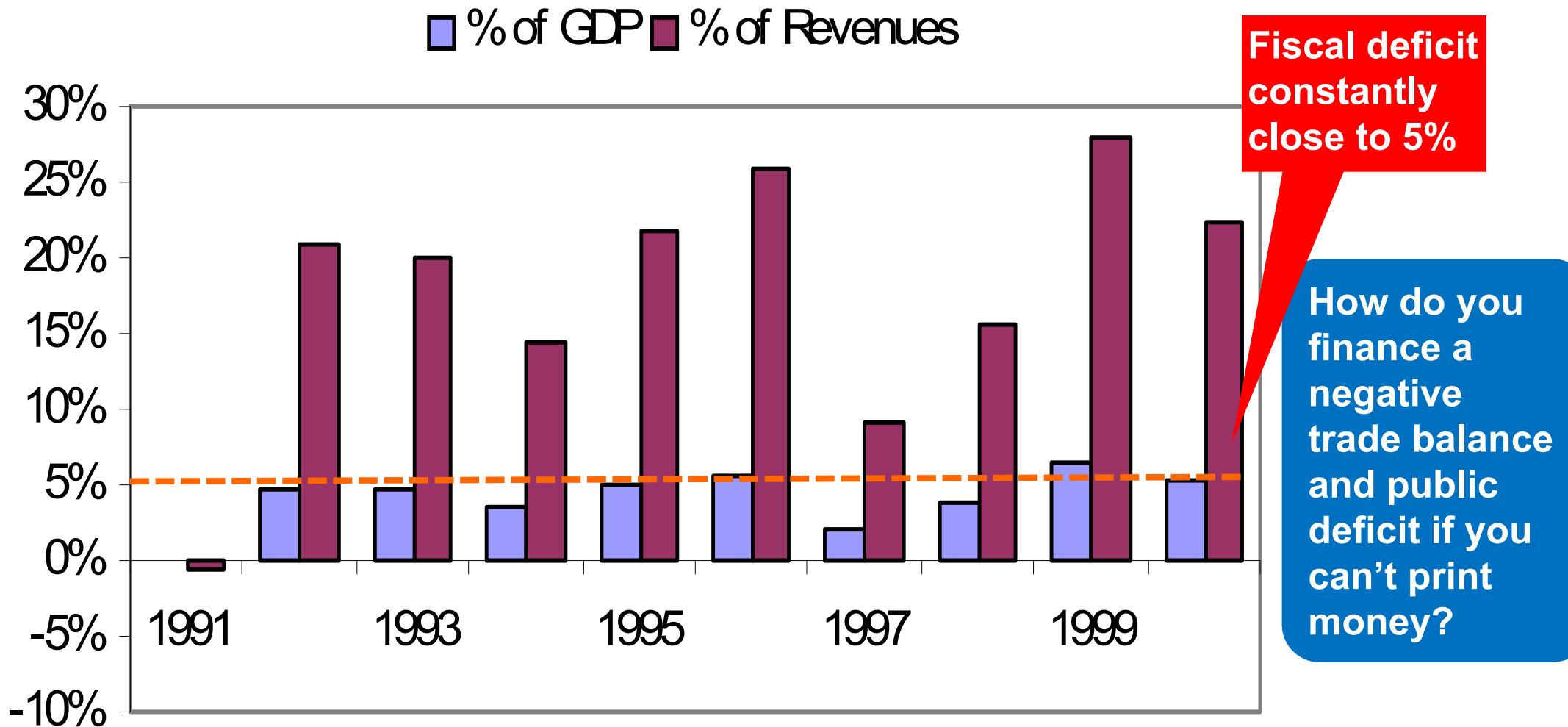


• Inflation did not decreased fast enough so the 1 ARS/USD, that was competitive at the beginning, was not so competitive by 1994

• By the end of the 90's the USD appreciation translated to the ARS, and that was too much

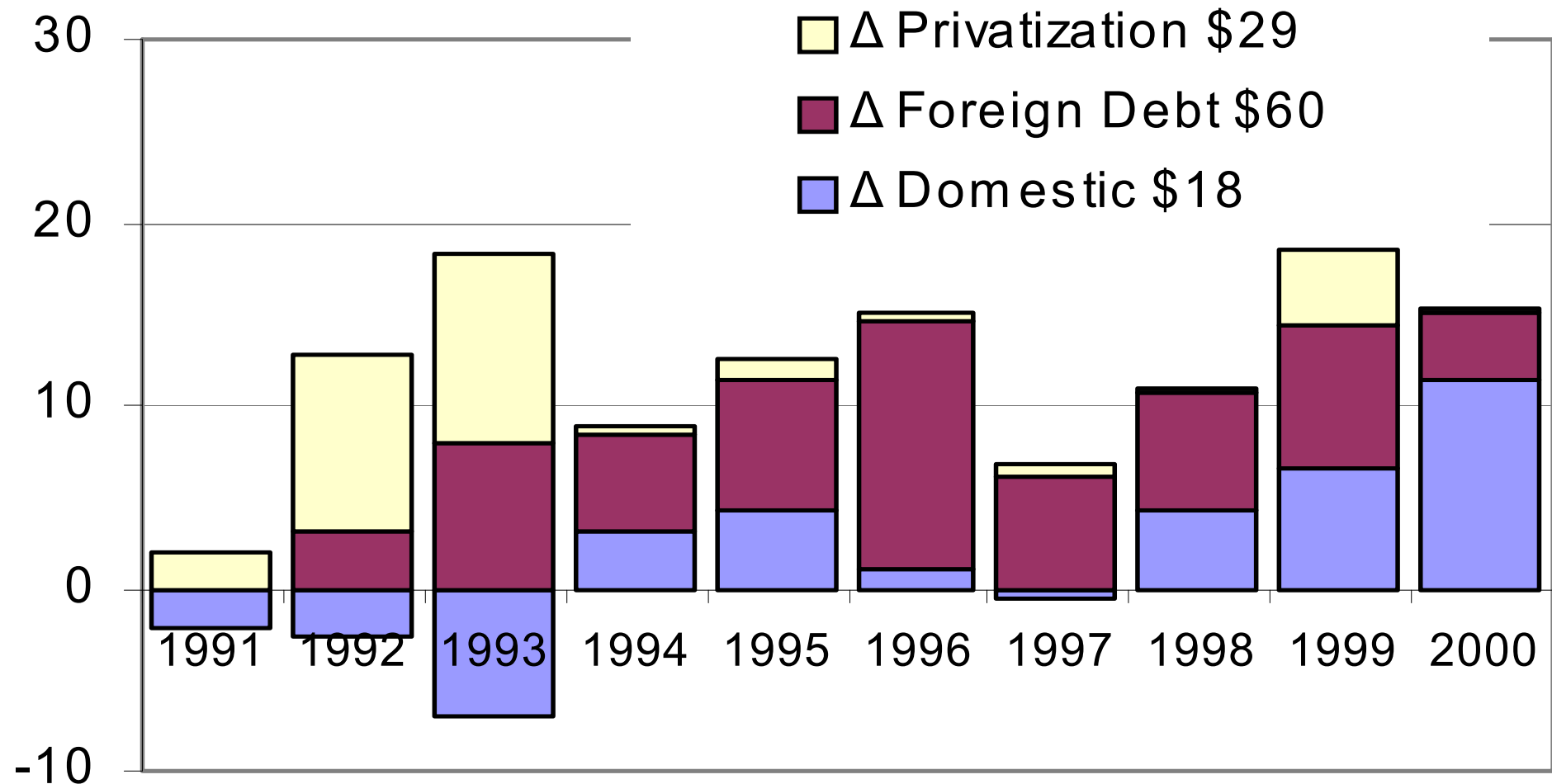
After the debt restructuring and the privatizations (extraordinary income), the government was not able to maintain fiscal balance

Government revenues and budget deficit



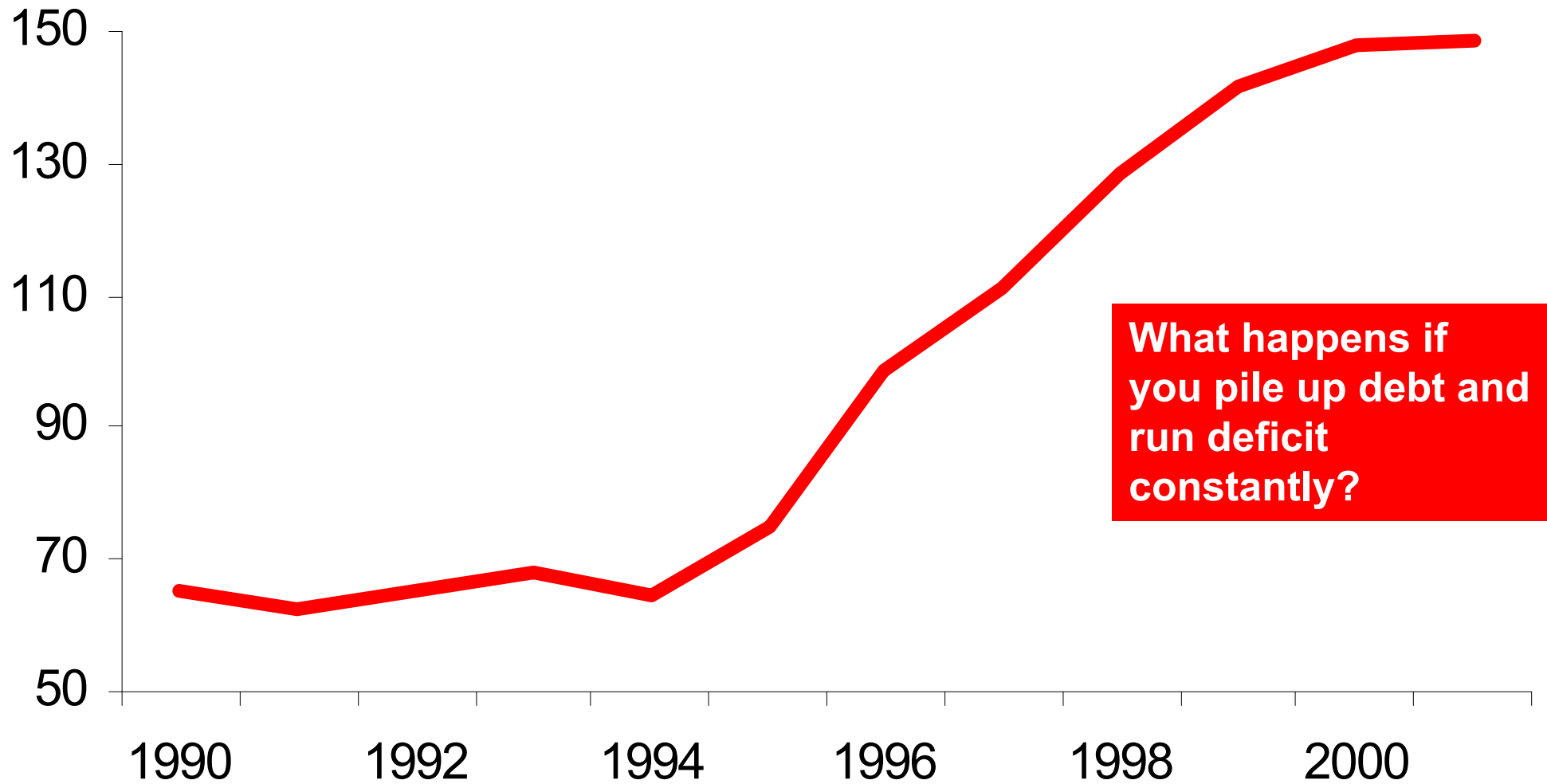
The government had to take a lot of foreign debt to sustain the fiscal deficit and the convertibility

The financing of the deficit (in US\$ billions)

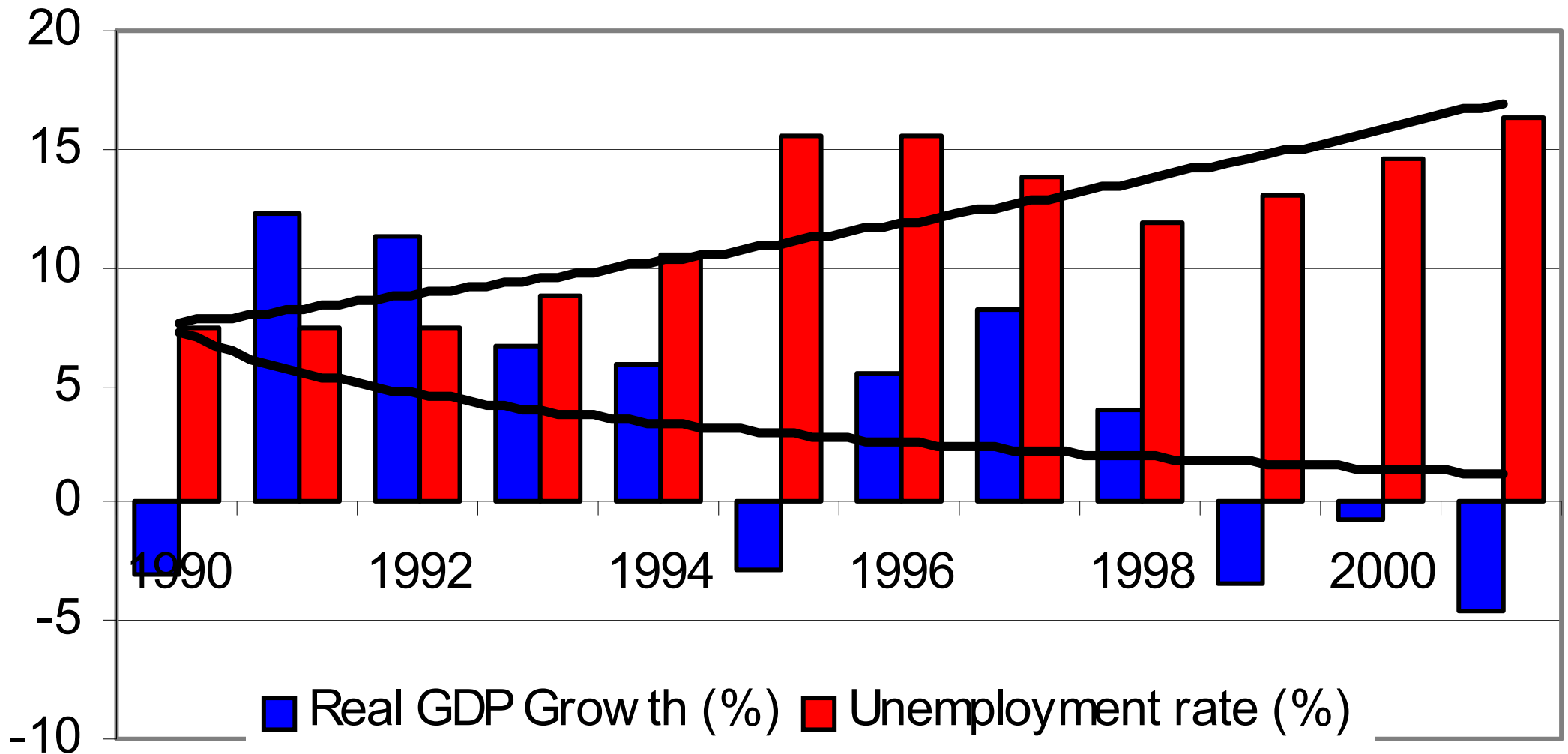


The government ended piling up a significant amount of foreign debt

Argentine government debt, USD billions



Real GDP growth deteriorated because of lack of competitiveness, increasing uncertainty and low investment. Unemployment also deteriorated significantly, as a consequence of privatizations and low investment



By 2001, all the elements were converging to create the perfect storm



In the fall of 1991,
the *Andrea Gail* left Gloucester, Mass.,
and headed for the fishing grounds
of the North Atlantic.

Two weeks later, an event
took place that had never occurred
in recorded history.

A PULP MAGAZINE...

THE PERFECT STORM

WARNER BROS. PICTURES PRESENTS

- Overvalued Peso, loss of competitiveness, stagnated exports and negative current account
- Increasing public expenditure, deficit and debt, mostly in USD
- Recession, mostly due to lack of competitiveness and negative expectations
- High unemployment, due to slow growth and lay offs after privatizations, resulting in increasing social unrest
- A weak government, a collapsing political alliance with a strong Peronist opposition

2001: Unhappy Christmas!!!!

Nov	Bank deposit and capital outflows accelerated
Dec 1	Government restricted withdrawals from banks (corralito)
Dec 5	IMF announced it will not disburse financial aid to Argentina
Dec 6	Private pension funds were forced to buy government bonds
Dec 13	Unions call to a nationwide strike. Unemployment was 18 %
Dec 17	Government new budget included 20% cuts
Dec 18	IMF: “Argentina’s economic policy is unsustainable”
Dec 19	Government declared the state of siege
Dec 20	The whole cabinet tender their resignation
Dec 21	President De la Rúa resigned
Dec 21-31	Presidents revolving door. Government defaulted its debt
Jan 1	Duhalde became Argentina’s fifth president in two weeks
Jan 6	Argentina devaluated the peso by 40%

Chaos, social unrest and death every where



Cavallo presentó el proyecto de Presupuesto al Congreso. Se mantiene el recorte de salarios y jubilaciones y se elimina el incentivo docente y fondos provinciales. "No votaremos fantasías", anticipó la oposición

El mayor ajuste de la historia

Páginas / 8 / 9

OTRO CAMINO
La Consulta
contra la
Pobreza logró
2.700.000 votos

Página/xx

Página/12

Buenos Aires, martes 18 de diciembre de 2001 - Año 15 - Nº 4697
 Precio de este ejemplar: \$1,20 - Recargo venta interior: \$0,20 - En Uruguay: \$23
 Opcional revista con CD León Gieco: \$6

La ola de saqueos y reclamos de comida llegó al Gran Buenos Aires. Más de mil desocupados sitiaron tres hipermercados de Quilmes. Estos recurrieron a la policía, que extendió la protección a Lomas de Zamora, Lanús y Avellaneda. El gobierno provincial se comprometió a distribuir alimentos.

NAVIDAD AMARGA

➤ En Rosario hubo 20 heridos con balas de goma cuando la policía reprimió a un centenar de vecinos que reclamaban comida. En Mendoza y Salta la presencia policial impidió que la gente asaltara los supermercados.

◆ **Desarrollo Social** prometió distribuir 200.000 kilos de alimentos en las zonas afectadas por los reclamos. Las Fuerzas de seguridad creen que no hay organizadores políticos detrás de los saqueos sino hambre.



ClarínX

[illegible]

Juvenis
20 de diciembre
de 2001

Elaborado por:
Miguel Ángel Argente
Año: 1999. Pág. 1/1

► **VIOLENCIA EN 11 PROVINCIAS Y CAPITAL. HAY 137 HERIDOS Y 551 DETENIDOS**

Saqueos y 7 muertos

► Evocan, por su extensión y gravedad, a los de la hiperinflación de 1989. Se producen en el marco de la peor crisis económica. Y con un complejo cuadro político. Una señal inquietante: tres de los muertos fueron baleados por comerciantes. En muchos casos hubo pasividad de la Policía Bonaerense. **PÁGS. 3 A 4**

Un cacerolazo nunca visto

► La clase media hizo su propia protesta. Cacerolas, bocinas y marchas en toda la ciudad de Buenos Aires. **PÁGS. 36 Y 37**



► DE LA RUA ANUNCIO LA MEDIDA Y LLAMO OTRA VEZ A UN CONSENSO NACIONAL

Estado de sitio por un mes

FRASE DEL DÍA: FERNANDO DE LA HUA. EN SU MENSAJE AL RECLUTAR LOS LÍDERES DE LOS GUAYANES CRISTIANOS EXISTE UN APROXIMADO 50 POR CIENTO DE LOS ESTADOS UNIDOS.

[illegible]

EL DIA
LA PLATA, Lunes 11 de Diciembre de 2011 www.eldia.com

Renunció Rodríguez Saá

El país a la deriva

El Presidente que asumió hace una semana se fue airoso. Había quedado muy debilitado tras el fracaso de una convocatoria a los gobernadores de su propio partido. En 48 horas se volvió a mover la Argentina (noticias). El país enfrenta una inédita crisis institucional.



ANÁLISIS

El quiebre de la gobernabilidad

[illegible]

También se fue Puerta y hablan de Duhalde como sucesor



Asume el diputado Camaño la Presidencia provisoria

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La renuncia desató una dura pelea con De la Sota

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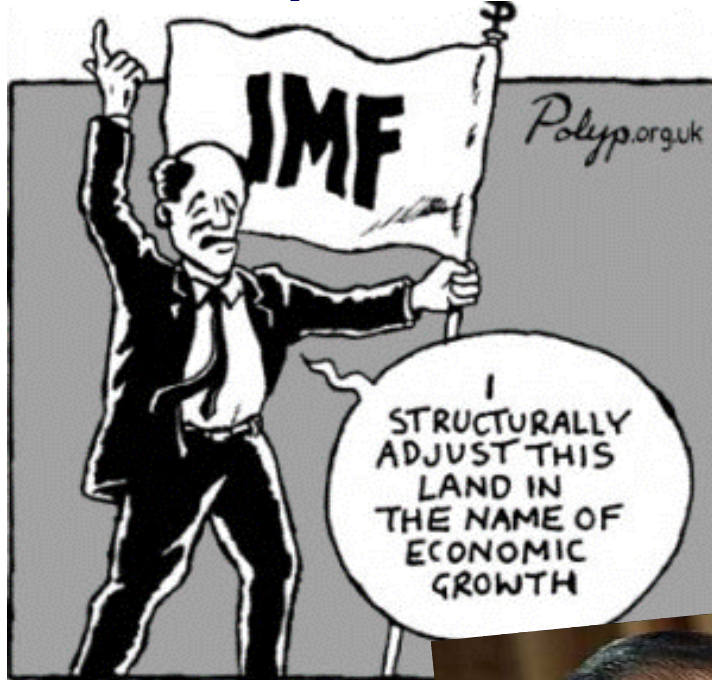
Hasta el miércoles: Mañana no se editan los diarios. EL DÍA volverá a aparecer el miércoles. Feliz Año Nuevo

Argentina in crisis ... what do we do?

President Duhalde found himself at the helm of a paralyzed country

- **The bank system on the verge of collapse**
- **Unemployment rate reached 25 %**
- **More that 14 M citizens were in poverty**
- **The dollar reached AR\$ 3.70 (from parity, a 470% devaluation)**
- **Most debts, both public and private, were in USD**
- **GDP decreased 15 %**

The collapse of the Washington Consensus reform



PRIVATIZATION

- The Convertibility foreign exchange and monetary system was too rigid and led into overvaluation of the peso and loss of competitiveness.
- Convertibility also created over confidence and allowed significant currency mismatches, creating a very risky and unstable system.
- The pension reform introduced a deficit in the fiscal balance that was difficult to sustain without significant economic and tax revenue growth
- Privatizations caused large unemployment that was supposed to be absorbed by the private sector, however, with lack of competitiveness in an open economy, increasing taxes and increasing uncertainty, investment and job creation decreased by time.
- A weak non-Peronist government unwilling to take decisions, without courage and political support to design and implement the policies to solve the problems without creating a crisis.
- Some international bad timing. Low commodity prices, strong USD, and an international financial community not willing to help/bailout another emerging economy in troubles.



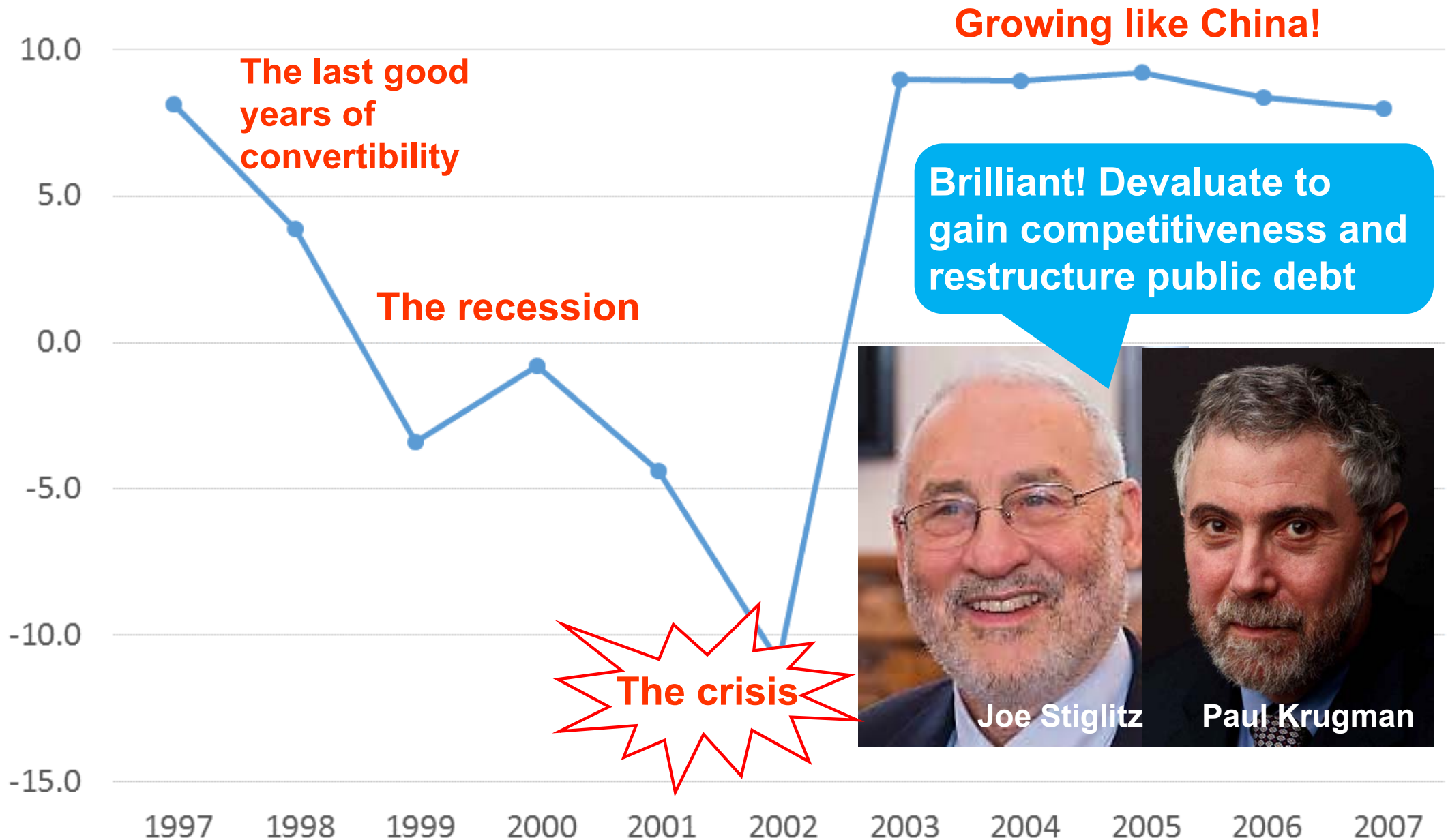
Argentina in crisis ... what do we do?



Duhalde formed a coalition government with peronist and some radicals

- Devaluation boosted competitiveness
- Imposed monetary discipline to avoid inflation
- Default helped to restore fiscal surplus
- Implemented cash transfers to the poor
- Asymmetric devaluation on financial assets avoided generalized bankruptcy of firms and banks, however, it hurt savers
- Utility prices were frozen

And after the crisis, a miracle. Argentina is growing like China!



What was behind the miracle?

1

Demand side: TAIL WIND

- World growth, especially, emerging markets & oil producers
- High ag commodity prices. We are rich, we want meat!
- Favorable terms of trade. Expensive commodities & cheap manufactures
- Favorable financial markets. Liquidity & interest rates close to 0 %

2

Supply side: SIGNIFICANT RESILIENCE

- Huge devaluation with low inflation restored competitiveness
 - Cheap and abundant labor
 - Cheap nontradable inputs, energy & utilities (regulated)
- Large stock of capital & infrastructure accumulated during the 90's
- Significant private reserves of capital in USD and low debts after pesification

3

Economic Policy: FISCAL & CURRENT ACCOUNT SURPLUS

- Debt default & renegotiation: Lower interest and capital payments
- Export growth: Increasing trade balance & Export taxes on commodities
- Increased economic activity, increased VAT and income tax revenues

**In 2003 there were election and a new political project was born:
Kirchnerism**

**So honey, what can we
do with all of this? ...**



Néstor Kirchner



Cristina Fernández de Kirchner

... Lets be truly peronist again

Objectives: Nationalism & Populism. The Nac & Pop model

- Economic independence: No foreign capital, trade protectionism, IMF FO!
- Social welfare: Full employment, high real salaries & cash transfers to the poor

The strategy: ISI + State Intervention

- Relative high tariffs, quotas and discretionary barriers
- Mercosur trade union
- Subsidies: energy, transportation and cheap credit
- Tight control on financial sector, energy & utilities
- Nationalization of firms (Aerolineas, Water, YPF, Pension Funds, Railroads)
- High consumption: wage rises, cheap credit, public employment, subsidies & cash transfers
- Overvalued Peso



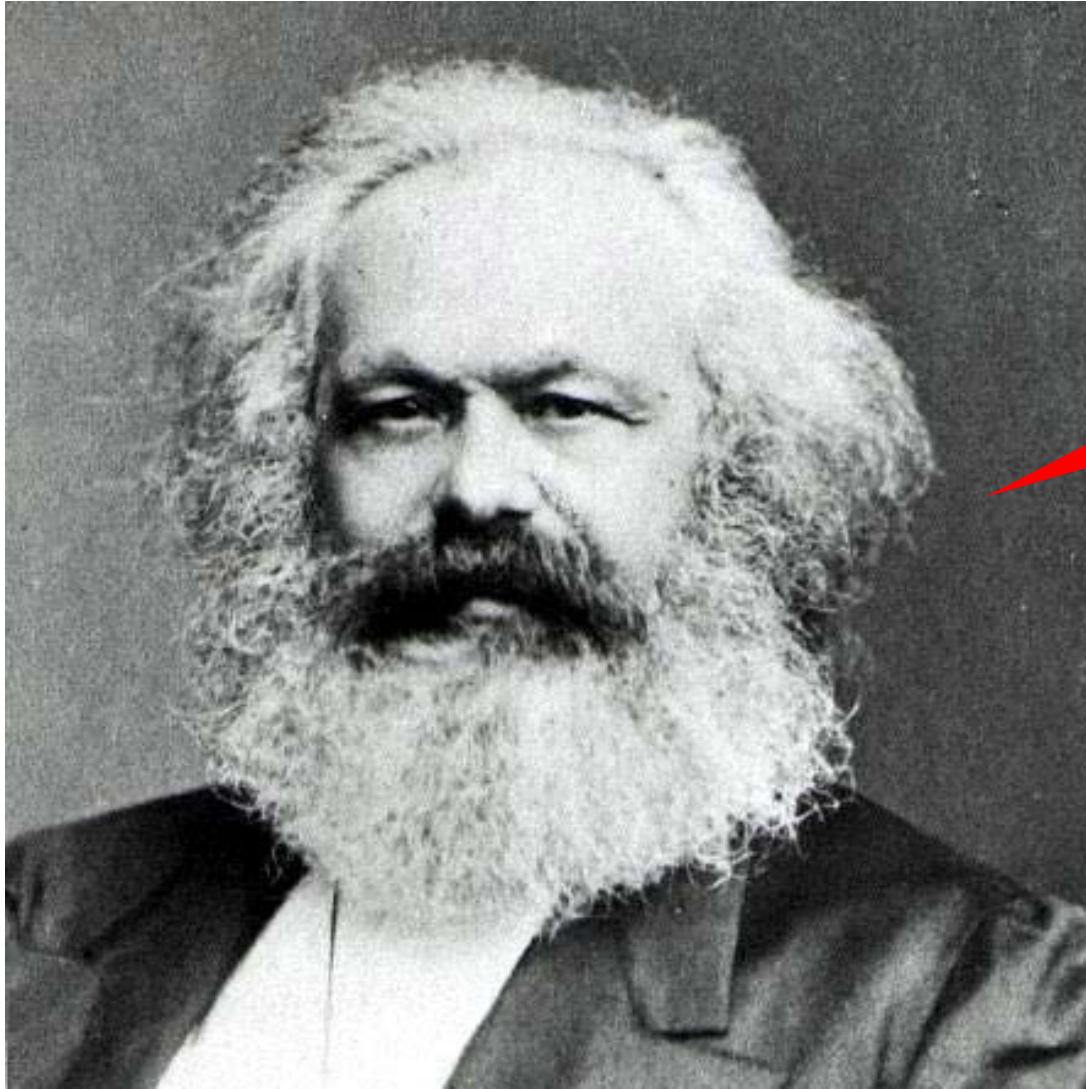
Political power



- Alliance with some unions, industries and governors (political support x cash)
- Demagogy & propaganda
- Support from nationalist and social welfare politicians
- Tough on opposition and free press

How do you finance all of this?

- Taxes? On Farmers, Industry or Households?
- Debt? Foreign or domestic debt? Who is saving? Who is lending?
- Pension funds? Central Bank monetary expansion?
- Private equity? National or FDI?



**History repeats itself,
first as tragedy, then
as farce.**

Most of the positive drivers eroded rapidly ...



2 - Competitiveness decreased

- Expansionary monetary policy to boost consumption and finance fiscal deficit
- “Anchored” foreign exchange
- Inflation and wages eroded competitiveness
- Tax pressure skyrocketed and productive investment decreased

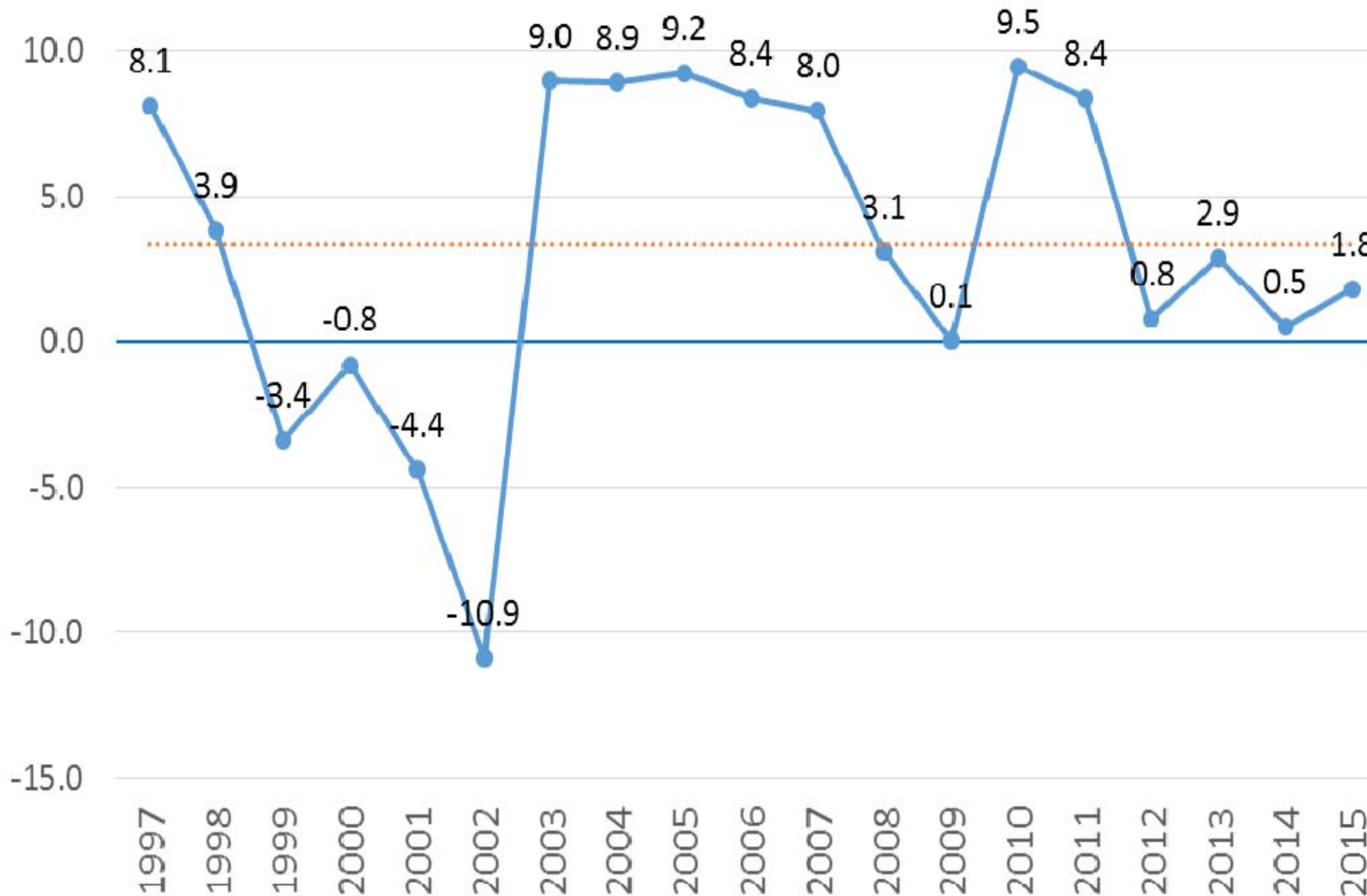
1 - Fiscal surplus eroded

- Energy & transportation subsidies increased significantly
- Government employment increased
- Power support rested on cash transfers to local governments, social welfare, football, which became too expensive

3 - Balance of payments deteriorated

- Lower competitiveness and commodity prices decreased exports
- GDP expansion and oil&gas production deficit increased imports
- Closed to international financial markets, no capital inflows
- Lack of security and stability, no FDI
- Inflation & uncertainty, savings in USD

After 2011, the Chinese growth rates vanished

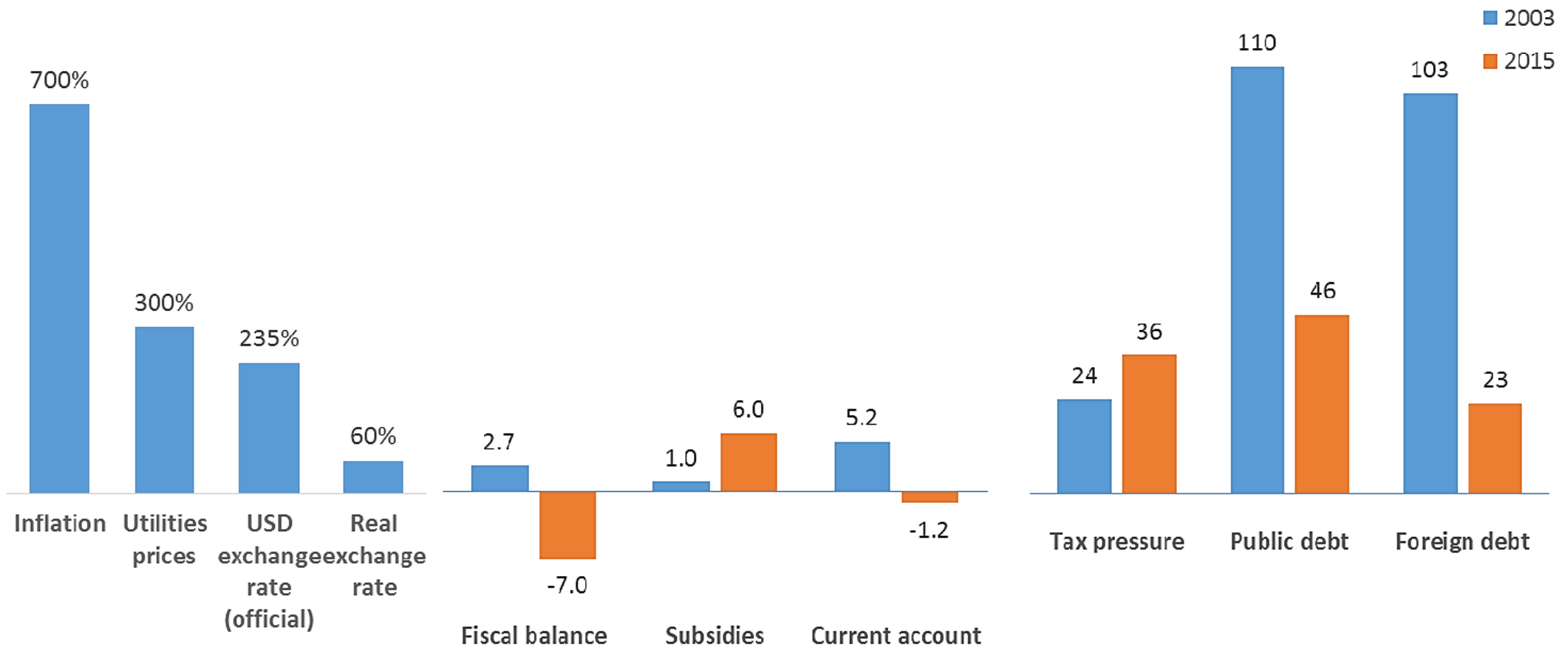


- From 1997 to 2015 Argentina grew at an average of 3% annually, less than Latam's average
- Most of the Chinese growth rates were the result of after-crisis recovery, high commodity prices, favorable terms of trade and good conditions in Brazil
- When these favorable conditions diluted, an imbalanced increased, growth was gone

Significant macroeconomic imbalances accumulated over the years, reducing confidence on the future

Increase 2003 – 2015

Change between 2003 and 2015 (% of GDP)



* Multilateral exchange rate by the end of December 2014

Source: Estimated with data from EIU, Argentina Central Bank, Ministry of Economy and INDEC. Inflation estimated from private sources

F. Diaz Hermelo

Chat with Peron. Why do politicians in Argentina keep repeating your steps?



My dear friend: Give the people, especially the workers, all that is possible. When it seems to you that you are already giving them too much, give them more. You will see the results.

Populism

- 1 A political and economic regime that builds power from the support of urban workers & industrialist through redistributive policies and epic propaganda.
- 2 It emphasize growth by stimulating consumption, protectionism and government intervention deemphasizing the risk of inflation, budget deficit, forex constraints and the negative reaction of investors to property rights weakening and macroeconomic instability.
- 3 Short term electoral and political necessities discourage correcting major inconsistencies until instability is so large that political support vanishes or a crisis explodes, usually triggered by an external shock.



**New president, new government. New party, new ideas. Really?
Renovated hope for the future. Will he deliver?**



Mauricio MACRI

Cambiemos

The logo for the Cambiemos political coalition, featuring the word "Cambiemos" in a bold, sans-serif font. Below the text is a horizontal bar composed of several colored segments: yellow, orange, red, purple, blue, and light blue.

The Economic Cabinet

Cambiemos



Chief of Staff
Marcos Peña, Politician



Chiefs of Economic Cabinet
G. Lopetegui, CEO LAN
M. Quintana, Owner Grupo Pegasus



Treasury
Alfonso Prat-Guy
JP Morgan, Arg. C. Bank

Agriculture
Ricardo Buryaile
Farmer, President CRA

Energy
José Arangueren
CEO Shell

Transportation
Guillermo Dietrich
Owner VW Dealership

Development
Francisco Cabrera
CEO&Board financial firms



Labor
Jorge Triaca
Politician

The Challenge



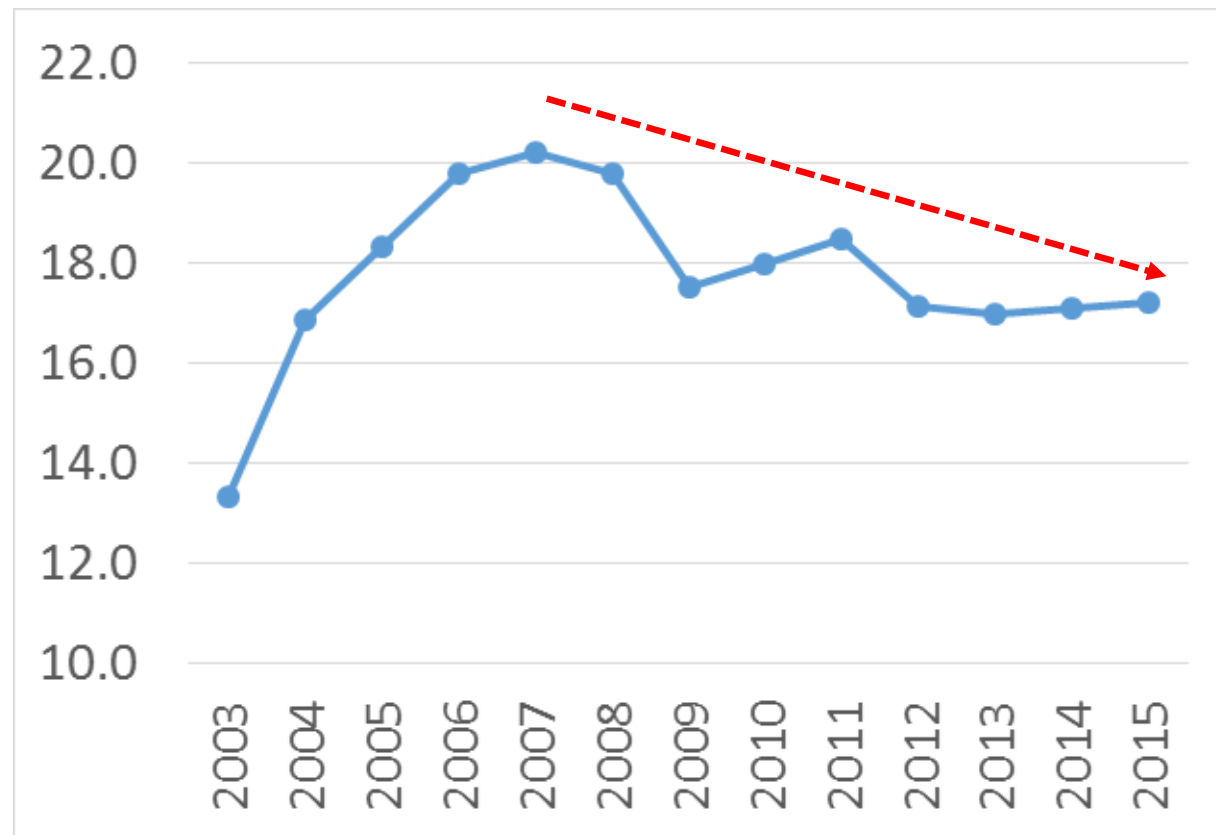
- Heavy weight inflation: 30 %
- Large fiscal deficit: 7 %
- Significant loss of competitiveness and exports, current account in deficit
- Flat GDP per capita, expected negative in 2016
- Investment collapsed
- Need to regain long term productivity and growth
- Without control of the Congress...
- and legislative elections in 2017!

The discount rate for business projects is one of the highest in the world and investment has decreased significantly

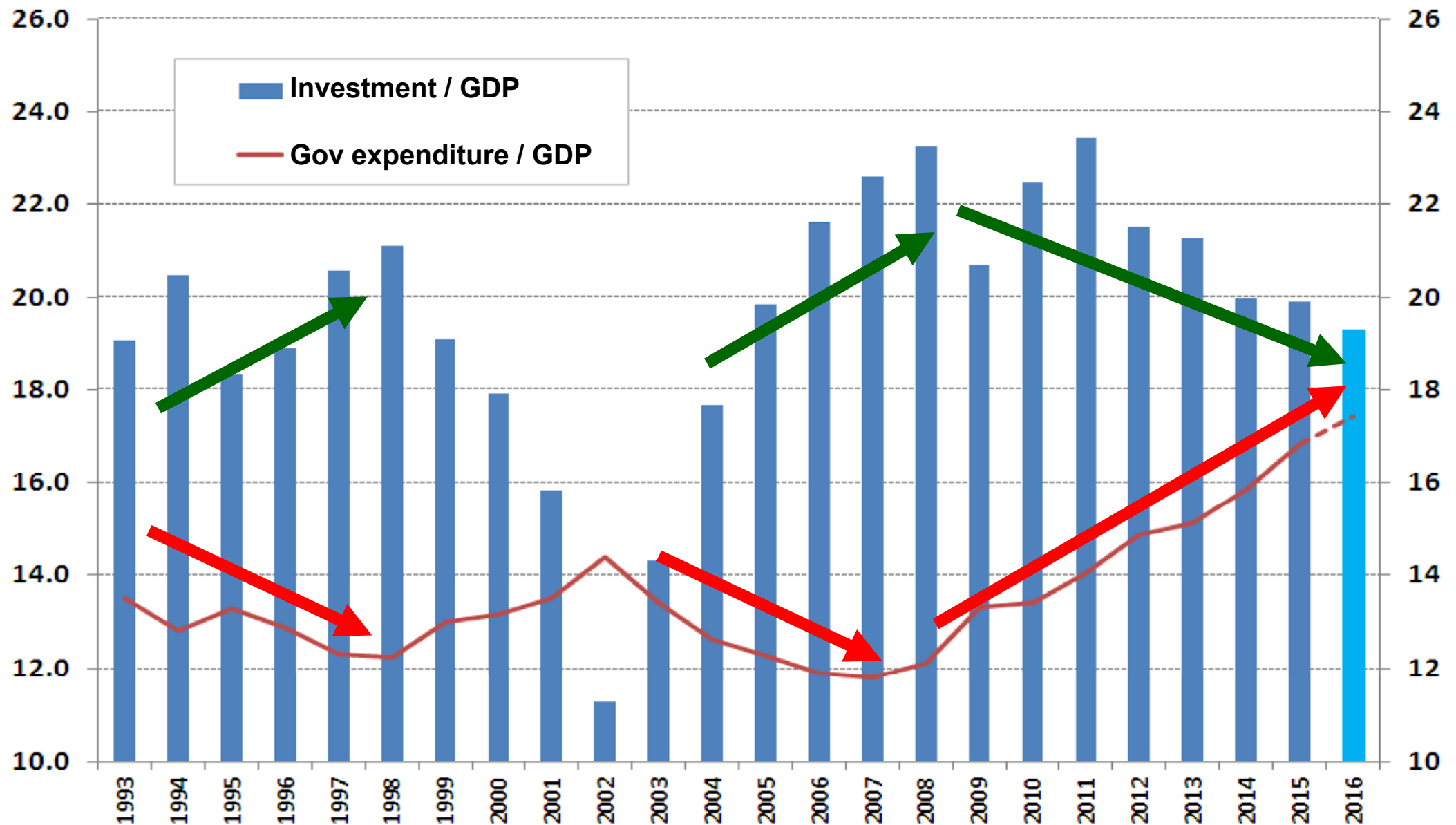
Average discount rate 19%

- Weak judiciary and poor property rights, high risk of expropriation
- High trade barriers, difficult to import parts and components
- High barriers to financial flows
- Poor infrastructure: Energy shortages & transportation bottlenecks
- High tax pressure
- Slow judiciary and inflexible labor markets
- Shortage of long term capital

Gross fixed investment (% of GDP)



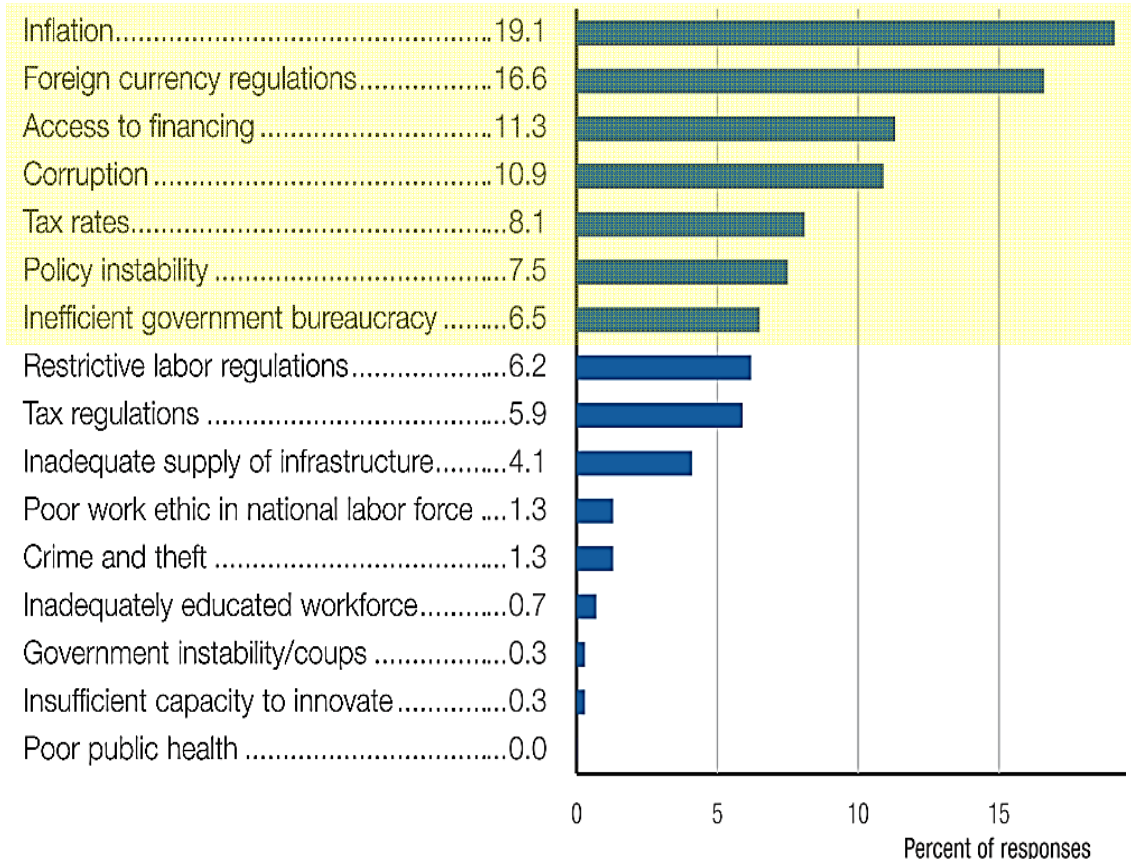
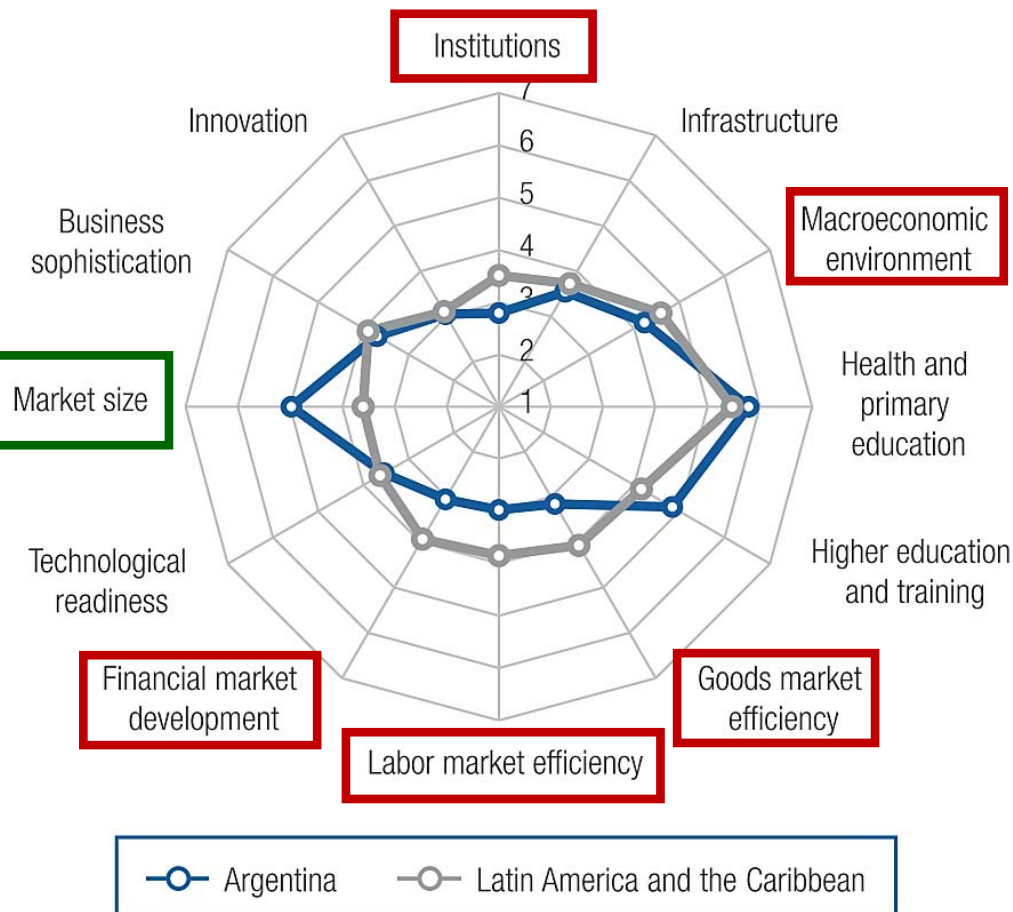
Increasing government expenditure, increasing deficit, asphyxiating tax pressure, resulting in reducing investment and private job creation



Argentina's competitiveness compared to the rest of Latin America is not encouraging

A large and attractive market with adequate education, however, it is lagging in institutions, labor and market efficiency, macro stability and financial markets depth

Most concerns are related to: Inflation, foreign exchange regime, financial depth, corruption, tax burden, and government bureaucracy & incompetence to deal with problems

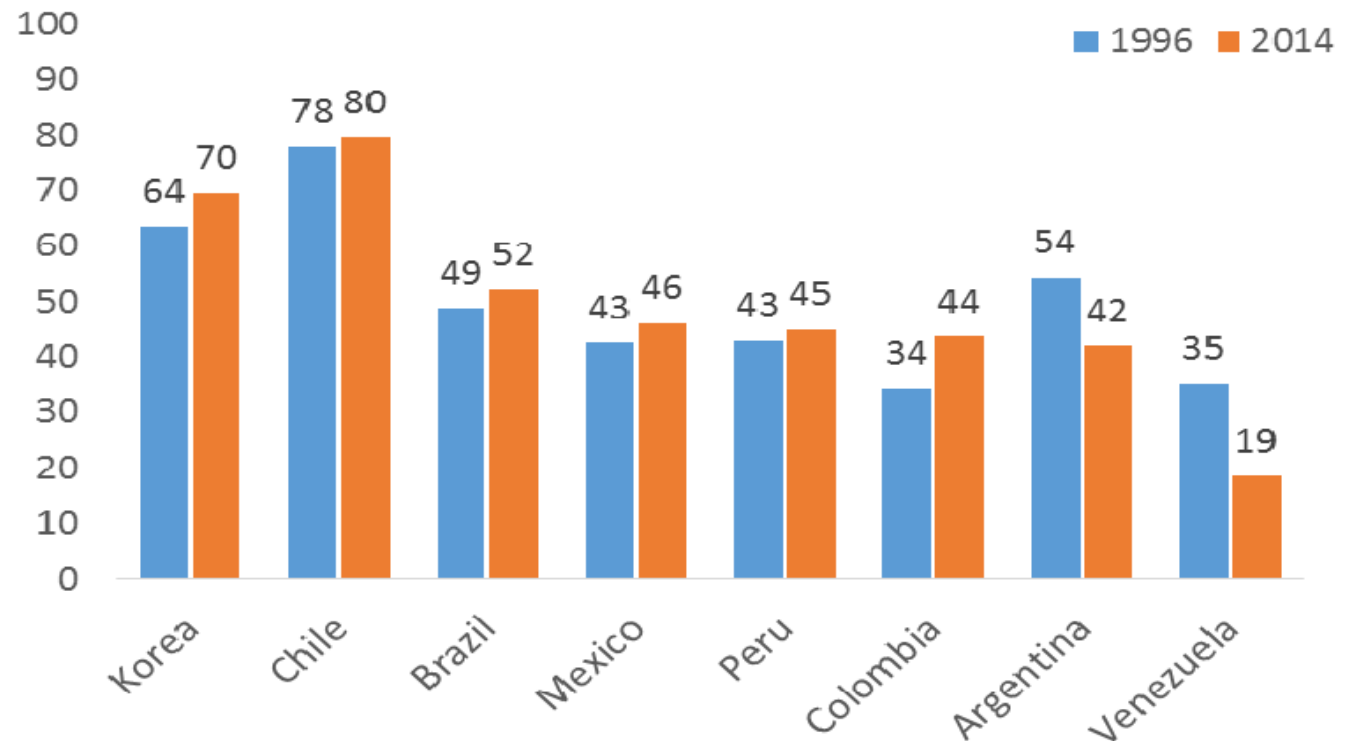


Argentina's institutional and governance evaluation is getting behind other emerging markets

Worse than Korea and Chile and not so bad compared to Brazil and Mexico, however, Argentina does not have the size attractiveness of Mexico and Brazil and is not in NAFTA

Argentina and Venezuela are the only two countries that did not improved institutions and governance in Latam

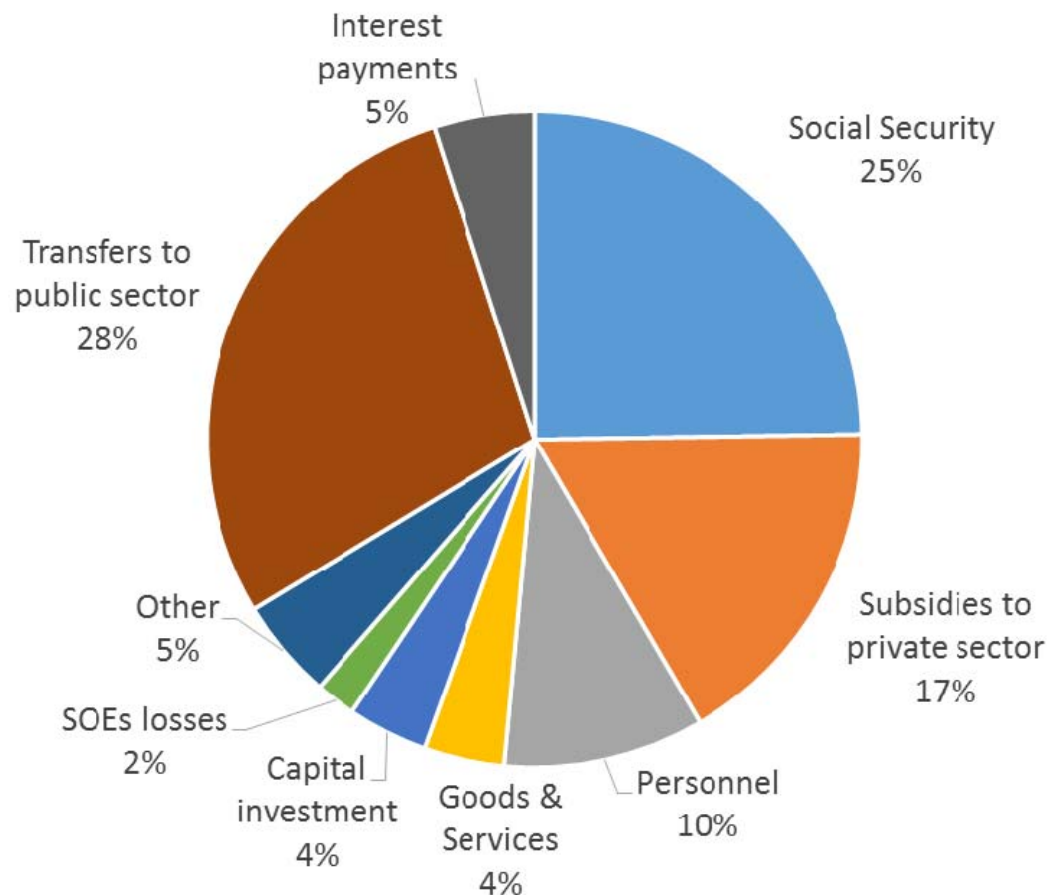
	Argentina	Brazil	Mexico	Chile	Korea
Governance	45	50	47	79	67
Voice & accountability	57	60	54	74	66
Political stability	46	47	37	64	59
Government efficiency	49	48	55	80	74
Regulatory quality	39	54	58	87	69
Rule of law	36	42	37	81	72
Control of corruption	40	49	43	85	60



National government expenditure also increased from 20% of GDP in 2004 to 35% of GDP in 2015

Share of government expenditure in 2015 (as % of total expenditure)

E total expenditure 35.5 % of GDP



The most significant increases in share of total were:

- Subsidies to the private sector
- SOEs losses
- And Other

While the most important decrease was in transfers to provinces & local governments

The political system is presidential, but the president has accumulated significant power in the last decades, specially, economic and fiscal discretion

Hyper presidential system

Weak system of checks and balances. Constant conflicts between powers.

Large state and state budget. Discretionary, non-transparent and inefficient.

Provinces have political power but lack tax & budget independence.

Political reasons dominate. Lack of technical expertise in several critical areas.

Atomized opposition. Weak parties, low participation.

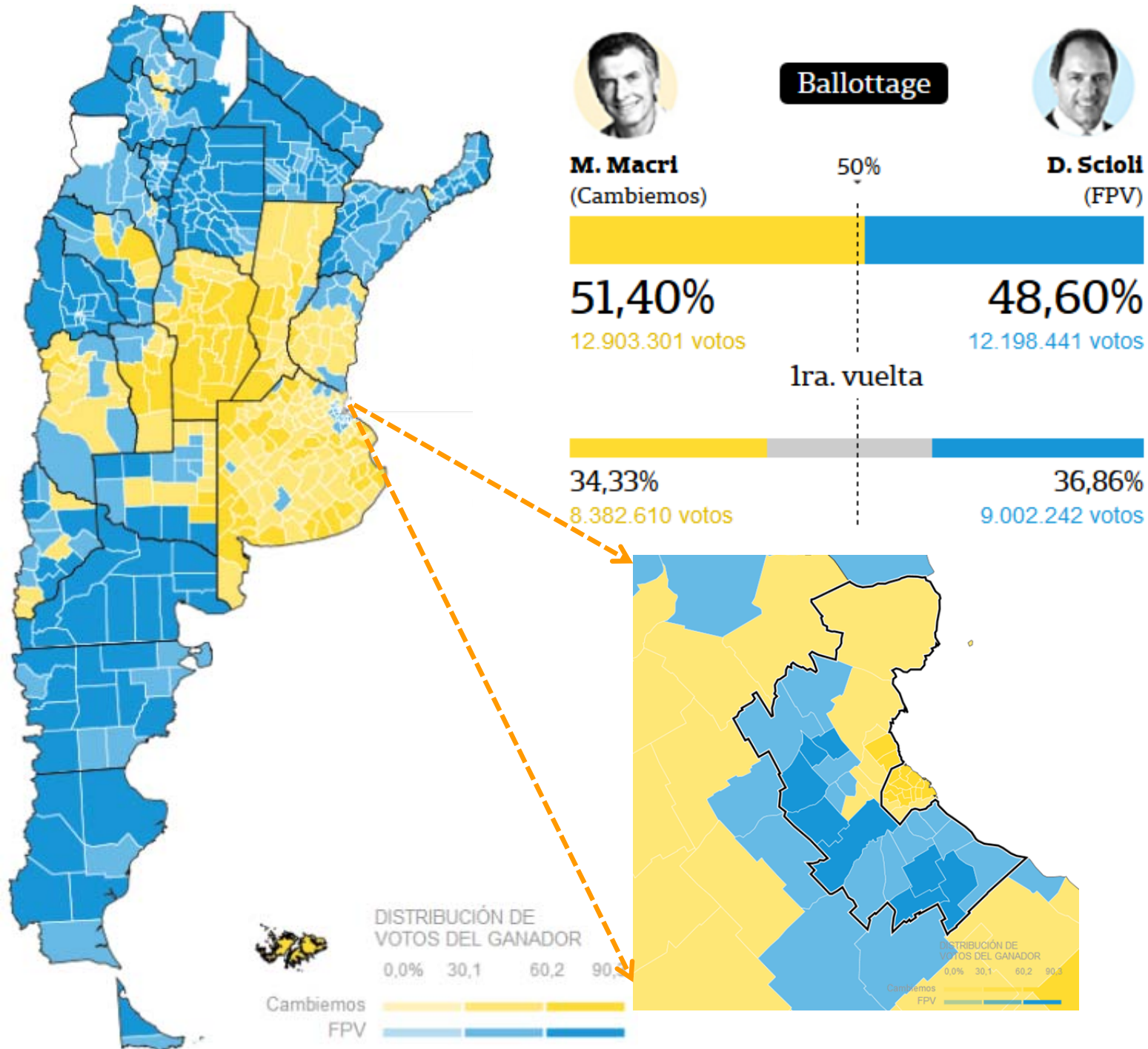
Strong unions, but only represent 25% of workers. Divided in front of the government.

Civil organizations do not have resources. Many coopted by the government

There are presidential elections every 4 years and parliamentary elections every 2. Since winners take it all, every four years political parties/factions are willing to do “anything” to win

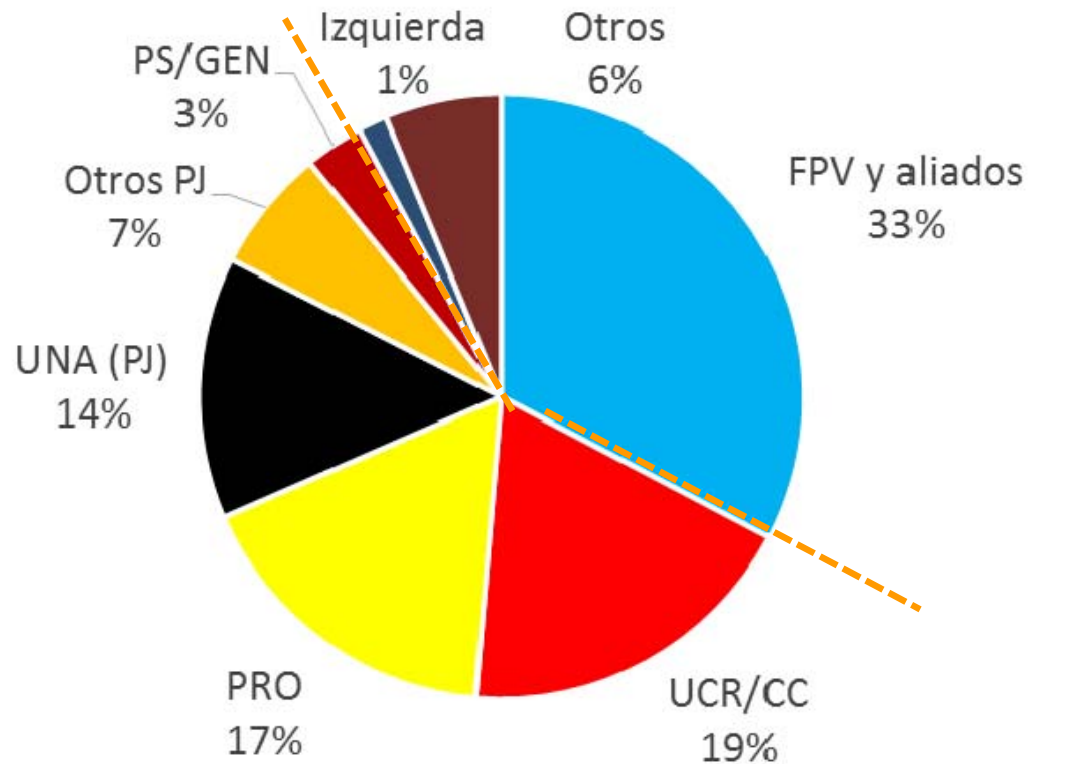


Who voted for Macri and actually want “Cambios”



The situation in the Congress looks weak for Cambiemos, unless they are able to close some “governability” deals with PJ and FPV breaks apart, especially in the senate

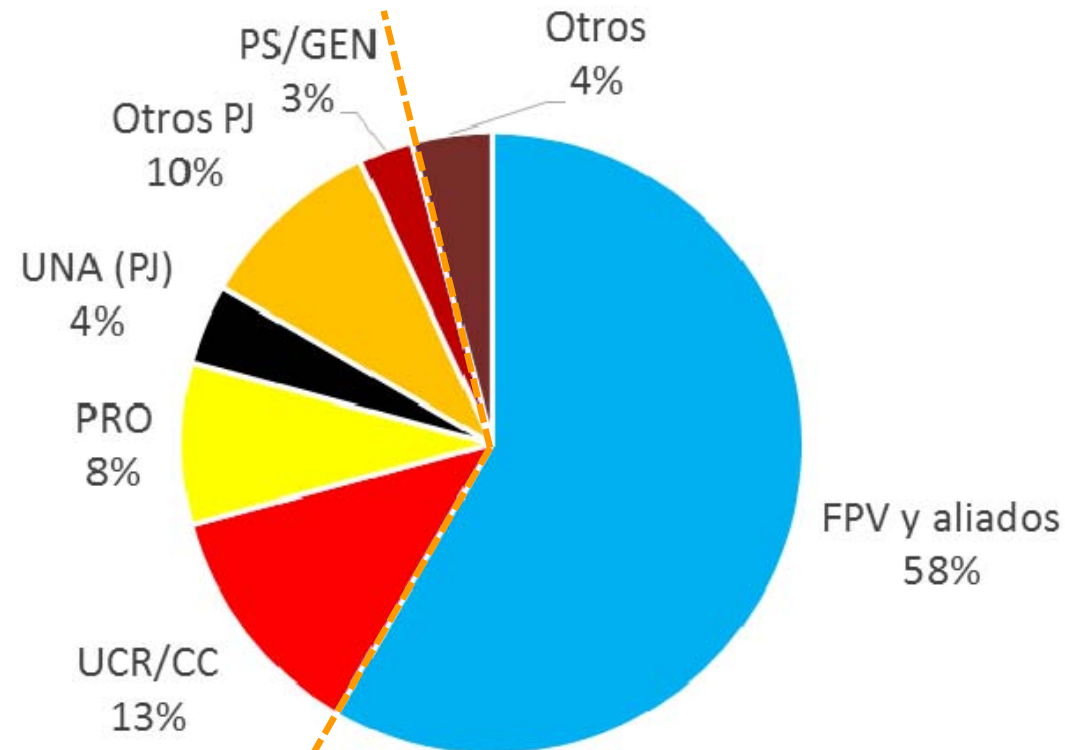
Deputies



Cambiemos 36 %
Occasional allies
Other PJ & PS/GEN 24 %
60 %

FPV
 Many controlled by
 several governors
 K fanatic faction about
 30 (12%)

Senate



Cambiemos 21 %
Occasional allies
Other PJ & PS/GEN 17 %
38 %

Argentina 2016: Hope for the best, prepare for the worst

Monetary

- Restrictive, but still high inflation (devaluation, tariffs up, unions) E 25 – 30 %

Balance of payments

- 60 % devaluation and export tax elimination, but competitiveness recovery will depend on inflation and other emerging currencies evolution
- Commodity prices very low and Brazil in deep recession
- Flows deregulation may increase outflows and end up with a Curr. Acc. 2-3 % deficit, increased dependency on capital inflows

Fiscal Deficit

- Energy subsidies were eliminated, but income tax reduced and export tax eliminated
- Political deals with governors will depend on flows to the provinces
- Deficit 6 % of GDP will require USD 35 bln from international capital

Private investment

- Everybody positive about a new COHERENT and EFFECTIVE ECON PROGRAM
- Poor infrastructure, energy deficit, telecom collapse, poor roads and railroads
- Other significant opportunities in agriculture, mining, tourism, IT, real estate, however ... we want to see some results first

Social conditions

- About 25 % of the population in poverty
- Real salaries decreased (devaluation, tariffs, inflation) and unemployment is increasing. Impatience is growing

Sovereign and market risk decreased significantly. It seems financial markets welcome back Argentina



What can we expect?

	2015	2016	2017	2018	2019
USD	13.5	17.5	21	23.0	25.0
Inflation (%)	29	30	18	12	7
Fiscal Deficit	7.0	6.0	4.0	2.0	1.5
Public Debt (%GDP)	46	50	51	51	51
Investment	17	18	20	21	22
GDP g	1.5	0.0	2.5	3.0	4.0

Government's Forecast

	2015	2016	2017	2018	2019
Inflation	29.3	25.0	17.0	12.0	5.0
Fiscal Deficit	7.1	5.6	3.3	1.8	0.3
Growth	1.7	0.5	4.5	4.5	4.5

I just came from New York. Everybody was interested in our projects, but told me to wait until July.

Real Estate Director

We are really happy with the changes. But our major concern is Brazil. I wish we had free trade agreements with more countries.

Automobile Country Manager

It will take commodity prices a couple of years to bounce back because of large stocks and slow growth. In Latam will only invest in Chile. With such low margins, we can't risk anything.

Commodities Global Director

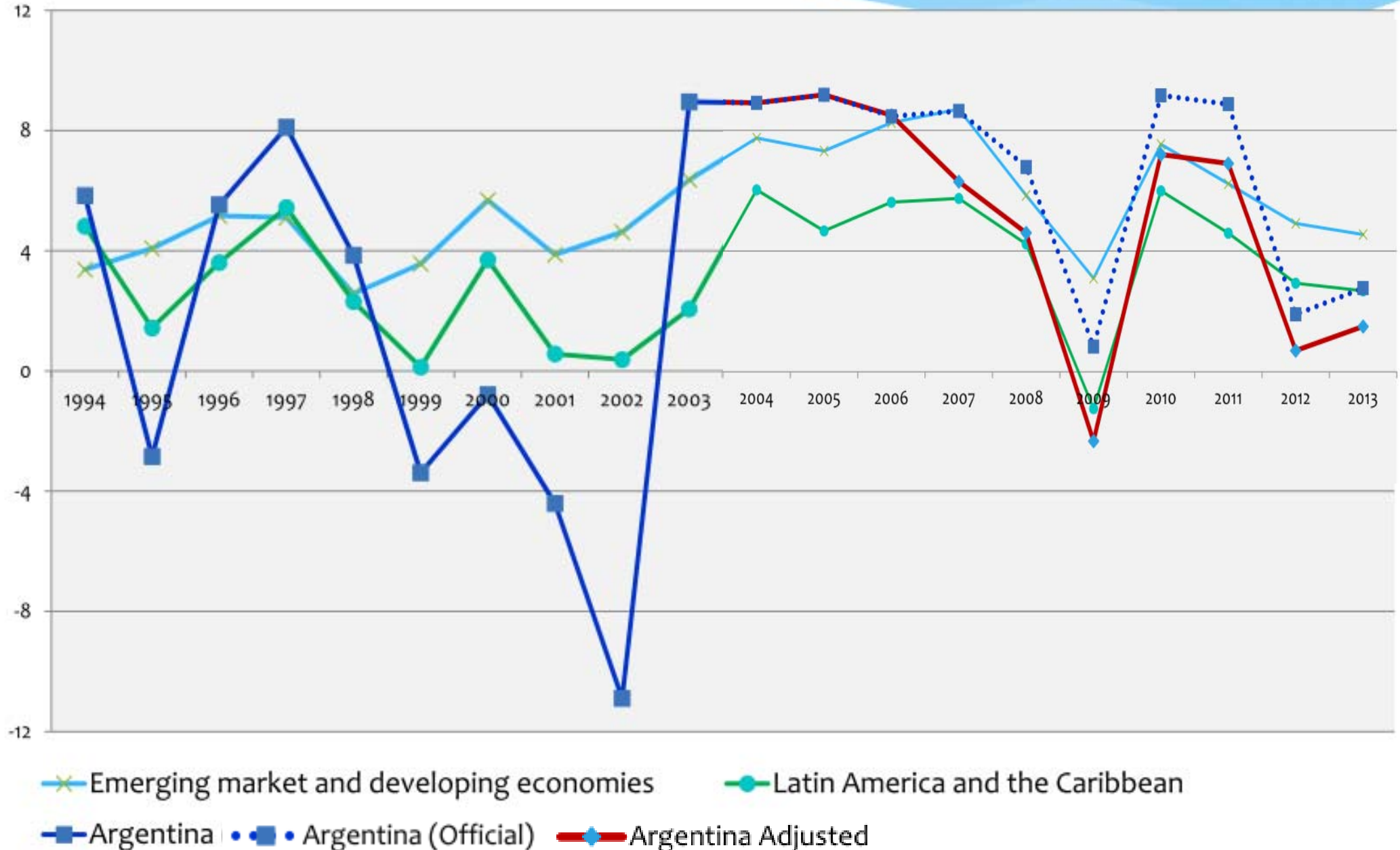
Kirchnerism was horribly unprofessional. But we enjoyed a strong protection. Now I'm not sure about the future.

Textile Firm Owner

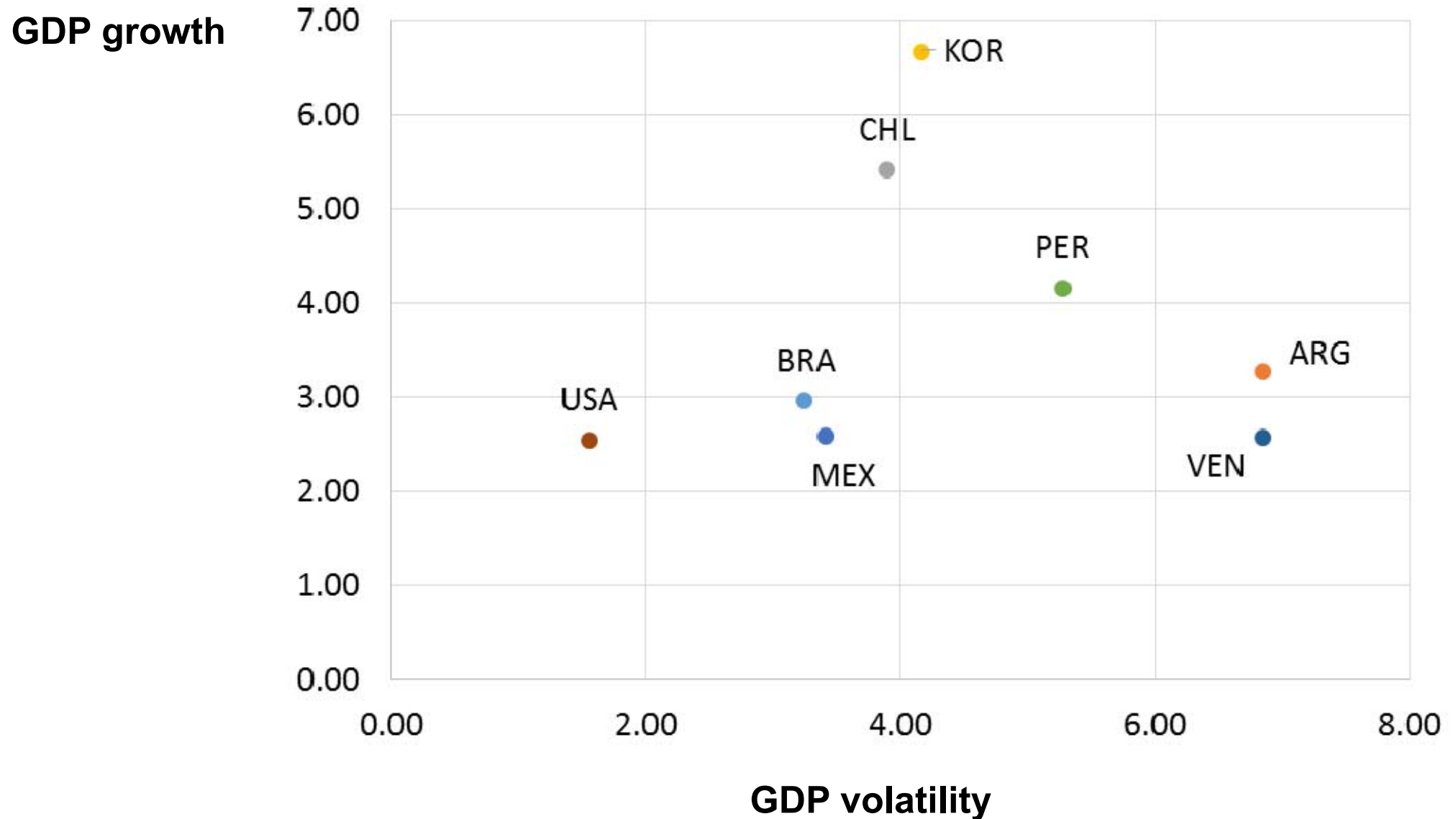
We are completely internationalized. We depend on global growth. We have deep roots here and Argentina, it is our most important talent pool, but I do not think if it may become a more relevant manufacturing center.

Manufacturing MNE Manager

Argentina, not so different from the rest of the world, but more volatile



In terms of growth-volatility, Argentina has one of the worst relationships among emerging economies. To make business in Argentina requires a excellent management of cycles and risk



Surviving the roller-coaster. How firms manage in Argentina



1. Diversified portfolio by income segments
2. Flexibility in the value chain, low fixed and high variable cost, broad network of suppliers
3. Copycast, find the adequate Price/Quality for the market. Reengineer the value chain
4. Low leverage (25-30%), mostly local currency, take advantage of low rates at SO Banks during the good years
5. Local talent and internationally experienced management
6. Quick decision making, proactive, creative and fast
7. Excellent cycle management: good economic and political skills. Stay cool during downturns
8. Operational efficiency and liquidity, preferable in USD, for bargains during crisis
9. International diversification/portfolio may help
10. Built political and social goodwill

Some conclusions

- There were several periods of growth jeopardized by economic policy mistakes and political instability that ended up in severe crisis
- Some times crisis were triggered by global shocks: 30's crisis & WWII, 80's & 90's Sudden Stops of foreign capital
- The industrialization project was ambitious, but
 - full of severe macroeconomic unbalances: fiscal deficit, inflation and balance of payments unbalances, high wages and insufficient productivity
 - There was too much Government intervention, and worse, too much discretion: unstable institutions, expropriations of savings and distributive conflicts that discouraged savings and investment
- Most of growth strategies were focused on the demand-consumption side not the production-investment-productivity side
 - High rates of urban employment protecting industry, SOEs & government employment that resulted in low competitiveness, low productivity, inflation, high government expenditure and fiscal deficit
 - High real salaries, strong unions, wage increases, overvalued exchange rate and cheap food due to exports taxes and export restrictions

Some more conclusions

- The production-investment-productivity side was neglected
 - The largest periods of growth were sustained by high rates of investment. However, domestic savings were relatively low, investment risk high (inflation, discretions & expropriations) and foreign investment volatile
 - Investment was subsidized by SO Banks, financial regulation and inflation, but in the long run it hurt savings and long term investment
- There were significant bottle necks in the balance of payments
 - Ag commodities played a significant role in the balance of payments to allow imports of intermediate and capital goods for the industry. However, sometimes agricultural expansion was obstructed by excessive tax pressure, differential exchange rates and uncertain policies
 - Manufactured exports lacked competitiveness, trade treaties and long term support
- Capital goods and technology adoption were several times obstructed by high tariffs & uncertainty
- Several policies were contradictory. High wages vs. profitable industries, wages vs. inflation, long term investment vs. macro instability & discretion, stimulate consumption but discouraging investment conditions

OK, maybe not the best place on earth to invest, but what a show!

