Argentina

Argentine Government Take Steps to Curb Inflation, FX Risk; Freezes Utilities Tariffs Ahead of Presidential Elections

Wed 04/17/2019 17:15 PM

Relevant Documents:
New Economic Measures (Spanish)
Central Bank New Targets

The administration of President Mauricio Macri is taking policy measures to curb inflation rates and reduce expectations on further peso devaluation ahead of presidential elections this year. The Argentine government seeks to limit the erosion of consumers' purchasing power amid accelerating inflation rates, announcing a package of new economic initiatives that includes a freeze on utilities tariffs and a new FX intervention zone for the reminder of the year.

To control prices, the government has reached an agreement with 16 leading local retailers to freeze prices of 60 essential products for "at least six months," according to a release issued today by the Macri administration. The government also plans to freeze tariffs shouldered by Argentine citizens for access to local utilities, particularly electricity and gas, that are under the scope of the federal government. Specifically, the government will halt increases on gas and electricity tariffs for the remainder of the year.

Argentina imposed a new tariff adjustment in March that entailed an immediate 10% increase, followed by additional increase of 9% this month and 8% in May, which, the government said today, will be the "last increase" for the tariffs this year.

Argentine corporates were trading down this afternoon after the announcements, with intraday losses for Argentine energy companies YPF and Pampa Energia, controlling companies of Metrogas and Edenor, respectively. YPF's 8.5% $1.5 billion bond maturing in 2025 was down 0.6 today, while Pampa's 7.375% $500 million international bond due in 2023 was down 0.5.

Finance Minister Nicolás Dujovne also called on regional governments to follow the same policy and freeze the current tariff scheme on local utilities.

"We invite the provinces to join us in this effort, for tariffs on the electricity distribution segment, which depend on regional government to remain at current levels" for the remainder of the year, said Dujovne during a press conference. Earlier this year, the federal government, the province of Buenos Aires and the autonomous City of Buenos Aires executed an agreement to begin the transfer of jurisdiction of Edenor and Edesur to the local governments from the federal government on March 1. The next tariff review was scheduled for August, which will be subject to whether the government of the City and Province of Buenos Aires chooses to follow the lead of the federal government and freeze tariffs for the remainder of this year.

"We are still convinced that to lower inflation rates in the long term, and put an end to this problem we have had for the last 75 years, the deep and structural changes we have been carrying forward are indispensable," the Macri administration said in the release.

"The 'dirigiste' economic package is contradictory," said Carlos Abadi, managing director at DecisionBoundaries LLC, a New York-based financial advisory firm. Freezing tariffs on utilities will "further slow down the primary deficit's downward trend and may soon clash with the near-zero monetary base growth objective," said Abadi, adding that he believes monetary policy will need to be loosened to accommodate the public sector's increased borrowing requirements or the downward trajectory in economic output will steepen.

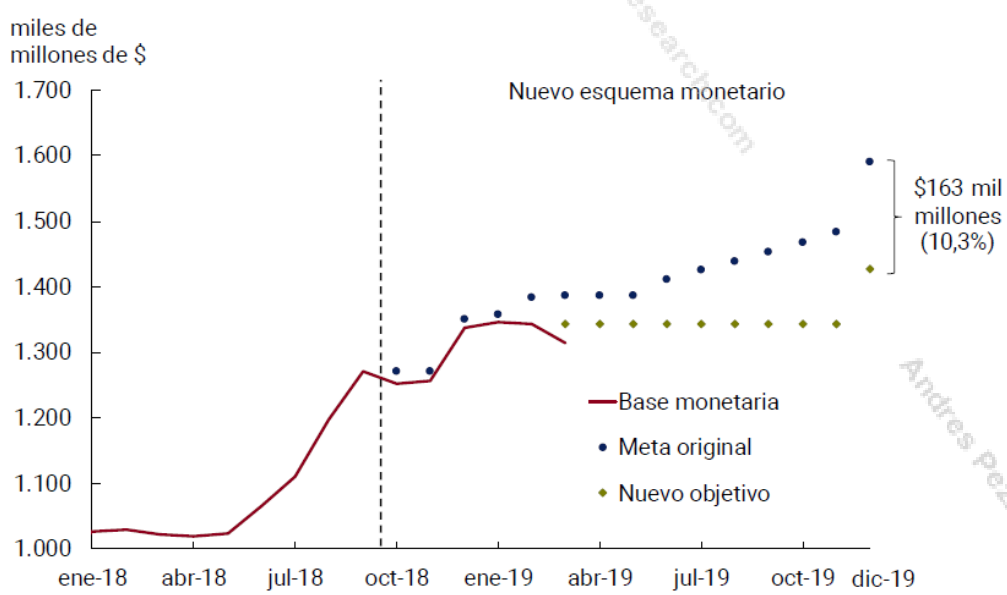
Despite the recent announcements, analysts say the local economy is also largely vulnerable to external factors, and Macri's intentions to run for a second term in office depends on a stable environment in emerging markets. According to an emerging-market trader following Argentina, Macri could reach October "in good shape" if Argentina can avoid external shocks. However, according to the trader, the market will still price Argentina's risk around at least 10% if Macri wins because his administration still lacks a serious plan to fix the country's economy.

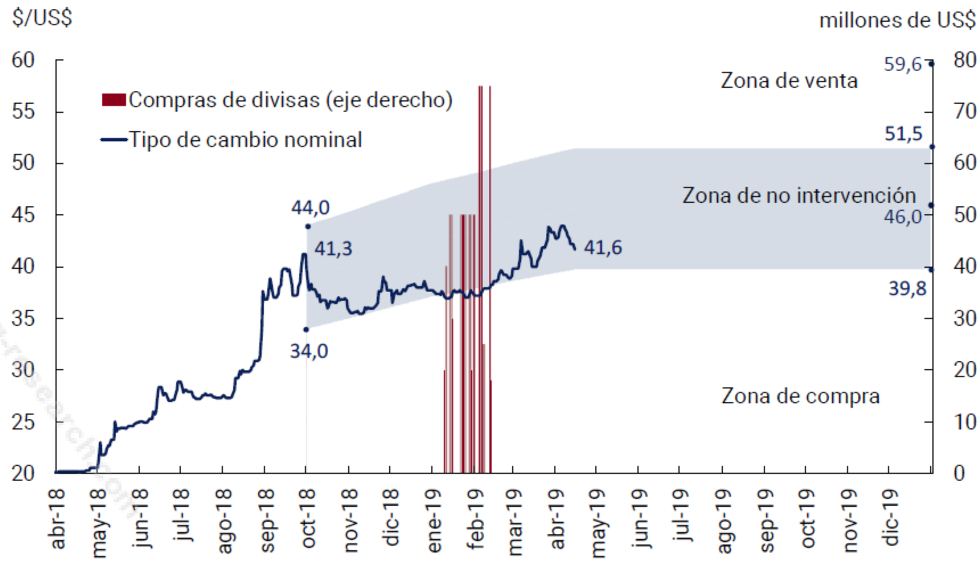
The measures disclosed today add to a new FX non-intervention zone announced Tuesday by Guido Sandleris, president of the local central bank, in an attempt to reinforce the bank's policy of controlling inflation expectations, anchoring the monetary base on new targets and framing a new non-intervention path for the peso-U.S. dollar exchange through the rest of this year.

The local central bank issued a new target for the non-intervention zone for the Argentine peso-U.S. dollar exchange rate, which will now be fixed between ARS 39.75 and 51.45 for the lower and higher values for the rest of the year. Another change to the previous monetary policy is that the monetary authority will abstain from intervening in the FX market by purchasing foreign currency if the rate falls below the lower value, or ARS 39.75 per U.S. dollar. The new non-intervention zone contrasts with the former policy rule, which was in force until Tuesday, under which the limits of the non-intervention zone were updated daily at a monthly rate of 1.75% throughout the second quarter of 2019.

The decision made by the monetary authority to fix the non-intervention zone at current levels is supported by an additional liquidity inflow expected to be provided by the Ministry of Treasury for about $9.6 billion in FX auctions until June; Treasury will auction off up to $60 million on a daily basis to finance its liquidity needs in local peso terms. According to the central bank, this additional liquidity to be provided by Treasury will cover an estimated $7 billion of potential demand for FX in the local market if certain risks materialize, considering that in 2018 the flight to quality that drove the peso to lose about half of its value represented about 12% of peso-denominated assets in the system at that time. Adjusted for inflation, that figure would imply a potential demand for $7 billion of FX for the remainder of 2019.

Below is a depiction of the new target for the monetary base, represented by the gray dotted line, compared with the former target, the blue dotted line, and the new non-intervention zone targets, in the second graph:





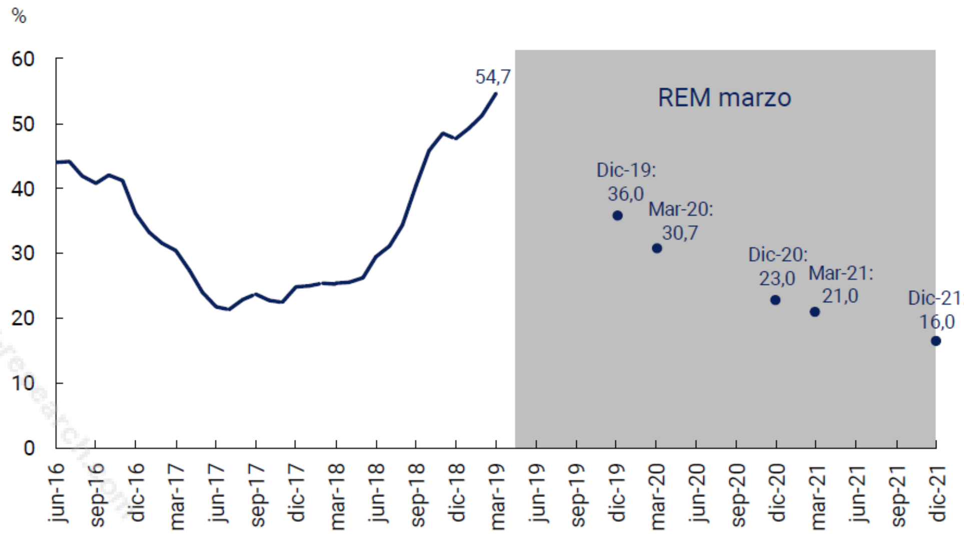
Last year, after the peso lost more than half of its value between April and August, the Argentine central bank established a new monetary policy scheme seeking to reduce inflation, committing to maintaining the monetary base until June 2019. The monetary authority also set ranges for an intervention zone and a non-intervention zone for the local peso-U.S. dollar exchange rate through the end of 2018. At that time, the lower limit of the non-intervention zone was established at an exchange rate of 34 pesos per dollar, and the higher limit was set at 44 pesos per dollar, with a daily adjustment of 3% per month through the end of 2018.

The new monetary policy implies that if the exchange rate rises above the maximum level or falls below the minimum value of the non-intervention area, the central bank commits to purchase or sell foreign currency to bring the rate back to the non-intervention zone, in which the exchange rate is set to fluctuate freely.

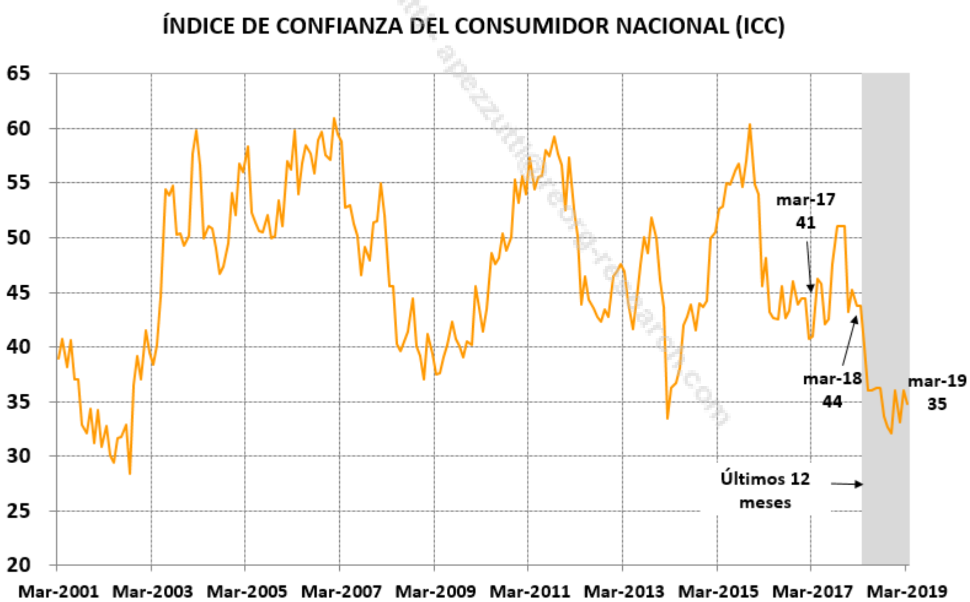
The new scheme was set in such a way to be consistent with the fiscal targets outlined in the $57 billion loan facility from the IMF, signed last year. According to the terms of that agreement, the government will seek to achieve a primary fiscal balance in 2019 and a surplus in 2020, with the central bank cutting further fund transfers to the Treasury in order to eliminate the main source of monetary issuance and a driver for inflation rates.

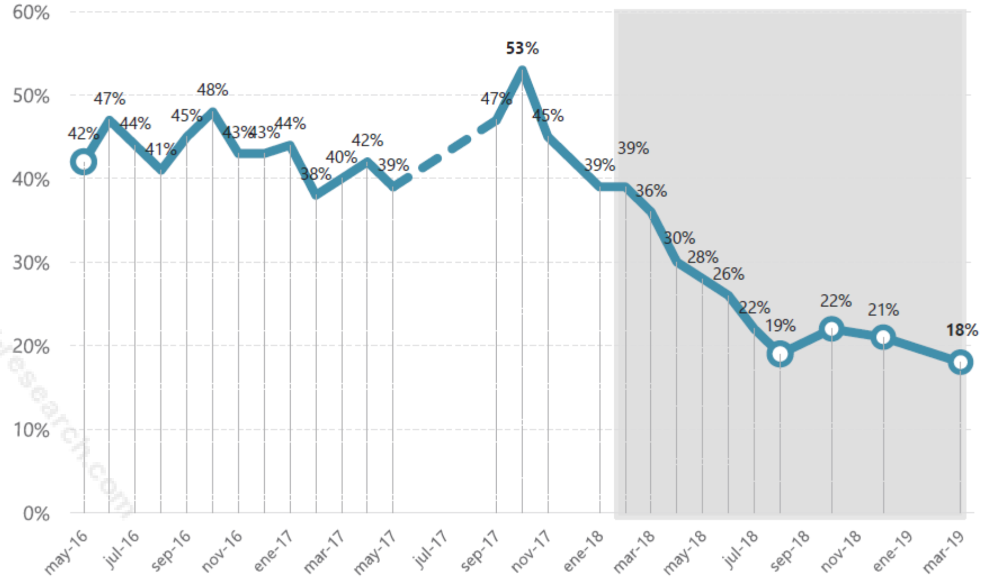
The new policy measures announced today come after local inflation rates continued escalating during March, peaking at a 4.7% monthly rate, according to the country's national statistics institute, or INDEC, for an annualized inflation rate of 54% as of March. Inflation is projected to reach 36% in 2019, according to the survey carried out by the local central bank, after hitting 47.6% in 2018 following the steep depreciation of the peso. The March data imply accelerating inflation, after the inflation rate hit 2.9% and 3.8% in January and February, respectively, on a monthly basis. In addition, as of the end of March, the local peso reached 43.6 per U.S. dollar, down more than 15% compared with the end of 2018.

The erosion in local purchasing power is undermining Macri's popularity and jeopardizing his plans to stay in office for a second four-year term. According to a recent poll from the University of San Andrés, during recent months there was a "discontinuity in the perception of the main problems that Argentines highlight," with inflation becoming the main problem for the interviewees, or 54% of the poll. According to a survey from Universidad Di Tella, inflation expectations as of March reached 40% for 2019. The annualized monthly inflation rate and the expected annual inflation rate for the period 2019-2021 (in gray), according to a survey from the central bank, are reproduced below:



Macri is betting his reelection plans on the new economic measures after the recent economic and financial crisis hurt his popularity and the intention vote for the official Cambiemos party. According to the same poll from University of San Andrés, the results for the last quarter of 2018 “continue to show low levels of approval of 33%, and a satisfaction level with the general progress of things reaching the 18% low,” while the satisfaction level with the performance of the executive branch is also low, 19%, “the lowest level recorded during the administration of Mauricio Macri.” Consumers’ confidence levels also reflect this trend, as shown by the consumer confidence index from Universidad Di Tella (top) and the overall approval level of the Macri administration, according to Universidad de San Andrés (bottom):





The sharp increase in the inflation rate, and the spillover on consumption and employment, will result in a challenging environment for Macri's re-election plans: About 24% of respondents to the poll carried out by Universidad de San Andrés said they will vote for the Cambiemos party, while 29% said they will vote for some candidate from the opposition. About 37% of the poll said they were undecided, and 10% did not answer. Both Macri and former president Cristina Kirchner have a "high negative image and a rejection level over 50%," according to the poll, while the former minister of economy under the administration of Nestor Kirchner, Roberto Lavagna, is regarded as the potential candidate with lowest rejection rejection level - only 35%. The rejection level reflects the percentage of poll respondents who "would never vote" for a certain candidate.

According to the same poll, the recent trend shows an electoral base fractured into thirds, given the recent growth in those still undecided, to 37% in March compared with 28% in June 2018, "in contrast to what would be expected as we approach the election date," partly explained by the uncertainty regarding the final candidates for each of the running political parties, according to the poll from Universidad de San Andrés. Given the fractured electoral vote, in a second round or ballotage, Macri would secure a victory against Cristina Kirchner, while he would lose against Lavagna by about 8 percentage points: