



International Commentary — August 11, 2023

Argentina Primary Election Scenario Analysis

Summary

Argentina will host primary elections (PASO) this weekend, with the outcome offering a potential sea change for the country's economic prospects. In Argentina, voting in the PASO election is mandatory. Compulsory voting allows financial markets to get clear insight and visibility into the direction of policy ahead of official presidential and legislative elections in October. If ever an economy need a sea change, it is Argentina. For decades, Argentina has struggled with the fallout from multiple sovereign debt defaults, currency crises, stagflation and overall economic malaise. Silver linings may be available as probusiness and market friendly political coalitions are likely to perform well in this year's election. As of the latest opinion polls, arguably the *most* business friendly coalition is likely to receive the most votes in the primary election. Juntos por el Cambio (JxC)—the coalition campaigning on a return to fiscal discipline, strengthening relations with the IMF, and lifting capital controls—is polling well, and in our view, likely to outperform in PASO voting. Should this scenario materialize, Argentina could be headed in a policy direction that includes fiscal restraint, limited central bank deficit financing, and an IMF-supported lifting of capital controls.

However, historically, Argentine opinion polls have not been all that effective at predicting political outcomes. So while we believe the Junto por el Cambio coalition will do well in the PASO voting based on the coalition's political stance and polling data, we take polls somewhat with a grain of salt. Running against JxC is the Peronist coalition, Union for the Homeland (UP). The UP coalition frontman is current economy minister Sergio Massa. While Massa comes from a Peronist party and coalition defined by political ideologies that concern market participants, Massa represents a more centrist version of Peronism that markets should digest more comfortably. While not our base case outcome, should Massa perform well this weekend, Argentina's long-term economic prospects could gradually improve. Of course, as is common in Latin America, a more unorthodox candidate has gathered momentum over the election cycle. Javier Milei, representing the Liberty Advances coalition, is campaigning on a more radical policy platform. Milei's coalition finds itself on the far-right end of the political spectrum and has suggested policies that could roil local financial markets and lead to a perceptible rise in the probability of sovereign default.

On the following page, we lay out our base case scenario for the PASO election as well as alternative scenarios. In addition to a scenario description and general policy platform of each coalition, we outline the potential financial market reaction in each scenario. While certain outcomes are more positive for Argentina than others, we continue to believe that no matter who takes office the Argentine peso is set for a large devaluation before the end of this year. Argentina's central bank has depleted its FX reserves, and while short-term buffers in the form of FX swap lines exist, these are only stopgap measures that are unlikely to prevent a significant depreciation of the currency for much longer. In our view, a JxC as well as a Massa victory likely to lead to a peso devaluation in late 2023, but latest by mid-2024. In the event Javier Milei outperforms this weekend and possibly wins the presidency, the peso devaluation could be much sharper and the risk of another sovereign default would be elevated.

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Argentina 2023 Presidential PASO Election Scenario Analysis

Sergio Massa Outperforms Likelihood: 15%

JxC In Control Likelihood: 60%

Javier Milei Outperforms Likelihood: 25%

Scenario Description: Massa outperforms and receives 35%-40% of the PASO vote, with JxC candidates mildly underperforming winning 25%-30% of votes, and Milei performing well receiving ~20% of the vote. Massa's recent track record of keeping Argentina's economy afloat and running on a center-left policy platform makes him an attractive candidate. Voters respond well to the renegotiated IMF program and front-loaded U.S. dollar disbursements, while also believing Massa can deliver a reform agenda to put Argentina on a path toward economic stability. Massa becomes the favorite to win the Presidency.

<u>Policy Platform:</u> Massa represents the incumbent Peronist party through the Union for the Homeland (UP) coalition, but is more center-left than prior Peronists. Massa understands the need for fiscal discipline, but is less fiscally conservative relative to the JxC coalition.

Local Markets Implications:

- FX: 10%-15% ARS devaluation by mid-2024
- Sovereign Debt: Government bond prices rise only modestly as Massa is market friendly, although not market participants' preference

Base Case: The combination of Juntos por el Cambio (JxC) coalition candidates, Patricia Bullrich and Horacio Laretta, secure ~40% of primary election votes. In this scenario, Massa performs well, but is behind JxC by a fairly wide margin, while Milei receives a respectable amount of votes but winning office is likely unobtainable. Bullrich and Laretta both garner strong positive responses from voters on platforms centered around fiscal discipline, an end to central bank deficit financing, and lifting capital controls. The Macri-style playbook resonates well, and the JxC candidate becomes the overwhelming Presidential favorite.

Policy Platform: Both candidates are running on market friendly platforms. Bullrich and Laretta have center-right policy stances, and support achieving fiscal balance and attracting investment. Enhancing IMF relations is critical in an effort to lift capital controls without destabilizing markets.

Local Market Implications:

- FX: 10%-15% devaluation by O4-23/O1-24
- <u>Sovereign Debt:</u> Bond prices rise sharply as debt sustainability and economic conditions on track to improve over the long-term

Scenario Description: Argentina's storied track record of sovereign default, elevated inflation, recession and suppressed household wealth generation prompts voters to seek an abrupt and significant turn in economic policy. Milei's platform of upending current institutions and taking an unorthodox approach to economic prosperity resonates well with younger voters, but also older generations frustrated with Argentina's lack of economic progress. Milei wins 25%-30% of votes, while the JxC wins ~30%. Massa wins 20%-25% of the PASO vote, and the outcome of the October presidential election is highly uncertain.

Policy Platform: Milei's Liberty Advances coalition is on the far-right end of the political spectrum. While he has advocated for fiscal restraint and a balanced budget, he's also suggested eliminating the peso, dollarizing Argentina's economy and abolishing the Central Bank of Argentina.

Local Market Implications:

- FX: 30%+ devaluation by Q1-24
- <u>Sovereign Debt:</u> Sovereign default risks rise as economic policy uncertainty and FX depreciation prompts significant capital flight from Argentina

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