



Economics Group

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Argentina's Economy Tumbles in 2016

The Argentine economy plunged 2.3 percent in 2016 as the Macri administration tried to untangle a cobweb of economy-wide subsidies that distorted its functioning. Now, the political costs of doing so should start to bite.

The Cost of Reforms Takes Its Toll

The Macri administration, in our view, needs to generate economic growth quickly or face an increasingly difficult political environment as mid-term elections approach. For now, the economy is not showing any improvement, even though administration officials continue to argue that the recovery is close. At present, the only thing that they have to offer is the fact that the economy plunged 2.3 percent in real terms during 2016.

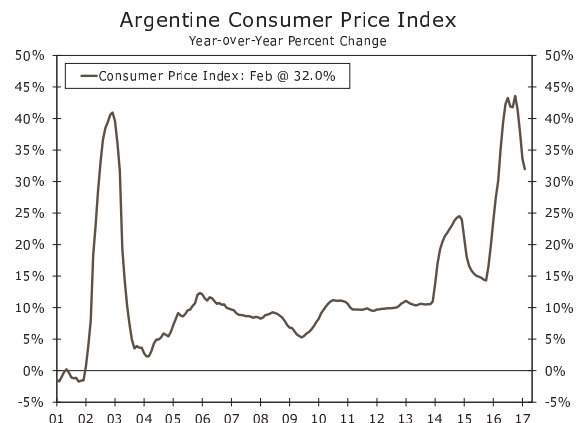
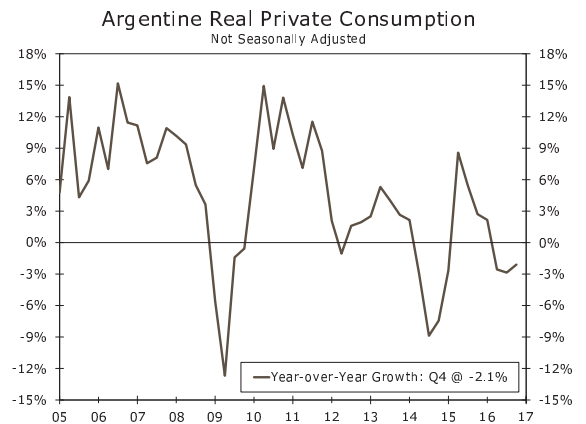
The Macri administration knew that untangling all the cobwebs of subsidies implemented by the Kirchner administration was not going to be easy. However, Macri supporters have criticized the many mistakes in policy implementation as well as the slow speed at which reforms have moved and contend that it would have been better to implement a “shock,” where the government implements all the changes at once and pays the costs of the reform process up front. Instead, the Macri administration chose to implement changes slowly, and this strategy is probably going to come back to haunt his administration.

Personal consumption expenditures (PCE), which represents 73 percent of GDP, shrunk by 2.1 percent year over year during Q4 2016, an improvement compared to a decline of 2.9 percent in Q3. Overall, PCE dropped 1.4 percent for the year as a whole. Meanwhile, gross fixed capital formation plunged 7.7 percent during Q4 and was down 5.5 percent for the year as a whole. Government expenditures, on the other hand, declined 2.0 percent during Q4 but rose 0.3 percent for the year as a whole. Real exports of goods and services surged 7.7 percent in Q4 and increased 3.7 percent for the whole of 2016. Meanwhile, real imports of goods and services, which enter the calculation of GDP with a negative sign, increased 2.1 percent in Q4 and 5.4 percent for the whole of 2016.

Economic Growth Needed, And Fast

The slow path chosen by the Macri administration for its adjustment process is understandable, as it did not want to shock the economy with measures that were going to hurt the most vulnerable. However, this slow reform process has kept inflation and interest rates higher and for a longer time than what proponents of the shock reform alternative would have estimated. Now, the strategy runs the risk of hitting the wall of the mid-term elections where political incumbency is normally not a good omen.

Thus, in our opinion, the Macri administration needs to show, very fast, that his measures are finally taking hold and growth is coming back if his administration wants to remain viable. That is, inflation needs to come down fast and economic growth has to surge. Both of these should determine the viability of his administration and of the new reform agenda in the country.



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