

Economics Group

Special Commentary

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Argentina Sets the GDP Record Straight

Executive Summary

After a very positive start to the Macri administration's efforts to right the wrongs of the economy during the Kirchner administration, the first cracks are starting to appear. Inflation remains extremely high and the economy is not reacting as the Macri administration expected it would when the reform process started. Everybody knew the transition from a highly regulated economy to a more market-oriented economy was not going to be easy. However, outsized expectations on the administration's early success with freeing the country's currency are giving way to concerns that the benefits of the reform process are not coming in with the speed they expected.

Meanwhile, the statistical institute released a revision of the GDP numbers since 2004 and what was thought to have been a period where there was no economic recession the new numbers show a very different environment, which could explain last year's surprising presidential election results that elected Mauricio Macri. According to the new numbers, the Argentine economy was in recession in 2009, 2012 and 2014.

Inflation remains very high, with some estimates putting it at 40 percent per year as a consequence of the depreciation of the currency plus the elimination of the consumption subsidies established by the Kirchner administration. Although inflation is expected to come down steadily, the transition is going to remain difficult for the Macri administration and for those that would like to show faster improvements in this front.

The economy slowed down considerably in the first quarter of 2016 from the growth rate recorded in 2015. Thus, the success of the Macri administration will depend on how fast it can deliver economic growth and bring down the rate of inflation.

Macri vs. Kirchner

Last year's presidential election results created a feeling, in the country as well as across the world, that Argentina was approaching another turning point and that the future looked brighter than the past. More than six months have elapsed since Mauricio Macri took over the helm of the country's presidency and cracks are starting to appear. The early success in freeing the exchange rate and starting to untangle the myriad of tight knots holding back the Argentine economy is starting to give way to concerns about future growth, high inflation, and even higher uncertainty about the future.

The administration assumed that the reform process would attract enough capital into the country that economic activity was going to take off soon after. So far, that has not panned out as the inflation generated by the liberalization of the exchange rate market has put pressure on personal consumption expenditures at a time when the new administration started to rationalize public utility prices as it ended the policy of subsidizing consumption.

While the successive Kirchner administrations enjoyed the strongest commodity prices in history, the Macri administration took over when the "commodity and export party" was over and resources became extremely scarce. Furthermore, regional and global growth remains constrained, limiting the ability of the economy to grow through exports. That said, real exports of goods and services were the strongest growth sector during the first quarter of the year as a

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consequence of the lowering of export taxes, which were the lifeline for the subsidy policies conducted by the Kirchner administration.

Meanwhile, high inflation as well as uncertainty regarding the direction for inflation will probably keep investors from investing in the country, which will contribute to weak economic growth at least until this uncertainty is reduced.

GDP Revisions Give a Different View of Economic Performance

The release of first quarter GDP results for the Argentine economy also included a revision of economic numbers since the GDP series was rebased in 2004. According to the revision, Argentina's economic performance during the Kirchner administration was not as positive as that administration claimed. Starting in 2007, according to reports and confirmed by the International Monetary Fund (IMF) sanction of Argentina's statistical numbers, the Kirchner administration "intervened" with the INDEC, the country's statistical institute, and started "penciling in" inflation as well as GDP growth numbers to suit their political agenda. The problem was so widespread, acute and troublesome that the IMF censured Argentina in 2013 for tampering with its economic statistics.¹ In fact, Argentina was the first country to be censured by the IMF, in its history, for tampering with statistical data.

Figure 1

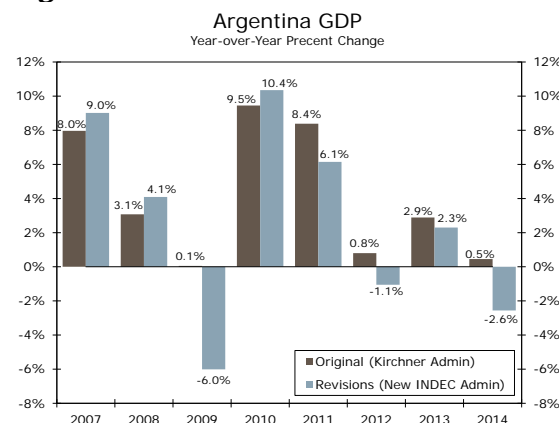
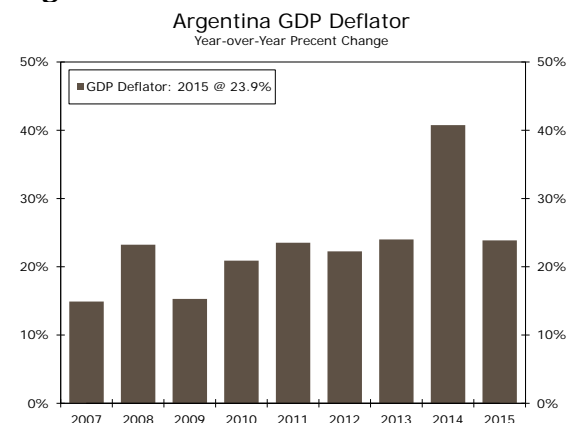


Figure 2



Source: IHS Global Insight and Wells Fargo Securities

The biggest consequence of tampering with economic statistics is that economic actors cannot make informed decisions. The country just released its first look at inflation in more than four months with the April and May consumer price index (CPI). According to that number, inflation increased 4.2 percent in May. However, the series is two months long so it is impossible to look at how much CPI inflation has increased versus last year. Furthermore, the statistical institute says they will have to redo the CPI using a different survey of consumer expenditures than what they are basing the current index today because that survey is not credible either. Thus, during the Kirchner administration the CPI was released but not credible, whereas today there is a new CPI but the statistical institute says it still has its issues. As we said before, this uncertainty is not good for economic actors nor for economic growth as it is impossible to make rational decisions under this uncertain environment. Thus, expect economic activity to remain weak until there is more certainty later in the year.

Having said this, the revised national accounts give a relatively good indication of where inflation is today. The GDP deflator increased 35.6 percent in the first quarter of the year compared to 23.8 percent during the last quarter of 2015, while the PCE deflator increased 35.9 percent in Q1 2016 compared to 20.8 percent during the last quarter of 2015. Thus, inflation has clearly accelerated and is hovering near 35-40 percent in 2016. The rate of inflation, according to the GDP deflator in 2014, was 40.8 percent and economic growth during that year fell 2.6 percent.

¹ Read "[Statement by the IMF Executive Board on Argentina](#)," Press Release No. 13/33, February 1, 2013.

Therefore, if the Macri administration cannot bring down inflation considerably during this year, Argentina will probably suffer another recession in 2016. And the second quarter has not started on a better footing. According to the first release of the consumer price index for May, the CPI increased 4.2 percent during the month, which means that inflation is still not slowing down.

At the same time, the result of the revisions to the numbers means that according to the Kirchner administration, the Argentine economy grew 33.1 percent during the period 2007-2014, but the revision indicates that the economy only grew 22.3 percent during that period. The biggest difference was allocated to 2009 GDP growth. According to the Kirchner administration, the Argentine economy grew only 0.1 percent during that year, but the revision shows growth actually fell 6.0 percent. In 2012, the Kirchner administration reported growth of 0.8 percent but the revision shows another decline in growth of 1.1 percent. A similar situation occurred in 2014, when the Kirchner administration said the economy grew 0.5 percent, but the revision showed a decline of 2.6 percent. This means that the Argentine economy was in recession during three of the eight years that spanned between 2007 and 2014. Furthermore, one of those recessions was a very severe one, with the economy dropping 6.0 percent. At the same time, economic growth during the last years heading into the 2015 presidential elections were dismal in terms of economic growth, which helps explain why Argentines decided to vote against the Peronist party.

Figure 1 shows the differences between the originally reported numbers and the revisions made by the new INDEC administration.

Weak Growth in Q1 2016

According to the restructured Argentine statistical institute, INDEC, the Argentine economy grew only 0.5 percent during Q1 2016 compared to the same period a year earlier, while dropping 0.7 percent on a seasonally adjusted basis compared to Q4 2015. This represents a relatively strong slowdown compared to a growth rate of 2.4 percent during the whole of 2015. However, the slowdown was expected as the economy is going through a difficult period of macroeconomic adjustments since the new Macri administration took over in December 2015.

One of the most affected sectors during the first quarter of the year was personal consumption expenditures (PCE), which only grew 1.1 percent on a year-earlier basis compared to 8.0 percent during Q4 2015 and 5.0 percent for the whole of 2015. This strong slowdown in PCE was not unexpected and follows the strong reversal in economic policies followed by the new Macri administration. The liberalization of the Argentine currency at the end of 2015, plus the elimination of a host of consumption subsidies as well as the rationalization of public utility tariffs with its ensuing increase in inflation are to blame for this strong deceleration of PCE. Furthermore, the prospects for the rest of the year are not much better because the new administration remains committed to continue on this path.

Of course, this important policy reversal is putting a lot of pressure on the Macri administration to deliver results for the economy, and our expectation is that the political environment will continue to deteriorate in the coming quarters, until the economy starts reacting to the new prudential macroeconomic guidelines, which is less government intervention and more reliance on the private sector. However, the economy had been micro-managed for such a long time that the transition has not been easy, especially because economic actors, from investors to firms and consumers, were making economic assumptions with incorrect information planted by the previous administration (see previous section for a discussion on these topics).

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Figure 3

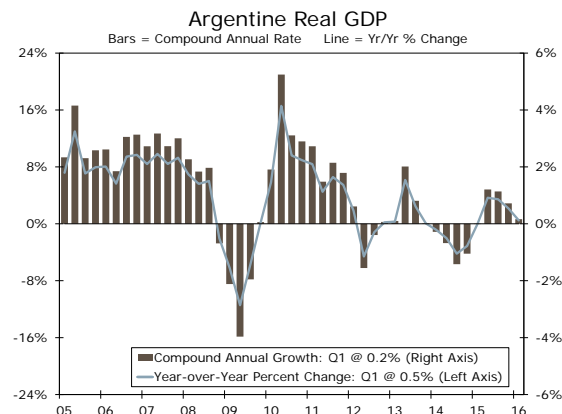
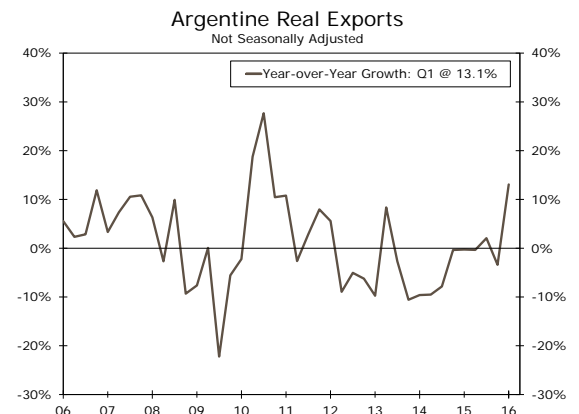


Figure 4



Source: IHS Global Insight and Wells Fargo Securities

Another sector that was affected significantly by the changes brought about by the new administration was that of gross fixed investment. The sector declined 3.8 percent in the first quarter of the year after increasing 12.0 percent in Q4 2015 and 5.5 percent during the whole of 2015. What happened to this sector perhaps has been one of the largest disappointments faced by the Macri administration as this was one of the sectors the administration thought was going to benefit the most from the policy changes. In fact, the new administration thought that capital flows into the country, due to the new and more rational policies, were going to drive economic growth during the first year. However, that did not happen during the first quarter of the year but they are expecting this sector to improve a bit during the rest of the year as the economy starts to recover.

Perhaps the best news for the Macri administration was the performance of the export sector, which improved considerably during the first quarter of the year benefiting from the lowering of taxes on exports set by the new administration. Exports of goods and services increased 13.1 percent during the first quarter of the year, the largest year-over-year increase since the Q3 2010 when exports grew at a 27.7 percent rate. This improvement is very consequential as exports of goods and services had declined for four consecutive years, 2012-2015, and this increase puts the sector on a better path that is expected to remain for at least the current year.

Furthermore, this is one of the sectors that the Macri administration expects to become a driver in terms of gross fixed investment as it rebuilds itself after a very rough period during the previous administration. The Kirchner administration's taxing strategy against the agricultural sector designated this sector as the "cash-cow" during the commodity boom cycle, something that discouraged production as well as investment in the sector. Thus, the fact that the sector's exports are growing again is one of the few bright spots going forward for the current administration.

Another reason for the weak performance in the first quarter of the year was related to the increase in imports of goods and services. Recall that imports enter negatively into the calculation of GDP, which means that a high growth in imports lowers the rate of growth of GDP. Imports of goods and services increased 12.2 percent during the first quarter, after climbing 14.6 percent in Q4 2015 and 5.5 percent for the whole of 2015. Our expectations for the rest of the year is for imports to continue to increase but be concentrated in imports of capital goods, which will help increase the ability of the Argentine economy to grow in the coming years.

Conclusion

The Argentine economy is going through a rough patch caused by the implementation of policies that are trying to reverse more than 12 years of economic mismanagement at a time when global and regional economic landscapes are hurting more than helping. However, for now, the lowering of export taxes has allowed the export sector to be the only bright spot in an otherwise weak economic environment.

Gross fixed investment was another sector significantly affected by the changes brought by the new administration.

We do not forecast the Argentine economy but the IMF expects the economy to drop 1.0 percent this year and then rebound to post a growth rate of 2.8 percent in 2017. However, the risks for a further deteriorating environment will remain present as long as the recovery in economic activity is delayed. The Macri administration is already showing signs of doubts regarding the path chosen, and social pressures are starting to put pressure on elected officials to deliver on growth. Furthermore, a slowdown in inflation will help considerably, but first the country has to reintroduce a credible consumer price index.

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