GLOBAL X INSIGHTS

Argentine President Milei’s First Year in Office: Laying the Foundation for Sustainable Growth

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Often mischaracterized as “radical,” Argentine President Javier Milei’s first year in office proves he has been anything but, being amongst the most economically orthodox leaders the country has seen in decades. Since taking office in December 2023 and despite having a minority in the Senate, he has amassed a long list of accomplishments, including devaluing the currency, cutting fiscal spending, passing the Laye de Bases Bill (a set of pro-business initiatives), making market friendly appointments to key government positions, reaching multiple agreements with the International Monetary Fund (IMF), and introducing a new framework to attract foreign direct investment (FDI). Although political gridlock slowed the process and somewhat limited the scope of reforms, Milei showcased his ability to negotiate in order to govern, while also not wavering on his staunch commitment to fiscal austerity and economic orthodoxy. We believe this transformation remains in the early innings, with Milei set to continue laying the foundation for long-term sustainable growth.

Key Takeaways

- As promised, Milei’s austerity weighed on the economy during his first year in office, but the outlook for 2025 is improving, with GDP growth expected to sharply accelerate while inflation will likely continue to rapidly slow.
- Milei’s RIGI framework, an incentive program for large investments, is a strong first step for attracting foreign direct investment, but a clear continuation of policy and the removal of capital controls will likely be key for unlocking this potential growth driver.
- The 2025 midterm elections present a risk to the Argentine investment thesis, but improving economic fundamentals could increase the probability that Milei’s coalition gains a majority in the Senate, which would almost certainly accelerate the pace of reforms.

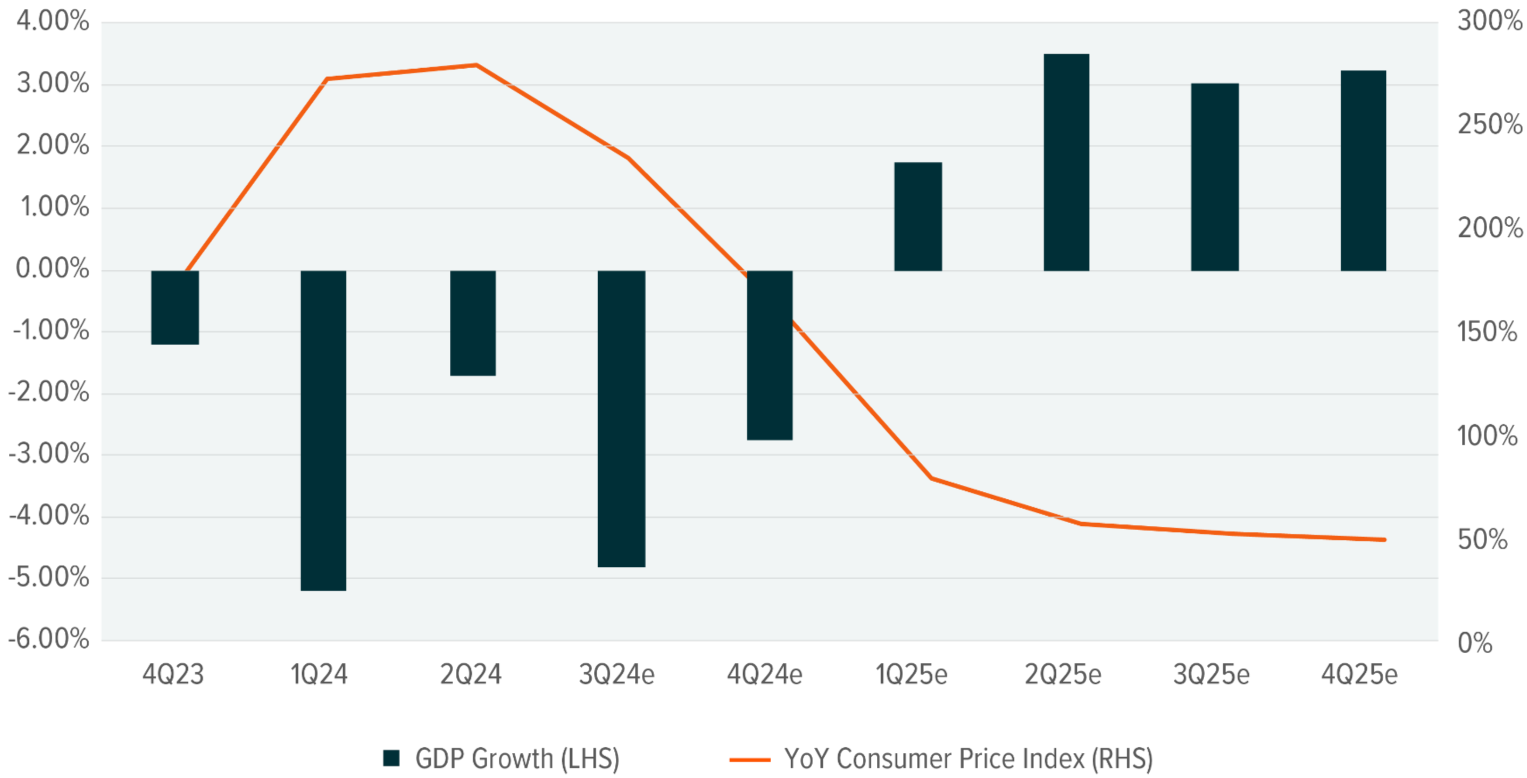
Is Argentina at an Economic Inflection Point?

Milei inherited an economy with an overvalued currency, sharply rising and synthetically suppressed inflation, a muted private sector, and negative central bank reserves, underscoring the need for the quick implementation of austerity policies. Milei rose to the occasion, righting the ship by cutting government spending, enabling the private sector through deregulation, and producing the country’s first quarterly fiscal surplus since 2008.[1] This austerity greatly improved the country’s long-term fundamentals, but it also uncovered the true weakness in the underlying economy stemming from decades of Peronist economic policies, pushing real wages lower in 2024 and weighing on the day-to-day life of the average Argentine.

However, looking to 2025 we see a different story, with the worst of austerity seemingly behind. This is expected to result in a sharp acceleration in both real GDP growth and real wage growth in 2025, illustrated by the chart below. When looking for a precedent, we see this setup as analogous to the United States and the United Kingdom in the late 1970s and early 1980s, when these governments implemented harsh but orthodox monetary and fiscal policies in order to stabilize the inflation scenario which, along with deregulation-focused policies, helped set the stage for a decade of above average real GDP growth. As a result, if we see policy continuity, we believe years of outsized growth could be ahead for Argentina.

ARGENTINE ECONOMY APPEARS POISED FOR SHARP IMPROVEMENTS IN 2025

Source: Global X ETFs with information derived from: Bloomberg LP. Data as of October 14, 2024.

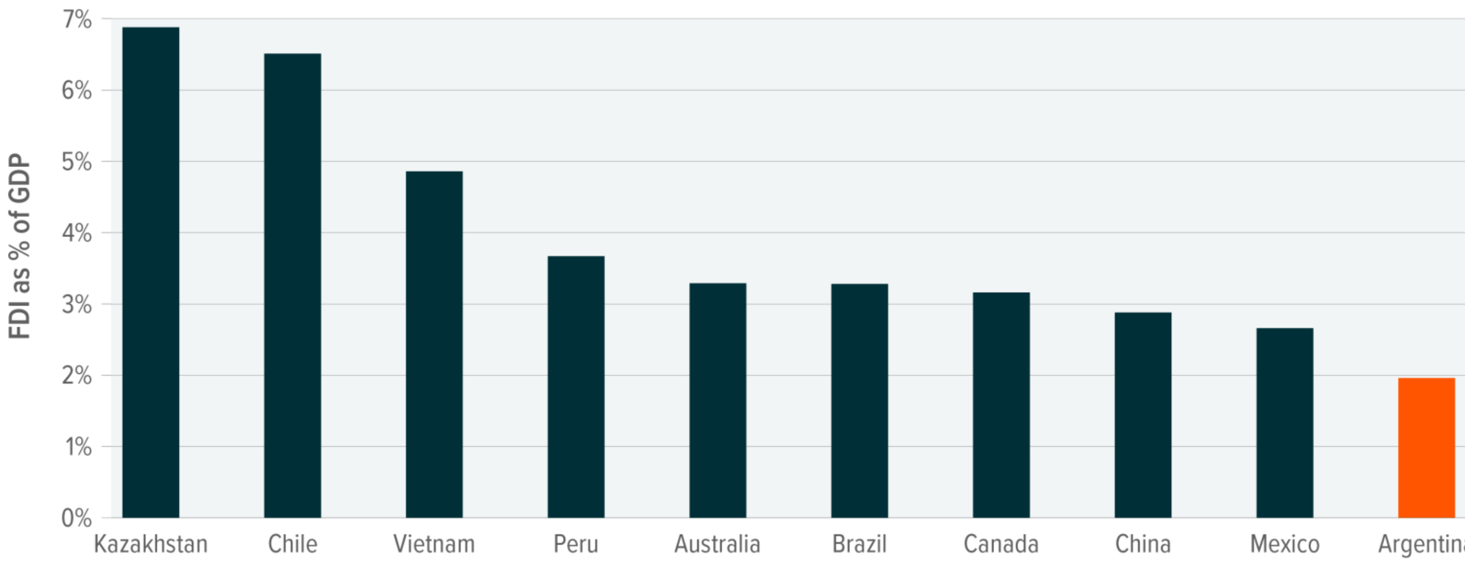


Foreign Direct Investment is Key to Unlocking Longer-Term Growth

Decades of Peronist policies and five sovereign defaults since 1982 eroded international investor confidence in Argentina, pushing foreign direct investment to low levels. This uncertainty became somewhat of a vicious cycle for Argentina, with the lack of investment weighing on domestic growth which, along with large fiscal deficits, pressured the currency, which reduced the purchasing power of the consumer, profitability of corporates, and tax revenue, making the already unorthodox Peronist policies less and less sustainable. Although Milei improved the short- to medium-term economic outlook, we believe a resurgence in FDI remains vital for longer-term and more structural growth, especially given Argentina's vast and largely untapped natural resource base. One key measure Milei recently introduced is the RIGI framework, which provides key incentives, such as tax breaks and foreign exchange incentives, for investments over $200 million. We have seen this initiative already bearing fruit, with two large deals already occurring in the mining sector. We see the removal of capital controls as the next key short-term catalyst to attract investment. Two sectors that appear set to benefit from these investments are mining and energy, with Argentina having the world's sixth largest copper reserves and the largest shale gas field outside the U.S.[2,3] However, at the end of the day, these types of investments have decade-long profiles, with the majority of companies looking for more clarity over the continuation of Milei's policies before meaningfully investing in the country.

ARGENTINA RECENTLY LAGGED PEER COUNTRIES IN ATTRACTING FOREIGN DIRECT INVESTMENT (FDI)

Source: Global X ETFs with information derived from: Our World in Data. Foreign Direct Investment, Net Inflows, as Share of GDP. Data accessed on October 14, 2024. Graph depicts average annual investment as a percentage of GDP from 2000-2022.

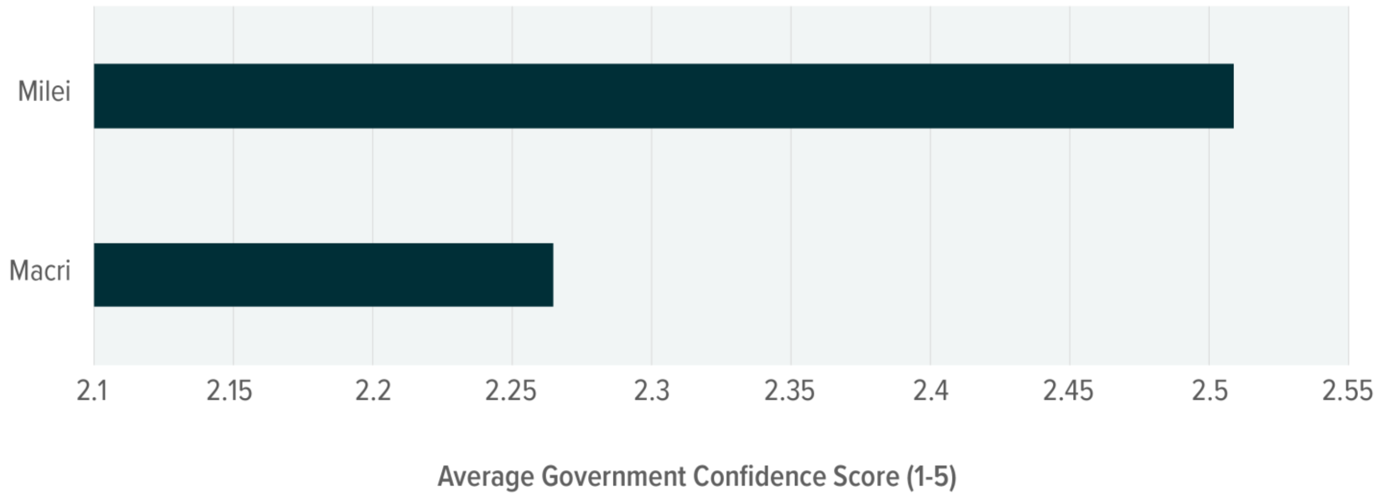


Key Risk: Milei's Policies to be Tested in the Midterm Election

The 2025 midterm election represents a major make or break test for Milei, with his orthodox economic policies set to be put to a vote. Milei's coalition, which currently holds a slim majority in the Lower House and a minority in the Senate, has much to gain or lose from the election outcome, making this an increasingly binary event. In highlighting this risk, it's important to look back at the Presidency of Mauricio Macri (2015-2019). Macri took a more gradual approach to policy normalization in Argentina, helping support the economy during the first two years of his Presidency and contributing to him gaining power in the midterms. Although Milei took a more rapid approach, we see the set up for the midterms as very comparable to the Macri era, with GDP set to sharply accelerate during the year heading into the election. We also note that Milei's approval rating is comparable to that of Macri at this point in his term, with Milei's popularity remaining resilient despite the short-term impacts of austerity. We continue to see the election as a key risk to the Argentine investment thesis, but also see the potential for Milei to follow the way of Macri and gain support in the midterms, which would likely be a key catalyst to accelerate the pace of reforms. Furthermore, if Milei gains a majority in both houses, the quicker normalization during his first year also bodes well for the outlook for the rest of his term. This was a key challenge that Macri's gradual approach was unable to overcome, with him losing popularity over the next two years and resulting in him losing the 2018 Presidential election. As a result, the uncertainty and binary nature of this event, as well as the associated potentially existential risk, make the election a key event for investors to monitor.

AVERAGE GOVERNMENT CONFIDENCE SCORE

Source: Global X ETFs with information derived from: Universidad Torcuato Di Tella. (2024, Sep). Indice de Confianza en el Gobierno. Average government confidence score on a scale of 1 (dissatisfied) to 5 (satisfied) over Macri's entire term (2015-2019) and Milei's term to date.



A Foundation for Prosperity

We believe Milei is misunderstood as a "radical" figure from an economic perspective, as he is amongst the most economically orthodox leaders that Argentina, and arguably Latin America, has seen in decades. He has already made significant strides in stabilizing the economy, and we believe the looming 2025 midterm elections could potentially act as a catalyst for him to gain power in the Senate to accelerate the pace of reforms. We remain in the early stages of this economic transformation, while valuations remain attractive despite the rally over the past 12 months, with the MSCI Argentina Index trading at a forward P/E ratio of 6.7x.[4] Finally, we believe this turn-around not only represents a boon for the Argentine economy, but possibly for the continent as a whole, unlocking another potentially significant driver of growth and potentially helping push Latin America's political pendulum back towards the center.

Footnotes

1. Reuters. (2024, Jul 16). Argentina Posts Six Months of Fiscal, Financial Surpluses.
2. Fastmarkets. (2024, Aug 20). What BHP-Lundin Deal Tells Us About Argentina's Mining 'Boom'.
3. Reuters. (2023, May 31). Argentina's Vaca Muerta Could Pump 1 Million Barrels Per Day of Crude by 2030, Rystad Says.
4. Bloomberg LP. Data as of October 16, 2024.