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# First thoughts about the Caputo Program

## Mr. Caputo announces a set of emergency measures, not a stabilization program.

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**Mr. Caputo announced a set of 10 emergency measures ranging from fiscal consolidation, changes to the FX regime, and support to social security transfers.** In a taped speech, Mr. Caputo shared a set of 10 emergency measures that will cover the new Administration's first steps. The first six measures focus on cutting the primary deficit:

- i) The Government will not extend any labor contracts for personnel hired over the last year;
- ii) The Government declared a one-year moratorium on public sector ads and will stop financing media groups;
- iii) the new Cabinet will cut the number of ministries from 18 to 9 and the number of Secretaries from 106 to 54, which should lead to a 50% cut in political appointees and high-ranking officials;
- iv) nominal reduction of transfers to provinces;
- v) The Government will not issue new capex authorizations and will cancel any projects that haven't reached the execution stage and
- vi) nominal reductions in subsidies to energy and transportation.

The following set of measures involves two announcements amending the FX regime:

- vii) Devaluation of the official fixing to 800, with a transitory increase in the PAIS tax to imports and non-agri export taxes. After the emergency period, the Government plans to scrap all export taxes.
- viii) The Government will replace the SIRA import compression framework with a new monitoring and information system that will not require previous import permits.

The final two measures focus on compensating for the impact of the fiscal cuts and the relative price adjustments on the disposable income of the more vulnerable part of society.

- ix) The Government will maintain the welfare plans in nominal terms at 2023 levels but seek to decouple them from political organizations.
- x) The Government will double the payment on the Universal Child Allowance and increase the Food Stamps transfers by 50%.

**The fiscal prong of the program looks the most fleshed out, with discretionary savings potentially reaching 6.5pp of GDP.**

**The fiscal prong of the program looks the most fleshed out, with discretionary savings potentially reaching 6pp of GDP.** The fiscal announcements were mostly in line with the leaks, except for two surprises: Mr. Caputo said that the Government planned on "reducing" discretionary transfers and subsidies, as opposed to the market expectations that these outlays would be eliminated. We wouldn't delve too much into these semantics. Discretionary transfers were unlikely to disappear entirely, but any nominal cuts combined with 300%yoy running inflation could lead to 80-90% cuts in real terms. Likewise, we expect subsidy cuts to be substantial in real terms, though some subsidies are likely to remain concentrated on the most impoverished segments of the population. Still, assuming an 80% cut in real terms for both outlays, it would yield 2.1pp of GDP in savings (1.6pp from subsidies and 0.5pp from discretionary transfers). The announced cuts to capex could subtract an additional 1.4pp of GDP from the budget. The personnel cuts could contribute another half a percentage point of GDP. Finally, a large subset of politically driven welfare plans will be kept in line with the 2023 budget, diluting them considerably, adding an additional 0.5pp of GDP in savings, increasing spending cuts to 4.5pp of GDP before the welfare spending hikes. On the other hand, we estimate that the rebound in the grain harvest could contribute over 1pp of GDP to export tax revenue, while other tax hikes (like the PAIS tax) could add an additional 0.5pp, totaling 6pp of GDP in discretionary savings.

**Factoring in the recession and the impact of the additional social security spending, we estimate that the Government could attain a balanced primary position in 2024 but probably not a surplus.**

**Factoring in the recession and the impact of the additional social security spending, we estimate that the Government could attain a balanced primary position in 2024 but probably not a surplus.** Assuming a starting primary deficit of around 3pp of GDP, the discretionary savings included in the fiscal prong of the announcements should be more than enough to consolidate the primary position. The problem is that part of the discretionary savings will be diluted by i) the additional social security spending, and ii) the recession. Calculating the impact of the additional social security is complex. While the Government vowed to double the Child Allowance and increase food stamps by 50%, these nominal increases could drop below inflation pretty quickly. Assuming the indexation formula remains, the proposed hikes would keep social security spending roughly constant. In our view, however, the Government will likely add additional rounds of social security hikes in the coming months, probably adding about 0.5pp of GDP to the SocSec budget. The recession is a different matter. Though Mr. Milei has repeatedly argued that the program's anchor is the fiscal consolidation, the actual anchor is a massive recession. Past administrations have tried to compensate for relative price corrections or devaluations with additional fiscal impulse to contain the drop in disposable income. The Milei Administration plans on combining a devaluation, relative price corrections, and a massive fiscal consolidation. In this context, aggregate spending is likely to suffer substantially in 2024, hurting non-grain tax revenue. A conservative estimate of the lost revenue could total 1.5pp of GDP, enough to bring the primary position to zero, eliminating the deficit.

**The FX side of the program is less clearly defined, with some better-than-expected announcements, like the FX at USDARS800, but also some big questions lingering.**

**The FX side of the program is less clearly defined, with some better-than-expected announcements, like the FX at USDARS800, but also some big questions lingering.** Our biggest concern with the FX side of the announcements was that rumors suggested that the Government was considering under-shooting the FX to minimize the program's pass-through and inflationary impact in the early months. Rumors pointed to an initial deval around USDARS650 with a highly restricted FX market where the Government would subsidize some transactions (with what? Borrowed USD?) during the first six months, eventually leading to a second devaluation to a REER about 20% weaker than the initial level. This created a myriad of problems, of which the two more pressing would have been (i) the need to keep the peg roughly in line with inflation and (ii) the political cost of the second deval. The Government surprised with a higher-than-expected devaluation, announcing that it would weaken the official fixing to USDARS800. The additional cushion allows for a peg that lags behind inflation initially (which, in turn, would allow the decoupling of the real interest rate from the devaluation expectations adjusted interest rate). The higher-than-expected devaluation would drive initial inflation higher (our BVAR model suggests that inflation could accumulate almost 10pp more in 1Q24 than if the initial deval had only weakened the currency to USDARS650) but would considerably reduce the need for a second one-step REER correction in 2H24, increasing the likelihood of inflation collapsing in the second half of the year, anchored by the recession and the fiscal cuts.

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**On the other hand, the FX framework announcements were pretty light on the fine print, leaving questions regarding (i) the multiple FX framework, (ii) import arrears, and (iii) regulations regarding the BCS.** Minister Caputo's address covered the measures in broad strokes, with the fine print coming tomorrow with a set of decrees and BCRA regulations. We'll monitor the BCRA regulation to answer three big questions Mr. Caputo left unanswered. The first question is how the multiple FX framework will work. Minister Caputo talked about bringing the official fixing to USDARS800, but importers and exporters will face different rates. Importers will face USDARS800 plus 17.5% of the PAIS tax on imports, or USDARS940. On the other hand, importers will face an FX of USDARS800 minus export taxes (USDARS700-750?). In other words, through taxation, the Government announced the creation of differential trade rates, which could prove problematic. The second question focuses on the import arrears. We estimate that by the end of November, Mr. Massa accumulated about USD50bn in trade arrears, exceeding the ordinary USD20bn float. Minister Caputo announced that the Government planned on deregulating imports, scrapping permits, and replacing the SIRA framework, but does that mean that importers will be allowed to pay for the arrears at the USDARS800+tax FX rate? Or will they be rationed as expected? The trade arrears issue is critical because it's the other side of the Leliq problem. Finally, the third question is whether the new government plans on keeping the regulations segmenting the BCS market from the official fixing.

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