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TPCG ARGENTINA
STRATEGY VIEW

Argentina – Strategy
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The Milei Program. What we know so far.

- **IN THIS PIECE.** This is the second of a two-piece set looking into the scenario following the Primaries (see part one here), focusing on what a Milei Gov't would look like given what we know about his program. We review Mr. Milei's fiscal plan and the role of dollarization.

- **OUR KEY TAKEAWAYS.** The three key findings from our deep dive into the Libertarian program are that (i) Mr. Milei is probably overselling the magnitude of his fiscal consolidation; (ii) still, even a fiscal program like the one proposed by Mrs. Bullrich seems inconsistent with Mr. Milei maintaining the support of the bulk of his voters, especially if (iii) dollarization fails to successfully collapse inflation and compensate for the rest of the program's impact on the disposable income of the most vulnerable electorate. On the fiscal side, the Libertarian program proposes cutting 15pp GDP in spending in the 2024-27 term, a figure that looks unfeasible considering that (i) the entire Federal Government primary spending footprint is 20pp of GDP, and (ii) 55% of that (11.3pp of GDP) is social security spending, which Mr. Milei has vowed to ringfence. In 2024, attaining the 7pp of GDP in savings that Mr. Milei stated he would seek means cutting 76% of the budget not allocated to social security or interest payments. In this context, the market unsurprisingly expects the Libertarians to settle for a much less aggressive fiscal plan. Mr. Milei would fall extremely short of a majority in both houses of Congress, pushing the market towards pricing a diluted program in the vein of JxC's. In our view, however, the Libertarians could find implementing the JxC program challenging while keeping its electorate's support. Mrs. Bullrich could get away with this kind of program because her voters support this path. We're highly skeptical that Mr. Milei's voters would agree to this plan. With an electorate that's more left-leaning, vulnerable, and dependent on fiscal transfers, a program that could be consistent under Mrs. Bullrich is likely to have a steeper political cost under Mr. Milei. The inconsistency between Mr. Milei's electorate and his plan could put a Libertarian Administration on a trajectory we've seen recently in many Latam countries, where voters weary of the establishment shake things up, only to quickly fall out of love with their choices, thrashing their approval ratings. This is where dollarization enters the picture. Dollarization is Mr. Milei's instrument to compensate for the impact of his fiscal and deregulation program on disposable income. He's thinking about dollarization with a fiscalist approach: a collapse in the inflation tax could compensate for the cuts in fiscal transfers. To successfully attain this objective, dollarization needs to (i) be implemented quickly and (ii) avoid a substantial REER correction that would accelerate inflation initially. Of course, the objectives of (i) getting dollarization done quickly and (ii) preventing a large REER correction contradict. The problem of frontloading dollarization is that the BCRA, Treasury, and financial system's balance sheets are in no condition to undergo dollarization. The BCRA has negative dollar assets and USD74bn in local currency liabilities. In this context, Messers. Ocampo and Cachanosky's proposal offers a shortcut to dollarization without the pain, quickly gaining Mr. Milei's favor. They argue that rather than going through a costly REER correction, or a harmful restructuring, the Government could tap into the BCRA and the FGS's Treasury debt holdings to raise additional dollarized assets and rescue ARS liabilities. Mr. Ocampo's solution is no silver bullet. He's avoiding a REER correction or an ARS restructuring at the cost of ballooning hard currency debt. We remain skeptical of international creditors willing to lend Mr. Milei USD50-60bn to bail out ARS domestic savers. Even if they did, debt dynamics would look ugly post-dollarization.

- **STRATEGY IMPLICATIONS.** We remain comfortably MW, with a wait-and-see stance. The current scenario makes it challenging to take a directional view. We expect the combination of robust approval ratings with advances in the stabilization program to drive valuations, making an UW positioning unattractive. Still, after the first few months, things could go sideways, with inflation spiking due to the fiscal impulse increase that Mr. Massa is recklessly engaging in, falling demand for real money balances, and relative price corrections. Suppose Mr. Milei can't implement dollarization, in that case, we're likely to see his support plummet in early 2025. Eventually, Mr. Milei risks following former President Lasso's trajectory.

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The Milei Program. What we know so far.

An extremely aggressive program from a fiscal, trade, and deregulation POV. Could it be just what the doctor ordered?

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From what we've been able to collect, the Libertarian program is very different from the JxC stabilization plan, even though, at first sight, they might seem similar. Ultimately, both programs use similar building blocks to accomplish a very different objective. Over the past few weeks, we've seen the market go from being scared of Mr. Milei to becoming convinced that the Libertarians would end up implementing a program identical to the one proposed by JxC. While both programs share similar building blocks (fiscal consolidation, normalization of international trade, and deregulation), they mix these blocks very differently to achieve different objectives. For the JxC program, the ultimate objective is cyclical stabilization. Lowering inflation and restarting growth are JxC's main objectives, hoping to build a robust foundation to enable policy continuity past the next election cycle. Suppose the plan eventually succeeds in stabilizing the macro. In that case, JxC expects the conditions to materialize for deeper structural transformations without the risk of an angry electorate tearing all apart at the first possible occasion. The Libertarian program is, in many ways, the exact opposite. Its short-term objective is to forge the system anew and a make-or-break dash for the structural reforms upfront. In its platform, the Milei campaign states, "The only model that works to achieve sustained growth is Freedom: a capped State, free trade, and unyielding respect of private property." In this context, the fiscal consolidation and the deregulation that Mr. Milei seeks are substantially more aggressive than the ones proposed by JxC, as they are designed to drive a structural transformation rather than to stabilize the economy.

The fiscal program includes slashing 15pp of GDP in spending, mostly concentrated on deep cuts to opex, capex, subsidies, and discretionary transfers.

The fiscal program includes slashing 15pp of GDP in spending, mostly concentrated on deep cuts to opex, capex, subsidies, and discretionary transfers. Fiscal cuts are a recurring theme in the Libertarian campaign. Mr. Milei has stated that he plans to use a chainsaw to cut spending. The part of the consolidation that usually gets more attention is opex, where Mr. Milei vows to shutter 9 ministries and sack all of its political structures. The Cabinet currently has 20 ministries; Mr. Milei plans to keep just eight (Economy, Justice, Interior, Security, Defense, International Relationships, infrastructure, and fusion education, healthcare, and social security into a new Human Capital ministry). Another cluster of savings would come from offloading capex from the balance sheet by implementing a PPP framework. Finally, a Milei Administration would seek to cut subsidies to the private sector and discretionary transfers to provinces. In terms of timing, Libertarian spokespeople have gone on the record talking of a 7-8pp cut in year one, with the rest coming in the subsequent years.

Still, for such an ambitious plan to slender the national Government, it doesn't seem to be fully fleshed out as the math becomes fuzzy very quickly, especially in a context where Mr. Milei vows to keep social security spending untouched but to eliminate the intermediaries.

Still, for such an ambitious plan to slender the national Government, it doesn't seem to be fully fleshed out as the math becomes fuzzy very quickly, especially in a context where Mr. Milei vows to keep social security spending untouched but to eliminate the intermediaries. As of July 2023, the total footprint of the primary Federal Administration is 20.5pp of GDP, meaning that the Libertarian program would include cutting the Federal budget by one-third in the first year and by almost 75% over its four-year term. Let's look at the breakdown of that. 11.2pp is social security, 3.2pp is opex, 2.5pp is Subsidies, 1.8pp is capex, and finally, there's a 1.6pp split in three between discretionary transfers to provinces, SOEs deficit, and university budgets. In other words, the fiscal consolidation is extremely path-dependent. Mr. Milei has been adamant that his plan includes ringfencing social security benefits, concentrating his consolidation efforts on eliminating the intermediaries that organize social security beneficiaries politically. In a 20pp of GDP budget, with 11pp in social security benefits, there's no way to cut 15pp and ringfence benefits unless you substantially reduce the number of beneficiaries. The Libertarian program assumes that job creation and growth will reduce the number of beneficiaries, but the math doesn't check out even then. Of the 11.2pp in social security spending, 6.8pp are pensions, which are highly inflexible, especially after the Fernandez Administration has been diluting them via inflation down from an 8.7pp peak. Of the remaining 4.4pp, 1pp is the Universal Child Allowance (AUH by its Spanish acronym), 0.8pp is healthcare for older adults, and 0.7pp is disability benefits. In other words, 2.5pp is inflexible to the economic cycle. That leaves 1.9pp in benefits that could be cut if the economy does well. In other words, if you can only trim less than 2pp of social security spending, even bringing the rest of the budget to zero would not be enough to hit Mr. Milei's consolidation targets.

Figure 1: With the total footprint of the Federal Government at 20pp of GDP, cutting 15pp in spending looks unfeasible, especially without deep social security cuts.

	in pp of GDP		
	2016	2019	2023
Total outlays	**23.2%**	**18.6%**	**22.6%**
Primary spending	**21.7%**	**15.7%**	**20.5%**
Social Security	10.5%	9.5%	11.3%
Opex	3.8%	2.8%	3.3%
Subsidies	3.2%	1.3%	2.4%
Energy	2.3%	0.8%	1.9%
Transportation	0.9%	0.5%	0.5%
COVID & other	0.0%	0.0%	0.0%
Transfers to Provinces	0.8%	0.5%	0.6%
Capex	2.0%	0.9%	1.8%
Other	1.4%	0.7%	1.1%
Interest payments	1.4%	2.8%	2.1%

	in pp of GDP			
	2020	2021	2022	2023
Social Security	**15.0%**	**11.7%**	**11.4%**	**11.3%**
Cyclicaly inflexible	**12.0%**	**10.0%**	**9.6%**	**9.3%**
Pensions	8.7%	7.3%	6.9%	6.8%
Family and child allowances	1.4%	1.3%	1.2%	1.0%
INSSJP (Medicaid)	1.0%	0.7%	0.8%	0.8%
Disability pensions	0.9%	0.7%	0.7%	0.7%
Cyclicaly flexible	**3.0%**	**1.7%**	**1.8%**	**1.9%**
Unemployment and income supplements	3.0%	1.7%	1.8%	1.9%

Source: TPCG Research based on the Treasury

In the first consolidation stage, Mr. Milei seeks to cut 7 or 8pp of GDP in spending during 2024. His campaign focuses on opex cuts, but there's not enough discretionary savings there.

In the first consolidation stage, Mr. Milei seeks to cut 7 or 8pp of GDP in spending during 2024. His campaign focuses on opex cuts, but there's not enough discretionary savings there. According to the Libertarian platform, the fiscal consolidation would happen in two stages. The first stage would see the Government cutting 7 or 8pp over its first year. The second stage would shave the remaining 7 or 8pp between 2025 and 2027 to complete the 15pp in fiscal cuts. In his campaign, Mr. Milei is adamant that he'll make politicians pay for his fiscal consolidation (he hits a Trumpian note, reminiscent of a certain former US President claiming that his southern neighbor would pay for the wall he intended to build). In the Libertarian platform, Mr. Milei vows to fire every political appointee and shut down every ministry but 8. The problem is that the stability of public sector employment is enshrined constitutionally, and, more importantly, the Libertarian platform states that "this process necessarily means that many public sector employees will be redundant due to the shuttering of many ministries. […] We will not fire any of the career employees. They'll be reassigned to those areas where they're needed." With the total opex for the national Government stands at 3.3pp of GDP, of which 2.6pp is personnel spending, and the exceptions to the headcount cut will probably dilute opex savings considerably, the total savings would be moderate, even assuming that the Government can bring the rest of opex, non-related to personnel spending, to zero (which you probably can't).

Figure 2: In 2024, attaining the 7pp of GDP in savings that Mr. Milei stated he would seek means cutting 76% of the budget not allocated to social security or interest payments.

	in pp of GDP					
	Dec-19	Dec-20	Dec-21	Jun-22	Dec-22	Jul-23
Total outlays	**18.6%**	**26.2%**	**22.8%**	**22.9%**	**22.2%**	**22.6%**
Inflexible spending in the short term	**12.4%**	**17.0%**	**13.2%**	**13.4%**	**13.2%**	**13.4%**
Social Security	9.5%	15.0%	11.7%	11.9%	11.4%	11.3%
Interest payments	2.8%	2.0%	1.5%	1.4%	1.8%	2.1%
Flexible spending in the short term	**6.2%**	**9.2%**	**9.6%**	**9.6%**	**9.1%**	**9.2%**
Opex	2.8%	3.3%	3.3%	3.3%	3.1%	3.3%
Personnel spending	2.1%	2.6%	2.3%	2.3%	2.4%	2.6%
Other opex	0.7%	0.8%	1.0%	0.9%	0.7%	0.7%
Subsidies	1.3%	2.6%	3.0%	3.0%	2.6%	2.4%
Energy	0.8%	1.8%	2.3%	2.4%	2.0%	1.9%
Transportation	0.5%	0.7%	0.7%	0.6%	0.6%	0.5%
Transfers to Provinces	0.5%	1.2%	0.8%	0.8%	0.7%	0.6%
Capex	0.9%	1.0%	1.4%	1.4%	1.6%	1.8%
Universities	0.6%	0.8%	0.6%	0.6%	0.6%	0.7%
SOE deficit & Other	0.2%	0.3%	0.5%	0.5%	0.4%	0.4%

Source: TPCG Research based on the Treasury

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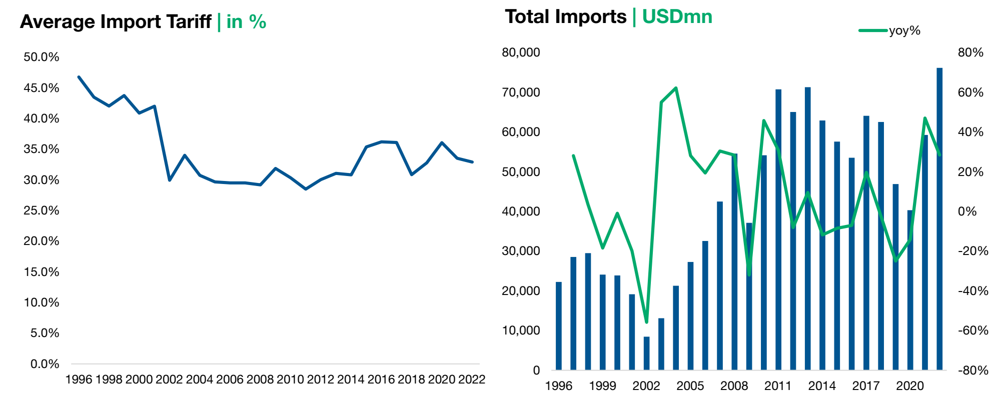
In this context, most of the initial discretionary savings would need to concentrate on Subsidies, transfers to provinces, capex, university budgets, and SOE deficit. With social security ringfenced and operational spending unlikely to contribute the savings that Mr. Milei seeks. What's left only amounts to 6pp, not enough to hit the 7-to-8pp consolidation target. The Libertarian Administration could phase out subsidies quickly. The SOE deficit and the Universities' budget are a tougher proposition from a political point of view. Mr. Milei has vowed to bring those outlays to zero, but he's likely to take a ton of flak for it. Even then, cutting that spending (1.1pp of GDP) to zero won't happen overnight. Capex amounts to 1.8pp of GDP; Mr. Milei presumes that most of that is a mix of graft and unnecessary works. Some, like school, hospital, and road maintenance, could be neglected for some time, but energy projects are likely to continue until they find a private sponsor. What's left is discretionary transfers to provinces, where the Milei campaign has sent mixed signals. On the one hand, Mr. Milei has been adamant about eliminating them. Still, some of his fellow candidates, like Mrs. Pagano, argued yesterday that a Milei Administration could continue to resort to them as a mechanism to discipline Governors and secure their caucuses' support in Congress. All in all, by ringfencing social security and using transfers to provinces politically, the Libertarians seem to be learning how to play the game fast. Of course, that means that the fiscal program is likely to be substantially less aggressive than what Mr. Milei boasts.

The Milei program is also substantially more aggressive than the JxC plan regarding deregulation, especially in privatizations and international trade.

The Milei program is also substantially more aggressive than the JxC plan regarding deregulation, especially in privatizations and international trade. Besides the fiscal consolidation, the Libertarian platform stands on substantial deregulation, particularly of the labor market, privatization of every public service, including schooling and healthcare, and a unilateral drop of every tariff and non-tariff barrier to international trade. The labor reform is part of the deregulation program that resembles Mrs. Bullrich's the most, introducing a new unemployment insurance that replaces severance pay in the vein of the system regulating construction workers and cutting payroll contributions, seeking to increase the incentives to hire and eventually reduce the welfare bill. Both plans diverge in the Libertarians' intent to deregulate public services. Mr. Milei seeks to stop public procurement of basic schooling and healthcare services. His proposal favors shifting public schools and hospitals towards private management and having the Government subsidize the cost of the services for the more vulnerable population. Mr. Milei's platform also includes shuttering SOEs like Aerolineas Argentinas or collateralizing the Government's stake in companies like YPF. The more aggressive part of Mr. Milei's program involves a liberalization of international trade. The average tax protection to local value added in Argentina has averaged about 35% over the past eight years (measured as the total revenue raised from tariffs, VAT, and internal taxes on imports divided by total imports). REER corrections like those in 2002, 2016, and 2018-19 tend to increase the effective protection, lowering imports, periods where the introduction of capital controls leads to a sizeable gap between the official fixing and the parallel FX, which dilutes effective protection is consistent with large spikes in imports. Mr. Milei's proposal to drop tariff and non-tariff barriers would result in a significant drop in effective protection (especially if the dollarization happens at the market rate, capping the REER correction) to a low-productivity economy that's been used to being tightly locked up. The sudden change would likely hurt import substitution industries, which are labor-intensive.

Figure 3: The Argy economy is used to working with an elevated effective protection. The Libertarian plan includes removing it.



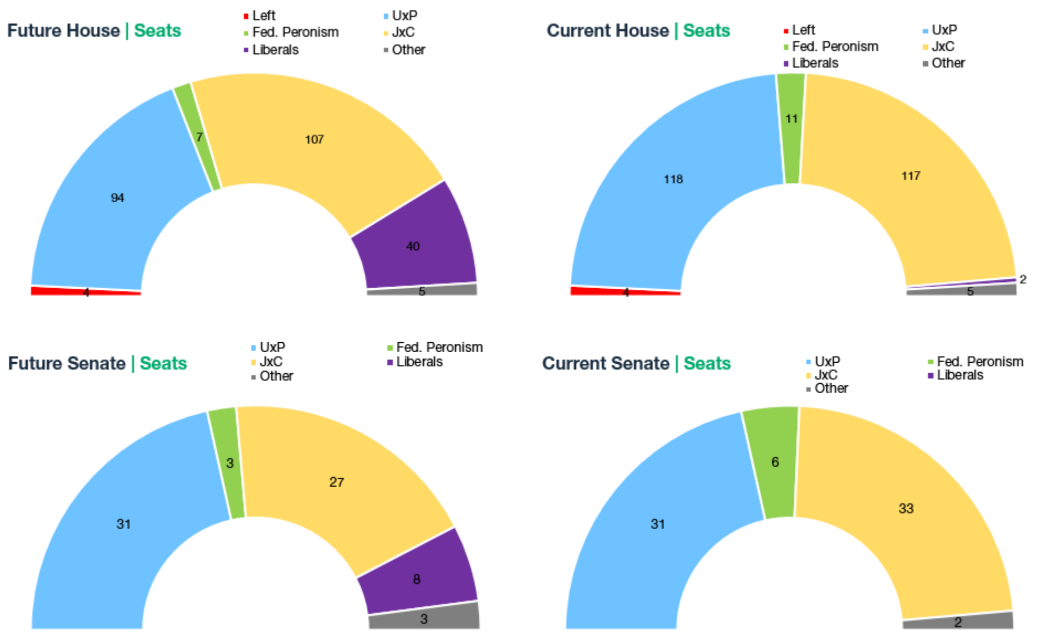
Source: TPCG Research based on the Indec

Is the Libertarian program feasible? Two political constraints work against it: Congress distribution and Mr. Milei's electorate.

The market consensus assumes that Mr. Milei's weakness in Congress will make his program unfeasible. Repeating the PASO result, the Libertarian caucuses in Congress would be less than a third of what would be required to get anything passed.

The market consensus assumes that Mr. Milei's weakness in Congress will make his program unfeasible. Repeating the PASO result, the Libertarian caucuses in Congress would be less than a third of what would be required to get anything passed. In our many talks since the August 13th election, we haven't found a single creditor who expects Mr. Milei to be able to pass his aggressive agenda of reforms. By design, the Argy Congress is extremely sluggish to refresh and react to electorate swings. In any given election, half of the House and a third of the Senate are up for grabs, meaning that building a majority in Congress takes at least three electoral cycles, assuming the party can win all three with a majority vote. JxC never had a shot at building a majority, especially in the Senate. Mr. Milei's party is new, with a slim performance in the 2021 mid-terms. Even a blowup win with over 50% of the vote in October would still leave him short of a majority. Currently, the Libertarians have only two seats in Congress, Mr. Milei and his VP, Mrs. Villarruel. Assuming a repeat of the August 13th election, the Libertarian caucus in the House would grow to 40 seats, as the JxC caucus drops from 117 to 107 and the Peronists from 118 to 94. In the Senate, the Libertarians would gain 8 seats, up from having no representation today. JxC would drop from 33 to 27, and Peronism would remain at 31. In other words, Mr. Milei would control less than one-third of the seats required to build a majority in Congress (129 seats in the House, 37 in the Senate), which means he has no chance of passing his reforms without a substantial amount of horsetrading with the remaining political parties.

Figure 4: The Libertarian caucuses would fall very short of the 129 seats required to control the House or the 37 seats to build a majority in the Senate.



Source: TPCG Research based on the Interior Ministry and TSE

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The consensus expects Mr. Milei to seek an alliance with JxC, diluting his program until it becomes Mrs. Bullrich's to ensure a Congressional majority. Surprisingly, the market has gone from fear of Mr. Milei to rationalizing his rise. Creditors expect Mr. Milei to seek an alliance with JxC to build a Congressional majority and confront Peronism. Assuming that passing the Libertarian platform as is, the consensus expects Mr. Milei to dilute his program, effectively watering it down to something that resembles Mrs. Bullrich's. Mr. Milei has an advantage there. His program is aggressive enough to still be extremely attractive to the market even after a substantial dilution. If the math of an upfront 8pp fiscal consolidation doesn't add up, the Government could still shoot for 4pp of GDP in cuts to subsidies, SOE deficit, and transfers to provinces, as the JxC economic teams propose. Both JxC and Mr. Milei offer a similar labor reform. Their conviction that social security needs reforming is similar. In that context, creditors expect both programs to fuse into a workable agenda supported by the center-right, which, in their view, secured more than 50% of the vote. In other words, the market consensus expects the next Administration to implement something that resembles the JxC program, either because Mrs. Bullrich wins or because Mr. Milei waters down his to ensure reforms pass through Congress.

In our view, the consensus glosses over some of the more complex political dynamics inside JxC. An alliance between the Libertarians and JxC would fail to yield a Congressional majority. In that scenario, Juntos will likely crack, with Pro joining Mr. Milei, while the UCR and CC remain in opposition.

In our view, the consensus glosses over some of the more complex political dynamics inside JxC. An alliance between the Libertarians and JxC would fail to yield a Congressional majority. In that scenario, Juntos will likely crack, with Pro joining Mr. Milei, while the UCR and CC remain in opposition. The Fernandez Administration's biggest failure (and boy, is its failure ledger an extensive one) is that JxC managed to stay unified despite spending four years in opposition. JxC has always been an unstable construct, ranging from the left-leaning CC to the centrist UCR and finally the right-leaning Pro. The three parties have had their frictions, but eventually, the looming threat of Kirchnerism pushed them to find ways to coexist. The rise of the Libertarians and the weakening of Peronism has stressed the internal JxC tensions to an extent where a breakup if Mrs. Bullrich doesn't win the election seems likely. The market assumes that Mr. Milei would add to his tally the 90-110 seats that JxC is expected to control in the next session of Congress. If JxC breaks up, Mr. Milei's affinity with President Macri could potentially add Pro's 40 representatives and seven senators to the Libertarian caucus. In other words, Mr. Milei would have a caucus of about 90 representatives and 15 senators, similar to the one Mr. Macri had when he was inaugurated in 2015. The rest of the JxC caucus, including the UCR, CC, and the JxC Peronist allies, would probably form a center coalition, independent of a Milei administration. If we organize lawmakers by ideological affinity, the median seat (the majority vote) would lie at the center of that caucus, on the more progressive wing of the UCR in representatives and the Peronist allies in the Senate. Still, the Congressional math is not our key concern, while a part of Peronism might barricade themselves into a harsh opposition, most of the political spectrum is likely to collaborate, at least initially, to get Mr. Milei's program going.

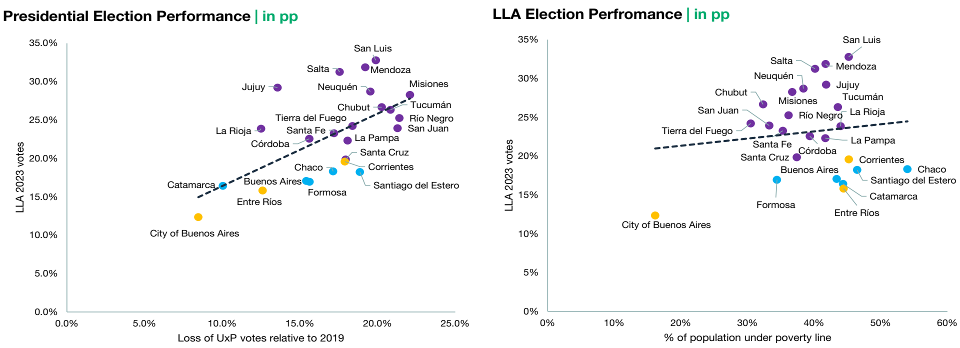
Figure 5: Composition of Congress following a JxC breakup

Source: TPCG Research based on the Interior Ministry and TSE

The biggest political problem is that Mr. Milei's electorate is the most vulnerable to the consequences of the Libertarian program of fiscal cuts and deregulation, creating an inconsistency between the plan and its voters.

The biggest political problem is that Mr. Milei's electorate is the most vulnerable to the consequences of the Libertarian program of fiscal cuts and deregulation, creating an inconsistency between the plan and its voters. In our latest piece (please see here), we did a deep dive into Mr. Milei's electorate and found that Mr. Milei's gains concentrated linearly in those districts where Peronism did worse. Mr. Milei won in the 18 provinces where Peronism lost at least 15pp relative to the 2019 Primaries and did better in the poorer provinces. In other words, contrary to what we expected before the primaries, Mr. Milei's electorate overlaps with that of Peronism rather than with JxC's. This creates a political problem. The market assumes that Mr. Milei is likely to moderate his program into something that resembles Mrs. Bullrich's. Our math suggests that a 4pp of GDP fiscal cut in year one may be feasible and could pass through Congress. An easing of trade restrictions depends only on the Executive's willingness. The more disruptive parts of the program, including privatizing schooling and healthcare or an aggressive reform to deregulate the labor market, would probably not make it through Congress. Mrs. Bullrich could get away with this kind of program because her voters support this path. We're highly skeptical that Mr. Milei's voters would agree to this plan. With an electorate that's more left-leaning, vulnerable, and dependent on fiscal transfers, a program that could be consistent under Mrs. Bullrich is likely to have a steeper political cost under Mr. Milei.

Figure 6: The elevated correlation between Mr. Milei's votes, Peronism's losses, and social vulnerability indices question whether he could even implement a program like JxC's politically.



Source: TPCG Research based on the Interior Ministry, Indec and TSE

A sudden drop in voter support could end up putting the Milei Administration in a tough spot like we've seen in Ecuador with President Lasso, especially if the Libertarians plan on resorting to referendums.

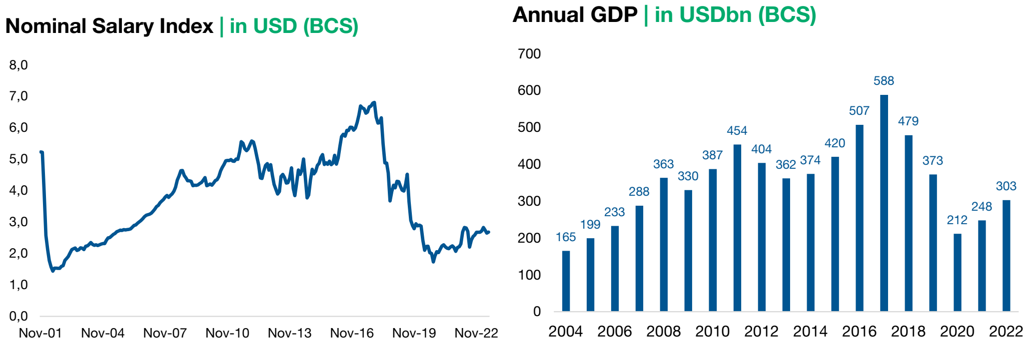
A sudden drop in voter support could end up putting the Milei Administration in a tough spot like we've seen in Ecuador with President Lasso, especially if the Libertarians plan on resorting to referendums. The inconsistency between Mr. Milei's electorate and his plan (or even the plan he might end up implementing) could put a Libertarian Administration on a trajectory we've seen recently in many Latam countries. Voters weary of the establishment shake things up, only to quickly realize their chosen isn't what they wanted. The list includes Messers. Castillo (Perú), Lasso (Ecuador), Boric (Chile), and Petro (Colombia), all of whom were elected to materialize a regime change, but voters quickly fell out of love with them, thrashing their approval ratings and, in the case of the first two, leading to their ousting. That's where we believe the current consensus view, expecting Mr. Milei to moderate and implement a program in the vein of Mrs. Bullrich's, misses the mark. Mrs. Bullrich's electorate would support Mr. Melconian's program, giving a JxC Administration a dependable base of about 30% of voters, like the one that kept the last three Administrations running long after their power had diluted. Mr. Milei's electorate is likely to prove more voluble. Even a 4-5pp of GDP fiscal consolidation is likely to require large cuts into the programs on which Mr. Milei's electorate depends. The Libertarian congressional weakness compounds with the inconsistency in its voters. To get his reforms passed, Mr. Milei will need support from the traditional parties, which could work with him as long as he has voters on his side. The alternative Mr. Milei has signaled, relying on referendums to push Congress, is hardly better. The Argy system is designed to discourage referendums by nerfing them as a tool to circumvent Congress. Any binding proposal requires Congress to call on a vote. The President can put up a question, but it wouldn't be binding. In this context, the benefit of calling for a referendum is low (at best it would put some pressure on Congress), and the risk is enormous. If the electorate rejects the proposal, it would signal to the rest of the political arch that Mr. Milei has lost his only asset: voters. All in all, to keep his Administration stable, Mr. Milei needs to find a way to shield his voters from the effects of his fiscal and deregulation plans.

Enter the dollarization, the Libertarian program's consistency instrument

In our view, the Libertarian program depends on dollarization to make its fiscal consolidation and deregulation plans consistent with its electorate.

In our view, the Libertarian program depends on dollarization to make its fiscal consolidation and deregulation plans consistent with its electorate. We're on page seven of a piece about Mr. Milei's economic program, and you're probably asking how come we haven't even mentioned his landmark policy proposal, dollarization. Mr. Milei's dollarization proposal is confounding in many different aspects. The first question that one should answer is whether dollarization is a policy in the Libertarian program or a campaign ruse. From a campaign point of view, the proposal has been highly successful. Over the past six years, wages and income have deteriorated in dollar terms by about 50 to 60%. In this context, it's unsurprising how many low-income voters support an alternative that staves further deterioration of real incomes. The case for dollarization to be disregarded as a campaign ploy is strong. Mr. Milei has pandered from promising to dollarize as soon as possible to calling it a 3rd generation reform (what's gen 1 and 2? Your guess is as good as mine) to downplaying it and arguing that he has alternative plans to dollarization and, more recently, claiming that he would like to seek to dollarize by the 2025 mid-terms. In other words, the sequencing of the dollarization is unclear, at the very least. If rammed at the beginning of his term, with the Treasury and the BCRA balance sheets unprepared, the risk is that the available hard currency to ARS liabilities ratio could require a disruptive REER correction to dollarize. If done much later, as an endgame once the economy is stabilized, what is it good for? Once the stability program is successful and inflation normalizes, why wouldn't the Government enter an IT framework like the rest of the normal countries in the world rather than resort to an extremely rigid framework with more costs than benefits once the macro is stabilized? These uncertainties drive the view that dollarization is like bubble gum: something you ought to chew but not swallow. Still, from the extensive interviews that Mr. Milei and his team have sat through, we believe that such a view misses the mark and that dollarization is critical to making the Libertarian program palatable to Mr. Milei's electorate.

Figure 7: In dollar terms, wages have dropped by 60% since 2017, and GDP is down by 50%. Unsurprisingly, voters opted for a proposal that promises to stave further deterioration.



Source: TPCG Research based on the Indec

Dollarization is Mr. Milei's instrument to compensate for the impact of his fiscal and deregulation program on disposable income. He's thinking about dollarization with a fiscalist approach: a collapse in the inflation tax could compensate for the cuts in fiscal transfers.

Dollarization is Mr. Milei's instrument to compensate for the impact of his fiscal and deregulation program on disposable income. He's thinking about dollarization with a fiscalist approach: a collapse in the inflation tax could compensate for the cuts in fiscal transfers. In our view, dollarization is Mr. Milei's silver bullet to make his program palatable to his electorate. His fiscal consolidation plan, even in a diluted version, is likely to make steep cuts into the programs that his voters' disposable income rely on. Moreover, his deregulation plans are likely to leave many of the labor-intensive sectors in Argentina, which depend on elevated levels of effective protection and employ many of Mr. Miei's voters, vulnerable. In Mr. Milei's mind, dollarization could offset the hit to his voters' disposable income. One way to make the Libertarian program neutral to aggregate spending would be to compensate the discretionary savings from the fiscal transfers that the Milei Administration proposes with a steep drop in taxation. In other words, the Government stops putting money into voters' pockets but reduces the amount it takes from them as well. Of course, because Mr. Milei's electorate is heavily slanted toward the more vulnerable population clusters, the only relevant tax that the Government could cut to offset the impact of its proposed fiscal consolidation is the inflation tax. Over the past 12 months, the Fernandez Administration raised over ARS17tn, or 9.2pp of GDP in inflation tax on the private sector broad money balances, part of which was used to finance the fiscal deficit, though most to pay for the interest on the BCRA debt. In our view, Mr. Milei's fixation with dollarization is that, like in the early 90s, this regime would allow him to quickly collapse the inflation rate, boosting disposable income by cutting the inflation tax. Considering how regressive the inflation tax is, Mr. Milei expects most of the relief to fall on the most vulnerable families, those likely to suffer disproportionately the impact of his fiscal cuts and his deregulation program. In other words, in an Excel spreadsheet, a collapse in inflation could make the Liberatian program fiscal-neutral on Mr Milei's electorate.

Figure 8: Collapsing the inflation tax revenue could compensate for the impact of the Libertarian program on aggregate spending.

	ARSmn
Sept-23 Real Money Balances (in Jan-03 prices)	103.650
Sept-23 Nominal Money Balances	31.538.934
Sept-22 Nominal Money Balances w/ Sept-23 Real money balances	14.439.742
Inflation Tax yoy	**17.099.192**
as % of GDP	**9,2%**

Source: TPCG Research based on the BCRA

Suppose the objective of dollarization is to collapse the inflation tax and compensate for the negative impact of the rest of the Libertarian project. In that case, it needs to (i) be implemented quickly and (ii) avoid a substantial REER correction that would accelerate inflation initially.

Suppose the objective of dollarization is to collapse the inflation tax and compensate for the negative impact of the rest of the Libertarian project. In that case, it needs to (i) be implemented quickly and (ii) avoid a substantial REER correction that would accelerate inflation initially. There's a lot of discussion about the sequencing of dollarization. Everyone seems to agree that it's not part of the policy package that will be sent to Congress on December 10th. Everyone seems to agree that fiscal consolidation comes first. But after that, the timeline starts becoming more diffuse. Mr. Milei and his team have been vague with the timeframe, with people like Mr. Ocampo arguing that it should be ASAP and people like Mr. Carlos Rodriguez and Mrs. Mondino arguing that it should happen once every other structural reform is already in place. Part of the problem is semantics. We can all agree on what day one means, but "in the medium term" is tougher to put on a calendar, as it means different things to different people. Mr. Milei chimed in this week, saying he expects to dollarize before the 2025 mid-terms. His timeframe is consistent with our view about the role of dollarization in the Libertarian program, as it would be consistent with a collapse in inflation before voters return to the polls in 3Q25. Of course, if dollarization is to successfully offset the impact of the fiscal and deregulation prongs of the program, the Libertarians need to avoid a disorderly REER correction that would spiral inflation initially and put Mr. Milei in dire straits with his voters.

The problem of frontloading dollarization is that the BCRA, Treasury, and financial system's balance sheets are in no condition to undergo dollarization. The BCRA has negative dollar assets and USD74bn in local currency liabilities.

The problem of frontloading dollarization is that the BCRA, Treasury, and financial system's balance sheets are in no condition to undergo dollarization. The BCRA has negative dollar assets and USD74bn in local currency liabilities. Of course, the objectives of (i) getting dollarization done quickly and (ii) preventing a large REER correction contradict. Net reserves are negative in a context where hard currency liabilities accumulate almost USD40bn and gross reserves stand just above USD27bn, leaving zero firepower to rescue the USD74bn in ARS liabilities that the BCRA has issued (USD18.9 in high-powered money and USD55.9 in interest-bearing liabilities). Like Mr. Milei's fiscal plan, his monetary plan has a problem with arithmetics. If you need to rescue any positive ARS liabilities (let alone one of the highest levels in history) with zero dollar assets, the breakeven FX tends to infinity. The financial system's balance sheet is not much better. With a massive fiscal deficit and zero international credit, Mr. Fernandez's Administration has unabashedly abused monetary financing over the past four years. Aware that capital controls wouldn't be enough to contain the flotsam of the money printing, the Government maintained an aggressive policy of parking public sector liabilities in the banks' balance sheets either to finance the primary deficit or to sterilize, crowding out private lending almost entirely. The exposure to the public sector, including Leliqs, stands at 68% of deposits. In other words, exposure to the public sector is systemic. Successfully dollarizing the private sector's balance sheet depends critically on rescuing not only the BCRA's liabilities but also the Treasury's ARS instruments held by banks, meaning that the Milei Administration would need the USD74bn in ARS liabilities, plus about USD20bn in ARS Treasury debt, putting the bill at around USD94bn.

Figure 9: Neither the BCRA's nor the banks' balance sheets look resilient to dollarization without a substantial REER correction.

BCRA Balance Sheet (in USDmn)			
Assets	**166.829**	**Liabilties**	**139.741**
in Hard Currency	**41.142**	**in Hard Currency**	**39.450**
Gross International Reserves	27.818	Reserve Requirements	9.349
Public securities in foreign currency	13.324	Government deposits in foreign currency	6.569
		BCRA securities in foreign currency	2.032
in ARS	**99.842**	PBOC Swap	18.000
Public securities in local currency	88.153	BIS Repo	3.500
Adelantos Transitorios	11.688		
		in ARS	**74.823**
Rest	**25.845**	Monetary Base	18.919
		BCRA securities in local currency	55.904
		Rest	**25.468**
		Equity	**27.088**

Financial System Balance Sheet (in USDmn)			
Assets	**205.814**	**Liabilities**	**171.100**
Reserve Requirements	**17.145**		
in Hard Currency	**21.494**	**in Hard Currency**	**18.785**
Cash	4.238	Deposits	17.789
Credit in foreign currency	4.178	Private Sector	15.291
Private Sector	3.983	Public Sector	2.497
Public Sector	195	Bond Issuances	996
Securities in foreign currency	13.078		
Private Sector	442		
Public Sector	12.636		
in ARS	**120.303**	**in ARS**	**113.170**
Cash	2.107	Deposits	113.170
Credit in local currency	39.744	Private Sector	90.411
Private Sector	39.226	Public Sector	22.759
Public Sector	519		
Securities in local currency	78.452		
Private Sector	2.457		
Public Sector	75.994		
o/w LELIQs	44.758		
Rest	**46.873**	**Rest**	**39.145**
		Equity	**34.715**

Source: TPCG Research based on the BCRA

Restructuring the Treasury's and BCRA's ARS liabilities would be one way to implement dollarization before the 2025 mid-terms without a massive REER correction, albeit with much pain. Given the banks' exposure to the public sector, such a restructuring would need a deposit restructuring to keep the financial system running.

Restructuring the Treasury's and BCRA's ARS liabilities would be one way to implement dollarization before the 2025 mid-terms without a massive REER correction, albeit with much pain. Given the banks' exposure to the public sector, such a restructuring would need a deposit restructuring to keep the financial system running. Over the past few weeks, we've seen many creditors looking deeply into the early 1991 trajectory that led to the introduction of the Convertibilidad currency board. While we agree that the early 1990s are a useful template to explore when building a view about the challenges involving dollarization, we believe that the market should be looking at the 1990 Bonex plan before studying the Convertibilidad. While Mr. Milei promises to dollarize at the market rate, economists from the rest of the political arc estimate that it would need to take place at a significantly weaker rate, with figures ranging from USDARS1,500 to USDARS10,000. Ultimately, it's a pointless discussion. Without a plan to deal with the BCRA's liabilities (and the Treasury's ARS debt, if we're at it), there's no way to estimate the dollarization breakeven. The Menem Administration faced a similar problem in the early 1990s. The need to keep real rates positive to prevent money demand from collapsing in the face of accelerating inflation made the quasi-fiscal deficit unsustainable, requiring an amount of money printing to cover it that created a hellish loop similar to the one in which the BCRA is currently trapped. The solution back then was to restructure the entire local currency space (I'm not even sure what the ISO code for the old Austral is or if it ever existed), turning public sector liabilities that were immediately due into long-term Treasury securities that didn't require unsustainably high-real rates to rollover daily. Of course, the move from zero-duration securities at positive real rates to long-term paper at negative rates meant that banks couldn't honor their CDs in the terms they had committed to. The 1990 Bonex plan was an attempt to keep the financial system running in the transition, suspending deposit convertibility and allowing banks to restructure their liabilities and offer holders of CDs a PIK, swapping them for the Treasury paper that banks had received. While money demand suffered due to the Bonex plan (suspending deposit convertibility and offering savers illiquid Treasury debt in exchange for their CDs hardly encourages keeping real money balances), money supply plummeted faster, capping the hyper-inflationary spike associated with cleaning up the BCRA's balance sheet. Recently, Mr. Carlos Rodriguez, one of Mr. Milei's top advisers and a veteran of the Menem Administration, argued that frontloading dollarization could require something in the vein of the Bonex plan to reset the board and re-balance the extremely skewed ratio between ARS liabilities and USD assets.

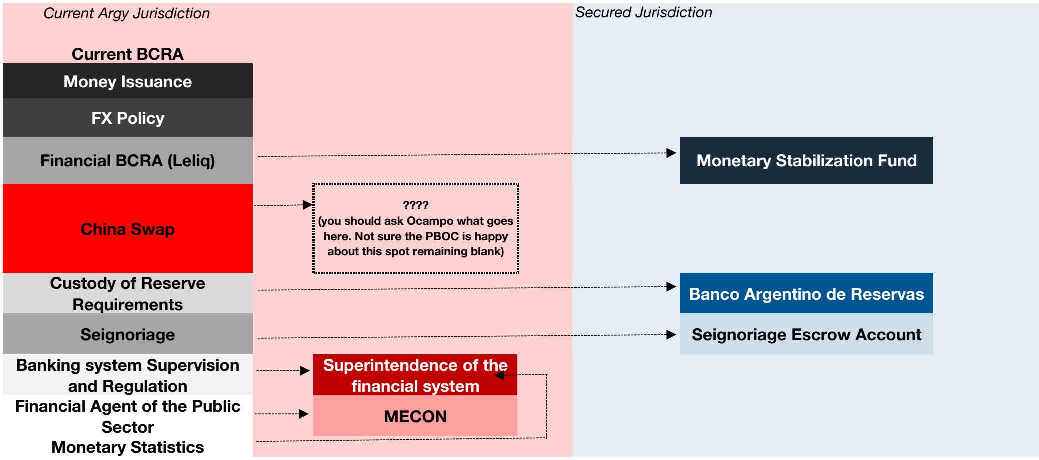
In this context, Messers. Ocampo and Cachanosky's proposal offers a shortcut to dollarization without the pain, quickly gaining Mr. Milei's favor. They argue that rather than going through a costly REER correction, or a harmful

In this context, Messers. Ocampo and Cachanosky's proposal offers a shortcut to dollarization without the pain, quickly gaining Mr. Milei's favor. They argue that rather than going through a costly REER correction, or a harmful restructuring, the Government could tap into the BCRA and the FGS's Treasury debt holdings to raise additional dollarized assets and rescue ARS liabilities. Mr. Milei keeps saying he has five different plans to dollarize the economy. Still, the one he seems to favor is Mr. Ocampo's, going as far as suggesting that he would seek to appoint him as the last BCRA governor. Mr. Ocampo's proposal offers a shortcut to dollarizing without going through a REER correction or restructuring the ARS space by designing an intriguing mechanism to lever the BCRA's hard currency balance sheet, giving the Central Bank

restructuring, the Government could tap into the BCRA and the FGS's Treasury debt holdings to raise additional dollarized assets and rescue ARS liabilities.

enough firepower to dollarize at the market rate. Mr. Ocampo argues that while the BCRA has almost no reserves, it holds tons of Treasury paper, which could be sold to increase liquidity. As of its latest balance sheet, the Treasury owes the BCRA USD113bn in notional, including USD13.3bn in hard currency debt, USD11.2bn in short-term, zero-interest bearing ARS loans, and USD88.1bn in ARS securities. Normally, we don't count these assets when we look at the BCRA's firepower because they are mostly toilet paper. The BCRA holds USD65bn in notional of non-transferrable 10-year bills that pay almost no interest and another USD11.2bn in zero-interest bearing ARS loans that mask grants to the Treasury rather than lending. Mr. Ocampo proposes swapping all of these for market debt, putting them into a NY-law SPV, tagging an IFI warranty, and selling CDOs from the SPV. In other words, Mr. Ocampo proposes the BCRA's resolution, trying to eke as much money as possible from every asset in the CenBank's balance sheet to repay creditors. He believes that the Government could raise enough hard currency from selling CDOs to rescue the BCRA's ARS liabilities with USD, which would then spill over to banks having enough firepower to swap ARS deposits for USD deposits cascading into a full dollarization. In this context, the BCRA would break into three: (i) the SPV holding the assets from which creditors of the CDOs would collect their payments, the Monetary Stabilization Fund, which he expects could be wound down in five years after the CDOs mature, (ii) the Banco Argentino de Reservas, which would hold any net reserves that the BCRA accumulates and the reserve requirements in a secured offshore SPV (much like dollar reserve requirements were kept during the Convertibilidad in the 1990s), and (iii) a financial system comptroller as the banks' regulator.

Figure 10: Diagram of the BCRA resolution mechanism under the Ocampo-Cachanosky proposal.



Source: TPCG Research based on Mr. Ocampo's proposed dollarization plan.

By tiering the BCRA's balance sheet, Mr. Ocampo estimates that his SPV would need to raise between USD53bn and USD60bn in CDO selling to rescue the BCRA liabilities successfully.

By tiering the BCRA's balance sheet, Mr. Ocampo estimates that his SPV would need to raise between USD53bn and USD60bn in CDO selling to rescue the BCRA liabilities successfully. Mr. Ocampo recalculates the BCRA's balance sheet consolidated with that of the financial system, pricing all securities at market prices instead of using the nominal valuation currently employed by the BCRA. At market value, he estimates that the net equity of the CenBank turns negative, from a positive figure according to official calculations, to something between -USD8bn and -USD15bn, depending on the aggressiveness of the discount factor used to price the BCRA's assets. To dollarize the economy, Mr. Ocampo proposes to recapitalize the Central Bank and offers a strategy to finance each of the BCRA's liabilities. Under his definition of Freely Available International Reserves, the BCRA counts with nearly USD20.8bn to rescue its ARS liabilities at the BCS rate. He argues that these reserves should be enough to exchange all the ARS currency in circulation (USD9.1bn) and to rescue the existing ARS and foreign currency deposits in banks (USD11.65bn) under the first and second systems, respectively. Then, to pay for the remaining BCRA liabilities, including BCRA issuances (Leliqs) and public sector and other deposits, totaling USD32bn, Mr. Ocampo would liquidate the existing BCRA assets, valued at USD46.6bn, mostly composed of the CenBank's public titles and advances to the national Government, leaving a USD14.6bn surplus under the third system. However, paying for the China swap (worth USD22.8bn) would leave the BCRA with a net equity of -USD8bn. In this context, Mr. Ocampo's BCRA recapitalization would require between USD53bn and USD60bn in the selling of

CDOs backed by the existing BCRA and FGS public securities to liquidate the financial BCRA liabilities and return the CenBank's net equity position to a positive/neutral level.

Figure 11: The Ocampo-Cachanosky BCRA/Treasury/Financial balance sheet dollarization proposal.

Freely Available International Reserves (FAIR)	**20787**
1st System (Swap)	**0**
Assets	
FAIR	9139
Liabilities	
Currency in circulation	9139
2nd System (Deposits)	**0**
Assets	
International Reserves 1st System	11649
Liabilities	
Deposits in ARS	2378
Deposits in USD and other foreign currency	9831
Third System (FEM)	**14615**
Assets	
FAIR	0
Credit to the Financial System	3
Rights from derivatives	1
Govt. Securities and advances to the national government	46604
Liabilities	
BCRA titles	32303
NFPS deposits	540
Other deposits	6
Liabilities from derivatives	42
Net liabilities from pases	-898
4th System (China Swap)	**-22849**
Fifth System (Other operations)	**847**
BCRA Net worth	**-7947**

Source: TPCG Research based on Mr. Ocampo's proposed dollarization plan.

Mr. Ocampo's solution is no silver bullet. He's avoiding a REER correction or an ARS restructuring at the cost of ballooning hard currency debt. Effectively, Mr. Ocampo would have the Government borrow from international creditors to rescue ARS domestic savers.

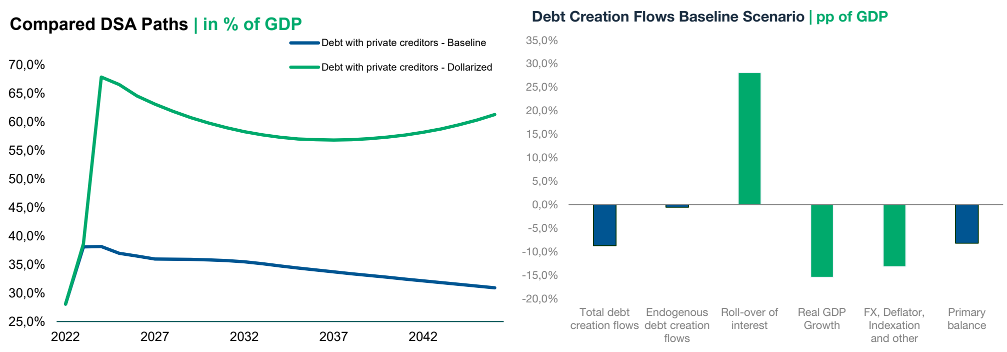
Mr. Ocampo's solution is no silver bullet. He's avoiding a REER correction or an ARS restructuring at the cost of ballooning hard currency debt. Effectively, Mr. Ocampo would have the Government borrow from international creditors to rescue ARS domestic savers. One of the first things every econ student is taught in college is that there is no free lunch. Mr. Ocampo's proposal fits the adage that if something sounds too good to be true, it usually is. From a political point of view, Mr. Ocampo's proposal is exactly what Mr. Milei needs: a way to collapse inflation before the mid-terms without going through a painful REER correction or deposit restructuring. Unsurprisingly, Mr. Milei adopted the plan warmly. There's just a small implementation detail: the entire plan boils down to borrowing over USD50bn from international creditors to bail out ARS holders. Raising that amount of money looks like a nightmare. For starters, the use of proceeds is unlikely to help the Republic's repayment capacity (more on this in the next paragraph). To raise USD50bn with a little over USD100bn in notional, Mr. Ocampo would need to sell the CDOs at about 50 cents, substantially increasing the average financing cost and derailing debt dynamics. This leads us to the second problem, finding demand at 50 cents. Creditors are currently reluctant to increase their exposures to Argy debt at 30 cents. The prospect of the Government dumping USD100bn in notional into the market is unlikely to make them keener into buying Treasury paper, much less bid it higher. Mr. Ocampo counters that (i) an IFI would guarantee the CDOs and (ii) the Milei Administration's reform agenda is likely to boost creditor confidence. We remain skeptical about the chances of any IFI being willing to put its own balance sheet behind USD100bn in Argy debt notional (it would rival the guarantees that the IMF and the ECB put in place to backstop the European Periphery debt crisis a decade ago). If the guarantees don't cover the entire notional, it means selling CDOs mixing tranches of fully secured debt, mezzanine claims, and unsecured flows. If Mr. Ocampo believes he can sell such a CDO as AAA security, he's 15 years late to the game. On the other hand, the boost to confidence also looks like a long shot. The recent meetings between LLA's economic team and international creditors highlighted that the consensus is worried about the stability of a Milei Administration and the risks to policy continuity. In other words, the market doesn't want to be sitting on an additional

USD100bn in Argy debt if Mr. Milei's Government fails and voters return Kirchnerism to power, like in 2019 or, more recently, what's happening in Ecuador.

Even if creditors bought the proposed SPV's CDOs, debt dynamics following dollarization would quickly come into question. The leverage ratio with private creditors would spike initially and fail to stabilize without an additional fiscal effort.

Even if creditors bought the proposed SPV's CDOs, debt dynamics following dollarization would quickly come into question. The leverage ratio with private creditors would spike initially and fail to stabilize without an additional fiscal effort. For all the problems in the Argy outlook, debt sustainability doesn't rank highly among our concerns. Total debt with private creditors stands at about 38pp of GDP, even after spiking almost 10pp in 2022 on the back of the crushing weight of indexed LCD. Still, EXD dynamics in the future seem favorable. Hard currency debt with private creditors is likely to end 2023 at around 25pp of GDP. It should remain stable over the next ten years under a moderate growth scenario, assuming the next Administration reaches a 1pp of GDP primary surplus. Under our baseline scenario, the leverage ratio should drop by 10pp of GDP over the next decade, mostly on the back of a fiscal consolidation. The contribution from endogenous debt creation flows to deleveraging should also contribute, albeit marginally, in a context where real GDP growth and the positive impact of a stabilization program are likely to offset the 2.7pp per annum in interest payments resulting from Mr. Guzman's cashflows. We estimate that dollarization is likely to skew these dynamics substantially for the worse. For starters, the initial selling of CDOs would almost double the debt held by private creditors. While it wouldn't change the overall leverage ratio, as it would imply transferring cross-holdings to private investors, it would put additional pressure on future rollover needs. Our baseline assumes that the BCRA and FGS's substantial holdings get rolled over automatically at negative real rates, preventing Argentina's almost 100% of GDP leverage ratio from spiralizing. Once this debt gets sold back to private creditors, the rollover would need to happen at market rates, increasing endogenous debt creation flows, especially in a context where dollarized economies tend to command wider spreads. On the other hand, dollarized economies tend to grow slower after the initial shock resulting from the disinflation. Combined, we estimate that these two dynamics will likely result in the leverage ratio spiking initially, easing along the economy's stabilization for the rest of the decade, but to begin growing again after 2035 due to slower growth and higher rollover costs. All in all, whereas moderate growth and a 1pp of GDP primary surplus would be enough to put debt on a downward trajectory in the coming years and to stabilize it by the early 2030s, our DSA model suggests that debt dynamics for a dollarized Argy economy would require a higher primary surplus to stabilize the leverage ratio.

Figure 12: Debt sustainability dynamics under a dollarized economy look less encouraging than under our baseline.



Source: TPCG Research based on the Treasury

Under a dollarized economy, the path to debt sustainability would shift from stabilizing the FX market to achieving a robust primary surplus. In our view, in the short run, achieving an external surplus is easier than a fiscal surplus.

Under a dollarized economy, the path to debt sustainability would shift from stabilizing the FX market to achieving a robust primary surplus. In our view, in the short run, achieving an external surplus is easier than a fiscal surplus. Part of our pre-PASO constructiveness in the Argy outlook was that we expected very encouraging FX market dynamics in 2024. The rebound in grain exports, plus the prospect of lower LNG imports and higher exports following the natural gas transportation network's expansion, should add around USD30bn to exports. That should allow the next Administration to normalize international trade arrears (which we estimate at around USD15bn) and still post a healthy 2pp of GDP current account surplus. Under our baseline, we expect a gradual easing of capital controls, which would keep many of the arrears in the income and the financial accounts trapped domestically, at least initially. In that context, a framework seeking to normalize the current account could cover most of the arrears while (i) gating the financial account outflows and (ii) initiating the process of rebuilding the NIR position without a traumatic correction. Under dollarization, the rationale would change considerably. The flows from the FX market would be less relevant, and the questions would move to the Treasury's GFNs and the fiscal consolidation. Our DSA for a dollarized economy suggests that it would require a 3.5-4pp of GDP primary surplus to put the leverage ratio on a consistent path. Mr. Milei would need to consolidate around 7pp of GDP, which seems politically unfeasible. In other words, the Argy policymaker would be changing a problem it can solve (normalizing the FX market) in 2024 for one that it can't solve (ramming a massive fiscal consolidation about twice as large as what looks feasible).

Figure 13: Stabilizing the FX market in 2024 is likely to prove easier than attaining a robust primary surplus.

	2022	2023f			2024
	CY	Jan-Jul	Aug-Dec	CY	CY
Current Account	**4.779**	**-6.417**	**-6.083**	**-12.500**	**8.200**
Trade Balance	21.817	3.569	1.431	5.000	24.200
Exports	90.533	39.570	26.930	66.500	94.200
Agri-flows	40.438	12.957	7.043	20.000	43.000
Energy exports (Indec)	8.398	4.385	3.915	8.300	9.200
Rest	41.697	22.228	15.972	38.200	42.000
Imports	-68.715	-36.001	-25.499	-61.500	-70.000
Energy imports (Indec)	-12.868	-5.514	-1.986	-7.500	-2.000
Rest	-55.847	-30.487	-23.513	-54.000	-53.000
Import arrears					-15.000
Services Balance	-10.106	-3.872	-4.128	-8.000	-6.000
Income Balance	-6.932	-6.113	-3.387	-9.500	-10.000
Capital & Financial account	**2.106**	**-13.971**	**4.006**	**-9.965**	**-3.725**
Retail dollarization	-779	-772	-28	-800	0
Non-residents net lending	-4.613	-2.247	-1.653	-3.900	-2.000
Treasury Net indebtness	7.857	-7.081	7.416	335	-1.725
IFIs	1.349	1.610	-610	1.000	0
Public sector dollarization	31	128	372	500	0
Net payments	-390	-843	1.843	1.000	-390
IMF	6.867	-7.976	5.811	-2.165	-1.335
Rest	-359	-3.871	-1.729	-5.600	0
Valuation effects	**-1.951**	**-117**	**117**	**0**	**0**
Change in reserves	**4.934**	**-20.505**	**-1.960**	**-22.465**	**4.475**

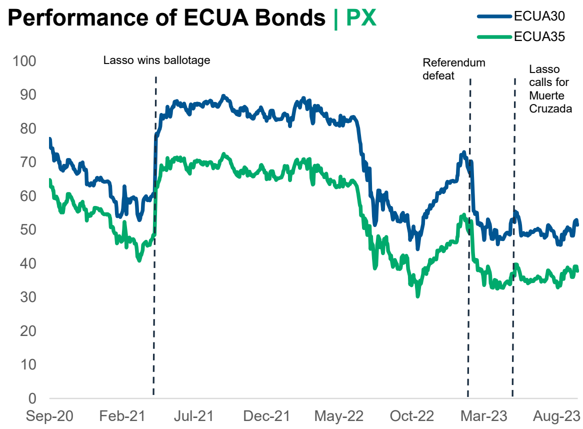
Source: TPCG Research based on the BCRA

Strategy: Directional positioning looks challenging. Prices might follow Ecuador's trajectory under Lasso.

The current scenario makes it challenging to take a directional view. The chances of Mr. Milei's program succeeding seem low, but its aggressive objectives will likely enthuse creditors, driving valuations initially.

The current scenario makes it challenging to take a directional view. The chances of Mr. Milei's program succeeding seem low, but its aggressive objectives will likely enthuse creditors, driving valuations initially. The three key findings from our deep dive into the Libertarian program are that (i) Mr. Milei is probably overselling the magnitude of his fiscal consolidation; (ii) still, even a fiscal program like the one proposed by Mrs. Bullrich seems inconsistent with Mr. Milei maintaining the support of the bulk of his voters, especially if (iii) dollarization fails to successfully collapse inflation and compensate for the rest of the program's impact on the disposable income of the most vulnerable electorate. This outlook makes positioning extremely challenging. Overall, it's an unconstructive narrative that pushes us to take a more protective approach. Still, we have few doubts that Mr. Milei will come out swinging with his fiscal cuts and reform plans. The market is going to like what they see in the early months. The primary deficit is likely to plummet initially due to seasonality, discretionary cuts, and the challenges of learning how to run the Federal Government's operations. The Macri Administration suffered through that in early 2016. The Federal Government is a complex machine, with plenty of red tape and quirky procedures. An unseasoned team is likely to find itself unable to execute spending, seemingly resulting in fiscal savings. In other words, the early results will be auspicious, and voter support could remain elevated in a context where Mr. Milei could make a few grand gestures, cutting some privileges of the political class to deflect from the impact of his fiscal program. We expect the combination of robust approval ratings with advances in the stabilization program to drive valuations, making an UW positioning unattractive. The problem is that, after the first few months, things are likely to start going sideways. Inflation should initially spike resulting from the increase in the fiscal impulse that Mr. Massa is recklessly engaging in (almost 0.8pp of GDP in tax cuts and spending increases in the last two weeks), falling demand for real money balances, and relative price corrections. Suppose Mr. Milei can't implement dollarization and have inflation collapse before late 2024. In that case, we're likely to see his support plummet in early 2025, putting his Administration's capacity to drive the agenda in question. Eventually, Mr. Milei risks following former President Lasso's trajectory, where the market initially applauded and rallied in support of his economic policy but panicked as voters turned their backs on the Government, leading to its ousting and the prospect of Correism returning to power. In other words, Mr. Milei's program may drive valuations in the short run, but ultimately, prices will be dominated by what would happen if his Administration failed. At current levels, we remain comfortably MW, with a wait-and-see stance.

Figure 14: Ecuador bond price trajectory under Mr. Lasso. Boom and bust.



Source: TPCG Research based TPCG Trading Desk

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