

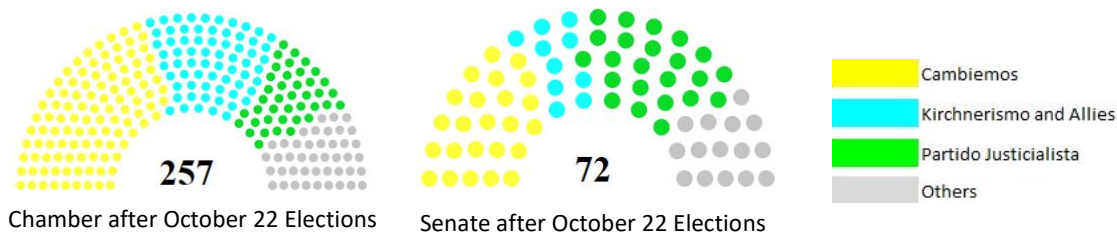


WHAT'S NEXT FOR ARGENTINA?

OCTOBER 27, 2017

RESULTS OF THE MIDTERM ELECTIONS

- Argentine **President Mauricio Macri's** governing coalition, *Cambiamos* (Let's Change) turned in a strong performance in the October 22 midterm elections. The election was largely seen as a referendum on Macri's reform agenda and the results provide Macri with momentum needed to accelerate structural reforms in the second half of his term.
- Macri's coalition picked up 20 seats for a total of 107 deputies in the 257-member Lower House, while gaining 9 seats for a total of 24 seats in the 72-member Senate. While these additions stop short of giving *Cambiamos* an outright majority in either house, they significantly strengthen the coalition's negotiating position heading into what is expected to be a busy legislative period.



- Notably, in the high-profile province of Buenos Aires, the Macri-endorsed senatorial candidate, **Esteban Bullrich**, defeated former President **Cristina Fernández de Kirchner** by 4.1 percentage points. Kirchner, candidate for one of the opposing Peronist party factions, was widely thought to be using this Senate race to launch a political comeback and unify the party behind her leadership. Bullrich's victory weakens Kirchner's ability to coalesce opposition to Macri's agenda and dampens her hopes of winning back the presidency in 2019.

POLITICAL AND ECONOMIC IMPLICATIONS

Cambiamos's strong showing gives President Macri a broader mandate to pursue more initiatives in his reform agenda, such as a tax overhaul, labor reforms, and deficit-reduction strategies, while also improving his chances for re-election in October 2019. The victory should strengthen investor confidence in the resurgent economy, which grew at an annualized rate of 2.7 percent in the second quarter.

ABOUT ASG

Albright Stonebridge Group (ASG) is the premier global strategy and commercial diplomacy firm. We help clients understand and successfully navigate the intersection of public, private, and social sectors in international markets. ASG's worldwide team has served clients in more than 110 countries.

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For businesses and investors, the key economic and political implications of Argentina's 2017 mid-term election are:

- Continued Reforms:** Since assuming office in December 2015, Macri has taken steps to open the economy, encourage investment, fight inflation and rein in the fiscal deficit. Some of the measures already enacted include eliminating tariffs and export taxes, settling litigation with holdout creditors, reducing energy and water subsidies, and ending currency controls. There is still much work to be done to assure investors and business that Argentina is on a path of sustainable economic growth. Macri inherited an economy that had accumulated large macroeconomic imbalances under the previous three administrations, but with the benefit of a broader congressional coalition, he has launched what he has termed a period of "permanent reformism." The first items on the agenda include ambitious tax, labor, and capital markets reforms aimed to make the Argentine economy competitive in a regional and global context (see a more detailed analysis on these below).
- Positive Investment Climate:** Since President Macri assumed office in December 2015, investors, analysts, and credit rating agencies have called into question the political sustainability of the reform drive. In particular, they have expressed concerns about a political comeback by former President Cristina Kirchner. Some prominent investors and credit agencies publicly stated that a precondition for investment was a successful midterm election, although this election has settled doubts over the political sustainability of both the Argentine government and its reform agenda. Argentina is poised to attract significant international investment in sectors such as oil and gas (conventional and shale), infrastructure, renewable energies, financial institutions, and auto manufacturing.
- Divided Peronists:** More than 55 percent of Argentines still loosely identify themselves as part of the opposition Peronists party, but divisions within leave them unlikely to secure a victory in the near future. Cristina Kirchner remains the most popular Peronist leader, but her high disapproval ratings and electoral loss in Buenos Aires limit her appeal as a future presidential candidate. Moreover, the Peronist party remains deeply divided among competing factions led by other prominent political figures such as Sergio Massa, Juan Manuel Urtubey, and Florencio Randazzo, among others.
- Anti-corruption Drive:** The increased fight against corruption continues to be a challenge in Argentina. Macri's anti-corruption efforts have served him well and should have a positive on the impact the long-term investment climate. To date, most of the implicated officials are from the Peronist and trade union camps, including Kirchner and the Planning Minister under her cabinet, de Vido; but there are concerns that the investigations present a political risk that could also sidetrack Macri's agenda, as recent corruption scandals have in Brazil. We expect that Macri will continue to support these efforts. However, if members of his own voting bloc, or members of moderate opposition parties that support his agenda, were to become implicated, Macri will be in the difficult position of balancing his popular position on this issue with the need to maintain congressional support for his reforms.

UPCOMING REFORMS

OUTLOOK AND IMPLICATIONS

Tax Reform

President Macri's comprehensive tax reform

Anticipated for End Of 2017

Macri will seek to conclude negotiations with governors and congress in the coming weeks. The most controversial issue will be the provincial turnover tax reform. He is likely to implement gradual adjustments to



that will include the following basic elements:

- reforming the political sensitive provincial turnover tax
- revising financial transaction tax
- allowing corporate income tax credits
- simplifying value added taxes
- adding capital gains tax

avoid significant reductions to government revenues before broader macroeconomic reforms can be implemented.

Tax reform will be heavily influenced by the government's top economic priorities, which include inflation reduction and fiscal consolidation.

In August, the Federal Government and 20 Argentine provinces signed a fiscal responsibility agreement, a first step towards reducing Argentina's total tax burden. The provinces agreed to freeze spending in real terms and to keep public sector payrolls at current levels. Non-compliance will carry penalties, including restrictions to debt issuance and eligibility for aid from the Federal Treasury. In the wake of the recent midterm elections, two more provinces are expected to join the agreement. All but two of Argentina's 24 provinces are likely to join the agreement.

Capital Markets

Reform would amend a provision to allow Argentina's securities regulator to remove company board members, and ease restrictions on foreign investment.

Anticipated for Early 2018

The need for reform in this area is dire. Argentina's financial sector, one of the world's smallest relative to GDP, is critical to financing the country's robust economic expansion. Indeed, after years of relative isolation, Argentina's capital markets remain small relative to the country's economy, and are among the least developed of the major Latin American economies. Argentina's 2015 stock market capitalization as a percentage of GDP (9.6 percent) lags far behind Brazil's (27.6 percent), Mexico's (35.2 percent), and Chile's (79.2 percent).

Labor Reform

To increase Argentina's global competitiveness and attract foreign investment, President Macri seeks to reduce labor costs, introduce greater flexibility into the labor market, and gradually decrease the power of trade unions.

Anticipated for Mid-2018

The substance of the proposed labor reforms has not been finalized or released. Indications suggest that Macri's government will not send a comprehensive labor reform bill. Instead, it will negotiate sector-by-sector agreements with the relevant trade unions. This divide-and-rule tactic aims to prevent negotiating with a united trade union front, which will likely adopt a harder stance. Industry-by-industry negotiations seek to maximize the concessions that can be wrought from an industry-specific trade union by isolating it from the others.

These negotiations will be a long and drawn out process. Trade unions, which have great influence on Argentina's economy and policies, have already indicated their intent to fight the changes. Their position, however, has been significantly weakened by the clear electoral support shown to Macri's reform agenda in last week's midterm elections, and by corruption cases involving some of its leaders.

ASG's Latin America Practice has extensive experience helping clients navigate markets across Latin America. For questions or to arrange a follow-up conversation please contact [Ignacio Petrocchi](#).

