Argentina Watch

Argentina holiday gifts: Omnibus Bill, Mega-Deregulation Decree, FX and prices.

04 January 2024

GEM Economics
LatAm | Argentina

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Omnibus bill: reforms and emergency powers

On December 26, the government sent an omnibus bill to congress with reforms and measures (664 articles) complementing the mega de-regulation decree. It includes pension de-indexation, tax changes (export, wealth), a tax amnesty, authorization to privatize companies, and political reform (details inside). The executive also requests delegation of legislative powers, declaring a public emergency until 2025.

Mega-deregulation decree

The Mega-Deregulation decree (DNU) announced on December 20 includes de-regulation of markets, fostering competition, lifting of price controls, labor reform, steps towards privatization, removal of export quotas, repealing the home rents law and authorizing hard currency contracts, among others (details inside). The decree is in effect since December 29.

Hurdles for the Decree and Omnibus bill

The reforms (bills and urgent decree) are facing opposition from unions, social groups and legislators. The national labor court suspended the labor reform chapter included in the emergency decree pending a final decision of other courts. The decree can be repealed by the rejections of the two chambers of in Congress. Watch potential changes in the omnibus bill.

BCRA bought $3.1bn. New import system.

The central bank has bought $3.1bn in the FX market since December 11 due to a competitive ARS (following 120% jump) and gradual payment of USD for imports. The parallel exchange bounced back to 26% gap (from a 9% low) as BCRA keeps a slow crawling peg (2% monthly depreciation). The new statistical system of imports (SEDI) is in place (does not require pre-authorization). Slow start of BCRA's USD bonds selling to pay import debts.

IMF negotiations continue in Buenos Aires

Argentina paid over $900mn to IMF on December 21 using the CAF bridge loan. An IMF delegation arrived at Argentina. The government has hinted it will try to revive the current IMF program by asking waivers for previous target deviations. We expect a staff level agreement in January and IMF loan disbursements in February.

Prices under pressure. Fiscal adjustment begins.

Inflation jumped to close to 30% in December. The government is doing public information events to define electricity price and natural gas increases (changes in the subsidy scheme expected). Fuel prices jumped another 27%. The devaluation put pressure on energy costs, complicating the reduction of subsidies. The omnibus bill is key for fiscal adjustment (export taxes, tax amnesty and pension de-indexation). The government extended 2023 budget into 2024.

Hurdles for the Decree and Omnibus bill

The reforms are facing opposition from unions, legislators, and court cases.

Court suspends labor reform chapter of Mega-Deregulation Decree

The national labor court of appeals filed an injunction to suspend the labor reform chapter included in the emergency decree (DNU). The suspension is transitory pending a final decision of other courts. We expect the government to appeal the decision.

The rest of the articles in the Decree would remain in place. See a summary of the mega-decree measures including on labor reform below. The government is expected to send the whole mega-decree to congress shortly without changes.

The national labor union (CGT) filed the request. Recall that the CGT announced the first national strike for January 24 (after more than 4 years), against the Decree. This adds to CGT and social movements protests last December.

The opposition UXP has rejected both the decree and the bill in general. Note that Congress can repeal the Mega decree with the rejection of both chambers. The Congress has to establish a bicameral commission to analyze the DNU.

Some leaders of Juntos por el Cambio also criticized the Decree process (despite coincidences in many of the proposals) and have some differences about the Omnibus bill (legislative powers, pension formula and tax hikes are controversial issues). The party would prefer that the Mega-Decree proposals are discussed in a mirror bill in congress.

The discussion of the Omnibus could take several weeks (original deadline is January 31, which sounds optimistic): committees in the Lower House (the first chamber to discuss it) are not ready yet (unlike in the Senate). Watch for changes in the omnibus bill in congress.

Fiscal impact

The bill is key for the fiscal adjustment, including export taxes (0.5% of GDP) and tax amnesty on capitals (0.5% of GDP) and pension de-indexation. We think pension de-indexation is key to reduce inflation, especially starting in 2H24 (as with the current formula disinflation would increase pensions in real terms). Note the bill does not include the reversal of income tax cuts key for fiscal adjustment and for negotiations with governors (that tax is shared with provinces). Recall the government seeks a 5% of GDP fiscal adjustment this year (3% of GDP spending, 2% revenue measures).

FX: BCRA bought $3bn. Controls eased very gradually.

BCRA has bought about $3.1bn in the FX market since December 11 following the devaluation. FX reserves increased by $2.6bn since. This generated the capacity to pay the bulk of USD bonds maturities for $1.6bn and IMF maturities $1.9bn in January.

We think the reserve accumulation is mostly due to 1) gradual allocation of USD for new imports (see below) coupled with delays in USD allocation to importers to pay their debts and 2) a very competitive exchange rate.

The parallel exchange bounced back to 1070 (after touching a 900 low recently) and the gap vs the official is at 26% (which still is considered a success, down from 170% gap before). BCRA keeps a 2% monthly depreciation crawling peg (after the 120% ARS jump last month), despite inflation is at 25-30% mom, which eats away competitiveness quickly. We expect BCRA to recalibrate the depreciation rate higher no later than in February.

New Imports. The new statistical system of imports (SEDI) is in place, which does not require pre-authorization for new imports (replacing the SIRA non-automatic system). The USD for imports will be handed in four monthly installments for most goods. Still, this is a massive improvement vs the previous discretionary system. (See Argentina Viewpoint: Emergency package stronger than expected, 14 December 2023.)

Old imports and bonds: BCRA sold only $70mn of USD bonds ("Bopreal") to importers to pay USD debts in the first auction of series 1. This series matures in October 2027, amortizing in 2 installments in April and Oct 2027 (5% interest bi-annual). The bond has some benefits, including the ability to access up to 5% of amount purchased of the bond at the official exchange rate to pay trade debts and the ability to buy USD at the parallel (by selling bonds settling in foreign currency) by the amount of the Bopreal acquired (starting April 1). BCRA expects to offer Series 2 and 3 in February.

The government is easing capital controls very gradually, which also backed the reserves accumulation and negative real interest rates. The central bank policy rate is at only 100% daily (1-day repo) or 8.6% monthly equivalent (well below inflation). The government paid -15% real interest rate for most linkers and 8.6% monthly rate for peso discount bills in an auction (amid the process to replace banks' Leliq's holdings by government paper). These negative real rates are inflating away part of BCRA peso debts, which is the monetary counterpart of the FX reserves accumulation.

We expect capital controls removal process to gain steam in 2Q amid the start of the soy harvest (jump in USD supply).

IMF team in Buenos Aires to continue negotiations.

Argentina paid over $900mn to IMF on December 21 using the Andean bank (CAF) bridge loan. An IMF delegation arrived at Argentina this Thursday. They will meet with Argentina officials to negotiate the current program. The government has hinted it will try to revive the current program by asking waivers for underperformance and try to achieve the targets moving forward.

We expect a staff level agreement in January and IMF resuming loan disbursements by February (including $3.3bn not disbursed in November) as the proposed FX and fiscal adjustment seem stronger than in the previous program (balanced nominal budget vs 0.9% of GDP primary deficit in the program). We do not rule out the IMF bringing forward the disbursements for H1 to strengthen international reserves.

Argentina bundled IMF January scheduled payments of $1.9bn to be paid on January 31.

Inflation under pressure. Subsidy reduction warm-up.

According to the presidential spokesperson inflation would have been close to 30% mom in December. This follows the 120% jump in the ARS and price deregulation. Food inflation is seen above 35% mom. Fuel prices increased 27% this week and pre-paid health services (also de-regulated) would increase 40% this month. We expect inflation at 205% this year (starting to decline significantly in March).

Electricity and natural gas price adjustments

The government announced public events to inform electricity price increases on January 26. Transportation discussion will start on January 29. The government could change the scheme of subsidies, prioritizing low-income households, subsidizing the consumption up to a certain level (and full cost tariff above that).

For natural gas prices, distribution companies suggested price increases between 300-700%. For trains and bus fares the government decided to increase prices monthly with inflation (beyond a subsidy reduction price increase component).

Recall the government seeks a 0.7% of GDP reduction in subsidies (0.5% in energy, 0.2% in transportation). The devaluation and resulting higher energy costs complicate the reduction of subsidies. The government said subsidy reduction would start as soon as in February. (See Argentina Viewpoint: Emergency package stronger than expected, 14 December 2023.)

Our view: A very ambitious package of reforms, but...

The omnibus bill and the mega-decree seek to de-regulate markets, increase competition, privatize state-owned companies, change taxes, pension reform, labor reform, hard currency contracts and political system changes. Besides, the bill request emergency legislative powers for two years. We think these reforms try to enhance growth potential and investment to partly offset the impact of the fiscal and external adjustment in the short term.

The decree and bills are very ambitious including over 1000 articles, and face reversal risks in courts and in congress. However, we believe the government has ample room to stabilize the economy through external, price and fiscal adjustment with executive power. Capital controls and import controls also can be relaxed through Central Bank decisions. Exchange rate and most relative price corrections do not need congress and are already on their way. At least 60% of the fiscal adjustment can be done without congress in our view.

Social tolerance and potential protests are still one of the most important hurdles for the stabilization plan and reforms. We think the economy could get worse before it gets better as real incomes are dropping substantially with the inflation jump and the recession.

Omnibus Bill Package Details

The Omnibus bill reforms package includes pension de-indexation, tax changes (export, wealth), a tax amnesty on undeclared capitals, privatization authorization, promotion of formal employment, and political reform. Congress will discuss it until January 31. Proposals include:

De-indexation of pension benefits

The current pension formula (tied to salaries and government revenue) is suspended, and pension benefit increases are determined by decree when the government believes it necessary (prioritizing low income) while the government studies a new automatic formula.

Tax Changes

Wealth tax rates reduction: gradual reduction of wealth tax rates, currently ranging from 0.50% to 1.50%, to 0.50%-1.30% in 2024; 0.50%-1.10% in 2025; 0.50%-1% in 2026, and a single 0.5% 2027.

Export taxes: in general, exports tax rates are increased to 15%, all soy products are up to 33%, many products will be at 8% (including hydrocarbons, most mining and wine). Regional economies exempt. The government would have discretion to modify the tax rates through 2027.

Tax amnesty on undeclared funds and moratorium

Tax amnesty of undeclared capitals (cash, stocks, bonds, real estate) with tax rates between 5% and 15% (5% until May 31 then 10% until August 31 and 15% until end of the program on November 2024 (capital exempt below $100k). It excludes public workers. It also proposes wealth tax invariability regime at lower rates (0.5%-0.75%) making an upfront payment of 75% of the tax).

Moratorium and promotion of formal employment

It also launches a tax amnesty on other unpaid taxes (with discounts on interest and penalties) depending on the size of contributor, up to 3-8 years of monthly installments including a percentage of the payment upfront.

Modifications to the hiring regime: the possibility of regularizing pre-existing relationships or the elimination of sanctions and fines for 90 days (including the extinction of the criminal action and the remission of infractions, fines, and sanctions).

Privatization

The bill requests the possibility to privatize up to 41 state-owned enterprises (or where the state is a majority stakeholder) (including YPF, Aerolineas, Banco Nacion, Aysa, mail, trains, public TV), within the framework in force under Law No. 23,696, to generate greater competition and efficiency and promote private investment. To privatize, "public limited companies shall be constituted, in which the National Executive Power may retain an action with the right of veto in decisions involving the closure of the activity".

Pension fund assets and external debt

All assets of the Anses pension fund (FGS) will be transferred to the treasury. In our view the government wants to consolidate intra-public debts. The government seeks to repeal the law that requires to ask congress permission to issue external debt (including IMF debt).

Mega-Deregulation Decree

The mega deregulation decree contains 366 articles of which president Javier Milei highlighted the most important 30 measures (summarized below).

The decree declares "a public emergency in economic, financial, fiscal, administrative, social security, tariff, health and social matters until December 31, 2025". Main measures:

Privatization. Repeal of the regulations preventing the privatization of public enterprises. Repeal of the State Company Regime. Transformation of all state-owned enterprises into public limited companies for subsequent privatization. Authorization for the transfer of the total or partial share package of Aerolíneas Argentinas (airline) to workers.

Labor. Modernization of the labor regime to facilitate the process of generating genuine employment (see below).

Hard currency contracts: Amendment of the Civil and Commercial Code. "To reinforce the principle of freedom of contract between the parties,". Amendment of the Civil and Commercial Code. "To ensure that obligations contracted in foreign currency must be paid in the agreed currency,".

Housing: Repeal of the Rent Act.

Price controls: Repeal of the Price Observatory of the Ministry of Economy. "To avoid the persecution of companies."

Health/price controls. Modification of the regulatory framework for prepaid medicine services and unions health services ("Obras Publicas"). Elimination of price restrictions on the prepaid health insurance industry. Incorporation of prepaid medical companies into the and unions health insurance.

Promotion: Repeal of the Industrial Promotion Law. Repeal of the Trade Promotion Law.

Promote competition, open markets: Modifications to the regime for pharmaceutical companies to promote competition and reduce costs. Deregulation of satellite internet services. Deregulation of the tourism sector by "eliminating the monopoly of tourism agencies". Amendment of the Companies Act so that football clubs can become public limited companies if they so wish.

Supermarkets/other: Repeal of the Law on Supply (Ley de Abastecimiento). Repeal of the Gondola Law. "So that the State stops meddling in the decisions of Argentine merchants." Repeal of the Buy National Act. "as it only benefits certain actors in power".

Land law: Repeal of the Land Law to promote investment (allowing foreigners to acquire domestic lands). Amendment of the Fire Management Act.

Sugar/wine: Repeal of the obligations that sugar mills have in terms of sugar production. Liberalization of the legal regime applicable to the wine sector.

Mining: Repeal of the National Mining Trade System and the Mining Information Bank.

Airplanes: Implementation of the Open Skies Policy.

Trade: Reform of the Customs Code to facilitate international trade.

Simplification. Establishment of electronic prescriptions to streamline service and minimize costs. Incorporation of digital tools for the processing of automotive registrations.

Labor market changes

Mega Decree Title 4 included repeals and modifications of labor laws, including the double compensation in the event of an unregistered or deficient employment relationship.

Laws are repealed to improve and simplify registration processes, giving legal certainty to the employment relationship, increasing the trial period (from 3 to 8 months), redefining the origin of conventional wage deductions, authorizing collective agreements to explore alternative compensation mechanisms to be paid by the employer, review the criteria for ultractivity and avoid blockages of productive activities.

The decree eliminates the forced withholding of contributions from workers to unions.

It expanded the essential work categories.

Employers and trade unionists can agree on a different compensation system in collective bargaining, based on the UOCRA union Severance Fund (Article 81): "By means of a collective bargaining agreement, the parties may replace this compensation regime with a severance fund or system (cost paid by the employer), with a monthly contribution that may not exceed 8% of the computable remuneration. Employers may choose to contract a private capitalization system to pay the compensation provided for in this article and/or the sum freely agreed between the parties in the event of termination by mutual agreement.

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