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Argentina's shock therapy yields results, but normalisation remains a way off

President Javier Milei has overseen sharp policy shifts aimed at stabilising the country's economy, including fiscal consolidation and disinflation. The latest IMF deal and peso liberalisation are further positive steps. But sustaining this progress and a major return to international capital markets will require further reform and is not guaranteed.

Key Takeaways

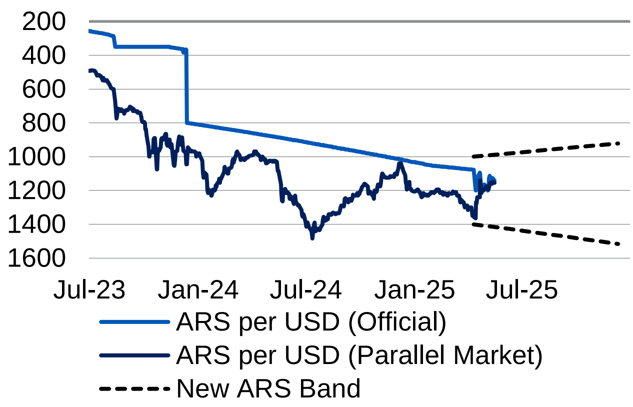
- Argentina has endured tough reforms since Javier Milei became president in December 2023.
- After an initial spike in inflation caused by the peso's devaluation, price growth has significantly moderated, while the economy is set to return to growth in 2025.
- The government's latest IMF deal, agreed in April, gives another reason for cautious optimism.
- The four-year deal provides an immediate boost to FX reserves, though they remain minimal. In exchange, the peso has transitioned from its crawling peg to a managed float, with the aim of reducing its overvaluation, while several capital controls have also been lifted.
- However, sustaining enough reform momentum for a major return of international investors is far from guaranteed.
- Stronger growth and a recovery in real incomes should help Milei at the October 2025 mid-term elections. An increased seat share for Milei's LLA party would be favourable for policy implementation over the remainder of his current term.
- That said, still high inflation, potential for overvaluation to exert greater downward pressure on the currency, and minimal FX reserves, suggest shock therapy has not conclusively revived Argentina's fortunes.

Argentina's prospects brighten more than expected

Argentina's fortunes have shifted significantly since President Javier Milei came to power in December 2023. Shock therapy measures – including a peso devaluation and sweeping restrictions on government spending – initially exacerbated the deterioration of living standards, contributing to a spike in inflation and a sharp recession.

However, since mid-2024, these policies have yielded a greater improvement in the fiscal balance and disinflation trajectory than was widely expected. Following two years of contraction, the International Monetary Fund (IMF) forecasts 2025 GDP growth of 5.5%. Meanwhile, popular support for Milei has stayed resilient.

Figure 1: Argentina's peso has gone from devaluation to a crawling peg and now a managed float



Source: Haver, Aberdeen, May 2025

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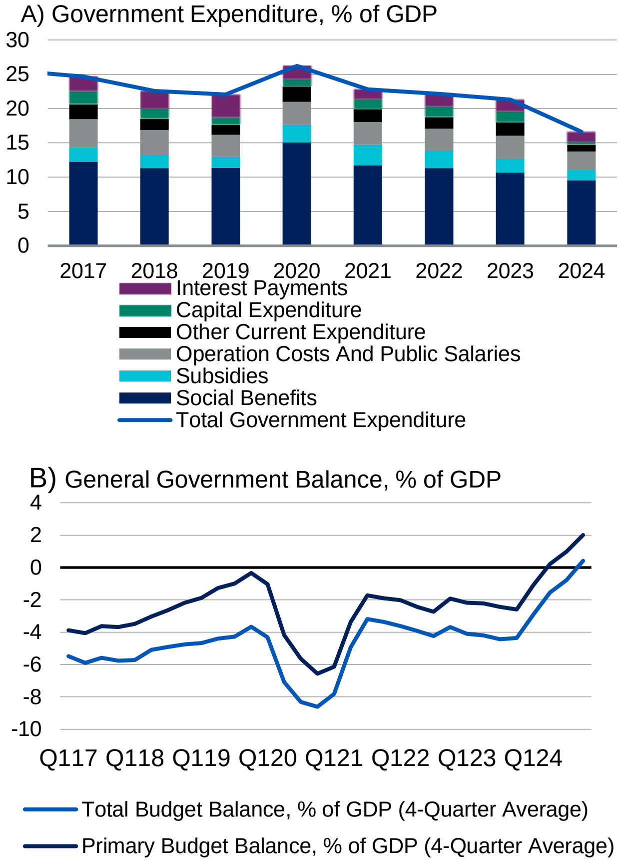
A new IMF deal announced in April provides another reason for cautious optimism. In exchange for an immediate boost of liquidity, Argentinian authorities have transitioned the peso from a crawling peg to a managed float (see Figure 1), while also easing some of its capital controls.

Milei's policy shifts over 2024 were painful, but have now put the economy on a better footing

The previous government, under President Alberto Fernández, ended its term with a budget deficit of 4.4% of GDP in 2023. Loose fiscal policy contributed to inflation that averaged 112% year over year in the 12 months before the October 2023 elections.

Since then, Milei has overseen spending cuts across primary expenditure, lowering total spending to 16.6% of GDP in 2024, below the 2016-2023 average of 23% (see Figure 2). This drove the budget balance to a surplus of 0.3% of GDP, with a primary surplus of 1.8%.

Figure 2: Wide-reaching spending cuts have driven the budget into surplus

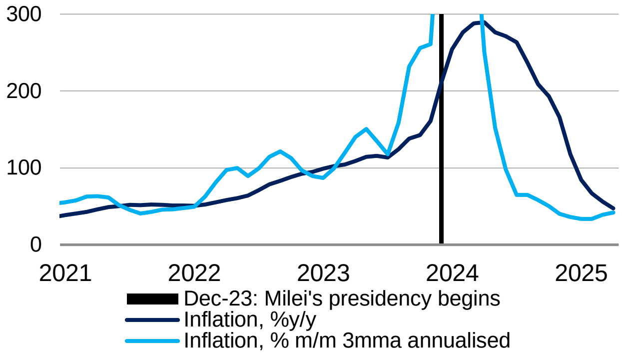


Source: Haver, Aberdeen, May 2025

Meanwhile, following a December 2023 devaluation of 55% against the dollar, the peso saw managed monthly depreciations of 2% (1% from January 2025). Though the net foreign reserves of the Central Bank of Argentina (BCRA) remained negative at -$2.4bn at the end of 2024, this marked an improvement from -$8.5bn a year prior, as the weaker peso relieved some pressure.

After the devaluation led inflation to a peak of 289% year over year in April 2024, the slower pace of depreciation and easing import restrictions lowered it to 47.3% in April (see Figure 3). Monthly inflation is running at an annualised rate around 42%.

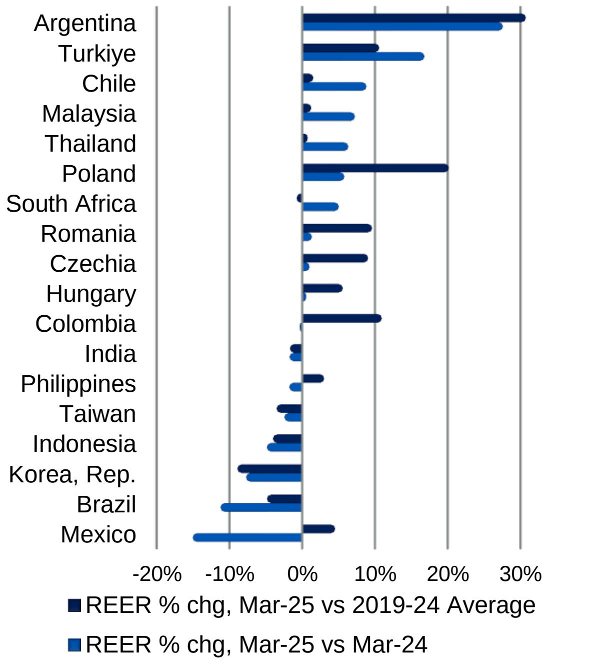
Figure 3: Inflation has fallen sharply compared to before the 2023 election



Source: Haver, Aberdeen, May 2025

Easing price pressures supported a rebound in consumer confidence from mid-2024. This, alongside recovering investment, led the economy out of recession in Q3 2024, and should support growth in 2025.

Figure 4: Sharp appreciation of the real effective exchange is keeping investors wary



Source: BIS, Haver, Aberdeen, May 2025

However, the limited depreciation despite elevated inflation has increased the real effective exchange rate (REER) by 28% since March 2024, a greater appreciation than all other major EMs (see Figure 4). This has contributed to resurgent import demand while dampening export competitiveness, altogether weighing on net trade.

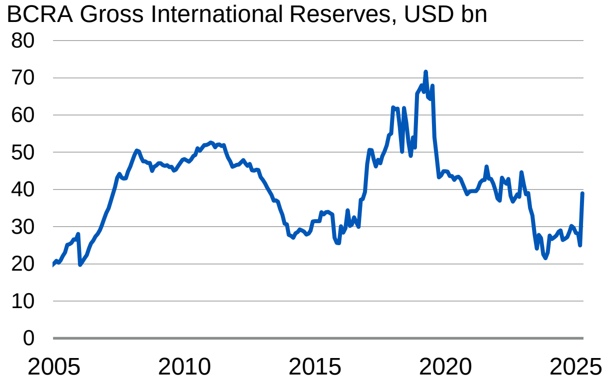
The new IMF deal marks a further milestone, but big questions remain

The IMF's approval of a new $20bn Extended Fund Facility (EFF), and Argentina's accompanying FX and capital controls adjustments, surprised to the upside of expectations.

The four-year EFF is Argentina's third IMF agreement since 2018, and its 23rd overall, the most of any economy. The latest deal is somewhat different from the last two in that it follows economic stabilisation measures that have begun to yield results. But it is certainly not the first time that IMF support has come after positive moves, only for Argentina to subsequently stumble.

The deal included an immediate disbursement of $12bn to Argentina's authorities, with a further $2bn scheduled alongside a first review of the programme in June. This will bolster Argentina's gross reserves (which totalled $25bn in March) and help alleviate pressure on its negative net stock of foreign currency.

Figure 5: IMF deal and new FX regime will relieve some pressure on reserves that are in need of replenishment



Source: BIS, Haver, Aberdeen, May 2025

A key pillar of the agreement was the peso's managed float. It can now fluctuate within a band that began between ARS1000 per USD and ARS1400 per USD, with this ceiling and floor each widening by 1% per month (see Figure 1). Currency interventions will be limited to keeping the peso within these bands in line with programme targets for reserve accumulation, eventual fair valuation, and a sustained minimisation of the gap between the official and parallel exchange rates (the latter existing due to private sector difficulty in accessing foreign currency).

The deal also sees certain capital controls (though not all) being relaxed or removed. These include a previous monthly limit of $200 worth of foreign currency purchases for individuals being removed, alongside firms now being permitted to repatriate profits abroad in the 2025 fiscal year.

Argentine authorities have also reaffirmed their commitment to maintaining a strong fiscal anchor. The IMF deal assumes a primary surplus of 1.3% in 2025, in line with the government's draft budget – alongside broader structural reforms and deregulation.

Though the agreement does provide room for optimism, continued caution is warranted.

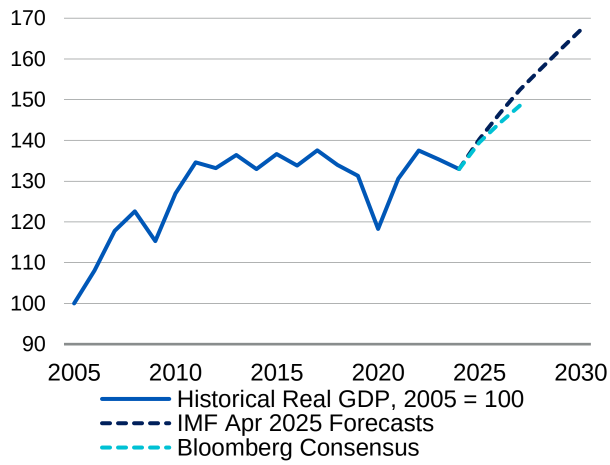
Firstly, the peso will remain highly overvalued for at least the remainder of 2025. If the peso ended the year at its lower bound (around ARS1516 per USD by December), this would mark an annual nominal depreciation of 32%. This looks set to be outpaced by inflation (with our preferred annualised figure again tracking a rate of 42%, which would likely be exceeded should the peso weaken this much).

Argentina's exports will therefore continue to rise in price versus peers more than the exchange rate can adjust for, while depreciatory pressures also risk further straining FX reserves.

Greater easing of peso flexibility and capital controls will be challenging before the October 2025 mid-term elections due to inflationary risks, though these are currently planned to be relaxed further in 2026. But Argentina's history of vulnerabilities means we cannot rule out progress faltering or even reversing course.

The sustainability of fiscal consolidation also remains in question. Capital expenditure has borne the brunt of cuts, and, without greater private investment, this will weigh on potential growth over coming years. Prolonged limits on broader spending will further dampen demand. We believe tight policy leaves the balance of risks to growth weighted to the downside of IMF and consensus projections (see Figure 6), while the electorate's long-term tolerance of these measures is also uncertain.

Figure 6: IMF and analyst growth expectations for Argentina's medium-term growth may be too bullish



Source: IMF, Bloomberg, Aberdeen, May 2025

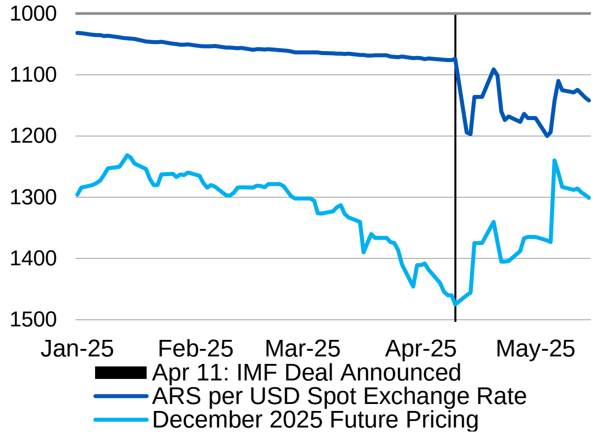
Markets have been receptive of Milei's reforms

The new FX regime had markets initially expecting a greater short-term peso depreciation, fuelling concerns for resurgent inflation.

After a 10% fall to ARS1200 per USD on 15 April, the peso has stabilised around ARS1132 per USD as of mid-May. Meanwhile, the gap between the two major exchange rates has narrowed to 1% as of mid-May, versus a pre-deal 20%.

This adjustment – combined with the peso's stability, partly aided by seasonal FX inflows from agricultural exports – has tempered pricing for the year-end depreciation (see Figure 7).

Figure 7: Market expectations for depreciation have eased, but a reversal remains plausible

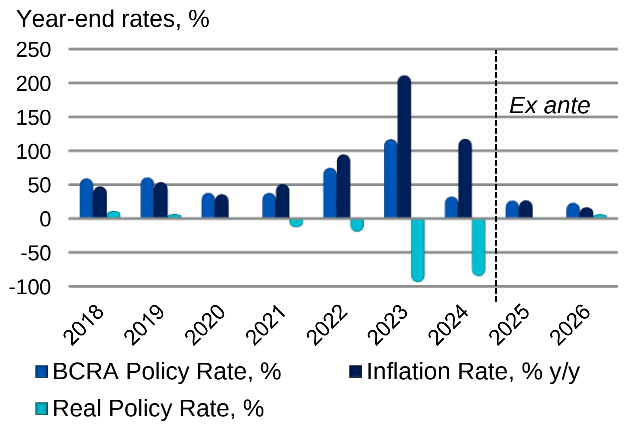


Source: Haver, Aberdeen, May 2025

Expectations for sustained disinflation and eventual positive real interest rates in 2026 also appear to be helping, but risk seeing a reversal. Year-end inflation expectations in April were for 32.1% in 2025 and 17.8% in 2026. This implies an ex-ante real interest rate of 5.6% at the end of 2026, versus -85.2% in December 2024 (see Figure 8).

However, April's expectations were up compared to March (+5ppts for 2025 and +1.1ppts for 2026, respectively). Likely upticks in monthly inflation following the new FX regime could see markets push back their expectations for improving rates, posing risks of renewed depreciation pressures unless the BCRA tightens monetary policy.

Figure 8: Expectations for a return to positive real rates are helping now, but could change quickly

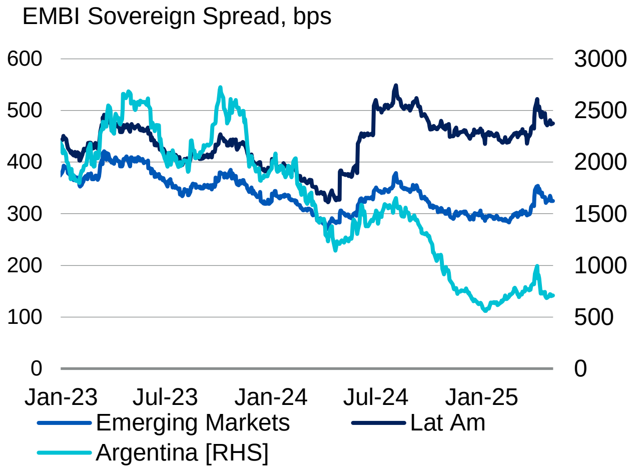


Source: Haver, Bloomberg, Aberdeen, May 2025. 2025-26 figures are derived from the BCRA's April survey and Bloomberg consensus.

Tighter fiscal policy and broader stabilisation have lowered Argentina's yield spread versus the US by around 1200bps to 700bps since the end of 2023, currently 250bps above the Latin America aggregate (see Figure 9).

This leaves yields elevated relative to thresholds that policymakers previously cited as appropriate for debt issuance, though a recently announced USD1 bn auction for international investors at the end of May marks another key milestone. A more significant return to markets will however remain a very gradual process.

Figure 9: Argentina's risk premium has narrowed, but borrowing conditions remain limiting



Source: Haver, Aberdeen, May 2025

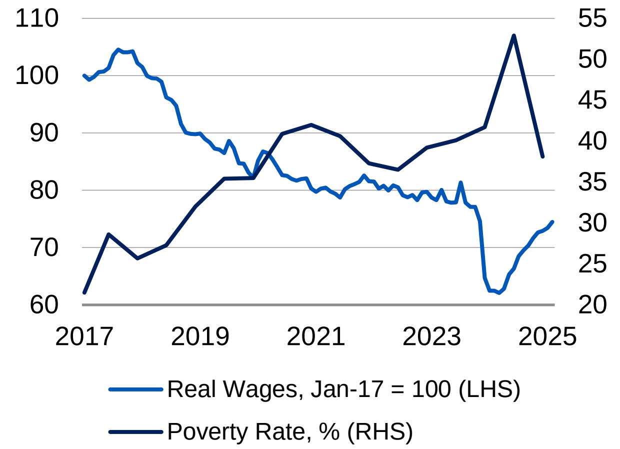
Mid-terms will be a key test for Milei's administration

The mid-term elections on 26 October – when half of 257 seats in the lower house and a third of 72 senate seats will be contested – will be crucial in determining Milei's policymaking power thereafter.

Milei's La Libertad Avanza (LLA) party has been able to enact significant policy shifts since coming to power in 2023, despite only holding 39 and 72 seats in the lower and upper houses respectively. This has required a combination of executive decrees, the support of other parties, and dealmaking in several areas.

The fragmented electoral landscape makes attaining an outright majority difficult. But should the LLA make significant gains, the government's power and scope for fulfilling the IMF targets would be strengthened.

Figure 10: A renewed deterioration of living standards could put greater pressure on the government

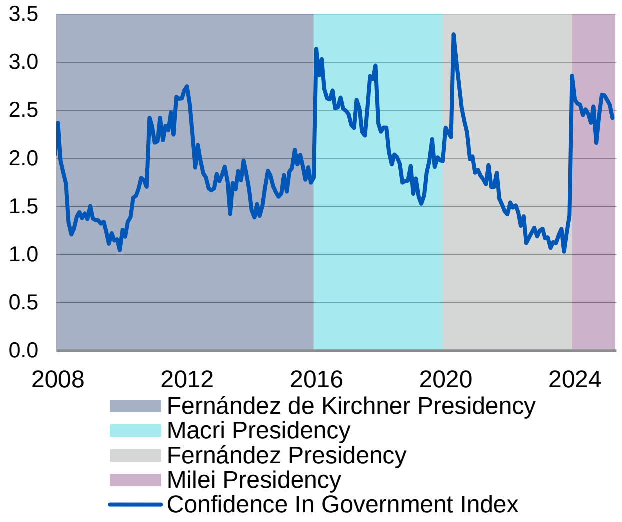


Source: Haver, INDEC, Aberdeen, May 2025

Current surveys, and a strong performance in the Buenos Aires city election in May, signal that the LLA will benefit from support that has weathered recent spikes in poverty and dented real wages (see Figure 10).

Milei's approval rating remains robust, around 45%. Measures of confidence in government have stayed strong (see Figure 11), and the LLA will also benefit from the weakened and divided state of the opposition.

Figure 11: Milei is continuing to enjoy high levels of support despite economic pain



Source: University of Torcuato di Tella, Aberdeen, May 2025

A strengthened LLA is the most likely outcome and would be well received by markets. However, certain aspects of the economy most in need of reform to bolster domestic and foreign investment will remain difficult without a majority.

Sustaining reform momentum beyond the mid-terms will be crucial if the government wants to attract foreign capital, meet ambitious growth expectations and break the inflationary spiral.

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