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Economic Research

Economic Insight

Milei remains successful

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Argentina's eccentric president Javier Milei may appear unchecked swinging around a chainsaw, insulting foreign heads of state, or using vulgar language. However, Milei's economic policy is based on a clear logic that is turning out to be more and more successful.

At the center of Milei's reforms is the consolidation of the state budget. To achieve this, Milei closed half of the ministries, eliminated 40,000 public service positions, cut subsidies, froze payments to the provinces, or only adjusted pensions partially to inflation. By massively reducing expenditures rather than increasing taxes, he managed to eliminate the previously high budget deficit.

Balanced budget is a prerequisite for …

Balancing the budget was a prerequisite for reducing the high inflation that had paralyzed the economy and eroded the purchasing power of poorer segments of the population over the past decades. Without the high budget deficits, the state now no longer needs to be financed by printing money, which previously caused the central bank to fuel money supply growth and inflation.

… lower inflation and more stable peso

When the peso is more stable domestically, it is also more stable against foreign currencies such as the dollar. Price stability and currency stability are two sides of the same coin. This allowed the government to release the exchange rate previously set by the state without having to fear massive devaluation or an increase in inflation. Exporters no longer have to hand over their dollar revenues to the state at politically suppressed rates, which the state then allocated to select importers, leading to bureaucracy, corruption, and a shortage of imported goods. Balancing the budget ultimately enabled the liberalization of foreign trade, which is vital for the flourishing of companies.

The domestic economy was also liberalized

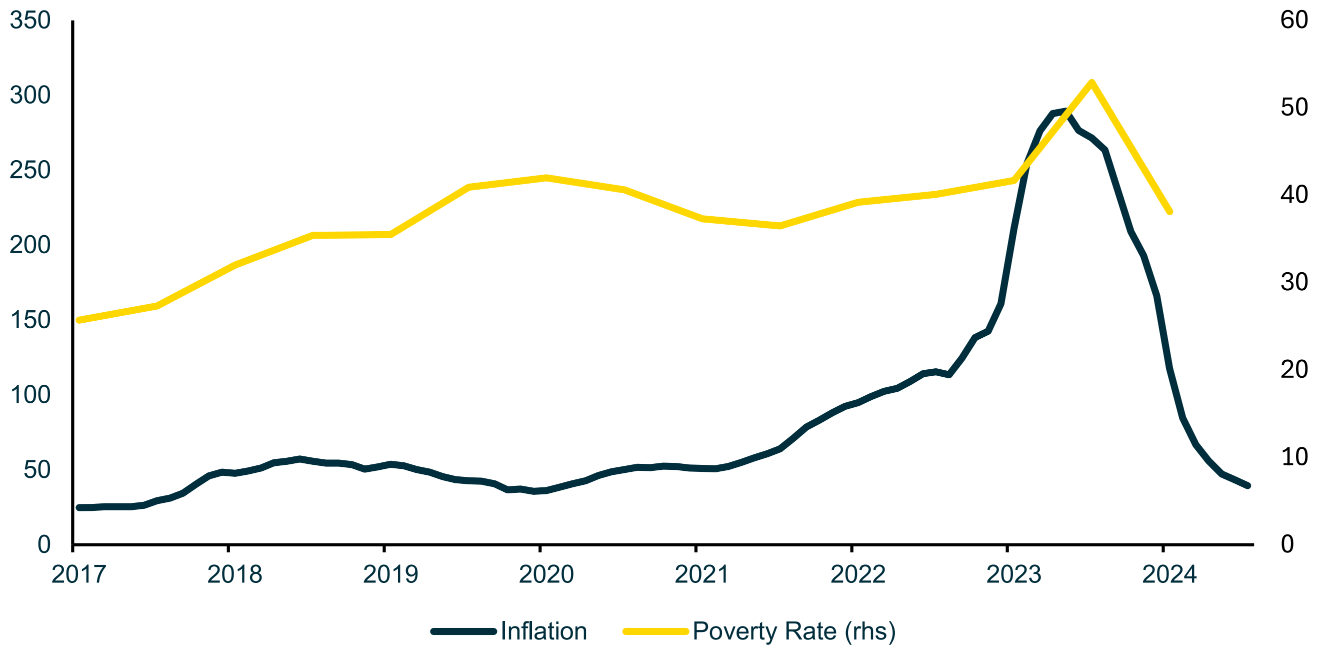
Furthermore, Milei liberalized the domestic economy. For example, he lifted price controls – including apartment rentals. As renting out apartments became worthwhile again, many previously vacant apartments were reoffered, significantly lowering rents. Additionally, Milei created incentives for large investments in important sectors like mining – for instance, in the form of tax exemptions.

The painful reforms are already resulting in rising economic activity. The International Monetary Fund predicts growth of 5.5% for this year. This makes Argentina one of the fastest-growing countries in the world. Most importantly, the poverty rate is now lower than before Milei's election, which is primarily due to the massive decline in inflation (chart).

The long-term success of the reforms is not guaranteed, as groups previously favoured by the state like civil servants or trade unionists could politically regain the upper hand. But Milei demonstrates that liberal economic policies can achieve a lot. This also concerns Germany, which still refuses to undertake necessary reforms.

Chart 1 - Declining inflation drives poverty rate down

Consumer price index for Argentina, change on previous year in %; poverty rate in %



Source: National Institute of Statistics and Census of Argentina, Commerzbank-Research

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