Issued: May 2025

MARKET COMMENTARY

Ashmore

Why Milei's IMF deal could Make Argentina Great Again

By Gustavo Medeiros and Ben Underhill

After President Milei's rapid fiscal rebalancing, a fresh USD 15bn disbursement from the IMF put Argentina in a position to slash its capital controls. Under the new FX regime, the peso – the world's best performing currency last year – is holding firm.

As inflation decelerates and growth recovers, Milei's popularity continues to surge. If he can consolidate power in the 2025 mid-terms, his promised tax, pension, and labour reforms can lay the foundation for the next leg of investment returns in Argentina.

It has been nearly a month since Argentina announced a USD 20bn deal with the IMF and lifted virtually all capital controls. To ensure macro stability, the previous crawling peg was replaced by a 'dirty float' regime where the currency is allowed to oscillate within a 1,000 to 1,400 band, which will widen over time.

So far, the results are very encouraging. The old Blue Chip parallel market is now redundant, as retail can now arbitrage any gap away. Since Javier Milei came to power, the Argentinian peso has been oscillating closer to the lower band of the new target anyway, depreciating less than 20% after the first devaluation in December 2023 brought the official rate closer to the Blue Chip. Holding Argentinian short-term peso bonds in that period has returned 46% in carry adjusted terms, making the peso the best-performing currency in the world, alongside the Turkish lira.

The side-effect of devaluing the currency much less than running inflation has made the peso relatively expensive in real effective exchange rate (REER) terms. While currency overvaluation concerns remain, the new regime looks sustainable for several reasons.

First, with the immediate USD 15bn IMF disbursement, Argentina's liquid FX reserves (c. USD 27bn) are now broadly equal to the monetary base (M0), the amount of money in circulation. Total reserves (c. USD 40bn) are also close to the size of M2, which aggregates the liquid cash available in the economy.

Second, the commitment to fiscal discipline indicated by ongoing government surplus targets will likely continue to anchor real wages. This should keep import demand contained, limiting any deficits in external accounts. Middle incomes have rebounded from the lows but are far from levels that would allow most Argentinians to travel to Santiago to buy iPhones. Most of the money that is being spent abroad by Argentine tourists is dollars accumulated abroad in previous years, which does not impact the Central Bank of Argentina's (BCRA) FX reserves.

Third, the US dollar is selling off. It would have been tragicomic if Argentina had dollarised only to see the US debasing the Greenback; a scenario unthinkable a few months ago, but very much possible today.

Finally, unless private sector credit expands significantly, the fiscal surplus alongside still-elevated inflation will cause a shortage of pesos in the system over time. If the BCRA increases the monetary basis more slowly than inflation, liquidity will tighten along with activity. This is deflationary and, at some point, the BCRA would have to inject more pesos into the system.

Buying dollars with newly issued pesos would kill two birds with one stone. Analysts estimate USD 7-15bn of dollar purchases would be needed to keep the monetary basis unchanged this year, depending on inflation and private credit creation. That's significantly above the USD 4bn target of reserve accumulation set by the IMF. Milei said any FX intervention by the BCRA would only take place at the lower end of the band, meaning tighter peso liquidity before any dollar purchases which would provide further protection from inflation.

Where does Argentina go from here?

With agricultural harvest inflows peaking between April and June, the main risk for FX stability ahead of October's mid-term elections would be an exogenous shock driving oil and agricultural prices down. In this scenario, the upper limit of the band may be tested, forcing the BCRA to sell reserves. While we can't discount this scenario, there's a low likelihood that it would derail the adjustment, as the fiscal anchor imposes a natural limit to dollar demand. The IMF buffer also provides significant protection from a more meaningful deterioration, and Scott Bessent indicated recently that the United States would be willing to offer its own credit line if push came to shove.

Stability in the run-up to the midterms would bode well for Milei and his La Libertad Avanza party. Milei already has the highest approval rate of any leader since Néstor Kirchner (2003-2007). With the economy tracking at 5% GDP growth in 2025 and inflation declining quickly, voters have legitimate reasons to believe the economic adjustment is working. With only half of Congress seats and one-third of Senate seats up for grabs in October, Milei's party is unlikely to get much more than a third of the seats in either house. Nevertheless, his impressive popularity could force many provincial governors (including moderate Peronists) to support his measures in Congress.

Having steadied the ship, Milei needs to double-down on structural reforms in the next leg of his administration. Countries can live with stronger currencies in real terms, if met by productivity growth. For example, after a major economic liberalisation in 1991, Argentinian rental prices declined as landlords felt more comfortable about getting paid and were less worried about losing their properties – a classic example of reform driving prices lower and productivity higher. This time round, a tax and pension reform to consolidate Milei's budgetary progress and a second attempt at tackling labour market rigidities are the priorities. Flexible labour markets are key for productivity and business confidence. These reforms, alongside inflation converging to and below 1.0% month-on-month would help to secure currency stability in the longer term.

The path forward is clear. Provided Milei can consolidate political influence in the mid-term elections and implement further structural reforms, foreign direct investment (FDI) should keep flowing. For now, FDI is limited to energy and agriculture, the most productive sectors of Argentina's economy. But other sectors, from construction to manufacturing, will start to benefit from more stable macroeconomic indicators, lower rates and higher growth. Productivity gains could then allow for more sustainable wage growth and currency appreciation.

The incoming dollar bear market that we now expect would be a tremendous tailwind for the peso and could not have come at a better time. Perhaps it's no longer farfetched to imagine Argentinians, and maybe even Milei, falling in love with their own currency.

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