

Juhana Hukkinen and Matti Viren
**What can we learn from
Argentina's new economic regime?**

Aboa Centre for Economics

Discussion paper No. 169

Turku

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ISSN 1796-3133

Printed in Uniprint
Turku
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ABSTRACT

Recent economic developments in Argentina give rise to several interesting observations about the workings and effects of economic policies. Of particular interest, of course, are the dramatic changes in inflation as a consequence of the economic policies of the newly elected President Javier Milei. Here, we briefly describe these policies and try to assess how much they contributed to this outcome. As a reference, we use indicators of monetary policy, which are conventionally considered to be of decisive importance in combating inflation. Although we cannot provide a formal test for the importance of different policies, it seems that policies which restored fiscal soundness were the decisive factor.

JEL Classification: E63, E65, E43

Keywords: inflation, interest rates, government finance, fiscal theory of price level

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Acknowledgements

A standard disclaimer applies to all opinions expressed in this paper. An abbreviated version of this has been published as a SUERF Policy Brief article 1098. We are grateful to John Cochrane for useful comments.

1. Who deserves to take the credit or blame: monetary or fiscal authority?

Argentina represents an interesting experiment in economic policies, given its history of failed economic strategies, low growth, high inflation, and repeated currency crises. Here we focus on the recent episode following November 19, 2023, when Javier Milei was elected President of the Republic. The striking aspect is the surprisingly rapid slowdown of inflation, which appears to lead to a permanent low inflation regime and a balanced growth of output.

The intriguing question is: why is that? Do these developments follow the general wisdom where credit is given to the Central Bank, so that inflation is said to be curbed by tight monetary policies, typically through higher interest rates? Or was it because a credible path of future fiscal balances was achieved by drastic reductions in government expenditures?

Clearly, these alternatives make a huge difference, not only because of different actors but also due to differing views on time horizons. With monetary policies, the focus has reduced to a kind of fine-tuning of interest rates at the level of basis points as reactions to changes in proxies of inflation expectations and individual commodity prices. With the fiscal view (interpreted according to the fiscal theory of the price level (FTPL), see Cochrane, 2023), everything boils down to the perceived ability of the government to service its debt, and thus, the time horizon is much longer, and relevant measures cannot be explained by mere decimals of the government deficit-to-GDP ratio. Thus, marginal changes in government expenditures and revenues do not matter unless we are in a scenario where government credibility is close to zero, i.e., when "a straw breaks the camel's back." Politicians are evidently happy with the monetary policy/central bank view: they can blame the central bank for the loss of price stability, whereas with the FTPL, they cannot pass the buck to third-party operators.

In the case of Argentina, inflation is a permanent visitor, and it is a bit hard to think that inflation is due to some monetary policy errors, repeated supply and demand shocks, or a perverse form of (inflation) expectations formation. Thus, one is tempted to consider more profound reasons for the continuous failure in preserving price stability, and it is hard to exclude the possibility that this failure stems from more general government failure, which in the first place shows up in excessive government deficits.

2. Main observations

When scrutinizing the data shown below, we strongly favor the "fiscal failure view" because of the following observations.

Monetary policy

The Central Bank's response to inflation developments was simply too weak to reduce the inflation rate. The rate of inflation—as conventionally measured—approached 290 percent during the first months of 2024, while the central bank's policy rate increased only to 132 percent for a couple of months at the end of 2023 (see Figure 1). However, we encounter a conceptual problem with inflation measurement here. When using the conventional percentage growth rate, the values are

indeed very high, but if we instead apply the “correct” $100 \cdot \log$ difference definition, the values differ significantly. In this case, the maximum value is only 136 percent! This figure is much closer to the maximum value of the central bank’s policy rate (see Figure 2). In fact, the policy rate even exceeded the inflation rate during the latter part of 2023.

However, if we adhere to the conventional published values of inflation (computed as percentage growth rates), we can conclude that the real interest rate remained negative throughout the post-COVID-19 period. In 2024, these values were notoriously low, reaching nearly -250 percent (see Figure 3). It appears that the Central Bank attempted—and failed—to maintain some semblance of a positive real interest rate but abandoned this effort well before inflation peaked (this becomes evident when focusing on the monthly inflation rates in Figure 4). Moreover, there is no evidence that high real rates led to a significant decline in output or a subsequent reduction in inflation.

If we were to use a conventional New Keynesian Phillips curve as a reference point, we would need a highly sophisticated explanation for inflation expectations—one that nobody could empirically verify. The data we have on inflation expectations suggest that, as in most other countries, expectations consistently fell short of actual inflation values, and the duration of inflation was grossly underestimated (we discuss inflation expectations in greater detail later).

If we instead focus on monetary aggregates, they all exhibit the same time pattern (see the graph for M1 in Figure 5), but there is no lead-lag relationship from money to prices—rather, the opposite appears true. Furthermore, the growth rate of money is far lower than the rate of inflation, indicating a substantial decline in real balances.

Fiscal developments

Things look quite different from the perspective of fiscal policy. Milei's fiscal policy actions have clearly made a significant impact from a historical standpoint.

First, Milei made a strong commitment to permanently balancing government finances. Had he abandoned this commitment immediately after the elections, he would have become a "dead man walking," and the entire movement or party would have collapsed.

Second, he achieved this balance through harsh measures, both legislative and operational. Perhaps the most significant action was the reduction of the government payroll (summarized in the timeline of events appendix). These cuts affected roughly one-third of the personnel in the central administration. Crucially, these actions were implemented immediately rather than being deferred as promises or future plans. As Alesina, Favero, and Giavazzi (2019) have shown, an expenditure-based approach is more effective than a revenue-based approach and may also be more credible than strategies that attempt to manipulate government transfers. Most decisions or laws regarding taxes and transfers apply for only one fiscal year and can be easily reversed, whereas reductions in public sector employment and the closure of government institutions are far more difficult to undo.

The data also show that inflation peaked just a couple of months after fiscal tightening, with no subsequent reversal (see Figures 6 and 7). This is particularly evident in the monthly values shown in Figure 8. The nature of the fiscal stance is reflected similarly in both the primary balance and the total balance, as interest expenses change very little. Clearly, fiscal policy aligns much more closely with inflation trends than changes in interest rates do (see Figure 9).

Fiscal austerity is evident not only in inflation trends but also in consumer confidence (see Figure 10). Consumer confidence experienced a dramatic improvement within a couple of months after the initial steps of fiscal consolidation. This trend has continued in a similar manner since spring 2024.

It is also interesting to examine inflation expectations following the line of research by Hazell and Hobler (2024), who study the events surrounding the (US) Georgia Senate runoff elections on January 5, 2021. These elections determined the Democratic majority in the Senate and shaped the trajectory of fiscal policies from that date onward. The outcome was clearly reflected in inflation expectations, providing an opportunity for a difference-in-differences (Diff-in-Diff) analysis of the effects of fiscal policies. We could attempt a similar approach by focusing on existing inflation expectations time series. Unfortunately, we only have monthly data, and the experimental setting is not as clear as it is in the U.S. context. Even so, we can analyze how quickly inflation expectations responded to the initial fiscal announcements made at the end of December 2021 (see Figure 11). However, the best way to examine this is by looking at monthly inflation rates (which are largely unaffected by the challenges of choosing between log differences and percentage change values; see Figure 12). The outcome is indeed striking: inflation expectations declined at a dramatic rate immediately following the first fiscal policy announcement, much more rapidly than the monthly inflation rate. In our view, this provides the strongest evidence supporting the idea that fiscal news plays a critical role in shaping inflation expectations and the subsequent development of actual inflation. The results are consistent across different indicators (see Figure 13). The only notable exception is the Central Bank's survey, which anticipates the acceleration of inflation in 2023 much more accurately than other surveys. However, regarding the decline in inflation, it follows nearly the same pattern. Finally, we may point that also the IMF changed its forecast of the future developments of deficits and expenditures quite dramatically (Figures 14 and 15).

Obviously, one might ask why inflation began in 2023. The most apparent reason seems to be the general public's loss of confidence in the government's ability to service its debt. In 2023, GDP was declining at a rate of -1.6%, while in 2024, the growth rate was -3.5%, reflecting a drop in investment and government output. This makes it difficult to attribute changes in the price level to demand shocks unless we assume highly unusual parameter values for behavioral equations.

Microeconomic developments

The very rapid recovery of total output toward the end of 2024 clearly calls for an explanation. One plausible explanation is the new economic regime, which brought price stability and a lower risk of financial and economic crises. Another explanation is the set of policies that liberalized markets, eliminated excessive bureaucratic burdens, and reduced barriers to trade (see the interview with Minister Federico Sturzenegger (2025)). These measures were intended to be permanent, and the scale of the legislative actions was unprecedented—roughly half of the regulations were simply scrapped, while the rest were simplified. This combination of institutional and legislative actions reinforced each other, further emphasizing the permanence of the change.

It is no surprise that, almost immediately, output began to rise, accompanied by lower unemployment, reduced poverty rates, and higher growth rates (see Hukkinen and Viren, 2025). The IMF's predictions for future GDP growth now hover around five percent, up from just two percent in 2023 (Figure 16) and the poverty rate is below the pre-2024 levels (Figure 17). Growth had already accelerated in the latter half of 2024, with, for example, a monthly economic activity growth rate of 4.6% recorded in December 2024. Thus, there is no evidence of large fiscal

multiplier effects that would have pushed Argentina into a severe depression. On the contrary, the data suggest that the multiplier has been negative rather than positive.

There are many possible ways to interpret this evidence. One compelling possibility is Lucas's (2009) model of technology diffusion and trade, where "everything boils down to the adaptation parameter, which in turn reflects how well the market mechanism works and how many barriers to trade exist." In a well-functioning market system, technology adaptation is a crucial driver of growth, accelerating progress in countries lagging behind the technology frontier—such as Argentina (see, for example, Gonzales and Nicolini, 2024). Perhaps the economic miracles of Germany and Italy during the 1950s and 1960s could also serve as examples of such a recovery.

3. Discussion and conclusions

This paper provides illustrative material on recent developments in the Argentine economy after the newly elected president, Javier Milei, initiated an extensive set of government reforms. The outcome of these reforms is particularly interesting in relation to inflation: does the successful consolidation of government finances eliminate inflation even when monetary policy remains relatively passive? The data sends a clear message—successful fiscal reforms are crucial for achieving price stability. Needless to say, more rigorous empirical analysis is required to examine this key issue in economic policy.

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and Consensus (INDEC) of Argentina <https://www.indec.gov.ar/indec/web/Institucional-Indec-QuienesSomosEng>.

Timeline of events

- Timeline of events in Argentina 2023/2024
- Javier Milei elected president: November 19, 2023
- Javier Milei's inauguration: December 10, 2023
- First (central) government employment reduction, December 26, 2023
- IMF agreement, January 10, 2024
- Second set of layoffs, February 2024.
- Plan to cut altogether 75000 jobs, March 10, 2024.
- Layoff Total Reaches 40,000, April 30, 2024
- Layoff Total Reaches 50,000, October 30, 2024

Table 1 Summary of employment reductions

Appendix: Summary of Workforce Reductions

Date	Event	Number of Jobs Cut	Cumulative Total
December 2023	Initial layoffs (non-renewal of contracts)	5,000	5,000
January 2024	Additional layoffs	4,000	9,000
March 2024	Announcement of 75,000 job cuts	16,000	25,000
April 2024	Layoffs continue	15,000	40,000
October 2024	Layoffs reach 50,000	10,000	50,000
December 2024	Announcement of further reductions	Planned: 25,000	Total planned: 75,000

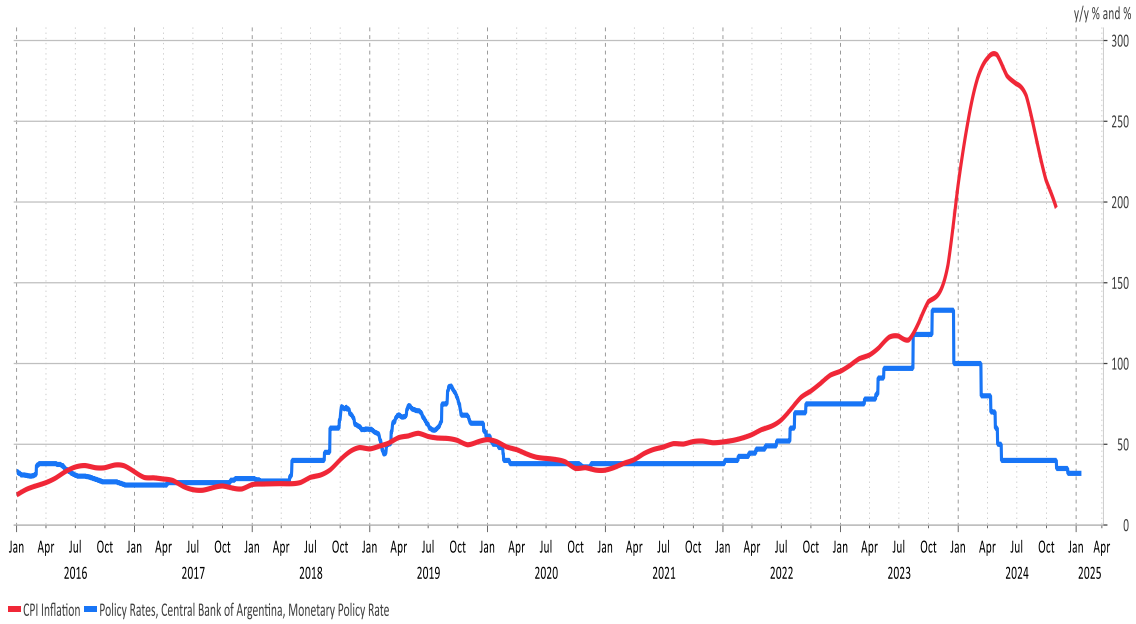
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Figure 1 Annual CPI inflation with the policy rate

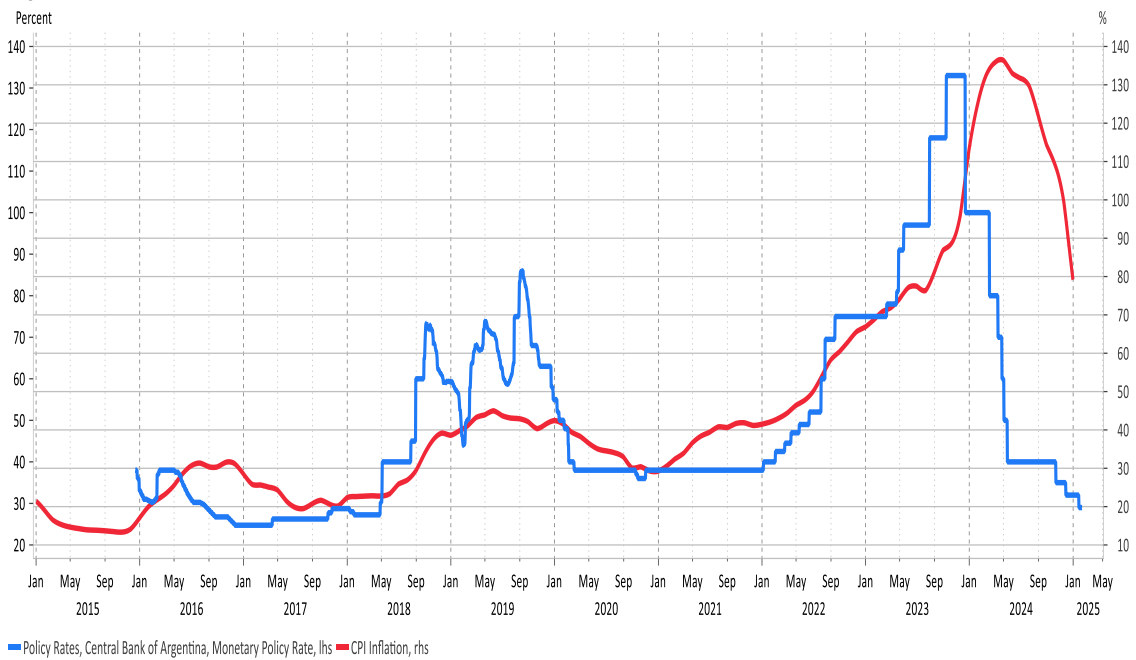
Argentina, Inflation and Policy Rate



Latest value: 32, 196 Monday, January 27, 2025, Thursday, October 31, 2024. Source: BIS (The Bank for International Settlements), Central Bank of Argentina, Argentina Ministry of Economy & Public Finance (MECON), Argentina National Institute of Statistics & Censuses (INDEC).

Figure 2 Annual “corrected” CPI inflation with the policy rate

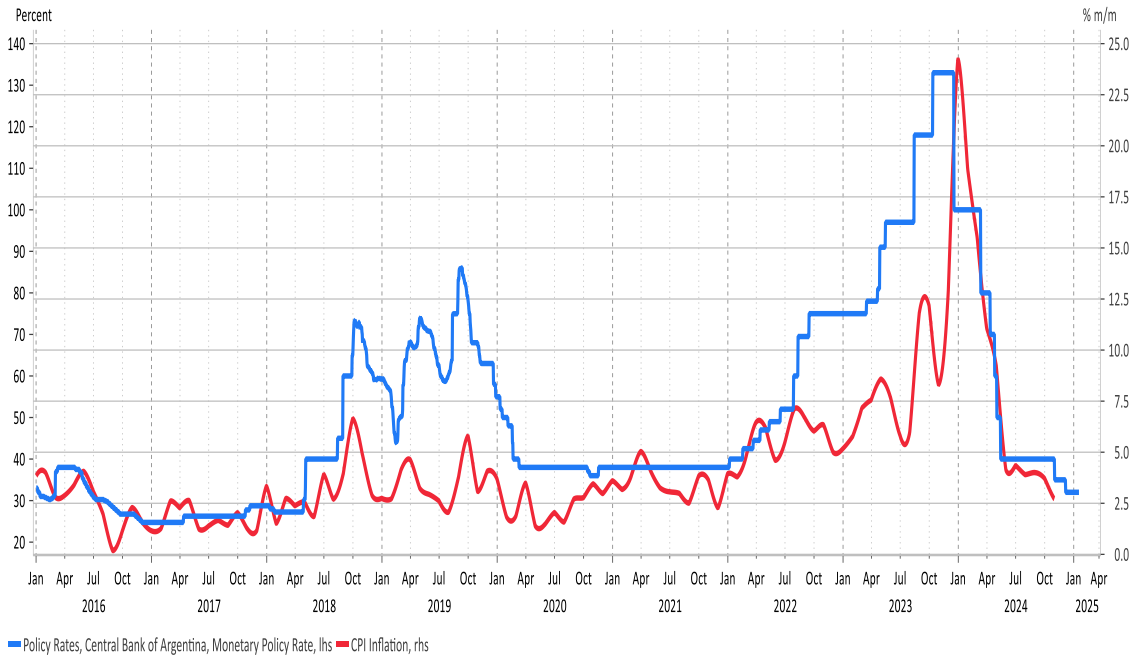
Argentina



Latest value: 79.2, 29 Tuesday, December 31, 2024, Monday, February 17, 2025. Source: BIS (The Bank for International Settlements), Central Bank of Argentina, Argentina Ministry of Economy & Public Finance (MECON), Argentina National Institute of Statistics & Censuses (INDEC).

Figure 3 Monthly CPI inflation with the policy rate

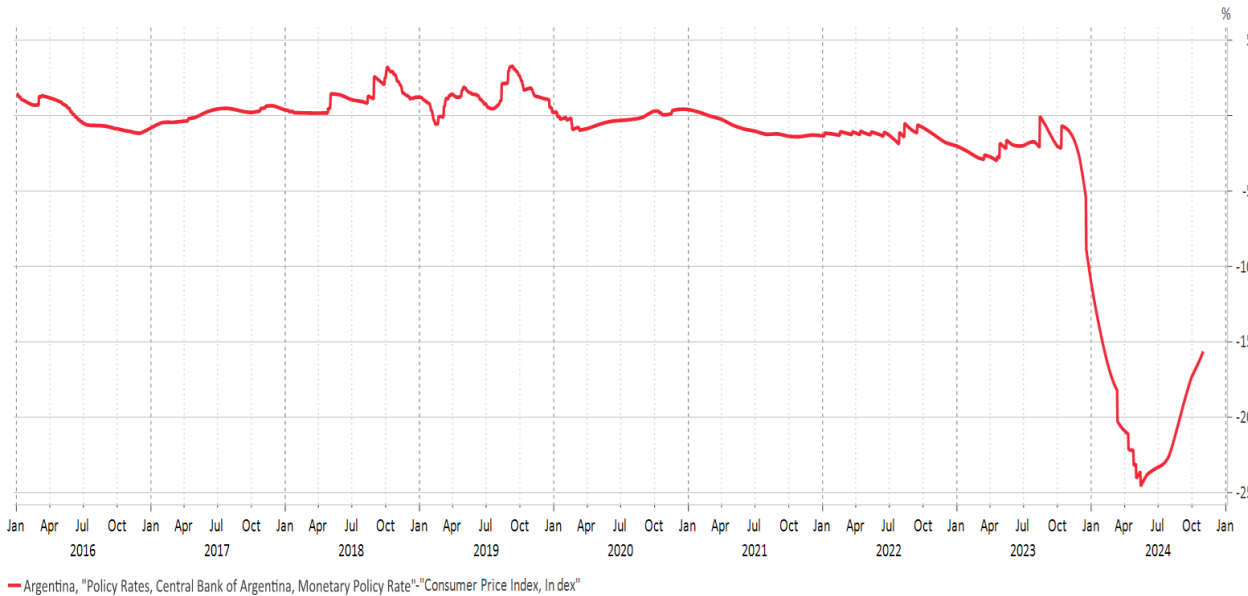
Argentina, Inflation and Policy Rate



Latest value: 2.72, 32 Thursday, October 31, 2024, Monday, January 27, 2025. Source: BIS (The Bank for International Settlements), Central Bank of Argentina, Argentina Ministry of Economy & Public Finance (MECON), Argentina National Institute of Statistics & Censuses (INDEC).

Figure 4 The real (policy) rate in y/y terms

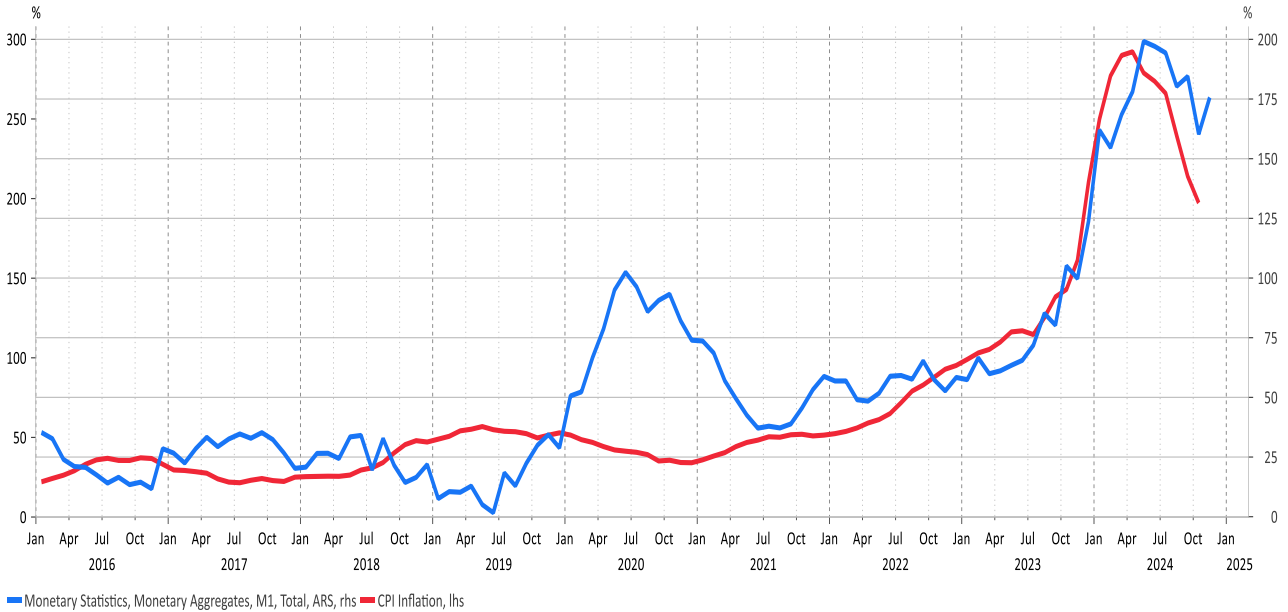
Argentina, Monetary Policy Rate - Consumer Price Inflation



Latest value: -156 Thursday, October 31, 2024. Source: BIS (The Bank for International Settlements), Central Bank of Argentina, Argentina Ministry of Economy & Public Finance (MECON), Argentina National Institute of Statistics & Censuses (INDEC).

Figure 5 Money supply and inflation

Argentina, Monetary Aggregates M1 and CPI Inflation

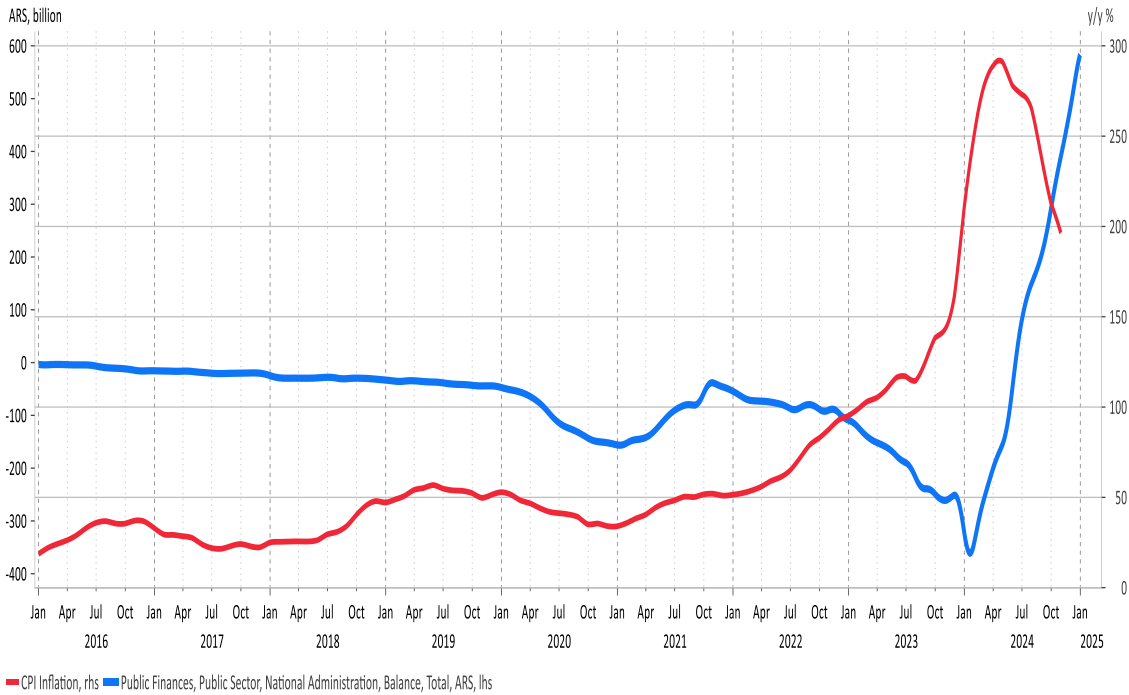


Latest value: 197, 176 Tuesday, October 1, 2024, Friday, November 1, 2024. Source: BIS (The Bank for International Settlements), Central Bank of Argentina.

Note that the money supply growth numbers are much smaller than inflation. The graphs for M2 and M3 are very similar.

Figure 6 Inflation and net lending in pesos

Argentina, Inflation and Budget Balance



Latest value: 583 billion, 196 Tuesday, December 31, 2024, Thursday, October 31, 2024. Source: BIS (The Bank for International Settlements), Central Bank of Argentina, Argentina Ministry of Economy & Public Finance (MECON), Argentina National Institute of Statistics & Censuses (INDEC).

Figure 7 Inflation and the net lending/GDP ratio

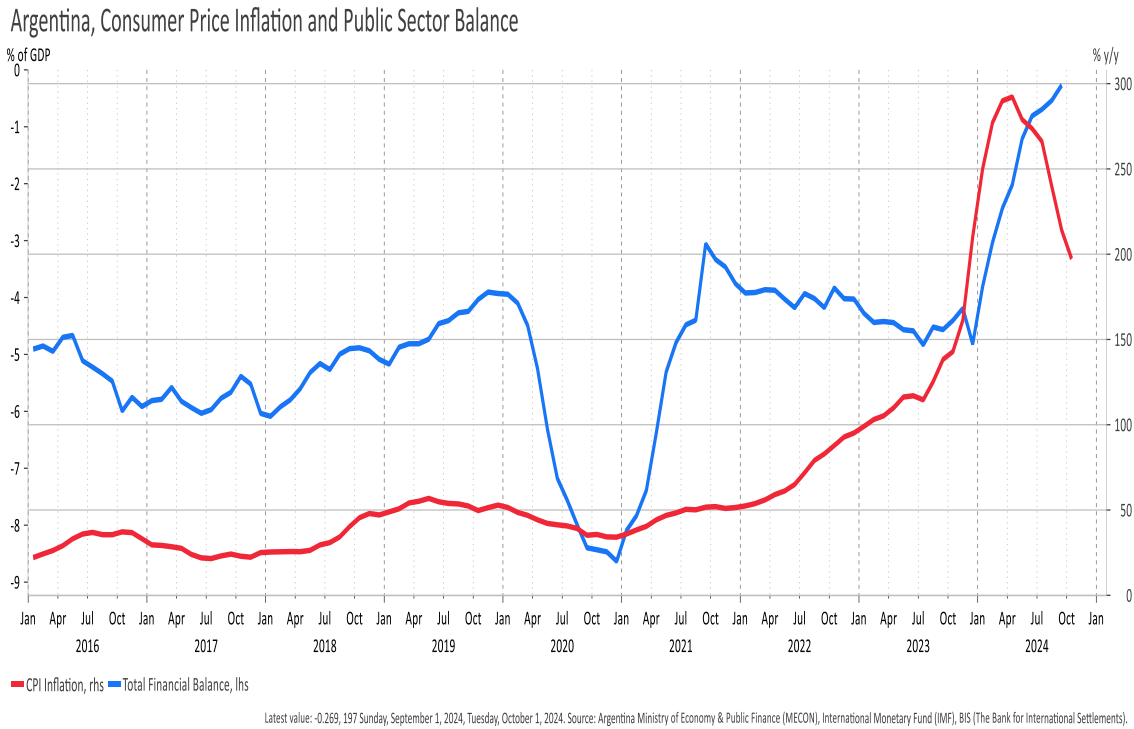


Figure 8 Monthly values of inflation and net lending

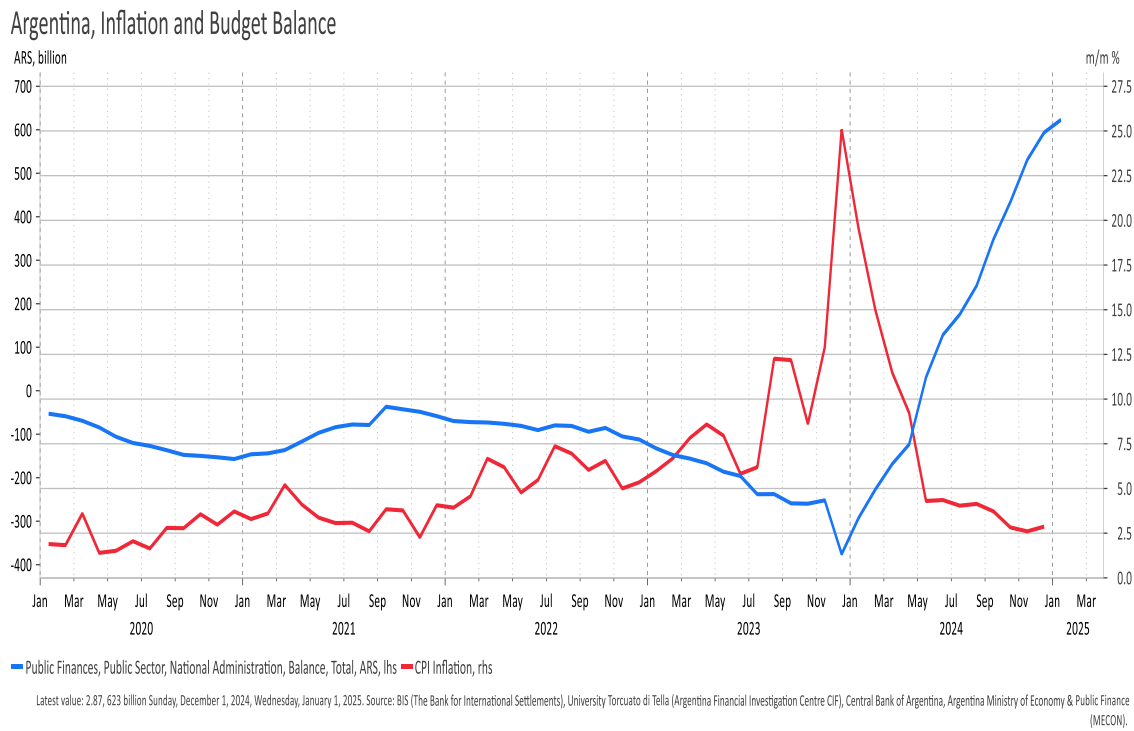


Figure 9 Horse-race between monetary and fiscal variables

Argentina, Consumer Price Inflation and Public Sector Primary Balance

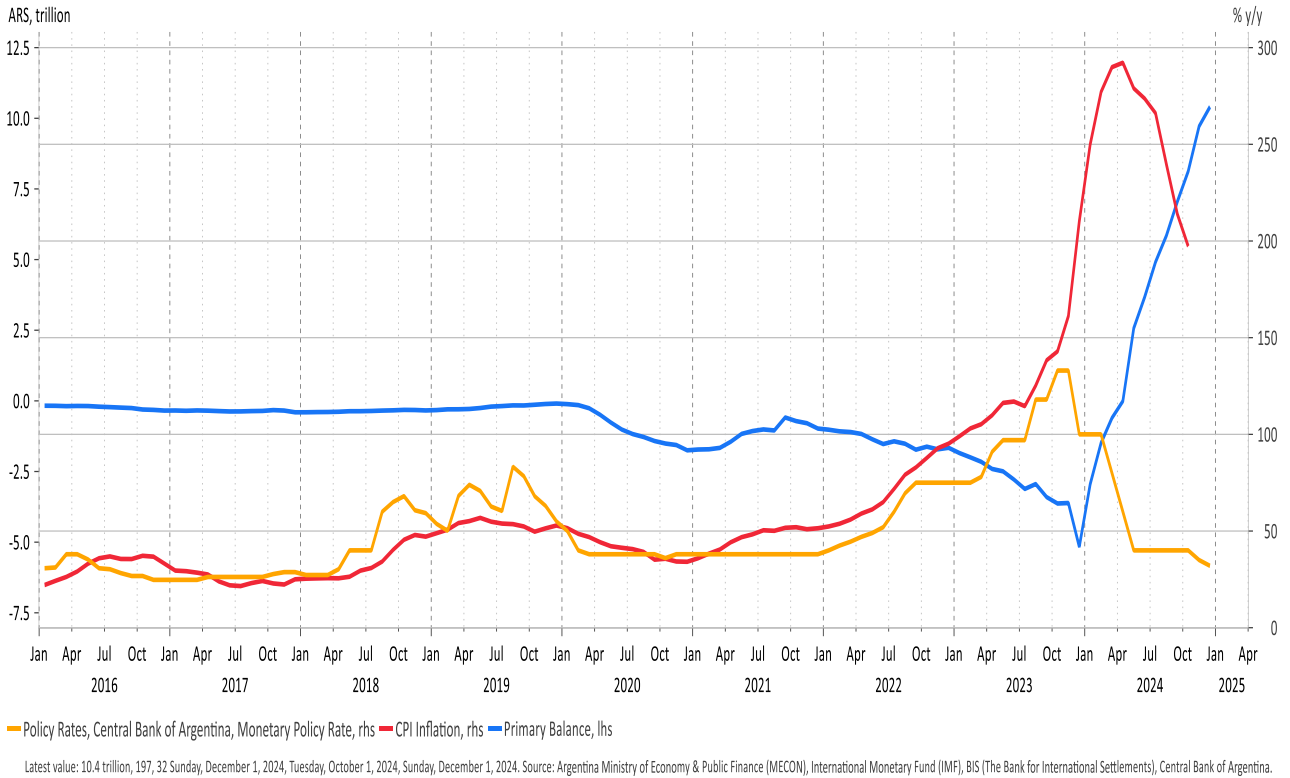


Figure 10 Government fiscal stance and consumer confidence

Argentina

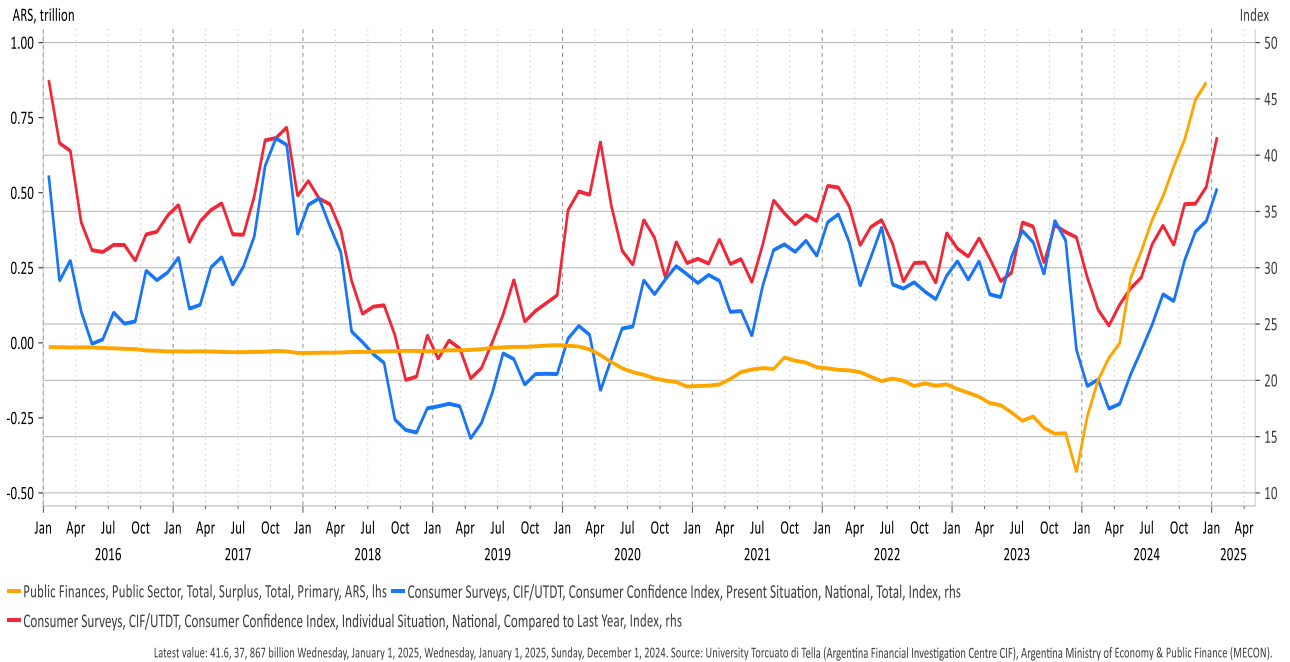


Figure 11 Inflation and inflation expectations

Argentina Inflation Expectations and CPI inflation

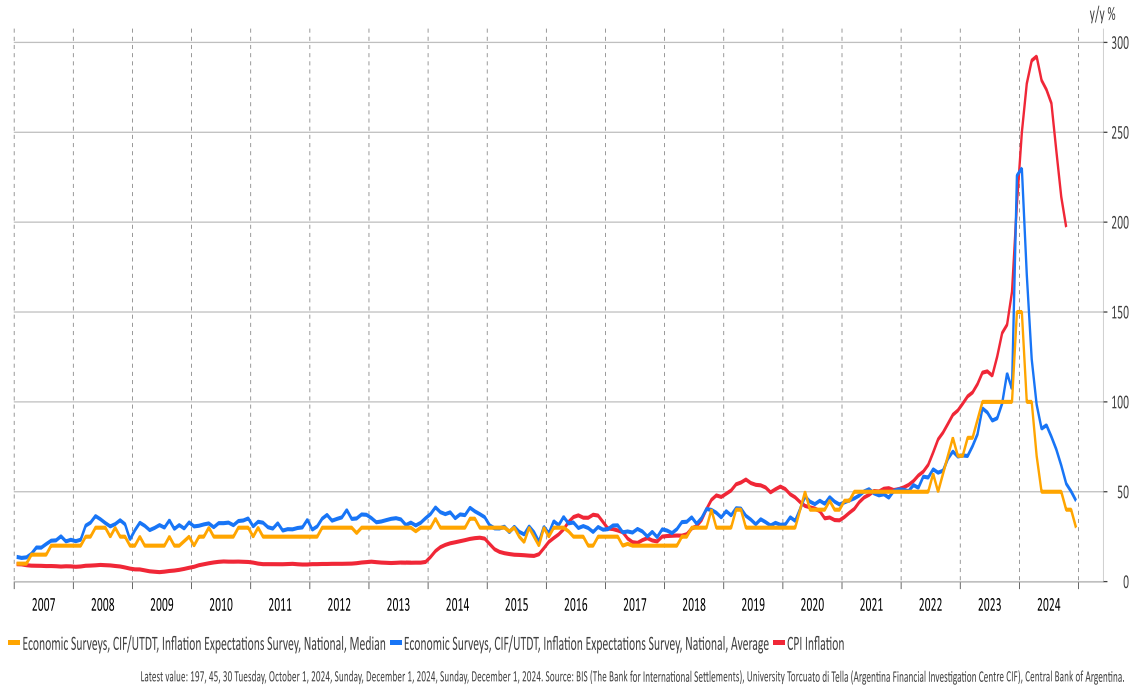


Figure 12 Monthly inflation and inflation expectations

Argentina Inflation Expectations and CPI inflation

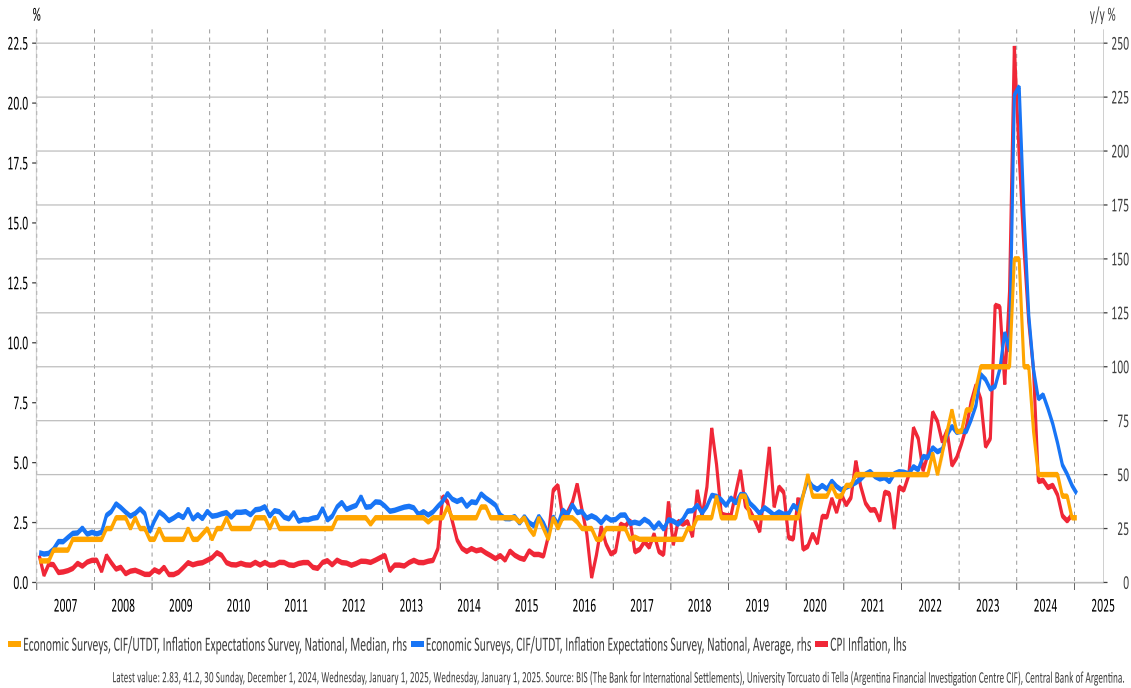


Figure 13 Scrutiny of alternative inflation expectations

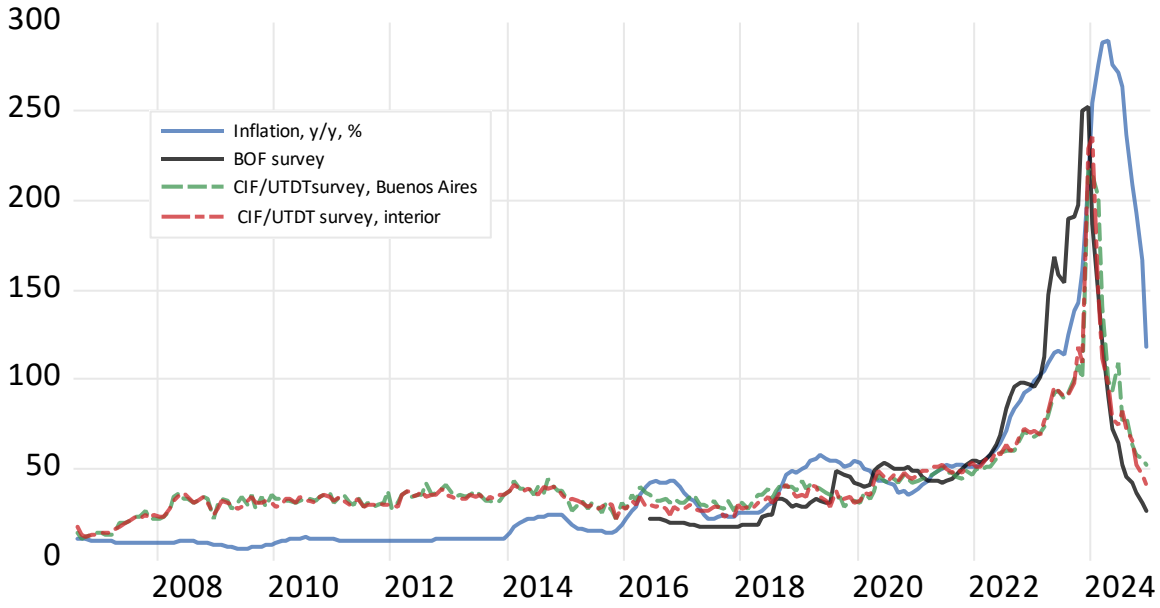
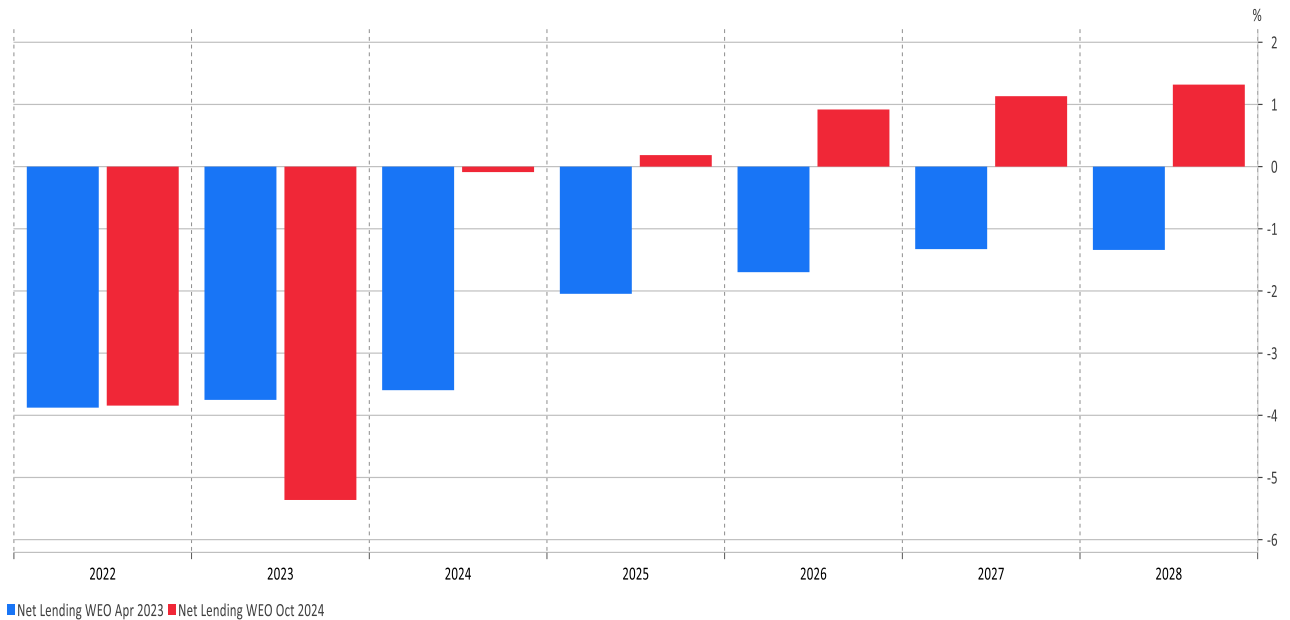


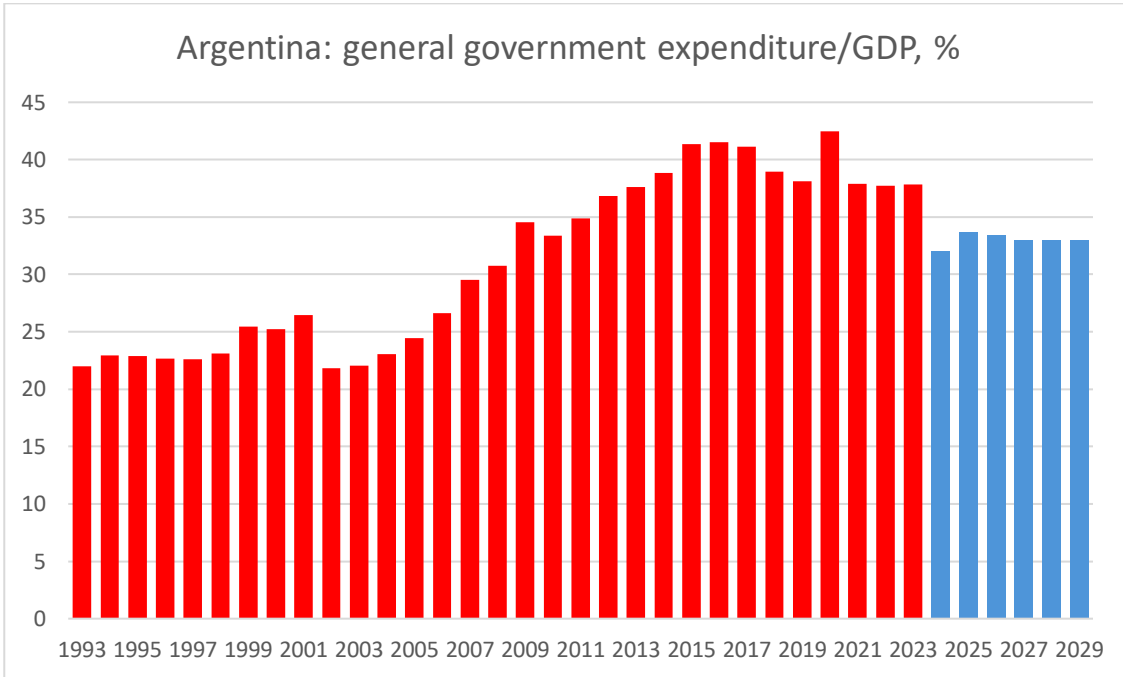
Figure 14 Comparison of consecutive IMF forecasts

Comparison of IMF forecasts, Argentina, General Government net lending / GDP, %, April 2023 vs. October 2024



Latest value: -1.34, 1.32 2028, 2028. Source: IMF Economic Outlook April 2023 & October 2024

Figure 15 IMF Economic Outlook data and the forecast made in October 2024



The post 2023 values are IMF forecasts

Figure 16 Consecutive IMF forecasts for GDP growth

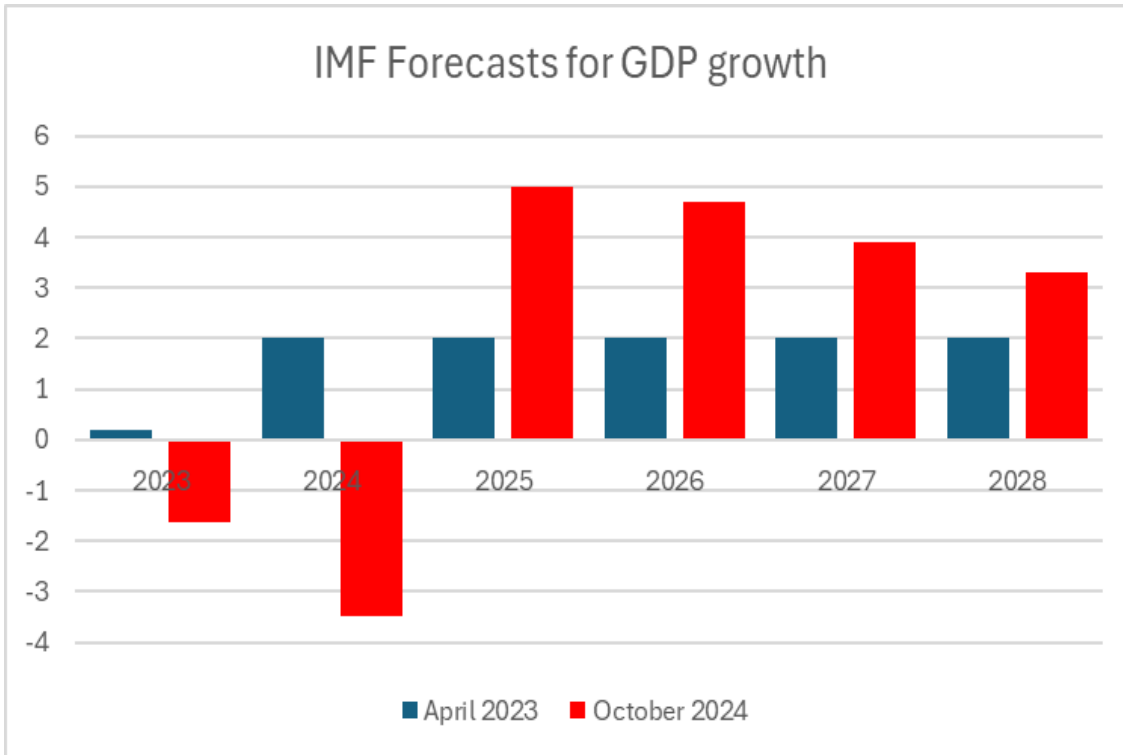
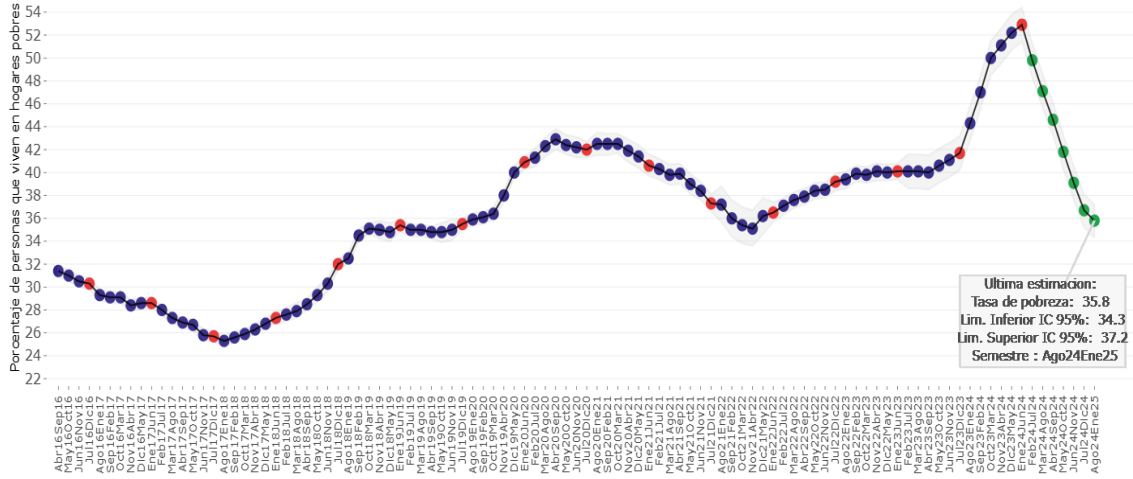


Figure 17 The poverty rate 2016M9-2025M1



Source: <https://www.utdt.edu/profesores/mrozada/pobreza>

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ISSN 1796-3133