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Argentina's New Inflation Index Looks Credible Enough

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Rare is the occasion when the words of a cabinet minister unalterably shift the direction of national policy. When it does happen, miscommunication is likely the cause. Recall the East German foreign minister's announcement, on 30 September 1989, that refugees were allowed to emigrate to West Germany. The unauthorized declaration marked the beginning of the end of the Cold War. Or, on such odd occasions, it could be that a minister is simply carrying out an order that his boss refused to be associated with. This was probably the case on February 13, when Argentine Economy Minister Axel Kicillof introduced a new consumer price index.

It marked a dramatic shift for the government of Cristina Fernández de Kirchner, which seemed bent on politicizing the nation's statistics agency, Indec, in recent years. Beginning in 2007, Kirchner pushed out Indec's career economists and replaced them with political allies. Official figures began to trail private estimates for inflation. In 2013, with Indec regularly reporting inflation figures roughly one quarter the actual rate, the IMF adopted the private estimate as its gauge for inflation in Argentina. In so doing, the IMF not only dealt Argentina's national statistics agency an unprecedented rebuke, it opened the way for sanctions against the country.

So, in unveiling the new consumer price index in February, Kicillof made official what everyone has known but the government of Cristina Fernández de Kirchner refused to acknowledge: Argentina has one of the world's highest rates of inflation. The new index showed that inflation was 3.7% in January, putting Argentina on track for 44% inflation in 2014. And still the official numbers remained below estimates of inflation by private economists.

Yet, Argentine bonds have rallied on the news. So far this year, the peso bonds have risen almost 30% in value, much of that owing to investor purchases of inflation-linked Argentina bonds between mid-February and mid-April. "They [inflation-linked bonds] gained so much after the government started reporting more reasonable numbers", noted Fausto Spotorno, chief economist at Orlando J. Ferreres & Asociados in Buenos Aires, "there's probably not much room for additional increases for now".[1]

But even if the short-term rally peters out, as seems likely, the new inflation index appears likely to restore confidence for two reasons. First, Argentina is "best in class" – if one can use that term – when it comes to inflation-addled countries. Back in January headlines of the economic situation read "Argentina and Venezuela – Which Will Survive?" and "Argentina and Venezuela: Brothers in Crisis".[2] Now the comparison with Venezuela no longer seems warranted. Inaccurate though the new inflation index is, it nonetheless provides a welcome contrast with Venezuela, where the Maduro government

1 Daniel Cancel, "Argentine Inflation Accelerated Less than Forecast in March" (*Bloomberg News*, 15 April 2014).

2 Kathleen Caulderwood, "Argentina and Venezuela – Which Will Survive?" (*International Business Times*, 30 January 2014); Kevin Lees, "Argentina and Venezuela: Brothers in Crisis" (*The National Interest*, 31 January 2014).

appears to be in denial, and the economic malaise has fueled bloody clashes between protestors and the police. Second, Brazil provides an interesting parallel. In the early 1990s, Brazil stopped hyperinflation by introducing a virtual currency, the Unit of Real Value (URV), which only gradually moved toward fair value. Brazil's economic policymakers did not pretend that the URV was an immediate solution to hyperinflation; Brazilians would not have believed this. Rather, they posted prices on store shelves that showed the URV was steady compared to the existing currency, the cruzeiro.

Point is, while the new inflation index still is not accurate it can be effective if, over a period of months, it shows that it is converging with the peso's real rate of inflation. Recent data suggests this is just what's happening. In March, the government reported consumer prices rose 2.6%, below the 2.9% forecast by nine economists polled by *Bloomberg*.[3] Inflation not only appears to be decreasing in Argentina – which, if true, is attributable to higher lending rates and a devalued currency rather than reporting consumer prices accurately – but the data has not incited a chorus of recriminations by economists and journalists, as was the case in the past. Instead, even many skeptics are no longer dismissive. "The credibility of the new index isn't conclusive", Luciano Cohan, chief economist at the business consulting firm Elypsis, told the *Wall Street Journal*: "The data is on the border of being believable or not".[4] In sum, the measure may be credible enough to soothe the nerves of foreign investors and disgruntled Argentines alike.

3 Daniel Cancel, "Argentine Inflation Accelerated Less than Forecast in March" (*Bloomberg News*, 15 April 2014).

4 Ken Parks, "Argentine Inflation Eases in March" (*The Wall Street Journal*, 15 April 2014).

For sure, Argentina's decade-long economic "boom" is at an end. It was a pell-mell era of growth where the successive Kirchner governments blithely ignored much needed economic reforms in favor of carefree reliance on Chinese demand for foodstuffs. The government's new inflation index should not be interpreted as an earnest turn toward reform. Cristina Fernández de Kirchner is a political opportunist, not a pragmatist, and as *The Economist* recently concluded, "It is not in her nature to execute a bold U-turn".[5] But, taken in league with other piecemeal attempts to right the Argentine economy, including the devaluation of the peso in January and higher benchmark lending rates, the consumer price index stands a good chance of encouraging enough foreign investment to keep the government from default, industry afloat, and inflation in check. It may sound like scant consolation, but at least the Kirchner era probably will not end as it began – in the ashes of economic implosion.

5 "The CFK Psychodrama" (*The Economist*, 12 April 2014).

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