October 31, 2025

A landslide victory that dispels doubts about governability

By Ignacio Labaqui. Guest columnist.

The overwhelming victory obtained by the government in last Sunday's elections removes from the horizon the uncertainties that had arisen after the Buenos Aires provincial election of September 7. The Peronist win in Buenos Aires Province in September had raised doubts about:

1. The performance of La Libertad Avanza (LLA) in the October elections. Until September, the question was the size of the ruling party's victory margin; after the provincial election, questions shifted to whether there would be any victory at all and whether the government would secure enough votes to reach one-third of the seats in the Lower House.

2. Governability. In the months leading up to last Sunday's vote, the government had been cornered by the opposition in Congress. A poor electoral outcome would have left it in a very vulnerable position for the remainder of the term.

3. Public debt sustainability. Predictably, the September result led to an increase in sovereign risk and pushed the exchange rate to the top of the band, forcing the Central Bank to sell dollars to contain further peso depreciation. U.S. intervention helped keep the exchange rate under control but did not dispel concerns about Argentina's repayment capacity, as country risk remained above 1,000 basis points until the eve of the election. A negative result at the polls would have deepened investors' doubts, even despite the U.S. Treasury's announced assistance.

4. The possibility of Peronism returning to power in 2027 and a 180-degree policy reversal, as happened in 2019. The September election's main winner appeared to be Buenos Aires Governor Axel Kicillof, who—despite his clash with Cristina Fernández de Kirchner—has shown no self-criticism regarding the economic policies of 2011–2015.

LLA's performance in October, in a sense, rewrites the recent past—as if the September election had never happened. The government and its allies secured over 40% of the vote, a figure consistent with the usual parameters of incumbent victories in midterm elections. The nationwide vote serves as a proxy for the strength of the government's mandate, and compared with other legislative wins by ruling parties, this represents a strong one.

Furthermore, by winning 64 of the 127 Lower House seats at stake and 13 of the 24 Senate seats up for renewal, the government not only secured a solid legislative shield but also gained significant leverage in congressional negotiations. Even more strikingly, in the Senate—traditionally a major obstacle for non-Peronist administrations—Peronism is now left with fewer than 30 of the 72 seats. Finally, the government reversed its September defeat in Buenos Aires Province and won the "mother of all battles," an outcome highly relevant to how markets and the private sector perceive the midterm elections.

In contrast, Peronism has emerged severely weakened from last Sunday's vote. It not only loses seats in both chambers but also remains mired in a deep leadership crisis that continues to undermine its ability to attract voters. The Buenos Aires defeat has weakened the one figure who might have emerged as a viable challenger to Milei in 2027. Looking ahead, the latest setback is likely to exacerbate existing tensions within Peronism, particularly in Buenos Aires Province.

It should also be noted that the poor performance of Provincias Unidas leaves Milei with no apparent rival for the 2027 presidential election. This, however, should not be overstated. Historical evidence shows that midterm elections—especially since 2009—have been poor predictors of subsequent presidential outcomes.

The results impact the government's internal dynamics. The electoral result, exceeding expectations, has strengthened Karina Milei's power and reduced the likelihood of Santiago Caputo gaining greater influence. The presidential adviser had warned against confronting governors who were former allies, arguing that doing so would complicate the government's position in Congress—which indeed happened. Yet the decision to challenge those governors in their own provinces ultimately proved successful, granting the administration greater legislative strength.

Cabinet changes will likely follow, though they are probable to be less sweeping than what would have occurred under a weaker electoral scenario. It's likely the government will stick with the governing formula it adopted in 2023: leveraging the strong institutional powers granted to the presidency by the Constitution while negotiating ad hoc legislative majorities with friendly governors and centrist blocs. A weaker electoral performance would likely have forced a shift toward a coalition-style presidentialism, as seen elsewhere in the region.

President Javier Milei's initial post-election signals have been moderate—an encouraging sign, given that despite Sunday's victory, the government lacks an outright majority in either chamber. Cooperation with the moderate opposition will therefore be crucial for advancing structural reforms. The upcoming budget debate will be the first real test of the government's willingness and ability to negotiate with governors.

Since the beginning of the administration, the specter of a governability crisis has loomed large. During its first year, the government enjoyed greater stability than expected thanks to the disarray Milei's rise caused within the traditional political establishment and a successful negotiation strategy. This year, however, a series of unforced errors led to successive legislative defeats that reignited concerns over governability.

That changed dramatically with the election. When Milei took office, his party controlled only 10% of the Senate and 15% of the Lower House. Starting in December, together with allies, he will hold roughly 110 seats in the Chamber of Deputies and about one-third of the Senate including the five PRO senators. In this sense, the government emerges from the election in a much stronger position. If it manages to avoid the string of unforced errors seen this year, it will be well positioned heading into 2027, with a realistic chance of securing re-election.

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The Election Result and a New Opportunity

By Sekoia Research

The surprising election result took markets by surprise and realigned valuations. The 400-basis-point drop in the country risk in just a few days, driven by a 15%–20% rally in sovereign bonds, is almost without historical precedent. Debt markets, along with the majority of the electorate, clearly expressed their preference not to return to a populist agenda. As we often point out, Argentina's center-left alternative, which governed for 16 years, is still debating whether rain falls from the bottom up or from the top down. This, clearly, is a component of country risk and became evident with this week's sharp compression. Argentina should feel a healthy envy toward the center-left spaces of Uruguay, Chile, or Brazil, where an election has only a very limited effect on country risk and on the cost of credit, both for the sovereign and for the private sector.

In January 2025, Argentina's benchmark bond (GD35) was yielding 10.25%. Of that, 4.75% corresponded to the risk-free rate (10y U.S.) and 4.20% to the Latin American risk premium (excluding Argentina and Venezuela). In other words, of that 10.25%, roughly 8.95% was "imported" risk (or regional base) while 1.30% reflected Argentina's domestic premium over the region. Last Friday, before the elections, the risk-free rate stood at 4% and the Latin American risk premium at 3%, meaning that the imported or base risk was only 7%. Despite strong support from the U.S. Treasury, the GD35 was trading near a 15% yield, leaving Argentina's excess risk premium over the region at around 8%. The decisive electoral outcome brought this differential back to about 3.5% above the regional average. Undoubtedly, the President's Sunday address and the open dialogue agenda with provincial governors to advance the necessary reforms provide a strong foundation for the normalization of external credit.

	Yield Arg (GD35)	USA 10y Treasury	Spread Latam	Spread Arg over Latam
January 2025	1025	475	420	130
Friday before election	1500	400	300	800
Current	1050	400	300	350

Fuente: Cucchiara Research.

The government is now very close to reaching reasonable yield levels for a first international market access after many years. It is worth recalling that Argentina does not need to issue debt abroad to finance current expenditures; rather, its funding needs stem from the refinancing of its own maturities. We believe that with an additional 150 basis point decline in country risk, and funding rates around 8.5–9%, the country could successfully carry out an initial issuance in the international market—either a new issue or a liability management offer for short-term securities. While the strong support from the U.S. Treasury is a tremendous aid in restoring credit market access, the economic team still faces domestic challenges, mainly tied to the usual three suspects: exchange rate, monetary, and fiscal policy.

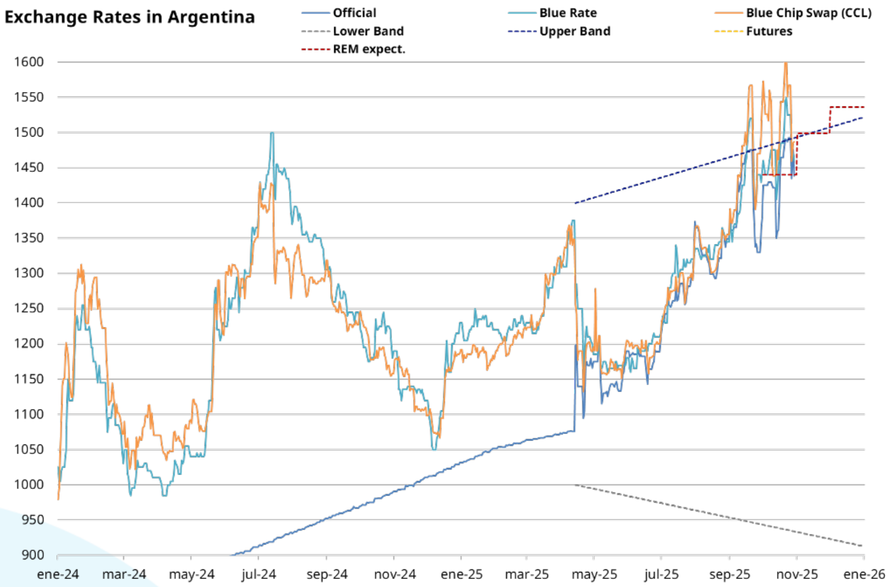
In terms of exchange rate policy, the dynamics of recent months have made evident the poor design of the FX bands. We have been quite insistent on this issue for some time, so we apologize in advance to the reader for being repetitive. The weak structure of the FX bands leaves the economy highly exposed to any adverse shock. In recent weeks, that headwind came from electoral uncertainty, but in the future it could arise from a deterioration in the terms of trade, a drought or poor harvest, another election cycle, or simply from a global strengthening of the U.S. dollar. Although the current real exchange rate (REER) is now much closer to reasonable levels thanks to recent corrections, the problem is that today's more balanced level sits almost at the upper edge of the band. A reasonable level should be closer to the middle of the range rather than the top. Our conclusion is very much in line with the IMF technical team's own estimates in its 2024 External Balance Assessment, the analytical framework used to evaluate whether a country's real exchange rate is consistent with its fundamentals.

Another weakness of the current FX band system is that these are fixing bands rather than intervention bands. This means that when the exchange rate reaches the upper (or lower) limit of the band, the central bank must sell (or buy) foreign currency to defend that limit. A far more flexible and sound framework, in our view, would be one based on intervention bands, where the central bank could sell reserves when the real exchange rate becomes excessively high without defending a specific level, and buy reserves when the exchange rate becomes overly appreciated, also without setting a fixed floor. In this way, at the upper end of the band, the likelihood of a speculative attack against the central bank's reserves which, as you know, are scarce, would be reduced.

Although net reserves have improved during Milei's administration, they remain very low both relative to GDP and to upcoming debt payments. Latin American countries with low credit spreads (Brazil, Chile, Peru, and Uruguay) show a much stronger reserve coverage of their international obligations. To put this into perspective, these economies hold, on average, reserves equivalent to about 20% of GDP; extrapolated to Argentina, this would represent roughly USD 120 billion.

It would be very healthy for the economy to strengthen the reserve position and we apologize once again to the reader for our insistence on this point. If the Central Bank shows a clear commitment not to sell its current reserves, whether owned or borrowed, and signals that starting in April it intends to buy reserves with the harvest to reinforce the external position, country risk will continue to decline. Before the main harvest season, however, accumulating reserves will not be easy. While much of the dollar demand was brought forward in recent weeks due to electoral uncertainty, supply was also advanced by the temporary removal of export taxes. Estimates for the wheat harvest are encouraging and will help on the supply side. Moreover, if in the coming weeks we see a greater supply of dollars through the capital account, thanks to the post-election calm, it would be very positive for the Treasury or the Central Bank to take advantage and purchase foreign currency. We are already seeing top-tier companies (Tecpetrol and YPF) issuing debt abroad, and some provinces may soon follow. It would be excellent news if the Central Bank used this additional supply to gradually rebuild reserves, as it did a few weeks ago through block-trade purchases.

There was also good news on this front after the elections. In a recent presentation, the Vice President of the Central Bank emphasized the need to support the remonetization of the economy and noted that one of the tools to achieve this will be reserve accumulation by the Central Bank. Although it was merely a statement made during a conference, the signal is nevertheless valuable.

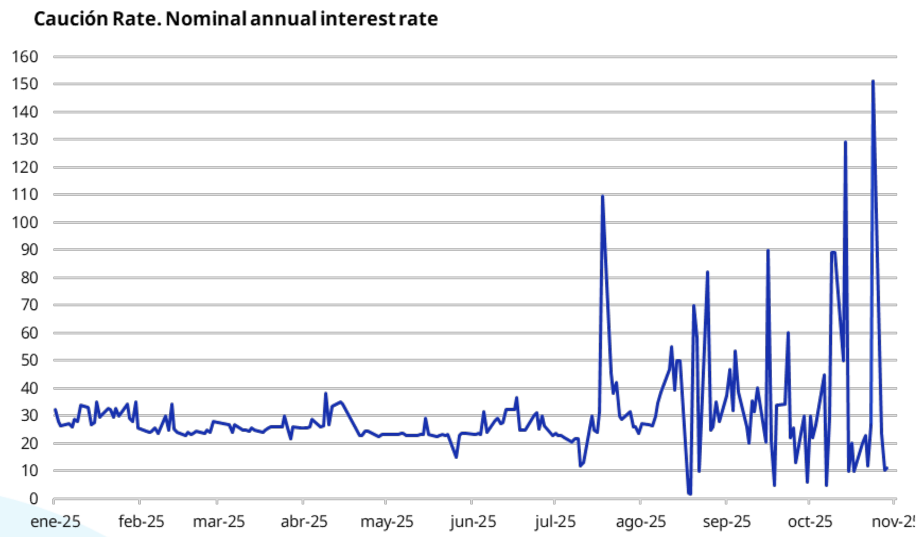


Fuente: Cucchiara Research.

Another key issue is monetary policy. Although the adopted monetary aggregates framework may entail greater interest rate volatility, the rate dynamics observed over the past few months have become completely unsustainable. The costs of monetary policy during this period whose sole objective was to prevent an exchange rate hike, were far from minor. The peso debt market, precisely the one that should have been most protected, deteriorated severely. The nominal annual yields on the shortest bills exceeded 70%–100% for several days, and the real rates on mid-curve inflation-linked bonds (CER) traded above 25% for many weeks.

No economic activity can withstand such extreme real interest rate levels. Activity data had already been showing a marked slowdown in recent months, and these rates delivered yet another setback. In the same mood, the share of non-performing loans has been rising within the financial system.

It is worth noting, however, that in recent weeks —especially after the election results— rates have been gradually normalizing, partly thanks to the Treasury's decision to inject liquidity by rolling over a smaller share of maturing bills. Another policy change announced yesterday was the modification of the Central Bank's daily reserve requirement rules, which had made liquidity management nearly impossible for banks and, consequently, for the entire financial system. The measure taken yesterday moves in the right direction but falls well short, as it only slightly reduces those requirements. Another policy of vital importance would be the establishment of an interest rate corridor. The Central Bank should implement a rate corridor to absorb idle balances (deposit rate) and provide liquidity (lending rate), in order to prevent the shocks that cause massive and unnecessary volatility in interest rates—volatility that only serves to further harm economic activity.

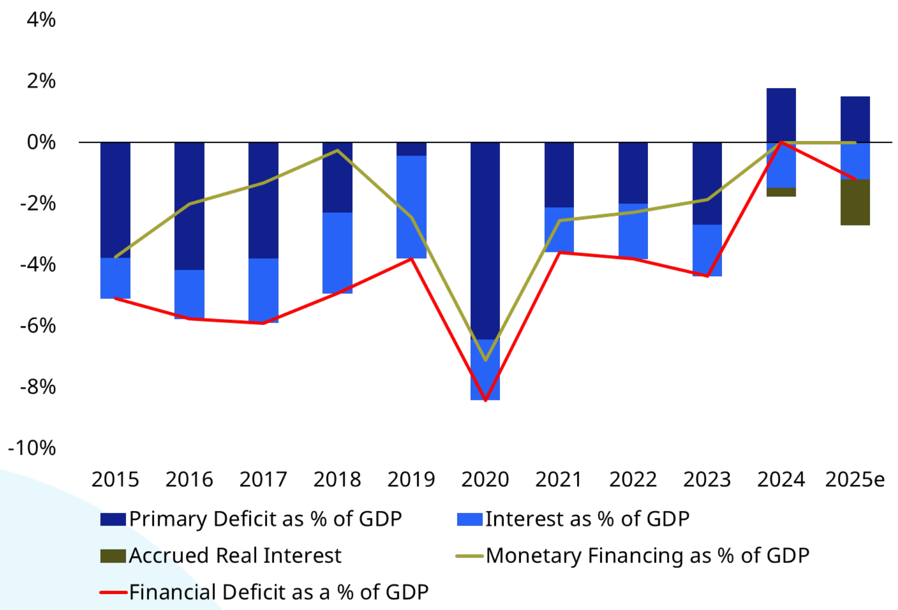


Fuente: Cucchiara Research.

The final key issue is fiscal policy. During its first year in office, the government managed to cut consolidated public spending by between 6 and 7 percentage points of GDP and reverse a virtually chronic primary deficit that had been financed through monetary financing. This year, the economic team will likely meet its target of a 1.6 point primary fiscal surplus. Looking ahead, it will be difficult for public spending to continue declining; in fact, in 2025 it is slightly increasing in real terms. Many of the tools used in 2024, such as the exchange rate adjustment, the real decline in pensions and public wages, the reduction of subsidies, public works, and transfers to provinces, have already been exhausted. We believe this is not particularly concerning: consolidated spending at current levels can be perfectly financed through tax revenues. It would be naive to think that society could legitimize another reduction in public spending of the magnitude seen in 2024.

In the same direction, the necessary call for consensus with provincial governors could entail some additional spending by the national government. Part of these fiscal concessions could be financed through sustained economic growth; let us recall that if the economy grows by 2%, tax revenues increase by about 0.5% relative to GDP. This is why stability is worth gold: it not only supports growth but also improves the fiscal outlook.

Finally, an important point. Let us assume that, in the short term, the government concedes some fiscal revenues in negotiations with the provinces and ends up with a primary fiscal surplus of 1% instead of 1.5%. This is not necessarily bad news if such a short-term concession enables the approval of structural reforms that foster long-term growth and strengthen the intertemporal consistency of fiscal balance. At first glance, labor reform seems the most feasible, given the shared incentives and alignment with provincial governors. Tax and pension reforms appear more complex, but given the new composition of Congress, achieving a comprehensive reorganization of both the tax and pension systems is by no means impossible.



Fuente: Cucchiara Research.

The strong social support shown at the polls opens a major opportunity for the government. To make the most of it, it must overcome the challenges mentioned above. In recent days, the signals have been encouraging: the government has invited provincial governors to the negotiation table, a very positive step toward building consensus and advancing the much needed long-term reform agenda. On the monetary front, interest rates have begun to gradually normalize; measures aimed at containing rate volatility, whether through reserve requirement adjustments or the implementation of a rate corridor, would be most welcome. Finally, the Central Bank has implied at its willingness to purchase reserves; a very positive step would be to take advantage of the post-election calm in the FX market to revise the current exchange rate band framework.

Society has backed the government in a complex environment. A great opportunity lies ahead, let's hope it is not wasted.

Thank you.

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