Viewpoint: Argentina shows SA what reform can achieve

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Key points

- Argentina's shift to a libertarian, free-market approach under Milei, achieving a budget surplus and 7.6% GDP growth in Q2 2025, contrasts with South Africa's stagnant economy, highlighting the need for bold leadership to shrink the state and boost private sector growth.

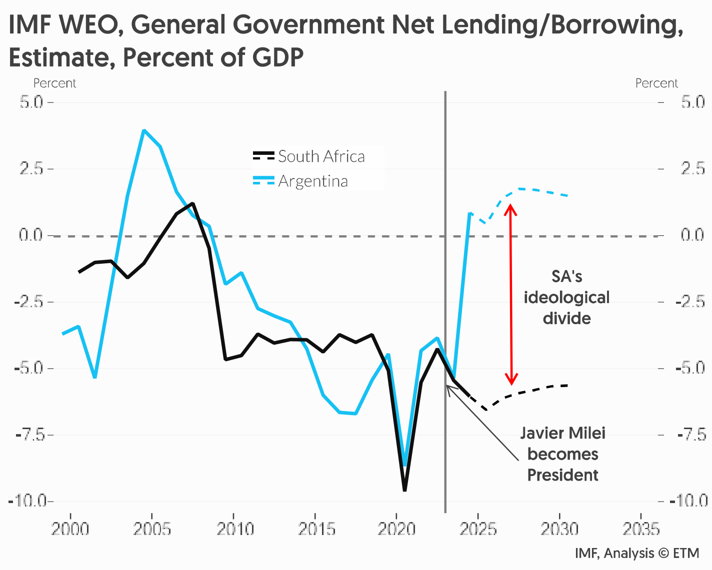
- South Africa's high debt, maladministered SOEs, and low Gross Fixed Capital Formation hinder growth, with the ANC's state-controlled ideology undermining Operation Vulindlela's reforms, unlike Argentina's successful privatisation and deregulation.

- Argentina's economic variables, from inflation to GDP growth, show the benefits of privatisation. There are lessons in Argentina's experience that we hope the government will pay attention to. Should the economic recovery in the Argentinian economy gain traction, there will be many parallels drawn with SA, and one hopes that the government applies some of those lessons to boost SA's GDP, employment and financial market prospects.

BASELINE VIEW:

The conclusion is that SA has the potential to achieve so much more and turn its fortunes around if the government allows it. For now, and under the current leadership, which seems unlikely, the ZAR will consequently need to trade at a discount. However, should reforms be targeted, the benefits to the country would be substantial and drive a significant improvement in the purchasing power of every rand.

Tariff volatility is unwelcome noise in an already uncertain environment



Argentina is a modern-day case study on what happens when a country adopts a more free-market and libertarian approach to economics, which seeks to shrink the size of the government relative to the rest of the economy.

It is an especially important case study for SA to pay attention to, as it may show SA the way to greater prosperity.

However, it will require visionary leadership that is unafraid to boldly adopt a different approach than the ANC's current ideology.

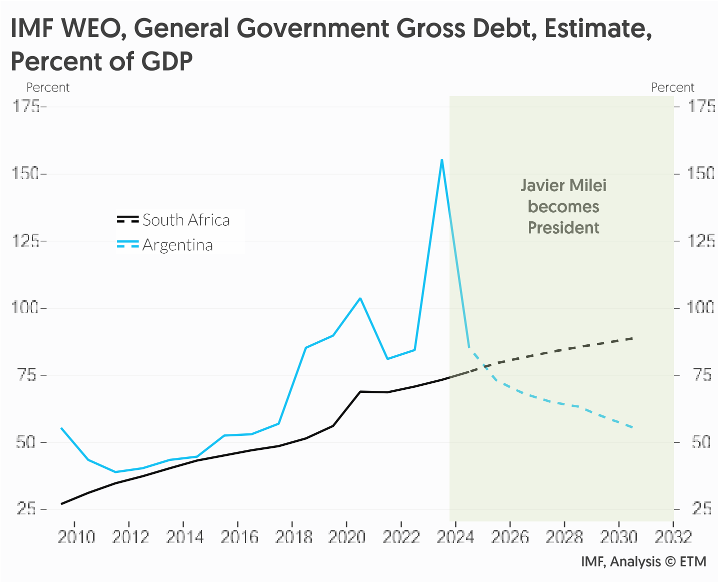
Current ANC ideology assumes that the state should have control over all aspects of the economy for the benefit of the majority of previously disadvantaged citizens of the country.

The problem is that the SA government is doing an abysmal job of it and systematically destroying capital.

In an environment where the SARB's study shows that the government's multiplier is negative, the obvious solution would be to shrink it and rely more heavily on the private sector to do some of the heavy lifting.

This is where Argentina's example will be significant, as it is the first economy to adopt such a bold strategy of shrinking the public sector and relying more heavily on the private sector to generate economic growth and prosperity.

Two opposing ideologies at play



As a result of the shrinking budget deficit and the acceleration of GDP, Argentina's debt profile improves significantly.

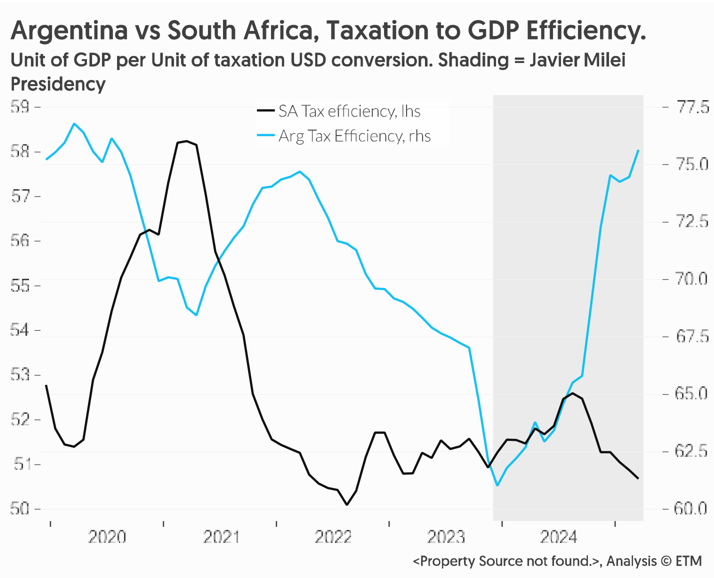
Whereas debt was projected to rise towards 180% before Milei came into power, it is already back below 100% and expected to trend towards 50% through the next five years.

One sees a very different story when one contrasts that with SA's trajectory. The role of the public sector remains larger than ever. The government has not gotten to grips with maladministered SOEs and their burden on the tax base.

In contrast, the steady erosion of institutional integrity across most strata of government means that inefficiencies continue to get baked in.

SA's GDP growth is set to stagnate through the years ahead, while Argentina's is expected to blossom and accelerate beyond the 5% mark through the year ahead. The signals to the SA government are very clear.

The case for shrinking the size of the public sector



The sharp turnaround in Argentina's fortunes is even more evident when looking at a measure of tax efficiency. It may have taken Milei six months to exert his influence and ideology on the government.

However, the results were clear when he eventually succeeded in shrinking the government and liberating the economy from the state's burden.

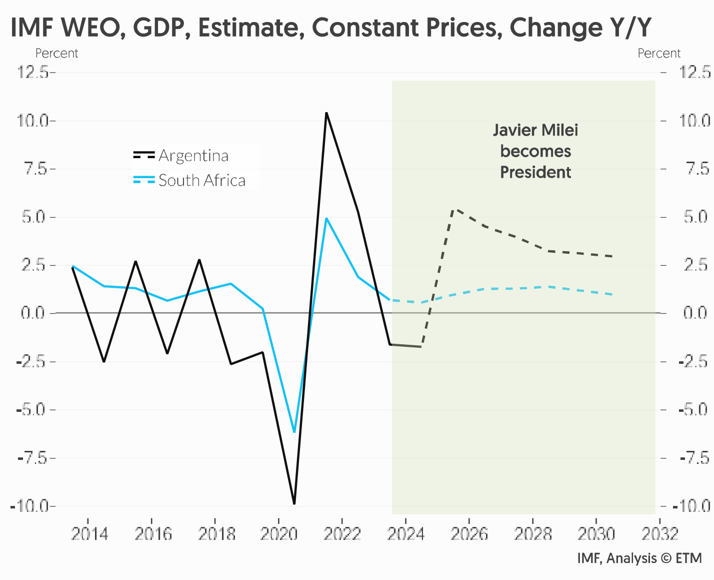
An economy does not require a large government to grow. From the charts above, it should be evident that the opposite is often true and for good reason.

A large, unwieldy government encroaches on the private sector in many ways.

Its crowding-out effect distorts market functioning, resulting in an economy fighting a state-generated headwind.

The more efficient the use of the tax base, the more it adds to economic dynamism. The private sector enjoys greater accountability and incentive to run efficiently.

Argentina shows SA what's possible through reforms



South Africa is crying out for economic dynamism. By now, it should be clear that persisting with the same ideology and strategies will yield anaemic GDP growth.

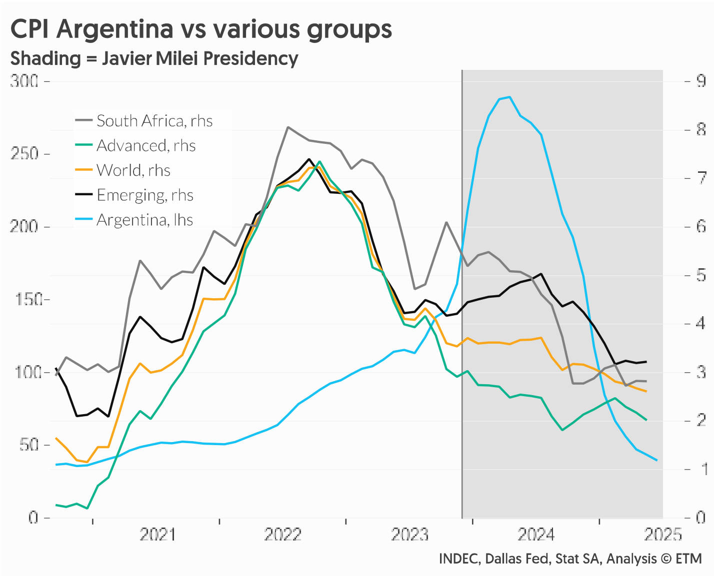
Forecasts conducted by the IMF in their World Economic Outlook show that SA's GDP growth is less than half that of Argentina.

SA desperately needs to focus on Operation Vulindlela and crowding in the private sector to help restore the efficiencies destroyed through years of SOE maladministration.

Soon, fiscal capacity will not exist to continue funding existing state structures.

The only plausible solution is for the state to shrink and liberalise the country's network industries, including electricity generation and transmission, rail, ports, IT and water reticulation. In other words, the state must embrace partial privatisation at a bare minimum.

Prudent policies have even helped Argentina out of hyperinflation



Argentina's inflation spiked to 289.4% year-on-year in April 2024, driven by President Javier Milei's economic reforms implemented after taking office in December 2023.

A 54% peso devaluation, liberalisation of price controls, and elimination of subsidies for utilities and transport caused a sharp price surge, with the Consumer Price Index (CPI) rising 1.7 times in three months, equivalent to an annualised 800% inflation rate.

This shock, intended to align the official exchange rate with market rates and reduce fiscal deficits, led to a 38% reduction in the central bank's monetary liabilities, exacerbating liquidity shortages and recessionary pressures.

SA is in a fortuitous position where it does not need to go through something as dramatic as it needs to. SA has a prudent central bank that has implemented a responsible monetary policy.

SA might even enhance the ZAR's performance and ensure that domestic inflation remains subdued if the required reforms are implemented.

This chart shows that once the necessary market adjustments are complete, even Argentina's inflation rate is likely to normalise, especially if Milei ensures that the central bank is given the room to implement prudent monetary policies. Yet more evidence that interfering with market forces only results in distortions and leads to unsustainable, counterproductive outcomes.

Arguably the biggest burden on SA's GDP growth

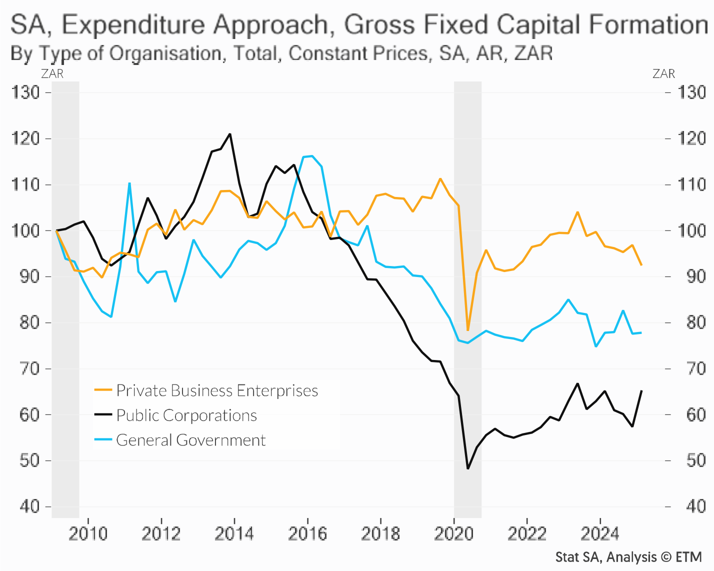
SA's economic policies have, unfortunately, undermined Operation Vulindlela. While the aim is to accelerate structural reforms to drive an economic recovery, there is no evidence of much progress. One of the best

indicators to gauge whether Vulindlela delivers economic benefits is Gross Fixed Capital Formation as a percentage of GDP. It should sit between 25%-30% in a healthy economy as a ratio.

In SA, it stands at just 14.2%. In short, the private sector is investing just enough to get by, and the public sector continues to undermine these efforts through faltering SOEs, decaying infrastructure, a heavily constrained fiscal environment, a growing burden on the tax base, and government-led inefficiencies all around, from policy positions to implementation.

SA's economy will never generate sufficient GDP growth to tackle unemployment without more investment.

Private sector and already does a better job

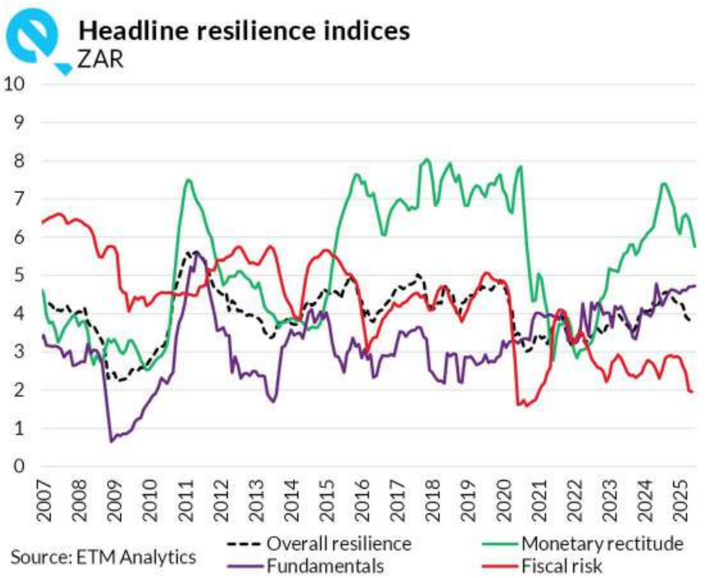


If one wanted justification for relying more heavily on the private sector to generate GDP growth, one could look at the Gross Fixed Capital Formation breakdown, which shows how, over the past fifteen years, the private sector has been the one that has invested the most, proportionately speaking.

From levels seen during the Global Financial crisis, the private sector's capital base has shrunk less than 10%. By comparison, the general government has dropped more than 20%, while public corporations fell over 50% during the pandemic, only to recover modestly to be down around 35%.

Maladministration and the destruction of institutional integrity are the main reasons for this. This economy is crying out for privatisation, accountability, and the professionalisation of the state, doing away with cadre deployment and other destructive policies that restrict the operations of businesses.

SA underperforms on SA's resilience indicators, but Argentina shows SA the way



ETM's resilience indices aim to offer readers a score out of ten for ease of understanding where the problems in the country lie. The accompanying chart shows that the lowest score out of ten sits with the fiscal authorities.

That is a function of an underperforming government that is amassing huge quantities of debt, that is running an unsustainable policy position and steadily undermining SA's economic performance.

It never used to be the case that fiscal policy was a drag. Looking back at the period before the global financial crisis in 2006 and 2007, fiscal policy was prudent and propped up the rest of the economy.

At the time, SA's debt levels were low at less than 25% of GDP, SA enjoyed an "A" rated credit rating from S&P, it ran a budget surplus and was able to issue bonds at up to 300bp below coupon to highlight the demand for SA bonds, but the relatively low perception of risk.

It is indeed frustrating to see how poorly SA is doing now. But the solution is there for all to see. It requires bold leadership, tough decision-making, and a shift in ideology. Some may say that it is unrealistic to expect all this while the ANC still commands so much support, and that will undermine the ZAR's performance in the long term. However, therein lies the opportunity. If SA can implement reforms, the purchasing value of every rand will rise once more.

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