Argentina on the Brink

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More than a decade after it defaulted on its foreign debts, Argentina is again facing a financial crisis caused largely by misguided government policies.

The administration of President Cristina Fernández de Kirchner recently devalued the peso and relaxed some capital controls in an effort to preserve the country's dwindling foreign reserves. The government is hoping that these steps will ease some of the pressure on the currency, which does not float freely against the dollar. But Argentina needs to do a lot more to address inflation and other underlying economic problems that have led investors and ordinary citizens to bet against the peso.

In the years after its painful default in 2002, which wiped out the savings of millions of people, Argentina enjoyed a fast-growing economy thanks in part to the booming world demand for soybeans and other commodities the country exports. But Mrs. Kirchner squandered the recovery in recent years by increasing spending on wasteful subsidies and financing the government partly by printing pesos. As a result, inflation has shot up; independent economists estimate that consumer prices jumped 28 percent last year. The official inflation rate was only 10.9 percent but few economists or the International Monetary Fund find that data credible.

Mrs. Kirchner has also hurt the economy by picking unnecessary fights with private businesses and investors. In recent years, she nationalized an oil company, an airline and pension funds. And, in 2011, the country implemented controls on how many pesos its citizens could convert into dollars, which has helped create a thriving black market for currency transactions and undermined public confidence in the government's economic policies. A recent poll showed that three-quarters of the country said the economy was headed in the wrong direction.

Government officials have begun taking some small steps to correct past mistakes. For example, the economy minister, Axel Kicillof, has been negotiating compensation for the oil company, YPF, that the government seized in 2012. And Argentina will put out a new inflation index next month to convince the I.M.F. to accept its official data again. But Mrs. Kirchner will have to take much bolder steps to repair the damage.

Argentina Devaluation Sends Currency Tumbling Most in 12 Years

By Katia Porzecanski Jan 24, 2014

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Argentina devalued the peso the most in 12 years after the central bank scaled back its intervention in a bid to preserve **international reserves** that have fallen to a seven-year low.

The peso has plunged 12.7 percent over the last two days to 7.8825 per dollar at 3:45 p.m. in **Buenos Aires**, after falling to as low as 8.2435, according to data compiled by Bloomberg. The decline in the peso marks a policy turn for Argentina, which had been selling dollars in the market to manage the foreign-**exchange rate** since abandoning a one-to-one peg with the U.S. dollar in 2002.

President Cristina Fernandez de Kirchner, who said May 6 that the government wouldn't devalue the peso, is struggling to hold onto dollar reserves which have fallen 31 percent to $29.4 billion amid annual inflation of more than 28 percent. Reserves are the government's only source to pay foreign creditors. Since changing her economy minister, cabinet chief and the head of the central bank on Nov. 18, the peso has fallen 25 percent, the most in the world, according to data compiled by Bloomberg.

"They're running out of cash and they're sitting in the corner at the moment," Phillip Blackwood, who oversees $3.5 billion in emerging market assets as a managing partner at EM Quest Capital LLP, said in a phone interview from **London**. "There's a feeling in the market that they're not going to intervene any more."

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Bonds Tumble

Dollar-denominated bonds due 2033 sank 2.7 cents on the dollar to 66.6 cents. The extra yield investors demand to own Argentine bonds over U.S. Treasuries surged 24 basis points to 975. Argentina's dollar bonds have plunged 8.2 percent this year, the biggest loss in **emerging markets**, according to JPMorgan Chase & Co.'s EMBIG Diversified index.

Yesterday, the peso declined 3.5 percent to 7.14 per dollar after the central bank abstained from intervening in the market.

Cabinet Chief Jorge Capitanich told reporters earlier today the government isn't intervening in the peso's decline, allowing the market, which is mostly closed to buyers of dollars, to adjust prices.

"It wasn't a devaluation induced by the state," Capitanich said. "For the lovers of free markets, supply and demand was expressed in the **capital markets** yesterday."

The central bank's press office didn't answer phone calls seeking comment on plans to depreciate the peso or a targeted exchange rate.

The government has changed its strategy which is leaving the market confused on the direction of their policies, Gustavo Quintana, a trader at Rabello & Cia in Buenos Aires said.

'Deliberate Strategy'

"There's no doubt this is a deliberate strategy," Quintana said in a telephone interview. "All of this is really hard to predict. No one saw the dollar at 8 pesos in January so it's difficult to speculate where it will end up."

The central bank intervened briefly when the rate hit 8.50, Quintana said.

A free-floating peso may fall as low as 14 per dollar, Citigroup Inc. strategist Dirk Willer wrote in a report today. The central bank sold a net $5.9 billion over the last year in the foreign-exchange market to help bolster the peso.

Since her re-election in 2011 when capital flight almost doubled to $21.5 billion, Fernandez has put into effect more than 30 measures to keep money from leaving the country. Her policies have included blocking most purchases of foreign currencies, taxing vacations abroad and online purchases, banning units of foreign companies from remitting dividends, and restricting imports.

Black Market

The controls cut the total amount traded last year in the local foreign-exchange market in half from 2010, according to data compiled by **Argentina**'s Mercado Abierto Electronico automated trading system.

Banned from purchasing dollars for savings to protect against inflation, Argentines have turned to an **illegal currency market**, where the price per dollar soared to a record 12.75 per dollar, according to Buenos Aires-based newspaper Ambito.

Argentina posted the largest current account deficit in the first three quarters of 2013 since 2001, when a crisis in **South America**'s second-largest economy led to the default. **International reserves** have fallen or remained unchanged for 14 consecutive business days and fell $80 million yesterday, according to central bank data.

As dollars vanish from the central bank, the government has sought to normalize relations with foreign creditors.

Foreign Creditors

On Jan. 20, Argentina presented a proposal to the **Paris Club** of creditors to seek a negotiated resolution to outstanding debt of about $10 billion. The government also has begun talks to compensate Repsol SA for the stake in oil company YPF SA it nationalized in 2012, and is preparing to unveil new inflation and growth data to address International Monetary Fund concerns over the accuracy of official statistics.

The government reported inflation was less than half of the 28.4 percent estimate by private economists in 2013. In addition to devaluing the peso, Argentina must boost **interest rates** to stem outflows, according to JPMorgan economist Vladimir Werning. Argentina's benchmark deposit rate, known as the **badlar**, is 21.5 percent.

"Longer term, it's a question of inflation, it's out of control," EM's Blackwood, who recently sold Argentine bonds, said. "They need to clear up the holdouts and open access to the international capital market. We don't think they'll take that route. They have a range of options but politicians always have better ideas."

September 1, 2011

Argentina's Turnaround Tango

By IAN MOUNT

Buenos Aires

ARGENTINA may seem like one of the last countries on earth to offer lessons for dealing with economic malaise. Once the eighth-largest economy in the world, it steadily slid through the 20th century, thanks to decades of repressive dictatorships and inconsistent market experiments. This ended ignominiously in 2001, when it defaulted on $100 billion in sovereign debt, plunging over half its 35 million people into poverty.

That, at least, is the Argentina people know. Since then, it has performed an economic U-turn — an achievement largely unnoticed outside Latin America, but one that President Obama and Congress should look to for inspiration.

Argentina is not without problems, but its recent economic record speaks for itself: the economy has grown by over 6 percent a year for seven of the last eight years, unemployment has been cut to under 8 percent today from over 20 percent in 2002, and the poverty level has fallen by almost half over the last decade. The streets of Buenos Aires are choked with cars as Argentines are on track to buy some 800,000 new vehicles this year; the wine mecca of Mendoza is full of high-end tasting rooms, hotels and restaurants offering regional haute cuisine; and plasma TVs and BlackBerrys have become household staples among the urban middle class.

Argentina has regained its prosperity partly out of dumb luck: a commodity price boom has vastly benefitted this soy, corn and wheat producer. But it has also prospered thanks to smart economic measures. The government intervened to keep the value of its currency low, which boosts local industry by making Argentina's exports cheaper abroad while keeping foreign imports expensive.

It then taxed those imports and exports, using the money to pay for a New Deal-like public works binge, increasing government spending to 25 percent of G.D.P. today from 14 percent in 2003. As a result, the country has 400,000 new low-income housing units, as well as a long-delayed, 235-mile highway between the northern cities of Rosario and Córdoba.

It has also strengthened its social safety net: the Universal Child Allowance, started in 2009 with support from both the ruling party and the opposition, gives 1.9 million low-income families a monthly stipend of about $42 per child, which helps increase consumption. Because the amount depends in part on how often the child attends school, it is also likely to improve the country's long-term educational performance.

The results have also paid off politically: President Cristina Fernández de Kirchner recently won about 50 percent of the vote in an open primary against nine other presidential candidates.

Why have Argentines embraced bigger government? In part because the preceding era showed how poorly austerity measures — the sort now being pushed by conservatives in the United States — promote growth. In the late 1990s, Argentina cut government spending drastically on the order of its lenders at the International Monetary Fund. Predictably, between 1998 and 2002, Argentina's economy shrank by almost 20 percent. It was only after Argentina turned its back on these austerity demands, and defaulted on its debt, that it began to recover.

Of course, Argentina is far from perfect: the import and export taxes have scared away some foreign investment, while high spending has pushed inflation well over 20 percent. There are also problems with the way Argentina is run: corruption, government opacity, authoritarian tendencies, confiscatory taxes and a temptation to tweak unpleasant inflation statistics. And it would be laughable to suggest that the United States follow its lead and default on its debt.

But Argentina still offers valuable lessons. For one thing, extreme cost-cutting during a stagnant economic period will only inhibit growth. And government spending to promote local industry, pro-job infrastructure programs and unemployment benefits does not turn a country into a kind of Soviet parody. It puts money in the pockets of average citizens, who then spend it and spur the economy. Spending cuts need to be made when times improve — an imperative Argentina is struggling with now — but not before.

Argentina is hardly a perfect parallel for the United States. But the stark difference between its austere policies and low growth of the late 1990s and the pro-government, high-growth 2000s offers a test case for how to get an economy moving again. Washington would do well to pay attention.

Ian Mount is the author of the forthcoming book "The Vineyard at the End of the World: Maverick Winemakers