

Argentina: two devaluation episodes

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Two Episodes:

- Currency Board and 2001 Crisis

(Sources: Sturzeneger talk at UW Madison 2002/ Feenstra Taylor, other)

- “Cepo” and Normalization of Jan 2016 ([Econbrowser Blog Entry](#), other)

Some definitions:

- Nominal Exchange Rate: $E = \# \text{ pesos per dollar}$
- Real Exchange Rate: $e = \text{peso/dollar exchange rate}$
= “Argentinean prices in dollars” / US Prices in dollars
= $(1/E) \cdot (\text{Prices Argentina in Pesos} / \text{Price in US in dollars})$

Growth Rate of Real Exchange Rate

Percentage of Change of $e =$

(Argentina inflation rate - US Inflation rate) – (percentage of change in E)

Currency Board

As defined by the IMF, a currency board agreement is

“a monetary regime based on an explicit legislative commitment to exchange domestic currency for a specific foreign currency at a fixed exchange rate, combined with restrictions on the issuing authority”.

For currency boards to work properly, there has to be a long-term commitment to the system and automatic currency convertibility. This includes, but is not limited to, a limitation on printing new money, since this would affect the exchange rate.

Argentina

Some History

- Rich Natural Resources
- High Human Capital
- Reasonable Infrastructure
- Great Performer in early 1900's.
- Closed economy/populist policies 1945-55
- Fiscal Problems, High Inflation, Macro Instability 70-80's

Reforms in the 90's

- Opening, Privatization, Financial Reform
- Currency Board (Convertibility Law 1991)
 - Fixed Peso/US dollar exchange rate
 - Pesos issued had to be backed by dollar reserves (fiscal discipline)
- Results:
 - End of Inflation
 - Great Performance 90-98

1999-2001

Deterioration and Crisis: What Went Wrong?

Combination:

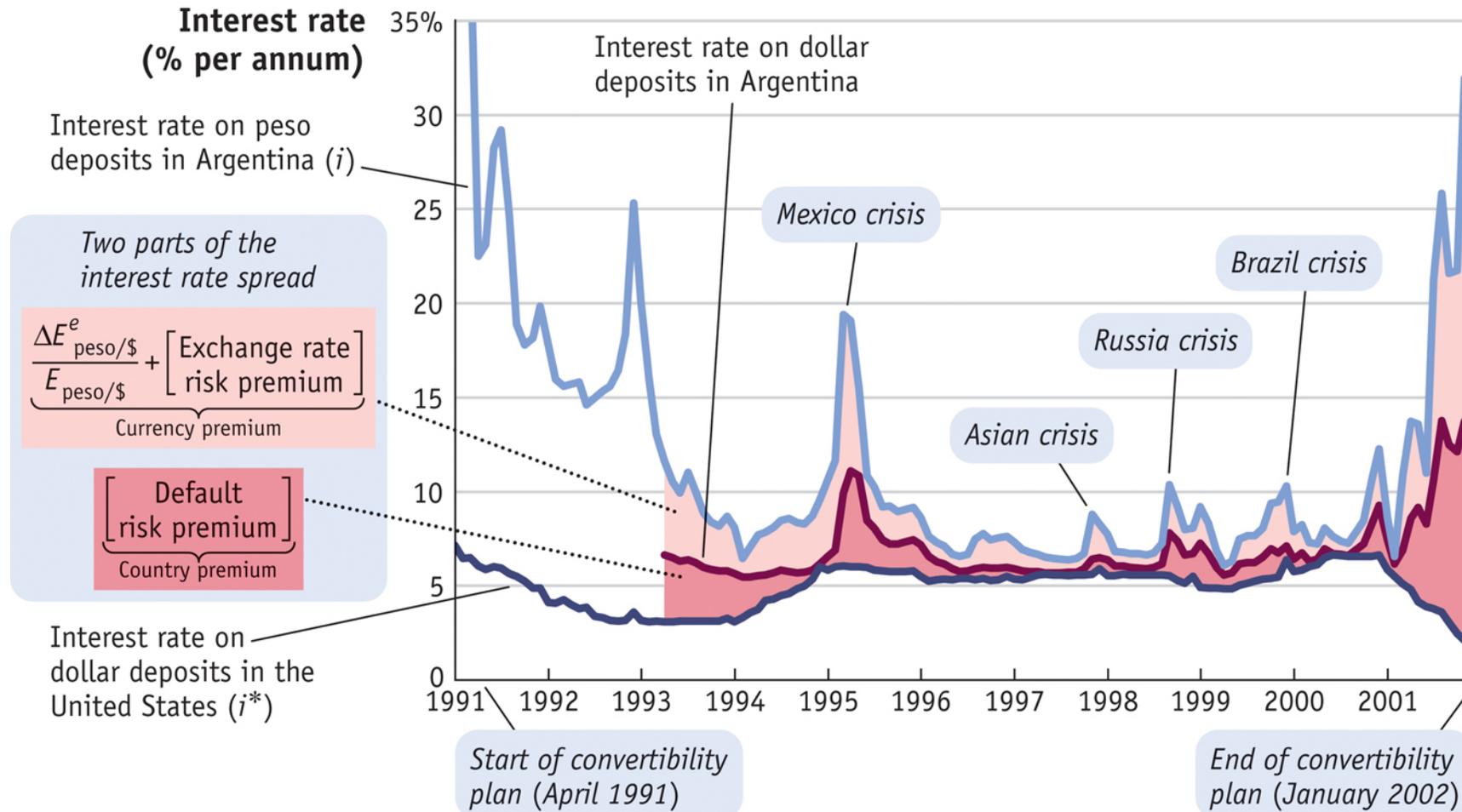
- External Shocks
- Peso overvaluation relative to currencies of largest trading partners (from external shocks+currency board)
- Fiscal dynamics (too weak during upswing, problem of provincial budgets, political issues)
- Debt dynamics (unsustainable nature was not addressed)
- Self Fulfillment Pessimism?

External Shocks

- Mexico Crisis 1995 (Argentina recovered)
- Asian Crisis 1997 (↓ terms of trade)
- Russian Crisis 1998 (K-flows dried out)
- Brazilian devaluation January 1999
- Euro depreciation against dollar 2000
- World recession 2001

Country risk ok until January 1999
(similar to Mexico)

(b) Argentina's Peg to the U.S. Dollar, 1991–2001



Fiscal issues/Debt

- Circumvention of currency board implicit fiscal discipline through the issuance of quasi-moneys by both provinces and federal government.
- Interest payment Brady Bonds negotiated in 90's (↑ interest rate increased cost of servicing foreign debt).
- After Russian crisis: ↑ interest rate in new debt
- Declining tax revenues, ↑ debt
- Attempts to collect more (↑ taxes in midst of recession) may have backfired

1999-2001

- Declining output
- increasing unemployment
- K-outflows
- Decrease in reserves
- Decrease in deposits in banking system

Early/Mid 2001

Crisis Inevitable

Big Problem:

Not easy way out: Float? Default?

Devaluation:

Positive: effects on trade

Negative: effects on Dollar denominated debt

Abandoning the Currency Board:

Monetary Policy: needs new discipline
(inflation targeting? Other?)

Issue of dollar deposits, contracts , debt
(property rights, legal challenges)

December 2001/Jan 2002

- December 2001: Frozen Deposits (corralito)
- Political Crisis
 - Change of 4 presidents
 - Riots, middle class protests
 - Society's negative view of politicians ↑
- Default
- Devaluation/Currency board abandoned

Pesification

2002

- Output drop continues
- Unemployment reaches 20%
- Increase in poverty
 - 52% in BsAs province
 - Per capita income of those at the lower 10% of the income distribution decreased by 41%.

2002-2006

- Very good economic Recovery
- Exports crucial in early stage
- Good export prices (soy boom 2004)
- Defaulted debt restructured and renegotiated
- Social indicators improve very slowly
- Some resurgence of inflation (12% 2005)

Other Issues (Populism)

IMF Debt cancelled (Jan 2006)

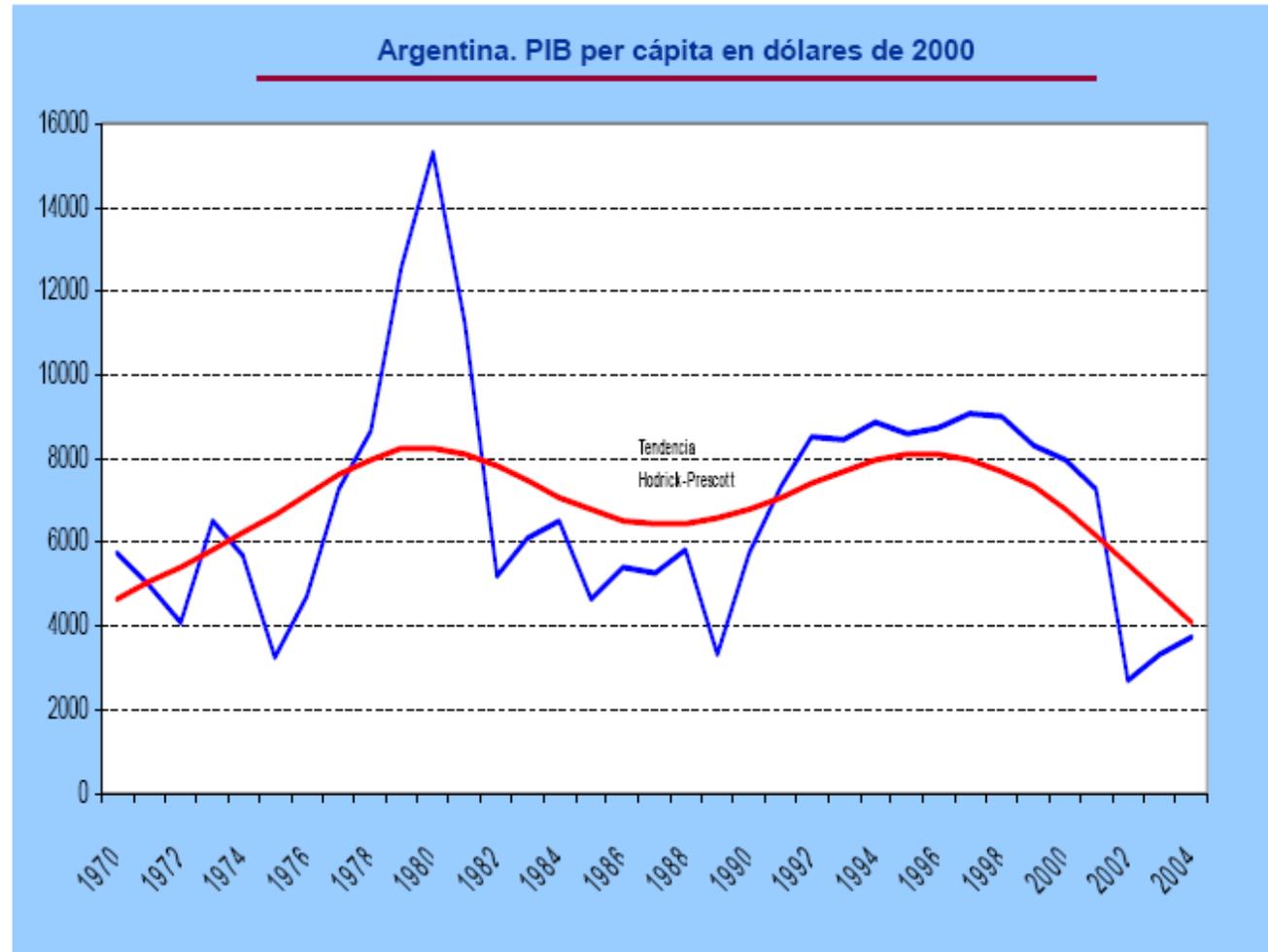
But it was the cheapest debt!!!

Ban on beef exports (March 2006) to lower domestic price of beef!!!!

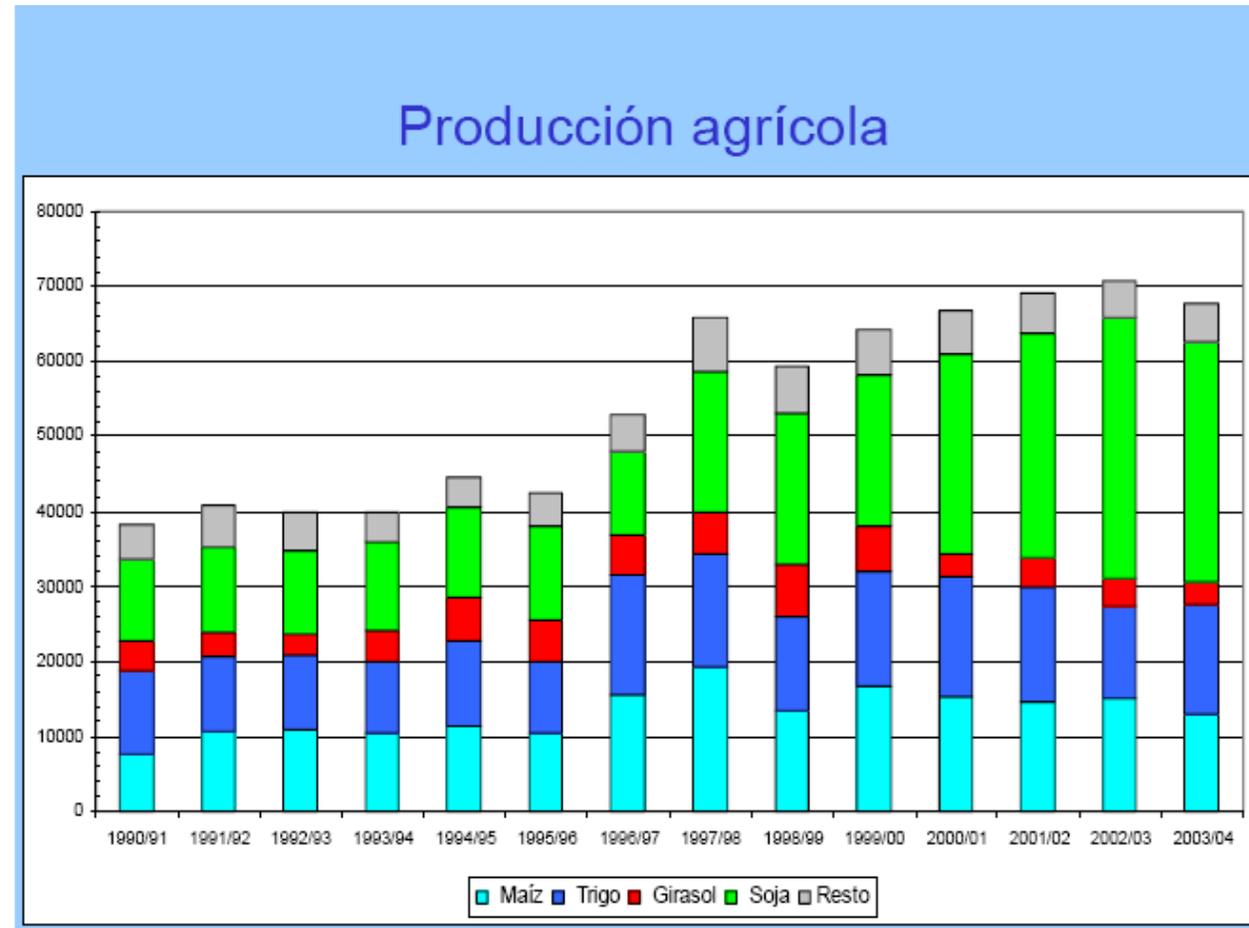
China has become a leading trading partner!

- Large increase in Social Spending (cash transfers)

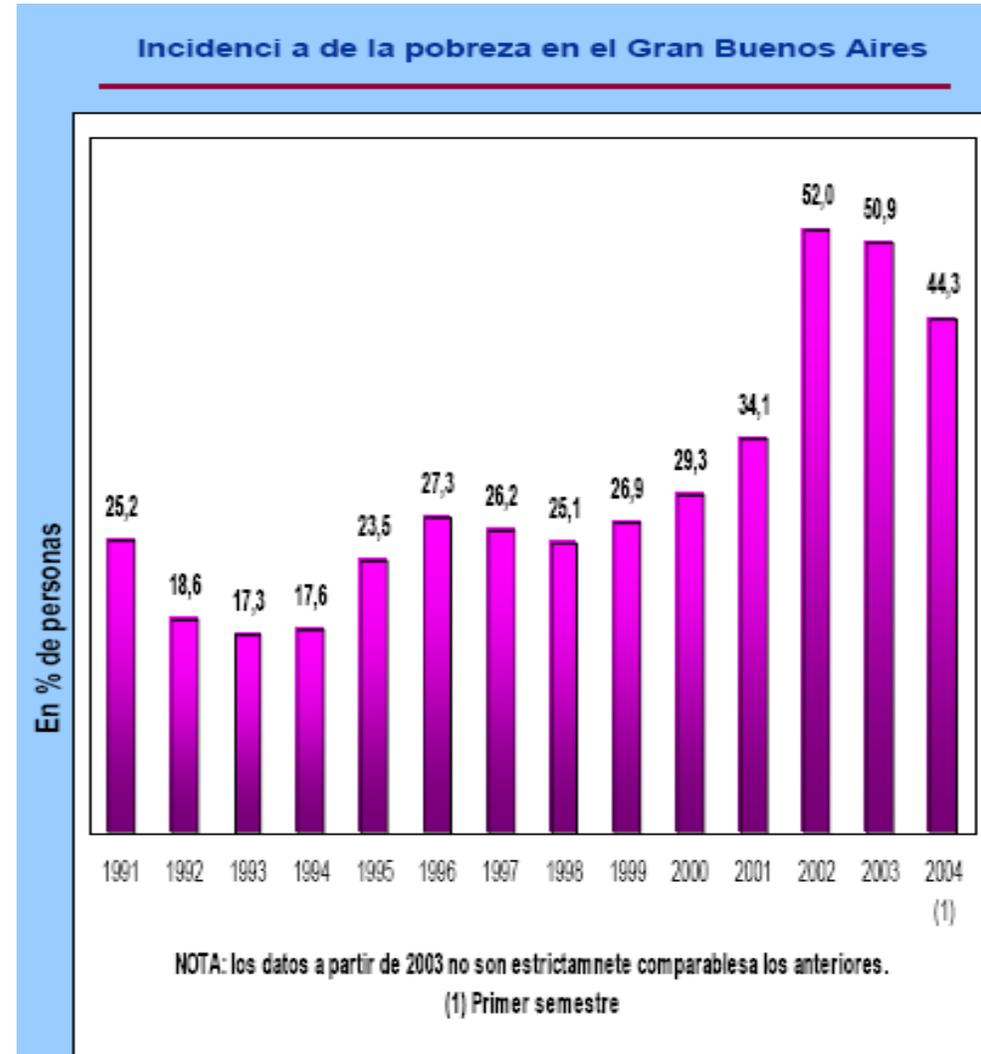
GDP Per capita (2000 USdollars)



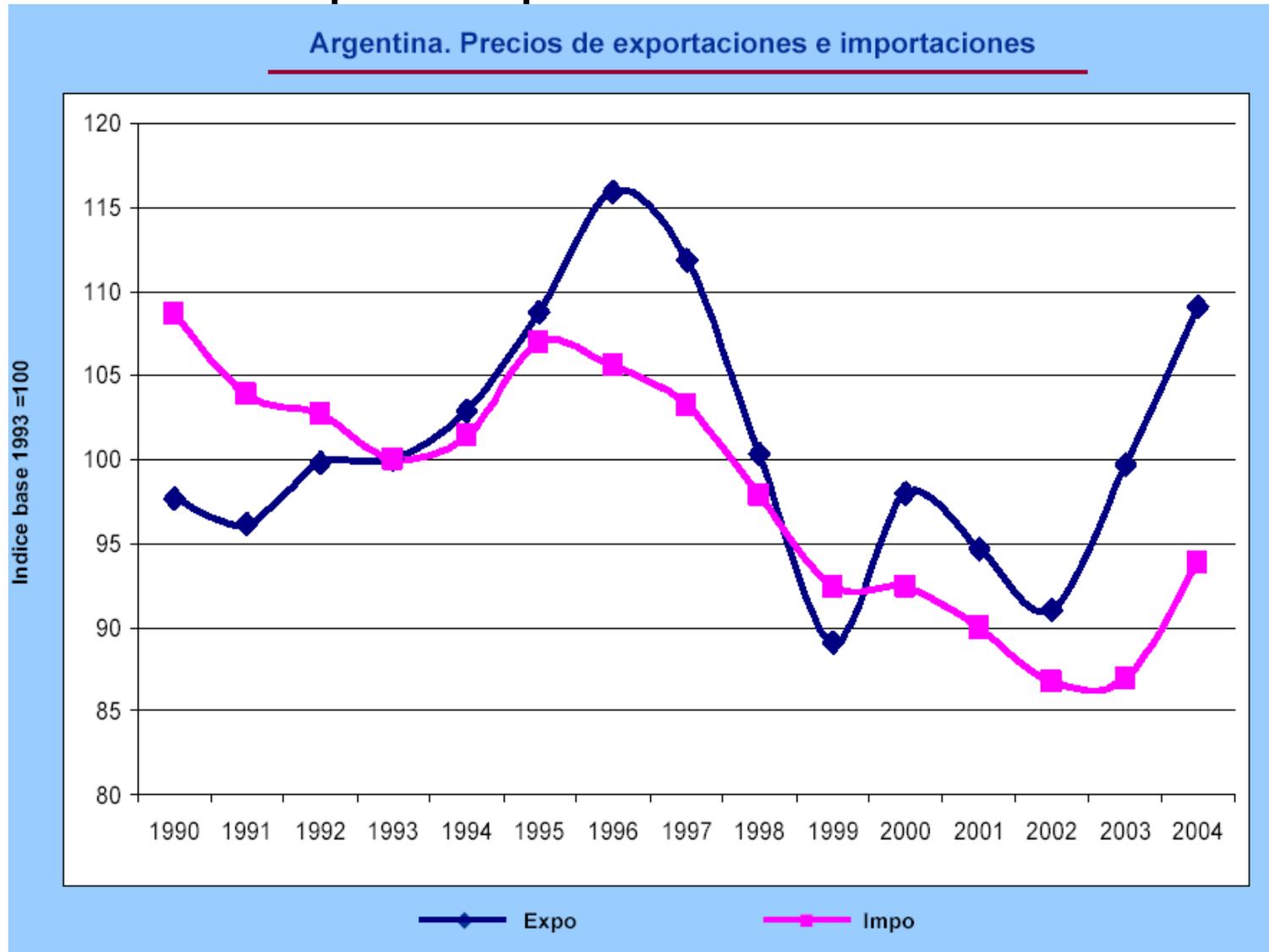
Agricultural Production



Poverty Index in Buenos Aires Metropolitan area

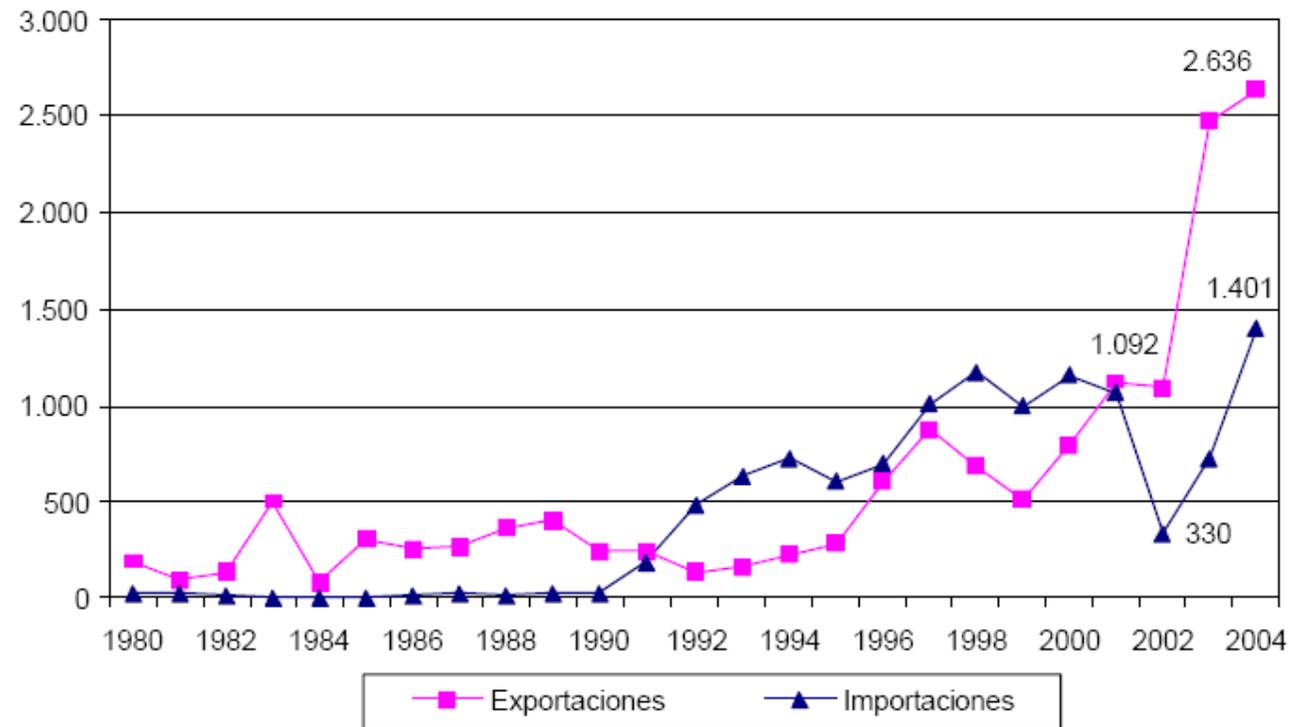


Export and Import prices



China-Argentina Trade (million of US dollars)

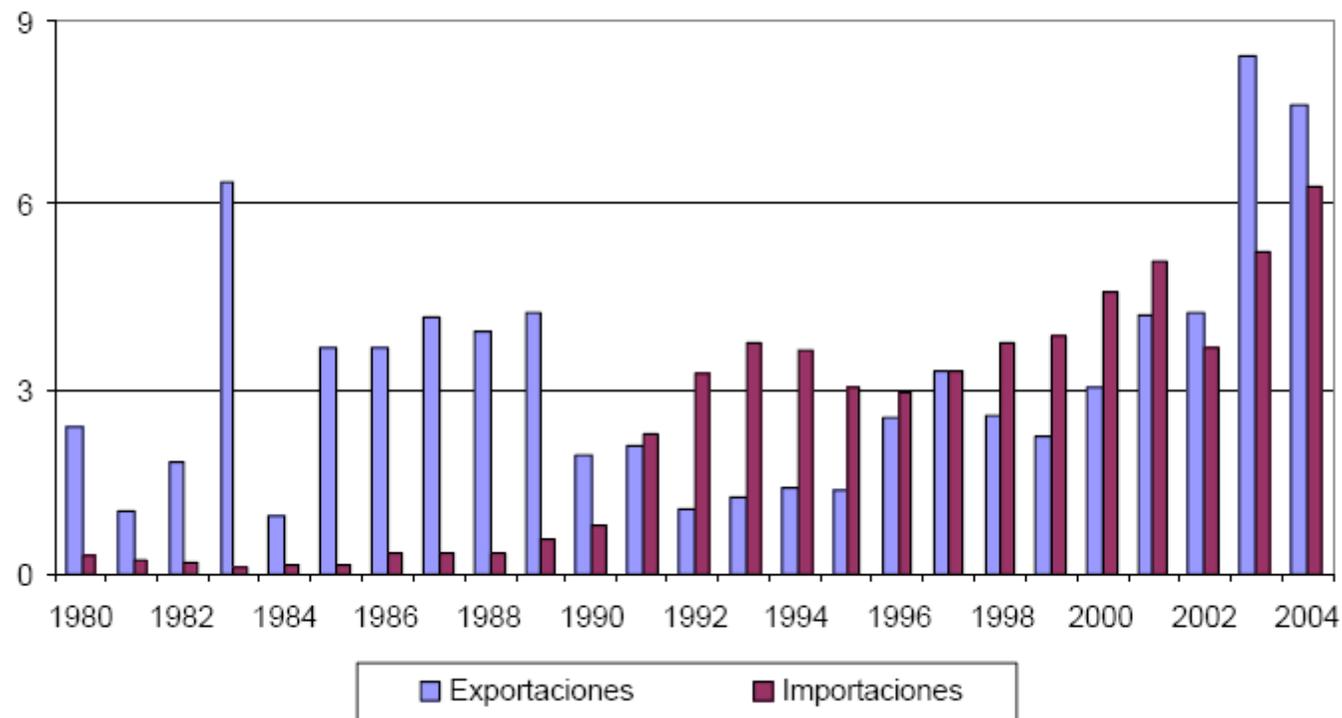
Gráfico 1
Comercio de la Argentina con China
en millones de dólares



Fuente: Centro de Economía Internacional

China's participation in trade

Gráfico 2
Participación % de China en el comercio exterior argentino

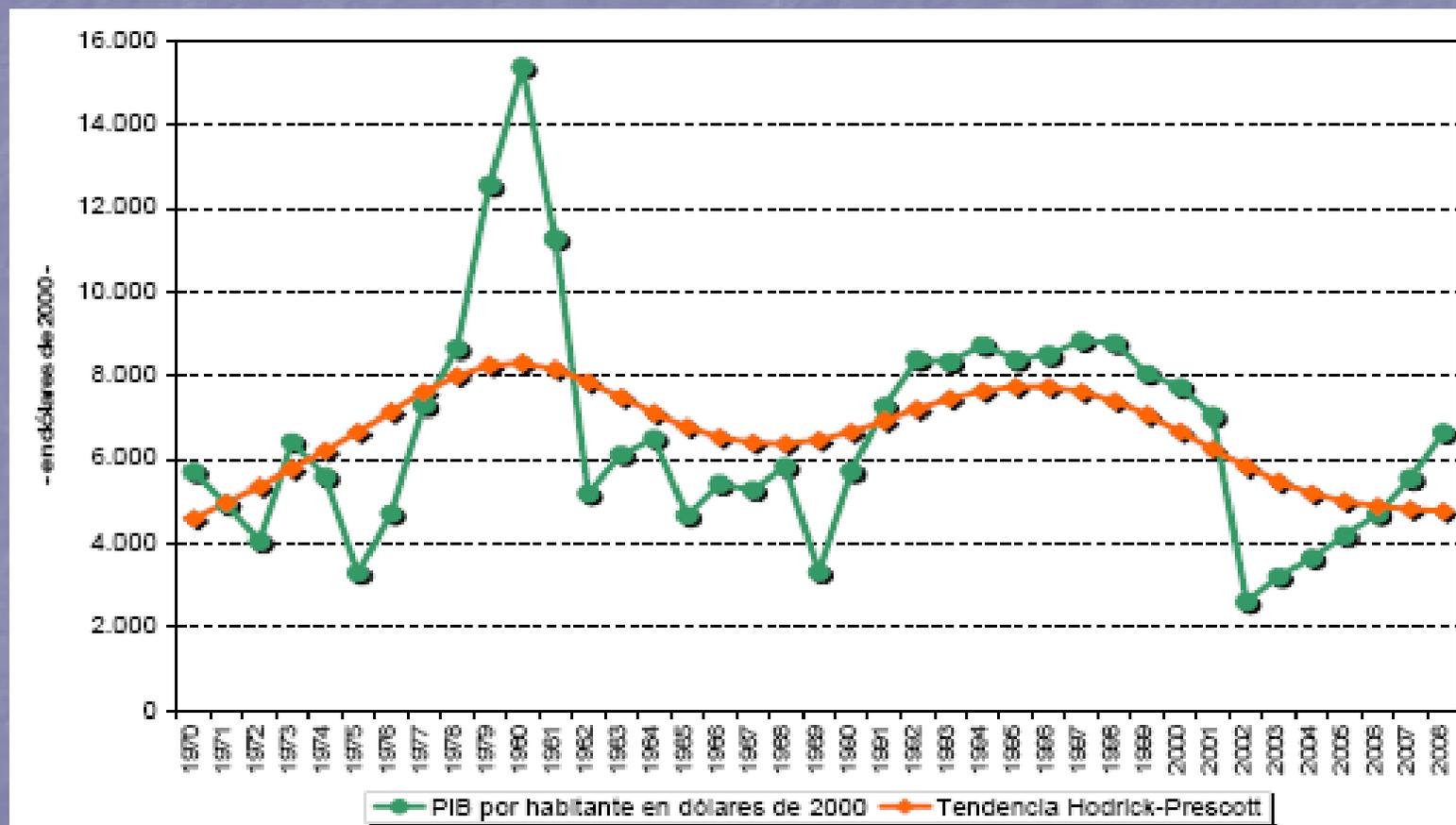


Fuente: Centro de Economía Internacional

Soy Prices



Argentina. PIB per cápita en dólares de 2000



Dec 2015/Feb 2016

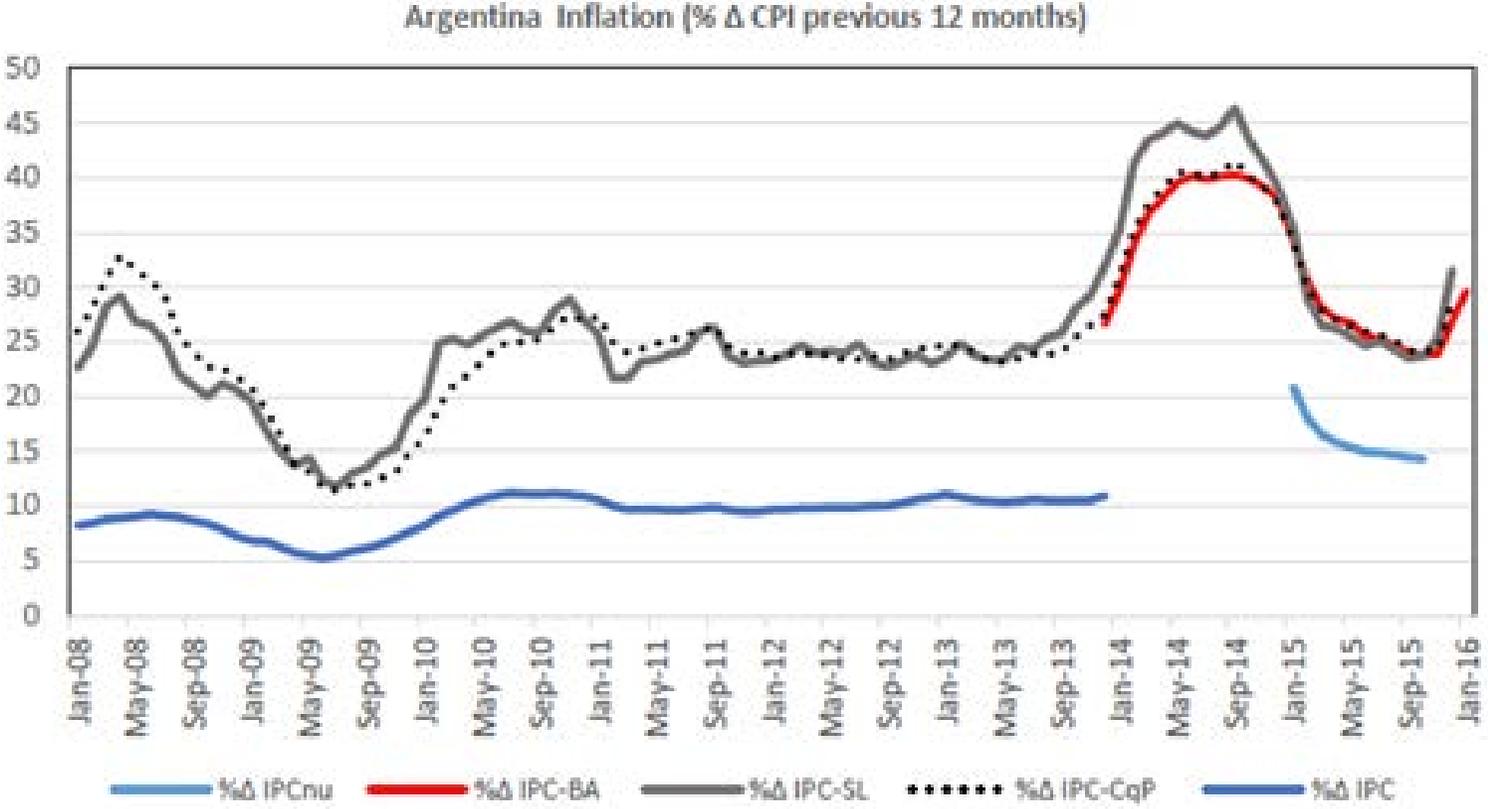
- **Argentina: A big change with problematic initial conditions**
- A little over two months ago, Mauricio Macri began his tenure as president after his coalition of center-right parties prevailed over the ruling party's candidate by a small margin.
-
- This is the first significant political change in many years, since the left leaning branch of "peronist" party held the executive office since 2003 (both husband and wife Nestor and Cristina Kichner held the presidency). The following statement by former Finance Minister Kicillof summarizes the previous administration's approach to economic policy: "since 2003, Argentina has been implementing an economic model of growth with social inclusion, where inclusion and redistribution of income are seen as a precondition for growth and not vice-versa, as stated by the mainstream economic precepts" ([October 2015 statement to the IMF](#)).

Very favorable primary commodity prices and high export taxes financed large government expenditures (social programs, variety of subsidies) for many years but when the conditions started to reverse the country slipped into a path characterized by government deficits, inflation and foreign exchange controls. The 2001 default and the subsequent one in 2014 resulted in an almost complete exclusion of the country from international financial markets and since 2007 the government engaged in the manipulation of statistical data.

- Since it took office last December 10th, the new administration has taken a number of important steps towards the elimination of major distortions, restoration of data transparency and return to international financial markets in the midst of a complicated political and social environment.
- The economic team inherited a very difficult situation with an inflation rate reaching about 25-30 % a year, a government deficit of 7.1% of GDP and almost depleted foreign exchange reserves.

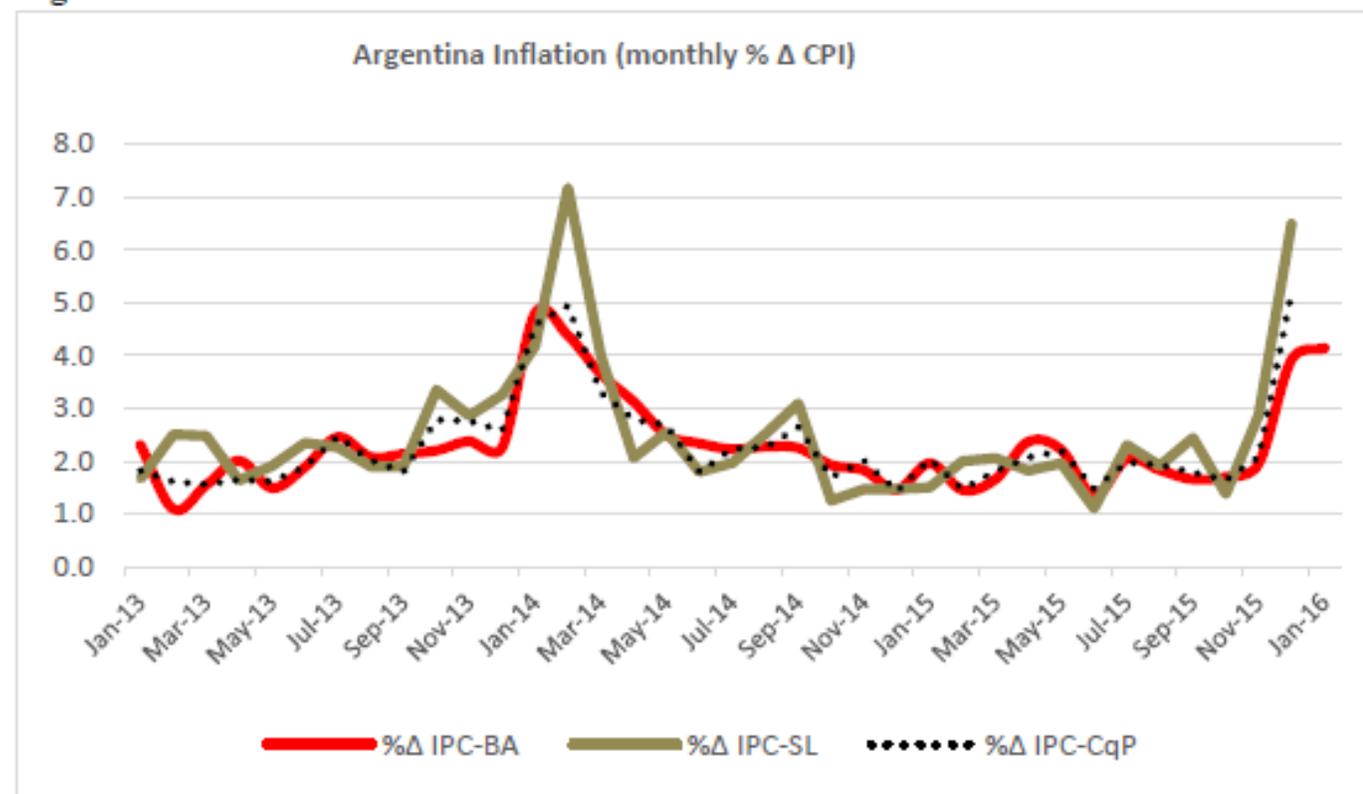
- The main economic policy measures have been: 1) elimination of the foreign currency controls (“cepo” or “clamp”) and unification of the foreign exchange market; 2) declaration of an “statistical emergency”; 3) partial elimination of utility subsidies; 4) decrease of export taxes on soy (from 35% to 30%) and elimination of those for beef, wheat and corn, 5) negotiations towards the return of the country international financial markets (negotiations with debt “holdouts”).

Data Transparency Issues and Inflation



Inflation surged in November and December (even before the official change of government) fueled by expectations regarding the future value of the dollar.

Figure 2



Sources: [Cosas que Pasan](#) , [DPEyC-San Luis](#) , [DGEyC-Ciudad de Buenos Aires](#)

- ***Foreign Exchange / Trade and Finance***

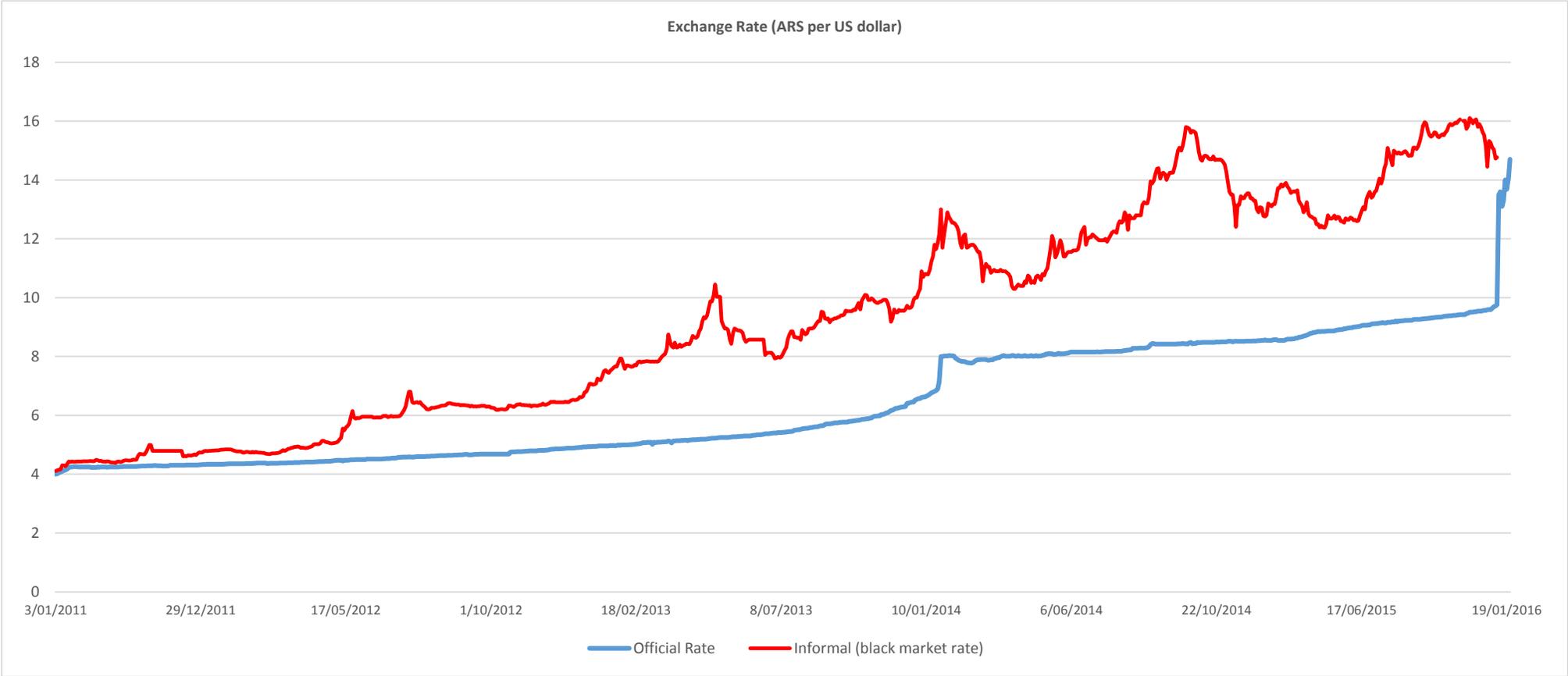
- In November 2011 the government began to impose strict controls on the foreign exchange markets (trying to stop the decrease of the Central Bank's foreign reserves) what made almost impossible for ordinary citizens to purchase dollars and severely restricted imports.
- The “cepo” (or clamp) resulted in the emergence of a black market for foreign currency, and the “official” value of the dollar was kept artificially low. Exports suffered (producers were hoarding grain), import restrictions severely affected the availability of industrial inputs, and tourists expenses overseas (at an undervalued exchange rate) ballooned.

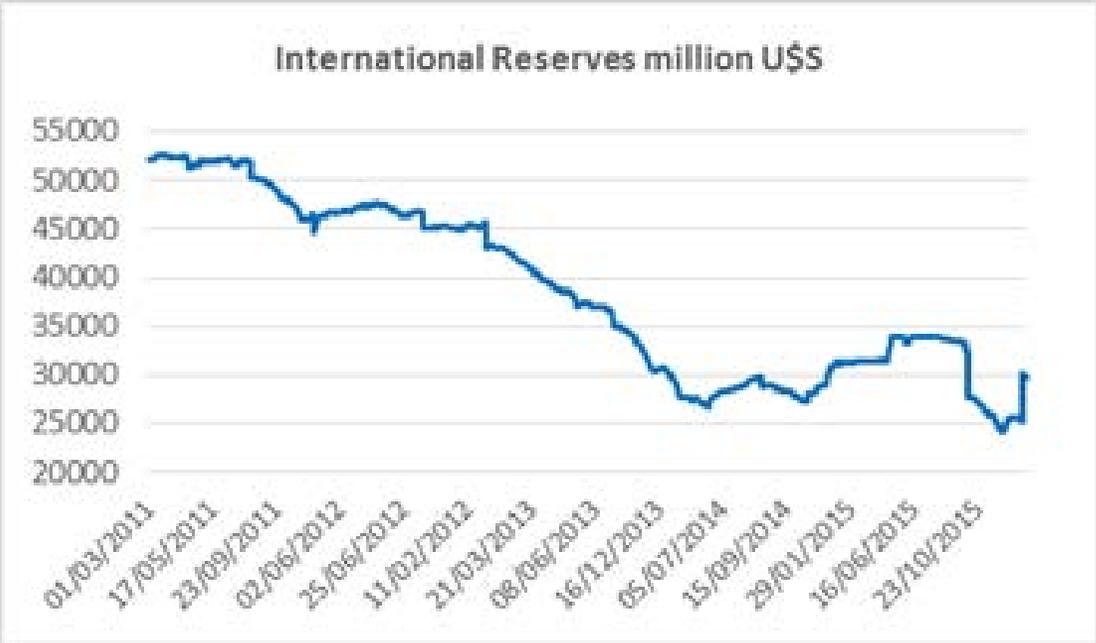


- On December 16, after securing additional dollar reserves (due to a Yuan-dollar swap with China) and later a bridge loan from a group of international banks, the government fulfilled its campaign promise of lifting the “cepo”. The exchange rate adjusted: there was an immediate devaluation of 35% and a gradual depreciation of the peso afterwards to arrive to a 55% devaluation since the lifting of the “cepo”. The market has been operating without Central Bank intervention - except for one day last week - what should be considered as an important success. Figure 3 shows the paths of the official and black market rates and Figure 4 that of the international reserves.

- Since the 2001 default, Argentina has been unable to borrow internationally and has been involved in a prolonged dispute with “holdout” bondholders (the 7% of that did not accept the 2005-7 restructuring). One of the judicial rulings (in New York courts) forced the default on the restructured debt in 2014. The current government has made significant progress in resolving the dispute and has stated its desire to return to the international financial markets (see [The Economist 2-6-16](#)).

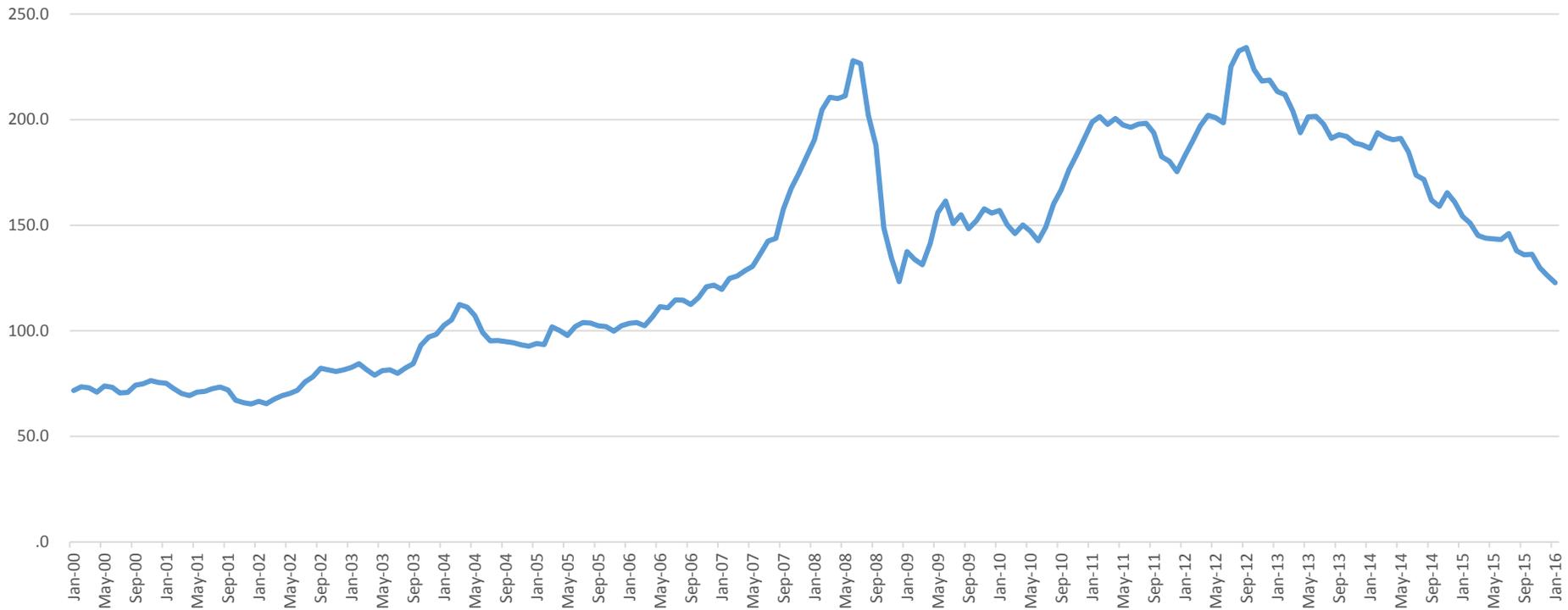




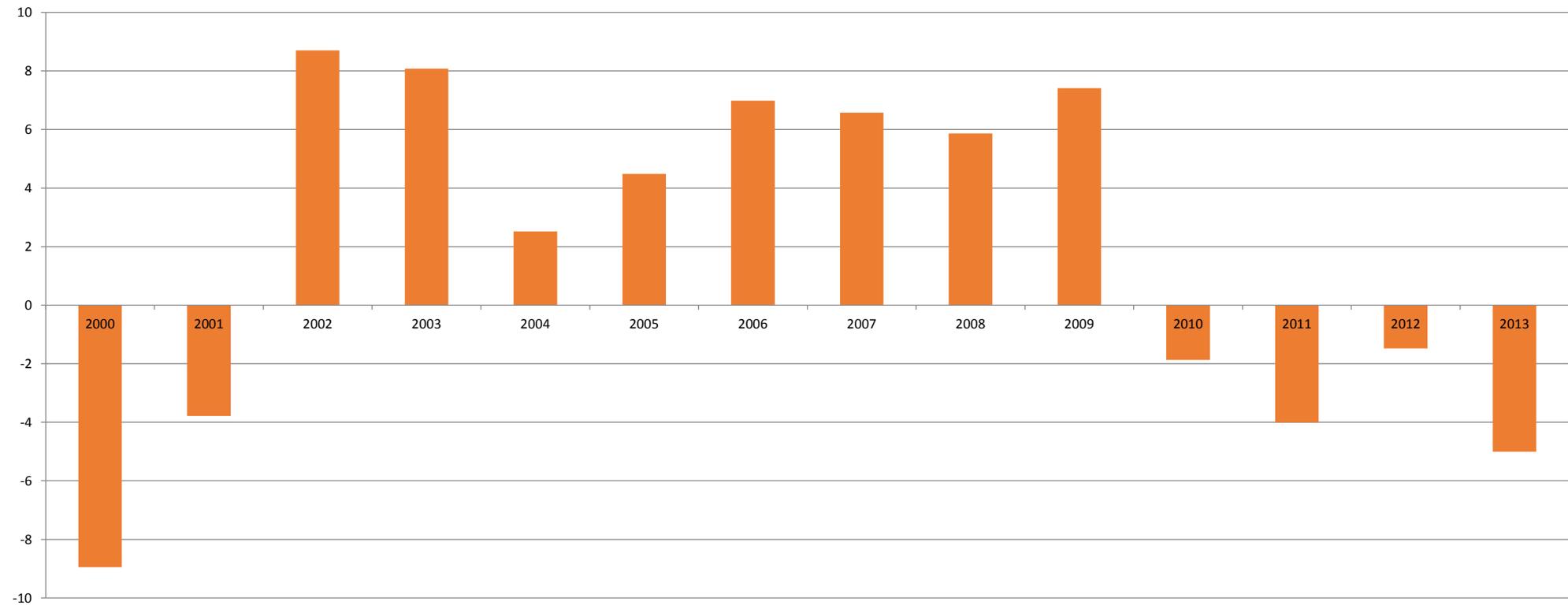


- High primary commodity prices resulted in a favorable Current Account for many years but the decline in those prices and large energy imports moved the balance into negative territory (see Figures 5 and 6). The new economic team reduced export taxes on soy by 5% and eliminated those on wheat, corn and beef. These adjustments together with the devaluation are expected to increase exports and the local supply of dollars.

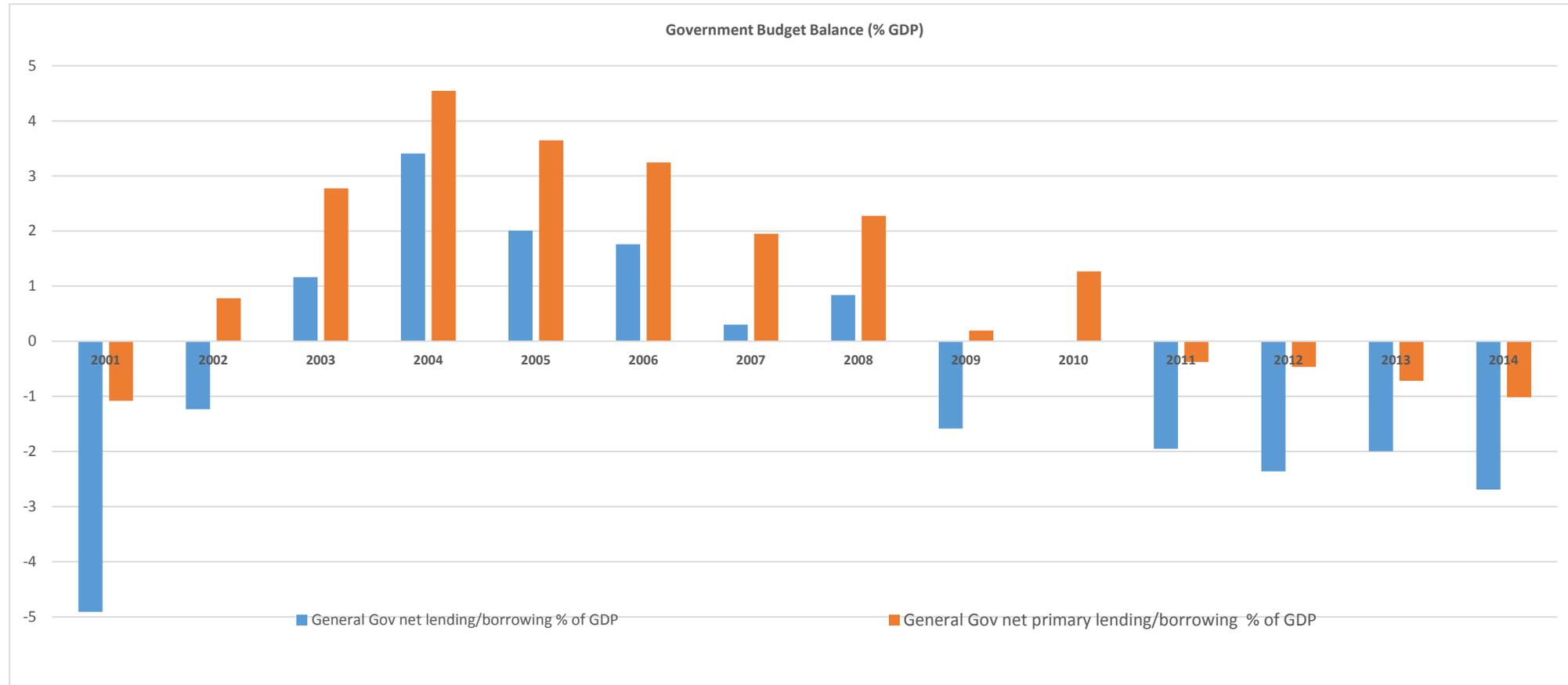
Argentina: Primary Export Commodities Price Index in US Dollars
1995=100



Current Account Balance U\$S Billion



Fiscal Situation



Last Update

Evolution of Exchange Rates: Official and “Contado con Liquidación”



Fuente: BCRA