

**Robert Mundell Global Risk Annual Lecture**

**Argentina: Lessons from  
recurrent financial distress**

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February 20<sup>th</sup>, 2020

# Argentina, one of the worst performers in the region

## Average annual GDP growth

| Country          | 2012-2019   |
|------------------|-------------|
| Bolivia          | 4.9         |
| Peru             | 3.8         |
| Paraguay         | 3.7         |
| Colombia         | 3.2         |
| Chile            | 2.9         |
| México           | 2.3         |
| Uruguay          | 2.3         |
| Ecuador          | 2.0         |
| Brazil           | 0.2         |
| <b>Argentina</b> | <b>-0.4</b> |
| Venezuela        | -11.1       |

- Argentina average inflation in the last eight years was 35.2% (in Latam was 5%)

Source: WEO database - October 2019

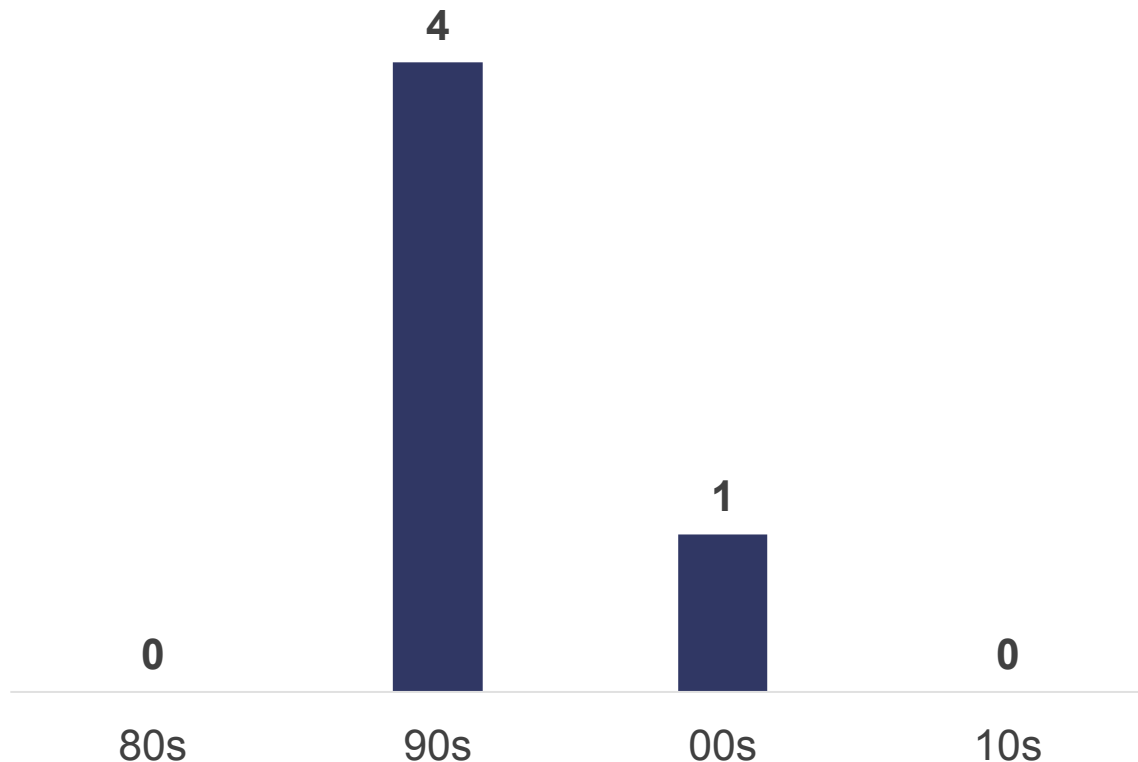
# Latin America's growth was dismal in the last eight years

## Average annual GDP growth

| Group of countries                       | 2012-2019  |
|--|------------|
| Emerging and developing Asia             | 6.6        |
| Emerging market and developing economies | 4.7        |
| Sub-Saharan Africa                       | 3.6        |
| <b>World</b>                             | <b>3.5</b> |
| Middle East and Central Asia             | 3.0        |
| Emerging and developing Europe           | 2.4        |
| Advanced economies                       | 1.9        |
| G7                                       | 1.8        |
| Euro area                                | 1.2        |
| <b>Latin America and the Caribbean</b>   | <b>1.2</b> |

# Years of low inflation and growth were the exception

## Argentina: Years with inflation below 5% and positive growth



- Only in 5 of the last 40 years Argentina had inflation below 5% and positive growth
- Argentina spent 17 of the last 40 years in recession
- Only in 17 of the last 75 years, Argentina had inflation below 10%

Note: sample size 194 countries

Source: WEO-IMF

# Agenda

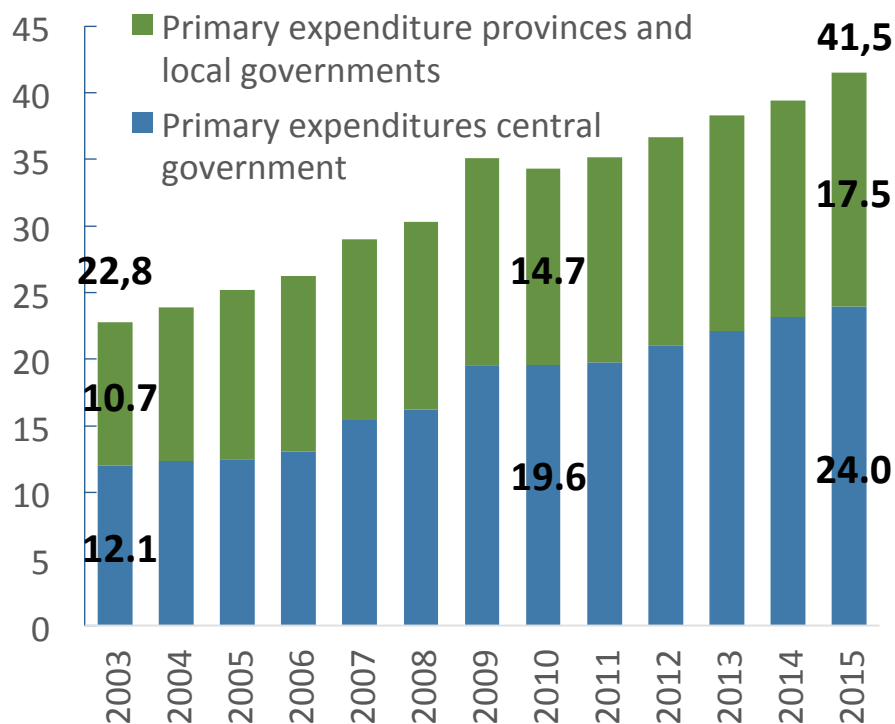
1. The starting point (2015)
2. The chosen path (2016/17)
3. Financial distress (2018/...)
  - 3.a. Sudden stop and adjustment (04/2018-07/2019)
  - 3.b. Elections and confidence crisis (08/2019-?)
4. Issues for discussion

The starting point (2015)

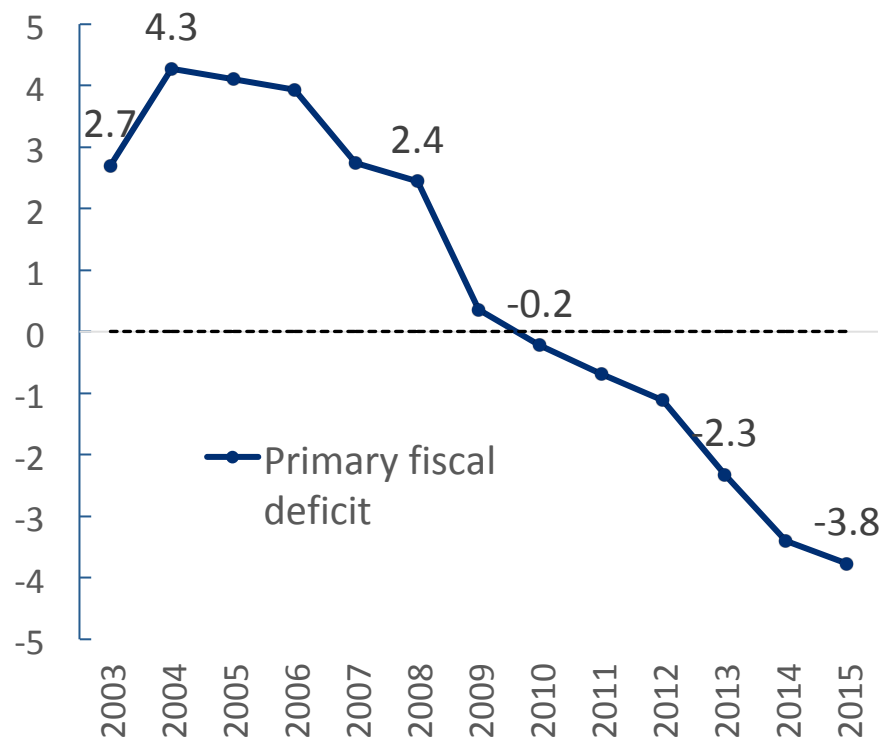
# Public spending was soaring and the fiscal deficit increasing

## Increase in size of public sector

% of GDP



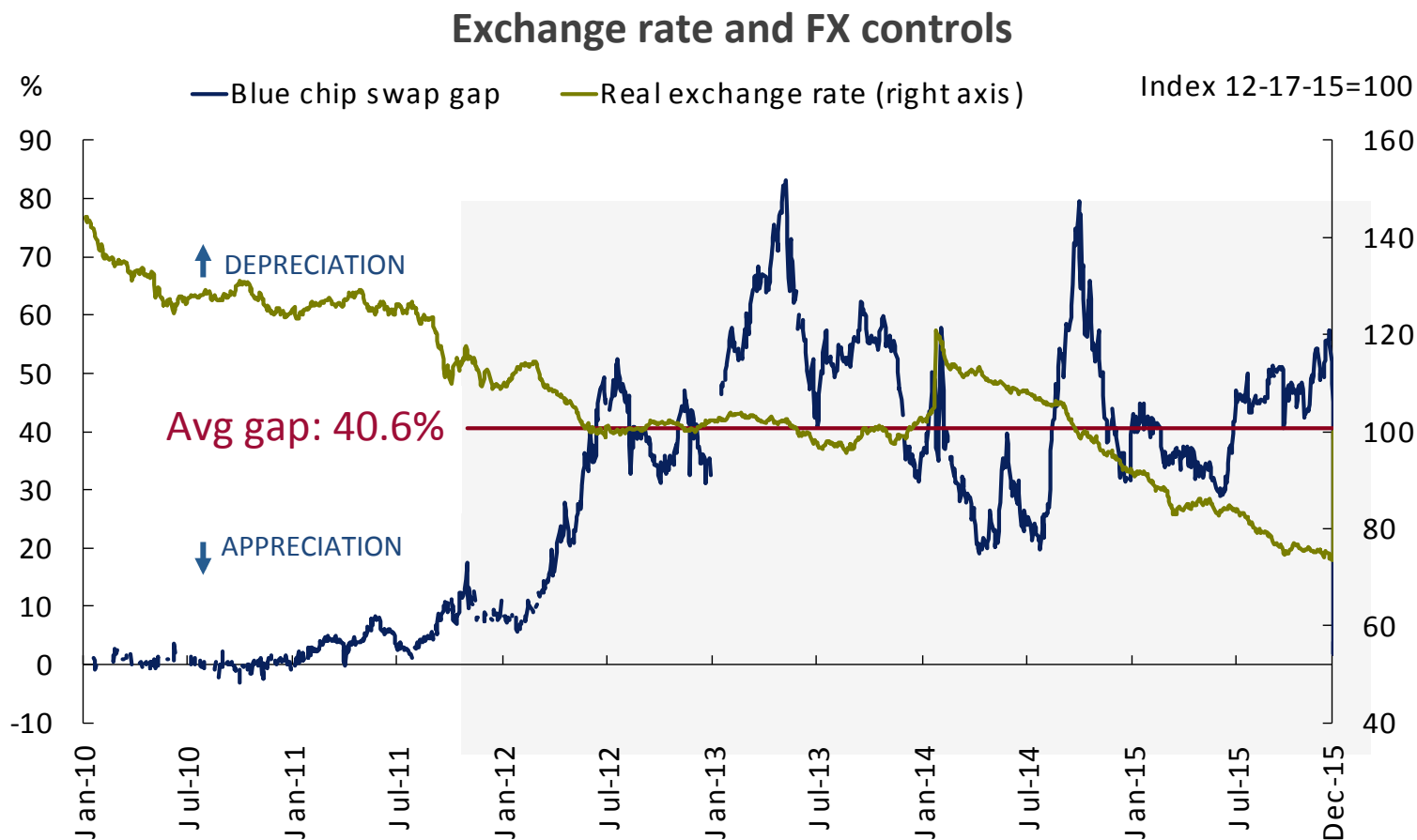
% of GDP



- Passive 2016 primary deficit: 5.3%
- Government in default without access to international credit markets

Source: Treasury – NFPS (national).

# Distorted prices: overvalued XR and capital controls, utility prices



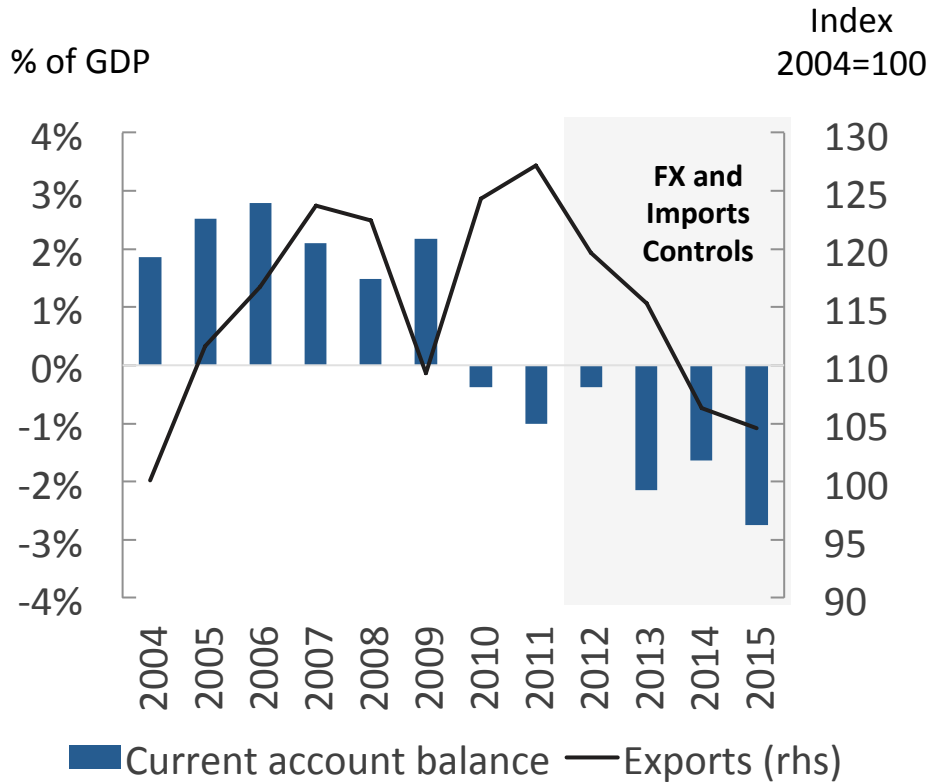
- Energy and transport prices covered between 10 and 25% of their cost of production
- Expenditures in subsidies to utilities' prices had been increasing year after year and amounted to 5% of GDP in 2015

Source: Central Bank of Argentina.



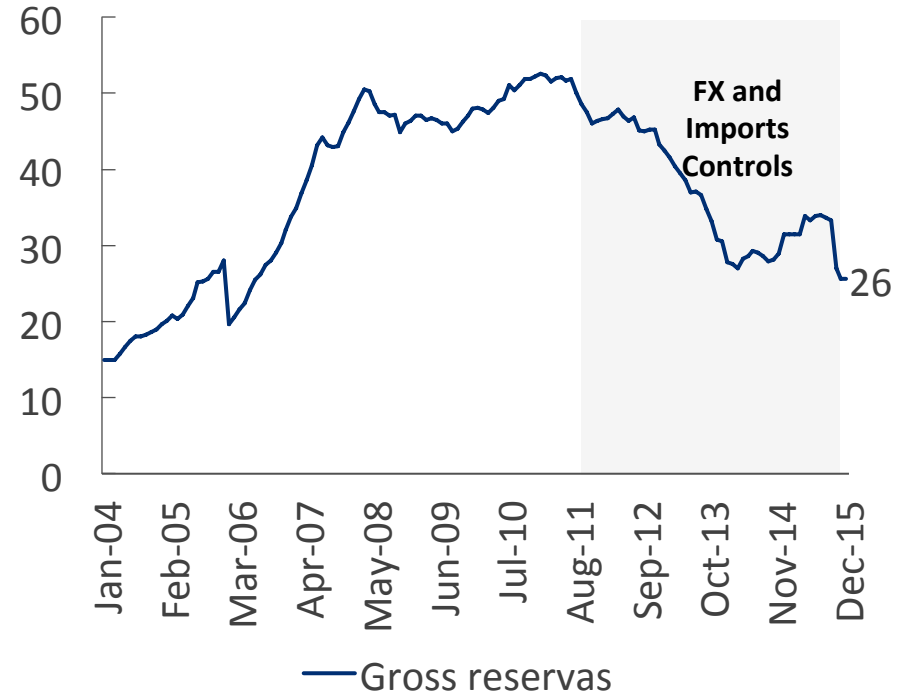
# Current account deficit and few international reserves

## Exports and current account balance



Source: INDEC

## International reserves (USD bn)

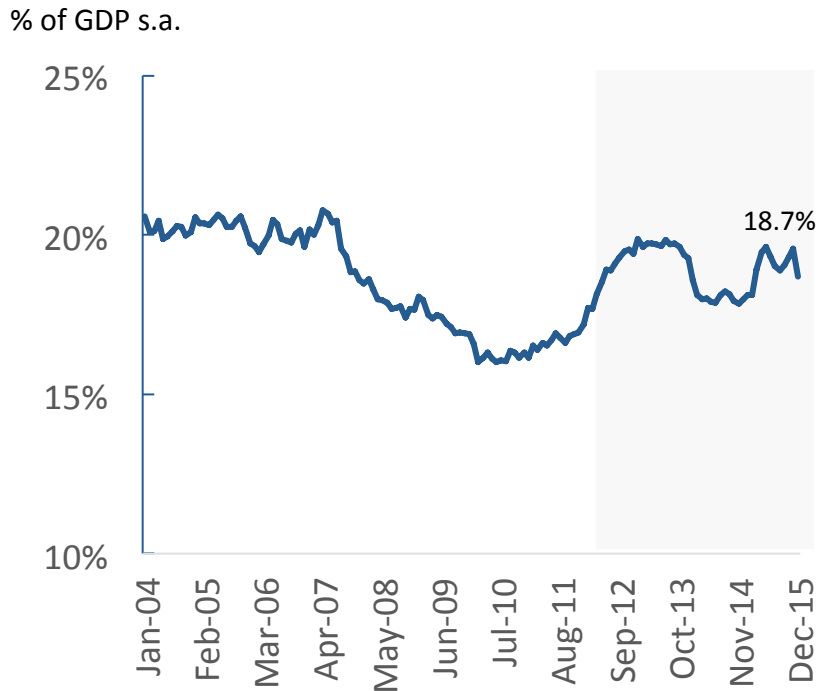


Source: Central Bank of Argentina.

- Third more closed economy in the world ( $(X + M)/GDP$  less than 25%)

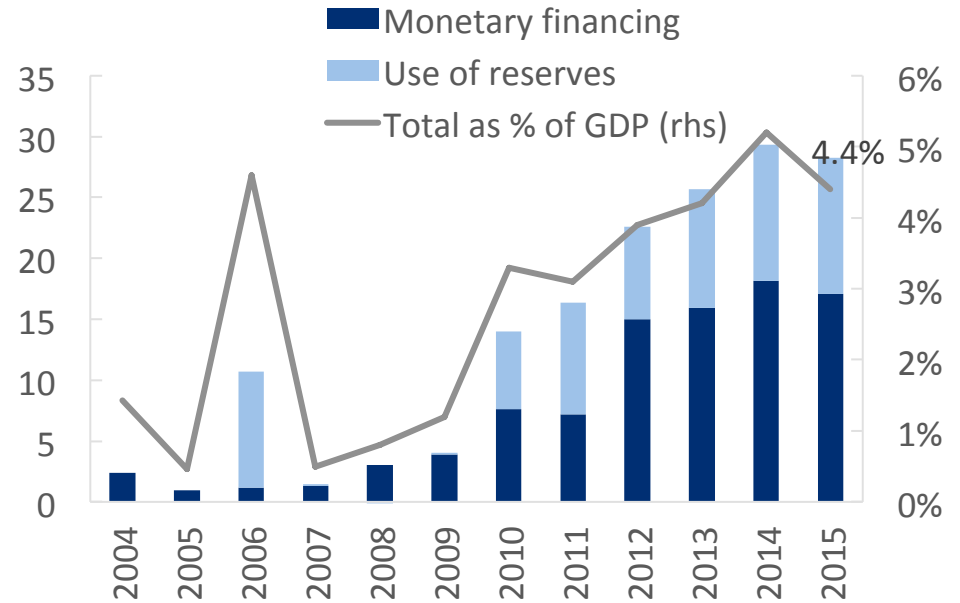
# Monetary overhang and CB financing to the Treasury

## Monetary Aggregates (M3)



Source: Central Bank of Argentina.

## CB financing to the Treasury (USD bn and % of GDP)



Source: Ministry of Treasury and Central Bank of Argentina

- Inflation was around 25%

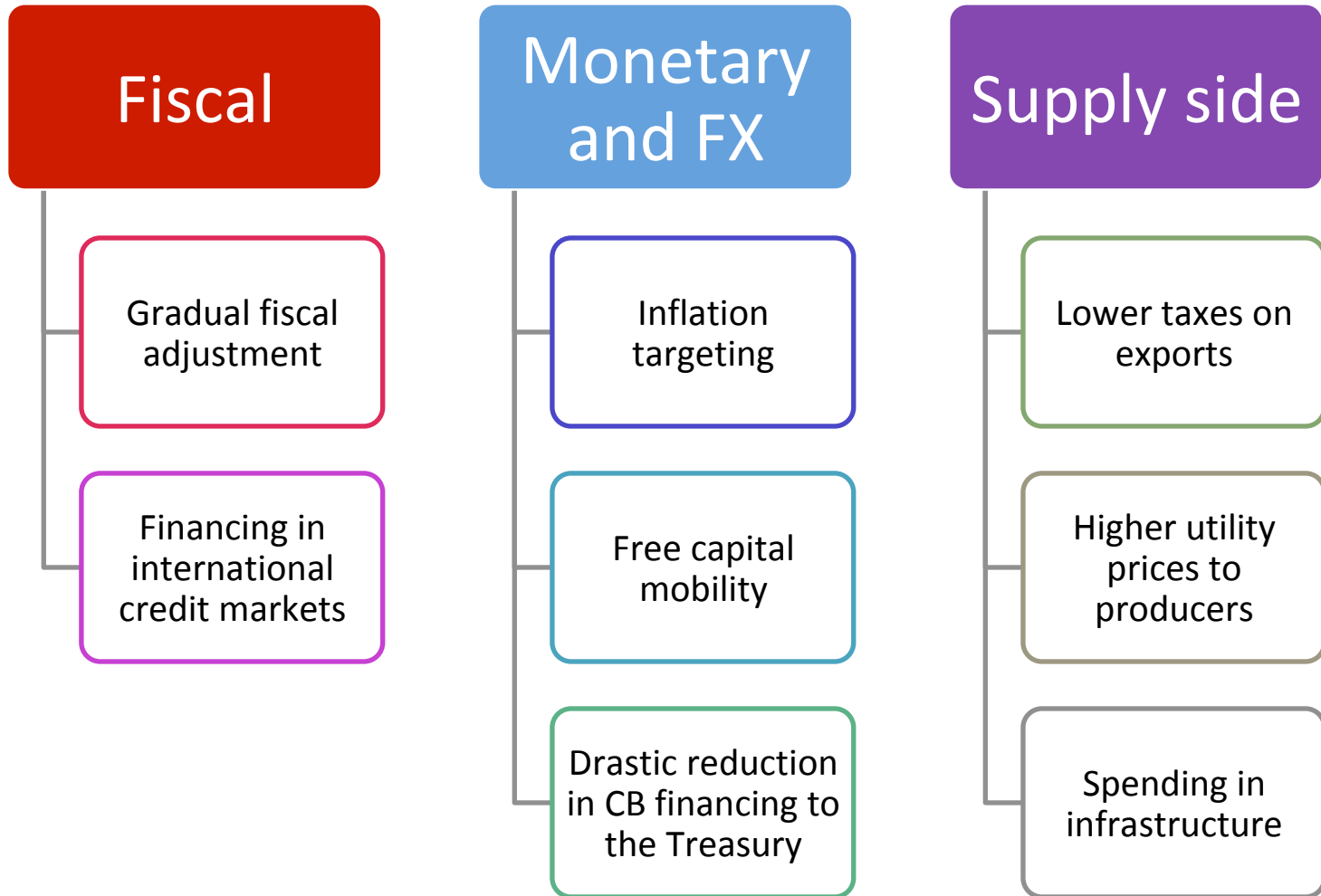
## The political constraints

- Non-Peronist Presidents hadn't finished their terms since 1945
- 2015 election was defined in a tight runoff (51% vs. 49%)
- Cambiemos was in minority in both houses of Congress

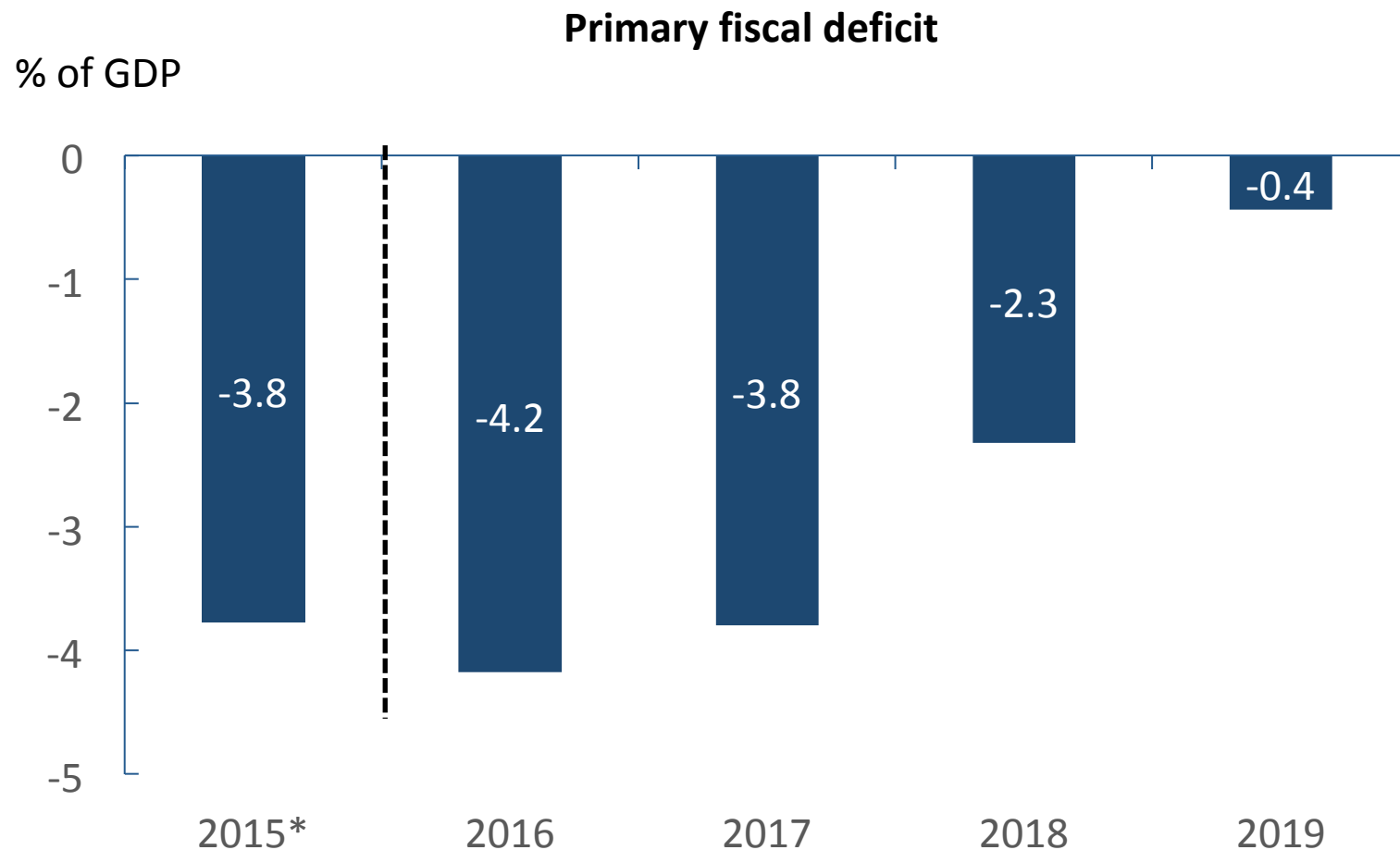


The chosen path (2016/17)

# The chosen path in a nutshell



# Little fiscal adjustment at the beginning



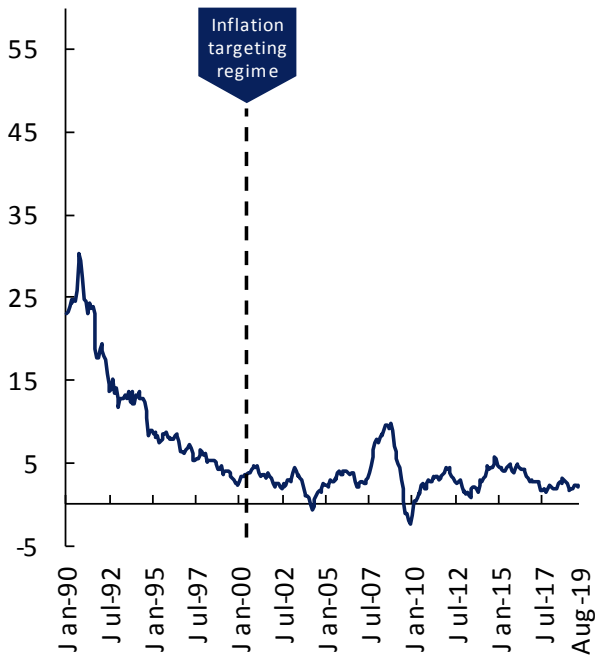
- In 2016 public expenditures went up, the adjustment began in 2017, but only gradually
- Tax cuts affected revenues

Source: Treasury – SPNF (national).

# Uncharted waters: Inflation targeting with high inflation

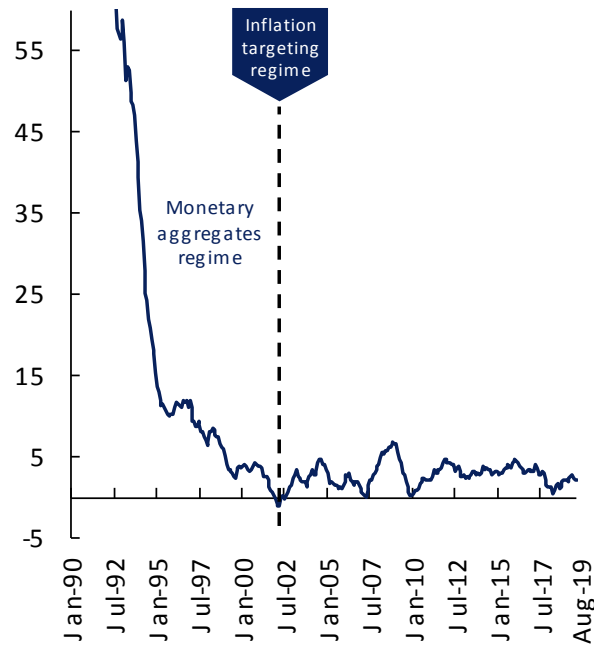
## Inflation. Chile

y.o.y. % chg.



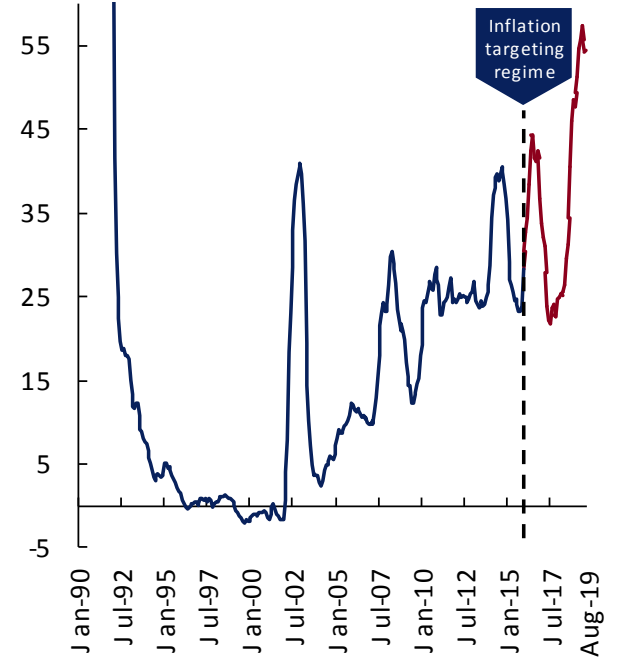
## Inflation. Peru

y.o.y. % chg.



## Inflation. Argentina

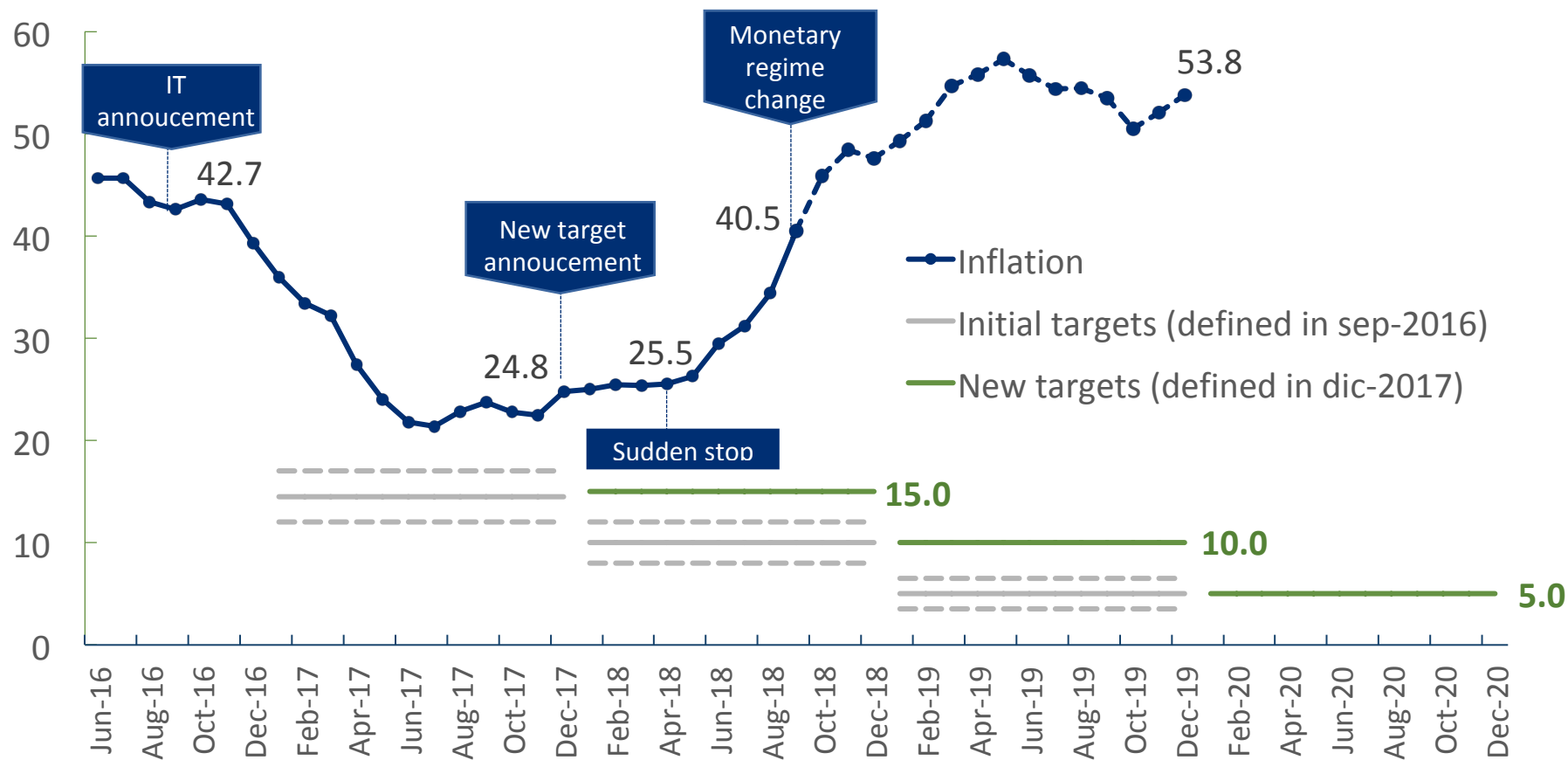
y.o.y. % chg.



Source: Central Bank of Argentina; Central Bank of Chile; Central Bank of Peru.

# Inflation targeting

y.o.y. % chg.

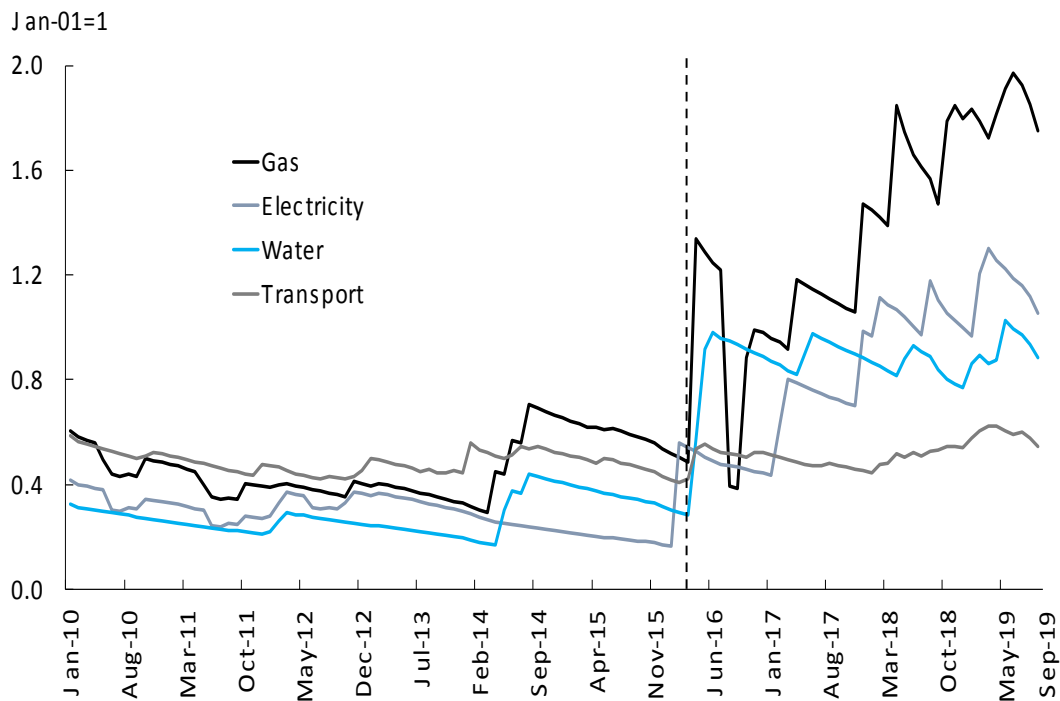


Source: Central Bank of Argentina.



# Large adjustment in utility prices

## Public services Prices relative to CPI

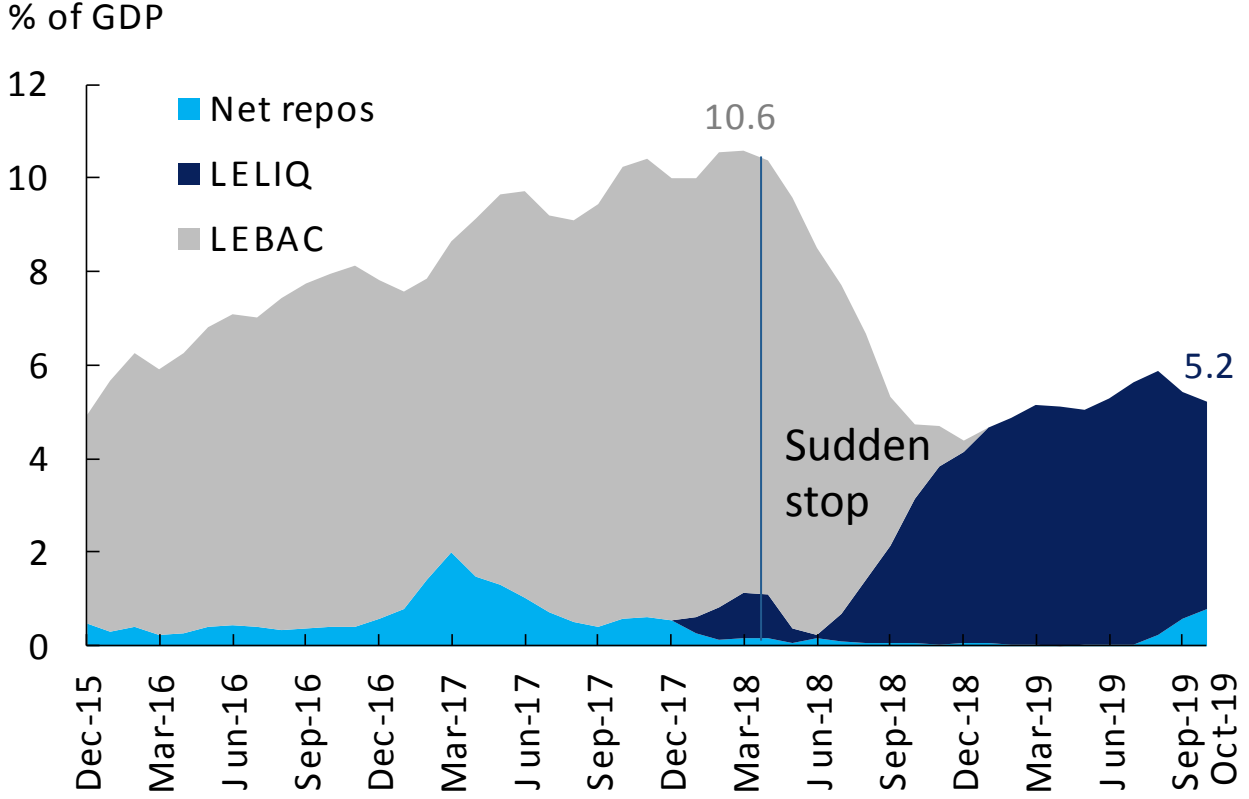


Source: INDEC.

| Services           | Average variation - fares |           |
|--------------------|---------------------------|-----------|
|                    | 2016/2015                 | 2017/2016 |
| <b>Water</b>       | 301%                      | 23%       |
| <b>Trains</b>      | 51%                       | 0%        |
| <b>Local buses</b> | 66%                       | 0%        |
| <b>Gas</b>         | 102%                      | 130%      |
| <b>Electricity</b> | 176%                      | 82%       |

# CB remunerated liabilities

## Central Bank remunerated liabilities



Source: Central Bank of Argentina.

## Early results

- The policy mix lifted the economy out of the recession in Q3 2016, and the economy grew almost 3% in 2017
- The current account deficit widened to almost 5% of GDP in 2017
- Inflation went back to 25% in 2017 after an initial spike in 2016
- But the strategy entailed risks

# Financial distress

Sudden stop and adjustment (2018-Aug 2019)

# The big risk

A sudden stop before the fiscal correction had concluded

- It happened. Financing for emerging markets dried up in Q1 2018
- And to make things worse, this came together with the worst draught in a decade that pushed the economy back into recession
- The sudden stop generated a run on the currency as LEBACs investors rushed for an exit and a spike in inflation
- The government sought IMF support to avoid a default (USD 50bn + 7bn, faster fiscal adjustment, tight monetary policy)

# IMF agreement: early results

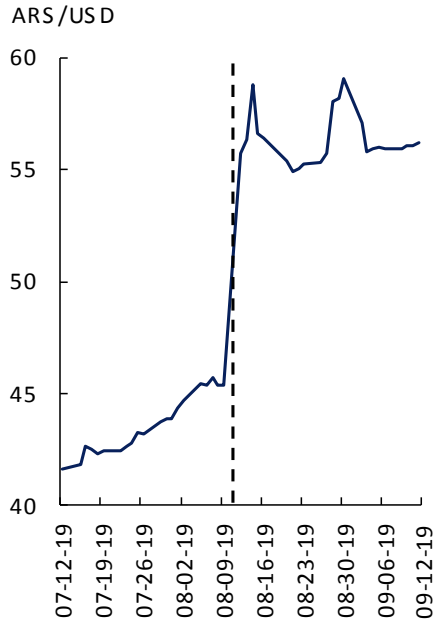
- Despite some political noise from the forthcoming presidential elections, the program managed to stabilize economic activity at the end of Q2 2019 and the economy grew 0.9% qoq in Q3 2019
- Inflation came down during 4 consecutive months between April and July
- But...

# Financial distress

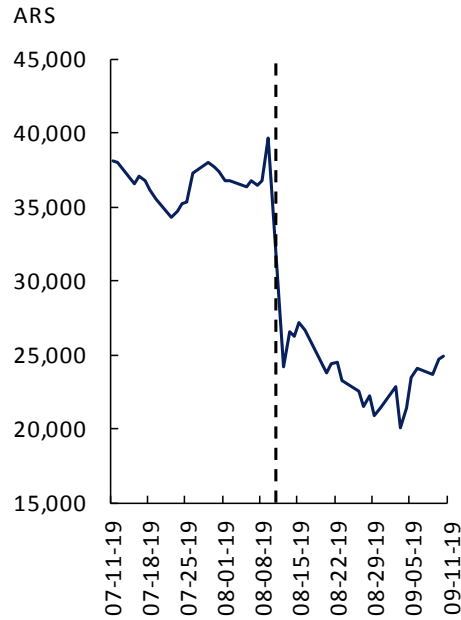
Elections and confidence crisis (Aug 2019-...)

# The primary elections results came as a shock

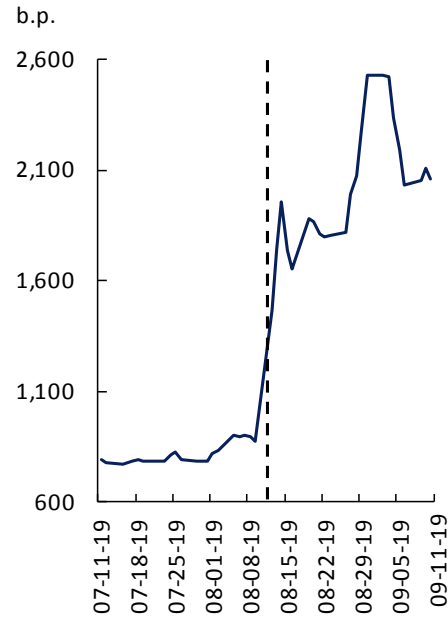
## Nominal Exchange Rate



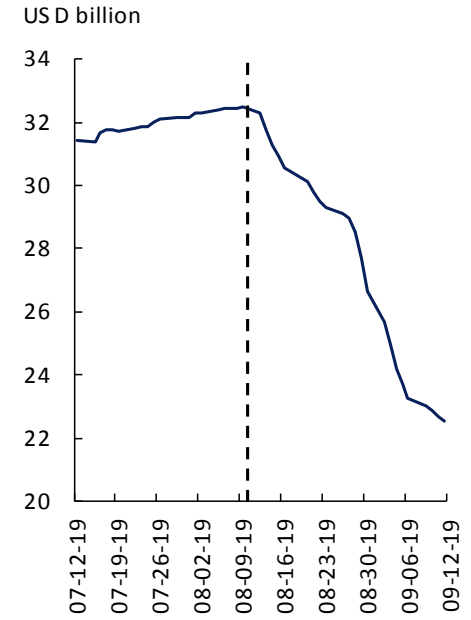
## S&P Merval Index



## Country Risk: EMBI Argentina



## Private Deposits in USD



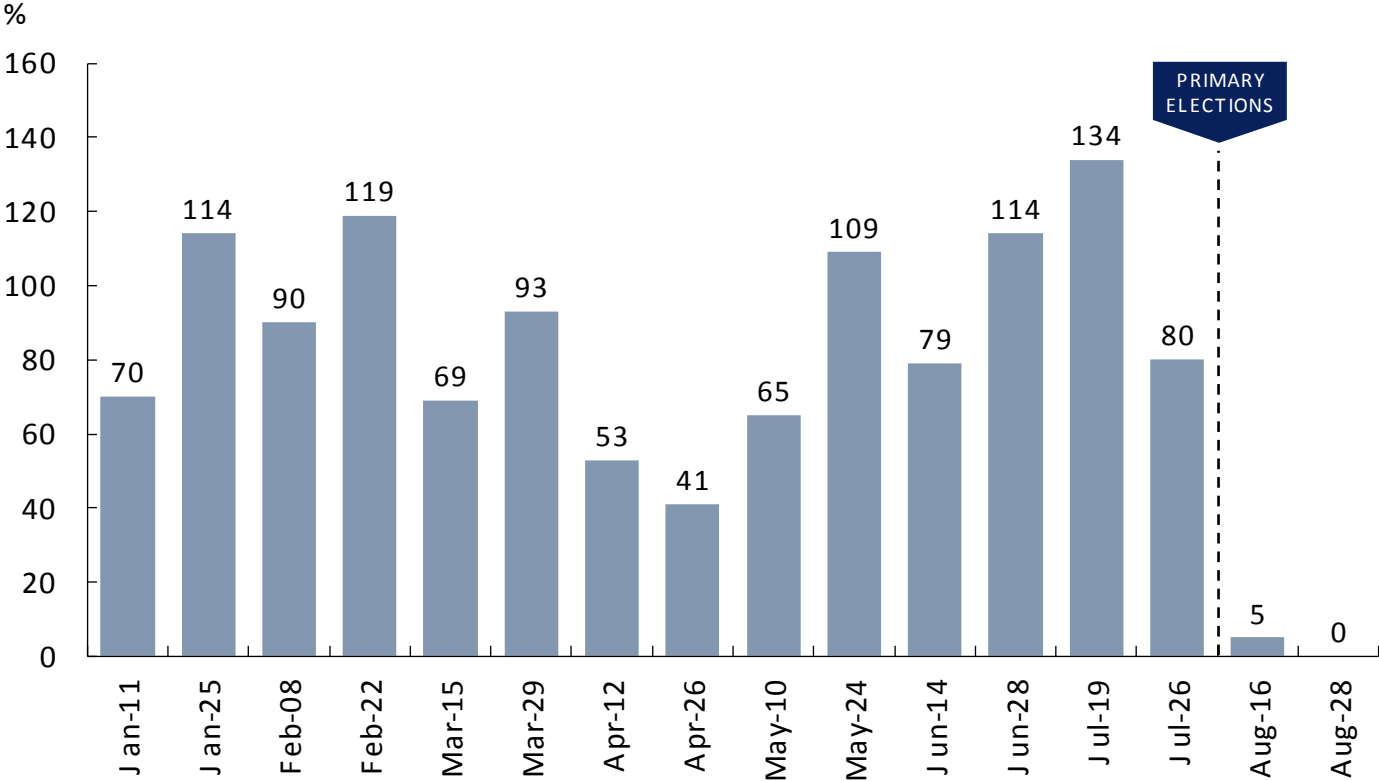
--- PRIMARY ELECTIONS

Source: Central Bank of Argentina; Bloomberg.



# A confidence crisis triggered a domestic sudden stop

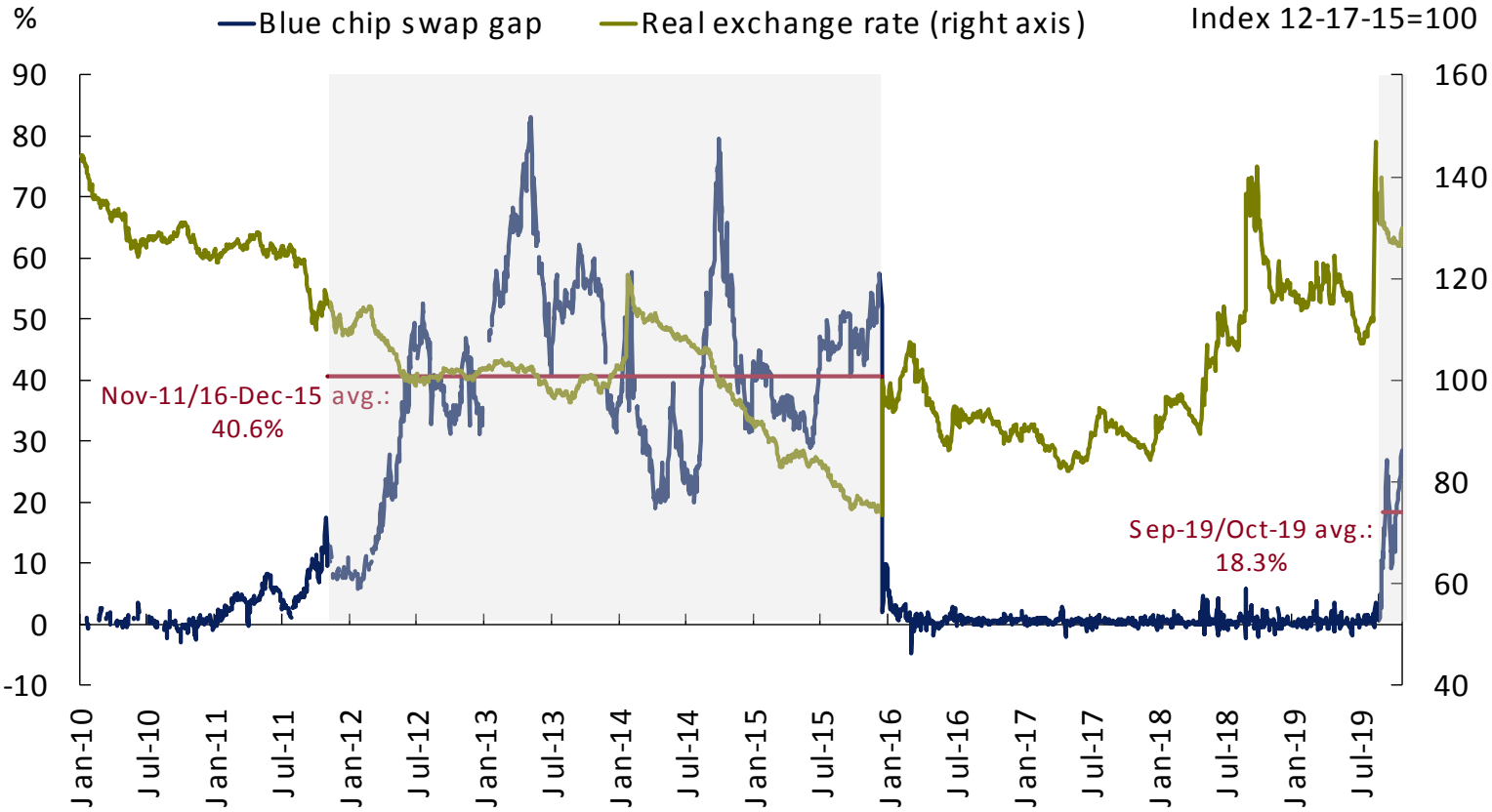
### Private Roll-over rate of Treasury Bills (LETE)



Source: Treasury.

# Capital controls had to be reintroduced

## Exchange rate and FX controls



Source: Central Bank of Argentina.

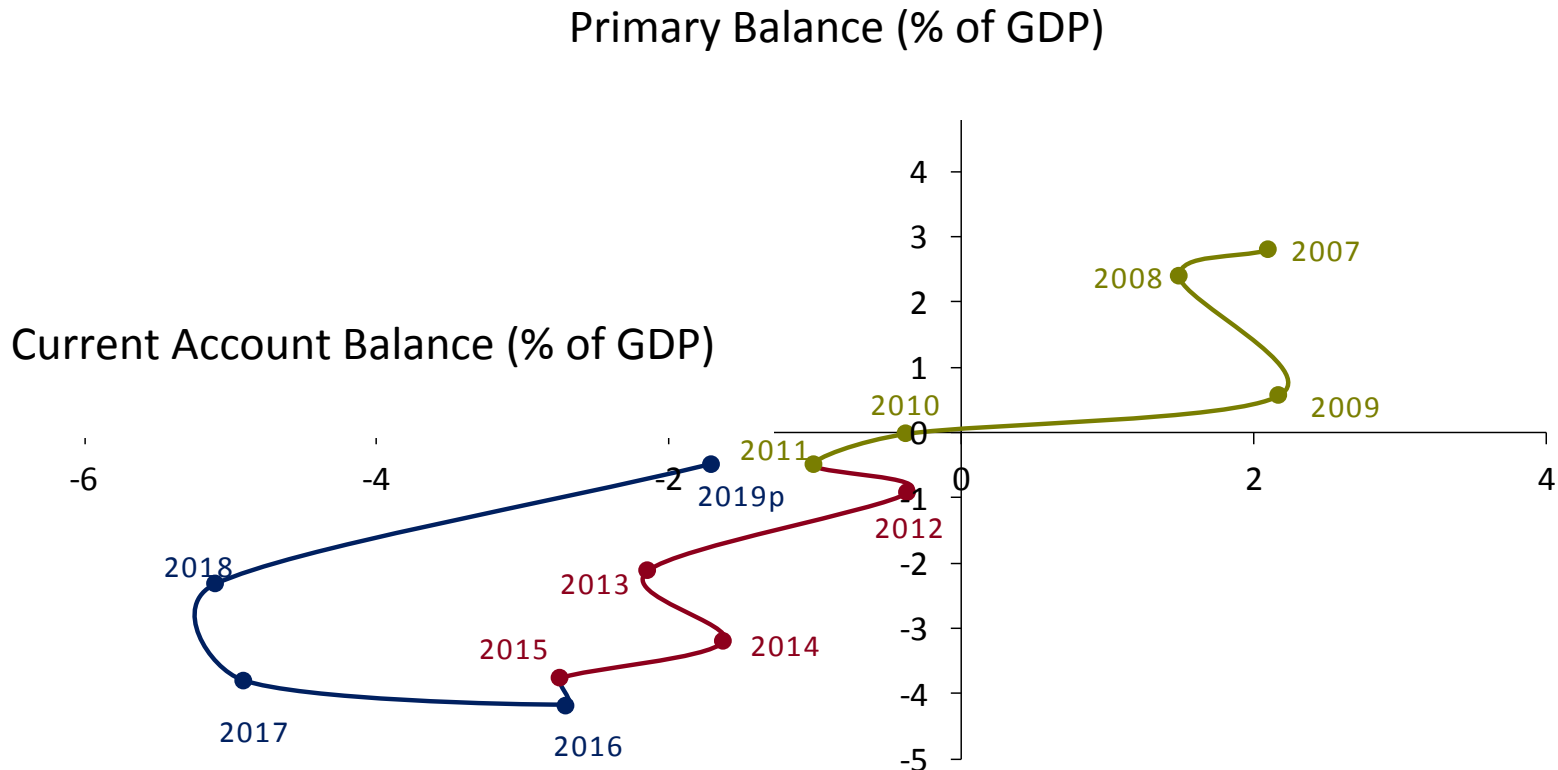
# The aftermath

- The economy went back to recession
- Inflation jumped up following the large FX depreciation
- Argentina once again struggling to restructure its debt

Issues for discussion

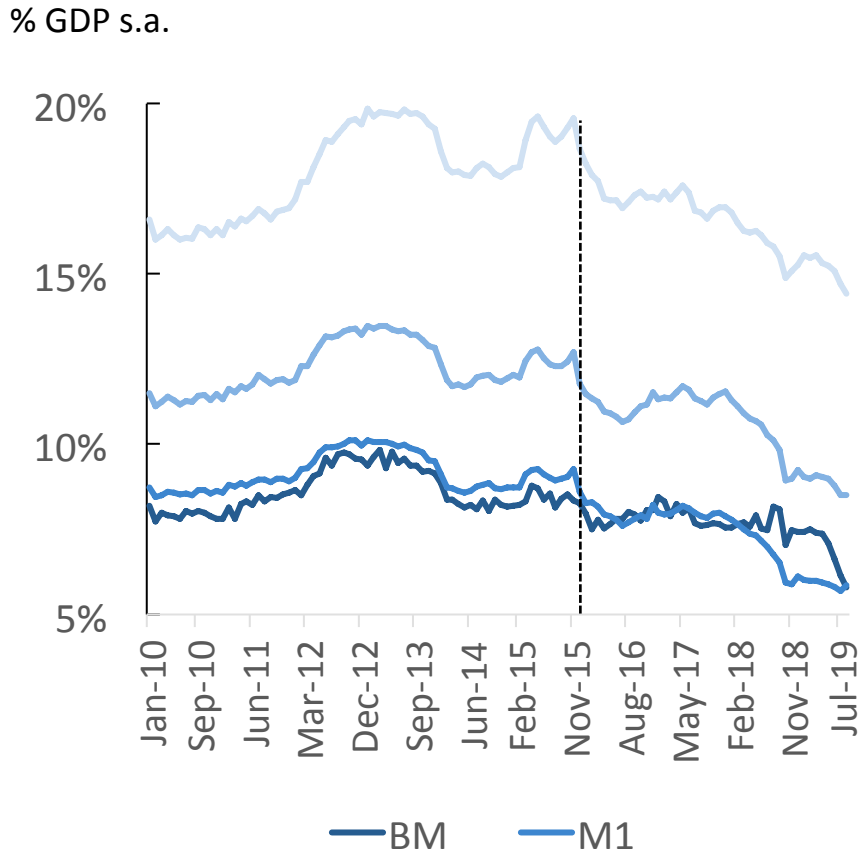
# Economic legacy

- The imbalances and distortions have been resolved (not as planned), but unable to achieve growth and lower inflation while doing so
- Confidence crisis leading to new debt restructuring

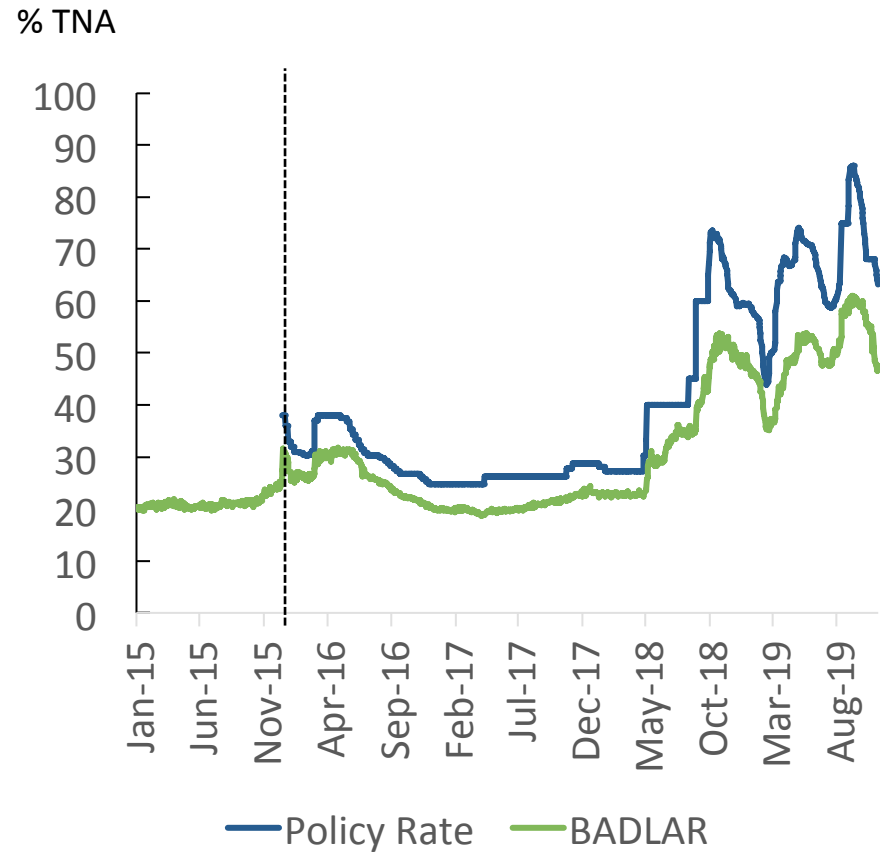


# No more monetary overhang and positive real interest rates

## Monetary Aggregates



## Interest Rates



Source: Central Bank of Argentina

# Lessons and issues for discussion

- To leave populism behind both consistent economic policies and some consensus about them are needed
  - Corollary: an economic plan without some political consensus is not a real plan
- Reducing the costs of the transition is key for consensus, but...
- ... it might create risks
- Beware of “partial equilibrium” best practices
- IMF (It’s Mostly Fiscal)
- Beware of Gresham law for economists

Thank you