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From Sovereign Default to Delayed Correction: Lessons Learned from the Argentine Monetary Policy

SUMMARY: This paper examines the background of the considerable depreciation of the Argentine peso in late 2013 and early 2014. Our hypothesis is that the unsettled crisis of 2001 is responsible for the vulnerability of the Argentine currency, and the exchange rate correction is a belated consequence of this. Our inquiry is based on a dual approach: on the one hand, we provide a brief overview of the circumstances of the sovereign default, the role of the Currency Board and the IMF, and the direct consequences of the default. On the other hand, we highlight the most important lessons learned from the debt restructuring together with the favourable trends of international trade that had allowed repeated postponements of an adjustment in Argentine economic policy. Although in respect of contemporary Argentine economic policy we should not ignore the interwoven nature of the country's fiscal and monetary policies, it appears that the international money market will compel a further depreciation of the peso and the launch of economic reforms.

KEYWORDS: Argentine sovereign default, IMF, exchange rate correction
JEL CODES: E02, E44, F34

INTRODUCTION AND METHODOLOGICAL DIFFICULTIES

Before 2008, restructuring public debt was seen as an extremely rare event based on the doctrine that a sovereign debtor cannot default. Nevertheless, in 2001 in Argentina the re-emergence of populism, the failed economic policy measures of the 1990s and the series of crises hitting emerging markets in the late 90s lead to the greatest sovereign default in history, sending the South American economy into a cyclical trough. Unprecedented in terms of its volume, the way to the crash was paved by the benevolent but unsustainable economic policy of the 1990s, which arguably marked the deepening of several years of recession (Boonman 2013) rather than its beginning.

Although that 'hot summer' was more than a decade ago, the nearly one and a half decades that have passed have virtually raised more questions than they have resolved. Sovereign default – as an event – is over; however, the repair of the severe economic and social damage, the repayment or restructuring of loans and the implementation of corrections in economic governance (including the liberation of monetary developments from government control) have yet to be accomplished. The only question is when. This paper was written on the occasion of the events occurring in late 2013 and early 2014 in Argentine mon-

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etary policy relating to the last item on the list; at the same time, our inquiry should also be concerned with the potential consequences stemming from the cyclical nature of Latin-American economies (Baer et al. 2010).[1] We seek to answer the question whether the event of default could still influence exchange rate movements, or they are merely the results of international developments.

In our hypothesis, the significant *peso devaluation* at the start of 2014 is also part of a monetary policy *correction* relating to the 2001 crisis. A major swing in the exchange rate more than ten years after the sovereign default points to the conclusion that favourable domestic and global developments have rendered an unreal peso exchange rate sustainable. Implicitly, underlying this is the assumption that in the early 2000, the depreciation of the *peso* did not hit its trough and thus, it did not reflect the real market exchange rate parity. We view the process as a correction and not as an adjustment because, owing to a number of unorthodox features in the Argentine economic governance, the unfolding developments are not controlled by the government of Argentina. We will only make a passing reference to the role of government in the process, while the central bank, due to its limited leeway in monetary policy, has become increasingly passive. Thus, the term *delayed correction* is used to denote an exchange rate correction that is enforced by international (money) markets and, as things stand at the moment, can no longer be postponed.

Our study is structured around three main lines of thought. The favourable global and domestic economic conditions that characterised the 2000s have changed and as a result, the only alternative to correction today appears to be another sovereign default. The first conceptual unit explains the default in 2001, including a discussion of the role of the Currency Board and the IMF. The second main unit is built around the debt consolidation of 2005 and 2010, which involved the restructuring of over 90 per cent of the bonds affected by the default. The events of 2014 will be examined in light of the foregoing, giving due emphasis to the trends emerging from macroeconomic data.

In the introduction, the concepts of sovereign default, debt consolidation and populism need to be clarified. Sovereign default is seen as an economic event in which the sovereign debtor (i.e. the state) unilaterally suspends or is incapable of honouring its debt service in respect of either principal or interest. At this point, we merely allude to the fact that the Argentine sovereign default was incomplete in this regard as it had no impact on commitments to international organisations, which in fact accelerated the consolidation process later on. In parallel to that, the term *public debt restructuring* refers to the negotiation process as part of which the debtor and the creditors subsequently agree to change (reduce) the nominal value, interest and maturity terms of the bond and may also capitalise past due interest, generally forcing creditors to write off significant losses (Hornbeck 2013). Based on *Dornbush–Edwards* (1991), populism is seen in a historical perspective as regimes that have "tried to deal with income inequality problems through the use of overly expansive macroeconomic policies. These policies, which have relied on deficit financing, generalized controls, and a disregard for basic economic equilibria, have almost unavoidably resulted in major macroeconomic crises that have ended up hurting the poorer segments of society" (Acemoglu et al. 2011, p. 1).

Compared to the clarification of the conceptual framework, a more severe methodological risk arises from the issue of data validity, because since the mid-2000s, the credibility of the statistics provided by the Argentine government and central bank has been a cause for concern. First and foremost, the problem arises with the real rate of inflation, since the difference between Argentine statistics and international estimates may be as high as 100 per cent. As the dilemma cannot be resolved, it will be 'bridged' by giving a parallel presentation of Argentine and international statistics.

ARGENTINA'S (RETREAT INTO) DEFAULT

Peaking in 2001, the Argentine crisis was induced by a number of factors. These include both domestic and international (monetary) policy drivers. For the purposes of our study, these developments will be explained only briefly, and a daily chronology of how the sovereign default was addressed will be also dispensed with.

Today, the Argentine sovereign default has an extensive body of international literature already, both academic (FRBSF 2002, Conde 2003, Schuler 2005, Baer et al. 2010) and governmental (Saxton 2003, Hornbeck 2013, MEcon 2014), yet in Hungarian literature it is mentioned only sporadically and as part of other monetary and economic analyses (Kóbor 2002, Kolozsi 2013). Specific mention should be made of *Museo de la Deuda Externa*[2] which, under the auspices of the Faculty of Economics at the University of Buenos Aires, provides an insight into the history of Argentina's financial indebtedness, its circumstances and consequences.

The domestic antecedents of the crisis date back to the turn of the 1990s, when Argentina was forced to carry out a significant adjustment to its economic policy. The economic policy of the country was made unsustainable by the low growth rate of previous decades, political instability discrediting economic measures, debt policy, the vulnerability of the banking sector (as revealed subsequently), procrastinated structural reforms, over-reliance on foreign funds (IMF 2003), and not least, by a monetary policy that financed excessive public spending by printing money. This situation emerged during the presidency of *Carlos Menem*, with *Domingo Cavallo* in charge of economic governance. Attributed to Cavallo, the Convertibility Act was in force from 1 April 1991 (IL 2014), and the economic system created by him was "widely praised for its achievements in stabilization, economic growth and market-oriented reforms under IMF-supported programs" (IMF 2003, p. 1). The Act included three key considerations of monetary policy (Saxton 2003, IL 2014), in which the Currency Board (*Convertibilidad*)[3] played a key role:

❶ putting an end to hyperinflation,

❷ introduction of a new currency (at an exchange rate of 10,000 australes = 1 peso), and

❸ maintenance of the exchange rate of the Argentine pesopegged to the US dollar at parity.

Saxton (2003) points out that the reforms were successful in that inflation was reduced significantly[4] and the economy was set on a growth path, not least owing to a boost in exports. Under such conditions, an industry policy aimed at import substitution became as much of a menace as it was beneficial owing to the threat that Argentine foreign trade might become uncompetitive and disruptions might emerge in its current account. In an inquiry into the role of monetary policy in crises, *Kolozsi* (2013) refers to the findings of *Keifman* (2008) on Argentina, according to which, without effective social control, the direction of formal institutional development may well be determined by interest groups "whose interests do not necessarily coincide with those of society at large" (Kolozsi 2013, p. 39). While the idea of 'jump-starting' the economy was good, overall, this cannot necessarily be said about its stability.

Nevertheless, the adjustment in economic policy, *ceteris paribus*, showed encouraging signs; yet the high level of Argentina's integration into global economy and international finance swerved the adjustment attempt into a negative direction. In particular, the factors of geography and time foiled the plans of the Buenos Aires government. The efforts of Argentine economic policy were severely hit partly by the Mexican *tequila crisis* of 1994–1995, and particularly by the Brazilian financial crisis of 1998, with the Brazilian recession bringing about a serious curtailment in trade across the Southern Common Market (Mercosur) – in this context, it should be borne in mind that Argentina's largest trading partner was in fact Brazil (INDEC 2014). *Lámfalussy*'s (2008) argument about the spillover of crises is therefore perfectly sound. The negative consequences were also reflected in soaring interest rates, as "[f]or 30-day loans (...) the prime rate (...) rose from below 8 percent a year in August 1998 to a high of 19 percent in late September. Argentina's economy went into recession by October" (Saxton 2003, p. 8). This marked the beginning of a four-year decline, which hit the trough with the sovereign default of December 2001, with the country's real GDP falling by 18 per cent between 1998 and 2002 (Schuler 2005).

Still, the sharp deterioration of Argentina's situation was not predestined. Owing to the Convertibility Act, inflation was reduced to a tolerable level, the 90s were characterised by an influx of capital (even in the aftermath of the 1997 crisis of the Far East), and according to the 1998 World Bank survey, Argentine banking supervision ranked second among developing countries, behind that of Singapore (FRBSF 2002). That notwithstanding, the IMF, which had played an active role in shaping the country's economic policy since the early 90s, is criticised for its activities on two key points: some think that it had not been strict enough in pushing through reforms in exchange for the amounts disbursed, while others argue that its was actually the IMF that lead the Argentine economy astray. Although in an earlier statement the International Monetary Fund said that the "consequences for the country have, rightly or wrongly, had a reputational cost for the IMF" (IMF 2003, p. 2), we do not consider it our task to judge the adequacy of international institutions' participation. At the same time, Hornbeck (2013) notes that "[w]ithout the IMF, the convertibility plan would have collapsed much sooner" (p. 3).

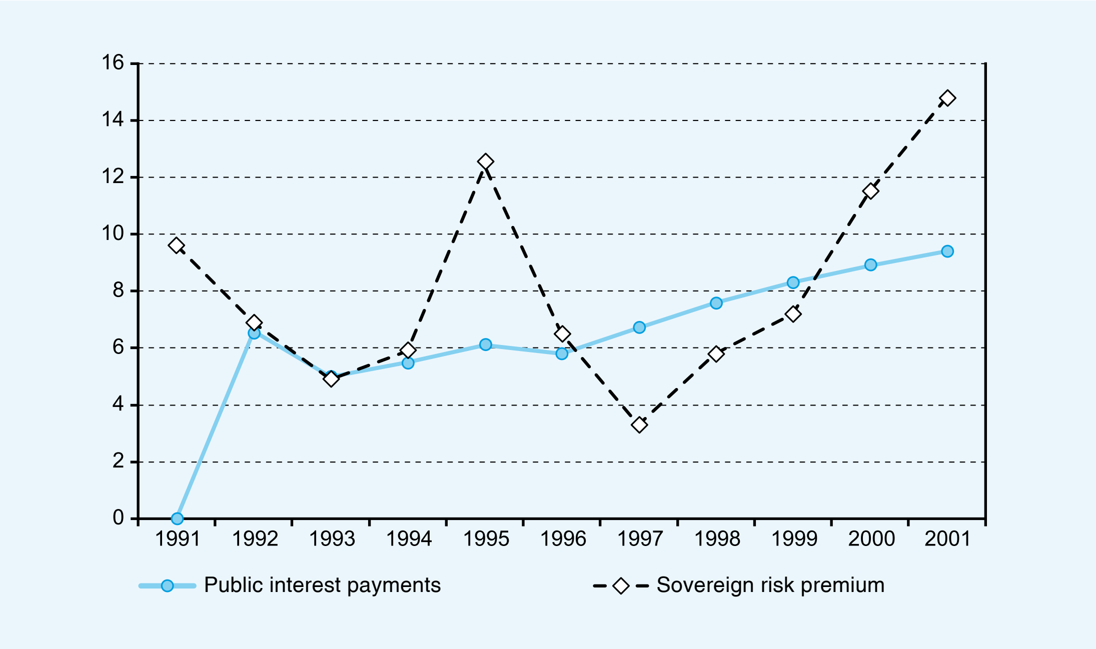
Growth and inflation statistics in the first two-thirds of the 1990s depict Argentina as a stable economy, which was not necessarily true for its current account or public debt (IMF 2003). By the late 90s, however, the situation had become unsustainable as a result of falling exports in the aftermath of the 1998 Brazilian crisis, poor prospects for growth and debt repayment, and political spite. Owing to the Currency Board, the peso could not be devalued to improve exports and competitiveness, while it also ruled out the possibility of a fiscal injection to provide economic stimulus (Hornbeck, 2013).[5] As a result, the Argentine administration, "partly because of the strictures of the convertibility regime, became increasingly constrained in its ability to use standard macroeconomic policy tools to engineer a recovery. As the economy slowed and international investors became nervous, the country's already high external debt service burden grew to a point where the debt became unsustainable" (IMF 2003, p. 1). This called for unprecedented radical monetary measures. As illustrated by *Chart 1*, the cost of financing public expenditures almost doubled between 1993 and 2001, with the risk premium peaking at 14.8 per cent on average in 2001.

In terms of monetary policy, sovereign default affected three areas (FRBSF 2002, Hornbeck 2002, IMF 2003):

❶ restricted deposit withdrawals (the '*corralito*'; as of 30 November 2001, the amount

Chart 1

TOTAL PUBLIC INTEREST PAYMENTS AND SOVEREIGN RISK PREMIUM (ANNUAL AVERAGES), 1991–2001, %



Source: Own editing based on Damill et al. (2005)

of withdrawals from private accounts was limited to USD 1,000 per month). On that day alone, the reserves of the Argentine central bank fell by USD 2 billion;

❷ partial suspension of payments on public debt (7 December 2001). This was preceded by two rounds of debt restructuring (16–17 June and 6 November in the same year), with the second already being treated as sovereign default;

❸ abandonment of the peso's peg to the US dollar, the termination of the Currency Board (6 January 2002). The peso was devalued (29 per cent for trade, with a floating exchange rate adopted for all other transactions) and subsequently depreciated.

The Argentine sovereign default led to devastating social and economic consequences. In 2002, unemployment rose to 19.7 per cent (USDoL 2010), while the ratio of those living below the poverty line increased from 25.9 to 57.5 per cent between 1998 and 2002 (Rabobank 2013). This is also confirmed by income statistics: per capita GDP fell from USD 7,800 in 1998 to a mere USD 2,700 by 2002 (Hornbeck 2004). In the three worst years of the crisis, the public debt-to-GDP ratio tripled: it soared from 45.7 per cent in 2000 to 166.3 per cent in 2002 (Hornbeck 2013), and re-entry to the international credit market was also hindered by increased lending rates. While the strong devaluation and depreciation of the peso were inevitable[6], combined with the conversion of dollar deposits to peso, they imposed significant losses on the population. Although tax hikes were intended to consolidate the revenue side of the budget, deteriorating economic performance coupled with capital flight lead to a negative spiral, placing heavy burdens on the population as well.

Based on *Catan* (2002), *Pearson* (2003) points out that the sovereign default nevertheless led to an upsurge in alternative markets: barter markets opened up, and – limited geographically or by the extent of acceptance – alternative currencies appeared such as the 'Evita' in La Rioja. The severity of the situation is aptly illustrated by her observation that "[a] whole range of other quasi money coupons are also circulating – including a range of government and provincial bonds – *patacones, lecops, portensos, locores, federales, petrones, huarpes* and *bocades*" (pp. 227–228).

RESTRUCTURING PUBLIC DEBT

The Argentine sovereign default involved extreme austerity measures. Based on their impact, the consequences of the sovereign default may be classified into two groups: while the compulsory conversion of bank deposits at market rates or restricted access to deposits (in addition to inflation) forced those with savings to incur one-off losses, and the fact that the country's financing had become more expensive threatened with new, long-term indebtedness. Restructuring public debt therefore proved to be a key issue not only for creditors but also in terms of providing sustainable funding for the Argentine state. The International Monetary Fund played a decisive role at the initial stage of the negotiations over restructuring public debt, although these did not gain momentum until 2003. The participation of the IMF may be explained by several factors, including the volume of public debt to be restructured (see *Table 1*) and the specific composition of the group of creditors (international organisations, investment funds and their home countries), but the importance of avoiding contagion should also be noted. Renegotiation of public debt concerned the loans included in the line 'Non-performing debt to be restructured' in Table 1, i.e. USD 104 billion,[7] while the rest of the debt with international organisations was not to be renegotiated.

The position taken by the IMF after the crisis[8] was nevertheless not obvious or unquestionable. Admittedly, the organisation was required to consider two options for a decision on its role in the Argentine settlement (IMF 2003). One was to provide financing and avert a deeper crisis, but at the expense of prolonging the unsustainable situation of the Argentine monetary system. The other option, weighing the consequences of a potential rejection of support, was centred around fears of contagion. The outcome of the answer to the dilemma was most certainly influenced by the emerging market crises of the late 90s (Mexico, Far East, Russia, Brazil), the objective being to avoid spillover effects. One milestone in the restructuring of Argentina's debt was a USD 12.6 billion standby loan agreement concluded with

Table 1

COMPOSITION OF ARGENTINE PUBLIC DEBT ACCORDING TO RESTRUCTURING, 2004

Debt category	Amount (USD billions)	%
Performing debt	84.7	43.3
Non-performing debt not to be restructured	6.7	3.4
Non-performing debt to be restructured	104.1	53.3
Total	195.5	100

Source: Own editing based on Hornbeck (2004) the IMF in September 2003, but the organisation also assisted Argentina's post-crisis efforts for monetary and economic reform (Hornbeck 2004) until it was finally dismissed in 2012 (BAH 2012). This also meant that, at least in the first round, Buenos Aires refrained from settling its debt to private creditors.

Not long after the agreement with the IMF, however, the settlement of debt to private creditors started anyway. The process was made extremely complicated by the structure of the debt: it affected 152 types of bond in total, issued in eight jurisdictions[9] and denominated in seven currencies[10]. Of the more than USD 100 billion worth debt to be restructured, 46.9 per cent was held by domestic investors, 34.6 per cent by Europeans, 12.3 per cent by those in the US, with the remaining 6.2 per cent shared between Asian and other Latin-American investors (Hornbeck 2004, Damill et al. 2005, Shapiro – Pham 2006).

In September 2003 the Argentine administration offered a unilateral solution to bondholders affected by the default (the so-called Dubai proposal). The debt restructuring, which would have affected the holders of all bonds issued prior to December 2001, disregarded the approximately USD 25 billion worth past due interest, and imposed a 75 per cent haircut; that is, under the new terms, new[11] bonds worth about USD 22 billion would have been issued (Damill et al. 2005). The terms proposed were obviously refused by creditors, who also had the IMF's sympathy, which "exerted pressure on the government in many ways and repeatedly called for signs of 'good-faith'" (Frenkel 2012, p. 8).

The Argentine government announced a new restructuring plan in June 2004 (the so-called Buenos Aires proposal). With the new proposal, Buenos Aires essentially passed the ball to creditors: the USD 81.8 billion worth of eligible debt[12] would be restructured based on the level of creditor participation. Under the proposal, new bonds would be issued for a total of 38.5 billion dollars, in case the level of acceptance of the swap was lower than 70 per cent, and for 41.8 billion dollars in case the level of acceptance was higher than the 70 per cent benchmark (Frenkel 2012). Owing, among others, to additional repayment pegged to GDP growth (Damill et al. 2005), the terms improved but were still unacceptable for investors.

The international abundance of liquidity characterising the mid-2000s and a rapid growth driven by agriculture pushed the GDP back to pre-crisis levels in the span of a few years, and the relatively fast acceleration continued until the 2008 crisis. This and the hard line represented by President *Néstor Kirchner* broke the deadlock over restructuring 'negotiations'. In February 2005, Kirchner and his government virtually sent investors an ultimatum by prohibiting the resumption of negotiations with those refusing to accept the proposed swap (*Ley Cerrojo*). Consequently, as part of the restructuring in 2005, USD 61.8 billion worth of bonds were exchanged for bonds worth USD 35.2 billion at interest rates of 2.08–5.96 per cent (Shapiro – Pham 2006), with 24 per cent of creditors declining participation.[13] However, the negative effects of the restructuring, which are also extremely important for an understanding of current events, cannot be ignored: Argentina was able to force creditors to write off 70 (!) per cent of the face value of its previous government bonds when its economy was growing by nearly nine per cent annually (Bickel 2005).

Following the 2005 debt swap, Argentina had USD 18.6 billion of bonds outstanding along with accrued interest, USD 6.3 billion of Paris Club arrears, and USD 9.5 billion of IMF debt (Hornbeck 2013). The author points out that the country's primary surplus and the international climate enabled debt restructuring, while the exhaustion of the unorthodox means of renewing debt (nationalisation of private pension funds, the sale of government bonds to the government of Venezuela, monetisation of debt) and the increased cost of market financing demanded it. Starting in late April 2010 and superseding the *Ley Cerrojo* of 2005 at the stroke of a pen, under a new debt swap deal two-thirds of the USD 18.3 billion were renewed in the amount of USD 7.831 billion (MEcon 2010) at interest rates of 2.5–8.28 per cent, with maturities of 2033 and 2038, and securities linked to GDP growth. With the two debt swaps, 91.3 per cent of the bonds affected by the 2001 default were restructured (Hornbeck 2013).

Fiat iustitia, pereat mundus[14]

Already in the mid-2000s, Argentina appeared to have recovered from its sovereign default of historic proportions, and to have entered a steady macro-economic path. This was not only demonstrated by a growth rate almost comparable to that of the Chinese economy and by the curtailment of public debt; even the current account and unemployment statistics pointed to a favourable economic position (see *Table 2*). As indicated by the method of renegotiating debt, this applies to the period with Néstor Kirchner in office (2003–2007). Externally, Argentina showed determination and stability, while internally it boasted the image of a state fiercely defending national interests which, partly after Kirchner's death and during the presidency of his wife, *Cristina Fernández de Kirchner*, showed strong signs of populism once again. Price regulation, excessive financial support to poorer social groups at the expense of the middle class, continuous rails against IMF policy, hostility to the United States, and the future of the Falkland Islands (AEI 2013) are only a few of the most

Table 2

SELECTED MACRO-ECONOMIC INDICATORS FOR ARGENTINA 2006–2013

	2006	2007	2008	2009	2010	2011	2012	2013
GDP growth (%)	8.5	8.7	6.8	0.9	9.2	8.9	1.9	4.5
Fiscal balance	1.9	0.6	0.7	–0.8	–0.1	–2.3	–0.4 (A)	4.5 (B)
Public debt (% GDP)	63.6	55.7	48.5	48.5	45.1	41.2	44.9	n/a
Unemployment (%) (C)	10.2	8.5	7.9	8.7	7.7	7.4 (B)	6.9	6.8 (D)
Current account (% GDP)	3,6	2,8	2,1	2,7	0,6	–0,4	0,1	–0,2
Inflation rate, INDEC (%) (E)	9.8	8.5	7.2	7.7	10.9	9.5	10.8	10.9
Estimated real inflation rate (%) (F)	–	15	25	15.8	10.9	22	25.6	28.3
International reserves (USD billions, January of each year)	19.7	33.7	47.6	47	48.1	52.6	46.6	42.5

Notes: (A) Without data for December 2012. / (B) Estimate. / (C) 2006–2011: urban areas. / (D) Q3 data. / (E) International opinion is that the Argentine Statistics Office (Instituto Nacional de Estadística y Censos – INDEC) has not been publishing real inflation rates. / (F) Estimates by international organisations and consulting agencies.

Source: Own editing based on BAH (2013), BCRA (2014), Clarín (2013, 2014), UN (2007, 2009, 2010, 2011, 2012, 2013), Hornbeck (2013), MP (2013), La Nación (2013a, 2013b), LR (2013), World Bank (2013) important features of economic and political populism. Although the outbreak of the crisis in 2008 did not end Argentina's economic growth, its dynamics switched to a decelerating trend. This is explained by a variety of domestic and international factors – consequently, an overview of the general economic situation is essential for an understanding of today's Argentine economic policy.

As shown previously, the Argentine economy was on a steady growth path in the mid 2000s with a strong influence from the performance of the domestic and international economy (Orgaz et al. 2011), the favourable trends of the international market for agricultural products, the international abundance of liquidity, and the resulting low interest rates. On the other hand, these collectively account for the failure to implement the necessary structural, monetary and, not least, political reforms. While the principal evil of the first category is linked to competitiveness (with the partial exception of large-estate and extremely efficient agriculture), chronic problems have been arising in finance from the double-digit inflation (as has been officially admitted nowadays) (Table 2), and from the multiple exchange rate maintained despite the continuous depreciation of the peso. Mindful of the fact that depreciation drives exports, it should be noted that a deteriorating ability to attract capital and capital shortage itself are undermining the economy's long-term perspective for growth and development. In all these developments a key role is played by populism, a specificity of Argentine politics: the purchase of social peace at a price that sometimes proves to be too high. The economic participation of the state is ubiquitous: price and wage regulation and the central control of international trade are common practice, while the government has no scruples about nationalisation either (Economist 2013, Porzecanski 2013). At the same time, coupled with today's capital-oriented economic order (Botos 2014), fierce international competition, the relatively low cost of bridging geographical distances and trade liberalisation have significantly reduced the differences between national economies (economies of scale, the size of the internal market and purchasing power, labour supply, availability of natural resources, etc.) and as a result, capital has also become less stationary. Additionally, the financial and political uncertainty that is a key characteristic of today's Argentina downright scares off international investors.

Highlighting the specificities of contemporary Argentine monetary policy by means of a comparative analysis[15], *Porzecanski* (2013) lists the following traits as specificities of the American economy:

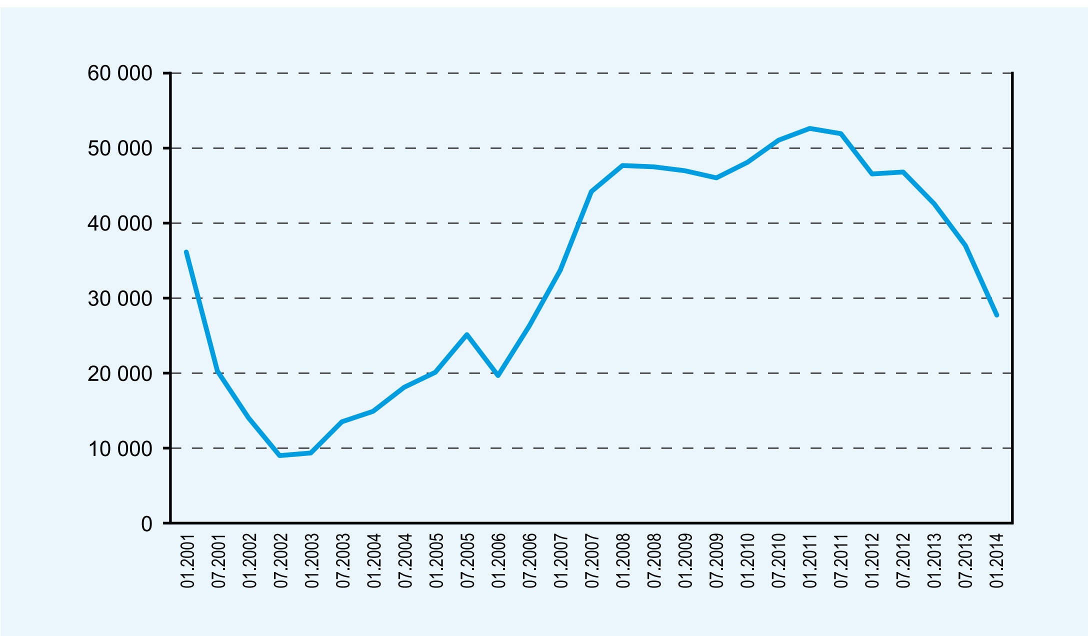
- capital outflow from Argentina despite controls on imports and remittances abroad,
- a major depreciation of the peso,
- a significant double-digit inflation preventing monetary policy interventions to provide stimulus,
- decelerating economic growth with a risk of wages losing real value, and
- unfavourable terms of borrowing due to sovereign risk.

In terms of monetary policy, Argentina deserves attention because of its currency policy, driven by two underlying factors. In January 2014, due to a change in the Fed's direction of monetary policy and speculations (WSJ 2014), the Argentine peso, along with the currencies of other emerging economies (South Africa, Turkey, etc.) came under heavy pressure (Forbes 2014), which called for more decisive central bank intervention than at any other time before. In response, Indian Central Bank Governor *Raghuram Rajan* voiced his concern that developed countries paid no regard to developing ones in their monetary policy considerations, although "emerging markets helped pull the global economy out of crisis starting in late 2008" (Bloomberg 2014a, p. 1). Notwithstanding that, in the case of Argentina central bank intervention has been pushed to its limits, which is also underlined by the fact that in late January, in an attempt to protect the national currency, the *Banco Central* sold 860 million pesos (over USD 100 million) of 98-day notes at 25.89 per cent, the highest since late 2002. Even more telling of the severity of the situation is the fact that the rate was 6 percentage points higher than in the previous week (Bloomberg 2014b). The central bank's international reserves plunged 32 per cent in the course of a year to hit a seven-year low (BCRA 2014, Bloomberg 2014b), amounting to a mere USD 27,007 million in March (see *Chart 2*). The government's ability to cover foreign currency expenditures much cheaper against the central bank reserves only makes matters worse.[16] Market financing for the state is extremely expensive as Argentina is a debtor with one of the highest sovereign risks in the world. In mid-April 2014, the CDS spread reflecting Argentina's default risk stood at 1,724 points compared to Brazil (156), Venezuela (1,006), and even Ukraine, on the verge of civil war (1,139), in the period under review (DBR 2014).

A cardinal problem for monetary policy arises from multiple exchange rates, which are used by the market to price the fair value of the peso, as well as by the government to influence currency management according to its own interests. From all this it follows that the existence of official and informal exchange rates is a fact acknowledged by the government, with some daily papers publishing both. The difference between the peso rate and the informal rate, termed *dólar blue*, *paralelo*, *negro, informal*, etc., could be as high as 40–50 per cent.[17] The agricultural rate of the peso, the *dólar soja*, may be seen as another in-

Chart 2

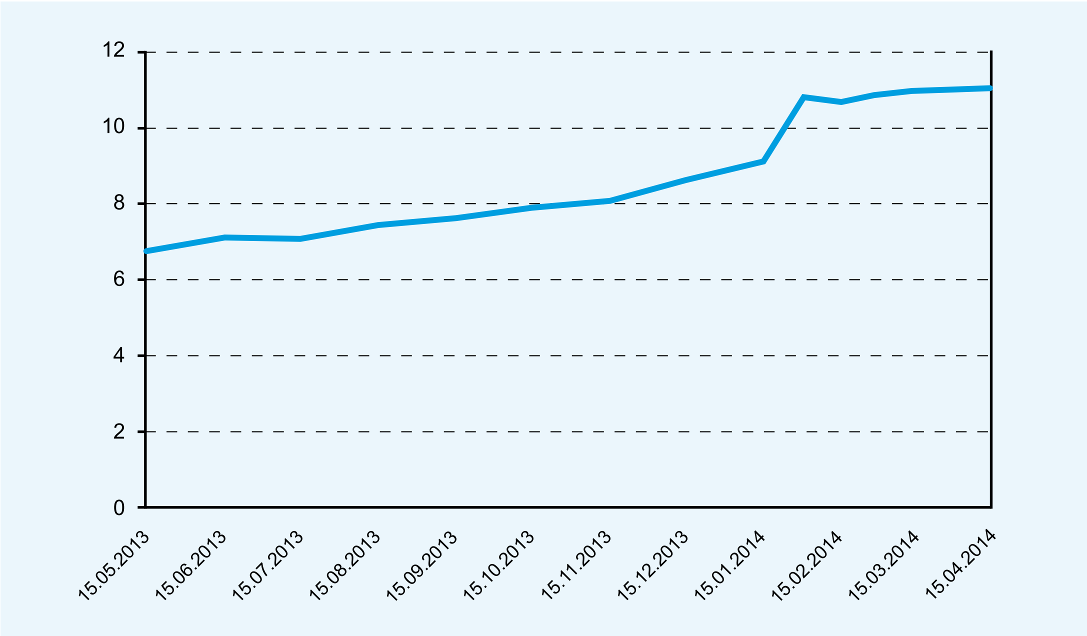
RESERVES OF THE CENTRAL BANK OF ARGENTINA 2001–2014 (USD MILLIONS)



Source: Own editing based on BCRA (2014)

Chart 3

EUR/AR$ EXCHANGE RATE 15 MAY 2013–15 APRIL 2014



Note: Value for the 15th of each month from the starting date up to 15 December 2013; values for the 15th and the last day of each month from 15 January 2014.

Source: Own editing based on Currency (2014)

stance of market distortion by the state, which is clearly used by the government to retain control over hard currency revenues from the price of agricultural products.[18]

In the period under review, the peso depreciated significantly (see *Chart 3*). This also fits into the trend emerging in the aftermath of the sovereign default, as after the elimination of the dollar peg, the Argentine currency was significantly devalued, followed by gradual depreciation. From 10 November 2013 onwards, the depreciation of the currency gained new momentum, which may be seen as financial markets' response to the Argentine president's new economic team, and as a result of the Central Bank's passive stance (FT 2014). The facts are that the peso weakened against the euro from 7.9634 to 9.4354 between 10 November last year and 24 January 2014 (18.48 per cent), followed by a 15.8 per cent plunge to 10.9267 in a single day. Following the significant correction, the exchange rate moved within the range of 10.61 and 11.11 (Currency 2014).[19] Underlying the slide in the exchange rate may be the possibility that the central bank's arsenal of intervention has become exhausted.

CONCLUSIONS

For international actors, there were lessons to be learnt from Argentina's 2001 sovereign default in a number of respects, which is not necessarily the case with the Buenos Aires administration. In addition to the internal – occasionally unsustainable – monetary policy considerations of the 1990s, the consequences of the financial crises in emerging economies in 1994–1998 are essential causes of the default. In this light, 2001 did not mark the beginning of the Argentine crisis, but its peak.

In connection with Argentina's default, the International Monetary Fund and 'irresponsible' investors drew heavy criticism. However, the moral hazard does not only lie with the international financial system. In addition to highlighting the drawbacks of excessive government spending, lack of political compromise and populism, the 'Argentine case' has been a warning sign for all actors in international finance, demonstrating that even a sovereign debtor may become insolvent. There were few examples of that before the 2000s.

Following the two rounds of debt restructuring it appeared, at least in macro-economic terms, that Argentina benefited from the sovereign default. This paper has not addressed the nationalisation of private businesses in detail, although current trends suggest that it is precisely the burden of economic unpredictability that crushes the Argentine financial system, and in 2014, not even central bank intervention can (or is willing to) stop the corrections driven by the market. Certainly, leaving the businesses in private property would not necessarily have provided a solution to economic troubles, but political uncertainty may have been avoided.

In summary, while on a value basis we cannot accept or reject our hypothesis without any doubt, we can draw a clear conclusion in respect of the timing of the correction. The Argentine peso is one of the few national currencies that depreciated significantly against leading currencies in early 2014, and this is primarily attributed to a change in the Fed's monetary policy, the new Argentine economic team being priced in by the market, and the limited options of the Argentine central bank. The fact that the peso has been moving in a relatively narrow range since early February may signal the long-term parity of the exchange rate, but does not necessarily demonstrate the market conformity of real economy developments and economic governance practices.

Notes

1 A few factors (government bond yields, CDS spread, peso exchange rate) warn that the events of 2001 may be repeated, or at least that the current situation is unsustainable. That is, there is a risk of another sovereign default, but for different reasons.

2 Mueso de la Deuda Externa: http://mde.museodeladeuda.com.ar/

3 The primary task of the Currency Board was to stabilise the monetary system. As part of this, the peso was pegged to the dollar at parity, coupled with a fully convertible peso and the same terms for dollar and peso contracts, while the central bank permitted the issue of new money only against its foreign exchange reserves (Baer et al. 2010).

4 Standing at 3,079.81 and 2,313.97 per cent in 1989 and 1990, respectively, inflation was reduced to 1.3 per cent by August 1991 (Kiguel – Liviatan 1995).

5 For the real economy, a pegged exchange rate may be a blessing as well as a curse, because its beneficial effects are only perceived when the economy is capable of remaining competitive without monetary policy intervention. The affordability of foreign products, their occasionally better quality and the financial literacy of the population all contributed to the exacerbation of the acute problems of the domestic economy, the erosion of domestic savings, and ultimately, the shaking of the foundations of the Argentine economy.

6 According to the calculations of the Federal Reserve Bank of San Francisco (FRBSF 2002), the exchange

rate of the peso fell by 356 per cent against the dollar by 20 September 2002, in the span of less than ten months.

7 This was distributed in a ratio of 80 to 20 per cent between government bonds and past due interest (PDI). Argentina has always challenged the legitimacy of the latter.

8 See Damill et al. (2005) for more details.

9 These were the following: United States of America, Argentina, Japan, Great Britain, Germany, Italy, Spain and Switzerland.

10 These were the following: Argentine peso, inflation-adjusted peso (the so-called UCP – Unidad de Cuenta de Pesificación), USD, EUR, JPY, GBP, CHF.

11 The issue of three bonds called Par, Quasi-Par and Discount was announced, in addition to a coupon tied to GDP growth (Damill et al. 2005). See Damill et al. (2005) for the contents of each bond.

12 The Argentine administration continued to ignore overdue interest.

13 For details of the debt swap, see for example Dhillon et al. (2006).

14 Justice be done though the world perish – Latin proverb.

15 The features highlighted run counter to international trends and as such are not explained in detail.

16 This does not necessarily affect energy imports only, as Argentina was still a net oil exporter even in 2012, although it imported natural gas (USEIA 2012). However, state subsidies for energy entail a heavy burden (Porzecanski 2013).

17 See www.dolarblue.net for the informal rate.

18 Exchange rate control is an established means of achieving various goals. See FIEL (1988) for the practice in Argentina.

19 As at 21 April 2014.

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