

# ARGENTINA'S LOOMING DEFAULT: NAVIGATING A DEBT CRISIS & GLOBAL PANDEMIC

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## *A Troubled History*

Argentina remains a nation plagued by perpetual economic mismanagement with an endemic propensity for public expenditures that exceed government revenues resulting in large fiscal deficits. These misinformed policies lead the Argentine government to employ imprudent monetary policy and foreign borrowing, which fuels inflation and debt accumulation. These trends often bring Argentina to the International Monetary Fund (IMF). The IMF promotes global economic growth and financial stability in critical markets to avoid radical shifts in economic policy. Since its independence in 1816, Argentina has defaulted on its external debt nine times, entered into 21 IMF programs since 1956, and has experienced economic contractions for 22 of the past 58 years.

The IMF mandates that countries who receive financial aid packages abide by strict austerity measures, with governments slashing spending and raising taxes. However, Argentina repeatedly fails to adhere to these regulations, most often avoiding cuts to public expenditures that its citizens rely on and expect. Argentina's inability to disengage from this familiar cycle of economic downturns and financial crises is primarily due to problems posed by gradual neoliberal reforms, a lack of commitment to austerity measures by politicians and the public, and depleted investor confidence in the extremely volatile emerging market.

Before Argentina's first debt default of the 21st century, former President Carlos Menem committed the nation to neoliberal

principles during the 1990s, courting foreign investment, cutting barriers to trade, and privatizing ineffective state enterprises. As a result, persistent inflation fell to single digits and the IMF praised the country for its free-market reforms. However, when Menem left the Casa Rosada in 1999, corruption and the preceding Asian, Russian, and Mexican financial crises triggered capital flight in Argentina, while a currency peg adopted during the Menem administration prohibited the government from printing money, forcing them to adopt foreign borrowing. Widespread unemployment, poverty, and social unrest followed, as Buenos Aires erupted into riots. Argentina's economy shrunk by a fifth and the government defaulted on more than \$100 billion in debt to private creditors, the largest default in history at the time.

From 2003 to 2015, Argentina's Peronist legacy allowed for the consecutive presidencies of Néstor Kirchner and Cristina Fernández de Kirchner. Following the 2001 default, Néstor Kirchner was able to leverage beneficial global commodity pricing to implement redistributive policies and maintain fiscal surpluses without external funding, allowing him to be less accommodating towards private creditors during the 2005 debt restructuring process. As well, holders of Argentina's defaulted bonds had not received payment on them since 2001, inclining them to be more flexible. Kirchner forced private creditors to accept a 70 percent "haircut" on their expected dividends before paying back the IMF in full. Following this conclusion, political support for the Kirchner's soared as regular Argentine's reaped the rewards of the distinct version of Peronism employed by their administrations, now known as "Kirchnerism," which was marked by intense protectionism, unsustainable public programs, and unorthodox financing methods that led to grave deficits, inflation, and criticism from the international financial community. During her presidency, Fernández de Kirchner took an uncompromising position against bondholders who had refused to accept the 2005 restructuring agreement, leaving Argentina expelled from international capital markets for a decade, while strengthening her popularity among working Argentines.

### *A Return to Normalcy?*

In 2015, the election of the business-friendly and wealthy

former Mayor of Buenos Aires, Mauricio Macri was predicted to be a return to economic orthodoxy and development in Argentina, as he aimed to address the Kirchner's mistakes through structural reforms. Macri immediately cut export taxes, lifted currency controls, and resolved disputes with international creditors to regain access to capital markets. At the same time, the central bank raised interest rates to 25 percent to curb persistent inflation. Following these reforms, the Argentine economy contracted by 1.8 percent in 2016, which hurt a third of Argentines living below the poverty rate in 2016. To maintain political support for his reform package, Macri avoided addressing the budget deficit of 4.3 percent of GDP. President Macri employed traditional borrowing from international capital markets to spur growth, as the government issued \$56 billion in external debt between January 2016 and June 2018. Still, interest payments caused the public budget deficit to grow to 6.4 percent of GDP in 2017.

Increased capital inflows financing the deficit contributed to an overvaluation of the peso by 10 to 25 percent, causing the current account deficit to expand from 2.7 percent of GDP in 2016 to 4.8 percent in 2017. Dependency on external financing left Argentina susceptible to changes in the cost and availability of international capital, and this risk came to fruition in 2017. The U.S. Federal Reserve raised its interest rates, leading investors to be bearish towards Argentine bonds. Macri lowered his inflation targets raising international concerns over his commitment to austerity, and an extreme drought hurt commodity yields, as agricultural export revenue eroded.

Investors sold their Argentine assets, which further depreciated the peso, making it even more difficult for the government to pay back its dollar-denominated external debts. To improve investor confidence, the central bank announced in April and May 2018 it would raise interest rates and pursue fiscal reforms to control the budget deficit. Yet, market volatility continued, forcing President Macri to approach the IMF, which ultimately granted Argentina a \$57.1 billion bailout package (the largest in the fund's history) administered in installments. During this period, the government committed to unpopular austerity requirements to bring the primary deficit to equilibrium by 2020, despite projections of the external debt reaching \$285 billion by 2019.

### *A Return to Normalcy... for Argentina*

The Macri government continued to enact gradual fiscal reforms, reducing the budget deficit from 5.3 percent of GDP in 2018 to 2.5 percent of GDP in 2019, without making significant gains. Still, rampant inflation, intense devaluation of the peso, economic contractions, and continued adherence to austerity lowered public approval of President Macri as the 2019 Presidential elections approached. Macri continued to advocate for economic pragmatism to guide Argentina through the recession. Nevertheless, the Peronist resurgence behind the ticket of party man Alberto Fernández and former firebrand, leftist president, Cristina Fernández de Kirchner, mobilized nostalgic Peronistas, while worrying investors who were familiar with the country's populist past.

After Fernández convincingly defeated President Macri in a shocking primary election result in August, capital flight, currency devaluation, and plummeting market valuations ensued, worsening the recession. Macri reinstated illiberal policies in response. He imposed convertibility controls, rolled out tax breaks, raised the minimum wage, and froze fuel and utility prices to curb social unrest. The government announced it would postpone \$7 billion in payments on short-term local bonds, extend the maturities of \$50 billion in long-term bonds, and seek to delay repaying \$44 billion in IMF loans.

On October 27, 2019, 26 million voters participated in Argentina's general election, as the Peronist Fernández - Fernández ticket secured the presidency over Mauricio Macri with 48 percent of the vote. After being inaugurated on December 10, 2019, President Alberto Fernández comes into government with an absolute majority in the Senate presided over by his Vice President, Cristina Fernández de Kirchner. However, he still faces a dire economic situation where two-fifths of Argentines are unable to afford a monthly basket of staple goods, and the year-on-year inflation exceeds 50 percent.

The new government hopes to restructure its \$105 billion in foreign debt, not including its obligation to the IMF. The Fernández administration will likely defer interest and principal payments to creditors for the next two years, and it could require even more concessions, as market evaluations expect a 50 percent loss in value of Argentine bonds' face value. President Fernández is likely to increase wages for public and minimum-wage workers while raising pensions.

To address inflation, the government will maintain currency controls to protect the peso and price controls on utilities, while also negotiating with employers and unions to freeze prices and wages.

While Fernández rebuked the IMF on the campaign trail to energize his Peronist base and held hope that he could avoid utilizing the remainder of the IMF loan, his government must still negotiate a deep debt restructuring with the IMF and private sector to prevent another external debt default. Despite economic saber-rattling by his more radical Vice President, Fernández signaled moderate pragmatism to attain the aid and patience needed from the IMF to address the inflation, unemployment, poverty, and recession afflicting the nation. He has worked extensively to garner IMF support to reschedule Argentina's debt repayments. Fernández also enjoys solidarity from the IMF's Managing Director, Kristalina Georgieva, who inherited this situation from the previous IMF director, Christine Lagarde, making her more receptive to Argentine requests.

Unfortunately, it has become increasingly clear to the government, the IMF, and private creditors that the country's debt is unsustainable, as the fund argued the actions necessary to balance the country's accounts while managing the debt-level was neither economically nor politically feasible (Under Fernández's current economic plan, Argentina will not achieve a fiscal surplus until 2023 at the earliest). A tortuous default is likely to occur, requiring bondholders to make a meaningful sacrifice for a possible solution. However, private creditors are not eager to accept a "haircut" in the short-term if it is likely that they will have to restructure the debt again in the long-term. Since the IMF's analysis of Argentina's debt following the fall primary elections, the peso depreciated more than 40 percent, international reserves fell by about \$20 billion, and real gross domestic product contracted more than expected, causing the gross public debt to rise to almost 90 percent of GDP at the end of 2019. At the same time, the poverty rate reached 36 percent, extreme poverty was 8 percent, and the country lost 167,000 private-sector jobs in 2019, with the unemployment rate hitting 9 percent.

### *Extenuating Circumstances: COVID-19 Muddies the Water*

As the COVID-19 pandemic spreads throughout Latin America, Argentina will face severe health and financial challenges, as

the economic effects of social distancing and global market volatility will overrun weak fiscal stimulus measures, deepening its recession as the economy contracts, weakening the peso and financial markets. Before the pandemic began, the likelihood of default, protectionist economic policies, insufficient government taxation, unimpressive export rates, and unemployment led many analysts to believe the economy would contract by 1.2 percent in 2020. The Economist Intelligence Unit now suspects a more significant contraction of 6.7 percent.

On March 20, President Alberto Fernández imposed a national lockdown to reduce the spread of the virus, opting for the protection of public health over economic activity, despite the looming threat of default. Mr. Fernández must illustrate that social distancing measures are effective in flattening the country's curve. As of now, his safety initiatives have garnered him politically advantageous public support, as his approval rating increased from 48 percent following his election to now 69 percent, but the number of reported cases has still risen to almost 2,000. Like many other emerging markets, health and economic concerns exist over Argentina's 10 million impoverished citizens who lack sufficient access to sanitation and healthcare and live in informal settlements. The national lockdown sacrifices Argentina's informal sector of the economy that makes up 36 percent of the economy, and federal and provincial authorities will struggle to support these individuals due to scarce resources.

While government officials continue to negotiate with the IMF and private creditors over the logistics of its debt restructuring, Argentina will be unable to access international credit markets. As well, Argentina failed to maintain cash reserves during the 2000s commodity boom and will face the pandemic with little savings. To support any economic stimulus programs, Argentina will likely have to print pesos, driving up inflation once more.

The problem facing President Fernández is inherently political and is only muddled by the complexity and uncertainty of a global health pandemic. If he surrenders to creditor's demands for austerity measures, then his administration will lack the necessary resources to sustain public spending and prop up Argentina's fledgling economy during this financial and public health crisis. The alternative could see Argentina's government fail to reach an agreement in time to avoid a default, once again isolating Argentina in the global economy, severely

damaging the country's credibility in international markets that will deter foreign investment for years to come. However, a question that some argue is that Argentina will likely not regain access to financial markets for some time given the country's dismal economic record, so why not simply default?

Ultimately, neither an amicable debt restructuring, nor a default will improve Argentina's long-term economic situation. The periodic debt crises that afflict Argentina are a product of embedded structural and political problems. The public sector is massive, inefficient and contributes to the country's large fiscal deficits. Citizens rightly distrust the national currency and financial institutions. Finally, the economy is comparatively not competitive enough in the international marketplace to gain the hard capital required to service debts and finance imports. The substantial reforms and austerity measures necessary to address these obstacles are historically, unpopular politically among Argentines and subsequently insufficient action from reactive public officials follows. As Latin America faces its worst recession in 50 years, Argentina will continue to navigate its complicated economic situation. However, it has become increasingly apparent that the tale of Argentina and creditors will not enjoy an idealistic conclusion. The only certainty is that Argentina's road ahead will be among the most difficult for the world's emerging markets.

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