ARGENTINA: CRISIS AND RECOVERY

Mario I. Blejer

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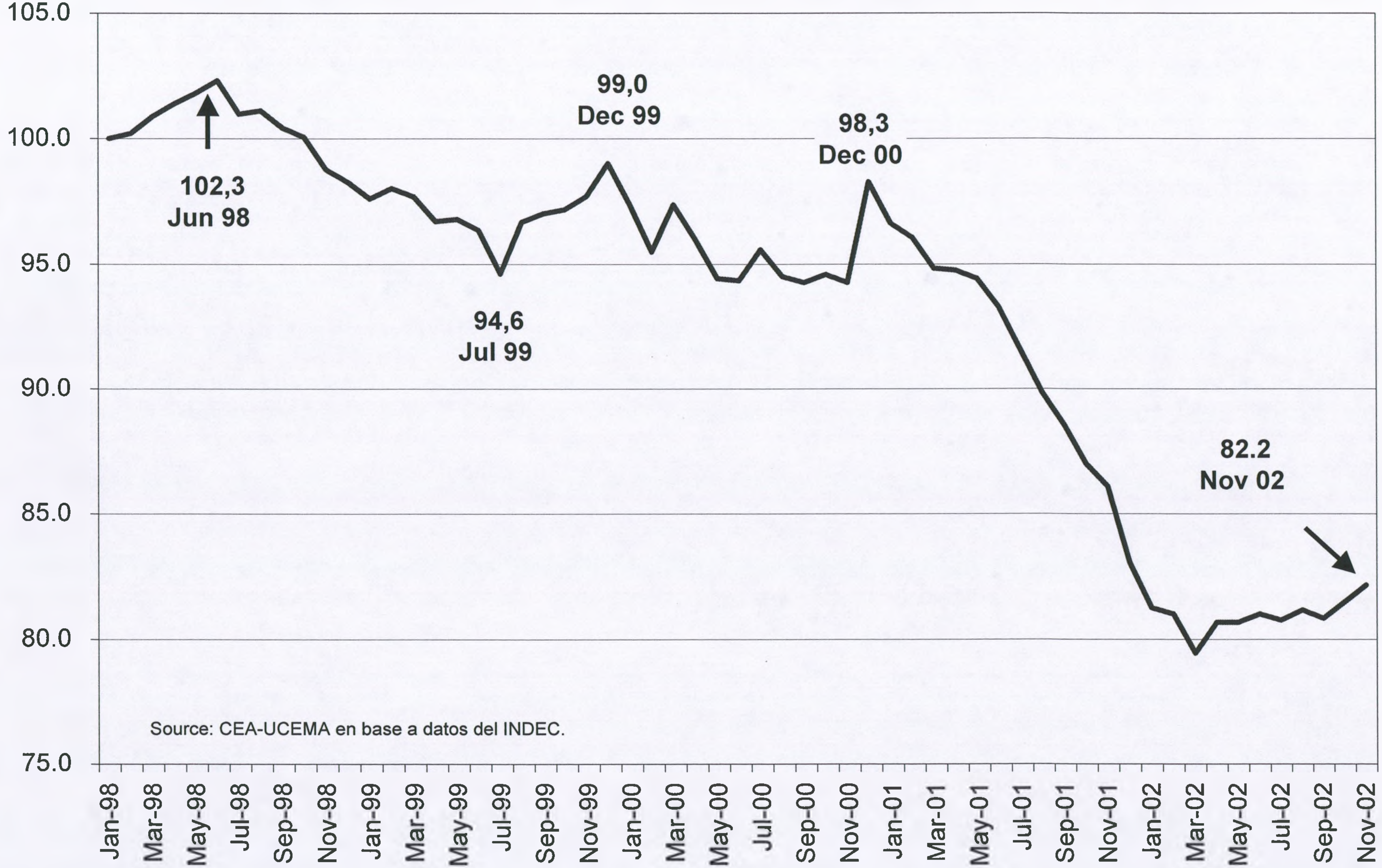
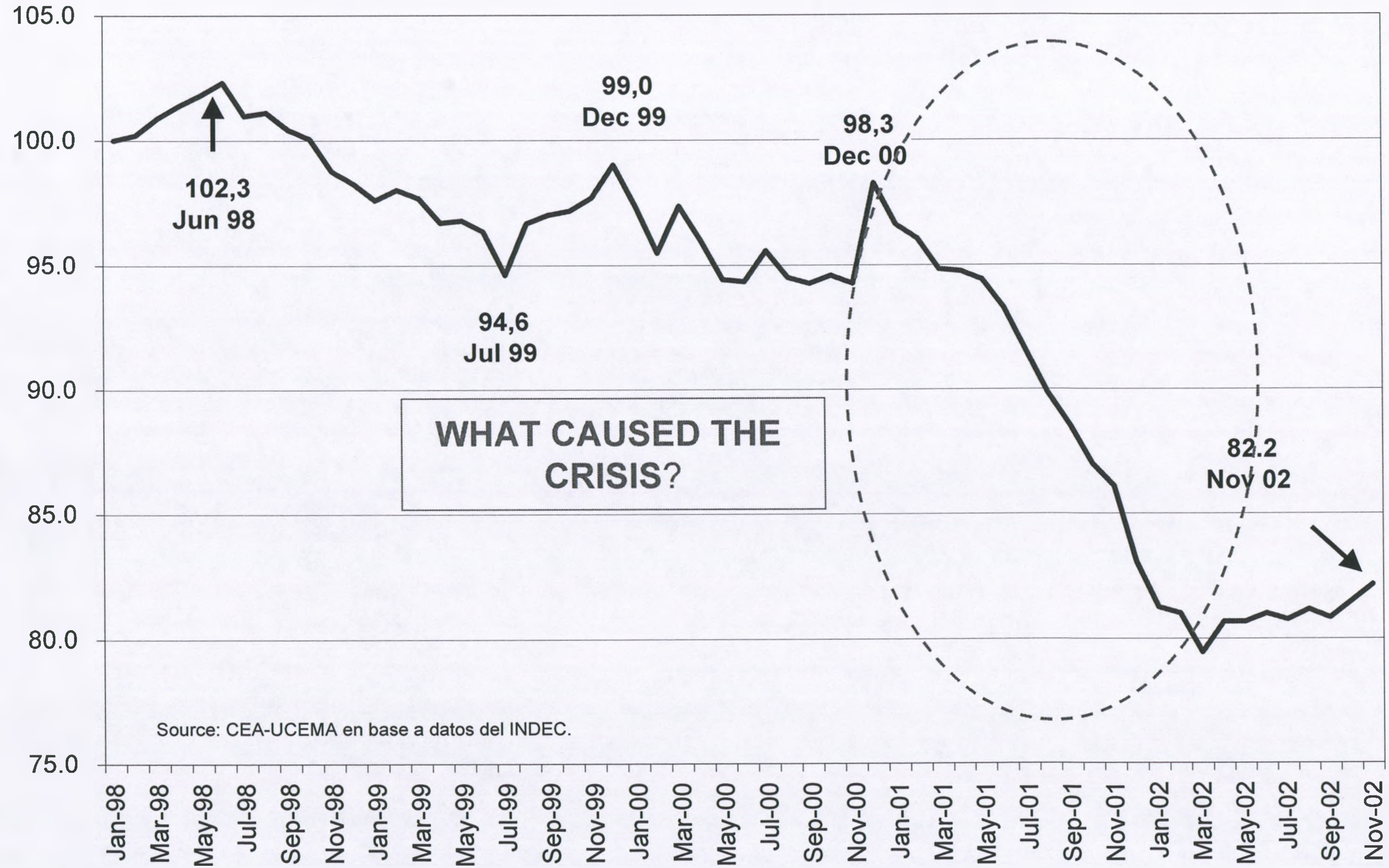
Monthly Gross Domestic Product
seasonally adjusted (Jan 98 = 100)



Monthly Gross Domestic Product
seasonally adjusted (Jan 98 = 100)



Monthly Gross Domestic Product
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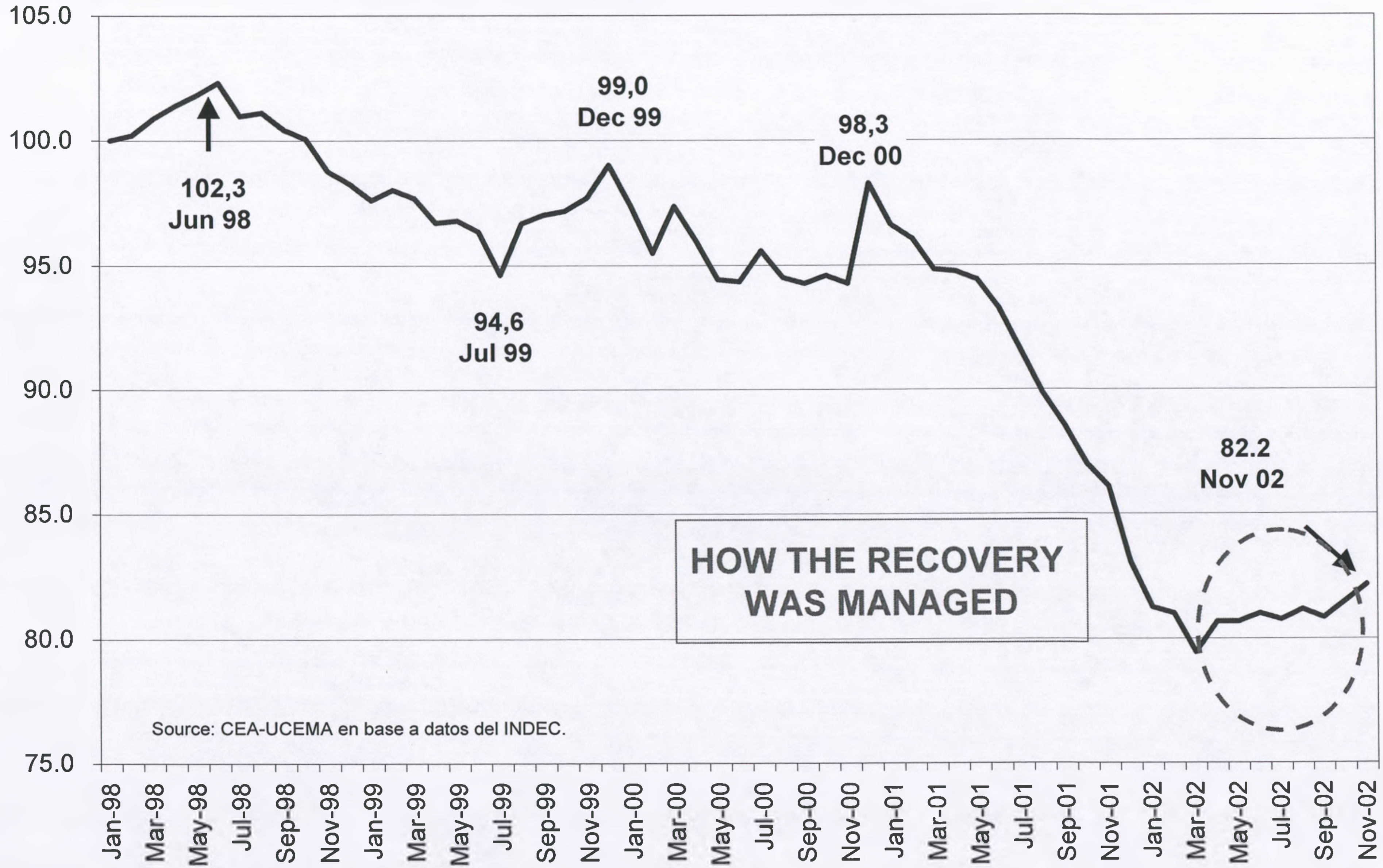
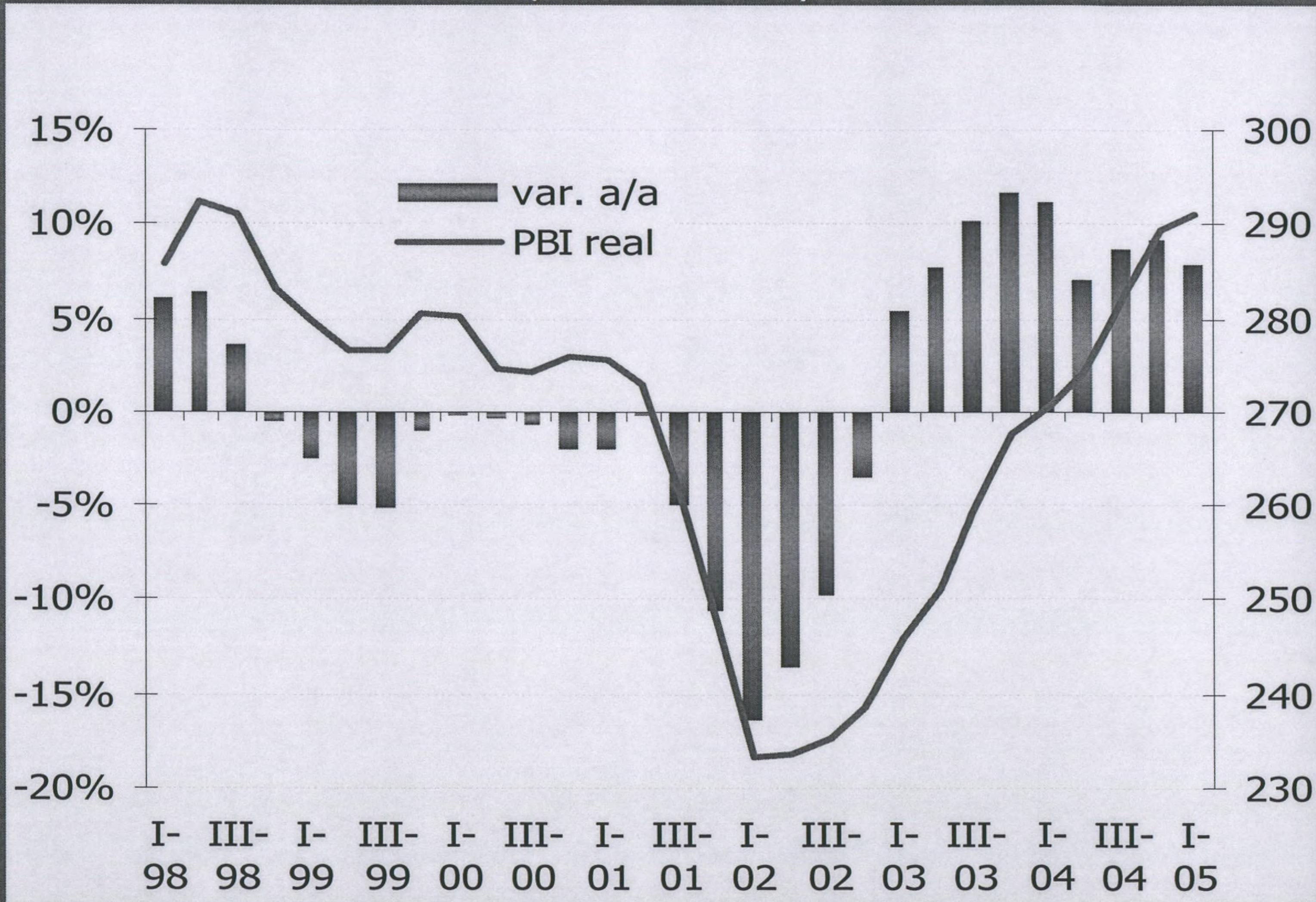


Real GDP

(base 1993)

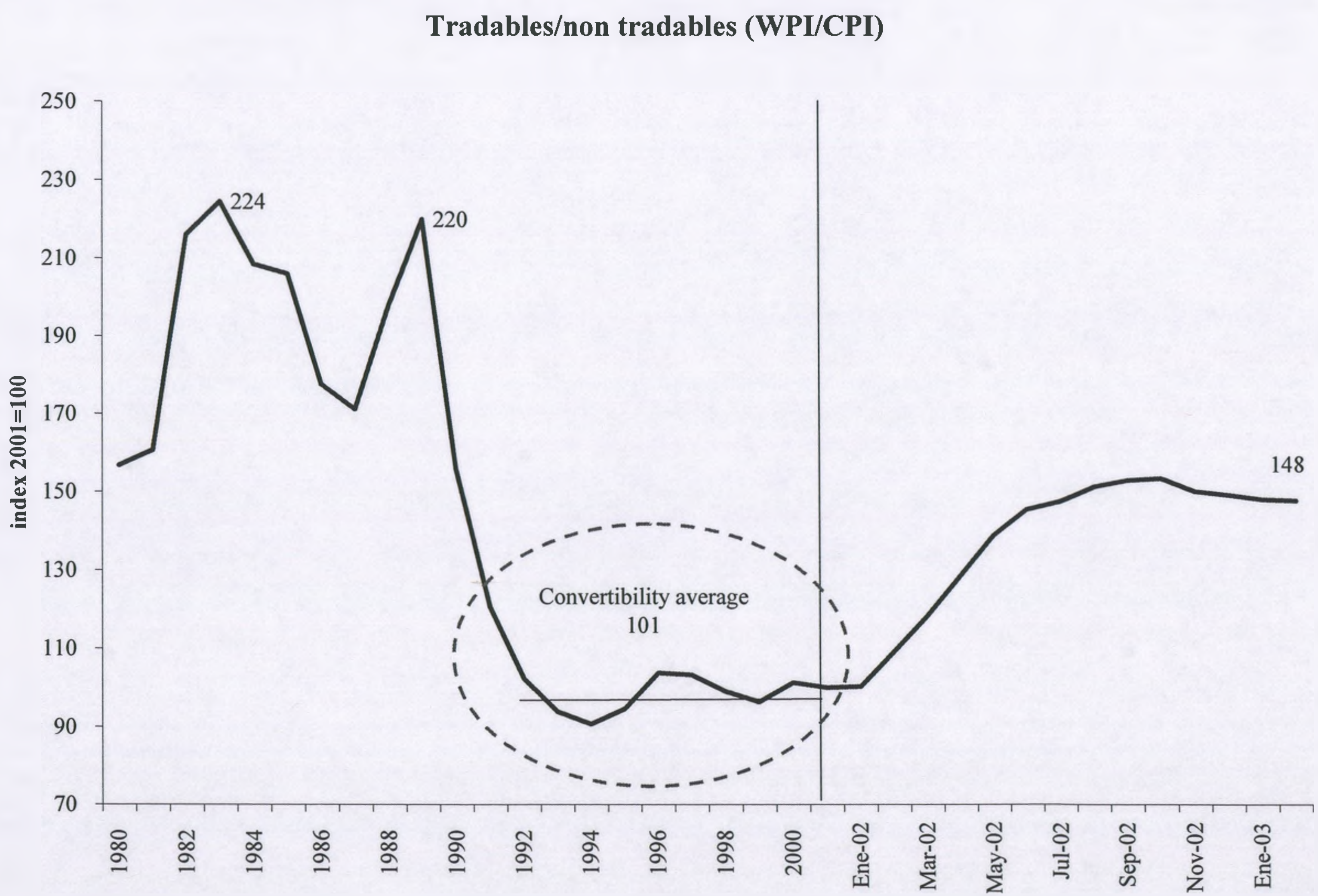


CAUSES OF THE CRISIS

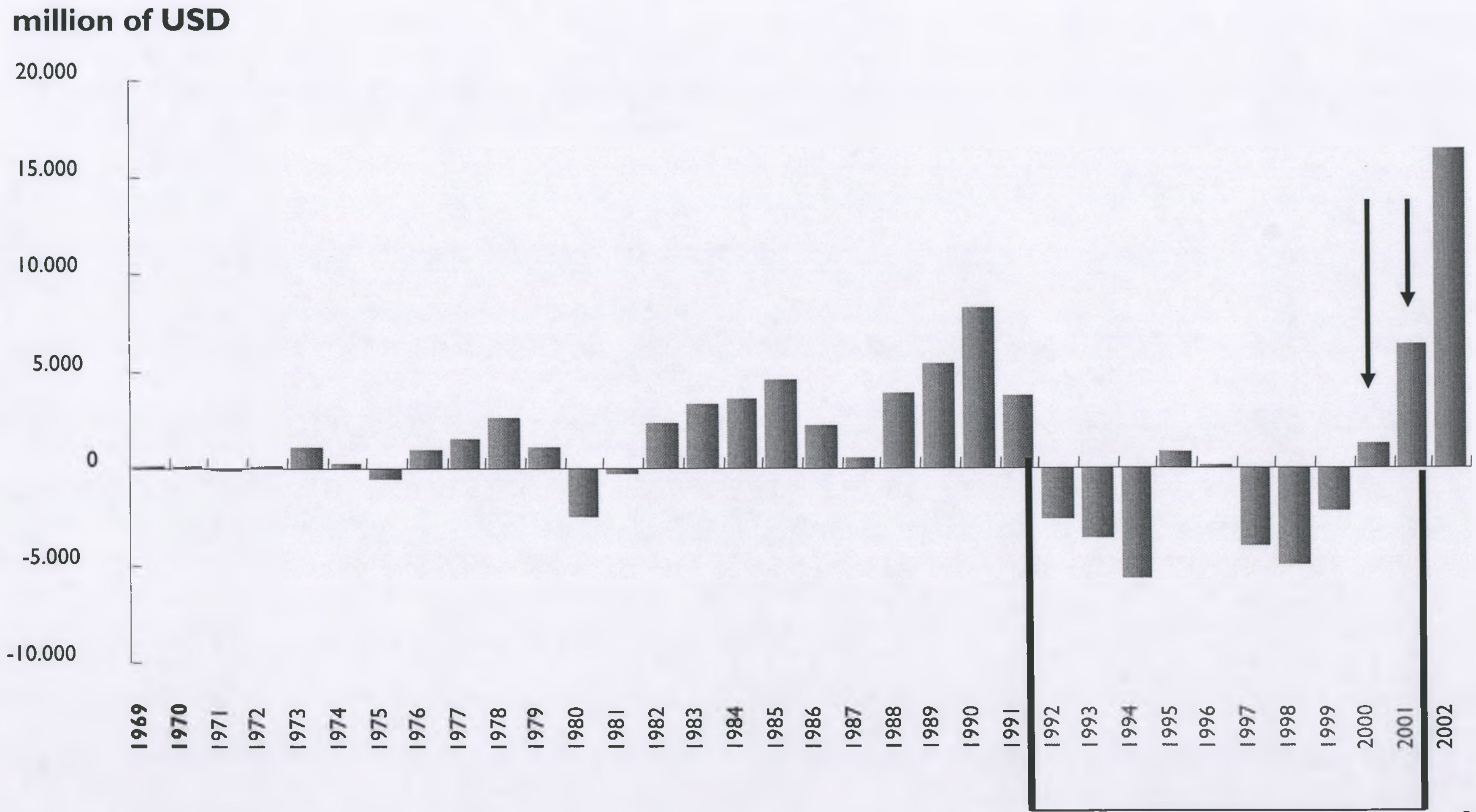
THREE APPROACHES:

1. The loss of competitiveness of the Argentine economy
2. The *"Sudden Stop"* argument
3. Macroeconomic policy inconsistencies

Loss of Competitiveness under the Fixed (Convertibility) Exchange Rate Regime

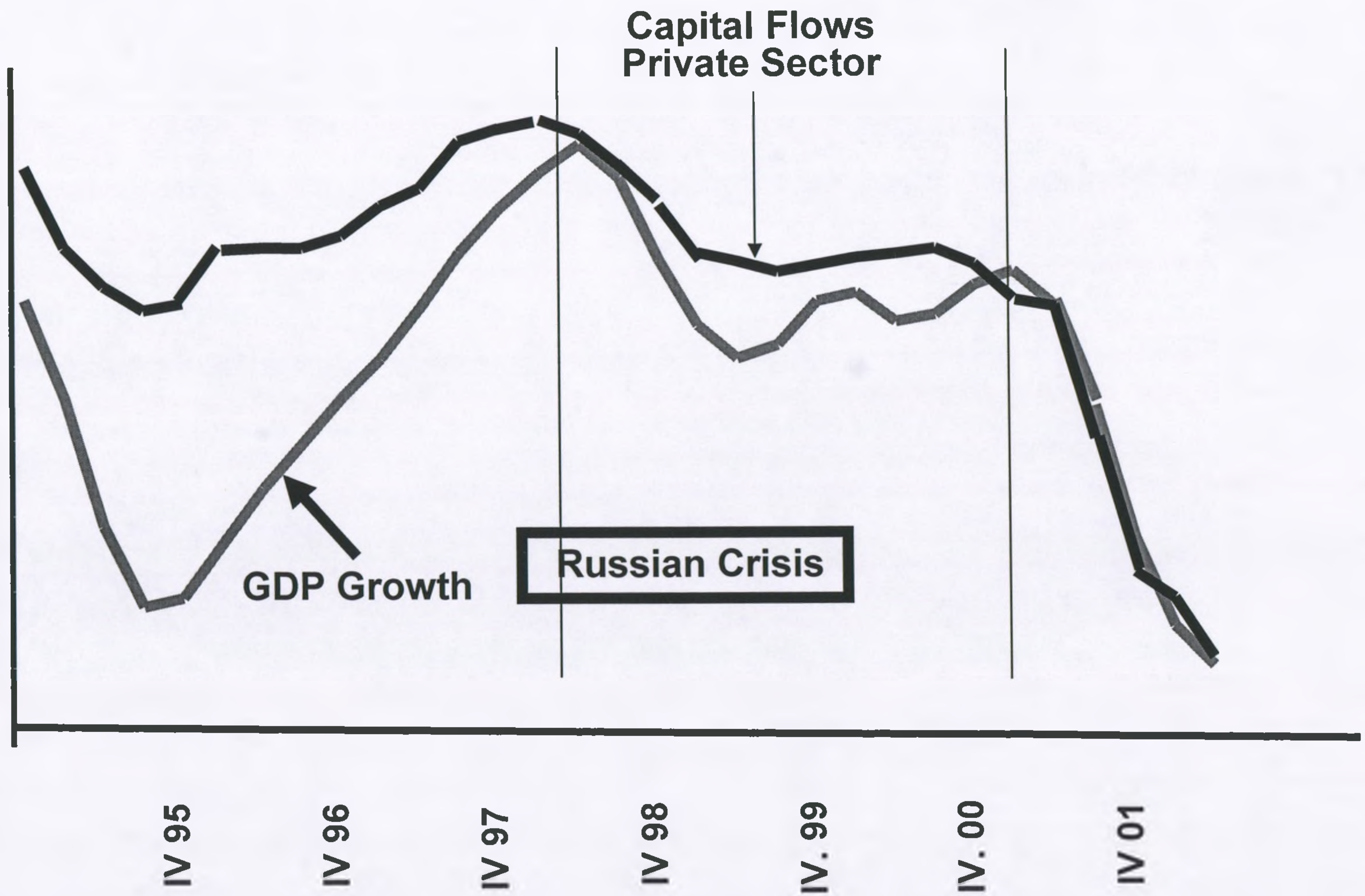


The Trade Account
(in current prices)

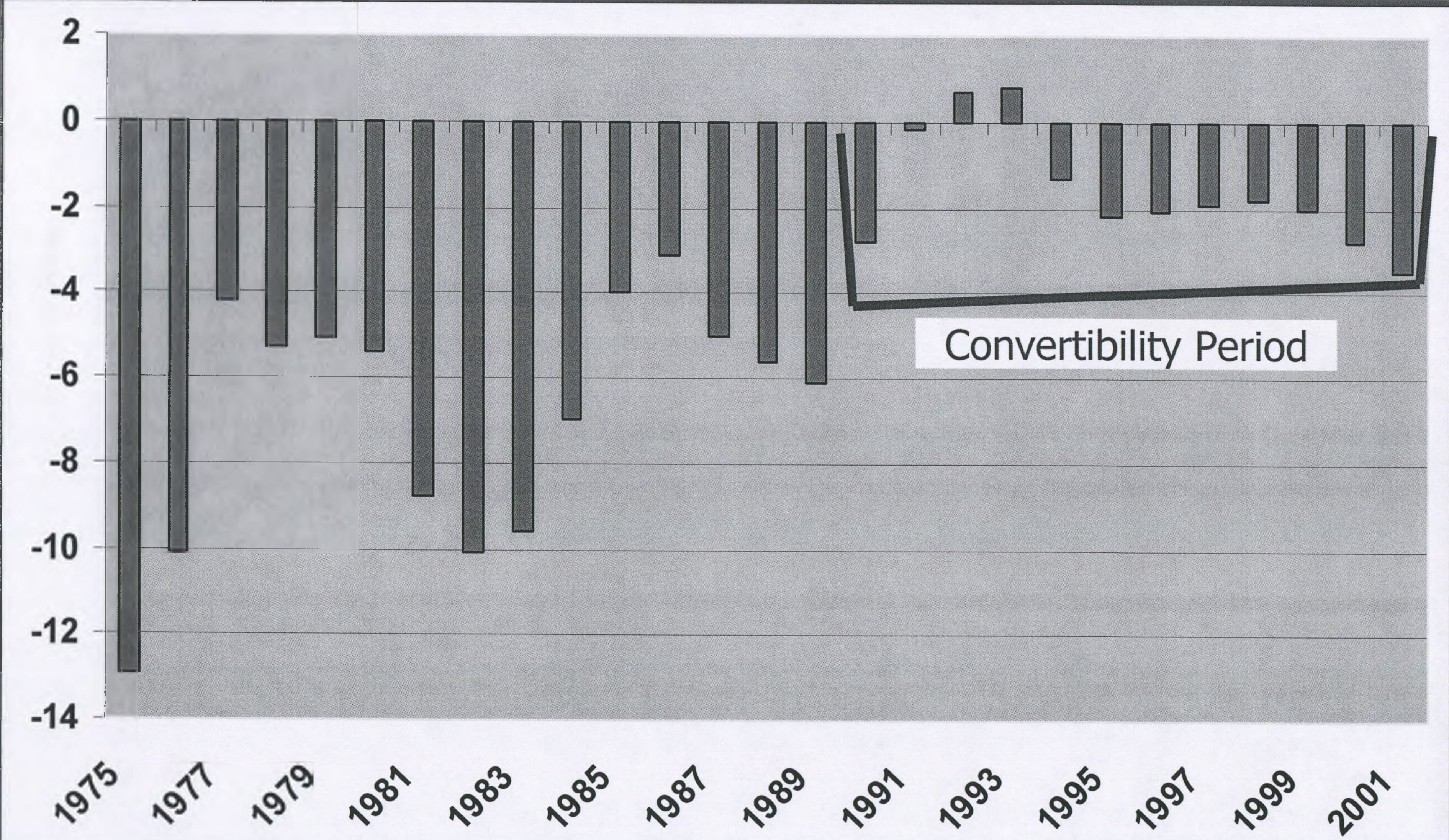


Capital Flows and Economic Activity

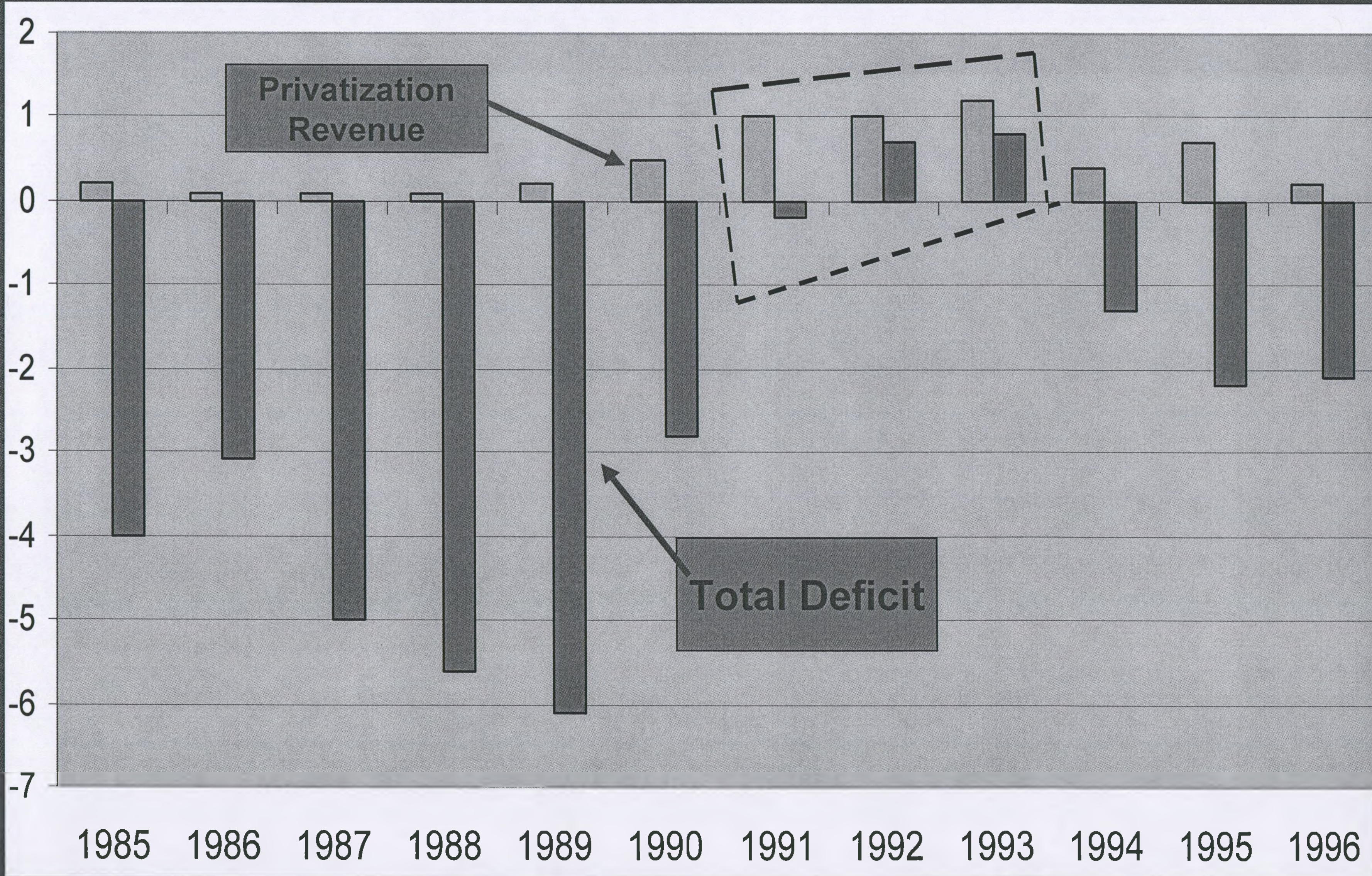
(Accumulated 4 quarters - U$Sm. GDP Cyclical Component)



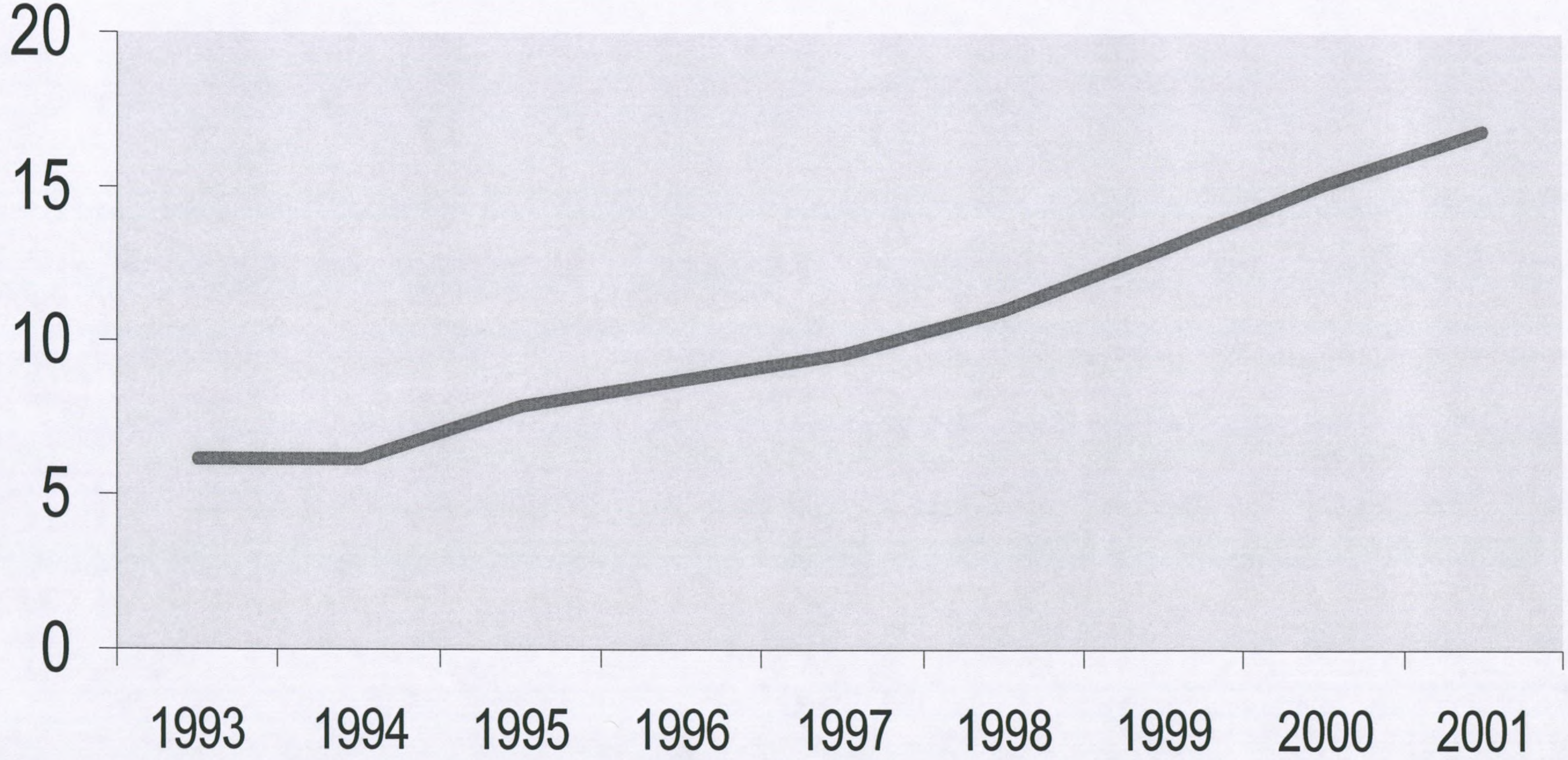
Fiscal Deficits
Argentina 1975-2001



The Use of Privatization Receipts to Reduce the Deficit

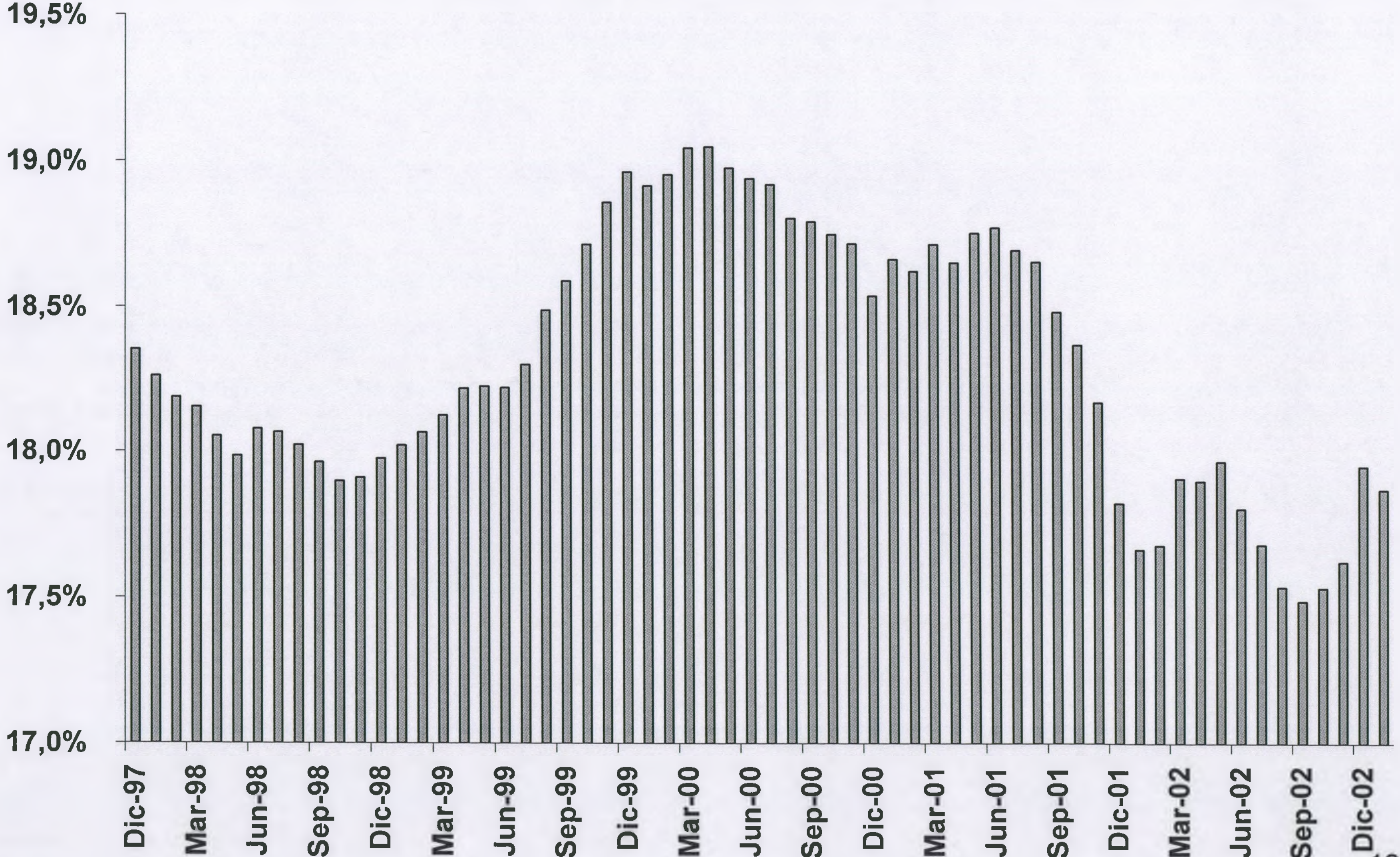


Interest Payments/GDP



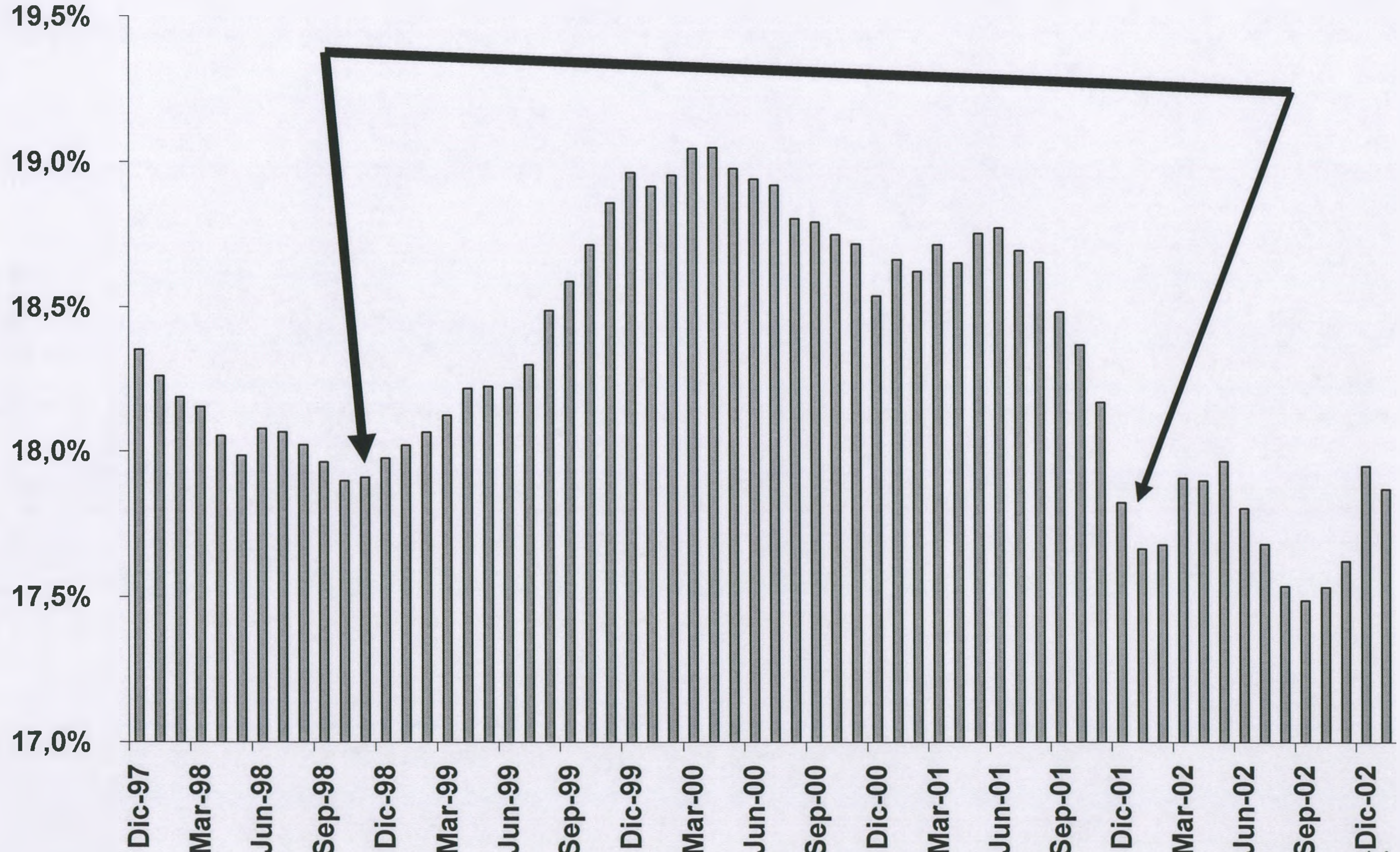
Primary Expenditures as % of GDP

(cumulative 12 months)



Primary Expenditures as % of GDP

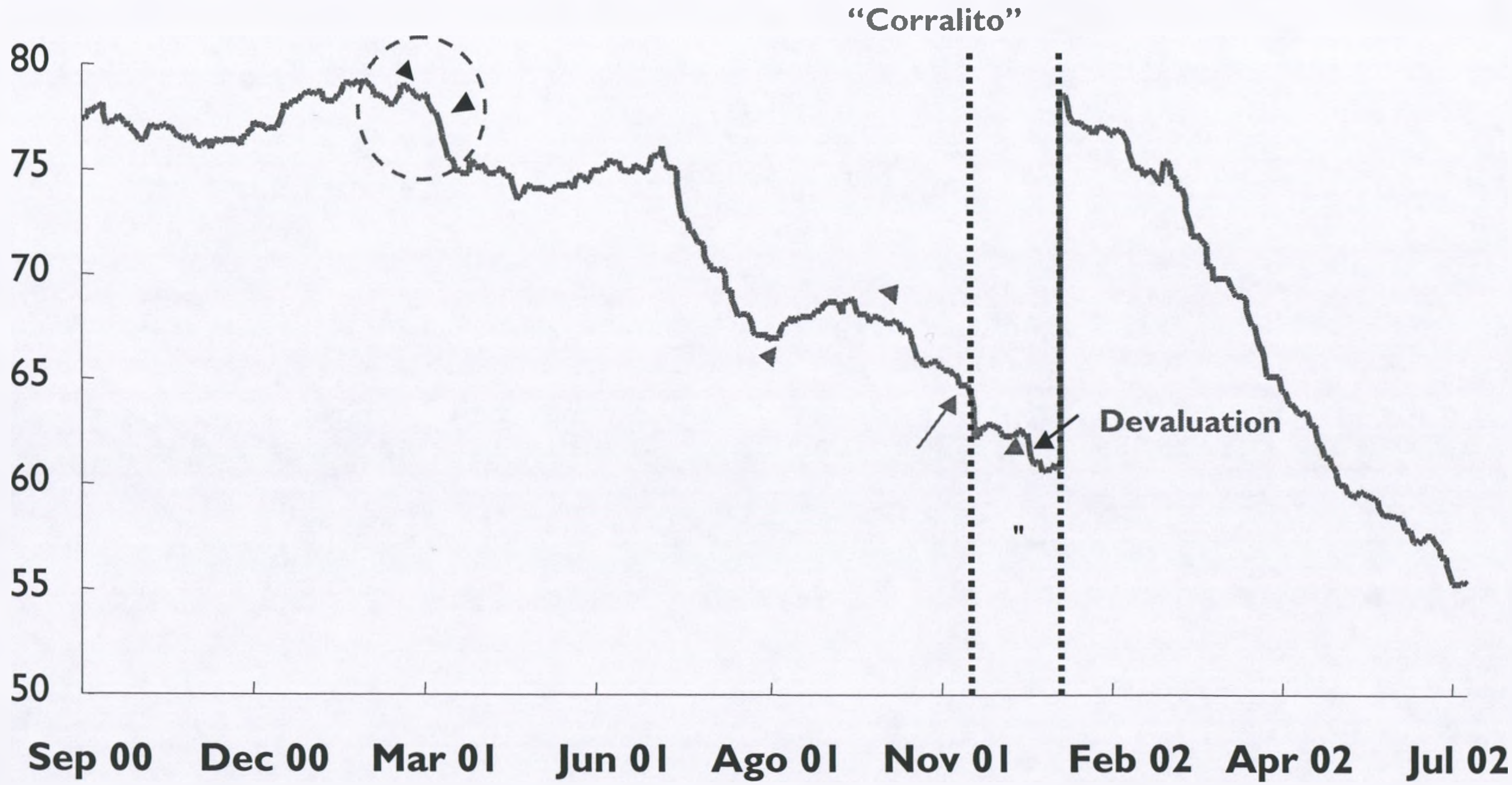
(cumulative 12 months)



First Symptom: The Banking Crisis

While the problems of convertibility and the consequent exchange rate uncertainty played a role, the ***banking*** crisis was largely caused by the <u>**government "abuse" of the banking sector**</u>, given its inability to to adjust the budget deficit

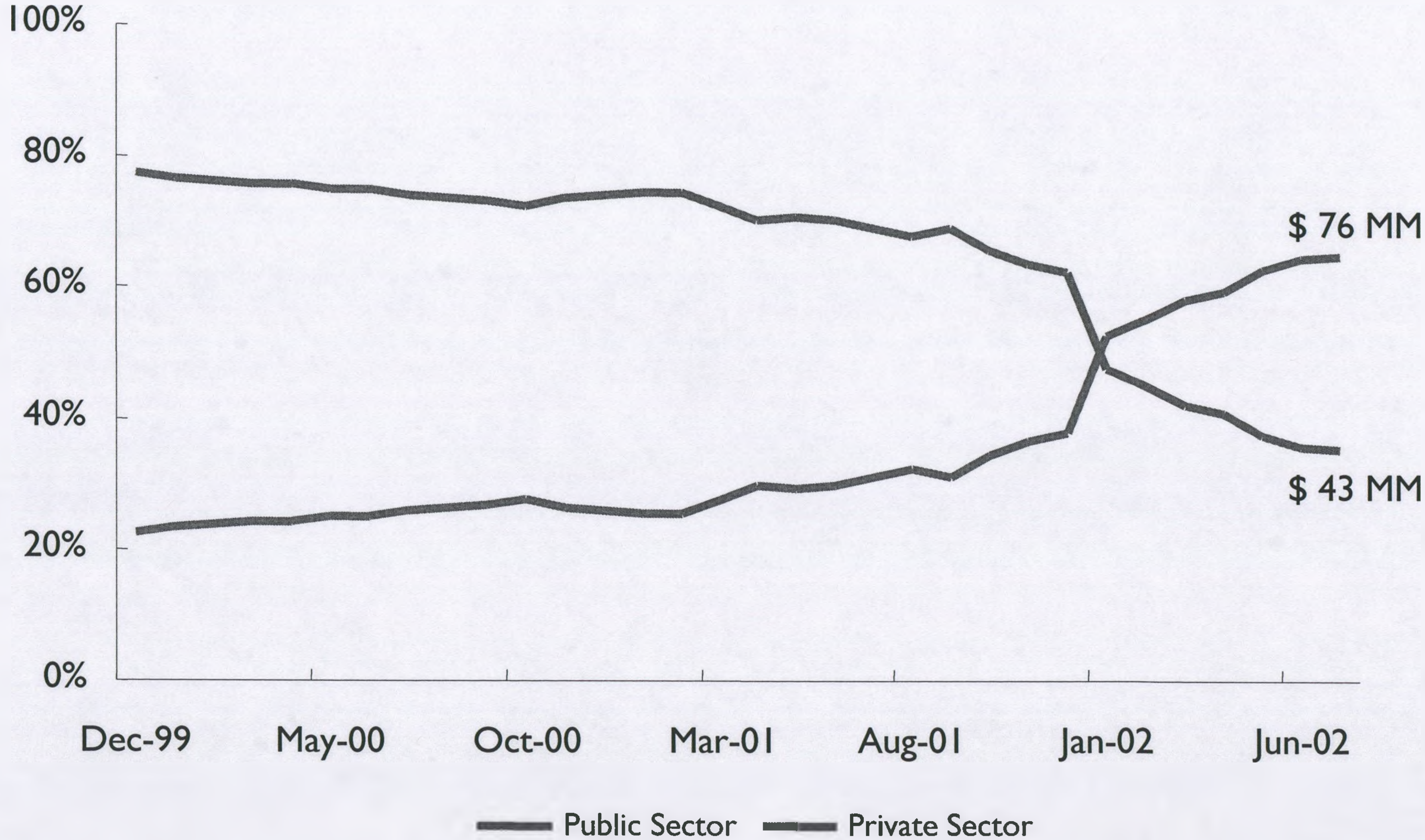
Private Sector Deposits (in bn Arg. Pesos)



The main cause for the banking crisis was the fear was that banks would be rendered insolvent by government policy and that deposits would be confiscated.

An important reason behind this fear was the fact that ***private sector assets were being displaced by public sector assets in bank's balance sheets.***

Private Sector assets have been displaced by Public Sector assets in bank's balance sheets

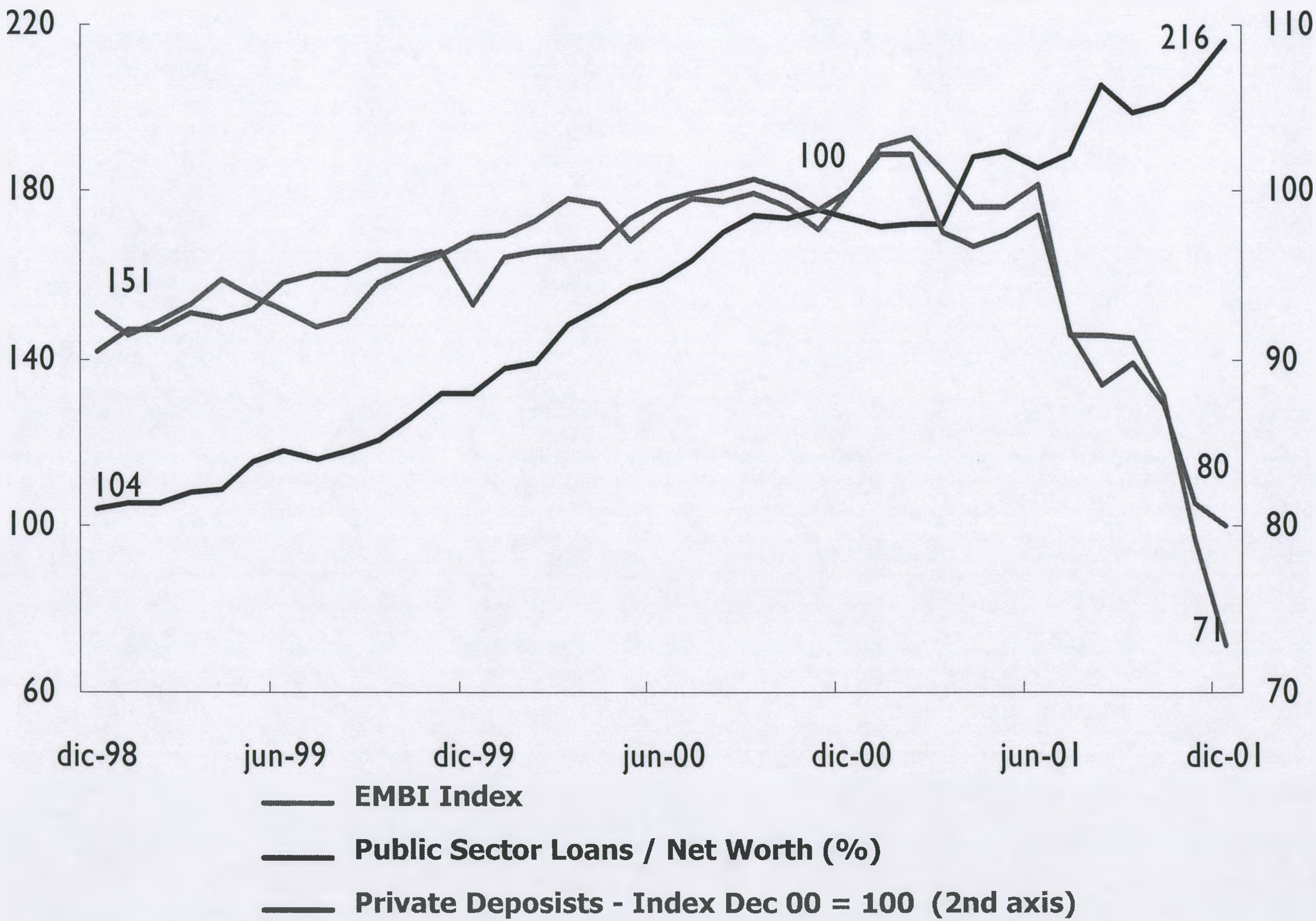


The increasing banking exposure to the public sector was accompanied by

1. **a <u>rapid decrease in deposits</u> and**

2. **a <u>sharp increase in country risk</u>**

Exposición del Sistema Financiero al Riesgo del Sector Público



- November 2001:withdrawal restrictions on bank deposits *("corralito").*

- December 2001: Riots and the De la Rua and Cavallo government falls.

- First two weeks of January 2002:
  --currency board is abandoned and the currency devalued
  --bank assets and liabilities are *pesified asymmetrically* - *i.e.* at different rates

The Tradeoffs and the Dilemma for the Central Bank

- Having regained the LOLR function the CB could provide the liquidity needed to finance the bank run. Pesos would fly to the exchange market – risk of hyperdevaluation and hyperinflation.

OR

- The CB could restrain the rediscount facility and let banks deal with the deposit run. May prevent hyperinflation, at the risk of the total collapse of the banking sector.

The Strategy Followed

1. **Default** on the Sovereign Debt

2. Provide **liquidity support** to banks to prevent massive bank closures.

3. Develop **sterilization instruments** at the Central Bank --the *LEBAC*-- to mop up liquidity and to compete with the U$S.

4. Utilize part of CB reserves to **intervene in the foreign exchange market** to slow the pace of depreciation and to avoid chaotic conditions.

On the Fiscal Side

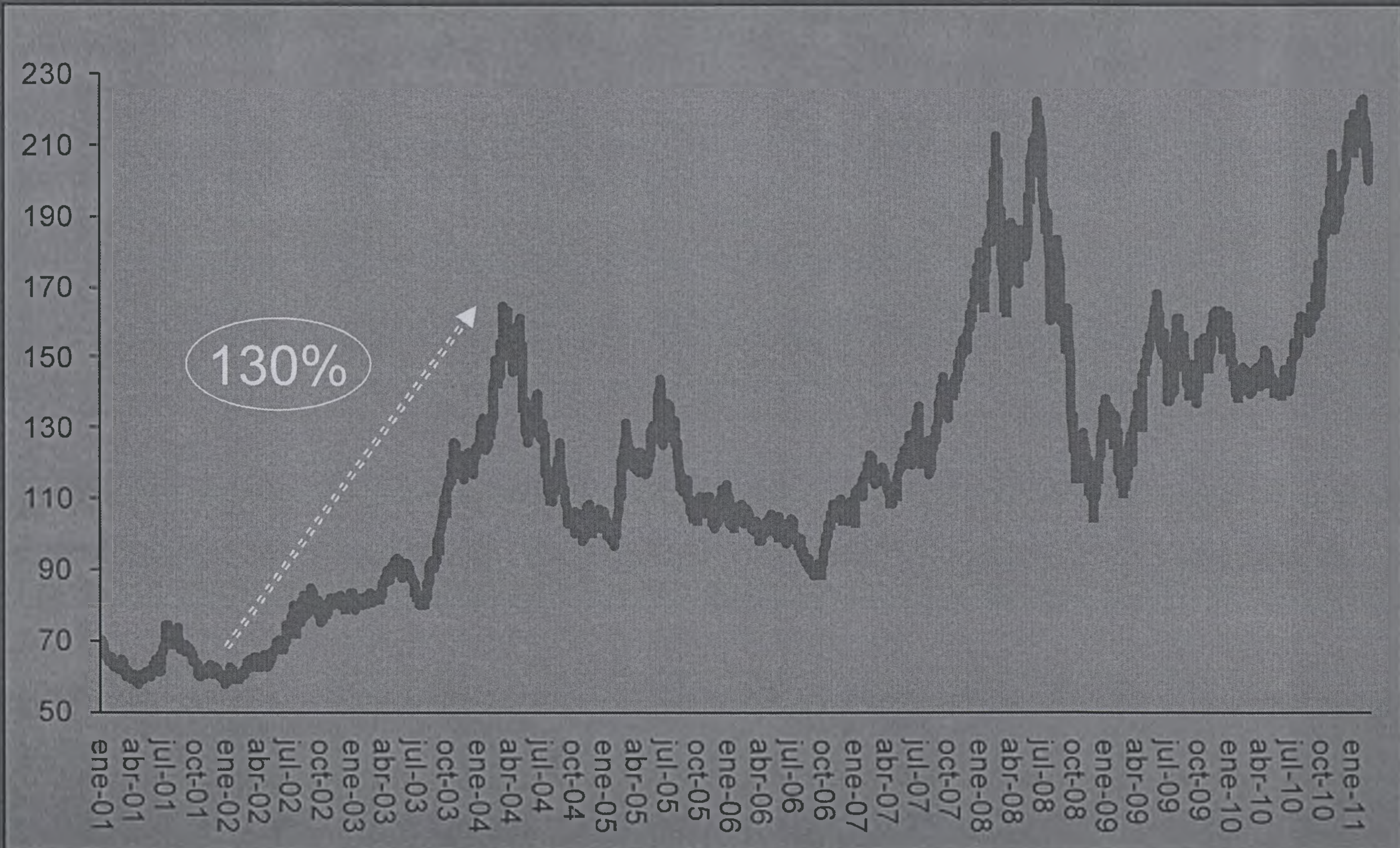
- Cut significantly fiscal expenditures, mainly through the non-adjustment of wages in the face of 40% inflation.

- Increase Export Taxes on Agricultural and Natural Resources

- Monetary and Fiscal Measures, plus regaining competitiveness, helped to achieve twin balance in the Fiscal and External Accounts.
- External (and crucial factor): Major improvement in terms of trade

Soybean Prices - Index

January 2001 – March 2011



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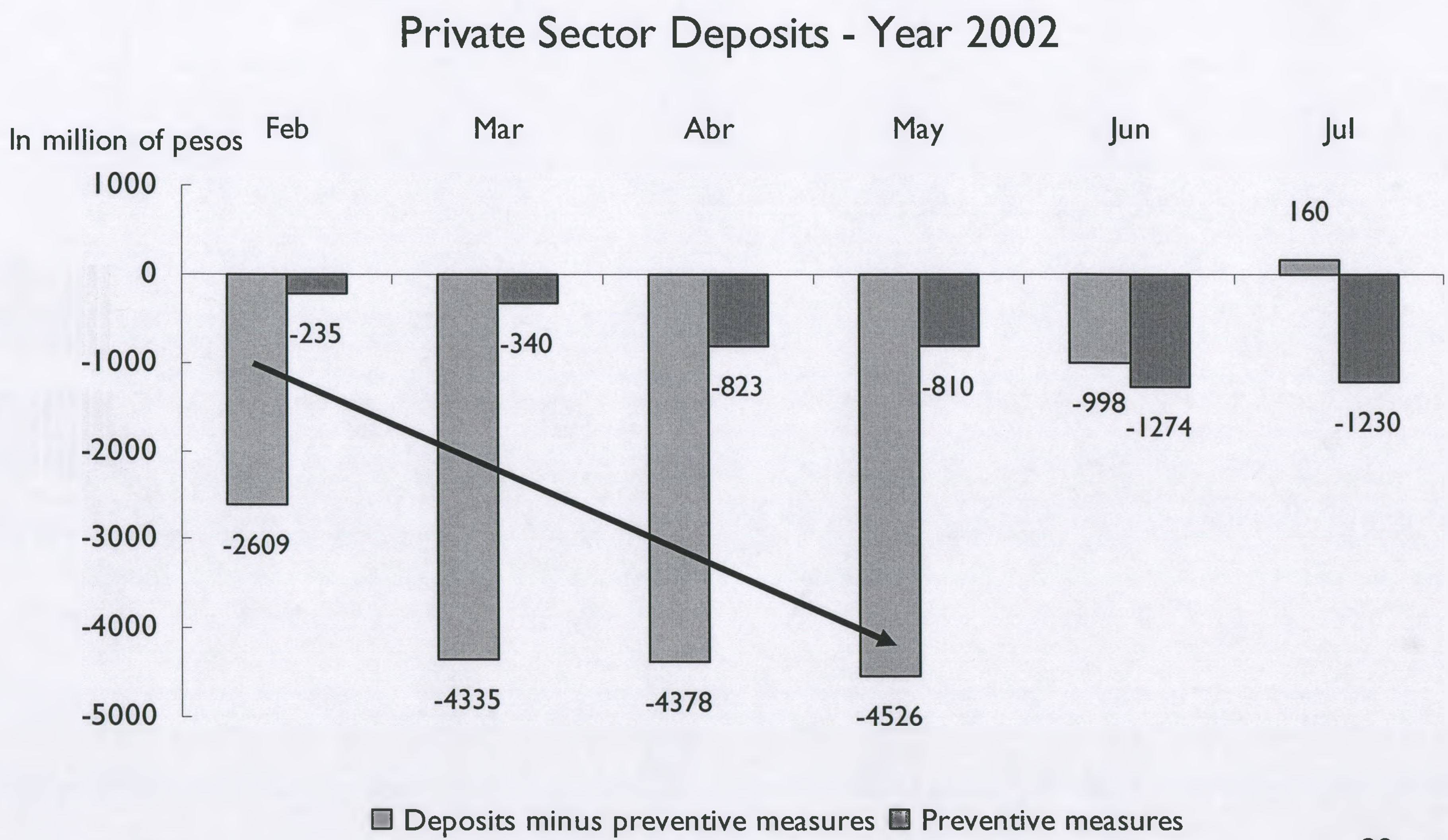
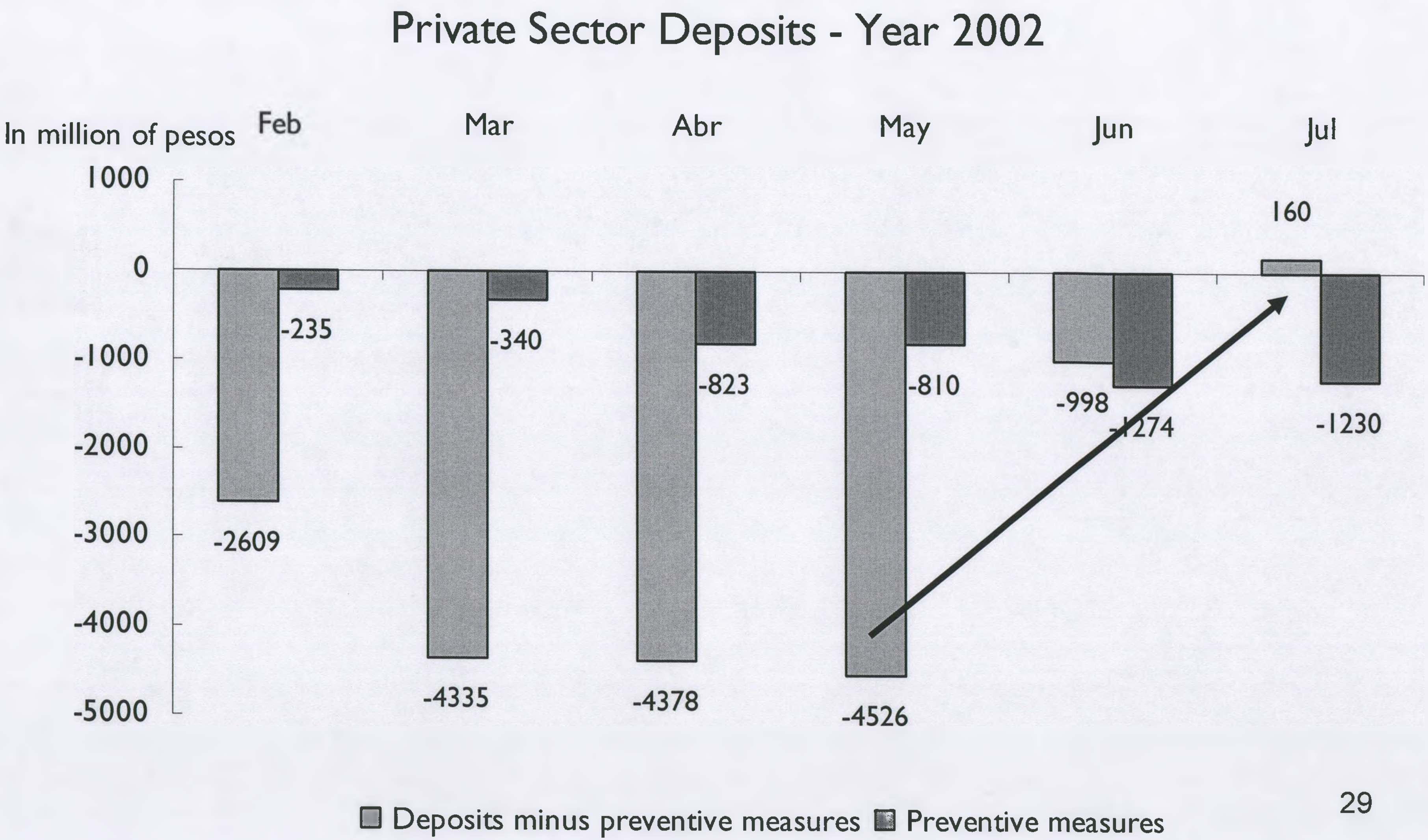
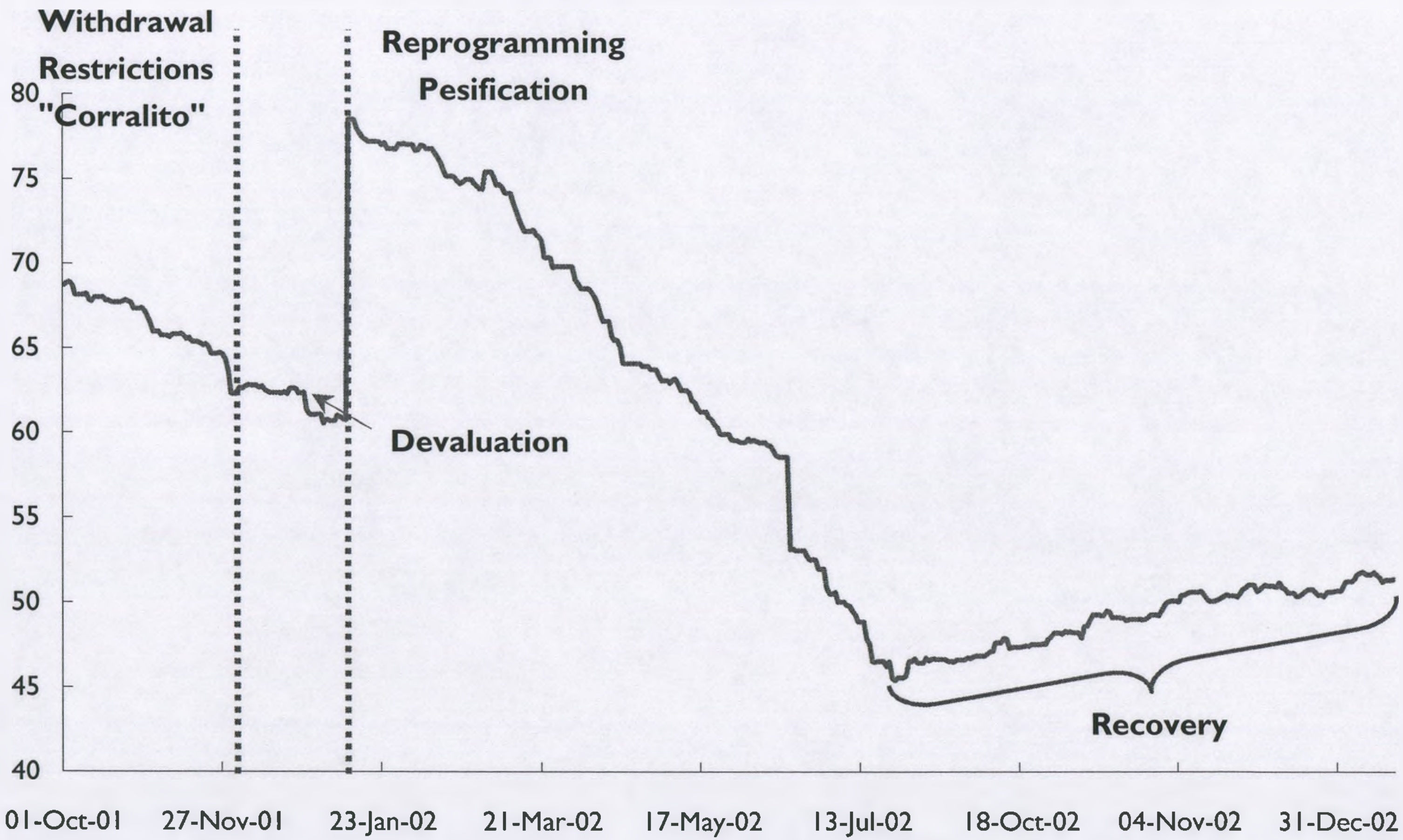
Initially deposit withdrawals continued



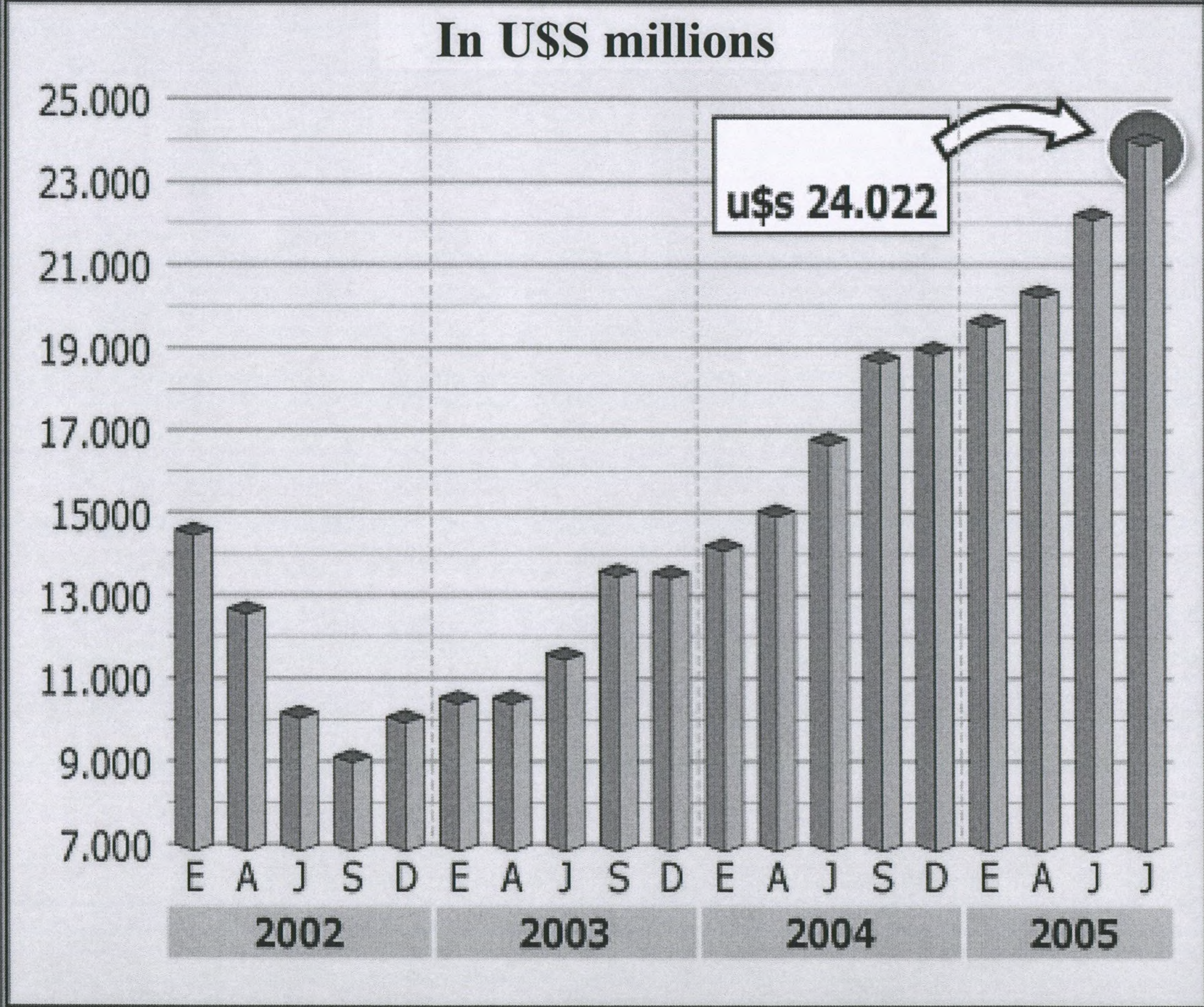
However, the trend reversed after four months



Private Sector Deposits
(in billion pesos)

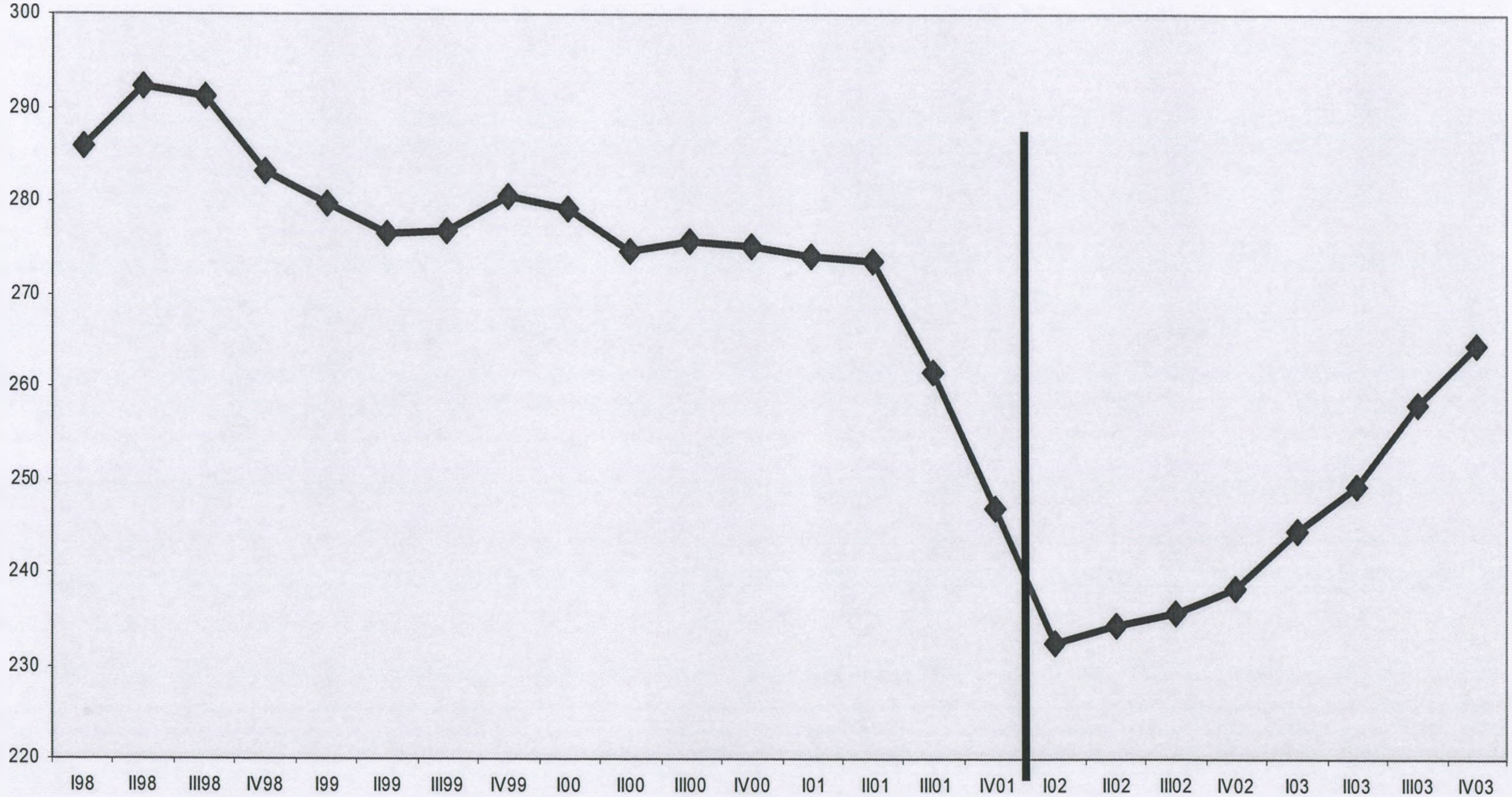


International Reserves



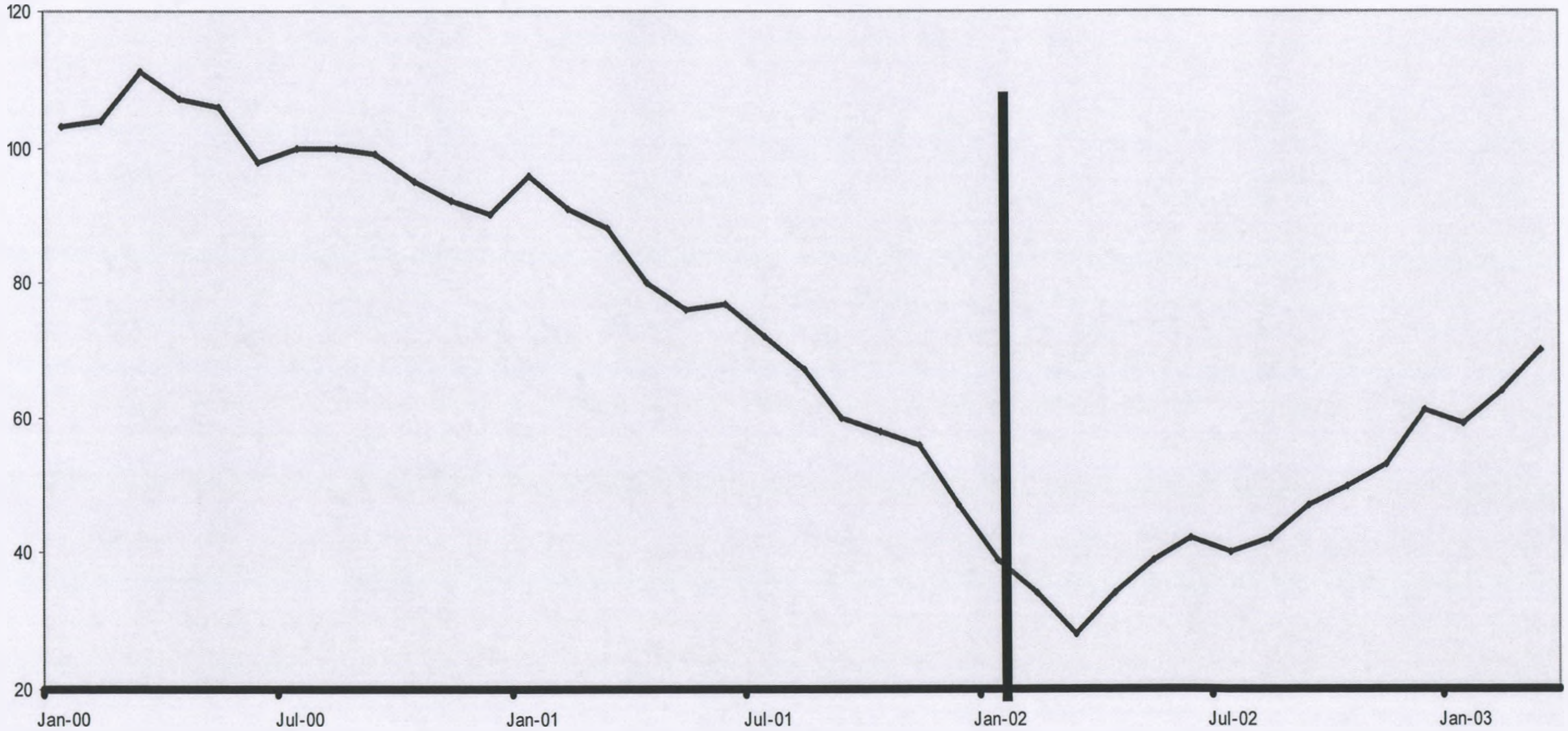
Total GDP

Quarterly – Seasonally Adjusted



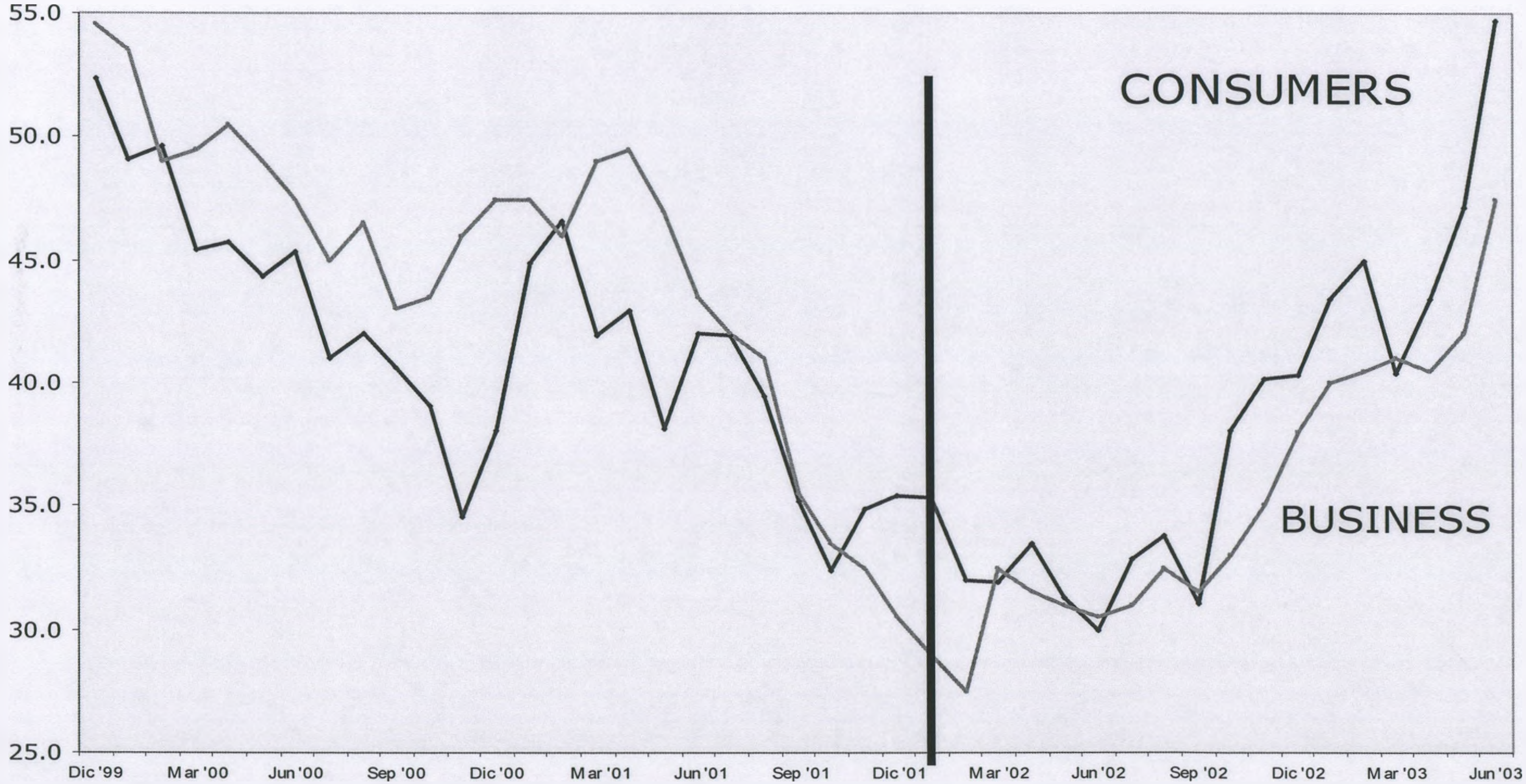
Fuente:Indec

Labor Demand



Fuente: Universidad Di Tella

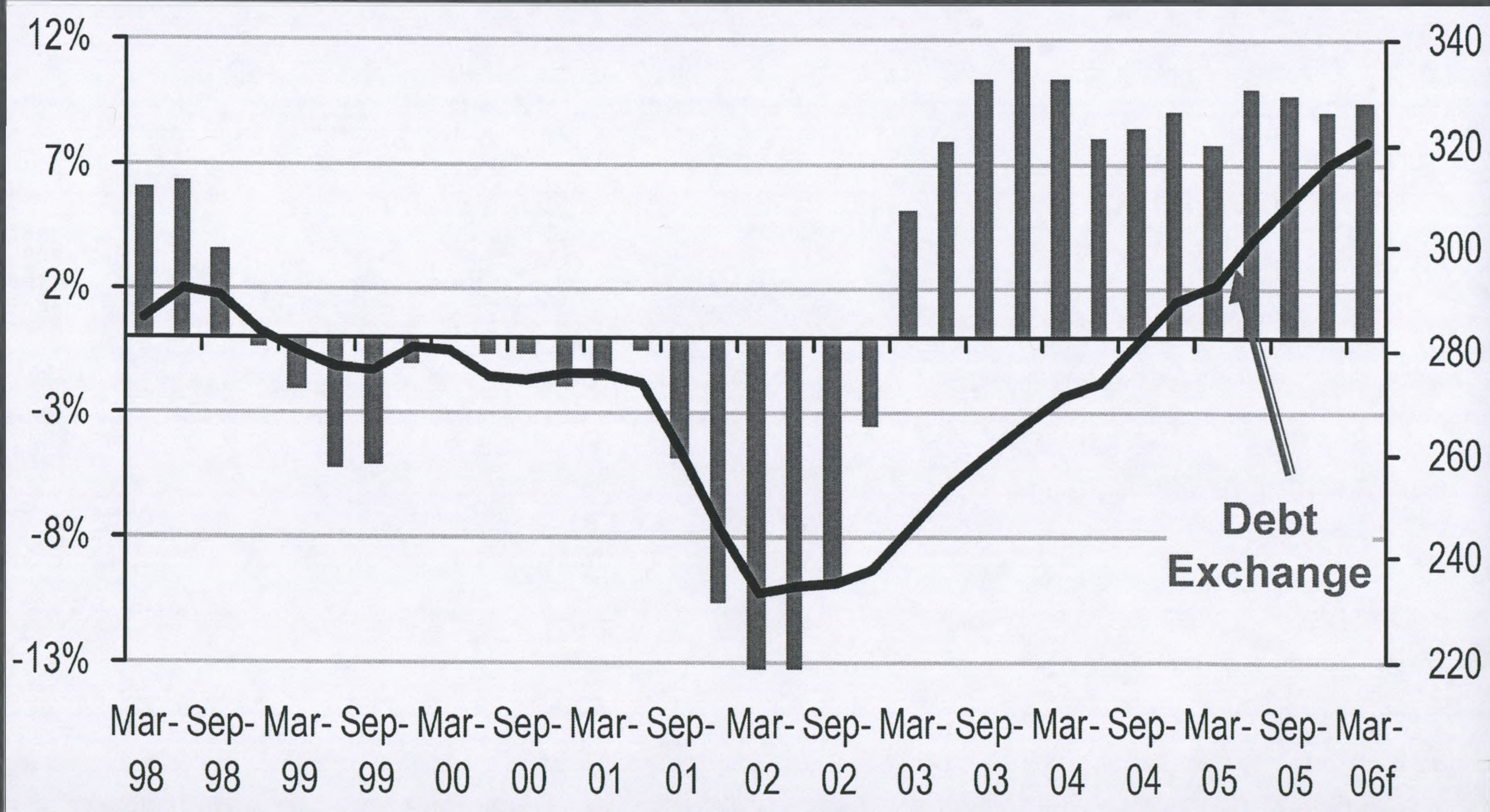
Consumers and Business CONFIDENCE



Fuente: Universidad Di Tella

- In 2005 the Debt in Default was Exchanged for new debt with an average 75% haircut.

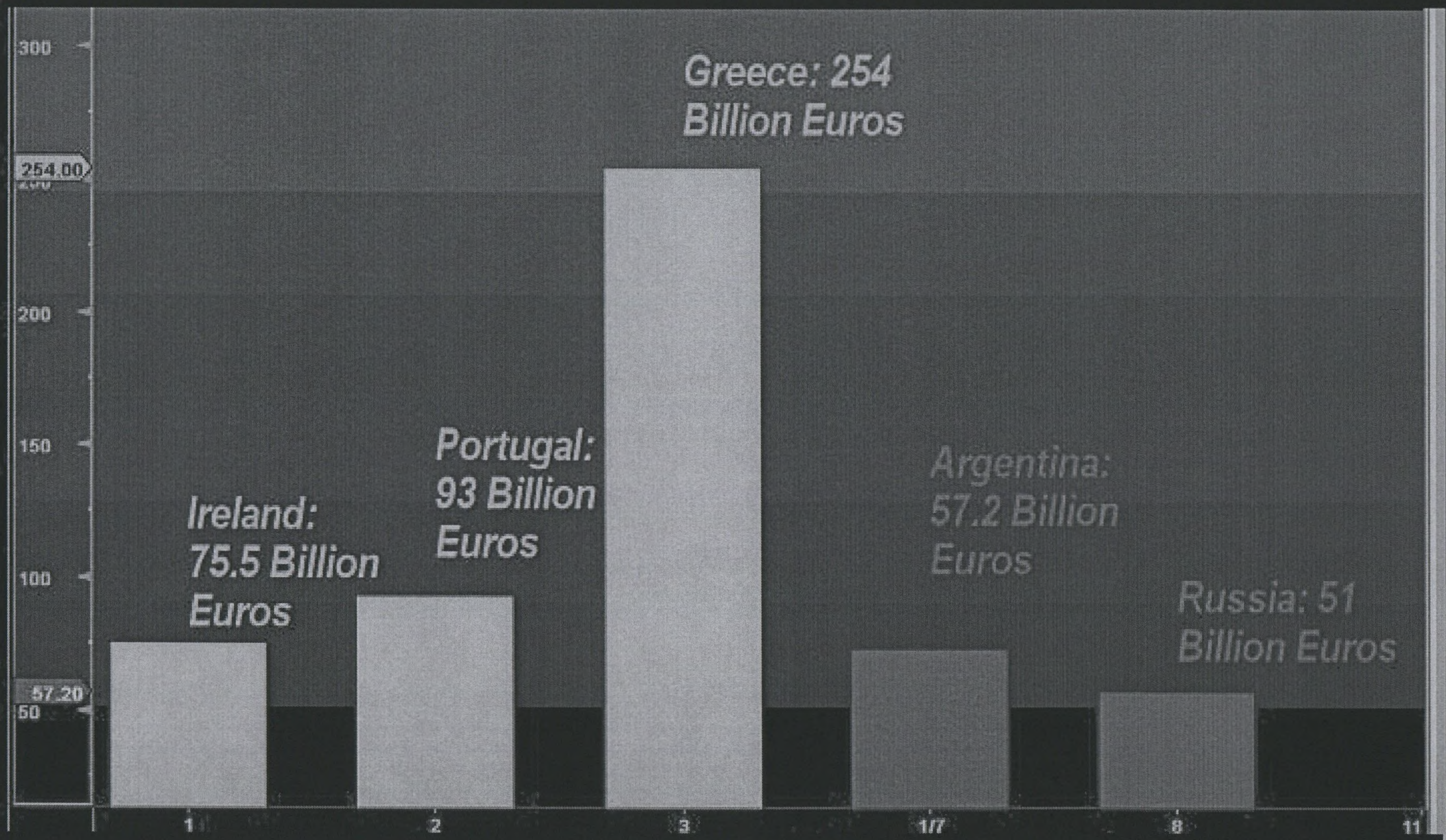
Real GDP
(base 1993)



- A second exchange took place 5 years later.
- There is today around 10% holdouts
- The Debt to the IMF was fully repaid
- Debt with the Paris Club is being negotiated

COMPARATIVE DEBT

ARGENTINA and RUSSIA (then) AND EUROPE (now)



THANK YOU!