Argentina: Government responds to peso crisis with panic selling of dollar reserves and interest rate increase

By Rafael Azul
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In the midst of increasing financial volatility across the world, a massive flight of financial capital took place last week from the weaker emerging economies as speculators converted their peso investments into US dollar denominated securities. The flight was in part triggered by the recent efforts by the US Central Bank to incrementally raise domestic interest rates.

Last week, the currencies of the largest economies in Latin America—Mexico, Brazil and Argentina—suffered drops in value of 5.25 percent, 4.83 percent and 8.26 percent respectively as speculators moved billions of dollars out of the region and into Wall Street and US banks.

Among them, Argentina was the most affected. In an attempt to avert a collapse of the peso, the Argentine Central Bank fed the dollar buying frenzy, selling six billion US dollars from its reserves at the beginning of May (roughly one fourth of its total dollar reserves).

The Argentinian government also raised the interest rate for short-term government and bank bonds three times over the span of several days to 40 percent (i.e., for every 10,000 pesos the government borrows from speculators, it must pay back 14,000). The great fear is that runaway inflation will lead to a repeat of the 2001 collapse of the peso which provoked mass demonstrations and led to the fall of several presidential administrations.

By Monday, these measures appeared to have forestalled a further drop, at least for the time being.

The decrease in value of the benchmark 10-year US government bond (to 3 percent per year) and the anticipated repatriation of financial assets held overseas by US corporations, in response to the Trump administration's corporate tax cuts and its one-time offer to lower taxes on repatriated profits, have fed into the run on emerging markets.

The banks were also partly motivated to pull funds out of Argentina attempt by the Macri government's imposition of a small capital gains tax on short term Central Bank bonds (know as *Lebacs*) owned by foreigners as a way of reducing the country's fiscal deficit. Speculators responded by cashing in their bonds and sending their money out of the country.

Fearing that domestic inflation will explode to 30 percent this year, up from the current 24.5 percent and double the government's goal of 15 percent, Argentine monetary authorities are preparing for new budget adjustments and social cuts.

Since the right-wing government of Mauricio Macri took power in 2015, the administration has attempted to control the peso's value with respect to the dollar by maintaining an artificially high peso value, through restrictions on circulation.

By raising the yield on Central Bank debt to forty percent and thereby flooding the bond market with bank debt, the Argentine Central Bank is lowering the money supply and purposely slowing down the economy, part of its overall policy of financial austerity. In announcing the increase in bank interest, the Central Bank declared that it would continue to use every means at its disposal to lower inflation to fifteen percent and prevent the peso from dropping further. The new interest rate is the highest in the world. Argentina has the highest inflation rate of any Latin American nation, except for Venezuela.

Preparations for an intensified attack on living conditions and wages are being sped-up as all indications are that inflation may rise further still. In

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yearly contract negotiations (*paritarias*) between employers and the union bureaucracies overseen by the government, the unions, businesses, and government have so far managed to limit wage increases to 15 percent, generally by offering non-monetary benefits to the workers.

There are indications of a broader wage push by workers fighting to break the 15 percent ceiling which amounts to a wage cut in real terms. This week saw strikes by drivers on the Buenos Aires subway system against the wage lag. The leader of the Union of Automated Tramworkers (UTA), Roberto Fernández, noted with concern yesterday that "the political situation has much uncertainty" as a result of growing working-class discontent. In a sign that the trade unions fear they will lose control of mass discontent, Fernández called for the General Workers Confederation (CGT) to hold "a national strike" if "the national government doesn't convoke a roundtable dialogue with business and the CGT to find a way out of this critical economic situation."

In a nation with a labor force increasingly dominated by the presence of part time and contingent workers, many of whom work for wages two-thirds lower than full-time workers that do the same work, the high levels of inflation are contributing to rising levels of poverty and economic insecurity.

With poverty rates of 30 percent and increasing unemployment, particularly among the youth, Macri has no option but to risk a mass confrontation with the working class if he is to reassure foreign investors that his government will stabilize the argentine economy and make good on cuts in government spending and debt payments to Wall Street.

According to the IMF's most recent Fiscal Monitor report, Argentina's budget deficit in 2018 will be 5.5 per cent of GDP. The report points out that total global debt is at record levels and calls on governments to "capitalize on the good times" to build rainy day reserves, rather than increase social programs or invest in infrastructure.

The Macri administration faces a debt payment deadline of May 16 of $1.6 billion that it expects to make. However, the events of last week motivated the financial magazine *Forbes* to say it may be time for investors to abandon Argentina.

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