

## Is it the beginning or the end of Argentinian crisis?

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*The crisis will be consummated when the reserves in foreign currency will be exhausted*

On January 23, the Argentinian peso depreciated by 10% and hit 7.75 per dollar, whereas, on the parallel market, it reached 13 pesos. The newspapers in Brazil talked about an exchange rate crisis. Is it really, or, since the new and young finance minister Axel Kicillof took office in November is the country on the road to coming out of the crisis?

Argentina was threatened by the “eternal return” that characterizes the process of the populist cycle of expansion followed by a financial crisis. The process begins with a balance-of-payment crisis, when the country's creditors lose confidence, suspend the foreign debt rollover, and the country goes bankrupt – ceases to honor its international debts.

Next takes place the exchange rate appreciation (for a few years), mainly caused by the use of the exchange rate to keep inflation under control, until the exchange rate reaches a “floor” corresponding to a high current account deficit, higher than the GDP growth, which implies that the country is increasingly indebted. But everybody is happy – wage-earners, rent-seekers and the government – this latter because its popularity increased, and the others because their revenues increased artificially. And happiness reaches an even higher level, because the government, besides incurring irresponsible current account deficits, incurs equally irresponsible fiscal deficits, thus meeting the voters' demands.

But, once the exchange rate floor is attained, the country enters a phase of financial fragility. It is not yet a crisis because the equally happy foreign creditors feed the credit bubble. At the same time, inflation accelerates due to demand pressures, and the Central Bank, that can no longer keep inflation under control with the “exchange rate anchor”, increases the interests not only in order to curb inflation, but also to attract capital to make up the current account deficit. For a few more years the country is caught in the trap of high interests and overvalued exchange rate, until the creditors once again lose confidence, and the exchange rate crisis breaks out.

In Argentina, that does not have access to credit since the 2001 financial crisis, the crisis will be consummated when the reserves in foreign currency will be exhausted.

Between 2003 and 2007, a peso close to the competitive equilibrium (roughly 3.7 pesos, at 2007 prices) ensured a high growth. But, from this year on,

inflation became a problem, the government did not resist populism and curbed the exchange rate in order to control inflation. Consequently, the high growth regime ended, whereas the peso continued to appreciate and the reserves continued to decrease. As a result, approximately two years ago Argentinians lost confidence in the peso, and it increased violently in the parallel market. The crisis was taking shape.

By reaching now roughly 8 pesos per dollar, the peso retrieved the lost competitive equilibrium; the government declared that the peso had reached the desired level, and, without fearing an increase in the dollar's official price, it suspended several restrictions to the purchase of dollars, in order to draw the parallel down. If this strategy of keeping the exchange rate at the competitive level is successful, profit expectations will rise, business enterprises will invest again, the current account surplus will be restored, and the Argentinian crisis will be over. But Argentina will still have to solve the inflation problem, without, obviously, resorting again to the perverse mechanism of the exchange rate anchor.