Who Lost Argentina, Again?

With a presidential election approaching next month, Argentina is once again on the cusp of a crisis that could end in depression and default, owing to mistakes made by everyone involved. If the President secures another term, he must waste no time in reversing the country's economic deterioration, writes Mohamed A. El-Erian for Project Syndicate

Argentinian President Mauricio Macri

The crisis is back

Investors and economic observers have begun to ask the same question that I posed in an article published 18 years ago: "Who lost Argentina?" In late 2001, the country was in the grips of an intensifying blame game, and would soon default on its debt obligations, fall into a deep recession, and suffer a lasting blow to its international credibility. This time around, many of the same contenders for the roles of victim and accuser are back, but others have joined them. Intentionally or not, all are reprising an avoidable tragedy.

> *Its sovereign debt has been downgraded deeper into junk territory by Moody's*

After a poor primary-election outcome, Argentinian President Mauricio Macri finds himself running for another term under economic and financial conditions that he promised would never return. The country has imposed capital controls and announced a reprofiling of its debt payments. Its sovereign debt has been downgraded deeper into junk territory by Moody's, and to selective default by Standard & Poor's. A deep recession is underway, inflation is very high, and an increase in poverty is sure to follow.

It has not even been four years since Macri took office and began pursuing a reform agenda that was widely praised by the international community. But since then, the country has run into trouble and become the recipient of record-breaking support from the International Monetary Fund.

Argentina has fallen back into crisis for the simple reason that not enough has changed since the last debacle. As such, the country's economic and financial foundations have remained vulnerable to both internal and external shocks.

The 'original sin'

Although they have been committed to an ambitious reform program, Argentina's economic and financial authorities have also made several avoidable mistakes. Fiscal discipline and structural reforms have been unevenly applied, and the central bank has squandered its credibility at key moments.

More to the point, Argentinian authorities succumbed to the same temptation that tripped up their predecessors. In an effort to compensate for slower-than-expected improvements in domestic capacity, they permitted excessive foreign-currency debt, aggravating what economists call the "original sin": a significant currency mismatch between assets and liabilities, as well as between revenues and debt servicing.

Worse, this debt was underwritten not just by experienced emerging-market investors, but also by "tourist investors" seeking returns above what was available in their home markets. The latter tend to lack sufficient knowledge of the asset class into which they are venturing, and thus are notorious for contributing to price overshoots – both on the way up and the way down.

In search for higher yields

Undeterred by Argentina's history of chronic volatility and episodic illiquidity – including eight prior defaults – creditors gobbled up as much debt as the country and its companies would issue, including an oversubscribed 100-year bond that raised $2.75 billion at an interest rate of just 7.9%. In doing so, they drove the yields of Argentine debt well below what economic, financial, and liquidity conditions warranted, which encouraged Argentine entities to issue even more bonds despite the weakening fundamentals.

The search for higher yields has been encouraged by unusually loose monetary policies – ultra-low (and, in the case of the European Central Bank, negative) policy rates and quantitative easing – in advanced economies. Systemically important central banks (the Bank of Japan, the US Federal Reserve, and the ECB) thus have become the latest players in the old Argentine blame game.

Argentina has received $44 billion under the IMF's largest-ever *funding arrangement.*

Moreover, influenced by years of strong central-bank support for asset markets, investors have been conditioned to expect ample and predictable liquidity – a consistent "common global factor" – to compensate for all sorts of individual credit weaknesses. And this phenomenon has been accentuated by the proliferation of passive investing, with the majority of indices heavily favoring outstanding market values (hence, the more debt an emerging market issues, like Argentina, the higher its weight in many indices becomes).

Then there is the IMF, which readily stepped in once again to assist Argentina when domestic-policy slippages made investors nervous in 2018. So far, Argentina has received $44 billion under the IMF's largest-ever funding arrangement. Yet, since day one, the IMF's program has been criticized for its assumptions about Argentina's growth prospects and its path to longer-term financial viability. As it happens, the same issues plagued the IMF's previous efforts to Argentina, including in the particularly messy lead-up to the 2001 default.

There is no time to waste.

As in Agatha Christie's Murder on the Orient Express, almost everyone involved has had a hand in Argentina's ongoing economic and financial debacle, and all are victims themselves, having suffered reputational harm and, in some cases, financial losses. Yet those costs pale in comparison to what the Argentine people will face if their government does not move quickly – in cooperation with private creditors and the IMF – to reverse the economic and financial deterioration.

Managing a domestic-led recovery will not be easy, but it is achievable – and far better than the alternatives

Whoever prevails at next month's presidential election, Argentina's government must reject the notion that its only choice is between accepting and refusing all demands from the IMF and external creditors. Like Brazil under then-President Luis Inácio Lula da Silva in 2002, Argentina needs to embark on a third path, by developing a homegrown adjustment and reform program that places greater emphasis on protecting the most vulnerable segments of society. With sufficient buy-in from domestic constituencies, such a program would provide an incentive-aligned path for Argentina to pursue its recovery in cooperation with creditors and the IMF.

Given the downturn in the global economy and the rising risk of global financial volatility, there is no time to waste. Everyone with a stake in Argentina has a role to play in preventing a repeat of the depression and disorderly default of the early 2000s. Managing a domestic-led recovery will not be easy, but it is achievable – and far better than the alternatives.

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