

Argentina's Economic Crisis and Default

In 2018, the Argentine government faced numerous economic challenges: the unsustainable buildup of debt, rapid depreciation of its currency (the *peso*), economic contraction, and inflation. The government, headed at the time by center-right President Mario Macri, reluctantly turned to the International Monetary Fund (IMF) for financial assistance to avoid defaulting on its debt. After securing the largest IMF loan (in dollar terms) in the institution's history, economic conditions failed to improve.

In the October 2019 elections, Mario Macri lost to the center-left Peronist ticket of Alberto Fernández for president and former President Cristina Fernández de Kirchner for vice president. The Peronist ticket campaigned on a reorientation of Argentine economic policies. After taking office, the Fernández government implemented several economic reforms and entered debt restructuring negotiations with its bondholders, which remain ongoing. The COVID-19 pandemic and resulting economic turmoil further stressed Argentina's economy, and the government defaulted on its debt in May 2020.

Economic Crisis in Argentina

Argentina has a long history of economic crises. It has defaulted on its external debt (debt held by foreigners) nine times since independence in 1816. It took 15 years to resolve Argentina's default in 2001. Argentina has also entered into 21 IMF programs since joining in 1956. The current economic crisis facing Argentina stems from both longstanding issues and recent developments.

Economic Reforms but Growing Vulnerabilities

When President Macri was elected in 2015, he ushered in a series of economic reforms aimed to address the unsuccessful economic policies of the previous Kirchner governments, which had governed Argentina since 2003. He cut export taxes, lifted currency controls, and resolved a 15-year long dispute with holders of defaulted Argentine bonds, allowing Argentina to resume access to international capital markets. The central bank also raised interest rates to 25% to curb inflation. The economy contracted by 1.8% in 2016, but resumed growth of 2.9% in 2017.

To maintain political support for the reforms and support the country's most vulnerable (one in three Argentines was living below the official poverty line in 2015), the government held off on substantial fiscal reforms to address the budget deficit, 4.3% of GDP in 2014. However, the Macri government saw borrowing costs rise, as it switched to traditional borrowing from international capital markets relative to the Kirchners' unorthodox financing tools, including money creation and coercing domestic banks into buying government bonds. The Macri government is sued \$56 billion in external debt between January 2016 and June 2018. Interest payments facing the government caused the budget deficit to increase to 6.4% of GDP in 2017.

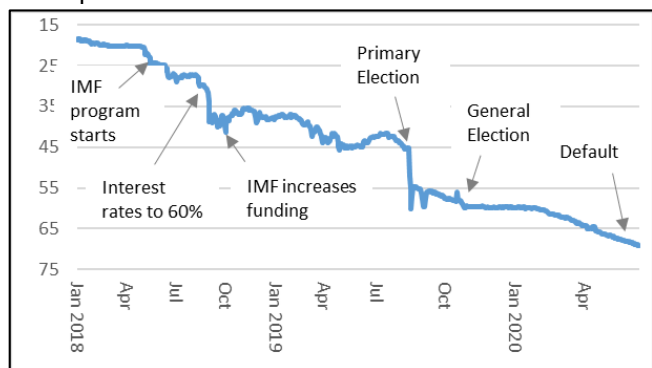
Meanwhile, capital inflows into the country to finance the deficit contributed to an overvaluation of the peso, by 10% - 25%. This overvaluation also exacerbated Argentina's current account deficit (a broad measure of the trade balance), which increased from 2.7% of GDP in 2016 to 4.8% of GDP in 2017.

Crisis and Initial Policy Response

Argentina's increasing reliance on external financing to fund its budget and current account deficits left it vulnerable to changes in the cost or availability of financing. Starting in late 2017, several factors created problems for Argentina's economy: the U.S. Federal Reserve (Fed) began raising interest rates, reducing investor interest in Argentine bonds; the Argentine central bank reset its inflation targets, raising questions about its independence and commitment to lower inflation; and the worst drought in Argentina in 50 years hurt commodity yields, significantly eroding agricultural export revenue.

Investors began selling Argentine assets, putting downward pressure on the peso (**Figure 1**). With most of its debt denominated in dollars, a depreciated peso increased the value of the debt in terms of pesos. To improve investor confidence, the central bank and government announced in April and May 2018 higher interest rates (to 40%) and fiscal reforms to cut the budget deficit. Market volatility continued, however, and in June 2018, the Macri government reached an agreement with the IMF for a three-year, \$50 billion program.

Figure 1. Value of the Argentine Peso: 2018 to date
Pesos per U.S. dollar

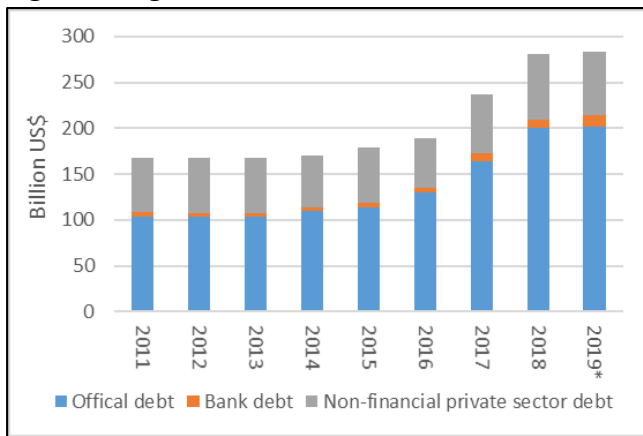


Source: Global Financial Data.

At the program's outset, skeptics raised questions about the fiscal cuts and growth projections underpinning the program. Through the program, the government committed to ambitious and politically unpopular austerity. The IMF was aware of the potential risks when the program was approved in June 2018: IMF staff noted in program documents they could not certify under the baseline forecast scenario with a high probability that Argentina's debt would be sustainable, with Argentina's external debt

reaching about \$285 billion in 2019, an increase of more than \$100 billion since 2015 (Figure 2).

Figure 2. Argentina's External Debt



Source: IMF, *Argentina: Fourth Review Under the Stand-By Arrangement*, July 2019.

Notes: * IMF forecast.

Despite an IMF program and fiscal reforms, the peso continued to depreciate over subsequent months. To stabilize the currency, the central bank raised interest rates to 60% in late August 2018, the highest in the world, and the government committed to hastening the pace of fiscal reforms. President Macri requested the IMF accelerate disbursements of its financing. In September 2018, the IMF increased the program to \$57 billion and agreed to front-load disbursements of financing.

Developments in 2019 and 2020

The Macri government pursued fiscal reforms, reducing the budget deficit from 5.3% in 2018 to an estimated 2.5% in 2019, and the IMF disbursed funds to Argentina in March and July 2019. However, Argentina's economy contracted by 2.2% in 2019, whereas the IMF program initially envisioned a return to growth in 2019. The peso's devaluation made it hard to tame inflation (with consumer prices growing by 54% by end-2019) and increased the real value of Argentina's debt (mostly denominated in dollars), accounting for about 76% of GDP in 2019.

The austerity measures and lingering recession in Argentina eroded Macri's political popularity. In the August 2019 primary election (which combined candidates from all parties), Macri lost decisively to the Fernández, who had pledged to "rework" the IMF program if elected. Following the primary, capital flight from Argentina accelerated, the peso reached a record low, and Argentina's stock markets dropped. President Macri subsequently shifted his economic policy approach, but still lost the election.

After taking office in December 2019, President Fernández pursued a number of measures that aim to revive the economy, including freezing utility tariff prices, reducing medicine prices, increasing worker wages, giving tax rebates to the most vulnerable members of society, and increasing severance pay. To offset the fiscal cost of these reforms, the government enacted a number of tax increases.

The government also focused on addressing public debt, opening talks with bondholders and other creditors, including the IMF. The government initially set March 31

as a deadline for renegotiating its debt, before large debt payments fell due between April and July. The deadline was subsequently extended several times. The COVID-19 pandemic further increased economic pressure on the government, even as the government's early lockdown successfully slowed transmission. Argentina's economy is forecast to contract by 5.7% in 2020, and the government is on track to run a budget deficit. The central bank is printing money to finance the government, which risks further inflation.

On May 22, 2020, the government missed a \$503 million interest payment on dollar bonds issued under New York law, putting the government into its ninth default. Although bondholders could demand immediate repayment on all outstanding debt or pursue payment through New York courts, negotiations are ongoing to swap the original bonds with new bonds that would provide some debt relief through principal and interest rates cuts and maturity extensions. In June, the IMF assessed that the government's revised restructuring offer to bondholders would likely restore debt sustainability for the government. More bondholders would need to accept the bond swap before it can proceed, however, and negotiations continue.

Economic Implications for the U.S.

U.S. economic exposure to Argentina through direct trade, investment, and financial channels is relatively limited. U.S. investors, however, are affected by the Argentine default and efforts to restructure the debt. The role of the IMF also has implications for the United States, the IMF's largest shareholder. Argentina has historically been a frequent IMF borrower, and previous programs have encountered difficulties. Argentina's default in 2001, while on a sizeable IMF program, led the IMF to substantially revise its lending policies. In 2018, the U.S. government strongly supported the IMF program for Argentina, given President Macri's demonstrated commitment to improving U.S.-Argentine relations and reforming its economy. U.S. government views, however, could change under President Fernández if his government takes an aggressive position against the IMF or U.S. creditors.

Oversight Questions for Congress

- In what ways is Argentina's current IMF program similar to and different from its previous programs?
- Given the size of Argentina's IMF program, what risks does it pose to U.S. financial commitments at the IMF?
- How does the pandemic affect the government's financing needs? Should the terms and conditions of Argentina's IMF program be revisited in light of the pandemic? What impact does the pandemic have on debt restructuring negotiations?
- Are U.S. financial institutions sufficiently capitalized and diversified to withstand a potential prolonged default by Argentina?

For more on Argentina, see CRS In Focus IF10932, *Argentina: An Overview*, by Mark P. Sullivan.

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