Argentina's famed 'convertibility' goes up in smoke

by Gonzalo Huertas

On July 12, the Buenos Aires stock exchange, or Merval, once again experienced a "Black Monday," with an 8.7% collapse in one day. The following day, the front page of the financial daily *Ambito Financiero* announced that this was the second worst "financial setback" in 1999; the first was the Brazilian collapse which followed the devaluation of that country's currency, the real.

During Argentina's most recent "Black Monday," the value of the country's so-called Global bonds which come due in 2017, collapsed 10.8%, while the Global bonds coming due in 2027 fell 7%. Brady bonds fell 2-4%. During the week of July 6-12, the Merval fell 14.1%.

Immediately, the financial soothsayers of Wall Street and Buenos Aires blamed the latest Black Monday on "an exaggerated reaction" of the "markets" to the statements by Presidential candidate Eduardo Duhalde, of the Justicialist Party, with regard to a possible default on foreign debt payments (statements which were denied by Duhalde), and to internal fights around this October's Presidential elections.

However, the truth is that Argentina—like Mexico and Brazil—is very close to defaulting on its debt, especially its private sector foreign debt.

Time to face the facts

In other words, the party is over; it's time to face the facts.

As economist Daniel Muchnik commented in his column in the Buenos Aires daily *Clarín,* "In Latin America, Argentina heads the list of nations with payment problems, way ahead of Mexico, Peru, Venezuela, and Chile. In recent months, Argentina became the country with the largest number of private sector defaults. No fewer than six companies were behind in their payments or went into default for some $700 million."

According to the April edition of *Informe Económico,* the Finance Ministry's quarterly publication, $26.429 billion of private sector foreign debt comes due this year, of which $11.045 billion corresponds to the largely export-oriented, non-financial private sector, and $15.384 billion to the financial sector.

"Under these conditions," wrote Muchnik, "both foreign and domestic creditors are reluctant to lend to Argentina, or do so at the highest interest rates. This poses major difficulties for the Treasury, and also for the private companies which are forced to shoulder the burden of these higher costs in a sharp recession."

In the aftermath of the debacle of the Brazilian economy, and given the dependence of Argentine exports on Mercosur (the Common Market of the South, whose members are Brazil, Argentina, Paraguay, and Uruguay), Argentina's production is collapsing, causing an accelerated increase in unemployment and a fall in tax revenues, which in turn is threatening the country's ability to meet public debt payments.

According to Labor Ministry figures, industrial production in May 1999 showed a 10.2% fall compared to the previous month. The hardest-hit sectors were automotive (−50.1%), tires (−29.3%), and metal-machinery (−27%). This, in turn, caused a fall in energy consumption for May of 4.8%.

In Córdoba province, the second most important in the country for its agro-industrial capacity, industrial production during the first quarter of the year fell 20.39% compared to the same period in 1998.

According to the National Institute of Statistics and Census, the government's statistical agency, real unemployment (under- and unemployment combined) in Argentina for May reached 28.2%, representing some 3.6 million people. This is 8.5% more than in October 1998.

It was thus with good reason that Msgr. Rafael Rey, the president of the Catholic relief agency Caritas and the bishop of Zárate, charged that the Argentine "middle class is disappearing, and has joined the poor." He referenced a World Bank study that indicated that some 13.4 million people in Argentina are now living "below the poverty line," and that "the rate of infant mortality in Argentina's northeast is equivalent to that of the African countries."

In the same vein, a study by the Institute of Fiscal and Economic Studies reported that "wages during the 1950-59 period were double those during the convertibility plan. During the 1960s and the first half of the 1970s, wages were 95% higher than what they are at present." The convertibility plan in Argentina refers to the currency board scheme first applied in 1991, in which the peso is pegged to the dollar in a one-to-one relationship.

This picture seriously affects tax revenues. On June 22, Undersecretary of Tax Policy of the Finance Ministry Guillermo Rodríguez Use admitted to *Clarín* that revenues for June "would fall between 8 and 9% over June 1998," and that the growing decline in revenues was due to "the substantial fall in imports, which are between 25 and 30% less than those of last year."

According to the July 14 *New York Times,* foreign bankers are confident that the Argentine government will meet its commitments for at least the rest of 1999, something which is in fact highly unlikely. But what has them really worried, as reporter Jonathan Fuerbringer noted, is that "there is a much greater likelihood of corporate defaults."