

How Argentina's financial tango could become a dance of death

Central bank and government's unholy alliance is storing up further trouble for economy



By Marcello Minenna

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Argentines know how to tango, with dancers moving in close or open embrace, and each relying on the other to co-ordinate a sequence of moves.

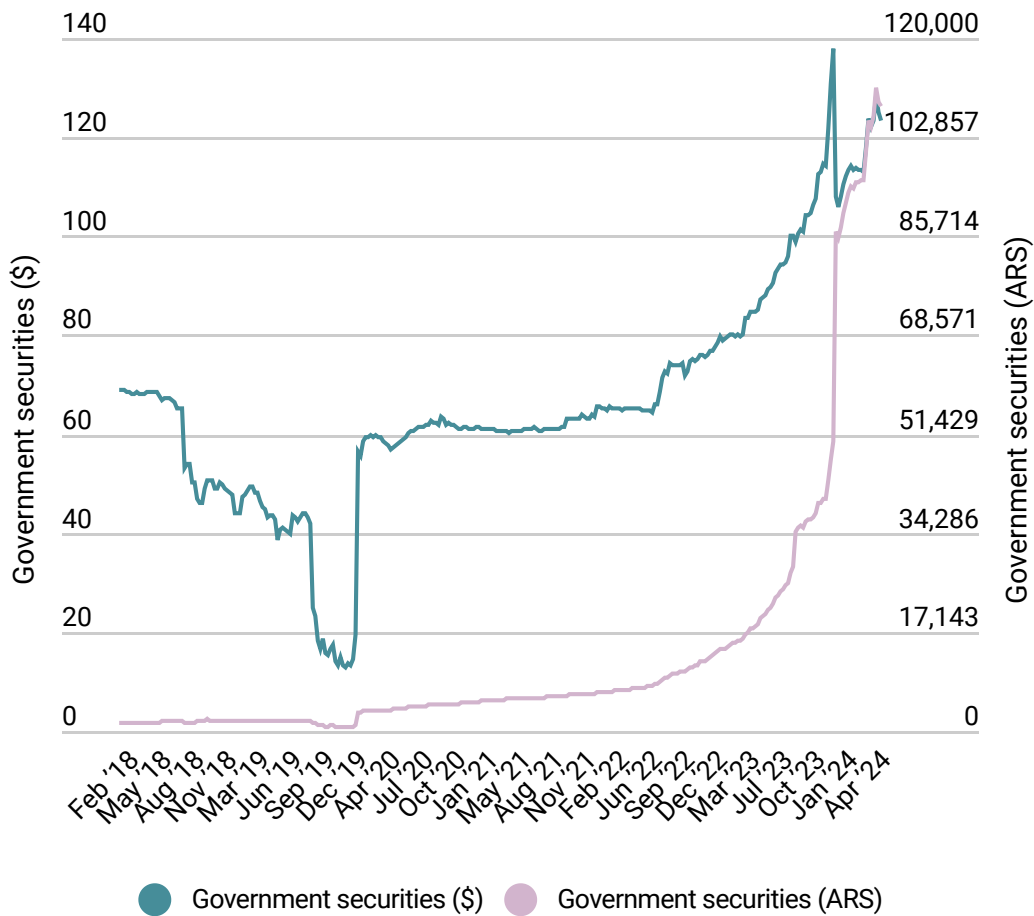
But a rather different type of tango has been playing out in recent years in the country's fiscal and monetary systems. And this partner dance, involving a relentless manipulation of accounting by the finance ministry and the central bank, is not strictly ballroom.

Since 2015, the Central Bank of Argentina (BCRA) has been issuing peso-denominated bonds to finance its balance-of-payments and public budget deficits. The aim was to avert indiscriminate growth in the monetary base – the pesos in circulation – and overcome the scarcity of US dollar reserves.

Since 2018, the BCRA has also been purchasing dollar-denominated bonds issued by the finance ministry at below-market interest rates. This last practice relies on a questionable accounting trick: the central bank's dollar bond purchases are held on its balance sheet at nominal value; consequently, the losses stemming from their deflated market value remain unaccounted for. More significantly, the BCRA garners capital gains from the devaluation of the peso – profits that it subsequently monetises to keep the dance going.

The result has been a Ponzi scheme that involves peso bonds being issued at gradually increasing interest rates and maturities. This has led to a progressive devaluation of Argentina's currency and a surge in inflation.

Value of Argentinian government securities



Murder on the dancefloor

Aside from a brief interlude in 2019, Argentina's accounting sleights of hand have resulted in an exponential growth in the countervalues of the two sets of bonds, both of which are classified as 'government securities' on the BCRA's balance sheet. Maintaining this state of affairs would require permanently high interest rates and a perennially devalued peso – a precarious balance that has already been cast into doubt by last December's devaluation.

Over the past four decades, the authorities have overlooked a fundamental economic principle, as set out in the [Mundell-Fleming trilemma](#): the inherent incompatibility of perfect capital mobility, a fixed exchange rate and an autonomous monetary policy.

This has resulted in a dysfunctional financial landscape. Private banks have deviated from their role in supporting the real economy, and the central bank has compromised its operability to meet the needs of the national budget. Meanwhile, the government has relinquished control over interest rates, inflation and fiscal policy, thereby undermining economic development.

Soon there will be no room for any further devaluation, and these recent 'embraces' might be the last tango in Buenos Aires

A few statistics illustrate the scale of the disaster. Argentina has a GDP of \$600 billion – a figure that has not grown in real terms since the accounting gimmicks began. In 2022, the country received a loan from the International Monetary Fund of \$44 billion – an amount equating to 12% of the national debt. In 2018, inflation was already above 25%. Today, the figure is around 290%. Since 2015, more than 45 million Argentinians have invested almost \$450 billion in foreign assets. And since 2020, more than 60,000 of the country's citizens have moved to the relative economic stability of neighbouring Uruguay.

After five defaults since the 1980s, Argentinian citizens' reluctance to invest in their country's public debt and the relentless flight of their capital abroad are both entirely understandable.

When it comes to his own plans for economic reform, Milei seems intent on not giving an inch. With his aim of dismantling the existing financial system and ushering in deregulation, Argentina's firebrand president has placed a strategic emphasis on the dollarisation of the economy. The rationale? A last-ditch effort to get Argentinians to repatriate some of that \$450 billion – something they have so far been reluctant to do.

If his plan works, it would help to restore Argentina's public finances. It would also help to rebuild citizens' trust in their government.

For now, Milei appears happy to take the lead in this new tango with the citizenry. However, given the inherent vulnerabilities of the nation's financial framework, it seems unlikely that many Argentinians with capital to invest will be willing to follow.

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