Why is the IMF helping Argentina to deepen its international Ponzi position?

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This section contains an earlier note, written in July 2016.

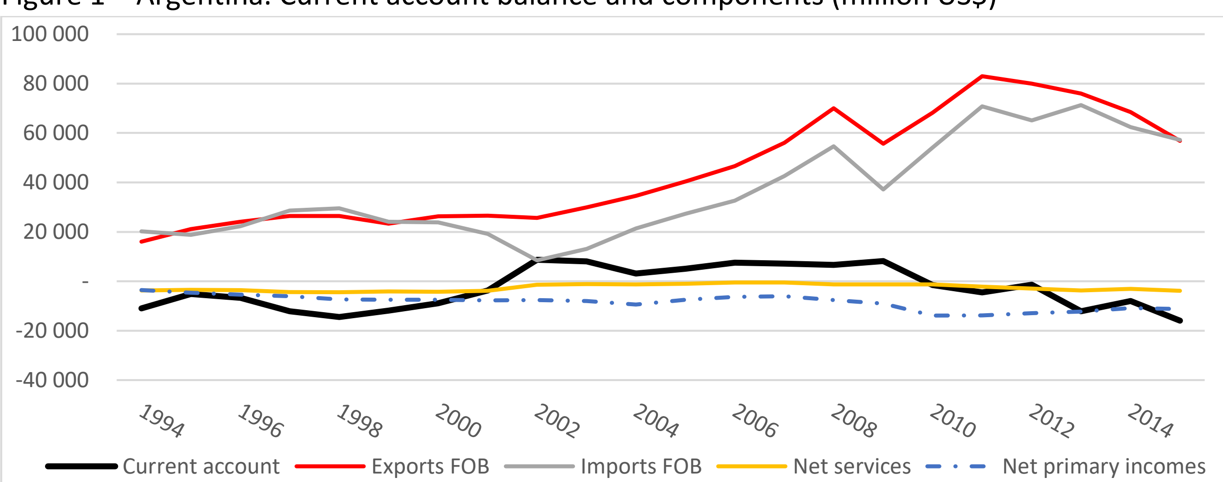
The intended consequence of the end of the Argentine saga with the holdouts ("vulture funds"), swiftly concluded by the new Macri government, was to reinsert the country into the global financial markets. Apparently, the government estimated that the net benefits coming from this reinsertion justified the high non-investment grade rate of interest (7.2%) to pay on what is essentially a generous swap of old foreign debt with new one, amounting to 16,500 million dollars.

Step two was to allow the Provincias to issue debt in dollars, around 8,000 million dollars already issued or planned, paying an average hefty 8% interest rate. Although starting from a low degree of foreign debt, it is not just its current volume but the mechanism that was put in motion that may raise fears of a return to the past. The Provincias cannot derive such high dollar returns from employing the funds thus obtained; more importantly, their revenue as well as that of the central government will be in pesos while the debt service will have to be honoured in dollars.

Overall, the service of the new public debt will produce a drag on the current account of the balance of payment for around 1,800 million dollars. This outflow will add to a current account that has been negative since 2010, just due to net negative income transfers. All this just sticking to the public sector, i.e. not considering the addition that may come from the push to tap international markets by private firms with revenues in pesos.

As Figure 1 shows, since 2010 Argentina is in a Ponzi position because it must issue new foreign debt (and/or decrease reserves) to pay interests and dividends on existing debt and foreign direct investments. If the fundamentals of the current account will not change, the new debt will just speed up foreign indebtedness.

Figure 1 – Argentina. Current account balance and components (million US$)



Source: Indec

The only solution might come from a future trade surplus of the magnitude existing in the period 2002-2008. Unfortunately, given the perspective of the world economy, going back to that 'golden' period of high prices and quantities of the Argentinian exports seems non-existent, while the elimination by the Macri government of a series of obstacles introduced by the previous administration will foster imports.

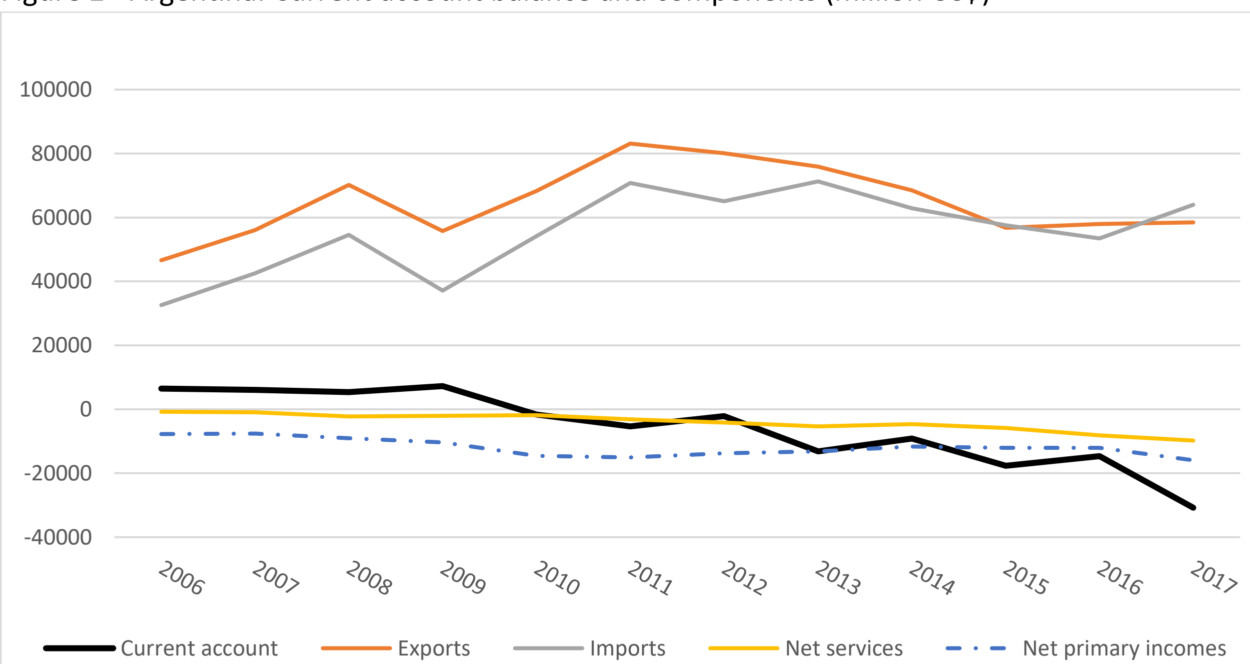
The expected inflow of foreign capital on which the government counts to revive internal growth does not convince too. It is a sad story experienced by many countries that inflows of financial capital ultimately cause financial and real estate bubbles; when other locations offer higher rents net of risk, sudden exits produce deep crises. The Ponzi mechanism of accumulation of foreign debt sooner or later leads to such outcomes. Foreign direct investment, too, should be treated with caution because the sustainability of the current account require that these funds were invested in greenfield activities earning enough foreign currency to pay for their import content and profit repatriation. A significant part of the current Argentine deficit of the income account come past liberalisations in the non-tradable sector, mostly the energy, communication and banking industries.

It is thus difficult to understand what projections have counselled the Macri government to adopt such a policy trajectory.

2. The evolution up to July 2018

The situation as it appears in July 2018 is shown in Figure 2, whose data comes from a new INDEC series. Although for overlapping years figures 1 and 2 show slightly different values, the path of the series does not change.

Figure 2 - Argentina. Current account balance and components (million US$)



Source: Indec

The last two years have confirmed the negative outlook outlined in the previous note. From 2015 to 2017 total external debt net of reserves has increased by 15.2%.

When confronted with a Ponzi position, the first thing to ask is the possible existence of an El Dorado, i.e. of a radical perspective change capable of shifting Argentina from a Ponzi to a speculative position, where a positive trade and service balance should at least cover the negative income transfers balance. Judging from the past, this change could only come from the trade balance.

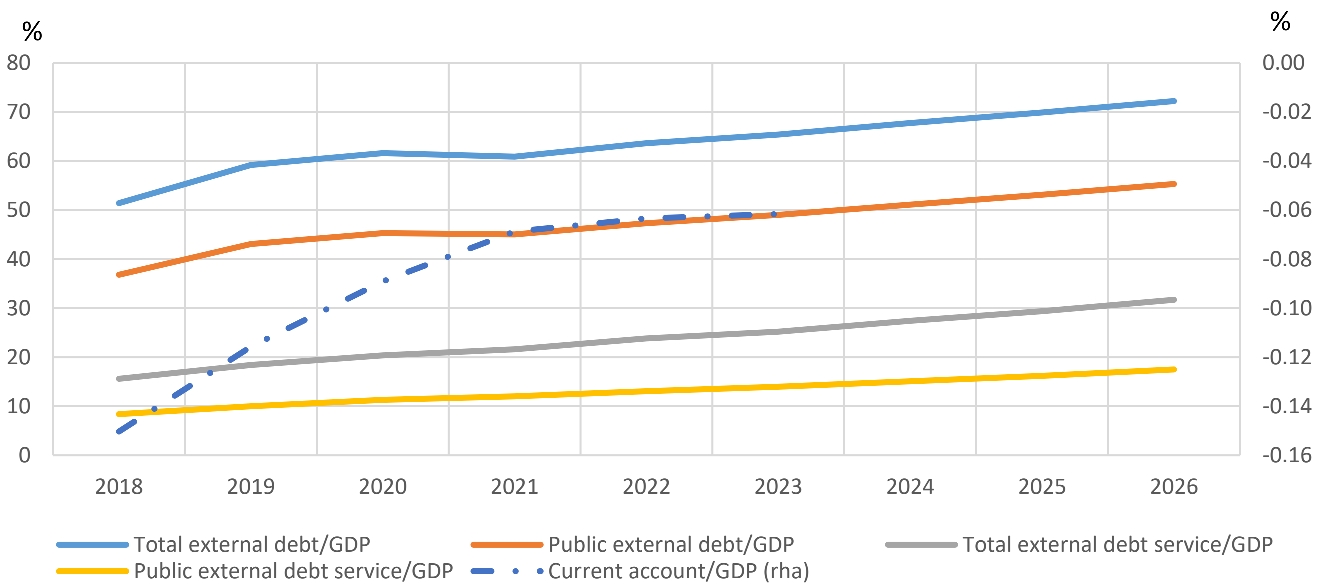
Apart from political reasons, enough economic ones thus exist that explain the turbulence in the foreign exchange of the last months.

3. The IMF comes in

Remaining one and half year of its quadrennial mandate, president Macri was forced by market turbulence to propose substantial policy revisions and to request a stand-by arrangement to the IMF.

The IMF opened a 50 billion US dollars credit line, based on the policy framework that the Argentine government agreed to adopt. Political difficulties that are emerging on the fiscal adjustment, and perspectives on inflation and the exchange rate make the projections utilised by the IMF for its basic scenario rather optimistic. Hence, the adverse scenario designed by the IMF now appears as a more realistic basic one. Taking the IMF projections for the adverse (now basic) scenario produced by the IMF for assessing the risks to the Fund, we can visualise in figure 3 the path of the external position of Argentina up to 2026, when the IMF exposition will be fully repaid.

Figure 3 – Argentina's Ponzi external position



Data: IMF projections

We can understand the preoccupation of the IMF for having its money back; but is the long-term situation of the Argentine economy consistent with it?

Figure 3 shows that an EL Dorado for the trade balance is not expected, at least not in the measure that would avoid a Ponzi path. The external debt curves do not show any sign of reaching a plateau just because the current account deficit seems to reach a negative plateau (for the c.a. the IMF optimistic projections stop at 2023). With a current account deficit, external debt goes on spiralling up. The rising path of the ratio of external debt service (interest payments and repayment of principal) on GDP well illustrate the magnitude of the Ponzi problem. Taking the end year of IMF projections, when its credit should had been fully repaid, in 2026 the service of external debt will reach almost one third of GDP, posing the threat of a monstrous default.

The focus of any policy adjustment should then be on the current account of the BoP. Traditionally, to have its money back, the IMF required reining on government expenditure and on monetary policy to produce a substantial decrease of imports through a deep recession. Judging from the projections on the current account contained in the IMF document, it may be that in this case, for political reasons and given the current social and economic conditions of Argentina, a 'softer' approach was chosen. However, the structural adjustment required on public finance and high real interest rates will produce a lasting recessionary effect with a limited effect on the current account. Consequently, the external debt will go on increasing as a percentage of GDP and exports. This means that the trajectory of the reimbursement of the IMF debt will necessarily depend on Argentina switching from IMF to private international financial markets. Lacking the perspective of an El Dorado for the current account, this appears wishful thinking. We may expect with all probability that well before 2026 international investors and Argentine savers will look for more secure jurisdictions.

Finally, a careful reading of the technical analysis included in the IMF documents shows that the IMF technical staff too has serious reserves on the happy ending of a sequence of events that in several respects brings to the memory the path followed by the Menem presidency in the 1990s. The almost desperate messages that president Macri is sending in these last days to Argentine's producers - export, export, export – suggest that the government is conscious of where the basic problem now lies.