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Argentina: Market Meltdown Can Be Halted

*By Arturo C. Porzecanski**


Ministers of Cristina de Kirchner

The unexpectedly strong performance of the Alberto Fernández-Cristina Fernández de Kirchner (FF) ticket in Argentina's August 11 presidential primaries has triggered a stampede out of the country's currency, stocks, and bonds, but FF hold the key to staving off a full-fledged crisis. If the confidence of local and foreign investors is not recovered soon, the market rout has the potential to induce runaway inflation, plunge the economy into a deep recession, and cut off domestic and international financing for both the outgoing and incoming governments, potentially leading to a default.

- The FF Peronist ticket's 15.6 percentage-point margin of victory over President Mauricio Macri and his companion was foreseen by none of the pre-election polls. The wide gap shocked investors because it indicates the Fernández duo could win in the first round in the October 27 general election, avoiding a second-round ballot on November 24 in which the pro-market Macri was thought to have a better chance. The coattail effect of FF helped allies in provincial and local primaries around the country. With likely majorities in one or possibly both houses of congress, FF would have a powerful government that could implement much of its agenda, for better and for worse.

Now the challenge is to stop the vicious cycle of capital flight, currency depreciation, accelerating inflation, and plunging economic activity sparked by the electoral results. Failure to do so sooner rather than later will make it very difficult for the government to refinance its maturing short-term debts, and the Central Bank will likely experience a steady drain of its international reserves. In that scenario, the IMF, which has been sending big checks to Argentina every three months, would probably not send the next one in late September.

- The Macri administration has announced some palliative measures (e.g., a 90-day freeze in gasoline prices and a tax exemption for food purchases), and the Central Bank has tightened marginally monetary conditions. But the government leadership team is powerless to restore the investor confidence that has evaporated.

Given his clear frontrunner status, Alberto Fernández could play a crucial role in reversing the trend. During eerily reminiscent circumstances in Brazil in mid-2002, local and foreign investors were increasingly worried that Luiz Inácio "Lula" da Silva, who was running strong in the polls in his fourth presidential campaign, would end the market-friendly policies of the outgoing Fernando Henrique Cardoso – including a break with the IMF, from which Brazil had been borrowing.

- Worried about potentially inheriting an economic and financial mess, Lula made a public statement – he called it a "Letter to the People" – making clear his commitment to sound fiscal and monetary policies and the rule of law. He wrote about a "new social contract capable of assuring economic growth with stability," one of whose premises was "naturally, a respect for the country's contracts and obligations." He followed those words with concrete actions. Two months before the elections, he gave his blessing to a new IMF program committing the next government to maintain, with minor modifications, Cardoso's austere fiscal and monetary policies.

Lula's actions after his election, including putting a market-friendly and popular mayor in charge of his transition team and choosing a career private-sector banker to run the Central Bank, provide a path that Alberto Fernández could follow as well. Under Lula, the Brazilian Central Bank felt supported in its all-out effort to extinguish the flames of inflation and to buttress the currency. Interest rates were thus hiked as needed before and after the October 2002 elections. He initiated confidence-building meetings with investors before taking office and reassured lenders and investors, both in Brazil and abroad.

- *So far, Alberto Fernández is denying any responsibility for the developing financial and economic crisis, blaming Macri for all that's gone wrong. But unless he makes announcements that give confidence to local and foreign investors, he will inherit a mess.*

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