

**Economics School of Louvain - ESL  
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# **Retrospect on Argentina currency crisis**

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## **1.1. Introduction**

At the beginning of the 90s, even after a decade of military dictatorship and a subsequent period of sociopolitical instabilities, Argentina was considered to be a country with a strong potential for steady growth. Its economy was based on the agro-industrial sector and large reserves of mineral resources, oil and natural gas (Nataraj 2003). The government, however, faced deep economic depression for many years and generally was unable to manage the country properly.

Determined to cure the national economy, the new president of Argentina, Carlos Menem, came into power in 1989. At that time, the country suffered from an incredibly high inflation rate with a peak of approximately four thousand percent annually. This became a primal goal of Menem's administration. Besides, due to the general deterioration of the national economy and ineffective legislation system, Argentina was not attractive for foreign investments.

In order to show the Argentina's openness to the international community, Menem tried to base his policy on standards of Washington Consensus as some sort of benchmark for economic reforms that was promoted by the International Monetary Fund and the World Bank in those times. Presidential initiatives included privatization and deregulation of the state-owned sector within railways, telecommunication, electricity, transportation and provincial banking (Kehoe 2002). The main changes, however, were foreseen to occur in the currency exchange rate and within governmental finance in general. In general, Menem's reforms seemed very optimistic and consequently were supported by both the Argentine nation and the international community.

## **1.2. Convertibility plan, inflation and the GDP growth rate of 1991-2002**

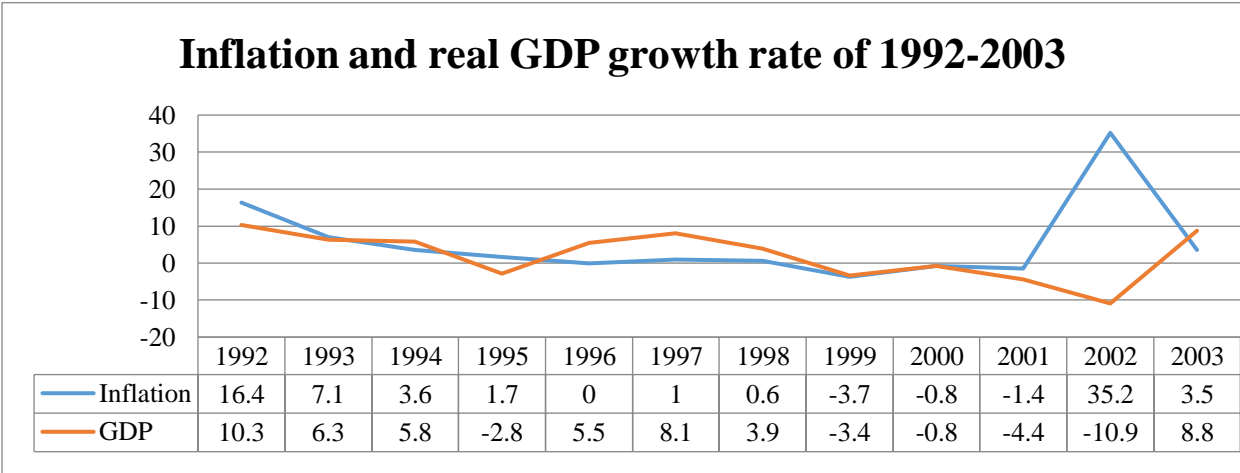
In 1991 Menem appointed a new minister of economy - Domingo Cavallo, who has immediately presented a solution to the problem of hyperinflation. The decision was to implement a fixed exchange rate by pegging Argentine currency (first austral and then peso) to the U.S. dollar at parity, i.e. in a strict proportion one-to-one. In the opinion of the government, it was a temporal economic instrument that should have led to decreasing of the annual inflation rate and to the consequent recovery of the national economy. That's how the Argentine Currency Board was established.

Cavallo's convertibility plan was not much praised by the IMF even though it was based according to the principles of Washington Consensus. The Fund was concerned about the initial overvaluation of the peso and what would happen if the dollar appreciates even more (IOE 2003). The peg, however, was perceived as a short-term tool for price stabilization, thus eventually it was accepted. The

government also promised to change peso to the dollar at the national bank without any limits (Economist 2001). This statement contributed to even more confidence in peso by both the Argentine people and foreign investors.

Indeed, the convertibility plan soon succeeded by significantly decreasing the annual inflation rate. At the beginning of 1991, the government expected the annual inflation rate to be within a range of 500-700% with a temporary peak even up to 1300%. Fortunately, that year ended with approximately 65%, according to national statistics (see graph 1), and even less according to other sources. During the next several years inflation decreased even more – to be about generally 2-5% per annum what, however, was yet higher than in the United States. The peso remained slightly overvalued. Nonetheless, Argentina stepped in a period of stability, thus Cavallo’s reform was praised by the Argentine nation.

Simultaneously, the decision of pegging the peso to the dollar was also the first but not the only root of a crisis that would appear in a decade. It is necessary to admit that Cavallo’s convertibility plan along with Menem’s reforms also stimulated the economic growth of Argentina during the 90s. Notable achievements of the government attracted foreign investors and net portfolio investments increased from 200 million USD in 1992 to 19 billion USD in 1998 (Nataraj 2003). Therefore, at the beginning of 90s real GDP growth was positive, with a peak of 10% in 1992 and a subsequent decrease to 6% in 1994 (see graph 1).



Graph 1. [Made by author. Data source: Instituto Nacional de Estadística y Censos de la República Argentina]

In 1995 Argentina felt a significant echo of the Mexican crisis, as national economies of these two countries were partially interconnected. It is stated that Argentine government did manage to overcome generally the impact of this crisis, but according to figures, in 1995 real GDP growth was negative – a bit

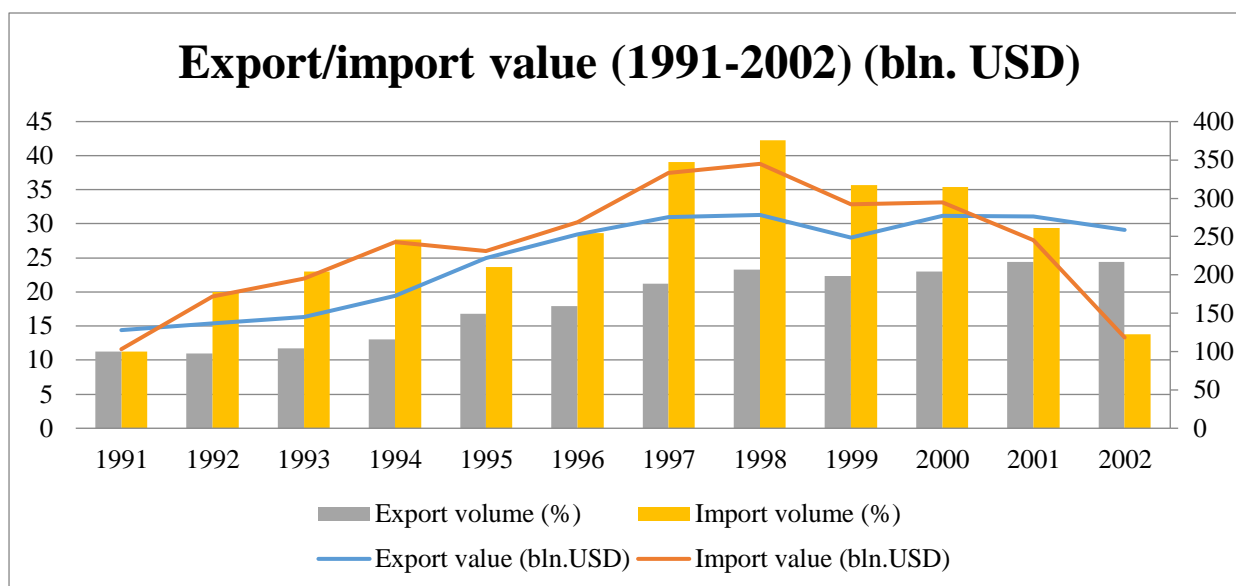
less than -3% – what was the first time since 1989. Simultaneously, the annual inflation rate remained under control to be even below zero in some months of 1995-1996. One year later Argentina renewed its economic growth and it remained positive till the end of 1998. In 1999 both inflation rate and real GDP growth rate were negative, so we can state that Argentina entered into recession in that period.

### **1.3. Trade balance and balance of payments of 1991-2002**

In order to get a more relevant image of Argentina's national economy before the crisis, we should provide basic information about the country's international trade at the beginning of the 90s. Main partners of Argentina were countries-neighbours (Brazil, Chile, other members of Mercosur), US and several countries of EU (France, Germany and Netherlands). In general, country imported heavy machinery, electrical equipment, chemicals and plastic material, while it exported mostly mineral oils and fuels, products of agriculture and vehicles.

According to data from the World Bank database, we built a graph of the value of the Argentina's trade to get the visual trend of the trade of the country during the period of 1991-2002 (see graph 2). In general, import prevailed significantly over export almost all the time. Although at the end of 1991 there was a short period of a balance in international trade of Argentina, during the next several years difference between these two indicators became huger. At the end of 1994 and during 1995 import growth rate significantly slowed down what led its value to almost equal to export's one. A year later growth of import renewed even more and a huge trade deficit of the country remained till the end of the year 2000.

In order to get more precise analysis and to evaluate international competitiveness of Argentina, we recalculate trade volume index of the country with 1991 as a basic year with 100%. Although volume of export nearly doubled by the year 1997 and then remained stable till 2002, the volume of import increased by almost 375% in 1998 comparing to the basic year. It shows us that Argentina faced incredibly huge imbalance not only in trade value (what can be explained by the government's monetary policy to some extent), but in volume of goods as well.



Graph 2. [Made by author. Data source: World Bank database]

For deeper analysis, I recalculate the growth of Argentina's international trade value indicators and its percentage to GDP (see table 1). First of all, it is also necessary to mention that share of both export and import value in GDP was more or less stable during pre-crisis period. In 1991, when Argentine trade balance was positive, export was equal to about 7% of GDP, while import almost – to 6%. Then both indicators fluctuated within range of  $\pm 1\%$  per annum. Finally, in 1998 import became equal to almost 12% of GDP and export still remained 9% of GDP since 1995 to 1999.

Notably, in absolute terms during the period of 1991-2001 export generally increased by two times – from 14 to around 30 billion of USD, while import's increased by three times - from 11 to around 33 billion of USD. As we can see, export increased more significantly during 1994-1995 with more than 18% and 28% of annual growth rate for each year respectively. Then it slowed down to only 13% a year later and even less, to 9%, two years later. Notably, in 1997 value of Argentine export remained almost the same as one year before, while next year its annual growth rate was negative with a bottom of -10%.

According to the trends, the import growth rate was not that different from export's but its volatility was more severe, at least at the beginning of the 90s. For instance, in 1993 Argentine export increased by 6%, while import did the same increase, however, by 13%. As it was mentioned above, in 1995-1996 there was some sort of equilibrium in international trade of Argentina. Nonetheless, according to figures, it was achieved only because the growth rate of import became negative in 1994. A year later its annual growth in absolute terms was 16% and then it fell sharply to be again below zero of approximately -15% in 1999.

Insofar as statistics confirmed total prevail of import over export during the pre-crisis period of 1992-1998, we can make relevant conclusions about Argentina's trade balance in general. In 1994 deficit was about 800 million USD what was equal to almost 3% of GDP. It was reduced during the next two years but deficit reemerged again in 1997 with the difference between Argentine import and export of approximately 650 million USD. One year later it increased on additional 100 million USD. In general, the trade deficit in the pre-crisis period was about 2% of GDP. It was causing lack of foreign currency in the country and overpressure on its external reserves. Therefore this fact can be called as the second driver for the 2001 crisis.

**Table 1. Argentina's international trade analysis of 1991-2002**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Export value (bln.USD)	14,4	15,4	16,3	19,4	25,0	28,4	31,0	31,3	28,0	31,2	31,1	29,1
- to GDP (%)	7,00	6,20	6,35	6,94	8,91	9,63	9,75	9,64	9,10	10,13	10,67	26,73
Export value growth rate (%)	-	6,81	5,99	18,85	28,94	13,90	9,07	0,81	-10,4	11,57	-0,38	-6,63
Import value (bln.USD)	11,6	19,3	22,0	27,3	26,0	30,2	37,5	38,8	32,9	33,1	27,6	13,3
- to GDP (%)	5,63	7,79	8,57	9,77	9,29	10,24	11,80	11,97	10,69	10,72	9,46	12,27
Import value growth rate (%)	-	67	13,75	24,11	-4,54	16,04	24,16	3,43	-15,2	0,50	-16,6	-51,7
Trade balance (bln.USD)	2,8	-4,0	-5,7	-7,9	-1,1	-1,8	-6,5	-7,5	-4,9	-1,8	3,5	15,7
- to GDP (%)	1,37	1,59	-2,22	-2,84	-0,39	-0,61	-2,05	-2,33	-1,59	-0,59	1,21	14,46

*[Calculated and edited by author. Source: World Bank database]*

Many researchers claim that Argentina's 2001 currency crisis is considered to be a classic balance of payments crisis. Therefore, it is also necessary to check the dynamics within all the accounts of the country's BoP as well (see table 2). According to obtained data, we can state there was a significant trade deficit which led subsequently to current account deficit. Yet in 1991 it was equal only to 600 million USD, while in 1998 it became much huger of a figure of 14.5 billion USD. Trade balance maladjustments, however, represented only a half of this deficit, hence we paid our attention to net interest payments of Argentina. Its dynamics is pretty notable, as till 1994 country paid an amount of about 3 billion USD per year, while after 1995 it began to rise with a peak of 11 billion USD of interest payments in 2000.

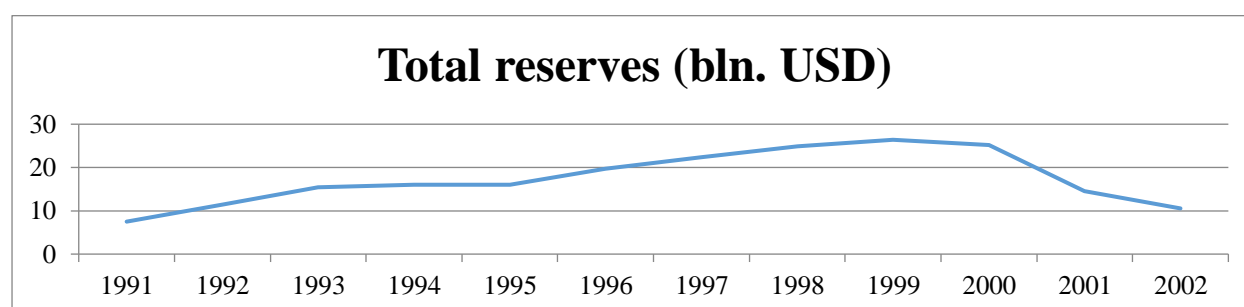
Along with that, deterioration can also be observed within the financial and capital account too. Therefore, the balance of payments during the pre-crisis period was generally negative. Its deficit was equal to about 9% of GDP in 1994 and it fluctuated within near 5% during next two years. During 1997-1999 balance of payments was again in deficit of approximately 9% of GDP. This calculation shows us significant problems of Argentina's national economy.

**Table 2. Argentina's balance of payments analysis of 1991-2002**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
<b>Current account (bln.USD)</b>	-0,6	-5,5	-8,2	-11	-5,1	-6,8	-12,1	-14,5	-11,9	-9	-3,8	8,8
<b>-Trade balance (bln.USD)</b>	2,8	-4	-5,7	-7,9	-1,1	-1,8	-6,5	-7,5	-4,9	-1,8	3,5	15,7
<b>-Net interest payments (bln.USD)</b>	-2,7	-2,66	-3,1	-3,65	-5,06	-5,89	-7,02	-8,65	-10,3	-11,7	-4,79	-1,43
<b>Financial and capital account (bln.USD)</b>	-0,8	-5,9	-9,9	-13,1	-7,79	-8,25	-14,3	-14,7	-12,3	-8,99	-6,34	7,71
<b>BoP (bln.USD)</b>	-1,4	-11,4	18,1	-24,0	-12,9	-15,0	-26,4	-29,3	-24,2	-17,9	-10,1	16,5
<b>- to GDP (%)</b>	-0,8	-4,99	7,65	-9,34	-5,00	-5,52	-9,03	-9,79	-8,54	-6,31	-3,76	16,85

*[Calculated and edited by author. Source: World Bank database]*

To cover this type of deficits, normally a country can use its external reserves. Taking into account the convertibility plan and the government's promise to change peso to the dollar with no limitation, we consider that it had to have enough amounts of foreign currency in reserves. Therefore we also should pay attention to their relevant dynamics during the pre-crisis period (see graph 3).



*Graph 3. [Made by author. Data source: World Bank database]*

Notably, the country's total reserves remained more or less till 2000 with only minor rise, while balance of payments, as we already found out, remained significantly negative. In 1991 they were equal to 7.5 billion of USD and in

1999 they became more than 26 billion USD. A year later the government used reserves and its value decreased to 14 billion USD.

#### **1.4. Governmental finance balance of 1991-2002**

To get more information about the reasons of the 2001 crisis, it is also necessary to analyze governmental finances during the pre-crisis period (see table 3). In general, a trend is almost the same as it was within trade balance. We can see that before 1994 budget revenues were higher than expenses. Contrary, during the rest of the 90s, Argentina's government had been encountering a budget deficit of more than 380 billion of ARS in the 1995 and even 775 billion of ARS in 1999. However, interest payments on the public debt were around 10% of all governmental expenses till 1995, while a year later it began to increase to a peak in 2002, when primary expenditures were only 65% and interest payments – 35%. In addition, after successful privatization of state-owned enterprises annual budget revenues were decreasing even more. In general, its deficit fluctuated within a range of 1.5-3% of GDP. Thus Argentina faced almost the same tendencies but not the amount of deficit in government finances as it did in international trade.

**Table 3. Argentina's budget revenues and expenses analysis of 1991-2002**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
<b>Revenue (bln.ARS)</b>	20,2	27,8	35,7	38,3	36,2	35,5	39,8	41,1	39,7	40,3	37,0	43,9
<b>- to GDP (%)</b>	11,2	12,3	15,1	14,86	14,03	13,04	13,6	13,76	14,01	14,18	13,78	14,1
<b>Expense (bln.ARS)</b>	20,3	26,7	33,8	38,4	40,0	41,3	44,0	45,1	47,5	47,8	45,7	61,5
<b>- to GDP (%)</b>	11,2	11,8	14,28	14,9	15,51	15,17	15,01	15,1	16,74	16,83	16,99	19,7
<b>-Interest payment on public debt (% of expense)</b>	11	9,8	7,61	8,32	10,20	11,21	13,04	14,71	17,27	20,10	22,27	34,3
<b>Budget balance (bln.ARS)</b>	-0,1	1,09	1,93	-0,10	-3,83	-5,78	-4,14	-4,01	-7,75	-7,55	-8,64	-17,6
<b>- to GDP (%)</b>	-0,1	0,48	0,82	-0,04	-1,48	-2,12	-1,41	-1,34	-2,73	-2,66	-3,21	-5,62

*[Calculated and edited by author. Source: World Bank database]*

Thus analysis of the pre-crisis period showed us that omens of the incoming crisis were obvious. In general, convertibility plan was successful as instrument of price stabilization but it also caused overvaluation of the peso and worsened trade balance of the country. Trade deficit became more than 6% of GDP in 1997 and subsequently led to significant current account deficit. Along with that government faced a huge fiscal deficit and a severe external debt burden of a bit

less than 50% of GDP in 1998. It is also necessary to mention that the country also suffered from a high level of corruption, while promoted by president Menem privatization and deregulation were not transparent and economically successful.

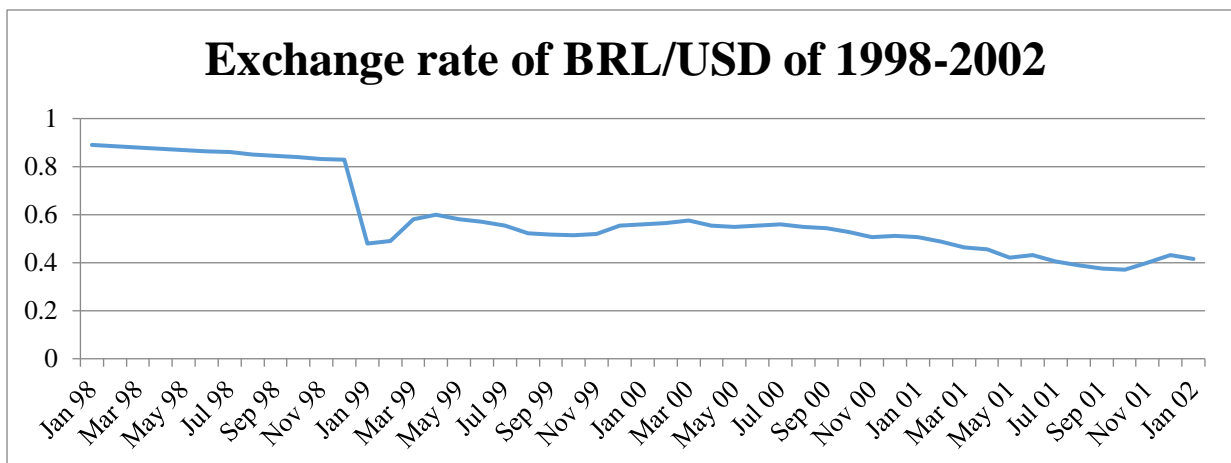
### **1.5. Deterioration of 1998-2001 and analysis of Argentina's relations with the International Monetary Fund**

Since 1998 the severe problems of the national economy became obvious for everyone: the foreign investors, Argentine people and the international community. GDP growth rate became negative, while the government encountered huge fiscal deficit. The situation went even worse when in 1999 Argentine economy was significantly impacted by Brazil crisis.

As it was already mentioned, Brazil was one of the main trade partners of Argentina. Two countries were interconnected significantly within not only political and cultural fields but also within industry, finance and banking. Besides, both produced almost the same types of goods and, therefore, had been competing by export. In 1999 the Brazilian government faced similar to the Argentine economic recession when the echo of the Asian economic crisis came to South America. The significant difference between the two countries was the exchange rate regime, as the Brazilian real's rate was floating.

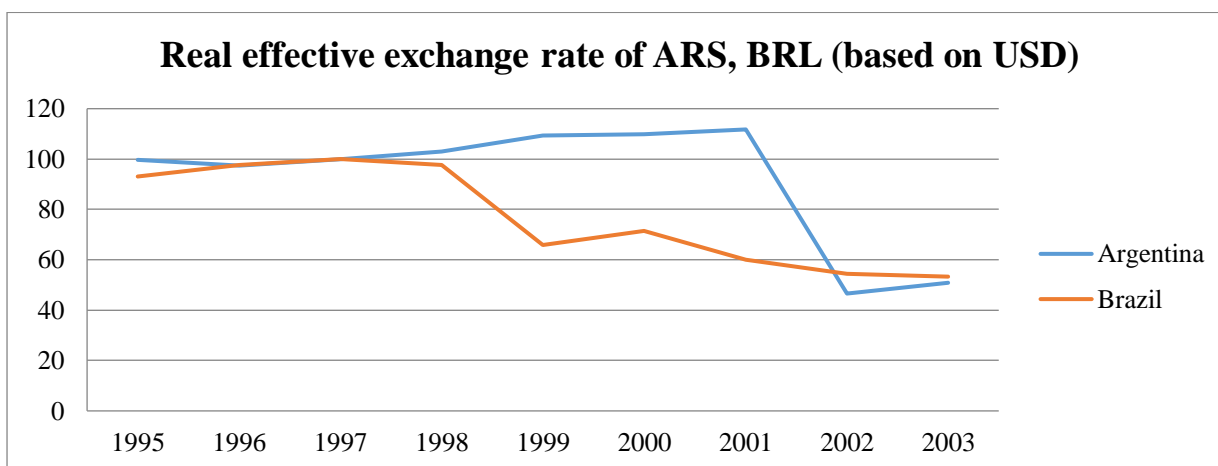
Normally, when the national currency of any country devaluates it makes its export cheaper while import – more expensive. The trade balance thus becomes positive. In contrast, export will be more expensive and import cheaper if the currency revaluates. In this case, the trade balance will, more likely, be negative.

The last thing was exactly what had happened to Argentina after 1995 as dollar exchange rate remained stable making peso's rate to be fixed at too high level, while significant devaluation of Brazil's currency occurred. During January 1999 the real lost approximately 40% of its value (see graph 4), what made Brazilian export cheaper and thereby more competitive. This was a shock for an Argentine economy whose export now became totally uncompetitive, as dollar's rate to which peso was pegged contrary continued to rise against European currencies.



Graph 4. [Made by author. Data source: investing.com]

Mentioned above conclusions about 40% devaluation of Brazilian currency, however, mean nothing if we do not compare it with the Argentina’s peso exchange rate. For better analysis, we shall use real exchange rate of both currencies with domestic CPI as basis (see graph 5). It is obviously seen that the Brazilian real devaluated in 1998, while the peso, in contrast, continued to appreciate by approximately 10% during 1997-1999 because of peg to the dollar. A result of this disproportion was that the Argentine export growth rate fell to -10% in 1998 (see table 1).



Graph 5. [Made by author. Data source: World Bank database]

Another trigger of the crisis was in a significant decline of capital flows to emerging markets. According to our analysis, during the 90s Argentina had been facing severe current account deficit. To cover it, the government often appealed to the international capital market, so when in 1998 global flows sharply decreased, it encountered lack of financing along with external debt which was continuing to rise much more than 50% of GDP. Many researchers state that the problem of Argentina was in this ‘too strong’ rely on external financing, while

its export was continuing to decrease, what is confirmed by our calculation above.

Argentina became even less attracting for international investors after Menem tried to change the state constitution in order to stay in power as a president for the third term. These actions caused general distrust of the government and its international condemnation. Fernando de la Rúa won next presidential election in October 1999 overtaking the second candidate on 10%. Notably, Domingo Cavallo, author of convertibility plan, also participated in the election and took the third place.

New president obtained severely deteriorated national economy with negative GDP growth, and incredibly large external debt burden. Just after his inauguration, de la Rúa initiated a dialogue with the International Monetary Fund in order to get additional financing and technical assistance to overcome the already existing crisis. To get clearer vision of the IMF role in the 2001 crisis, we shall describe their particular relations during pre-crisis period. As it was already mentioned, the ex-president Menem had actively been advised by the Fund in implementing many aspects of his policy. Furthermore, the influence of the IMF on the Argentina during the 90s became so huge that the country's international attractiveness for the foreign capital flows became to some extent depended on the Fund's report and decisions. It is claimed that investors paid a lot of attention to relations between Argentina's government and the IMF's authorities and this relation was as some sort of indicator either the Argentine national economy sound or not.

The Menem's administration actively cooperated with the Fund and asked not only for an advisory and technical assistance, but also for financing. The country's net interest payments were negative and the governmental budget was in deficit, so these two factors were the main reasons for Argentina to apply to the IMF. The country conducted two Stand-by programs and two Extended arrangements for the period of 1992-1996 and of 1998-2000 (see table 4). Hence, it received funds in foreign currency almost each year of the pre-crisis period (see graph 6). Finally, in 1998 Argentina applied for new SBA, under which more than 8 billion SDR was disbursed in 2001, just before the country defaulted. The financing was mostly used to assist the functioning of the Currency Board, to get consolidated fiscal balance and to support national economy in general, as these were the main demands of the Fund.

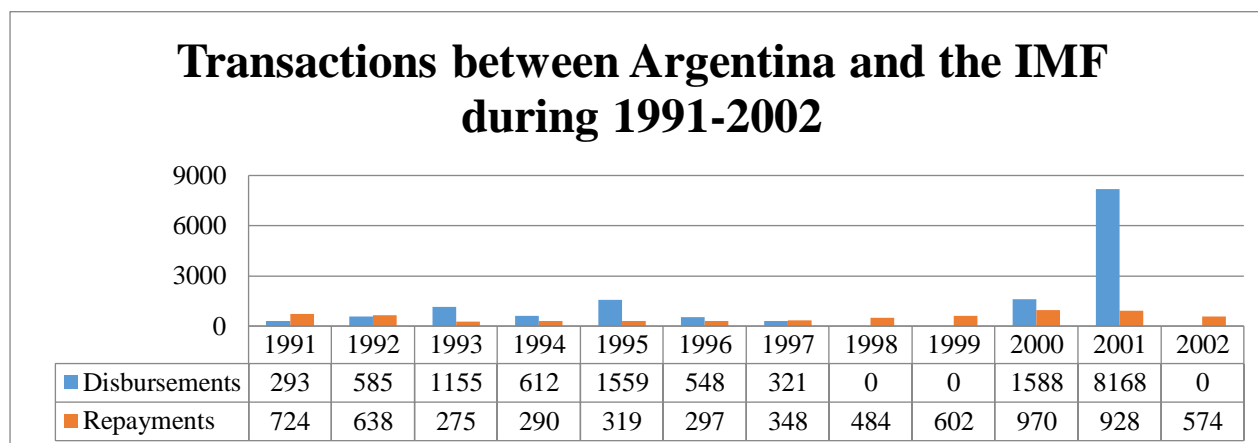
Although requirements about governmental finance balance seemed sound, we state that trade deficit was not less severe problem of Argentina in those times. Moreover, as we found out, the Argentine national economy was in recession as

both inflation rate and GDP growth rate were negative. In our opinion, it was better to use external financing to take Argentina out of the recession and, simultaneously, decrease taxes in order to stimulate domestic production.

**Table 4. Arrangements between Argentina and the IMF of 1991-2003**

	Date of approval	Date of expiration	Amount agreed (bln.SDR)	Amount drawn (bln.SDR)
SBA	7/1991	3/1992	0.78	0.44
Extended	3/1992	3/1996	4.02	4.02
SBA	4/1996	1/1998	0.72	0.61
Extended	2/1998	3/2000	2.08	0
SBA	3/2000	1/2003	16.94	9.76

[Edited by author. Source: IMF database]



Graph 6. [Made by author. Data source: IMF database]

### **1.6. Argentine sovereign default of 2001**

After 1999 the situation in Argentina deteriorated even more. Although the inflation rate remained very low, the recession caused the general stagnation in the domestic production, while the government was forced to cut the state spending on the wages. A result was regular social unrests and complete distrust of the people in the new president. Nonetheless, de la Rúa administration continued to implement an unpopular policy that was very similar to Menem's one. Presidential austerity plan was based on achieving balance in the governmental finances by even more significant cuts within spending and simultaneous increasing of taxes. Besides, Convertibility plan was decided to be kept, as the government believed that abandon of a peg would cause hyperinflation as it had already been at the beginning of the 90s.

At the end of 2000, the Argentine bond yields rose from 9% to 16%. As this source of foreign currency to the country became too expensive, the government began new negotiations with the IMF. In October both parties conducted new Stand-by arrangement to overcome existed recession and to support an economic program for next several years. The Funds stated almost the same requirements to the Argentine governments. It should have achieved balance in public finance, recovered GDP growth to a positive figure and implemented structural reforms within the national economy. In return, Argentina obtained about 7.2 billion USD what was almost equal to existed budget deficit in those times.

It is generally claimed that the Argentine crisis of 2001 was caused by an incredibly high amount of external debts (see table 4), that generally were owned by the central bank and the government, but also included private debt too. Yet in 1995 total Argentine debt was more than 100 billion USD what was equal to approximately 36% of GDP. The closer to 2000, the more this percentage was increasing. Thus a year before Argentina announced its sovereign default, total debt was 60% of GDP. In addition, we have already found that interest payments on the external debt was also huge and the country, for instance, had to repay more than 11 billion of USD for debt service in 2000, what was equal to almost 40% of Argentina's export. Indeed, debt burden was incredibly severe and the government was already unable to change the situation completely.

**Table 5. Argentina's total (public+private) external debt of 1991-2002**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
<b>Total external debt (bln.USD)</b>	71,5	70,2	78,5	94,1	103	115	112	132	146	187	181
<b>- to GDP (%)</b>	34,8	28,3	30,6	33,7	36,7	39,1	37,7	40,9	47,6	60,9	62,2
<b>-Interest payments on external debt (bln.USD)</b>	2,69	2,66	3,06	3,65	5,06	5,89	7,02	8,65	10,3	11,7	4,79

*[Edited by author. Source: World Bank database]*

In 2001 the government claimed that its earnings in foreign currency were not enough to repay both the loans and the current interests. Domingo Cavallo, who returned to the position of the minister of economy, implemented so-called 'Megaspwap', by which the government offered lenders to swap their current

bonds (of 52 different structures and maturity) to five new ones (see table 6), with longer maturity and less principal repayments for the period of 2001-2006. As a result, this plan was accepted by both the IMF and the majority of lenders.

**Table 6. Argentina's Mega-swap structure**

	<b>Old maturity</b>	<b>Interest rate</b>	<b>Swapped to</b>	<b>New maturity</b>	<b>Interest rate</b>
<b>USD bonds</b>	2002 and 2004	Floating	=>	2006	Floating
<b>Peso bond</b>	All maturity	Fixed and floating	=>	2008	Fixed
<b>USD bonds<sup>1</sup></b>	2007	Fixed and floating	=>	2008	Fixed
<b>USD bonds<sup>2</sup></b>	2009-2017	Fixed	=>	2018	Fixed
<b>USD bonds<sup>3</sup></b>	2019-2031	Fixed	=>	2031	Fixed

*[Edited by author. Source: IMF database]*

For the most urgent bonds in USD and with floating interest rate repayment due were just delayed to the year 2006, while bonds in peso, with both floating and fixed interest rate were swapped to the equal peso global bond with maturity of 2008. All the rest bonds in USD with repayment due in 2007, 2009-2017 and 2019-2031 were changed to the USD global bonds with fixed interest rate, maturing up in 2008, 2018 and 2031 respectively.

Nonetheless, due to distrust in the government and because of panic mood all over the country, the Argentine people began to withdraw peso deposits and to exchange them into hard currencies as this right was provided by the Convertibility plan earlier in 1991. To prevent outflow of foreign currency, Cavallo was forced to implement so-called 'fence', i.e. to freeze the majority of private bank accounts and to allow withdrawing an only small amount of money per one day.

The national economy of Argentina, however, continued to deteriorate and the government was unable to fulfill the requirements of the IMF program to get new financing. The Fund, however, reviewed the existed arrangement four times by changing the conditions and increasing an amount provided, but finally refused to disburse a consequent tranche of 1.3 billion USD in December 2001 claiming that the government failed to reach stated norm of the budget deficit. Finally, at the end of 2001 Argentina announced default on a larger part of its

public debts of approximately 132 billion USD. Convertibility plan was abandoned and the peso got floating exchange rate.

### **1.7. Conclusive explanation of Argentina's 2001 crisis**

Theories offer three generations of models to understand the origins of currency crises. Therefore for a clearer vision of Argentina's 2001 crisis, we shall define its particular features and relevant chronology, based on our preliminary analysis of the country's macroeconomic indicators and general observation of the government's behavior during the 90s. Although Argentina's 2001 crisis was a specific case, we can state that it contained signs of all three generations of crises.

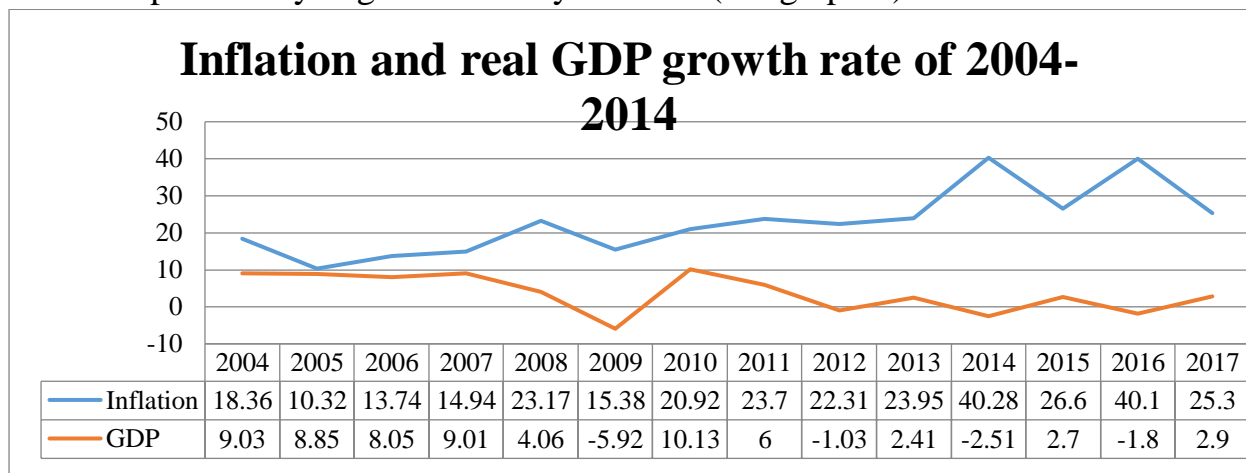
As we found out, there were several drivers for the crisis with a fixed exchange rate as a major one. On the one hand, the peg to the dollar cured hyperinflation, but on the other hand, it caused overvaluation of the peso and consequently led to the current account deficit. Simultaneously, the country encountered a huge fiscal deficit, while the national economy entered into recession after 1995. In so far as external debts were mostly denominated in foreign currency, it created a more severe burden on the governmental finances. Then devaluation of the currency in Brazil made the Argentine export completely uncompetitive.

Notably, the government did not issue money to cover fiscal deficit but instead asked for financial support from the international financial organizations. Investment flows to emerging economies, however, declined at the end of the 90s what caused lack of foreign currency in the country. Nonetheless, the outflow was not extremely huge as many investors believed that the IMF would rescue Argentina in a bad case. However, when the next tranche of the loan was not provided in 2001, the country announced sovereign default. After the peso got floating exchange rate, it devaluated significantly, while inflation rose to more than 35% in 2002. The country, however, left the recession soon and GDP growth rate became positive – up to 8% next year. The crisis ended and Argentina's national economy began to recover.

## **2.1. Intercrisis period of 2002-2009, technical default of 2014 and an introduction to the crisis of 2018**

Argentina's 2001 default attracted the attention of numerous academic researchers. As we mentioned above, debates about particular drivers of such sudden deterioration still exist. It is possible, however, to state that the crisis itself was caused by the overvaluation of the national currency, the enormous amount of both public and private debts and general incompetence of the government to manage the national finance properly.

In 2002 after peg was abandoned and the country defaulted on its external debt, it is stated that a peak of the crisis passed, but the country generally did not avoid some negative consequences. Argentina's international reputation on the financial markets worsened significantly, while the Argentine people still mistrusted both the government and the banking system. In May 2003 new president, Nestor Kirchner, was elected, winning over the revanchist Menem, who tried to retake his position again. In general, during the presidency of Kirchner, Argentina's national economy was slightly recovering. To check this, we analyzed inflation and real GDP growth rate for the period since Nestor Kirchner presidency began until the year 2014 (see graph 7).



*Graph 7. [Made by author. Data source: World Bank database]*

According to the data obtained, we can see that before the year 2008, Argentina's national economy rose by approximately 10% each year. Actually, such rate confirms a statement that the period of recession for Argentina passed. When the whole world faced the credit crunch crisis in 2008, the Argentine real GDP rose only by 4% and a year later the rate became even negative of about -6%. This was an exact consequence of global economic deterioration. Nonetheless, the country did manage to renew its economic growth by up to 10% in 2010, while one year later Argentina's national economy grew only by 6%. We can state that since 2012 the country entered a period of instability

again. Negative dynamics, however, had not been observed every year, as the real GDP growth rate fluctuated from a negative figure of -2,5% to a positive one of +3%.

As we have mentioned above, the problem of hyperinflation was the primary reason to establish and then to manage the convertibility plan during the 90s. After a peg of the peso to the dollar was abandoned, the inflation rate rose and then stayed high enough during the whole decade. The last bottom point of 10% was observed in 2005 and since the year it rose even more. The first peak of more than 23% was in 2008, the year of the credit crunch. Subsequent dynamics shows that inflation entrenched at a point of approximately 20% per year till the next peak of 40% in 2014.

Back to the year 2007, when Nestor Kirchner refused to run on the reelection for a new term and presidency was taken by his wife Cristina de Kirchner, who won the election with 45% of votes. New president implemented mostly liberal policies, enforced human rights, increased governmental financing on the healthcare and the science and subsidized poor and middle-class families. She is considered, however, to be more a populist leader than a reformer, as no really important structural reforms were developed under her presidency, while her administration was accused of corruption schemes. Nonetheless, Kirchner was reelected in 2011 with only 30% of votes. Since that year, as we found out, real GDP growth dropped significantly to be either negative of -1% in 2012 or positive of only 2% the next year. Cristina de Kirchner's presidency, however, is mostly considered with an incident of a technical default on sovereign debt in 2014.

As we have already mentioned, the mega-swap of the Argentine bonds that were implemented in 2001 delayed principal repayments but increased interest payments. A decade later, in 2010, it offered a new exchange of defaulted bonds, however, with 70% of 'haircut discount'. This unpopular decision was accepted by 93% of bondholders, while the rest 7% represented mostly by US hedge funds and leading by Paul Singer of Elliott Management refused to swap, but instead they demanded the full repayment of 832 million USD (UNCTAD 2014).

Renegotiations were not successful and an issue had been brought to the New York court. Finally, in the year 2014 Argentina was forced to default on this 7% of bonds. Generally, it is stated that the impact of the new default to the international image of the country was not that significant, as it was rather due to the president's inability to renegotiate with creditors than because of the collapse of the national economy. Nonetheless, it is important to take into

account this incident and its consequences for the national economy in our further analysis.

In November 2015 Kirchner's era ended, when Argentina elected a new president Mauricio Macri, the first non-peronist candidate since 1916. Indeed, the economic downturn was already obvious in those times, even though an inflation rate decreased from 40% to 26%. Downturn reemerged next year and the inflation rate rose to 40% again. Finally, in 2018 the government applied for financial aid from the International Monetary Fund.

The nature of the crisis is not fully clear, so it is necessary to make a relevant analysis of the principal drivers of the crisis as we did for the 2001 crisis. For this objective, we propose to conduct a research of relevant macroeconomic indicators and their dynamics with regard on the governmental policy during the period since the end of the active phase of the credit crunch of 2008, when the country was still affected by global economic deterioration.

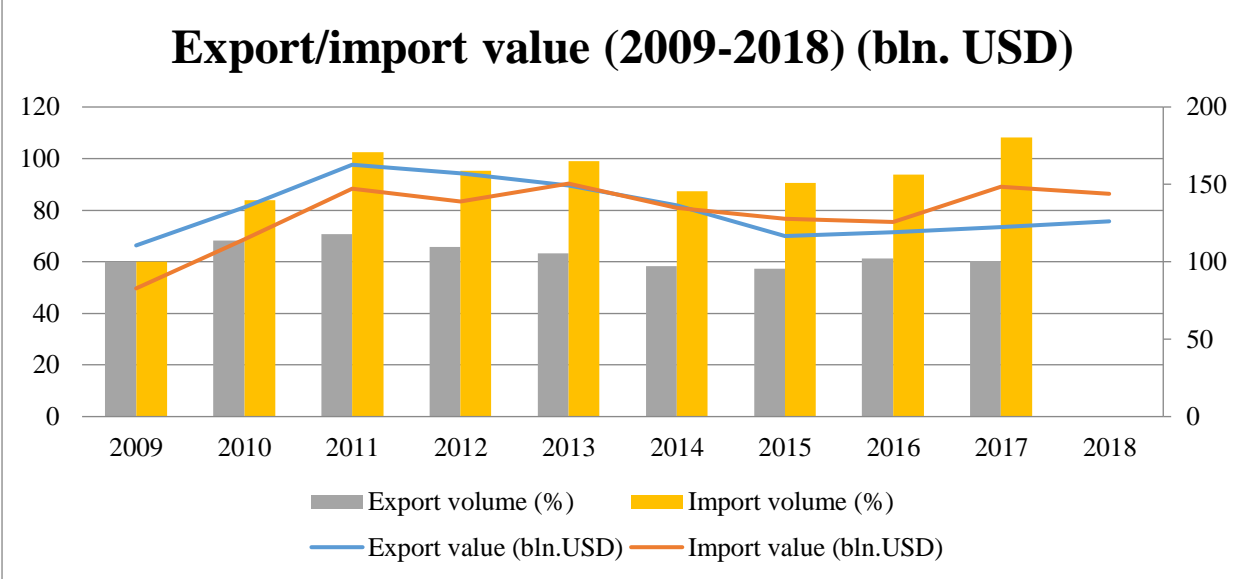
## **2.2. Trade balance of 2009-2018**

As it was mentioned above, one of the drivers for the 2001 crisis in Argentina was significant trade imbalance. In order to get a clear understanding if there was a similar problem during the period prior to the crisis of 2018, we analyzed the country's export and import, both in value and volume (see graph 8). First of all, we should mention that there were no significant changes neither within the main trade partners of the country nor in kinds of goods Argentina sells and buys.

Considering the value of Argentina's international commerce during the period of 2009-2018, we can see that the dynamics were more or less similar for both export and import of the country. Both indicators rose constantly for three years in a row to a peak in 2011 and then began to decrease. Notably, export value prevailed over the import's till the beginning of 2013, when the country entered to some sort of a balance in trade with, however, still negative dynamics according to the graph. When the new president took his position in 2015, import value already prevailed over the export's. For four years in a row, the situation did not change and the biggest gap between export and import was in 2016-2017. In the year 2018, the trade imbalance can still be observed.

We also paid our attention to the volume of Argentina's trade with recalculation the year 2009 as the baseline. According to the graph, we can see that, although the volume of export was increasing along with its value till 2011, subsequently it decreased. The most important point, in our opinion, is that in the year 2017 the country exported the same number of goods as it did 8 years ago. In contrast,

the volume of import almost doubled during the period, moreover the biggest part of the rise occurred at the beginning of the period. When in 2011 Argentina’s export volume increased by only 17% to the basic year, its import did the same increase by 70%. Finally, in 2017 the country imported 80% more than it did in 2009.



Graph 8. [Made by author. Data source: World Bank Database]

Then we recalculated main international trade indicators in percentages to Argentina’s GDP and checked its nominal growth rate (see table 7). First of all, it is necessary to mention that even though the value of export was increasing till 2011, its ratio to GDP contrary decreased during the whole decade. Yet in 2009 it was equal to nearly 20%, while in 2017 it decreased by half, to approximately 11%. Import remained more or less stable as it fluctuated within a range of 14-16% of GDP. However, it also fell after 2015 to be around 12% of Argentina’s GDP.

Considering the nominal value growth rate, it represents the same dynamics for both indicators. The most remarkable point is that the volatility of the country’s export was more severe. For instance, from 2009 to 2010 the value of import increased by almost 40%, while export’s – by only 23% and in 2015 when the import decreased by 5%, the export fell by 15%.

Finally, we looked at the trade balance of Argentina. As we have already mentioned, the export prevailed over the import till the year 2012, so the country had a surplus in international commerce. Yet in 2010, it was approximately 16 billion USD, what was equal to 5% of the country’s GDP, but in 2013 value of Argentina’s export and import was nearly equal, with the last one’s minor prevailing of 0,66 billion USD that was less than 0,13% of GDP. Since 2015

trade deficit is still observed each year, as the biggest rise was in 2016-2017 from 4 billion USD to a bit more than 15 billion USD. Finally, in 2018 it was equal to approximately 10 billion USD.

**Table 7. Argentina's international trade analysis of 2009-2018**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>GDP (bln.USD)</b>	333	423,63	530,16	544,98	552,03	526,3	595	554,9	637	-
<b>Export value (bln.USD)</b>	66,34	81,12	97,62	94,33	89,61	81,84	70,02	71,38	73,39	75,77
<b>- to GDP (%)</b>	19,92	19,15	18,41	17,31	16,23	15,55	11,77	12,86	11,52	-
<b>Export value growth rate (%)</b>	-	22,29	20,33	-3,37	-5,01	-8,67	-14,4	1,95	2,81	3,24
<b>Import value (bln.USD)</b>	49,68	68,78	88,42	83,39	90,30	80,94	76,62	75,42	89,00	86,34
<b>- to GDP (%)</b>	14,92	16,24	16,68	15,30	16,36	15,38	12,88	13,59	13,97	-
<b>Import value growth rate (%)</b>	-	38,44	28,55	-5,69	8,29	-10,37	-5,33	-1,57	18,01	-2,99
<b>Trade balance (bln.USD)</b>	16,65	12,34	9,20	10,94	-0,69	0,90	-6,60	-4,04	-15,6	-10,57
<b>- to GDP (%)</b>	5,00	2,91	1,74	2,01	-0,13	0,17	-1,11	-0,73	-2,45	-

*[Calculated and edited by author. Source: World Bank database]*

In conclusion, we can state that the first driver for the 2018 crisis, definitely, was in an international trade imbalance of the country and this is the common point for both crises of 2001 and 2018. Our analysis showed that Argentina suffered from trade deficit since 2015. This happened because both the value and volume of the import increased, while the export's decreased or remained almost the same.

As we found out, another economic problem of Argentina prior to the crisis of 2001 was a negative current account balance. Hence, after we analyzed the dynamics of the international trade of the country, we looked at its balance of payments statement (see table 8). The most remarkable point is that the current account balance was only positive in 2009 when negative interest payments were covered by a huge trade surplus. Since next year, the balance of current accounts went below zero and it continued to decrease every year. In 2015, when Kirchner's era ended, it was equal to -17 billion USD and during the next

two years, it even nearly doubled. Financial and capital accounts also were in deficit since 2010.

According to the data we obtained, we can see that in the year 2017 all indicators decreased suddenly and significantly. As a result, the balance of payments deficit became more than -60 billion USD what was equal to approximately 10% of GDP that year. As we found out above, Argentina faced almost the same deficit of 10% of GDP during the pre-crisis of the years 1997-1999. Hence, we can state that the negative balance of payments can be the second driver for the crisis of 2018, even though the deficit decreased to -40 billion USD this year.

**Table 8. Argentina's balance of payments analysis of 2009-2018**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Current account (bln.USD)</b>	7,25	-1,62	-5,3	-2,14	-13,12	-9,18	-17,62	-15,10	-31,60	-28
<b>-Trade balance (bln.USD)</b>	16,65	12,34	9,20	10,94	-0,69	0,90	-6,60	-4,04	-15,61	-10,6
<b>-Net interest payments and income (bln.USD)</b>	-9,4	-13,9	-14,5	-13,08	-12,43	-10,08	-11,02	-11,06	-15,99	-17,4
<b>Financial and capital account (bln.USD)</b>	6,79	-3,72	-5,19	-2,74	-16,13	-9,26	-18,45	-13,60	-31,13	-11,3
<b>BoP (bln.USD)</b>	14,047	-5,35	-10,5	-4,878	-29,256	-18,443	-36,068	-28,703	-62,732	-39,3
<b>- to GDP (%)</b>	4,22	-1,26	-1,99	-0,90	-5,30	-3,50	-6,06	-5,17	-9,85	-

*[Calculated and edited by author. Source: World Bank database]*

### **2.3. Governmental finance balance of 2009-2017**

The next stage of our research was an analysis of the governmental finance balance where we found several remarkable points (see table 9). First of all, we see that the governmental budget was in the deficit over the whole period and both revenues and expenses grew, however, with different dynamics. Yet in 2009, the deficit was -37 billion ARS what was equal to 3% of GDP and it fluctuated around this percentage next four years. After 2013, it began to increase significantly to a peak of 13% of GDP in 2015 when the new president was elected. Notably, this year the governmental expenses exceeded revenues by

almost two times. Even though the next ratio of budget deficit to GDP decreased to 11%, it still increased in nominal terms to approximately -900 billion ARS.

**Table 9. Argentina's budget revenues and expenses analysis of 2009-2017**

	2009	2010	2011	2012	2013	2014	2015	2016	2017
<b>Revenue (bln.ARS)</b>	148,7	230,2	235,1	283,1	372,5	546,8	741,6	850,9	2061,4
<b>Revenue growth rate (%)</b>	-	54,84	2,11	20,42	31,61	46,79	35,61	14,74	142,26
<b>- tax revenue (bln.ARS)</b>	115,7	162,1	208,2	254,7	307,0	423,1	524,8	626,6	1166,2
<b>- tax revenue (% to revenue)</b>	77,82	70,40	88,58	89,99	82,41	77,37	70,76	73,64	56,57
<b>Expense (bln.ARS)</b>	185,8	237,8	308,6	397,7	614,4	915,9	1529,0	1760,2	2588,6
<b>Expense growth rate (%)</b>	-	27,97	29,77	28,88	54,50	49,07	66,94	15,12	47,06
<b>Budget balance (bln.ARS)</b>	-37,1	-7,6	-73,5	-114,6	-241,9	-369,1	-787,5	-909,4	-527,2
<b>- to GDP (%)</b>	-2,97	-0,46	-3,37	-4,35	-7,22	-8,06	-13,23	-11,10	-4,99

*[Calculated and edited by author. Source: Instituto Nacional de Estadística y Censos de la República Argentina]*

In order to get a more precise understanding of the problem, we again looked at the dynamics of both budget's indicators over the period. In general, revenues rose less than expenses. The hugest difference is observed in 2013 - +31% of revenues contrary to +54% of expenses and in 2015 - +35% to 66% respectively. We also provide an analysis of fiscal revenues as a major part of the general revenues of the country. Yet in 2012 taxes counted for about 90% of government's income (see table 9). When Macri took a presidency in 2015, it is already decreased to only 70% and finally, in 2017 it became equal only to 56%, so the country became more dependent on external financing.

Thereby, we decided to check the structure of all governmental spending during the period of Kirchner's administration and the first years of Macri's presidency prior to the 2018 crisis (see table 10).

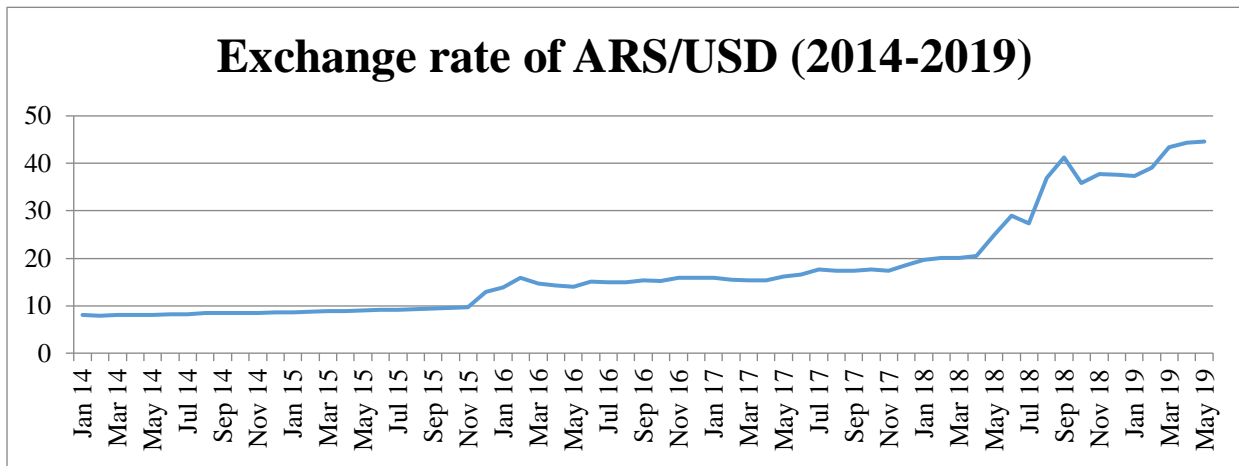
**Table 10. Argentina's budget expenses structure analysis of 2011-2016**

	2011	2012	2013	2014	2015	2016
<b>Total expense (bln.ARS)</b>	308,6	397,7	614,4	915,9	1529,0	1760,2
<b>Wages and social security (bln.ARS)</b>	68,7	91,3	122,9	173,9	239,1	305,1
<b>(% to total expenses)</b>	22,27	22,97	20,00	18,99	15,64	17,33
<b>Interest payments (bln.ARS)</b>	51,4	67,2	63,6	158,4	137,1	396,1
<b>(% to total expenses)</b>	16,66	16,89	10,35	17,29	8,97	22,50
<b>Transfers (bln.ARS)</b>	132,6	153,3	211,8	319,0	389,5	528,3
<b>(% to total expenses)</b>	42,99	38,56	34,47	34,83	25,47	30,01
<b>Other (bln.ARS)</b>	55,8	85,8	216,1	264,6	763,3	530,7
<b>(% to total expenses)</b>	18,08	21,58	35,18	28,89	49,92	30,15

*[Calculated and edited by author. Source: Instituto Nacional de Estadística y Censos de la República Argentina]*

The first remarkable point is that spending on wages and social security as a percentage to total expense decreased constantly but not significantly from 22% in 2011 to 15% in 2015. The similar but more significant dynamics is observed within governmental transfers as yet in 2011 their share was equal to almost 43%, while in 2015 it fell to 25%. Interest payments fluctuated over the period decreasing from 16% in 2011-2012 to 10% next year. The bottom was in 2015 when interest was equal to only 8% of total governmental spending, but a year later it suddenly rose to more than 22%.

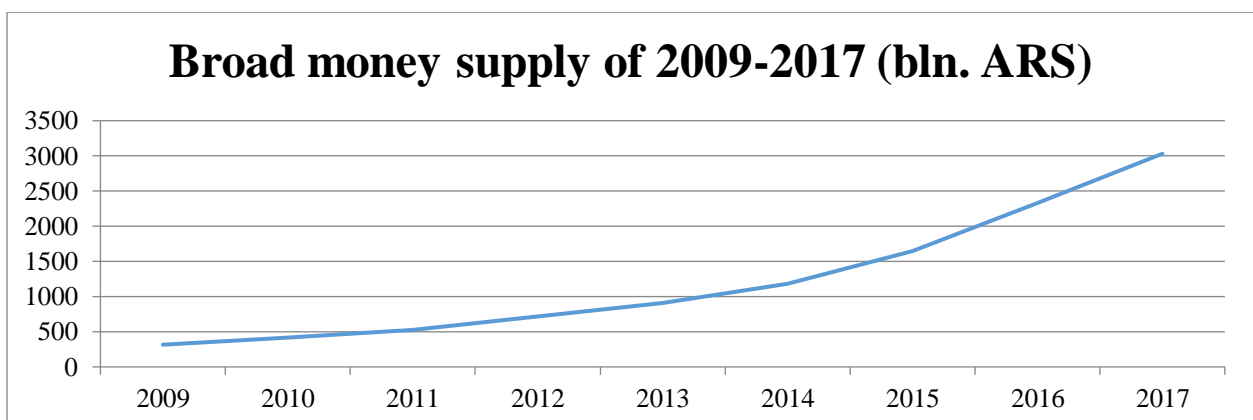
Insofar as the year 2015 was the most notable, with incredible prevailing of expenses over the revenues, we decided to analyze the structure of all governmental spending during this year more in details. It is obvious that the problem was in the group "Other expenses" as within the year they were equal to nearly half of all spending. More exactly, this happened because of the category of "Difference in the exchange rate". Hence, we paid our attention to the exchange rate of Argentina's peso (see graph 9), which became a floating, i.e. dependent on the market's demand/supply, after abandoning of the peg to the dollar in 2001.



Graph 9. [Made by author. Data source: investing.com]

Peso's exchange rate remained more or less stable till the end of the year 2015 when during two months of November-December it rose from 9 ARS/USD to 13 ARS/USD. Since that, it continued to slightly but constantly increase till spring 2018, during which the Argentine currency devaluated to approximately 40 ARS/USD.

In general, we found out that Argentina's balance of both international trade and the state's budget were negative, thus the government had to cover these deficits somehow. First of all, we analyzed the money supply of Argentina during the pre-crisis period (see graph 10). In general, we can see that it increased constantly over the whole period, especially after 2015, when the incredible budget deficit was observed. Therefore, the supply of money in Argentina rose nearly three times during this decade. Moreover, a year after Macri took the presidency, in April 2016, he initiated a record rise of external financing of 16,5 billion USD on the bond market (Hartley 2016).



Graph 10. [Made by author. Data source: National Bank of Argentina]

An important feature of the 2001 crisis was the incredibly high external debt of Argentina, thus we also checked its dynamics during the period of 2011-2018

(see table 11). We found out that public external debt rose over the period from 40% of GDP in 2011 to 56% in 2017. Next year its ratio increased significantly to enormous 86% of the country’s GDP. This fact, in our opinion, is the most remarkable, as we found out that even in 2001, the year when Argentina defaulted, its total debt, i.e. both public and private, was equal to approximately 60% of GDP.

**Table 11. Argentina’s public debt of 2011-2018**

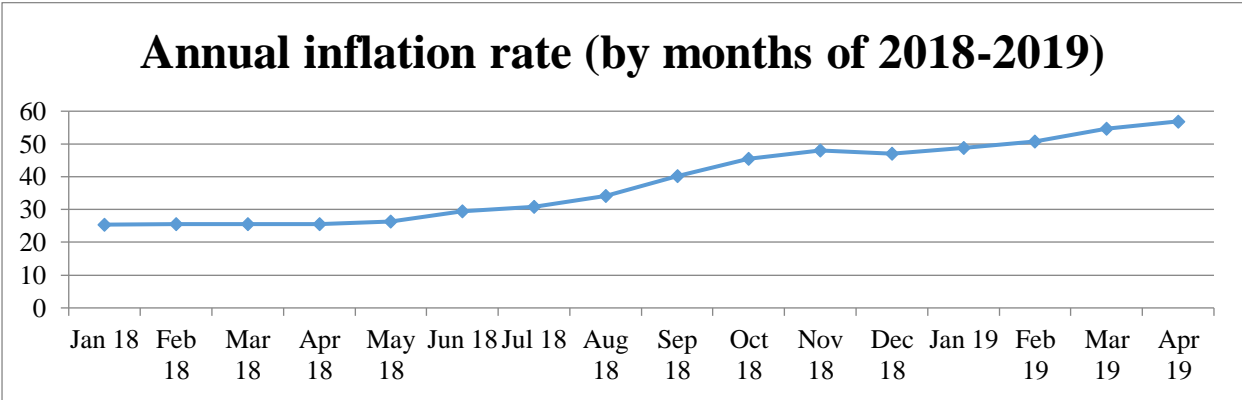
	2011	2012	2013	2014	2015	2016	2017	2018
<b>Public external debt (bln.USD)</b>	206,23	220,2	240,1	235,26	313	294,65	360,54	-
<b>- to GDP (%)</b>	38,9	40,4	43,5	44,7	52,6	53,1	56,6	86,2

*[Calculated and edited by author. Source: Instituto Nacional de Estadística y Censos de la República Argentina]*

After we conducted a research of the dynamics of Argentina’s main macroeconomic indicators during the pre-crisis period, it is necessary to analyze the signs of 2018 crisis and to restore the chronology of events that happened and are still happening till nowadays.

**2.4.Deterioration of 2018 and causes of the crisis of 2018**

First of all, we pay our attention to the annual rate of inflation and its dynamics by months of the years of 2018 and 2019 (see graph 11). Our analysis shows that inflation remained high enough, approximately 25%, but stable in dynamics till the month of April. Since May it began to increase constantly to the actual peak of 56% in April 2019.



*Graph 11. [Made by author. Data source: World Bank database]*

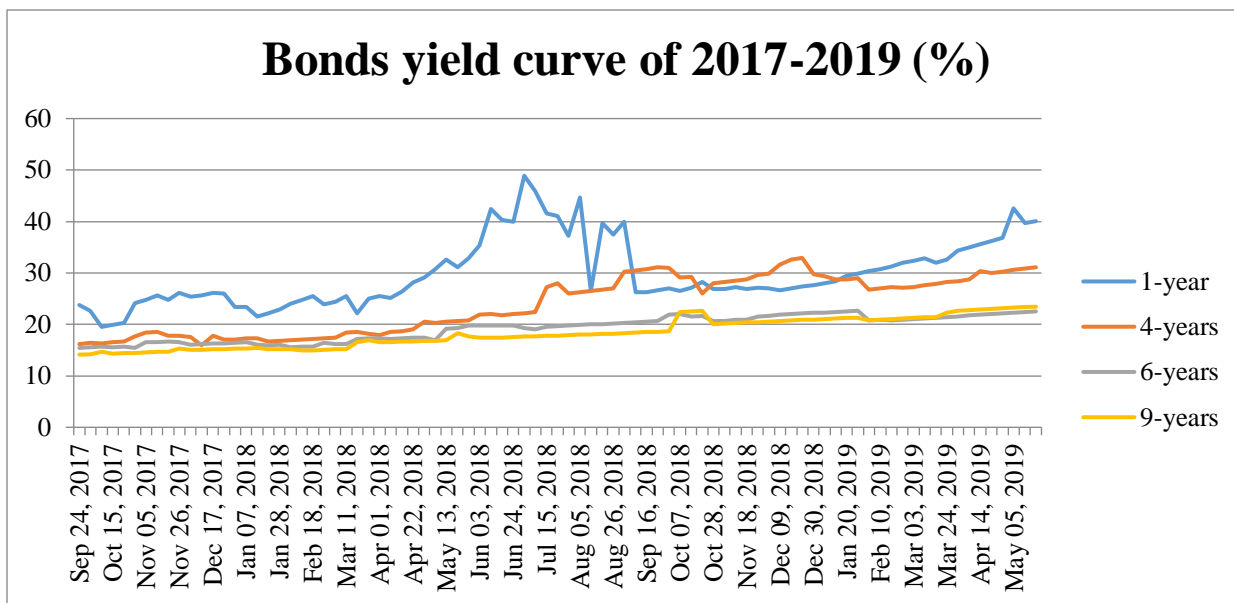
As we mentioned above, in May 2018 Argentina’s government applied for an urgent financial intervention from the IMF. Notably, the last arrangement

between the country and the Fund was conducted yet in 2003 and all respective debts were repaid yet in 2006, during Nestor Kirchner presidency. Hence, for 12 years Argentina avoided any financial contacts with the Funds, even during the period of significant current accounts deficit in 2013 or in 2015. One of the reasons for this was in general belief of the Argentine people that the severe dependency of the country on the IMF was one of the main drivers for the default in 2001. Hence, cooperation with the Fund would have meant a decrease of political ratings of the government.

Nonetheless, after several weeks of negotiations, on 20th of June, the IMF approved new Stand-by arrangement for Argentina of an amount agreed of 50 billion USD and with a right of immediate purchase of 15 billion USD. The Fund defined the main objectives to be achieved by the government under this arrangement. The first one considers implementing a new macroeconomic program in order to renew sustainable economic growth of the national economy and to reduce the budget deficit to no more than -1,3% of GDP by the year 2020. Indeed, as we found out, Argentina's real GDP growth rate fell significantly after 2012, while the government was unable to cover a severe budget deficit over the whole period. The other demands were related to a deficit in the balance of payments, high inflation rate and limiting Central Bank intervention on the financial market. Finally, the arrangement was conducted under requirements to increase social safety of the most vulnerable.

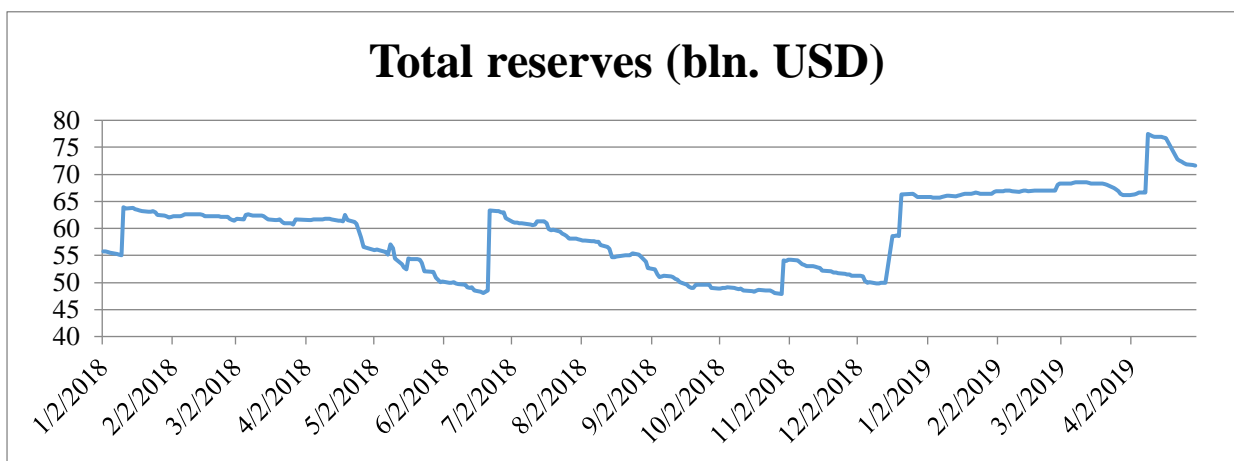
Actually, the Argentine government stated that the reasons to apply for support from the IMF were severe deficits in both: balance of payments and state budget, and, moreover, increased volatility on a bond market. Hence, we checked the dynamics of the yield curve of Argentine bonds of different maturity over the period since 2017 (see graph 12). Indeed, yet in winter yields rose, but the most notable increase began since April 2018.

Regardless of problems on the financial market and general worsening of economic indicators, the international credit ratings of the country remained stable. For instance, Fitch kept it at B, changing only its outlook from stable to negative in November 2018.



Graph 12. [Made by author. Data source: investing.com]

We also checked the dynamics of the official reserves of the country since the beginning of 2018 (see graph 13). In general, they decreased significantly in May-July 2018 but then recovered when the country received financing from the IMF. Reserves reached a peak of 77 billion USD one year later, just after the next tranche of funds was disbursed. Since that moment, negative dynamics reemerged.



Graph 13. [Made by author. Data source: National Bank of Argentina]

In addition, we also checked an official interest rate of the country. In April 2018 the government kept it at a point of 30,25%, but then aimed to restrain an inflation the National Bank of Argentina began to increase interest rate gradually, so in August it reached a point of 60% and in October 67,5% what was the highest rate all over the world (Le Monde 2018). Finally, in April 2019 it was equal to 70%.

Although in June 2018 SBA agreement was concluded, it did not bring any confidence to the market, as yields continued to rise. Moreover, the government did not manage to restrain inflation rate and it reached 40% in October contrary to 26% in May (see graph 11). Regarding general failure, on 26th of October, the IMF conducted the first review of the current arrangement, while the second occurred in December. The most remarkable point was that the Central Bank had been allowed to invent the currency market as peso's exchange nearly doubled since June (see graph 9). In as result, exchange fell to a point 37 ARS/USD and remained stable till January 2019, when it re-continued to rise. In April 2019 the Fund reviewed current SBA agreement for the third time and disbursed an additional 10 billion USD to Argentina, as we mentioned above.

### **2.5. Conclusive explanation of Argentina's 2018 crisis**

First of all, we should mention our conclusions about an analysis of the country's trade balance over the last decade. We found out that the value of Argentina's import prevailed over the export's significantly. The similar dynamics was observed a decade prior to 2001, but in those times it could be explained by an overvaluation of the peso. After peg to the dollar was abandoned in 2001 and an exchange rate of Argentina's national currency became floating, the country obtained an opportunity to use 'advantage' of devaluation. Nonetheless, trade balance went to a deficit mostly because the volume of import grew faster than the volume of export. In addition, the government also did not manage to keep the state budget in balance and in 2015 the deficit reached 13% of GDP. Contrary, an amount of external debts were not that severe until 2017.

Unlike a decade prior to the 2001 crisis, Argentina did not apply for financing from the IMF but instead raised it through financial markets and via issuing new money. Hence, inflation became an obvious problem when its rate reached 40% in 2016. The actions of the new government were generally ineffective and Argentina remained in recession. Finally, the government had panicked and commenced negotiations with the International Monetary Fund, just as the bond market began to volatilize severely and investors were leaving Argentina at the beginning of 2018. During less than a year, the Fund disbursed more than 25 billion USD. Nonetheless, no significant results are observed till this moment, as inflation continued to rise and the external debts became equal to 86% of GDP. The crisis is still evolving, so it is a bit early to make conclusions of when the country will manage to deal with the current deterioration.

Summing up, the main driver for the 2001 crisis was in the growing external debt and strict peg to the dollar, which led to a deficit in the balance of

payments. Similarly, the 2018 crisis is laid in a systemic deterioration of all economic indicators of Argentina, especially in the international trade and governmental budget.

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