



SOCIETY OF ACTUARIES

Article from:

# International Section News

August 2002 – Issue No. 28

# Argentina—An Update on the Economic Situation

by Jorge Noronha

## Introduction

The last article that I wrote on Argentina entitled “Argentina—Is a turnaround around the corner?” was published in the October 2001 issue. A number of events have happened since that have prompted me to write an update.

The country is now facing the worst crisis in its near 200-year history. Spontaneous movements all over the country brought down two presidents in December. The crisis has generated a whole new vocabulary—“cacerolazo” (pan-bashing protest), “escrache” (to publicly identify and protest against someone). There is widespread disdain for all politicians and there do not appear to be any leaders that have the necessary political leadership to pull the country out of its current mess.

The current economic chaos is only really a symptom of a deeper malaise—corruption, lack of judicial certainty—although nearly four years of recession brought on the problems. The end of the convertibility law (see below) has caused widespread chaos. Argentina has never been a popular country amongst its neighbors who are looking on with something approaching glee at their arrogant neighbor having a difficult time.

## Chain of Events

The last few months have seen Argentina default on its \$155-million public debt. Five presidents have been in power, although in effect only three are material as the other two were appointed for 48 hours, as required by the constitution to allow the congress to meet, debate and appoint a president. The convertibility law (mechanism that allowed the Argentine peso to be fixed at parity to the dollar) was abandoned. Since December 1st, savings accounts have been frozen. Dollar savings accounts have been turned into devalued pesos (at a rate of 1.4 pesos to 1 dollar) and depositors now face restrictions on how much they can withdraw from current accounts (generally known as “corralito”). All these changes caused a near banking collapse in January which limited the bank’s ability to operate. In late February the Government proceeded to free float the currency which caused the currency to go from the official rate of 1.4 to trade as high as 3.4 (as this article was going to press).

The IMF has insisted on very tough measures to repeal the bankruptcy law, ensure greater judicial certainty and require greater fiscal discipline. However the IMF itself is also to blame for having ignored, or permitted, structural fiscal imbalances and dubious governmental practices over the past decade.

Let us look at the impact of each of the changes on the financial environment.

## Macro-economy

The economy has ground almost to a halt. What was a recession is now a full-scale slump. Deflation turned overnight into rampant inflation. The chain of payments between consumers and supplier has broken down. There are now wide shortages in anything from imported wines to emergency medical supplies. While last year the prediction was that the economy was due to expand in 2002, the current prediction is of contraction in the range of 10 to 15 percent.

The Big Mac index which stood at 2.5 dollars in December of 2001 is now worth 0.78 dollars (May 2002) which would make it one of the cheapest countries in the world. This shows



that at the current level, the Argentine peso is significantly undervalued.

### **Privatized Social Security Pensions Market (AFJP)**

AFJPs have traditionally invested 50% of their assets in public debt which was previously dollarized. These instruments have recently been expressed in peso terms showing an apparent appreciation (as they were converted at 1.4 to 1). However in dollar terms, these investments are now worth one-third of their previous value. Proposals are still being studied to maintain the assets in the currency they were invested in, although I am skeptical that anything will come of it. Retirement annuities have been suspended since January to prevent a loss for the member due to the inability to obtain the true value of the retirement account. Disability and death annuities continue to be processed.

A recent proposal is being put forward allowing contributors to the private pensions to switch back to the government-run pensions scheme. This is a surprising event given the lack of distrust of government institutions. Other proposals such as suspension of AFJP contributions are also being studied to allow reforms to the current provisional system to take place and provide some needed relief to individuals. It is important to note that only 30% of AFJP affiliates currently contribute to the private system.

### **Banks**

The loan portfolios of banks have been converted at 1 to 1 while their dollar-based liabilities have been pesified at 1.4 to 1. The government is supposed to compensate banks for the loss but no formal proposal is in place. Few banks have the liquidity to sustain continued bank runs, and some banks have announced their intention to exit the market (e.g., Scotia Bank).

The current control on bank deposits is the only thing sustaining the solvency of the banks. Once controls are lifted, depositors will rush to get their savings back and convert them back to dollars. This will undoubtedly lead to the crash of the peso de-facto adoption of the dollar.

The control on bank deposits has been declared unconstitutional, and thousands of depositors have gone to court to try to recover their deposits. Some have been successful while others await their turn in court.

### **Insurance Companies**

Insurance contracts were previously expressed in dollar terms, although they were paid and cancelled in pesos at one to one. Insurers, assets were largely invested in government bonds which now have gone into default. A new law decree has been issued requiring insurers to submit a "restoration of financial health" plan to the Superintendent of Insurance within the next 180 days.

In the meantime, insurers have applied different practices. Some have converted the contract to pesos at 1 to 1, consistent with current legislation. Others have converted dollar contracts at 1.4 to 1, based on the previous official dollar exchange rate. A third group (small number) has chosen to express the contracts in dollars with both benefits and premiums being paid in pesos but at the equivalent floating exchange rate.

The Superintendency is still studying how to convert and return dollar based investments in dollars provided they are kept with the insurer for a number of years and subject to decreasing surrender charges.

### **Conclusion**

Events are moving so quickly that by the time this article is published, it will already look like an amusing historical footnote. It is unclear whether the current President Duhalde has the necessary political support to continue in office until September 2003 when elections are scheduled to be held. It is also unclear whether he has enough political power to comply with IMF requirements which are a necessary evil if Argentina is to get additional financial assistance.

Given all these changes, it is difficult to remain positive, but we have to look at the fundamentals—countries do not disappear. When Argentina recovers from the mess it is currently in, it could conceivably have the most transparent and renovated political system in the whole region with very little tolerance for corruption. There are certain parallels with the Tequila and Samba effect that impacted Mexico and Brazil. Both countries have been able to recover from it and so will Argentina.

For those who are interested in finding more details about the situation in Argentina, a case study on Argentina will be presented at the fall meeting in Boston. □

---

**Retirement annuities have been suspended since January to prevent a loss to the member due to the inability to obtain the true value of the retirement account. Disability and death annuities continue to be processed.**

---



*Jorge Noronha is a Fellow of the Society of Actuaries and senior consultant for NMG Financial Services Consulting in Latin America. He can be reached at Jorge.Noronha@NMG-Group.com or by phone at (54 11) 4776 5022.*