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How Argentina's Evolving Economic Crisis Unfolded

The country's inflation rate has skyrocketed and stocks have been pummeled as foreign investors flee

By Julie Wernau and Ryan Dube
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As rising U.S. interest rates and the dollar's resurgence ripple through emerging markets, Argentina has been among the countries most-punished by investors. The rout, sparked by concerns that those relying heavily on dollar borrowing will feel the most pressure, has left investors saying the country must pass a sustainable budget and communicate a coherent economic strategy that goes beyond calling on the International Monetary Fund for support.

On Monday, Finance Minister Nicolas Dujovne announced measures aimed at regaining investor confidence by reducing the primary fiscal deficit to 0% of GDP in 2019 from a projected 2.6% this year. That will involve implementing a tax on exports, cutting the number of ministries, and reducing spending on public works projects and the government's payroll, moves that will be politically risky as Argentina heads into an election next year.

How the Crisis Unfolded

Argentina's currency is reeling and its interest rates have been raised to 60%, pummeling investors who piled into the country in recent years after it cured a longstanding debt default.

Confidence in Argentina began to wane after the government increased its inflation target in December, raising questions among investors about the independence of the central bank. That uncertainty was compounded when the central bank cut its interest rate in January, despite inflation being well above the new target range. With pressure increasing on the peso, the central bank began to dip into its reserves to support the currency, selling $1.47 billion on April 25, the biggest intervention in the spot market in years. That had little impact, however, and over the course of eight days the central bank unexpectedly raised its interest rate, pushing it to 40% in early May.

To stem the currency crisis, President Mauricio Macri sought financial support from the IMF. In June, the government and IMF agreed to a $50 billion credit line, while the central bank president, Federico Sturzenegger, resigned and was succeeded by Luis Caputo. While the move was initially supported by investors, Argentina's peso continued to depreciate amid a rout in emerging-market currencies, making payments on the country's foreign debt more expensive. Catching investors by surprise, Mr. Macri last week went on TV to request that the IMF speed up disbursements of the bailout package to cover next year's debt payments, causing the peso to plummet even further and the central bank to raise its interest rate to 60%. This week, Mr. Dujovne plans to meet in Washington with the IMF to request the funds after announcing spending cuts and new taxes.

Heap of Trouble

Beginning in 2016, Argentina rapidly took on debt to reinfuse capital into a beleaguered economy to finance a gradual approach to unraveling the free-spending policies of Mr. Macri's predecessor, Cristina Kirchner. That approach—known as gradualism—was intended to avoid social unrest as a result of steep spending cuts.

But investors say the government delayed unpopular fiscal tightening measures that would have made Argentina less reliant on outside capital.

Mr. Macri's popularity is sinking amid soaring inflation and an expected economic recession. His government's austerity measures are politically risky ahead of next year's election as Argentines are already upset about higher utility prices and opposed to new taxes, while powerful unions will oppose cuts to government jobs.

Argentine stocks have been pummeled as foreign investors flee.

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