

ARGENTINA: END OF THE ADJUSTABLE BOND FESTIVAL

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THE ARGENTINE GOVERNMENT HAS ANNOUNCED THAT IN THE FUTURE IT WILL ISSUE DEBT ONLY IN DOLLAR VALUES AND NOT IN PESOS ADJUSTED BY THE CER INDEX.

To deflate inflationary pressures and the overheating of the financial market, the Argentina government has announced that in the future it will issue debt only in dollar values and not in pesos adjusted by the CER index (one of two indexes used to adjust “pesoified” debts for inflation). The announcement was made in the middle of an inflationary spiral that could go beyond control considering the October mid-term elections.

When Minister of Economy Roberto Lavagna made the

announcement to the business sector, he obtained their immediate support. The sector confirmed that the adjustable bonds were one of the main reasons for the increase in market interest rates, which are thereafter translated to costs and then to prices. The government agreed.

The decision seems, for the time being, to “dolarize” the debt, an abrupt departure from the original Lavagna plan of “pesoifying” the Argentine debt to match revenues with expenses in the same currency. But the implications of this policy change are vast, beginning with a progressive revaluation of the peso that would make Argentine exports less competitive.

The Minister of Economy has also announced that the government will

resort to all measures to avoid the increase in internal prices. He said that exporters should sacrifice part of their exports in order to supply

THE ARGENTINA ECONOMY MAY BE ENTERING INTO A VICIOUS CYCLE: AS MORE DEBT IS ISSUED IN PESOS, FOREIGN INVESTORS ARE MORE INTERESTED IN BUYING IT SINCE THEY CANNOT OBTAIN ELSEWHERE THE 15% RETURN THAT ARGENTINA IS OFFERING TODAY.

the internal market and thereby reduce internal prices by the increased offering of products in the market, an idea not well received.

Those close to the Minister believe that the economy may be entering into a vicious cycle: as more debt is issued in pesos, foreign investors are more interested in buying Argentine debt since they

NEVERTHELESS, THE CB HAS JUST ANNOUNCED THAT IT WOULD ISSUE LEBAC ADJUSTED BY THE CER INDEX, A POSITION REJECTED BY THE MINISTRY OF ECONOMY.

cannot obtain elsewhere in the world the 15% return that Argentina is offering today. This flow of funds is adding more pressure to revalue the peso and consequently oblige the Central Bank (CB) to print more

local peso currency to lower the peso rate. This pushes prices up and affects the Treasury. The original strategy of issuing debt indexed to inflation was possible with a 5% annual increase but not with a 15% inflation rate as forecast for this year.

Since adjustable bonds have been released, inflation is up to 12%—which implies an increase in the public debt of \$5.421 million—only as a result of the CER clauses. If instead the debt had been issued in dollars, the total debt would have fallen \$922 million due to the peso's appreciation.

The new decision implies a total revision of the CB bond placement program instrumented to regulate the increase of the monetary base.

As a result, the CB withdrew a tender to replace almost \$750 million in Lebac (Las Letras del Banco Central) and Nobac (Los Notas del Banco Central) that matured a week after the announcement. Instead, it decided to join the position of the government by suspending the issuance of Lebac and Nobac adjusted by the CER index. Nevertheless, the CB has just announced that it would issue Lebac adjusted by the CER index, a position rejected by the Ministry of Economy.

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¹Joint Committee on Taxation, "Description of the Tax Technical Corrections Act of 2005" (JCX-55-05), July 21, 2005 ("TCA").