Argentina & the Next Global Financial Crisis

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On August 12, 2019, financial markets in Argentina crashed. The stock market contracted 38% in just one day. The currency, the Peso, fell 20% after falling as low as 30% and recovered to 20% only when Argentina's central bank raised its interest rate to 75%. Watch next for bond prices, both government and corporate, and especially dollarized bonds which Argentina has loaded up on in recent years, to freefall as well.

What's going on in Argentina? What's likely to happen next? And what do the events in Argentina have to do with falling financial asset prices—i.e. stocks, currencies, derivatives, commodity futures, real estate prices, etc.—now underway globally as well?

The precipitating cause of yesterday's crash in Argentina stocks, peso, bond rates, etc. was the primary presidential election results over the weekend. The election was a preview for the general election that will happen this October. Macri, the current president, a businessman whose election in 2015 was assisted by US interests, lost heavily to his challenger, Alberto Fernandez. Fernandez got 48% of the vote; Macri only 32%. A gap that is likely insurmountable for Macri. It's almost certain now that Macri will now lose in October. That prospect has global bankers and investors quite worried. For Fernandez is associated with the Kirchner government that held office prior to Macri from 2002 to 2015, and that government refused to pay US hedge funds and other investors the exorbitant rates on Argentina bonds they demanded ever since the last crisis in 2001-02.

The US media and business press today expressed deep confusion over the weekend's political results. They just can't understand how Macri could have done so poorly in the primary. As the talking heads put it, 'Macri's been putting the economy in order', why did he lose so badly to Fernandez?

But all the perplexed 'talking heads' in the US media needed to do was to look at the facts: Inflation has been running at 56% per year, one of the highest in the world. The pundits say Macri has done well, bringing inflation down from 70% in 2018. But annual inflation rates, whether 56% or 70%, have been devastating real incomes of workers and small businesses. The currency has also been collapsing for two years now, having fallen from an exchange rate of roughly 16 to the US$ in 2017 to 52 to the dollar, after hitting a 60 to the dollar low yesterday. That falling will almost certainly continue in coming weeks. And with the 20% collapse of the peso this past weekend, inflation will now accelerate even faster once again.

Add to that the Argentine real economy has been in recession, contracting the past four quarters on average by more than -5%, with unemployment officially at double digit levels and likely much higher. Industrial production has fallen nearly -10% over the past 12 months, with manufacturing double that, at around -20%.

In other words, living standards have been falling sharply due to both accelerating inflation and chronic double digit job loss for the vast majority of workers and small businesses ever since Macri took office in 2015 and instituted his austerity reforms demanded by the IMF. That austerity has included cutting pensions, slashing government jobs, raising utility costs, eliminating past household subsidies. A third of all Argentina households now officially live in poverty. Is it any wonder then that Argentinians expressed their discontent in the primaries this past weekend? US business media and pundits of course don't choose to look at this human cost of US neoliberal policies and its corollary of Argentina austerity. For them, it's just about whether Argentina continues to service its debt to global bankers and whether the stock market in Argentina, the Merval, continues to produce capital gains profits for investors.

But wait. Didn't Argentina recently receive a record $56 billion loan from the IMF? Isn't that boosting the economy? No, it isn't. Because the $56 billion is not going into the real economy. So where is the $56B IMF loan going? It's going to pay the debt that Argentina owes to global bankers and investors, including the 'vulture capitalist' hedge funds, who Macri welcomed back in 2015 after he took office.

The IMF never gives money to a country to spend on stimulating its real economy. Quite the opposite. It extends loans with the condition that the country introduces austerity measures that reduce government spending or raise taxes. So what if that does the opposite—i.e. slows and contracts the real economy. That's not its objective.

The IMF officially says it lends money to help stabilize a country's currency. Translated, however, that means lending with the understanding the country first pays off foreign investors to whom it owes money. In fact, IMF loans never even get routed directly to the country. The IMF loan goes directly to paying of principal and interest to the investment banks, hedge funds, and billionaire 'vulture capitalists' who get the country indebted in the first place. The IMF actually pays them off and then send the 'bill' to the country for repayment—i.e. payment of the principal and interest on the debt it owes the IMF now instead of the private investors. And the debt payments are made with the money extracted from austerity programs levied on workers and the real economy. The IMF is thus the bill collector for big finance capital, and transfers the debt owed from their private investor and banker balance sheets onto its own IMF balance sheet.

The IMF recently loaned Argentina the largest amount it has ever loaned a country, the $56 billion. But it wasn't the first time it did so. In 2001, caught in a recession that originated in the USA, Argentina couldn't repay interest on the $100 billion debt it had incurred with private investors in the late 1990s. The IMF stepped in and did its duty. It loaned Argentina money to bail out the private investors. But some of them—led by hedge fund US billionaire Paul Singer—didn't think the IMF loan terms didn't pay them enough. Singer and his consortium of vulture capitalist hedge funds kept demanding Argentina pay more. The dispute went on until 2015, when the pre-Macri government was replaced by Macri, an election engineered with the assistance, financial and otherwise, of the Obama government on behalf of Singer and his buddies.

The first thing Macri did when he took office was to pay off Singer and friends the full amount they were demanding since 2001. Where did he get the money for that? From the IMF of course, which loaned Argentina the $56 billion. The payoff also opened the door for Macri & his business friends to get more private loans from US investors. They immediately trotted off to New York, met with the US bankers, and came back with a bag full of private loans. In other words, they loaded up on more private investor debt after 'borrowing' from the IMF to pay off the old private investor hedge fund debt.

So how is it that Macri—with big loans from not only the IMF but from New York bankers as well—couldn't get the Argentina real economy back on its feet the past four years? The IMF money went directly to the hedge funds and vultures. But where did the new private money go? It certainly didn't go into the real economy—i.e. investment, jobs, household income for consumption, and thus GDP. Likely it's been skimmed off the top by Macri and his friends in part. The rest diverted to financial markets in Argentina, in the USA, or Europe.

Despite the nearly $100 billion in capital provided by the IMF and New York investors, the Argentina economy has performed poorly ever since Macri took office. In 2016 the Argentina economy contracted. It recovered briefly and slightly from recession in 2017. But in 2018-19 it has fallen into recession once again, this time more deeply as its currency has collapsed, from 16 to the dollar to more than 50 to the $US—with more collapse to come. The loans it arranged since 2015 from New York investors, moreover, have been heavily denominated in US dollars. Argentina has one of the worst run-ups in dollarized private bond debt in the world. That means as the US dollar rises the cost of making payments on that debt also rises.

Not only is the prospect of default on the IMF $56 billion debt in the near future now rising, but the parallel default on corporate debt is also rising. The value of a US dollar denominated bond dropped since last week to 58 cents on the dollar, from 77 cents. Defaults are on the horizon, both government and private, in other words.

The peso's precipitous collapse also has further 'knock on' negative effects that are now intensifying the crisis in the country. Here's how: As currencies fall in relation to the dollar, what happens is capital flight accelerates from the country. That reduces investment further in the country, in turn exacerbating the recession and layoffs even more. To slow the capital flight from the country, its central bank then typically raises interest rates dramatically. Argentina's central bank benchmark rate is now an amazing 75%. Rising domestic interest rates further slow the real economy. In turn, the slowing real economy results in domestic stock and bond markets collapsing further—thus feeding back into the financial sector and making it even more unstable and driving financial asset price deflation even more.

What results, in other words, is a negative feedback effect between all financial markets in the country, an effect that dries up the availability of credit in general forcing more layoffs and a deeper recession. That's what is going on now in Argentina.

But Argentina is just the leading edge of a similar general process of global financial asset price deflation. Argentina is just an intense example of financial asset markets declining everywhere globally. And in that sense its current financial and economic collapse may be the harbinger of things soon to come.

USA and other emerging market economies' stock markets are now contracting sharply since the beginning of August. The 20%-30% decline of US stock markets last November-December 2018 has resumed. We are beginning to see November-December 2018 events déjà vu all over again. The 2018 stock market contraction was halted temporarily by the US central bank, the Fed, capitulating in late December to Trump and financial interests demanding the bank stop raising interest rates. The Fed halted raising interest rates in January 2019 and both US and emerging market economies' financial markets regained their losses in the first quarter 2019. Aiding the halt of rate hikes by the Fed was the appearance of an imminent agreement between the US-China on trade, as negotiations resumed between February to May 2019, which also helped to restore stock market losses of 2018.

But two events happened in late July-early August 2019 that have resulted in stock and other financial markets resuming their trajectory of decline of last November-December 2018: the US Federal Reserve cut rates on July 28 by only a token 0.25% when financial markets expected more aggressive action by the Fed; and Trump a day later scuttled the prospect of a trade deal with China by raising more tariffs on $300 billion of China imports. Add to these two events the rise of Boris Johnson as the new UK prime minister and the almost now certain 'hard Brexit' coming after October 2019; evidence of German and Italian banks increasingly in trouble; and central banks around the world in a 'race to the bottom' to cut their domestic interest rates to lower their currencies exchange value to boost exports as global trade stagnates—now growing at only 0.5% annually and is about to contract for the first time since the 1930s.

Together, all these current events have translated into investors worldwide selling their stocks and other financial assets, and diverting the money into 'safe havens'—like US Treasuries, the Japanese Yen, and gold. Argentina's economic mismanagement by Macri has occurred in the context of a global financial asset deflation that only exacerbates Argentina's crisis—and makes it increasingly difficult to deal with by Argentina alone, notwithstanding the record $56 billion IMF loan.

Look around. The global economy is on the precipice of a potential financial asset market price deflation not seen since 2008. It's not quite there yet. But the momentum is now clearly in that direction.

Not only have stock prices globally contracted sharply worldwide in just a few weeks, but so too have other financial market prices:

Government bond interest rates are falling rapidly everywhere in the advanced economies. More than $15 trillion in bonds globally are now yielding negative rates. Trillions of Euro bonds are now in negative territory, up more than a $trillion in just the past year, including in Germany, and are continuing to fall further. Currencies are also contracting everywhere (driving up the value of the US dollar). Property prices are leveling off, and have begun to drop. Global oil futures, a financial asset, have fallen 20% again, from $75 a barrel to the low $50s and may soon to fall below $50. The same for many other commodities.

Financial asset prices are deflating across the board and investors are dumping them and converting to cash—i.e. a sure sign of pending global recession. What's rising in price are the 'safe havens' into which the cash is flowing: gold, the Yen, US Treasuries, high end residential properties in select markets in the advanced economies, art works, and even cryptocurrencies. Also rising sharply is the cost of insuring bonds with credit default swap derivatives. In Argentina the CDS cost has accelerated to $38 for every $100 of Argentina debt, and that's in addition to regular debt principal and interest payments.

But Argentina is just the 'worst case' scenario of this global financial asset deflation underway. Its financial asset prices are deflating faster and deeper than others at the moment. It is just the worst case of a more general scenario emerging globally. Global trade volumes have already collapsed, and a recession in the global economy will necessarily follow. Global manufacturing is already in recession. And a global recession tomorrow will only exacerbate Argentina's current recession today.

Argentina today is therefore likely a harbinger of things to come, i.e. the canary in the global economy coal mine, and the victim of a 'made in the USA' global slowdown driven by Trump trade and US monetary policies. Of course, Argentina's economic crisis can't be explained alone by US government policies. Macri's austerity and loading up again on private foreign investor debt and IMF loans since 2015 is also responsible. And Macri's recent austerity policies to pay for that debt by cutting more pensions, social subsidies, raising utility costs and taxes on households has contributed heavily to Argentina's current crisis. But that debt and austerity too can be traced back to US vulture capitalists and their friends in the IMF and among New York bankers.

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