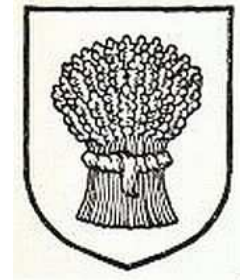


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# HALLGARTEN + COMPANY

Country Coverage

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## Argentina: Dollarisation : On the Cusp

### March 2024

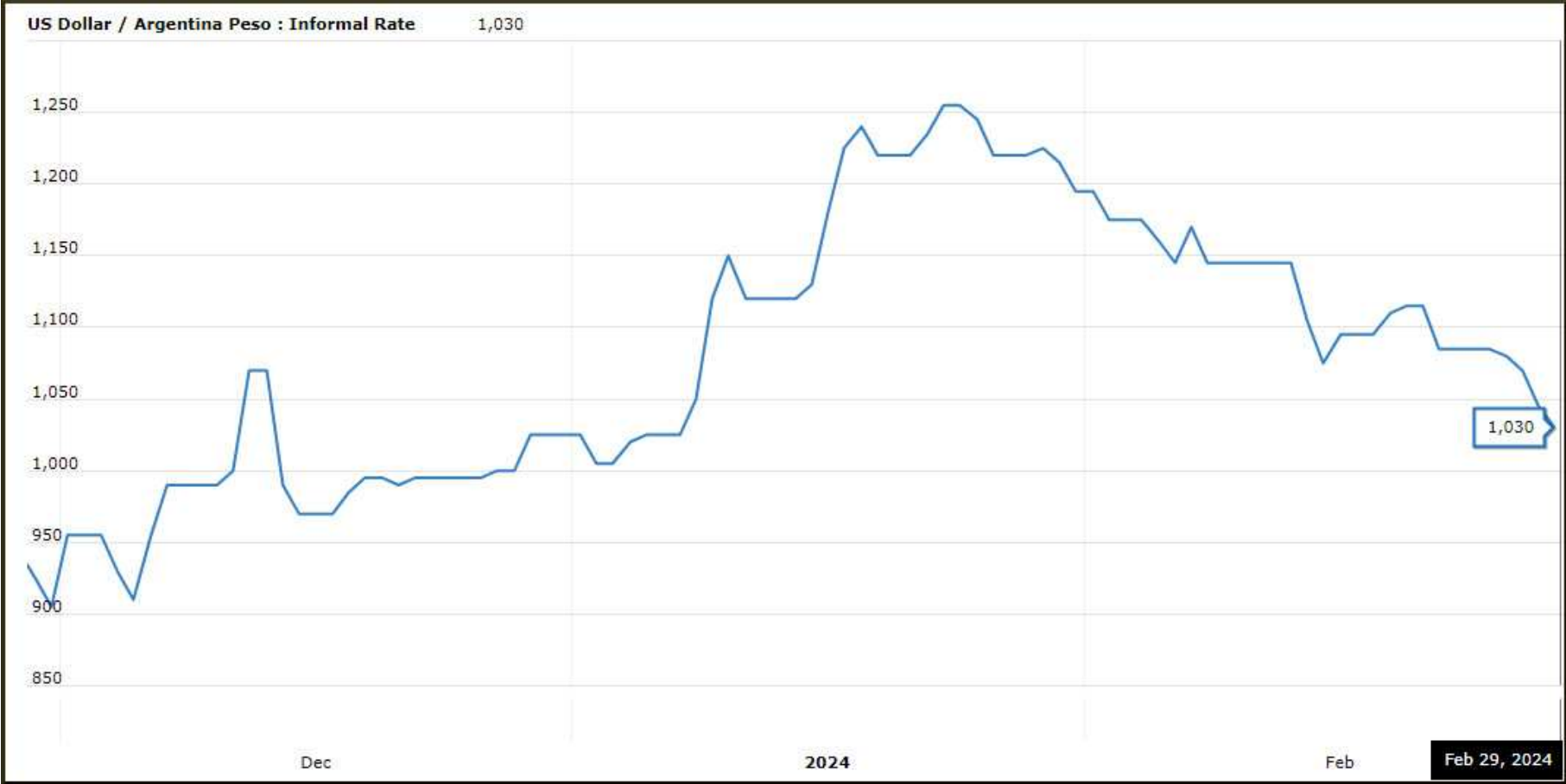
# Argentina

## Dollarisation: On the Cusp

- + Dollarization seemed to go on the backburner with the horse trading over ministerial positions between the under-powered Libertarian faction and the PRO forces in Congress
- + Eight weeks into power and Milei seemingly has been able to convert a hemorrhaging budget situation into a surplus
- + By reducing the number of pesos in circulation he has forced the middle and upper classes to disgorge their stashed dollars to sustain their lifestyles while the Banco Central has been a steady buyer of dollars as these groups sell dollars to pay for their summer vacations
- + The parallel dollar (the so-called *dolar blue*) ended February at \$1030, a hair's breadth away from what we view as parity and the likely dollarization tipping point
- + The situation for the peso is best summed up as "more buyers than sellers"
- + The stock of US dollars has risen by US\$8.315bn since the inauguration, taking total holdings in international reserves to US\$27.5bn as at the 27<sup>th</sup> of February
- + The Chinese initially tried to blackmail Milei over the line of credit and this failed miserably
- + The US government, believing erroneous and ignorant press comment that Milei was a cryptofascist, sent only third-line officials to the inauguration now, belatedly, Blinken has appeared on Milei's doorstep
- + The IMF perversely has found it hasn't needed to come in with its cudgels, but has found Milei already applying IMF tenets without external urging
- ✗ The Omnibus Reform Law sent to the Congress was largely defeated due to a rather ham-fisted handling of the issue without a Congressional majority
- ✗ Inflation romped in December in the expectation of a currency collapse, and instead the currency has strengthened, with the result that Argentina has going from being "cheap" to being "expensive" in fairly short order, now deflation is needed

### Decisions, Decisions

To dollarize, or not to dollarize, that is (not) the question. If anything has become event from the first days of the Milei regime is that the man is somewhat like his rather fierce looking dogs in that when he has a bone, he is not going to let go of it. Thus, while dollarisation has gone from the front pages, it has by no means gone from his agenda. Margaret Thatcher, one of Milei's role models, was known for her statement that "The lady is not for turning" and this is very much his approach. While he may turn down the volume on an issue he will suddenly return to the attack from another direction.



While Argentine politicians usually measure success by what they get out of it personally, Milei is measuring his success in economic measures, of which a whole swathe (except inflation, thus far) have been going in his direction. While the public may not be seeing the feathers in his cap that he sees, he wears his plumes with pride and the two that matter most to him are the budget deficit (now dearly departed) and the dollar exchange rate (with the peso strengthening by the day). Businesses may not have “got the memo” but the belief from on high (and us) is that the price hikes by supermarkets and many other businesses in December are ultimately unsustainable as the public stage a buyer’s strike, mainly because they don’t have money to buy at prices that are now 50-80% higher in dollar terms than they were when Milei assumed office.

The thumbscrews are out, and it is the public applying them to businesses, not the government.

Meanwhile, the budget deficit is not catching the public imagination but is being noticed far and wide, internationally. We have even seen calculations of what the US deficit would look like if the same *volte face* could be achieved in Washington. This is bordering on the embarrassing when Argentina is seen as a paragon of fiscal virtue.

*Sotte voce* underneath this noise is the activities of the much-maligned Banco Central (BCRA). While its death sentence has been written, it has not yet been signed. It clearly as its remnant uses and one of those is as a window to the marketplace. By chopping the deficit and stopping the printing presses the poor old peso has now become an obscure object of desire. A few weeks back, we could go to an exchange shop (now no longer clandestine) and switch US\$100 for a pile of rather crisp 1,000-peso notes. Now the exchange shops will only give the exchanger of dollars a mixed pile of 1000s and 500s. Its not that the 1,000s are scarce but rather that there is now a finite supply, and a seemingly infinite supply of dollars. Oh, how the worm has turned.

Ans thus the stage is set.... But for what?

### **Menemismo Redux**

As the original “team” of Milei started to disband after the first round of the elections, it was swiftly replaced by many of the cohorts of the PRO (i.e. Bullrich/Macri) more than a few old hands in political and journalistic circles started to muse that the incoming regime was taking on a neo-*Menemista* tinge.

Then when Martin Menem, the former nephew of Carlos Menem, was named Speaker of the Congress, the direction of travel became apparent. Martin Menem being the son of Eduardo Menem, the former President’s brother, who had been a senator and President of the Senate at times in the 1990s.

If *Menemismo* is associated with anything it is with *Convertibilidad* policy that gave Argentina near to zero inflation for a decade in the 1990s. The Golden Years (Los Anos Dorados, as we call them) were the best ten years that Argentina has had since the 1920s. We became almost an embarrassment at Argentine gatherings since 2001, in lauding Carlos Menem, but when push comes to shove his

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detractors have to admit he was the best thing to happen to Argentina since early last century and they then shut their mouths. To have neo-*Menemismo* as a neologism is somewhat of a vindication for us of the stance that brought us so much opprobrium over the years.

So, what is the role of neo-*Menemismo*? Essentially it is the completion of the task left unfinished when the hapless De la Rúa administration, with Cavallo as its castrated Economics Minister, kowtowed to the US Treasury, and wimped out on the final leg of *Convertibilidad* which was dollarization. Argentina's economy self-immolated like Brunnhilde in a bonfire of the vanities (we do like our stacked allusions) and spent 23 years in the wilderness. Nigh on a quarter of a century of development was lost due to the abnegation of the final step in the *Convertibilidad* process. And now here we are on the cusp, brought about by the surprise election of an economist to the Casa Rosada.

### Some History

We recently found this bank note that we'd used this as a bookmark years ago. It comes with the scribblings that Argentines would put on notes then (something they no longer do).



Of course, when one mentions to foreign journalists about the *austral* they express total incomprehension. Many, of course, have taken hook, line & sinker the big lie from last year's presidential campaign that 2023 was the "worst of times". Where were these people in 1989, the Year of the Two Hyperinflations?

Let's go back to the *austral*. This was introduced by Alfonsín at one austral equal to US\$1.25. So, this ragged piece of paper was once worth around US\$500. However, by the time Menem and Cavallo introduced *Convertibilidad* at 10,000 australes equaling one peso equalling one dollar (on the first of April 1991) the country had really been thru the inflationary wringer and it was worth a mere 5cts. Having lived it myself, I can understand how a foreign journalist could be hoodwinked that 2023 was the

worst of times, but how can Argentines tolerate (and repeat) such a negation of history. Most of them after all had lived 1989. How could 2023's 100% inflation beat the 10,000% inflation of the late 1980s??

### **Dollarisation in Play**

Argentina was long afflicted in the 1990s by uninformed comments emanating from Wall Street. Fortunately, the country fell off the radar (and into total disgrace) in 2001 and we did not need to listen to Wall Street anymore. Neither were their analysts/strategists/"economists" interested in pontificating on the "Land that Time Forgot". They had moved on to ravage other economies.

Much of the Wall Street commentary in those days was back-scratching, with Domingo Cavallo's fan club being rewarded by privatization mandates. When no more mandates were on offer then Wall Street hewed to the World Bank line, particularly resistance to the ultimate end-game of Convertibility, which was dollarization. The latter policy though did not fit the needs and wants of the foreign banks that then ruled the heights of the Argentine banking system because it would mean they would need to make good to Argentine depositors on the dollar deposits they had rapaciously and deceptively collected from them. We were strong supporters of dollarization at that time.

The rest is history, Cavallo betrayed the middle-class depositors and made good on his sycophancy to the Wall Street crowd. Cavallo was dispatched to the dustbin of history, with his brilliant Convertibility construct being vilified as a plan destined to fail (in retrospect) despite it bringing ten years of zero inflation to Argentina. Ironically, all these years later, one of the main policy pillars of Javier Milei is the very dollarization that Wall Street then excoriated.

### **Starving the Dollars out of Hiding**

So, what is the state of play two- and a-bit months into the Milei experiment? Surprisingly for many it is much more advanced than any would have projected with the budget already having passed into surplus, due to the swingeing cuts to the glaringly obvious fat in the system.

In an inflationary environment, slamming on the brakes of money printing is like any old deacceleration. Physics has its laws, and its laws apply to money as well. Argentina went from swimming in pesos in early December to a virtual peso desert around the New Year, on the cusp of the Argentine middle and upper classes embarking on their annual summer holidays. As a result these classes suddenly

### **The 51<sup>st</sup> State of the US?**

Here is the part that should keep US politicians and central bankers up at night, if they even knew if it was coming down the tunnel towards them like a freight train.

A dollarized Argentina, with 46 million people, would be the largest state by population, it would be the fourth or fifth state by economic activity and it would be a bigger agricultural producer than any US state and second or third or fourth in terms of oil & gas production.

And that is just the Argentina at the *status quo* position. If it were to have a massive growth surge and a plunge in perceived political risk, then it could clamber up the aforementioned rankings.

It is bemusing to think of Argentina as potentially the tail that waves the US dog...

### **Small Change**

Dollarisation is both easy to do and difficult depending upon the economy concerned. One of the more prosaic issues is what to do about small denomination transactions. One cannot just roll up to a US bank (even the Fed) and say give me \$10 billion in dimes, nickels, quarters, ones, fives and tens. Thus, the countries that have dollarized have needed to maintain some sort of local currency in small denominations, obviously convertible into the US equivalent. In El Salvador this may be a billion dollars or less, but in Argentina, anything up to \$10bn in small change might be needed to oil the smaller wheels of commerce. Though we would note that Argentina has gone from being largely a cash economy in 2000 to largely a cashless one in 2024.

Well, numbers are indeterminate one could make a sweeping statement such as “there are probably more US\$100 bills in circulation than there are US\$1 bills” and one would get few challengers to its veracity.

Thus, a local currency would be required, but this doesn't need a Central Bank to administer it. It could be the responsibility of the Casa de Moneda (the Mint) or some such entity (maybe a Caja de Convertibilidad).

### **What's In a Name?**

The dollar actually has origins in 16th century Europe. The ‘thaler’, a common name for a Czech coin, became used to describe any similar European silver coin – translated into English, it means ‘dollar.’

The term dollar found its way to the New World during the Spanish colonisation, where the Spanish peso, or dollar, was used in Mexico to back paper money.

In Argentina, with pesos (of multifarious variations and fates) and australes having not much historical repute, when searching for a new name for a stop-gap currency, why shouldn't one seize upon the dollar itself? Ironically, despite the Spanish origins of the dollar, the countries of Latin America have firmly eschewed employing the denomination despite a plethora of heavyweight nations, besides the US, having dollars (Canada, Australia, Singapore, New Zealand, Hong Kong etc) as their currency.

Latin America is the region that spurns the dollar, while embracing it most-wholeheartedly as its favorite

stuffing for the “colchon”.

Cunningly, lopping off three zeros and creating an Argentine *dolar* under a Neo-*Convertibilidad* scenario would actually technically be *dolarisation*, rather than dollarization, thus fulfilling in the very short-term one of the election promises of Milei.

### **The Empire Strikes Back**

The last time Argentina approached the event horizon of dollarization, the US “powers that be” went into overdrive thwarting not only the full move to a dollarized economy, but they brought down *Convertibilidad*, the Argentine economy, triggered the corralito and cast Argentina into its 23 years in the economic wilderness.

Make no mistake, the US did not want dollarization then and does not want it now. The difference is that then it seemed to be a clear and present danger, while now it seems to be pie in the sky. This *blasé* attitude works in Argentina’s favour, as events could quickly overtake the hapless Fed/US Treasury combo and leave them wrongfooted.

Having also reduced their dialogue with successive Argentine governments to the bare minimum, with US banks a shadow of what they were in the Argentine system and being largely clueless as to the exact amount of dollars really in circulation in Argentina, the scene is set for a financial mugging of epic proportions.

In those far distant days, Cavallo could virtually ignore calls from De La Rúa, but always took calls from the Fed or Treasury. Now the Bat Phone has ceased working thru long disuse, and the only vague Washington interlocutor that the Argentine government has is the IMF and, as we well know, the IMF does what it damn well likes and is not necessarily the cat’s paw of US policy that many of its debtors believe.

The stage is set for the US policy makers to be massively wrongfooted. Milei is keeping *shtum* on when and how he will strike and relying on the fact that these days even the screamingly obvious eludes analysis in Washington’s halls of power.

### **How it Plays Out**

The element of surprise is with Milei these days. He comes out of left-field and leaves his potential blockers wrong-footed. As 2000-2001 showed the most dangerous adversary is the US. The Fed and the US Treasury had ten years to ponder where Convertibility might go and in its last years they took up their cudgels to resist the drift to dollarization and clubbed not only dollarization, but Convertibility itself, to death like a baby fur seal.



The scene was bloody and brutal and an erstwhile ally (but economic competitor) was sacrificed on the altar of maintaining control of the almighty US dollar. That was delusional in itself because the US had lost control of its own currency as long ago as the late 1960s/early 1970s with the birth of the petrodollar market on the coattails of the great monetary surge to pay for the Vietnam adventure.

But enough of history and what of the future. Milei is planning a mugging and it's the Federal Reserve that will be roughed up down a dark alleyway when it least expects it.

Too many in Washington and on Wall Street believed the New York Times and the other ignorant organs of the Great & Good press of the US when they dismissed the tousled-hair Argentine presidential wannabe as a cryptofascist (with Hasidic tendencies no less, go figure). He has turned out to be anything but their worst nightmares and the IMF, at least, is loving what it sees and hears.

This gives Milei a window of opportunity. Things are moving fast and the sequence of events is not too hard to foresee.

The *dolar blue* could be at 1,000 pesos with the USD in mere weeks, the dollar balances in the reviled BCRA are rising steadily. The official peso rate is on a crawling peg with a direction of travel towards the 1,000 pesos to the USD also. When the planets align at 1,000 then the official rate can be ditched and the BCRA's dollar selling window shut down. Then the traditional lopping of zeros takes place, with three dropping into oblivion. Then there is an Argentine currency which equals one to one with the USD. Call it what you may but let's have an Argentine *dolar*, for sake of argument. Technically a dolarisation has been achieved by this stage, though it would really be a New *Convertibilidad*, with a *dolar* instead of a peso.

As we noted earlier, for practical reasons, a small denomination local currency would be required due to a shortage of small change in US notes and coins. This would be easy enough to arrange as it's been done before. Meanwhile the heights of the economy would be dollarized (with double "l"). As currently, all property transactions would be in dollars as would all big-ticket items (literally, such as international airflights) and a further step being the likes of auto purchases would require the payee to cough up US dollars. Taxes could be paid in US dollars or *dolars*, but as there would be a finite amount of these small denomination notes, the taxpayers would need to find dollars.

### **Potential Flies in the Ointment**

Let us leave the US to the side as they will be given little say in the matter and probably will be the last ones to find out what is happening.

As Milei has often said, he doesn't need Congress's approval to do most of the things he needs/wants to do. Dollarisation is largely within the purview of the Banco Central, which much as he wants to kill it off, has many of the levers at its disposal to trigger the changes that would propel the conversion forward.

There will inevitably be some legislative changes required and how they will fare in Congress remains to be seen. With Milei's "crash thru, or crash" style of management of the ornery deputies we suspect he

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will leave that fight until another day and get as much done as he can, so that he then presents them with a *fait accompli*. He will then leave them to be perceived by the public as self-serving troglodytes.

Finally, who is going to pay for all this? As usual the exporters! Argentina is having good year in the “*campo*” and Vaca Muerta is ramping up while the Lithium is starting to flow. All are dollar earners so it will be at the ports that Milei’s gatekeepers will be looking to skim off the dollars to keep/get his dollarization show on the road. Meanwhile the importers who think they can roll up the BCRA and swap pesos into dollars to pay for their imports and shall find the exchange window shut and they will have to pay for their imports with hard currency and thus sell the goods on, in-country, for hard currency.

### **Conclusion**

As always in Argentina, the best advice is to “fasten your seatbelts, it’s going to be a bumpy night”.

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