Emerging countries

Argentina-Venezuela: a tale of two stories

- **Argentina and Venezuela were both hit by the downturn in commodity prices.**
- **Argentina succeeded in clearing its external debt arrears while Venezuela is close to default.**
- **A look back at two opposing trajectories.**

To cope with the downturn in the commodity price cycle and the recession that followed, Venezuela and Argentina are following two diametrically opposed macroeconomic management strategies.

In Venezuela, Nicolas Maduro's government, in power since 2013, has pursued an external strategy in which the structural shortage of dollars is managed through a system of multiple exchange rates, one that is as complex as it is ineffective, while giving preference to bilateral sources of financing (China, Russia) in a vain attempt to curtail the haemorrhaging of central bank reserves. Domestically, year after year, the government has become increasingly financially dependent on PDVSA, the national oil company, and has used and abused devaluation in another vain attempt to balance its accounts. This has triggered a totally uncontrollable inflationary spiral and a widespread shortage of goods, including basic necessities. Lastly, PDVSA's financial troubles have resulted in production cutbacks due to a lack of investment.

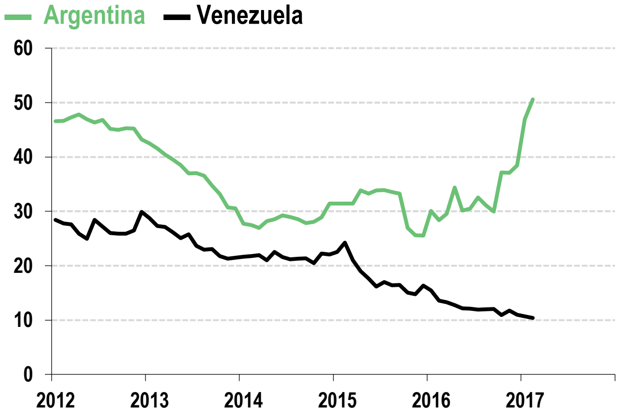
In Argentina, in contrast, after Mauricio Macri took power in December 2015, the government's external strategy has focused on easing currency controls, the successful unification of the official and parallel exchange rates (at the cost of a sharp but one-off devaluation) and the settlement of arrears on foreign debt. Domestically, the new government launched 1) fiscal consolidation based on spending cuts, notably for subsidies, and tax amnesty; 2) the unification of exchange rates to anchor inflation expectations, a strategy whose credibility was bolstered by less use of central bank financing, and less monetisation of the fiscal deficit.

These contrasting trajectories can be illustrated by trends in two simple macroeconomic indicators: inflation for internal imbalances and foreign reserves for external imbalances.

Inflation. In Argentina, the shock created by devaluation and higher public utility prices triggered a sharp surge in inflation in the first half of 2016, which peaked in June-July at 46% year-on-year. But inflationary pressures quickly eased over the course of the year, dropping from 4% a month in H1 to 1.3% in H2, thanks to the renewed credibility of foreign exchange policy. This is illustrated by disinflation expectations (from 21% in 2017 to 15% in 2018 and 9.5% in 2019).

In Venezuela, in contrast, inflation has not slowed from a monthly average of 15%, with peaks at 30%. As both the cause and effect of hyperinflation, the spread between the black market rate and the least overvalued of the two official rates (the dicom rate) swelled from only 20% in early 2015 to a ratio of 1 to 4.

Official foreign exchange reserves (USD bn)



Chart

Source: Macrobond

Foreign exchange reserves. Argentina's foreign reserves dropped to alarming levels in late 2015, but then doubled last year, from USD 25 bn to USD 50 bn (see chart). Net foreign trade swung into positive territory again, resident capital outflows were checked, and the Argentine government was welcomed back to the international debt market, with cumulative issues of USD 32 billion since April 2016, to settle arrears and cover external debt servicing charges. This year, it only needs to raise another USD 3 billion to cover the USD 10 bn emission program.

In Venezuela, in contrast, foreign reserves (in gold and foreign currencies) have been slashed in half since year-end 2015 (from USD 25 bn to USD 11 bn, including only USD 3 bn in hard currency), even though the country has maintained a trade surplus, and at the price of import restrictions. The shortage of dollars is so acute that the authorities had to restructure its debt to China, extend the maturity on PDVSA's debt and, in early 2017, issue dollar-denominated debt instruments to enable importers to settle arrears. Importers were also responsible for finding investors willing to take the risk to buy securities of a state in quasi-default. With a debt servicing charge of USD 13 bn this year, the risk of default is indeed approaching if China decides not to provide additional financing. The next big test will come in April, when Venezuela needs to repay nearly USD 3 billion.