# 'Tequila effect': Argentina's financial system on the brink

by Gerardo Terán Canal and Chris White

Clinton administration and Mexican government officials have been meeting to elaborate the rescue package for the peso, against a background which includes the possiblity of a dramatic breakdown in the U.S. dollar.

Some at Britain's Treasury insist that the Mexican crisis is of local significance only, and have used that view to promote opposition to what President Clinton is attempting to achieve. Now, the managing director of the notorious International Monetary Fund has made his voice heard. All financial crises are systemic by nature; there is no isolated Mexican, Asian, or European crisis, the IMF's Michel Camdessus said in an interview with the French business journal *Les Echos* of Feb. 11.

"We need a system of coordinated and rapid reaction," along with increased capital for the IMF to respond to "an increasingly dangerous world," Camdessus said. He added that at the recent Toronto preparatory meetings for the Group of Seven summit, there was a clear difference in perceptions of the systemic character of the Mexican crisis: While the Americans and Japanese evaluated it as a threat to the system, the British and Germans insisted it had to do with local problems only.

Camdessus warned not to continue "to view the world like the king of Spain, who liked to say that the Latin American crises were crises of the Americans, while the crises in Europe were crises of the Europeans. This does not make sense. All crises are systemic by nature."

On Feb. 8, Camdessus had given a press briefing in Paris stating that he could identify at least 10 countries which could go the way of Mexico this year. But, he said, "Do not expect me to give you the list." The list is widely thought to include Argentina, China, Brazil, Hungary, Russia, the Philippines, Thailand, Sweden, Italy, and Canada.

The idiocy of the local crisis school is made clear by the following report from our Buenos Aires bureau.

## Panic in Argentina

The panic generated by the "Tequila effect"—the reverberations of the Mexico crisis—has completely exposed the fragility of Argentina's Convertibility Plan, the policy put into effect in April 1991, which by law establishes a one-to-one parity between the peso and the dollar. Despite government efforts, especially those of the plan's architect, Finance Minister Domingo Cavallo, to emphasize the "differences" between Mexico and Argentina, Argentina is increasingly vulnerable to a Mexican-style explosion.

Since Dec. 20, the Buenos Aires stock market has not been able to recover a trading volume which, at its high point of euphoria last year, reached over $100 million a day. During the second week of February, it reached its lowest level of $12 million, and on most days since December, analysts reported that both stocks and bonds closed the day "at historic lows." On the international markets, few people are purchasing Argentine debt paper. According to Daniel Muchnik, economics editor of the daily *Clarín,* holders of Argentine stocks and bonds have lost at least $17.5 billion between Dec. 20 and the beginning of February.

The government insists that Argentina is not like Mexico. Yet it has just copied the disastrous policy of issuing instruments like Mexico's *Tesobonos*—short-term, dollar-denominated debt—which were one of the detonators of the crisis in the first place. The first issuance will be worth $400 million and the 1995 total will reach $1.7 billion.

Argentina's trade deficit is estimated to be 100% higher than that of 1993, between $6 and $7 billion. Members of Cavallo's economics team admit that at least $10 billion will be required this year to cover the current-account deficit.

Rounding out this pessimistic picture, the central bank has had to inject at least $5 billion into the banking system to prevent its collapse.

Muchnik wasn't far wrong, when he noted in one of his regular Sunday columns in *Clarín* that "financially, commercially, emotionally, and psychologically, Mexico's developments are present in Argentina."

## The weak link

But as economist Daniel Novak put it in comments to the daily *Página 12,* "The banks are the model's weak link, the genitals of the Argentine financial system." There really isn't much that can be done, he added, except "1) pray; 2) try to convince foreign investors that Argentina and Mexico are totally different; 3) set up all the safety nets possible to prevent financial collapse and . . . 4) keep praying." The crisis, he said, "is building dangerously on Convertibility's first line of defense, its Maginot Line: the financial system."

The Convertibility Plan depends solely on how many dollars there are in the system to maintain parity with the peso. While it is true that the Buenos Aires stock market and the placement of bonds on international markets play an important role for purchase of dollars, no less important, and perhaps more so, is the role of the bank reserve ratio in dollars which the central bank holds for deposits in that currency. Media have reported the flight of those "deposits" to neighboring Uruguay and other countries in the amount of $2 billion. Reliable sources have told *EIR* that average capital flight is now $70 million daily.

Most affected are the so-called retail banks, which receive very large deposits in dollars from both foreigners and Argentines, on a fixed-term basis. One of these banks, the Extrader, had to close its doors in early January, due to a lack of liquidity. From the beginning of the crisis, the central bank has used the liquidity of the state-owned Banco de la Nación Argentina to set up several safety nets to bail out troubled banks, yet the consensus in the banking community is that the safety nets aren't working.

The illiquidity generated by withdrawal of funds is not unlike what happened in the United States, where large banks absorbed the smaller ones, which could offer at least a partially recoverable portfolio. Even President Carlos Menem has publicly advised people to take care where they deposit their money, recognizing that some banks are going to go under.

## An unpayable debt

Interviewed by television talk show host Mariano Grondona, central bank director Roque Fernández tried to calm fears by asserting that bank portfolios were very solid, since loans granted by each one of the banks audited by the central bank had mortgages attached to them. What Fernández didn't mention, however, was that the bank's ability to pay, based on this portfolio, is in doubt. The reality is that there has been a 20% drop in prices in the real estate market, and upper class neighborhoods are now dotted with "for sale" signs on apartment buildings, because people are defaulting on mortgage payments on their condominiums. This is not unlike the situation that detonated the October 1987 collapse of the savings and loans in the United States.

An article in *Clarín*'s Feb. 12 economics supplement, entitled "The Mexican Case Hits the Financial System: a Summer Storm," reports on statistics released by the Fundación Capital in December of 1994 which show that the banks' "irregular [or non-performing] debt portfolio reached 29.6%, compared to 17.2% in December of 1993." The same study reports that at the beginning of 1994 "banks held 4.9 billion pesos in public bonds. In October . . . the amount in the hands of banks fell to 3.4 billion, equal to 25% of the sector's net patrimony . . . the drop in bond volume between January and October reflects the fact that some companies were forced to lower prices and liquidate their positions. Beginning with the Mexican devaluation, bond prices dropped even further, causing a new collapse in the financial sector's stock prices."

Despite this, the government is now allowing banks to register stocks and bonds at their nominal value, in order to alleviate losses caused by the market collapse.

Also, this year, $350 million of all the negotiable debt service obligations issued since the beginning of the Convertibility Plan come due; 80% of that debt is held by nine of the major banks in the city of Buenos Aires.

According to the Feb. 10 *El Economista,* most of the smaller provincial banks are agonizing over the situation. This is the case for Salta's state bank, 93% of whose debt portfolio is non-performing and whose profit rate is −38%; or the bank of Entre Rios, one of the country's most important agricultural regions, 75% of whose debt portfolio is non-performing and whose profit rate is −796%. Except for those in six provinces, the rest of the provincial banks have non-performing debt portfolios ranging from 20% to 90%, and profit rates that are for the most part negative. The government's solution is to privatize these banks, even though they play a crucial role in issuing credit to finance increasingly depressed local productive activity in industry and agriculture.

Paradoxically, a survey published recently by *Clarín* shows that 40% of indebted Argentines are nonetheless willing to vote again for Carlos Menem in the presidential elections in May. This is evidence of people's terror at the thought of what would happen if the Convertibility Plan were to collapse and a subsequent devaluation were to cause their dollar debts to grow.

The same conditions apply, more or less, in each of the 10 countries believed to be on Camdessus's list, and in many that are not—for example, the United States. Not surprisingly, as the Mexican peso falls to new lows, and Ibero-American stock markets crumble, it is the U.S. dollar which financial specialists say is on the precipice of a confidence crisis.