

ARGENTINA LOSING ITS ANCHOR AGAIN.

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It is easy, of course, to be ironic about Argentina's latest financial crisis. Just think: this is a country that has defaulted three times on its sovereign debt since the beginning of the century and, on average, has had a program with the International Monetary Fund (IMF) every three years since 1958. Since 2018, Argentina has also held the record for the largest credit line ever granted by the IMF (\$57 billion). It remains its largest debtor to date (34% of total outstanding loans).

- 1- Since the beginning of September, the country has once again experienced large capital outflows, a stock market crisis, pressure on the exchange rate, and an increase in the risk premium on its sovereign debt. All this suggests that Argentina has probably lost access to the primary capital market, even to refinance maturing debt – US\$4.2 billion is due by next January and US\$14.6 billion by the end of 2026 (both relating to external debt only). Currently, usable foreign exchange reserves are estimated at US\$7 billion. In April the IMF approved a new US\$20 billion Stand-By loan, with rapid disbursement, but most of these funds have already been depleted through Central Bank interventions in the foreign exchange market.

The state of financial emergency was confirmed by the announcement of a meeting between the Argentine and US presidents (held on Sept. 23), followed by the opening of negotiations with the US Treasury for a credit line (or currency swap) of around US\$20 billion. Broader support has been mentioned but remains vague at the time of writing. The markets recovered, but there is little doubt that any uncertainty over the conclusion of an agreement could trigger panic. Similarly, a substantial defeat by President Milei at the mid-term parliamentary elections, on October 25, would obviously have a most adverse impact. Still, Argentina's economic landscape is not entirely bleak. The inflation inherited in 2023 from President Alberto Fernandez, a left-wing Peronist, has been gradually reduced (from over 200% to 20%) without resorting to the kind of shock therapy seen in 1985–1991. As well, for once, the country is not in a catastrophic fiscal position, with a deficit of just 1% forecast by the IMF last August, backed by a primary surplus of

around 1,5% of GDP for the past two years. Finally, the current account deficit, at 1.7% of GDP, is not a source of concern [IMF 2025]. In other words, here is not a solvency crisis that would call for a debt-write-off.

- 2- Why, then, does the country once again find itself in such a precarious position? And more broadly, how can we explain the recurring Argentine crises? Brazil, for example, last signed a Stand-By Agreement with the IMF in 2002, and Mexico in 1999. None of the countries affected by the Asian crisis of 1997–1998 has returned to the Fund since, nor have those in Central Europe. Today, middle-income or emerging economies no longer turn to the Fund for support. The Euro-crisis of the early 2010s is the only exception, but again no country later relapsed.

Generally, those trying to explain Argentina's dismal performance focus on a political system that forever functions as a zero-sum game, plus large income and wealth inequalities, and inefficient and often corrupt public institutions. For sure, none of this is untrue, but neither are these patterns exceptional. To understand the Argentine exception, we must start from the exceptionally narrow limits within which its unstable macroeconomy has to operate.

- i. This relatively small country (47 million inhabitants) remains very closed to international trade. Exports of goods and services account for only 15% of GDP - closer to the level of the United States (10%) than that of Mexico (37%) or Canada (43%). In other words, Argentina's limited export earnings allow it to service only a comparatively small volume of foreign debt. Furthermore, when currency depreciation occurs, it affects a narrow export base dominated by commodities, which are traded in dollars, so that their overall impact on export volumes, foreign exchange earnings and growth is muted. Adjusting a given current account deficit therefore has to work mostly through demand compression (lower consumption and investment), which bear disproportionately on purchasing power and employment. This dynamic often fuels volatile social relations.
- ii. Total tax revenues are not insignificant (32% of GDP), except that the federal government's share is small (around 17% of GDP in total, 11% excluding Social Security). Still, it bears by far the largest part of the public debt (71% of GDP, of which 41% of GDP is traded on the market). This creates a clear vulnerability to any shock affecting the debt or federal revenues. Servicing the external debt is thus doubly constrained: first, by the limited capacity to raise domestic taxes (in pesos), and second, by the difficulty of acquiring the foreign currency required to repay foreign investors. This is the "double transfer" problem identified long ago by John Maynard Keynes.
- iii. But that's not all. Domestic savings are not only very low (15% of GDP), they are also very poorly intermediated. Domestic credit accounts for only 17% of

GDP (compared with 76% in Brazil and 103% in Chile); the bond market is very narrow, absorbing only about 20% of total public debt; lastly, a very large portion of private savings is invested abroad, in US dollars—in Uruguay for the middle class and in the United States for the truly wealthy. For decades, capital flight has been indeed a national sport in Argentina. The scarcity of domestic financial savings thus makes the country highly dependent in general on capital inflows, and therefore on the evolving assessment of its financial position by international investors and the wealthiest segment of the population. Other things being equal, Argentina would have a much more stable economy if its savings rate were 25% rather than 15%.

All result in an economy with very low resilience to external shocks or policy errors. Major tensions can quickly arise in each of these three areas – exports, tax revenues, savings – meaning that the risk of a liquidity crisis is never far away, as all local stakeholders are well aware—from the governor of the central bank to the taxi driver, as the cliché goes. This is also why a by-election lost by the ruling party, or an open conflict with provincial governors, can lead to an open crisis within a matter of weeks. Any financial and economic equilibrium is, by definition, precarious.

- 3- Let us return however to the diagnosis made in recent weeks by most commentators: a liquidity crisis caused by an overvalued exchange rate. After his election, at the end of 2023, President Milei and his team adopted a mixed strategy to curb inflation: a controlled depreciation of the peso/dollar exchange rate within an "oblique" fluctuation band; plus a strict control of money supply, backed-up by a drastic reduction of the public deficit (the chainsaw approach). Harsh as it was socially, the package proved economically coherent and worked well for eighteen months. The problem, as in many similar experiments, is that this partial peg to the dollar led to a gradual appreciation of the real exchange rate, which is no longer considered viable. The decision to call on the Fund, in April, signaled mounting pressure. Today, most commentators argue that there is only one solution left: abandon the peg to the dollar, let the exchange rate float, tighten again the domestic policy mix (monetary and fiscal) and, if possible, ask the IMF to lend credibility to the overall approach. A generation of economists who learned their trade studying the 1992 sterling crisis find themselves on familiar ground here.

The problem is that the Argentine peso is not the pound sterling. This is the fourth constraint that makes life so difficult for Argentine policymakers: the peso is a degraded, low-quality currency that Argentinians use only partially—in short, for daily transactions and taxes. Beyond that, they typically set prices in dollars (unit of account) and pay in pesos (unit of payment) at the daily exchange rate. And for durable goods and investments, they calculate, save, and pay in dollars.

This is the legacy of decades of economic and monetary instability: since at least the 1980s, private agents and successive governments have made the diffuse, gradual, but largely irreversible choice of dollarization as a defence against the redistributive effects of high inflation on both incomes and savings. This was not a necessary choice: at the same time, Brazil rejected this form of monetary extroversion (pegging to the dollar) and opted instead for a strategy of internal price indexation, which later enabled it to restore a much more coherent and effective monetary regime for both private agents and policymakers [[Sgard 2014](#)]. Still today, Brazil is one of the least dollarized countries in Latin America, which certainly facilitates the conduct of monetary policy and the development of the financial system.

A critical aspect of dollarization is that it makes it very difficult to use the exchange rate as a tool for correcting a given trade or current account deficit. If it depreciates, a large proportion of domestic peso-prices immediately adjusts to the new exchange rate, creating an inflationary shock that will soon be transmitted to non-dollarized prices. The initial gains in terms of trade are thus quickly lost, calling for a further depreciation of the nominal exchange rate. If, in addition, the central bank begins supporting the government or the commercial banks through money injections, then the overall trajectory can quickly become uncontrollable. In Argentina, hyperinflation has typically begun this way.

It is therefore not out of blindness that Argentine governments seek to avoid floating exchange rates. Nor is it out of some immoderate taste for baroque economics that they regularly put on the table the alternative of full dollarization—that is, abandoning the peso altogether and its unmanageable exchange rate. Argentina's tragedy is that a floating exchange rate tends to require high interest rates that weigh on growth and employment - even when the fiscal position is sound, as we have just seen. But dollarization is not panacea either, given the structural constraints discussed above. Already in the 1990s, the so-called *Currency Board regime*, involving a very close peg to the dollar, failed spectacularly precisely because of the pitfall that is now alarming investors: the gradual appreciation of the real exchange rate.

Even the IMF does not know what to do. In 2000, faced with the rapid decline of the Currency Board and the swelling foreign debt, it supported this monetary regime until the last moment. But it later concluded that it had "erred in failing to call an earlier halt to support for a strategy that, as implemented, was not sustainable" [[IMF 2004](#)]. Again in 2018, the huge Stand-By agreement granted to Argentina at the insistence of the first Trump administration created problems: the Staff's ex-post evaluation of this episode concluded that it had caused "considerable financial, reputational, and enterprise risks for the Fund" [[IMF 2021](#)]. One can thus suppose that the Fund was somewhat relieved, last month, on seeing the US Treasury take the lead to seek a new, more solid anchor for Argentina.