

Hsbc and the argentine peso crisis

[Economics](#), [Macroeconomics](#)



G3 Consultants Inc. has been faced with the assignment of determining the feasibility for HSBC Holdings to invest more money into their Argentine subsidiary. Argentina is currently in the midst of a recession that has lasted nearly 4 years. After considerable help from the IMF in an attempt to control impending foreign debt, a mix of Argentina's political and monetary policies has resulted in the instability of the Argentine economy and the suspension of payments leading to an uncontrollable build up of national debt.

The questionable sustainability of the Argentinean government has led to a freeze in the cash flow of foreign investors in the country, consequently placing HSBC as one of the main investors to decide whether or not to permanently cut its losses and fully pull out of Argentina or believe in Argentina's historical economic climate and continue to invest in the hopes of an outstanding upside to the current crisis. G3 Consultants Inc.'s objective is to evaluate and analyze the crisis and provide HSBC Holdings with a recommended course of action.

II. KEY ISSUES

G3 Consultants Inc. has been faced with the assignment of determining the feasibility for HSBC Holdings to invest more money into their Argentine subsidiary. In order to analyze the feasibility of this investment opportunity, all of the key issues must first be presented and analyzed in order to understand the full picture. Obviously, in this case the various economic and political factors of the economic crisis must be visited to understand the current economic situation of the country for foreign investment. We will now proceed to introduce these key issues to be considered:

1) Fiscal Policy

Argentina flourished from 1991 to 1997 boasting real GDP of 6.1% including massive revenues from international privatization of Argentine-owned companies and the federal government's fiscal policy is to be blamed for not using these excess reserves to pay off public debt. On the contrary, the fiscal policies were very lax and persistent budget deficits reveal the poor transparency of fiscal operations, and resulting widespread tax evasion through the use of offshore accounts among other means.

Additionally, the federal government grossly misspent funds and was unable to manage their constituents (provincial) expenditures. There exists the problem in Argentina that the federal government is wildly unable to manage their provinces major public expenditure responsibilities, which significantly limits the government's control over the fiscal national policy. The Argentine government was unable to pay off their public debt when they had the ideal opportunity due to strong GDP growth because of their weak fiscal policies, and consequently when the recession hit in the late 90s, the national debt only grew (19).

2) Convertibility Plan

The Convertibility Law effectively pegged the exchange rate of 1 Argentine peso to 1 USD, was signed into effect in 1989 and was implemented for 10 years. While the Law initially had many positive consequences such as raising the standard living for Argentines, promoting imports and returning investor confidence by ruling out the risk of inflation, it resulted in making

Argentina vulnerable to external shocks and was one of the primary causes of the economic meltdown of 2001. Specifically the devaluation of the Brazilian real in 1999 and the international revaluation of the USD in the late 1990s, did not allow the real exchange rate of the peso to depreciate when it was necessary. This revaluation of the peso effectively stifled Argentina's competitive prices and curbed growth by making their commodities too expensive for Brazil to import-one of the country's principal exporting partners at the time (19).

3) Structural Reform

Throughout the 1990s, G3 Consultants Inc. identifies Argentina as a relatively closed economy based on several factors and with little control to implement the necessary structural reforms. Firstly, the country was fairly closed-off to trade and while it did remove some barriers to direct and indirect trade, the structural reforms were not significant enough to promote substantial trade which could have earned foreign exchange to pay off the national debt. Secondly, the revaluation of the US dollar in the late 1990s and consequential effective revaluation of the peso required a significant devaluation of the peso and/or reduction in domestic prices and wages in order to promote exports, and these necessary structural reforms were impossible due to the rigidity and inefficiency of the Argentine economy (19).

4) External Shocks

Due to Argentina's lax fiscal policy, Convertibility Law, and weak structural reforms, G3 Consultants Inc. has identified the country to be very susceptible

to external shocks. As much as the favorable global economy benefited Argentina throughout much of the 1990s, the external shock of the devaluation of the Brazilian real and the parallel revaluation of the USD effectively made Argentina's exports uncompetitive. And the resulting global economic slowdown beginning in 2001 resulted in hyperinflation, recession and the eventual economic meltdown in Argentina (19).

5) Debt Factor

Taking into consideration the country's inefficient fiscal policy when managing public debt during times of real GDP growth, it is understandable why the large existing national debt resulted in the uncontrollable rise of debt to GDP ratio when economic growth slowed down in the late 1990s. The debt to GDP ratio could only have been prevented from rising further with a large trade surplus similar to that seen in the early 1990s (19).

6) International Monetary Fund Situation

The occurrence and severity of the Argentine crisis should be particularly disturbing to the International Monetary Fund given its extensive engagement in the country for many years beforehand. There is little doubt that the Fund's experience in Argentina calls for fresh thinking about its role, both in normal times and in the context of a crisis. According to G3 Consultants Inc.'s research, HSBC holdings lost US\$1. 1 billion in 2001 in Argentina due in part to the depreciation of the peso and the IMF's debt restructuring deal with Argentina to write off 70% of the present net value of their government bonds. The country still owes debts worth 75% of its

annual economic output, and a pending loan with the IMF is essential. The Fund has realized the necessity for structural readjustments and has demanded that Argentina implement certain economic reforms, including spending cuts and restructuring of the banking sector before they will approve a new debt deal. The IMF's requisites are in line with HSBC Holding's best interests, and the pending loan will greatly benefit the company's reinvestment in the country (19).

7) Banking System Crisis

Perhaps one of the primary key issues for HSBC holdings has been the loss in customer confidence in the banking system due to the federal government's widely resented measures to reduce the bank runs and capital flight leading up to 2001. The government's highly controversial measures to avoid dropping the currency board including freezing bank account withdrawals, limiting monthly withdrawals for a whole year, and the forced conversion of dollar accounts to be exchanged to peso accounts at a provisional exchange rate of 1.4 pesos to 1 USD undermined consumer confidence in the banking system and has resulted in a banking crisis (19).