

Argentina research papers examples

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Impact of Currency Devaluation on Argentina's Economy

In January 2014, Argentina devalued its currency, peso, by 15 per cent against the United States dollar; this represented the sharpest decline since the 2001 devaluation when Argentina had failed to pay its foreign debt.

Previously, the Argentine economy experienced current account surpluses due to high commodity prices and competitive exchange rates. Nonetheless, poorly formulated and implemented policies led to a decline in the current account balance and finally into a deficit. The devaluation of the currency will significantly lower the price of Argentine products in the international market increasing their competitiveness. In the converse, imports will be more expensive. In the long run, high demand for exports and low import demand will lead to a surplus in the current account balance.

The GDP growth will contract slightly compared to the growth recorded in 2013. In a country characterized by highly unpredictable economic policies, economic contraction is not an unlikely feature. Poor economic policies such as an unprecedented devaluation create uncertainty in the economy consequently eroding producers, investors and consumers' confidence. As a result, Argentina's gross fixed investments will diminish leading to lower economic growth. Furthermore, the devaluation together with the intensified import barriers will make it hard and expensive for the local manufacturers to access intermediate goods required for increased production. This will too negatively affect economic growth. In addition, demand for goods and services by households is anticipated to fall considerably because the devaluation will lead to increase in prices of goods and services. High prices will lower worker's real wages eroding their purchasing power.

The correct inflation rate in Argentina has been between 20 and 25% for a number of years; however, subsidies on critical commodities such as fuel and foodstuffs has maintained the official inflation rate at 10%. Besides devaluation, Argentine central bank increased the money in circulation to cater for the government's high fiscal expenditure. This policy action will lead to inflationary pressure, therefore, the inflation rate is expected to be over 30 per cent. The interest rates have skyrocketed as the monetary authority endeavours to prevent the peso free fall after the devaluation. For example, the interest rate stood at 15. 1% at the end of year 2013 but was revised twice to 19. 6% and 28. 5% in January and February 2014 respectively. The measure was aimed at curtailing currency depreciation, control inflation and lower the demand for the dollar and capital flight. Interest rate represents the cost of capital thus high-interest rates have a negative impact on investment.

The real exchange rate devaluation will lead to increased foreign direct investment (FDI) inflows arising from the decreased value of domestic assets as expressed in terms of foreign currencies. Nevertheless, the instability of the Argentine currency may deter FDI since foreign investors are wary of the prospect of exchange losses inflicted by currency depreciation. The government must enact economic policies that are favourable to the economy to attract FDI. Argentina's foreign exchange reserves have been greatly depleted in the past one year falling to a record low of \$27 billion by April 2014. The government must put in place measures to curb the depletion of foreign reserves by increasing the yield of domestic assets. Devaluation will further compound the fiscal deficit; the government printed

more money to finance the public sector. This is a major cause of the currency crisis as it will lead to high inflation that will inconvenience consumers, producers and investors.