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Slippery Slope: Will Argentina devalue?

Last month, Argentina started down the slippery slope to possible currency devaluation by partially scrapping the decade-old peso/dollar peg under which every Argentine peso is backed by a U.S. dollar. Now exporters and importers will use a floating currency based on the average of the euro and the dollar. Exporters received an immediate 8% boost in peso prices overnight for goods sold abroad, while consumers now pay 8% more for imported goods.

Economy minister Domingo Cavallo's decision to loosen the dollar peg is an old-fashioned attempt to stimulate exports and the economy generally. It follows a debt swap in May in which investors exchanged more than \$30 billion in maturing Argentine debt for higher-yielding debt of longer duration. Latin America's deteriorating financial picture was the subject of a recent *Barron's* story ("[Look Out Below](#)," May 21, 2001.)



"The Argentine economic team claims the changes to the exchange rate do not constitute devaluation," says Walter Molano of BCP Securities in Greenwich, Connecticut. But, he adds, they do signify the government's acknowledgment that the peso is overvalued. Despite the noise in the currency and fixed-income markets, Argentina's Merval stock index is down just 2.5% for the year. But it's off around 25% from its fleeting January high.



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Domingo Cavallo

Mexico, by contrast, has been a bright spot for investors south of the border, but an economic slowdown tied to the slump in the U.S. is dampening any thoughts of celebration. The Bolsa is up 15.1% in local currency and 21.6% in dollars, pointing up the divorce between short-term market trends and deteriorating local-business conditions. The peso has risen almost 9% in the past 12 months (and 2% since our story).

"The peso's strength is based on two misperceptions," says Mexico City-based economist Rogelio Ramirez de la O, a respected academician who advises foreign companies and hedge funds operating in Mexico. "The first is that Mexico is a safe haven against turmoil elsewhere in the region. The second is that President Vicente Fox will implement structural reforms." Ramirez believes foreign capital inflows and heavy offshore borrowing by Mexican banks and companies have set the stage for an abrupt drop in the peso later this year.

-- Christopher Whalen