Dollarizing Argentina

In April 1991, Argentina established a currency board to cure its chronic inflation. Because the currency board issues only pesos for dollars at a fixed rate of one-for-one, dollar reserves back Argentina’s monetary base. The currency board cannot undertake open-market operations or make loans. Tying the peso to the dollar protects the peso’s purchasing power by linking Argentina’s monetary policy to the U.S. Since 1994, Argentina has maintained an inflation rate similar to that of the U.S.

With the peso fixed to the dollar, however, Argentina’s exchange rate cannot act as a buffer against economic shocks. Adjustments, which rely on domestic price movements, often entail unemployment and lost output. Argentina’s growth rate fell in 1995 after the Mexican crisis; it will probably slow this year because of Brazil’s predicament.

The credibility of the peso–dollar peg rests on Argentina’s ability to ride out these adjustments. A recent rise in the differential between peso and dollar loan rates in Argentina suggests that confidence ebbed following the Brazilian real’s depreciation. Calls for complete dollarization in Argentina seem to have alleviated these concerns somewhat; dollarization would prevent Argentine policymakers from breaking the peg and returning to their inflationary past.

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The real exchange rate adjusts the nominal exchange rate for inflation in both countries. A decline (rise) represents a real appreciation (depreciation) of the peso against the dollar resulting from higher (lower) inflation in Argentina than in the U.S.


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