Martín Redrado: A convincing strategy

Article by Mr Martín Redrado, Governor of the Central Bank of Argentina, published in La Nación newspaper on 18 May 2008.

*   *   *

In Argentina we have overcome a week of financial turmoil. However, those focusing on the ghosts of our troubled history are looking at our country through the rear-view mirror. There is currently no relationship, not even remote, to the conditions that led to the critical events of the past.

The Central Bank has proven that it is in a position to play for the first time in decades its fundamental role: ensuring monetary and financial stability to all Argentineans.

Our strategy in the foreign exchange market is the most eloquent proof of the robustness of our policies. This resilience of our system is not by chance but causal, since it derives from the existence of multiple preventive mechanisms built throughout recent years so as not to jeopardize stability even in situations like the current one.

Preventing the use of reserves in times of dollar demand by the public would be as absurd as not using an umbrella when it rains. In this case, the stock of foreign reserves would not be a "cushion" to buffer financial ups and downs but a "bedrock" with no absorption capacity.

The strengths of our monetary and financial system are evident. Foreign reserves reached a record-high level for Argentina: they currently account for almost 100% of demand deposits plus cash held by the public (45% in 2001). In addition to providing resources to face possible shocks, foreign reserves are also a deterrent: they limit the chances of success of any speculative movement against the peso.

Likewise, a trade surplus close to 12 billion dollars this year ensures a structural foreign exchange supply that may more than offset any temporary dollar demand, making any nominal devaluation speculation irrelevant.

Exports dynamics in general, and industrial exports in particular growing at an annual rate of 18%, show that there is no competitiveness problem today, which was the main cause for past crises.

In turn, the current managed floating regime proves to be the right one for an economy in transition like ours. That is, it provides predictability and prevents excessive volatility from affecting economic decisions. What would have happened in these circumstances under a pure floating exchange rate regime? Our strategy curbed depreciation expectations and, thus, the potential pressure on prices.

Moreover, thanks to a sound financial system we are not facing a run on deposits as in the past. It is natural to witness an upward trend in the interest rate. The facts show that private sector deposits have remained unchanged in the past month.

The structural conditions we have built leave no room for speculation and reflect on the banks' solvency and liquidity after three years of positive systemic profitability, also involving an unprecedented Central Bank balance sheet. This allowed us to adopt a decisive preventive action in the peso market.

The use of instruments devised to that end injected liquidity through a lower primary issue of our notes, the early repurchase of those bills in the secondary market and the full availability of repos (one-, seven- and sixty-day credit lines to commercial banks in need of liquidity), both at fixed and variable rates.

Our scheme is based on what is known as risk management approach applied to the monetary policy in economic theory. It entails not focusing any longer on the short term, combining technical tools with the policymaker's judgment, evaluating risks associated to each circumstance without being limited by dogmatic prejudice or betting on excluding scenarios.

All in all, the objective probability of a crisis similar to those of the past is virtually zero in Argentina now. This reality is not fortuitous but the result of implementing a robust and consistent agenda.

The Central Bank has enough tools – patiently designed in recent years – to use in situations like this week's. The big difference is that, this time, Argentineans may trust that these tools will protect their savings and jobs.