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26-12 Argentina: The Challenge and the Opportunity

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ABSTRACT

Argentina ranked among the world's 10 wealthiest nations during the late 19th century but has never durably recovered from its post-World War I decline. Its relationship with the United States has been complex over its history, but new US ambitions have brought Argentina into focus in Washington, along with its radical libertarian president, Javier Milei. Since becoming president in December 2023, Milei's stabilization program has had genuine successes—dramatically reducing inflation, restoring growth, and achieving an unprecedented fiscal adjustment—but the underlying monetary policy framework remains fragile. The current exchange rate regime leaves monetary policy without a credible nominal anchor, debt obligations are daunting, unemployment is rising, and US financial support under the Trump administration, while it has been unprecedented in the recent past, may depend on Milei's political success in the future. A transition to a floating exchange rate with inflation targeting would provide a more durable institutional foundation for Milei to build on his policy successes and mobilize Argentina's underlying economic strengths. Without it, the country risks repeating its long history of collapsing into crisis.

JEL codes: E31, E52, E63, F5

Keywords: Argentina, inflation stabilization, economic reform, exchange rate, foreign exchange intervention, Trump corollary

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INTRODUCTION

Composing just 7 percent of Latin America's population and 10 percent of its dollar GDP, Argentina was not top of mind for most US administrations until September 22, 2025, when Treasury Secretary Scott Bessent announced extensive financial support for the country and pledged to do "whatever it takes" to support its embattled currency and its libertarian president, Javier Milei, ahead of critical mid-term legislative elections.

In contrast, Argentina had undeniably been top of mind for the International Monetary Fund (IMF) for decades, and intensely so since 2018. In July of that year, the IMF lent $50 billion to Argentina under a program negotiated with then-President Mauricio Macri. The loan was the IMF's biggest ever to a single borrower, even before being augmented by a further $7 billion as Macri's difficulties quickly worsened. Argentina borrowed billions more from the IMF in 2022 to help pay back its earlier loan and then a further $20 billion in a new program under the Milei administration in April 2025. When Bessent announced his intervention late in 2025, Argentina still owed the IMF $57 billion, more than a third of the crisis lender's total outstanding loans.

Bessent's intervention was not motivated by concern for the IMF's balance sheet. Instead, the secretary called Argentina a "systemically important U.S. ally in Latin America." That description seemed strained when compared with the *truly* systemic Mexican currency crisis of 1994–95, which also elicited a historically sizable US rescue. Mexico's crisis sent shockwaves throughout Latin America (including to Argentina). In addition, the Clinton administration feared migrants fleeing north from economic calamity. The North American Free Trade Agreement had launched only a year earlier, and Mexico accounted for a large share of US goods exports—9.92 percent in 1994 compared with Argentina's 0.44 percent in 2024. In 1994, Mexico generated about 30 percent of Latin American and Caribbean dollar GDP and comprised about 19 percent of the region's population.

But Bessent's understanding of *systemic* flowed from ideology, not economics. In his telling, Argentina under Milei was a "beacon" to draw other Latin American countries away from left-leaning leaders. The second Trump administration's new National Security

Strategy soon revealed that Argentina was only the spear tip of a wide-ranging plan to establish US commercial and military dominance in the Western Hemisphere while rooting out Chinese influence and narcotrafficking cartels. President Donald Trump meddled in Honduras's presidential election later in 2025, and in 2026 he has ordered the US capture of Venezuela's leader, authorized joint military operations in Ecuador, increased pressure on Cuba, endorsed a presidential candidate in Colombia, and held a new "Shield of the Americas" summit with the administration's "strongest likeminded allies" in Latin America—thereby excluding the leaders of Brazil, Colombia, Mexico, and Peru, which together compose about 65 percent of the region's population. Several South American countries, including Argentina, have engaged with US efforts to reshape supply chains for critical minerals.

Can Milei harness the US government's new focus on Latin America to achieve his own ends? Historically, relations between Argentina and the United States have been complicated, with long periods of mutual frustration or indifference punctuated by briefer periods of rapprochement (at least at the level of ruling elites). Now, Milei is hugging Trump tightly, hoping US support will be the magic ingredient that helps him produce sustainable macroeconomic stability and growth where other Argentine leaders failed. Trump has telegraphed, however, that US support may be contingent on Milei's political success.

Milei's reelection bid looms in October 2027 and the economy's performance in the preceding months will be the dominating factor. Despite Milei's remarkable success in reducing inflation and restoring overall growth, many Argentines still suffer economically, unemployment has risen, and the government remains reluctant to issue bonds in global capital markets despite its big bills to foreign creditors. Worse, Argentina's monetary policy framework may not be up to these challenges, and any economic instability could be magnified if Milei falters and Trump decides he needs a steadier "beacon."

Milei will need to revamp Argentina's exchange rate regime and monetary policy approach, making them more resilient to economic shocks, to build on his successes and reduce the risk of relapsing into crisis.

THE ARGENTINE ECONOMIC PUZZLE

Until recently, Argentina has flown below the radar of the American public—apart from cameo appearances such as the hit musical *Evita*, Jacobo Timerman's searing account of human rights abuses under military rule, the Falklands War, and the football exploits of Maradona and Messi. But the country has been a perennial object of fascination for economists.

Table 1

The world's 10 richest countries in 1896

Country	Per capita GDP (2011 international dollars)
United Kingdom	$7,211
United States	6,886
New Zealand	6,357
Switzerland	5,967
Australia	5,874
Argentina	**5,716**
Belgium	5,660
Netherlands	5,359
Denmark	4,521
Germany	4,368

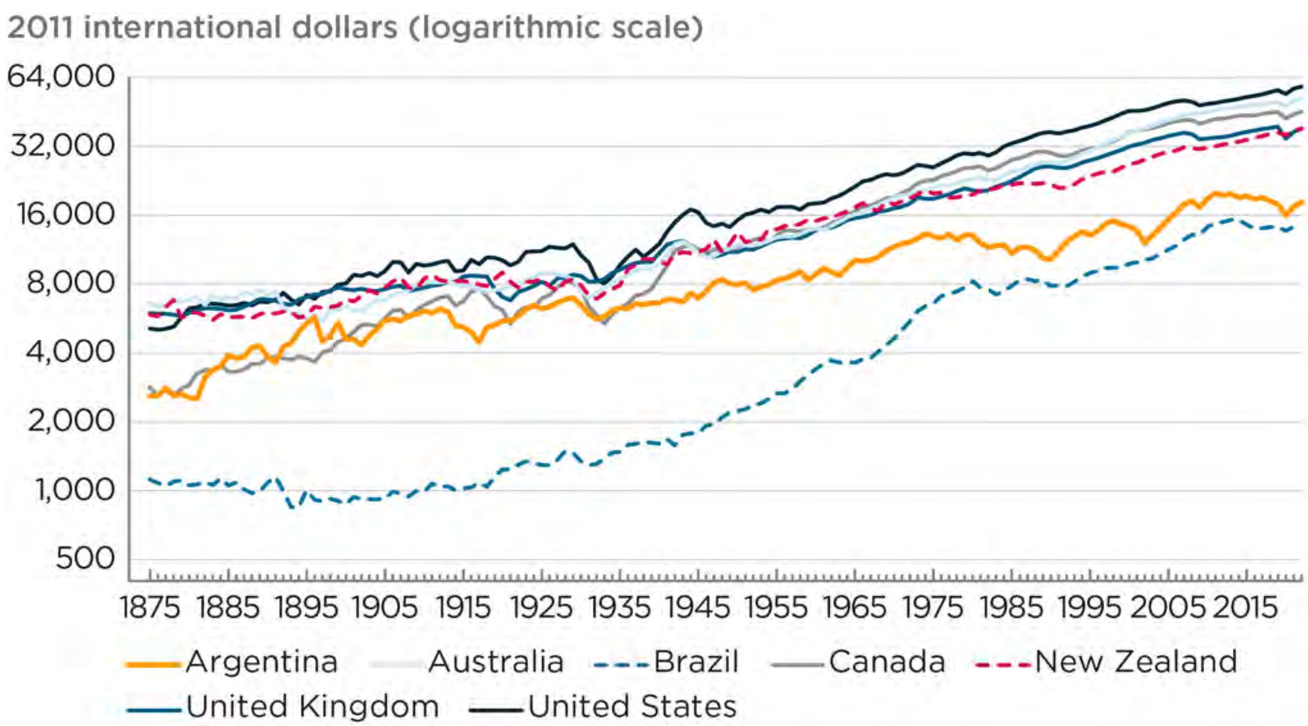
Source: Groningen Growth and Development Centre, Maddison Project Database, 2023, https://www.rug.nl/ggdc/historicaldevelopment/maddison/.

With abundant resources and a highly literate population, Argentina has vast economic potential that never seems to translate into sustained economic advancement, as hopeful stretches of growth collapse into crisis and high (even hyper) inflation. That potential was evident during the late 19th and early 20th centuries as the country's exports of beef, wheat, maize, and wool placed it several times among the 10 richest countries in the world, measured by real per capita income, and sixth in 1896 (see table 1, page 4). Yet after World War I, Argentina fell behind and has never durably recovered.

Argentina's singularity stands out especially clearly when it is compared with other economies that received waves of European immigration in the century before World War I. In research that was awarded the 2024 Nobel Memorial Prize in Economic Sciences, Daron Acemoglu, Simon Johnson, and James A. Robinson observed that countries with high rates of European settler mortality due to malaria and other tropical diseases tended to become extractive colonies where oppressive governing institutional structures took root and persisted, at the cost of later economic growth.

Figure 1

Argentina's per capita real income over time compared with other economies, 1875–2022



Source: Groningen Growth and Development Centre, Maddison Project Database, 2023, https://www.rug.nl/ggdc/historicaldevelopment/maddison/.

In contrast, the large flows of European migrants to more temperate regions—Australia, Canada, New Zealand, and the United States—brought along institutions that protected individual property rights, promoting investments and market development supportive of long-term growth. Despite being a temperate country also settled mostly by Europeans, Argentina has lagged far behind the other "regions of recent settlement," as well as the once leader, the United Kingdom (figure 1, page 5). Even largely tropical Brazil, with its legacy of plantation slavery, is no longer far behind Argentina today. These facts encapsulate the Argentine puzzle.

THE BLAINE DOCTRINE

The 2025 US National Security Strategy proclaims, "We will assert and enforce a 'Trump Corollary' to the Monroe Doctrine" in the Western Hemisphere. However, the true precursor of Trump's approach is not President James Monroe but James G. Blaine, a US senator from Maine, speaker of the House, and Republican presidential nominee who also served as Secretary of State under three presidents during the late 1800s.

While Trump often speaks fondly of another nineteenth-century US leader, President William McKinley, it was Blaine, a dominant figure in American politics in his day, who authored a strategy toward US-Latin American relations startlingly like Trump's. Obsessed with countering British influence in the Western Hemisphere and less of a dogmatic protectionist than most other Republicans, Blaine tried to use trade tools to draw Latin America economically and strategically closer to the United States while promoting US exports. He called the process "annexation of trade," not of territory, but Blaine's biographer, Edward P. Crapol, remarks, "In truth, he wanted both." Territorial annexation through military action followed soon, as did President Theodore Roosevelt's corollary to the Monroe Doctrine.

As the historian Marc-William Palen recounts,

> The 1890 McKinley Tariff . . . was authored by . . . [then] Ohio Congressman William McKinley and secretary of state James G. Blaine of Maine. The tariff allowed the United States to expand its informal empire through its protectionist reciprocity provision. . . . This meant that the 1890 tariff allowed for the signing of a series of

> bilateral reciprocity treaties, mostly in undeveloped regions of Latin America, so as to expand US market access while also curtailing the ability of signatories to sign similar treaties with the American empire's European rivals.

Blaine also sponsored the Pan-American Conferences, the first one taking place in 1889 with a grand hemispheric customs union among its goals. The project, which the *New York Nation* newspaper characterized as "free trade will be safe along parallels of latitude, but not safe along parallels of longitude," failed. But the Pan-American Conferences continued periodically over the years, with the ninth (in Bogotá in 1948) creating the world's oldest regional organization, the Organization of American States (OAS). Now Trump wishes to sidestep the OAS with his narrower Shield of the Americas.

Blaine especially resented British dominion over Canada, which he sought to make the 45th US state. The McKinley tariff included punishing duties on Canada, purposefully omitting the opportunities to negotiate bilateral exemptions that were available to some Latin American countries. As in recent experience, the tariffs only enraged the Canadians. Rather than joining the United States to escape them, Canada retaliated harshly and diverted its trade toward Britain.

Two of Argentina's biggest exports, beef and wool, also were excluded from bilateral arrangements that might spare them from the McKinley tariff. But Argentina had other reasons to resist US ambitions in Latin America. Carlos Díaz Alejandro, one of the preeminent economic historians of Argentina until his untimely death, explained how Argentina opposed US regional policies and aligned itself with Britain, its major creditor:

> At least since the first Panamerican conference in 1889, Argentine foreign policy had clashed with that of the United States. Argentina came to view herself as the other major power in the Western Hemisphere, one whose strong economic and cultural links to Europe and whose desire for an independent stand in international affairs, made her skeptical of US-sponsored Panamericanism. During the early decades of this "American Century" both Right and Left in Argentina criticized United States intervention in the Caribbean and Central America. . .In spite of her close economic ties with the United Kingdom, Argentina

remained strictly neutral during the First World War, and voiced opposition to the harsh terms imposed on Germany by the Treaty of Versailles. Argentina became an active and respected member of the League of Nations, adopting what today would be called a "non-aligned" stance, much more so than either Australia or Brazil.

INTERWAR TURBULENCE AND PERONISM

Despite Argentina's adoption of strategic independence during the 1920s, the United States became its biggest source of foreign finance and manufactured imports like automobiles and farm equipment, while Britain remained the prime destination for its exports. When the Great Depression came in the 1930s, US financial flows dried up at the same time as the United States (with its Smoot-Hawley tariff), Britain, and other countries restricted access to Latin American exporters. Less able to sell abroad or to secure foreign financing, Argentina had little choice but to expand its industrial base and produce more of its imports at home, drawing labor from the countryside into the major cities. World War II accelerated this process of import-substituting industrialization. Like other countries in Latin America, Argentina found it hard to obtain imports during the war due to shortages and disrupted shipping. Argentina's neutrality in the conflict and its continuing dealings with German businesses further alienated Allied countries.

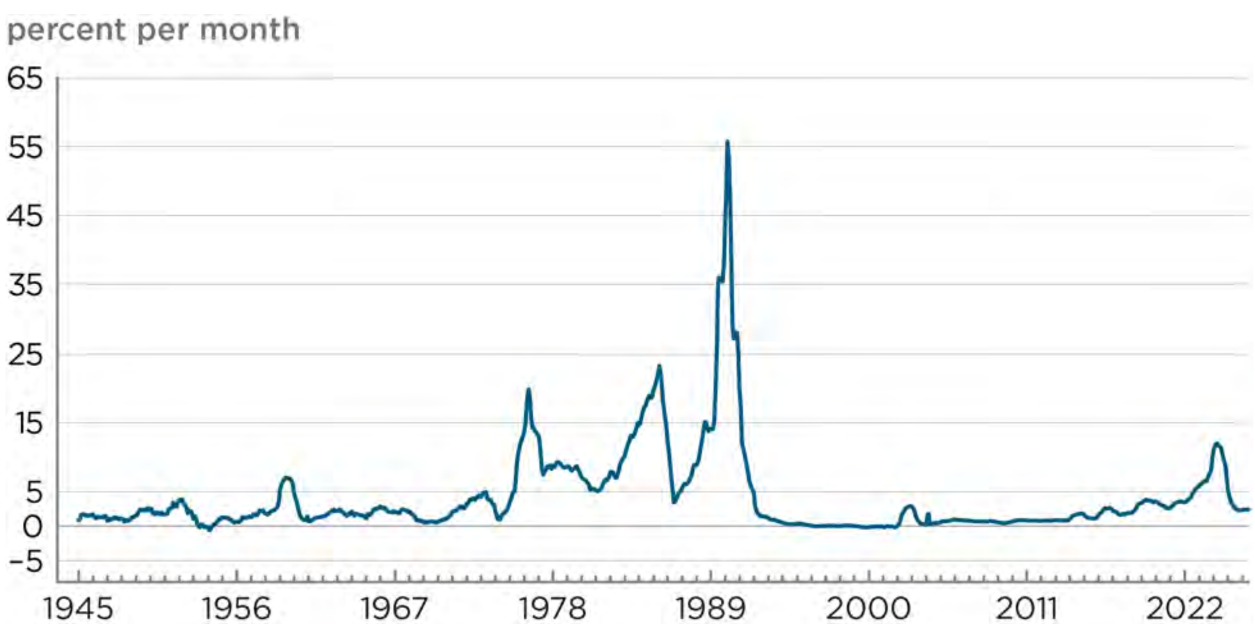
To ease balance-of-payments pressures and later to wean them from dependence on trade with Germany and its allies, the US Treasury's Exchange Stabilization Fund (ESF), established in 1934, made loans to several Latin American countries during the 1930s and 1940s. Argentina was not included. Only in 1959 did Argentina receive its first ESF loan after US policy for the region shifted to countering communism. (The ESF is the same funding source Bessent tapped for Argentina in 2025.)

Argentina did not declare war on the Axis until March 27, 1945, shortly before Germany's surrender and barely in time to be made a founding member of the United Nations (UN). Yet its postwar relations with the United States remained troubled into the 1950s. Marshall Plan administrators went so far as forbidding aid recipients from using the funds for Argentine products—an apparent attempt to undermine Juan D. Perón, who was elected to Argentina's presidency in 1946.

Perón came to power on the back of an urban working-class constituency and populist promises to deploy the state in favor of further industrialization, a bigger role for the state in the economy, and a redistribution of income: away from traditional landowning elites and toward workers (through higher wages and social benefits) and an expanding Peronist elite of functionaries extracting rents through an elaborate state patronage system. Industrialization meant import substitution, supported by industrial tariffs, government-directed credit, and controls over foreign exchange transactions. The Peronist policy mix, coupled with a government budget deficit that had to be financed by printing money, touched off the inflationary process that characterized Argentina during the decades after. It became a hyperinflation around 1990 before being contained for about a decade (see figure 2 below, which plots the *monthly* inflation rates corresponding to year-on-year rates).

Figure 2

Argentine inflation, January 1945–June 2026



Note: Year-on-year inflation is expressed as an inflation rate per month.

Source: Author's calculations based on monthly data for year-on-year inflation from the Banco Central de la República Argentina.

Peronism has gone through several phases and evolved over the years, but it has remained a potent force in Argentine politics. There is no one-line answer to the puzzle of how Argentina fell from its high-income status before World War I, but any explanation for its poor postwar performance must include the tenacious hold of Peronism, which itself has deep causes.

In most incarnations—under Perón himself (1943–55 and 1973–74); his third wife, Isabel (1974–76); the Kirchners (2003–2015); and Milei's immediate predecessor, Alberto Fernández (2019–23)—Peronism led to macroeconomic instability and pervasive clientelism and corruption, which in turn have underpinned the movement's durable political base. As is typically the case with populist programs, unsustainable fiscal and monetary policies can spark short-term booms, but these inevitably end in crashes that more than erase the initial gains. Perón's vision of populist policy is memorably summarized in a 1954 letter to the president of Chile at the time, Carlos Ibáñez (quoted in an essay by the economist Albert O. Hirschman):

> Give to the people, especially to the workers, all that is possible. When it seems to you that already you are giving them too much, give them more. You will see the results. Everyone will try to scare you with the specter of an economic collapse. But all of this is a lie. There is nothing more elastic than the economy which everyone fears so much because no one understands it.

As a political movement, Peronism could on some occasions depart from Peronist populist economic policies. Carlos Menem (1989–99) was the exceptional Peronist president: his neoliberal policies, a radical break from the past, produced the decade of price stability (shown in figure 2, page 9); however, a chaotic financial collapse in late 2001 ultimately brought the Kirchners to power. Several factions inhabit the large Peronist tent, drawn together when political power is at stake by a populist orientation, partisan identity, their shared commitment to state power, and a powerful political machine.

As president, Perón not only imposed a populist agenda but also channeled long-standing Argentine resentments against the United

States. His antagonistic stance toward the UN, which he viewed as a tool of US imperialism, included a refusal to join the IMF, which is a UN agency. (Because of its neutrality in the war, Argentina had not been invited to the founding Bretton Woods Conference in 1944.) In September 1955, worsening economic conditions, along with Perón's battles with the Catholic Church and his personal deterioration after the premature death of his wife, Eva, in 1952, inspired a military coup. Perón fled to an 18-year exile.

Exactly one year later, in September 1956, Argentina finally joined the IMF. It was not long before the country began an IMF-supported loan and stabilization program in December 1958—the first in a series of 23 that culminated in the April 2025 IMF loan to the Milei government.

MILEI'S POLICY REVOLUTION

In the November 2023 runoff election, Milei faced Sergio Massa, the economy minister in the outgoing Fernández government. Massa went all out to pump up the economy and pay off key constituencies before the election—a classic political budget cycle. Year-on-year inflation, already running at 100 percent at the start of 2023 due to policy mismanagement, doubled by the end of the year. But voters had had enough of established politicians. Despite having little political experience—he had gained recognition as a television personality—Milei won in a landslide.

Milei's radical economic platform promised to take a chainsaw to the government budget, to dismantle the web of regulations smothering the economy, and to "dollarize"—that is, to replace the Argentine peso with US dollars. (Currently, the much smaller economies of Ecuador, El Salvador, and Panama are dollarized.) Milei stepped back from dollarization after taking office, but he slashed the national budget and erased a deficit that had been running at about 5 percent of GDP. He also scrapped a complex array of trade and price controls. As figure 3 on page 12 shows, monthly inflation, running at an annualized rate of more than 1,400 percent per year in December 2023, plummeted quickly.

Figure 3

Argentina's month-on-month inflation rate, having spiked in the election year 2023, fell sharply after Milei took charge

Source: Monthly inflation rates from the Banco Central de la República Argentina.

What explains the rapid turnaround in a country where high inflation has been so endemic? Milei's fiscal bloodletting, and his willingness to tolerate the accompanying recession, convinced economic actors that deficits would no longer be financed by printing money. This had immediate inflation-reducing effects. The economist Thomas J. Sargent explained the mechanism at work in a classic paper on historical episodes of rapid inflation reduction:

> This is not to say that it would be easy to eradicate inflation. On the contrary, it would require far more than a few temporary restrictive fiscal and monetary actions. It would require a change in the policy *regime*: there must be an abrupt change in the continuing government *policy*, or *strategy*, for setting deficits now and in the future that is sufficiently binding as to be widely believed.

A regime change, a sharp departure from Argentine business as usual, is exactly what Milei was attempting. But to cement the perception of regime change and prevent inflation from returning, further action was necessary.

MANAGING INFLATION THROUGH THE EXCHANGE RATE

A supporting element in Milei's strategy was to move the peso's dollar exchange rate (the price of dollars in terms of pesos) to a more realistic level, and then to enforce a specific low rate of depreciation over time (a crawling peg) by letting the desired exchange rate determine the overall stance of monetary policy rather than the reverse. In other words, the central bank was instructed to adjust the money supply to match money demand, given the promised path for the exchange rate. The central bank controlled the exchange rate by buying or selling dollars for pesos in the foreign exchange market, and the strict controls over private cross-border financial transactions that Milei initially retained made this easier.

Under this approach to monetary policy, the exchange rate serves as a *nominal anchor* for the economy, a strong signal of where prices are headed. It ties the peso prices of internationally tradable goods to their global dollar prices, with a major impact on the overall price level that Milei's trade liberalization measures made stronger and more direct.

Upon entering the presidency, Milei carried out an immediate maxi-devaluation of the peso followed by a crawling peg regime that forced the currency initially to depreciate by 2 percent per month against the US dollar. That depreciation rate fell to 1 percent a month starting in February 2025. After February 2025, Milei, in effect, was following policies consistent with a longer-term inflation rate of about 1 percent per month—still high by international standards, but much lower than in the recent past. Reducing this rate of crawl further over time might have been one approach to bringing inflation to international levels (about 5 percent per year before the Iran war), which Milei's economic team has put forth as a long-term goal.

There was one major catch: Milei would need to convince people that the commitment to the exchange rate's future path was unshakable; otherwise, inflation expectations, and therefore inflation, would not fall durably. As it happens, the strategy of reducing inflation by controlling the exchange rate had been tried many times in the past, including in Argentina. Such *exchange rate-based stabilization* has failed more often than not, notably in Argentina. While Milei's personal commitment was unquestionable, several factors common to earlier failed exchange rate-based stabilizations threatened his program's success.

One major vulnerability was the Argentine government's low holdings of dollar foreign exchange reserves, which it needed both to peg the peso's exchange rate and to repay its extensive debts to the IMF and other external creditors. In the run-up to the 2023 elections, Economy Minister Massa had run the country's reserves down to very low levels; in the IMF's accounting, net foreign exchange reserves (reserves minus dollar borrowing) were *minus* $8.5 billion when Milei took office.

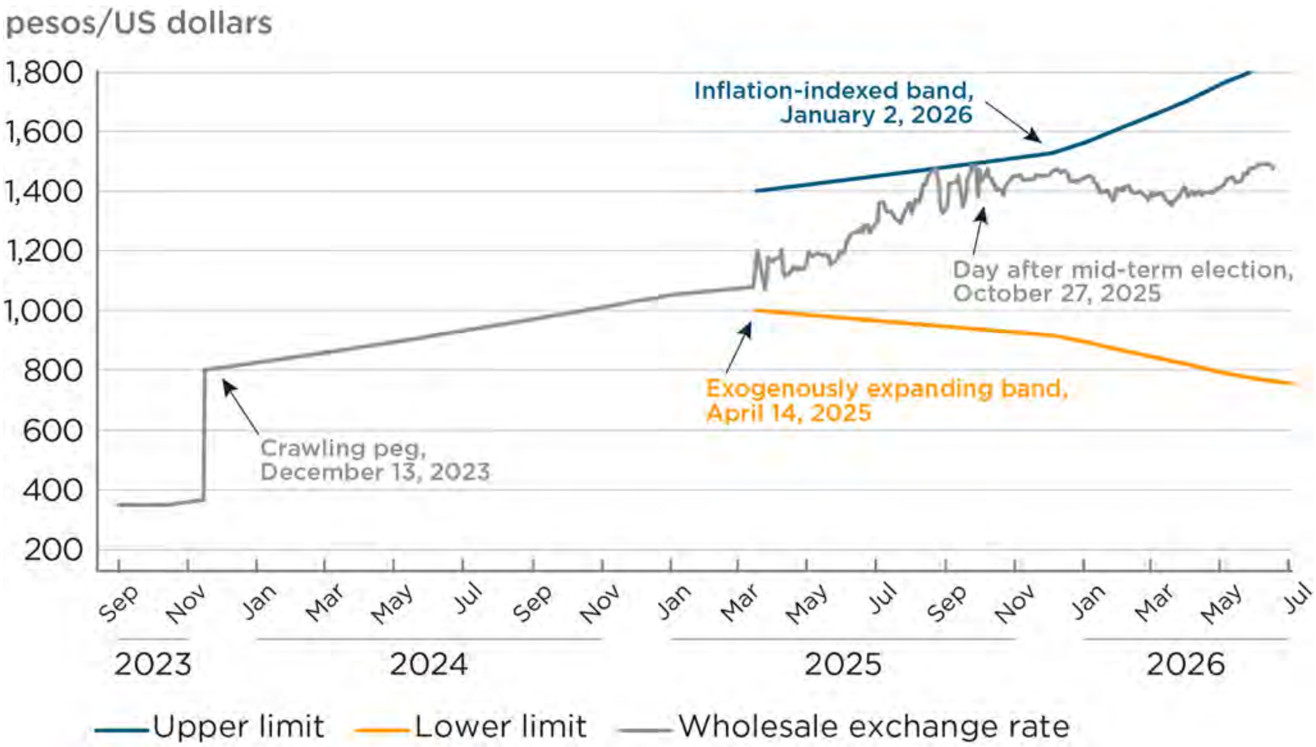
A second vulnerability was the ongoing process by which inflation consistently ran at a much higher rate than the peso's scheduled depreciation under the crawling peg (see figure 3, page 12), a phenomenon economists call *real currency appreciation*. This made imports progressively less expensive in peso terms, worsening the trade balance and thus reducing the country's earnings of much-needed dollars. Instead, the government hoped to induce Argentines to convert some of the more than a quarter trillion in dollars they held in mattresses, safes, and offshore accounts into pesos. This effort yielded fewer dollars than were needed.

THE APRIL 2025 IMF PROGRAM

With dollar reserves still perilously low and falling, Argentina sought its most recent IMF program. In April 2025 the IMF committed $20 billion over four years and made a tranche of $12 billion available immediately, unlike its more common practice of doling out smaller sums over time while monitoring program compliance. (To bolster reserves further, Argentina simultaneously renewed a $5 billion currency swap with China.) Milei also moved to mitigate the peso's real appreciation. He changed the crawling peg to a wider crawling band for the peso/dollar rate, with upper and lower exchange rate limits expanding at 1 percent per month (see figure 4 below). The hope was that additional exchange rate flexibility would allow for market forces to determine the exchange rate, with the bands as a fail-safe in case of extreme foreign exchange market volatility. In addition, it was now the upper limit of the band that provided monetary policy with its nominal anchor.

Figure 4

After a sharp maxi-devaluation at the start of Milei's presidency, Argentina's exchange rate regime has evolved from crawling mini-devaluations to dynamic bands



Source: Banco Central de la República Argentina.

In implementing the new IMF program, Milei made another fateful move that would imperil his new exchange rate framework quickly enough. His government lifted most of the currency controls that had limited residents' ability to buy dollars with pesos and importers' freedom to pay dollars to foreign suppliers. This change made the credibility of the exchange rate limits even more important, as suspicion of an impending devaluation could fuel massive resident purchases of dollars, further draining official reserve buffers and depleting the government's ability to defend the upper limit of the exchange rate band. In turn, this possibility threatened the nominal anchor on which future inflation control rested.

Potential currency instability became reality in September 2025. Mid-term legislative elections were set to be held on October 26, 2025; Milei needed to increase his strength in the National Congress to prevent Peronists from passing bills sabotaging the government's economic program and then overriding presidential vetoes. But the president's popularity had fallen. Not only were many in the economy struggling as high real interest rates held the economy back but also scandals involving Milei and his sister were damaging his administration's claim to have risen above the corrupt past. Just seven weeks before the national legislative elections, the Buenos Aires provincial legislative elections gave Peronists a 14 percentage point vote advantage over Milei's party. Speculation against the peso erupted, and within 10 days the peso was at the top of its band, with the government desperately bleeding reserves to keep the currency from depreciating further (see figure 4, page 15). The increasing likelihood of a currency collapse placed Milei's entire program in danger, a prospect that seemed sure to spell disaster in the upcoming October 26 election.

ENTER BESSENT

That is when Treasury Secretary Bessent declared Argentina to be a systemic US interest and pledged "to do what is needed" to rescue the peso. The peso rallied as Bessent pledged a $20 billion swap line to the Argentine central bank and, in an unprecedented move, intervened directly in the Buenos Aires foreign exchange market to buy a reported $2.5 billion in pesos.

In retrospect, the Trump administration's commitment to intervention in Latin America, financial or otherwise, was not yet as clear as it would become. To be sure, Trump's exorbitant tariff on Brazil in retaliation for the Jair Bolsonaro prosecution was announced in July 2025, and the first strikes on small boats in the Caribbean occurred earlier in September. But Trump's more aggressive initiatives mostly came after the release of the National Security Strategy in November 2025, with its new "Trump corollary."

Trump's interest in Latin America was intermittent during his first term. He supported the Venezuelan opposition and the IMF loans to President Macri. He also imposed a US citizen loyalist as president of the Inter-American Development Bank. But there was no obvious overarching strategy for the region. The Heritage Foundation playbook for a second Trump term, Project 2025, goes further, but not as far as Trump has now gone. It bemoans China's inroads in the region, singles out Nicolás Maduro's depredations, recommends cooperative action on drug interdiction, and calls for "re-hemisphering" manufacturing and industrial activity. Quaintly, some of the most detailed recommendations for Latin America are laid out in the chapter on the US Agency for International Development (USAID), which lauds the agency's efforts to counter Chinese influence under the first Trump administration and urges their reinstatement and extension. In the event, soft-power investments have not been the central element in Trump's intensified attention to the region.

The US Treasury's interventions did have the effect of relieving the pressures on the peso long enough to provide a "bridge" to the October 26 election, as Secretary Bessent described it. No one could doubt that the United States had the means to peg the peso to the dollar, even if Argentina did not.

But the decisive factor that saved Milei and the peso was his overperformance in the mid-term election. Voters did not want a return to Peronism. Milei's party gained 41 percent of the vote, more than 16 percentage points ahead of the Peronist coalition and enough to sustain Milei's vetoes in the National Congress. The path was cleared for the president to implement further liberalizing reforms and run on those for reelection in 2027. A centerpiece accomplishment was the Labor Modernization Law of February 2026, which loosened employment regulations and permitted firm-level wage bargaining—to the fury of the Peronist opposition. But introducing these changes at a moment of weak employment could prove politically challenging.

ADRIFT WITHOUT AN ANCHOR

Having weathered the immediate currency crisis, Argentina changed its exchange rate regime effective January 1, 2026. The new system was designed to avoid the problem of real appreciation that could occur when the crawl rate of the band's upper edge was below the inflation rate. It did so by indexing the rate of crawl to the inflation rate two months earlier. For example, with a November 2025 (monthly) inflation of 2.5 percent, the band expanded by 2.5 percent in January, rather than the previous 1 percent, exactly counteracting the lagged effect of inflation. Immediately, the band of currency flexibility began to expand more quickly (see figure 4, page 15).

While this scheme addressed one problem—enforced real peso appreciation—it created another. Monetary policy now lacked a nominal anchor. Whatever inflation rate prevailed in a month would determine the maximum rate of currency depreciation two months later; conversely, the rate of currency depreciation two months ahead would drive inflation in that month by dragging up import prices. The new system was entirely self-referential, with no concrete anchor to pin down the path of prices or inflation expectations. Nothing in the system forces inflation down to the central bank's stated goal of converging to global average inflation levels. If inflation accelerates, the upper edge of the currency band follows suit, with no natural limit.

To complicate matters, the government must also accumulate enough dollar reserves to defend the exchange rate band in case of attack and to help service the extensive obligations to foreigners coming due over the next quarters. How to do this without igniting more inflation—by purchasing dollars from the public with money—depends on the public being eager to convert dollars into pesos at scale and hold the pesos as cash rather than spending them immediately.

Pending a sufficient increase in the demand for pesos, the government has deployed a Rube Goldberg-like array of ploys to meet its obligations. In late December 2025, it repaid a $2.5 billion drawing on its US swap line using funds obtained from an "unnamed multilateral institution." Analysts believe that institution was the Bank for International Settlements, which may have accepted as collateral Argentine gold reserves that Milei spirited out of the country to London or Switzerland in June 2025. In January 2026, Argentina was able to repay several billions to private creditors by inking a repurchase agreement with six big foreign banks, including a Chinese bank, using heavily discounted government sovereign bonds as collateral. Despite purchasing about 5.5 billion in dollars from the public this year through April, Argentina's net reserves remain short of IMF targets because these purchases were mainly used to meet debt-service obligations. With respect to its international reserve position, Argentina is creeping forward rather than making dramatic headway.

An easier route would be for Argentina to take advantage of its improved reputation in international capital markets simply to borrow dollars and repay previous creditors, as Ecuador did in January 2026. But Milei's team apparently views such market-rate borrowing as still too expensive, and the president prefers to find ways to reduce the government's total indebtedness rather than rolling over past foreign debts or relying on cheaper alternative financing. Argentina will have to pay foreign creditors around $11 billion in the second half of 2026 and more than $30 billion in 2027, sums that may be challenging to assemble absent further support from the US Treasury or multilateral institutions such as the IMF and World Bank. Early in 2026, Argentina's finance secretary resigned over the government's delay in tapping private foreign capital.

Under Argentina's new exchange rate framework, official measures of monthly consumer inflation have averaged around 2.6 percent per month since late 2025—equivalent to an annualized rate of about 36 percent per year—despite declines in recent months. Commodity-price pressures connected with the Iran war could add further to inflation persistence. Any increase will automatically feed through to the exchange rate band. Monetary fragility, coupled with higher unemployment (still well over 7 percent) and the potential need for further bailouts, could undermine Milei's political standing further as the October 2027 presidential election nears.

The peso's exchange rate against the US dollar has been roughly stable for the past six months, bolstered by bumper harvests and rising oil production—the latter in part due to the global fuel scarcity induced by the Iran war (see figure 4, page 15). With still-rapid domestic inflation, however, the result has been a substantial real peso appreciation. Thus, the peso's nominal stability against the dollar, as Argentina acquires international reserves, may prove fleeting.

A BETTER WAY

The Organization for Economic Cooperation and Development reckons that 11 countries in Latin America and the Caribbean now have inflation-targeting central banks, in common with the norm in developed economies. Inflation targeting is based on an independent but accountable central bank, a floating exchange rate regime, a publicly announced target for inflation (the system's nominal anchor), and the adjustment of a central policy instrument (e.g., a short-term interest rate) to restrictive settings when inflation is above target and to accommodative settings when inflation is below. When coupled with greater independence for central banks, inflation targeting has delivered good results in emerging market economies, even in the face of domestic political turmoil (Peru being a notable example) and global shocks such as COVID-19. The framework could alternatively be implemented by a money-supply rule that responds systematically to inflation.

Table 2 on page 21 shows the experience of the five earliest Latin American adopters of inflation targeting, all of whom embraced it around the turn of the millennium after histories of very high inflation. Their inflation reductions have been big and, so far, durable.

Like some of these countries, Argentina could start with a relatively high short-term inflation target (albeit below current inflation) and plan to reduce it over time. Market expectations could coalesce around this nominal anchor, which is lacking in the current Argentine framework. Recent IMF research confirms that established inflation-targeting regimes in Latin America have helped to keep inflation expectations anchored during the price surge that the Iran war has caused. The research also suggests that progress toward inflation targeting can stabilize inflation expectations if institutional prerequisites (e.g., central bank independence and accountability, fiscal restraint, exchange rate flexibility) and domestic political support are present. In the Argentine case, finalizing a long-overdue update of the official consumer price index, something the Milei administration has resisted, would raise the credibility of announced inflation targets.

Table 2

Inflation-targeting experience of five Latin American countries (percent per year)

Year	Brazil	Chile	Colombia	Mexico	Peru
1990–1999	665.4	10.8	21.4	20.2	793.9
2000–2009	6.7	3.3	5.9	4.9	2.5
2010–2019	5.9	3.1	3.8	4.0	2.9
2020–2025	5.8	5.8	6.6	5.2	4.0

Source: International Monetary Fund.

With a floating exchange rate, Argentina would have less need to use reserves for foreign exchange intervention and less reason ever to restrict international payments, allowing an earlier return to financing from global capital markets on better terms. These reforms would provide a favorable backdrop to realize the country's growth potential and spur inward investment.

A DELICATE BALANCE

President Milei is currently in a relatively strong political position and has accomplished unprecedented reforms, but his popularity has weakened and Argentina's policy framework remains too vulnerable to reversals. Renewed pressures loom in the forms of continuing weak employment, lagging government revenue, and persistent attention to corruption in the president's circle. With a presidential election in October 2027 that could bring Peronists back to power, Milei faces a credibility trap. Should the success of his program become widely doubted, his political prospects could deteriorate, making more likely the return of Peronism and all its economic damage—an expectation that further damages economic performance immediately. Milei should make his policy framework more resilient to economic shocks, which have become more frequent in an increasingly turbulent world.

As in the 19th century, Argentina remains resource rich with enormous potential. Its Vaca Muerta shale formation holds huge reserves of gas and oil. Argentine farmlands are still extraordinarily productive. Significant deposits of lithium, copper, gold, uranium, and other sought-after elements remain to be fully tapped. Finally, Argentina has a talented, well-educated workforce. Macroeconomic and political stability are prerequisites for the effective mobilization of these resources.

Under Trump, the United States may not be a steadfast ally if Milei's political fortunes waver. On the other hand, if Milei succeeds and finally breaks the hold of Peronism, other countries in Latin America may well adopt aspects of his approach, as Secretary Bessent hopes. But theorists of a "Western Hemisphere first" version of Trumpism should be careful what they wish for. Latin American countries, including Argentina, depend strongly on trade with China and the European Union, among other non-US trade partners; they will not easily accede fully to the "Trump corollary." Many will resist other possible US demands, such as pivoting away from renewable energy use. A strong and democratic Argentina that has overcome the politics of the past and reclaimed some of its 19th-century economic mojo could shake off US domination and return toward its traditional independence in foreign relations.

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