

Argentina: how recent events shape the investment outlook



Yerlan SYZDYKOV
Global Head of
Emerging Markets



Abbas AMELI-RENANI
Portfolio Manager,
Emerging Markets Debt

- **Recent update on Argentina:** Government's decision to freeze energy prices and suspend VAT on certain products will complicate fiscal metrics. The country is likely to miss the IMF target of a primary balance for 2019. However, the IMF could disburse the September tranche of financial assistance, although conviction levels are low.
- **Credit rating downgrade:** As expected, markets reacted negatively to this news. The focus now would be on government's ability to roll over short-term USD and Argentina Peso (ARS) denominated loans.
- **Markets in the coming weeks:** A bounce in asset prices could be seen as an opportunity to lighten further exposure to Argentina. Markets will now focus on the roll-over ratio of short-dated government debt in the country. Elsewhere, investors will closely watch the US-China rhetoric, comments from the Fed Chairman at Jackson Hole and global growth data.

What is your reading of the most recent events in Argentina? Do you think markets will be relieved or do we expect further deterioration?

President Macri's announced measures to freeze energy prices and suspend VAT on a range of products will further complicate the fiscal metrics. Achieving the IMF's target of a primary balance for 2019 is almost certain to be missed, even accounting for the 0.5% leeway for spending on social emergencies. Investors may now question whether the IMF will disburse the next tranche of USD 5.4bn financial assistance scheduled for September, resulting in further weakness in Argentine assets.

The appointment of a new Finance Minister will do little to dampen the knock to investor confidence in our view, even though the new Finance Minister is well regarded across the political spectrum and would have represented a strong pick in normal market conditions. Under our base case scenario, the IMF will disburse the September tranche, although conviction levels are not high on this issue.

After rating agency downgrade, what has been the reaction of the markets? What is now priced in?

The market has reacted negatively to the downgrade by rating agencies, although other factors may also be playing a role in the weak price action, including the Finance Minister's resignation. Comments from Alberto Fernandez casting doubt over Argentina's ability to repay IMF loans is also adding to the pressure. Finally, we think the market will be increasingly focused on the government's ability to roll over short-term USD and ARS denominated loans in the coming weeks. These amount to around USD 2.5bn in the next two weeks alone.

Have you seen increased contagion risk in other EM assets?

Contagion to other EM has been fairly limited with the exception of a sharp sell-off on the first day after the primary election results were announced. The key contagion channel is via negative sentiment and to some extent via portfolio effects if investors are forced to raise liquidity by selling more liquid EM assets. Evidence on the latter impact is fairly limited at this stage. We view direct economic linkages between Argentina and other EM economies to be small. Only Brazil has meaningful trade linkages with Argentina.

"IMF's target of a primary balance for 2019 is almost certain to be missed. Investors may now question whether the IMF will disburse the next tranche of USD 5.4bn financial assistance scheduled for September."

“We have taken a more cautious approach on Argentina. With the most recent weakness, we view current market prices to be not far from eventual recovery prices.”

How are you dealing with this phase of heightened volatility? On Argentina specifically but also at the overall portfolio level.

We have taken a more cautious view on Argentina. With the most recent weakness, we view current market prices to be not far from eventual recovery prices. However, we think that given the extent of overweight positioning across the investor community, the risk of bond prices undershooting fair value levels is relatively high. We believe that a bounce will provide more an opportunity to lighten exposure to the country further, than re-build positioning. Outside of Argentina, we have not seen material reason to change our view: we see value in local EM rates and EM credit, but expect continued pressure on EM currencies from a challenging global growth backdrop.

What are the aspects you are looking at in the markets over the coming weeks?

In Argentina the focus will be on the roll-over ratio of short-dated government debt. We'll also be paying close attention to comments and potential future cabinet appointments from Alberto Fernandez. Outside of Argentina, the focus will be on US-China rhetoric around trade and technology; comments from Fed Chairman at Jackson Hole and whether he will validate market expectations of plentiful more easing ahead. We'll be closely scrutinising growth data around the world, with the upcoming US Manufacturing PMI data an important focus point. Finally, a key market mover could be signs of whether Germany will turn on the fiscal spending tap.