

Argentina: Closing the Gap Between Policy and Public Opinion

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January 23, 2014

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EXECUTIVE SUMMARY

Poliarquía Consultores, a prominent Argentine polling firm, designed, oversaw and executed two surveys on public attitudes towards the current economic and social environment in Argentina. The study was commissioned by Graham Fisher & Co. The first survey was conducted over the telephone and questioned over 1,000 Argentines between September 2nd and 16th, 2013 in 40 localities across the nation. This survey had a 96% confidence level. The second survey was conducted with direct interviews of 40 “thought leaders,”ⁱ selected by Poliarquía, between October 15th and November 22nd 2013. The results of these surveys are illuminating and suggest a significant gap between the concerns of the public and the decisions of the current government. The results also indicate that the Argentine government can abandon its hardline stance against the international community with little to no popular backlash.

Specifically, the study reveals that Argentina’s public attitudes towards the economic and political environment in the country can be summarized as follows:

- 75% of the public disapproves of the government’s handling of crime, 73% disapproves of the government’s handling of the country’s inflation problems, 62% disapproves of its economic policies and 51% disapproves of its handling of the country’s debts with foreign and local institutions and investors.
- The majority of those who responded agreed that paying debts that were in default would help integrate Argentina into the world, provide improvements in the economy and support job creation, reduce inflation, re-activate the real-estate market, result in a removal of capital controls and drive investment in the country’s infrastructure.
- A significant majority of the public believes that all of the government’s debts should be paid.
- Most people prefer to re-negotiate the debt terms, but if given a choice between paying and not paying the debt, the majority leans towards paying it in full.
- A policy of direct negotiation with creditors would have a positive impact on the President’s image at home. Interestingly, this is even truer among people who identified themselves as supporters of President Kirchner’s administration.

The mandate for change is clear.

Poliarquía Consultores also carried out a survey amongst Argentinean decision-makers and opinion leaders. The research focused on the leaders' perceptions of the country's economic situation in general, and particularly about their views regarding the public debt issue. The key takeaways from the 40 interviews are as follows:ⁱⁱ

- The research depicts a declining economy, with stagnation issues. Nevertheless, the experts suggest that some minor adjustments would bring a considerable improvement to this scenario.
- A majority of the interviewees perceives that the most important economic problems are caused or aggravated by government policies (uncontrolled emission of money, restrictions on the exchange market, subsidies, and the creation of an environment of distrust regarding institutions in general). Some of the opinion leaders consider that the current administration's economic policies lack the proper coordination and that – even if there are good intentions – their officials are poorly advised.
- The interviewees suggest there are several factors that combine to produce the current state of the economy. In the first place, the government had not exhibited the will to resolve its conflicts with private creditors. The aggressive discourse against U.S. Courts and the statement refusing to pay notwithstanding the judgments deepened the conflict, and might have encouraged the verdict of the New York Court of Appeals.
- Additionally, the remaining conflicts with International organizations, including the IMF, also discourage foreign capital. These have resulted in a lack of credible inflation and GDP statistics offered by the Institute for Statistics and Census (INDEC).

From the two surveys, it is clear that the public has a strong opinion on these issues.

Introduction

At the turn of the last century, Argentina, was the eighth-largest economy in the world. Today, according to the World Bank, the country is ranked 73rd in real per capita income. According to Transparency International's corruption index, it is ranked 106 out of 177 countries (with 177 being "highly corrupt"). Following the World Bank's cost of "Doing Business" index,ⁱⁱⁱ Argentina is ranked 124 out of a 185 countries. And to top it off, according to the recent World Index of Economic Freedom,^{iv} Argentina is in the bottom 15 countries in the world and 27th in the region.

This acceleration of economic and social decline, over the past several years, may be attributable to the patchwork series of domestic economic policies that were intended to allow the economy to function while avoiding reengagement with the outside world. In particular, global capital markets and foreign investment have been

largely shut off to the country after its 2001 sovereign default. While the majority of Argentines believe that foreign investment is important to the country^v, that investment has not been available.

More than a decade after its historic default, **Argentina again finds itself in an increasingly unstable and unmanageable economic situation. Argentina is exposed to an increased risk of sovereign default.**^{vi} This is largely the unnecessary result of a failure to fully resolve disputes with the International Monetary Fund over its GDP and inflation statistics and ongoing disputes with creditors including the Paris Club and holdouts from the 2001 default. Unlike past crises in which the government did not have the ability to avoid default, today it has the ability but appears to lack a willingness to do so. **Unfortunately, if the country continues on its current path, it will find itself without the ability to pay regardless of its willingness.**

Argentina is a democracy and has twice elected President Cristina Fernández de Kirchner. The votes were in support of her long history of focus on social inclusion and populism. Because of her political origins, there has been confusion about why the President has not chosen a more direct path towards social and economic prosperity.

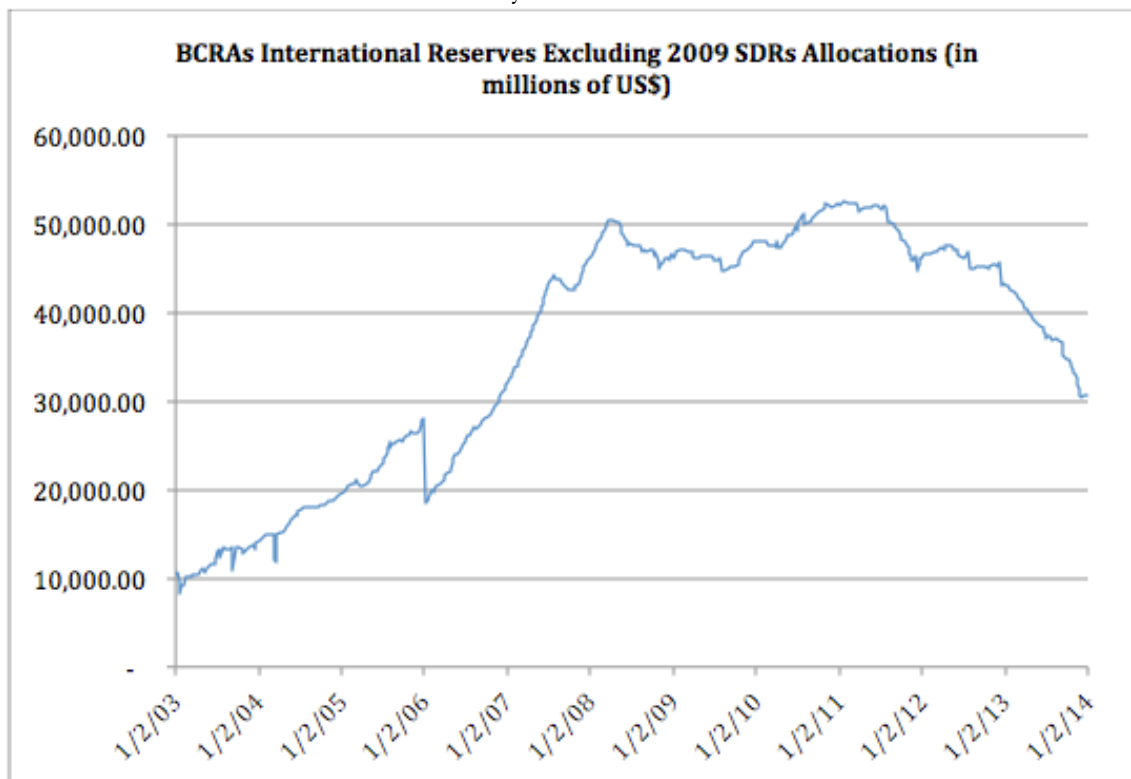
The Poliarquía surveys help to determine whether, in fact, these policies were a response to political realities or were disconnected from public opinion. **The results of the surveys suggest that Argentines are more willing to reengage with the international community than current government policies suggest.**

Mission Unfulfilled

In November 2011 we presented a report, “The Argentine Model, Part II: Avoiding Crisis and Securing the Future”^{vii}, at Libertad y Progreso^{viii} in Buenos Aires. In that report, we warned that “el modelo K,” the program of economic reform and repair instituted by Nestor Kirchner, was rapidly devolving into a program of protectionist and distortive practices that would lead to further economic isolation and economic failure. We demonstrated the domestic benefits that could be realized by pursuing policies that supported productive engagement with the international community. These benefits include significant increases in foreign direct investment,^{ix} dramatic cost savings to the public and private sectors and an ability to expand President Kirchner’s goals of social inclusion. **Unfortunately, since Argentina’s economy rapidly deteriorated in the time between when the paper was published and today, we must review the benefits of reengagement with the global community and update our estimates.**

At a November 2012 conference, jointly sponsored by the Global Interdependence Center and the Bolsa, we expanded our analysis and noted that expansion of the monetary supply and reliance on central bank reserves (as a substitute for access to global capital markets and foreign direct investment) would result in the crowding-out of domestic support for provincial and private-sector debt and would lead to rising inflation, declining

real economic performance, greater reliance on destructive policies and the eventual need for a more drastic devaluation of the currency.



Source: BCRA

These policies remain in place and time is short. Argentine experts polled noted that *“Argentina is in a current state of political and social unrest, mainly due to the actions of the government”* and that *“legal insecurity at the economic sphere is Argentina’s main problem.”* These experts also confirmed our long-held beliefs that capital controls, price controls, nationalization of private enterprise without fair compensation and a refusal to settle external debts have all been part of a series of short-term and shortsighted policies. These moves have exacerbated inflationary pressures, driven deficits, prevented inflows of much needed foreign direct investment and U.S. dollars (especially in the area of energy exploration and development), reduced economic freedom and, in turn, increased public dissatisfaction.

Resentment of the government is rising as social conditions deteriorate. This can be seen in the seemingly ever-increasing frequency and attendance of public protests. One protest in November 2012 was attended by between 250,000 and 1,000,000 people who were protesting against limits on foreign currency, rising inflation, the slowest-growing economy in the region and high crime rates.^x In April 2013, almost 2,000,000 Argentines protested against the government and its policies.^{xi} Rather than seeing the problems as the result of external forces, the public holds the administration to blame. **More than 65%^{xii} consider the current economic problems to be the fault of erratic government planning and more than half of the public sees the probability of an economic crisis as likely or**

very likely within the next 24 to 36 months. Only 11% sees the chances of such a crisis as very unlikely.^{xiii} Whether they will be proven correct will be determined by the policy choices made by the Kirchner administration over the next several months.

According to the poll, **43% of the public believes inflation to be the most important economic problem for the government to address while 39% believe unemployment is the most important economic problem. The lack of U.S. dollars was viewed as the third most important economic issue to be addressed.**^{xiv} Clearly, the Kirchner government should be able to recognize that resolving its international disputes is the key to solving problems of inflation, unemployment and a lack of hard currencies.

Some of the experts polled did present some optimism, and one suggested that “there might be some economic adjustments in the months to come ... probably some energy and oil rates increases and a more favorable approach towards the global capital market.” Still, the general view of those surveyed was that “there is a poor economic management; there is no coordination within public policies” and “this government does not change its policies unless the social and political context is one of extreme discontent and fragility.” Have the results of the last national and provincial elections created such a context?

President Kirchner has, at times, demonstrated herself to be a pragmatic leader. **The current confluence of public opinion and economic demands should lead her to direct her new cabinet toward economically sound policies.** One sign for potential optimism is Argentina’s outreach to the Paris Club, to which Argentina owes close to \$10 billion. While no formal proposal has been made, the press reports the country is seeking a payment schedule of up to ten years. Such an approach, even in the unlikely event that is ultimately accepted by the Paris Club, would require, as international rules require, the IMF to oversee the disbursements if the schedule exceeds the 18 months that creditor countries expect. The government has rejected such a requirement^{xv}, as a result it is unclear whether this is merely a negotiating position or another case of failing to understand the dire reality of its economic circumstance.

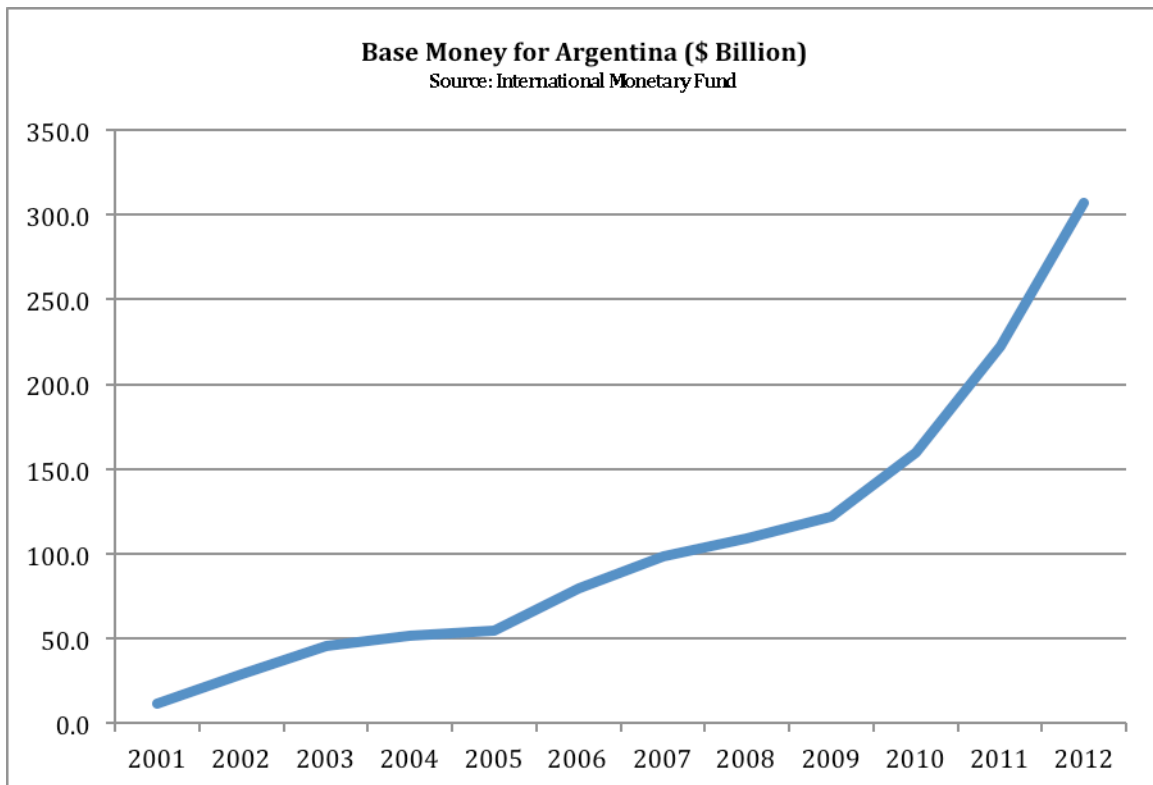
Still, even assuming the country can achieve an agreement with the Paris Club, without a settlement of its outstanding judgments from U.S. courts, over its holdout creditor judgments, the country will not be able to regain access global markets. Unlike the Paris Club, which is bound by specific rules which determine the structure and schedule of payments, private creditors are not bound by rules in the restructuring of debt. As a result, while settlement with the Paris Club might slowly unlock access to a few billion dollars of new lending, the benefits of first settling with remaining private creditors are immediate, and would result in the opening of the country to larger amounts of hard currency through foreign investment and access to global capital markets.

Argentina has a long history of swinging from crisis to crisis, hopefully President Kirchner has finally learned to avoid this mistake and will recognize the benefits of finally cleaning up the unresolved issues remaining from its 2001 default.

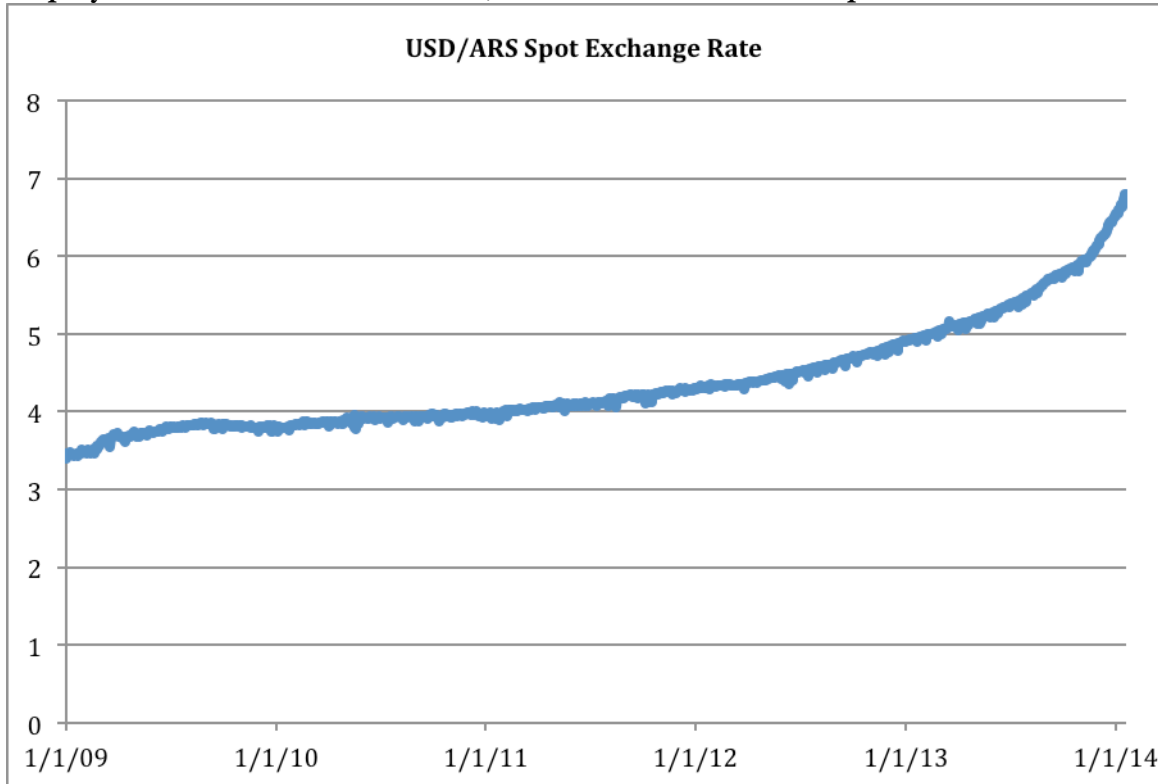
The Risks of Failure: A Failed Legacy

Argentina's main economic problems appear to stem from what one expert described as "an ideological bias" against compliance with international agreements and obligations. Experts cited the government's unwillingness to negotiate settlements over international disputes or to address the lack of credible economic statistics. These two factors make it difficult for Argentine businesses and policymakers alike to adequately forecast economic activity. In addition, they have resulted in an unprecedented censure from the IMF.^{xvi} One major problem is that the government's inflation index, which the government has repeatedly promised to fix, is not credible. Many argue that much of the public anger reflects an awareness of the inaccuracy of the country's statistics on inflation, poverty and crime.^{xvii}

The government has implemented short-term fixes that will leave the Argentine economy worse off in the long term. Measures include the expansion of the monetary base, increases in public subsidies, price controls and the use of the international reserves from the central bank and national pension fund. **Transportation and energy subsidies that were almost zero a decade ago today represent almost 4% of GDP today.**^{xviii} **Radically easy money policy and its impact on inflation are pushing the country into dangerous territory.**

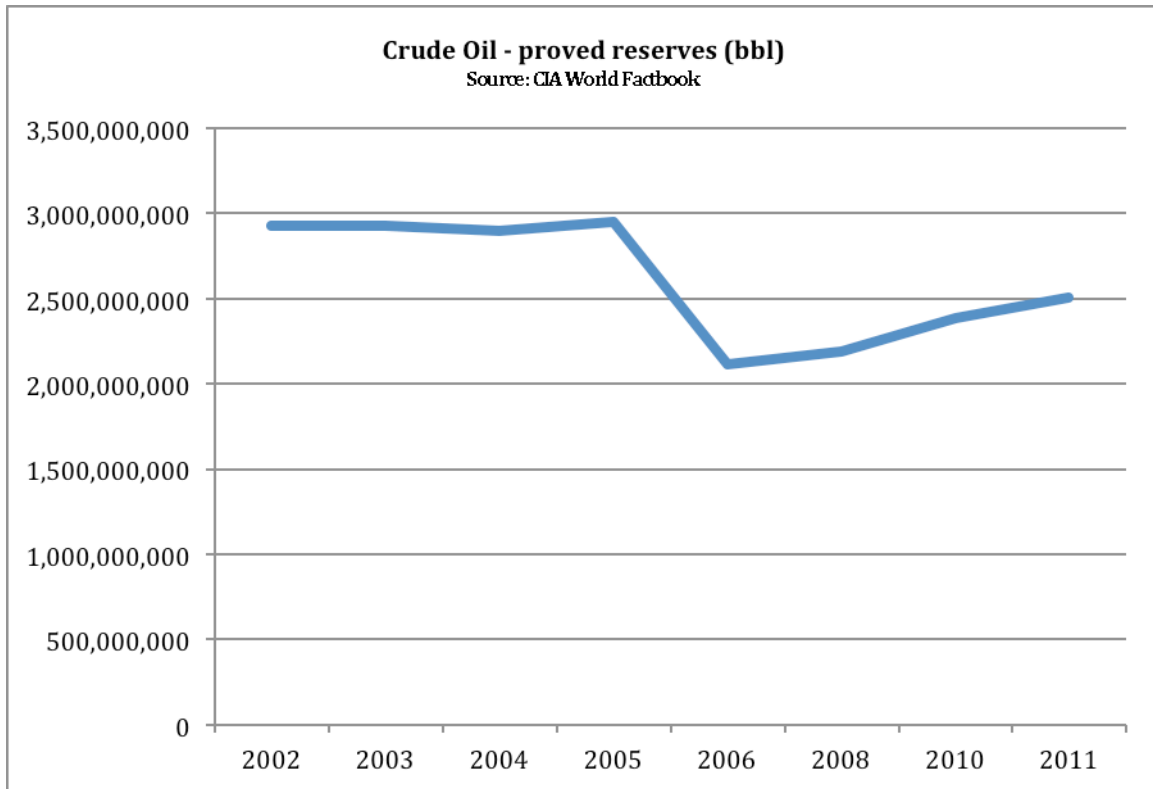


While an expansion of the monetary base has now become one of the key tools of the government, its peso policy has also driven economic dislocations. As of 2014, the peso has fallen to new lows against the U.S. dollar. On January 16th, 2014, the black market rate reached 11 pesos to the dollar and the official rate slid to 6.76. **An artificially strong peso has made imports cheaper but, due to international competition, it has lowered exports and productivity. A high exchange rate is also detrimental to Argentine employees and to its service sectors, which are unable to raise prices.**

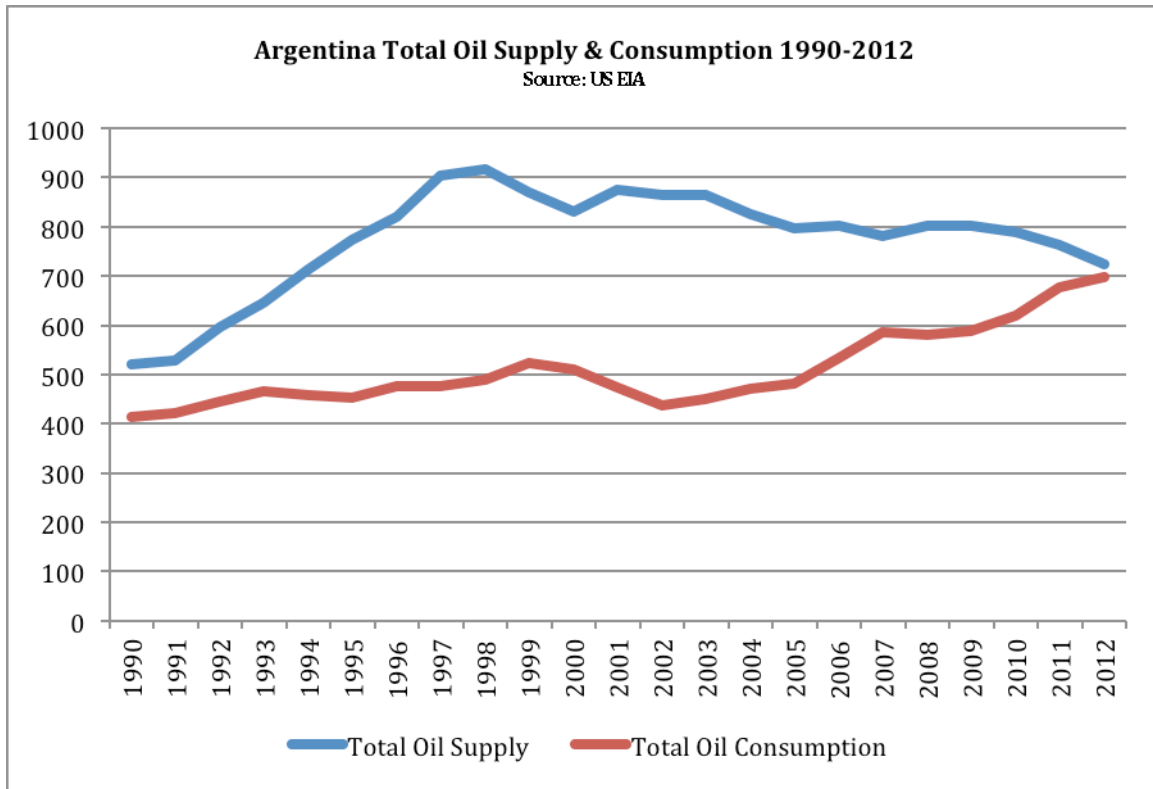


Source: Bloomberg

The government's peso policy has increased the number of imports, especially in the energy sector. **Inadequate investment in the energy sector has caused Argentina, a country with some of the world's largest oil fields, to fail to develop proved oil reserves much above 2005 levels.**

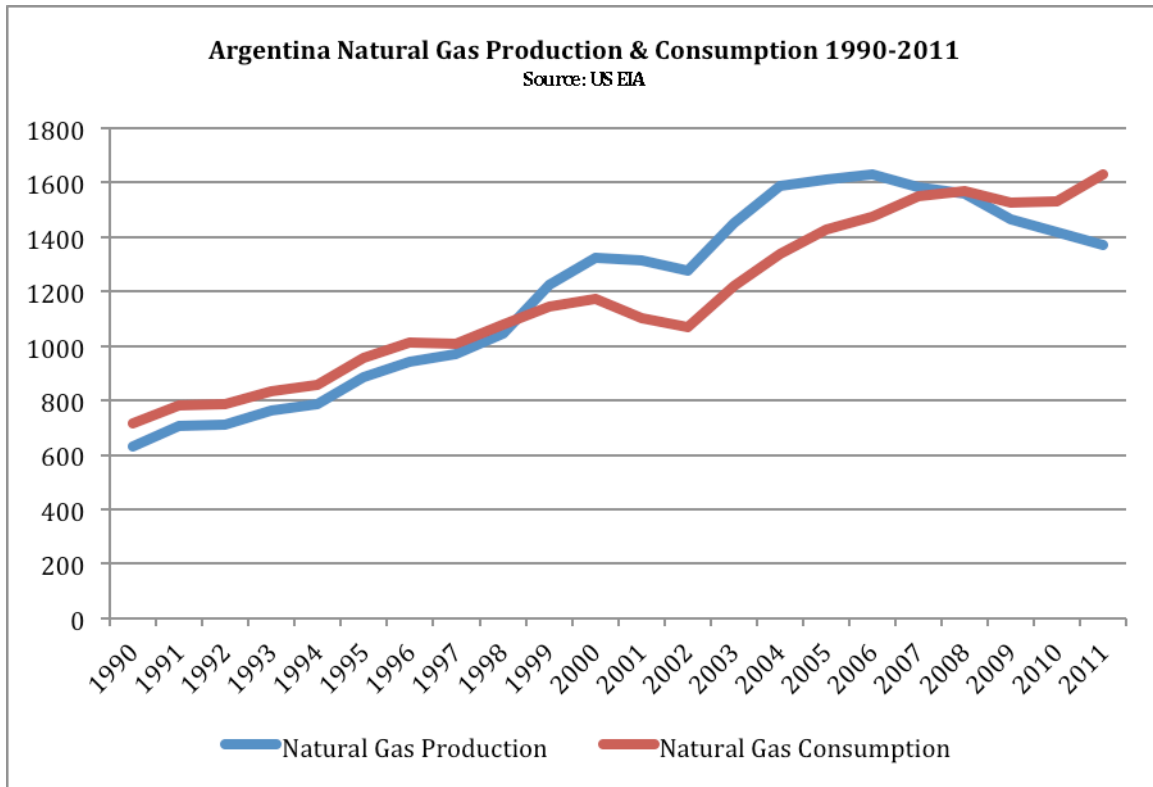


This is not a new phenomenon. The low levels of exploration activity and decline in production from maturing oil fields have led to the erosion of production since 1998^{xix} due to the inability to access foreign investment and international markets. Coupled with a decade of ongoing lawsuits and serial violations of international bodies and courts, these factors have since 2010 supported labor unrest in Argentina’s oil production sector, which has resulted in shutdowns in capacity, reduced refinery runs and lower local supply. **At times, Argentina’s output has been reduced by up to 100,000 barrels of output per day.**



Argentina’s oil industry is not the only part of the energy sector suffering as a result of the country’s isolation. **Output in the natural gas sector has also declined since the 2001 default, much of it accelerating over the past few years as the government’s policies have become more defiant toward the international community.** Gas prices have been locked since 2002, at the demands of the government, and the gas industry has become wholly reliant on the federal government for funding.^{xx} This can be seen most clearly by last year’s 72% year-over-year increase in energy subsidies, to \$60 billion, in the first three quarters.^{xxi}

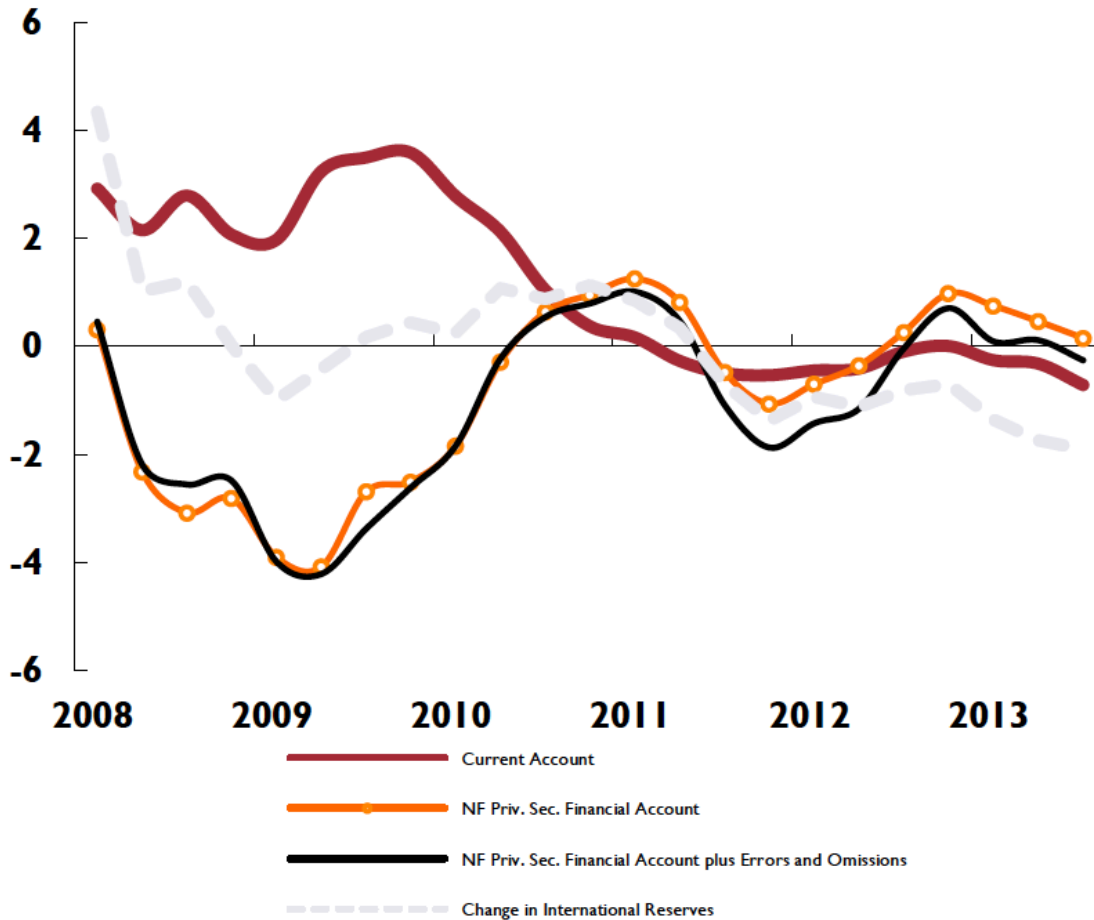
With increased reliance on imports and a dwindling supply of dollars with which to acquire imports, Argentina has suffered severe **wintertime shortages of natural gas, by as much as 40% of demand at prevailing prices.**^{xxii} Roughly one-third of gas consumed is used to generate electricity and the other two-thirds are consumed, in roughly equal proportions, by the consumer and industrial sectors. In response to shortages, the government has been repeatedly forced to divert supply from industrial users to residential users, further negatively affecting industrial output.



During the summer of 2013, in the midst a heat-wave, Buenos Aires suffered severe blackouts that affected industrial users and left approximately 19,000 households without power for nearly two weeks. Despite official denials of responsibility, and threats to nationalize the utilities that failed, **the problems are ultimately the result of government's failure to create an attractive environment for investment and a well-functioning energy sector.**

Interruptions of rail lines, the setting on fire of a power station, the fire bombs, riots, road blocks and anger that resulted from these latest shortages should highlight the rising tensions within the country. Regardless of whether the government follows through on its recent and counterproductive threats to nationalize those electrical utilities, the country needs dollars to avoid similar future crises of increasing frequency and magnitude.

This lack of investment and the country's aggressive import and export tax regimes support frequent monthly declines in export prices to levels that regularly fail to offset volume increases. In the most recent period, Argentina saw a 3% increase in exports, but that was driven by a 12% increase in volumes while prices fell 8%. Declines in the country's productivity and the increasing need to "burn the furniture" through a strategy of trading volume for prices suggests that the longer the government waits to address its economic policy problems, the larger the costs of repair. **These problems are not likely to dissipate, and according to the World Bank, the country's current account balance is expected to remain negative through at least 2016.**^{xxiii} Looking at the balance of payments, the extreme levels of stress are clear.



President Kirchner’s advisors, individually and in concert, have led to the implementation of policies that stoke the furnace of inflationary pressures. As noted in the “experts survey,” *“the main economic concerns of most of the participants are inflation, the loss of competitiveness, the external constraint (lack of U.S. Dollars), and the energy shortage. Another situation that generates great concern is the current intervention of the National Institute for Statistics and Census (INDEC), which is producing poor quality and not at all credible information about the main demographic and economic national indicators.”*

In the aftermath of the 2008-2009 global financial crisis, the government’s official measures of inflation, as reported by INDEC, have increased markedly. However, as we have previously discussed, these statistics lack credibility. **The actual inflation rate is likely closer to three times the official rate, and according to recent projections published by private economists, they are likely to reach a decade high of 28-30% this year.**^{xxiv} Rather than taking rational measures to reduce inflation, the government has recently implemented a second round of “voluntary”^{xxv} price controls on hundreds of consumer goods. While these programs are intended to ensure the availability of consumer goods, in

the past they have led to hoarding and resulted in the application of anti-hoarding laws that can result in the confiscation of private stocks of goods.^{xxvi} Still, the government has chosen to ignore the failure of this approach.

Given policies of this nature, it seems reasonable to expect that even private estimates of inflation understate the natural rate of inflation. After all, **while the government can restrain end market prices in the short run, eventually market prices will rise and inflation will reflect those increases.**



If the government continues on its current policy path, it is likely that Argentina’s next economic crisis will look frighteningly similar to 1989-1991’s series of massive devaluations and repudiations of domestic debt. This outcome would be unnecessary and tragic, for savers and pensioners, especially given the clear and manageable options available to avoid such an outcome. Having already raided the international reserves of the pension system (ANSES), drawn down much of the dollar reserves of the Central Bank (BCRA), and replaced those dollars with inflated pesos, **there is a serious risk of leaving future generations with massively devalued peso-denominated pensions.**

To quote one respondent to the “experts survey”: *“Argentina is out of the global capital market, currently lags in the FDI agenda, and is losing ground on the commercial end. Its exports have increased less than in every other South American country in the last ten years.”* If the government ever wants to pursue a new economic policy path, the time to do so is now. The government must recognize that it is in a race against a full-blown crisis that cannot be stopped by disjointed policies.

What can be done? Facing the World

The gaps between the public’s views and government policies make it clear why the current administration is struggling politically. With little time left to secure her legacy

and set the country on a path toward sustainable growth, President Kirchner must embrace a comprehensive and rational approach to resolve the country's problems, lest history will judge her as just one more Argentine President who left a massive crisis for her successor and the public.

With 75% of disapproval of her government's handling of crime, 73% disapproval of the government's handling of the country's inflation problems, 62% disapproval of her economic policies and 51% disapproval of her handling of the country's debts with foreign and local institutions and investors, her mandate for change is clear.

Some of the respondents to our "experts survey" have expressed the view that the most urgent matter is to resolve the conflicts with international organizations and to then deal with domestic issues. These domestic issues include the creation of a credible inflation index and the reversal of government-imposed capital controls, which are opposed by 58%^{xxvii} of the public. Others maintain that those internal issues need to be addressed before dealing with the international issues. We strongly agree with the former.

Settling disputes with private creditors and international organizations, as a first step, would send a strong signal to foreign investors that the government is committed to reengaging with the international community. The ability to attract foreign direct investment in infrastructure would accelerate the country's transition from a largely commodity-based economy to a value-added economy. Of course, foreign investors would have to be assured and made comfortable with the security of their property rights. These assurances would become harder to rely on if the government were to nationalize more firms, including the Buenos Aires electric utilities, Edenor and Edensur. Moreover, without settling these outstanding disputes, the government would not be able to benefit from the ability to refinance existing debt, at lower rates, due to ongoing threats that creditors could attach the country's assets.

The inevitable social and economic dislocations that would result from the ultimately necessary devaluation of the currency would come at a reduced social cost. Once foreign investment and a reduced cost of funding were secured, it would become easier to access much-needed U.S. dollars.

The Politics are Feasible and Sensible

Beyond the economic rationale for avoiding crisis and supporting growth, the President must consider the potential affects that policy changes could have on her party. The two surveys by Poliarquía demonstrate the political implications of these recommended shifts. One expert reflected the vast majority of respondents to the public survey when he commented that: *"There would be no negative impact on the President's image if she were to pursue a more favorable strategy towards foreign capital and even reach an agreement with the holdouts and other financial organizations, especially if the government emphasizes the effects it would have on the country's economy and development"*.

In fact, given public opinion of the administration and its policies, there is little doubt that the population is ready for change. If the President implemented these changes in recognition of the benefits to social inclusion, the public response would be overwhelmingly positive.

Why has the government been slow in changing its confrontational behavior toward the international community? It appears to be a combination of President Kirchner's political style of demanding without compromise and vilifying opponents. Until today, this has been a viable approach given that the international community has taken no meaningful actions against the country for violations of trade agreements or manipulation of its economic data. Railing against those President Kirchner has defined as enemies of the state, whether the IMF, the World Bank dispute awardees or the "vulture" holdouts, has made for good rhetoric. Unfortunately, there are no villains left which the public believes are truly at fault. Instead, it is now members of the administration that have increasingly become the focus of public ire.

Argentina's politics have changed as the effects of isolation have inflicted grave harm on ordinary Argentines. Most dramatically harmed have been those working-class and poor Argentines whose needs the President has always claimed to champion. While it used to be politically productive to focus her anger against the international order, the damage that has been done appears now to have resulted in the conversion of the political atheists, who previously supported her, into supporters of international engagement.

It appears that the President, who has been absent from the public eye for over a month, may be starting to recognize this. **While the decision to engage in prior negotiations with creditors, launched by Nestor Kirchner as debt swaps, are viewed favorably by 75% of respondents,^{xxviii} there is little chance that the terms of the current offer will be accepted by the holdouts.** This view is supported by most of the opinion leaders surveyed, who do not believe that, in the face of a U.S. court judgment that requires payment in full, a re-opening of the debt swap will have much acceptance among the creditors. Still, many do believe it shows that the administration is ready to start negotiating a way out of conflict. This is important given that, even if the country is able to get the U.S. Supreme Court to hear its appeal on the payment formula created by U.S. Justice Griesa, many respondents believe "the chance of getting a favorable outcome is very low."

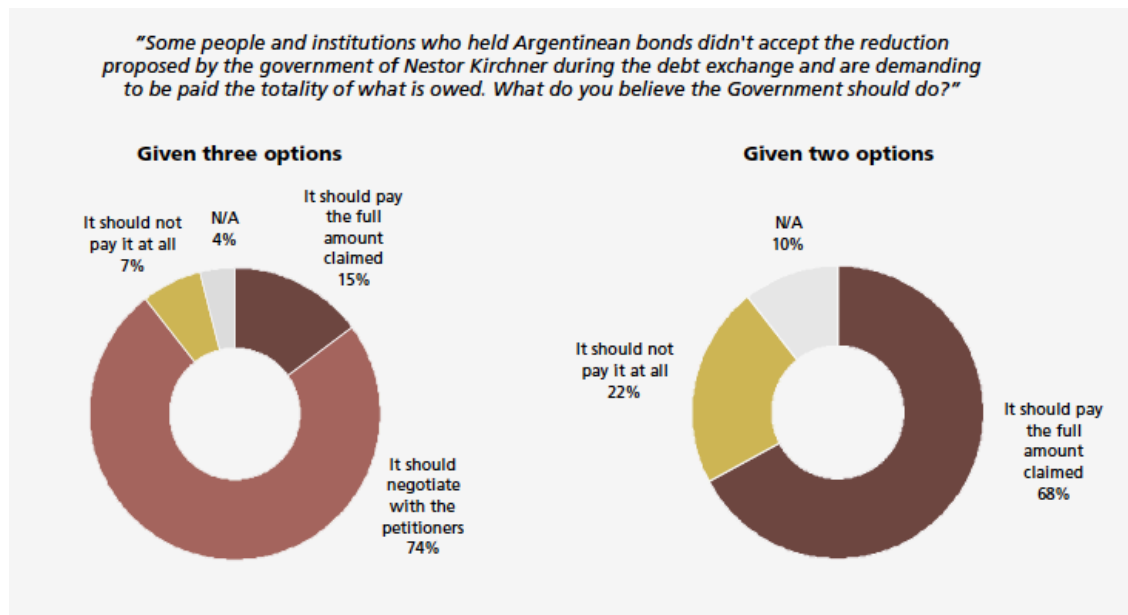
Importantly, even in the unlikely event that the Supreme Court rules in its favor, that would not change the verdict which requires Argentina to pay the holdouts in full. Instead it would only result in the case being remanded to Judge Griesa, thus wasting precious time and increasing uncertainty and economic risks. The public clearly recognizes the benefits of direct negotiations.

When asked *"do you believe that the Argentinean debt must be paid in full"*, *three quarters of the public responded that it should be paid in full. When polled about those matters in which international courts have entered judgments and awards*

against Argentina, 82% of the public felt the country should negotiate and only 5% suggested Argentina should refuse to pay.^{xxxix}

These negotiations would be met with overwhelming support. **These views are not only widely held but remain fairly consistent regardless of the dispute or the claimant involved.**

When asked about dealing with the holdouts, which we defined in the same terms^{xxx} as we would define the “vultures,” the results were fascinating and counterintuitive. On this subject, we offered two scenarios for those surveyed to consider. **The first scenario provided only a choice between paying in full or paying nothing, and 68% of the responses supported paying in full while only 22% felt that the government should pay nothing to the holdouts. When given a third option of negotiating, 74% believed the government should enter into negotiations with the holdouts, 15% believed they should be paid in full and only 7% felt they should be paid nothing.^{xxxi} Even when we chose to use the term “vultures”, only 24%^{xxxii} of the public stated the government should refuse to pay them.**

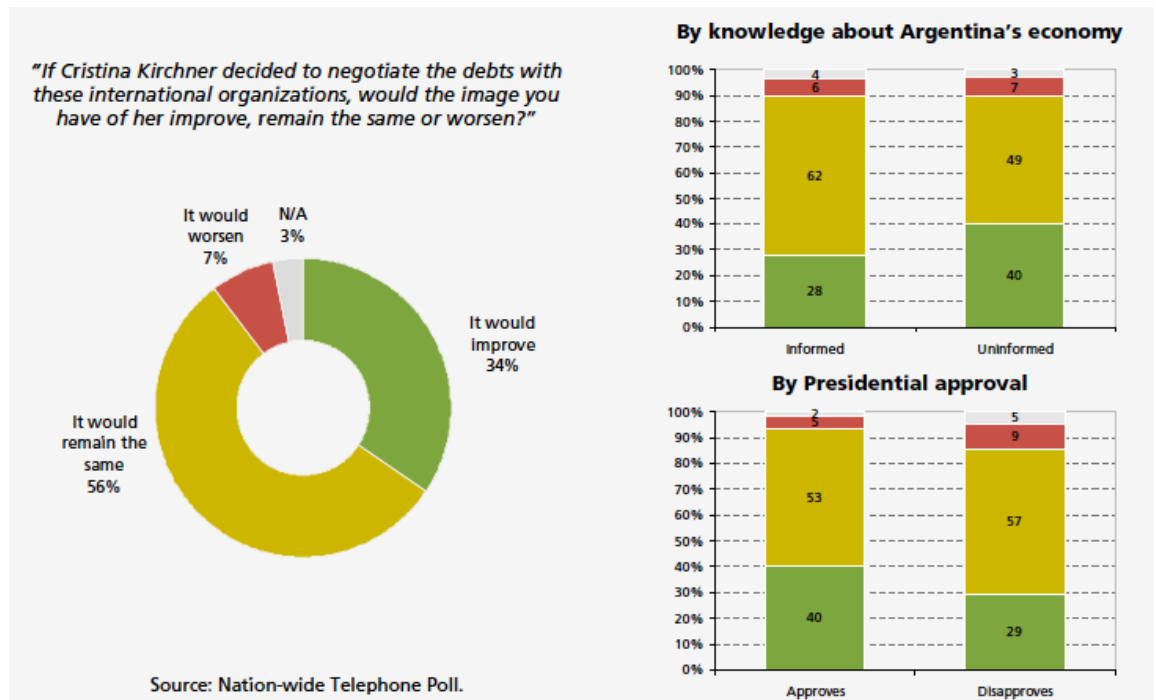


While the outcomes suggest that perhaps President Kirchner is waiting until after a judgment on the payment formula before negotiating, it is clear that those majority of public respondents who already want change may be correct in choosing now as the time for that change to begin. This appears to be true given the dwindling dollar reserves, the deepening economic crisis and the rising social dissatisfaction. The urgency is even more clear when reviewing the reasons, both moral and practical, that respondents state for paying Argentina’s debts.^{xxxiii}

“In your opinion, which is the main reason of why Argentina should pay the debt still in default?”

	%
Debts must be honoured	27
To improve its international position	15
To improve its economy	13
To encourage FDI and get us credit	11
To pursue economic sovereignty	8
To stop paying interest	3
None, it shouldn't be paid	2
It must be paid, but in different terms	2
To avoid default	1
Others	1
N/A	17
Total	100

In the survey, we then sought to gain insights into the practical political impacts of entering into negotiations and settling Argentina’s disputes. When asked ***“If Cristina Kirchner decided to negotiate the debts with these international organizations, would the image you have of her improve, remain the same or worsen?”***^{xxxiv} more than 55% of the public felt that their image of President Kirchner would remain the same and 34% said their image of the President would improve. Interestingly, among those who specifically identified themselves as supporters of the President, 53% said their image of her would remain the same and 40% stated that it would improve.



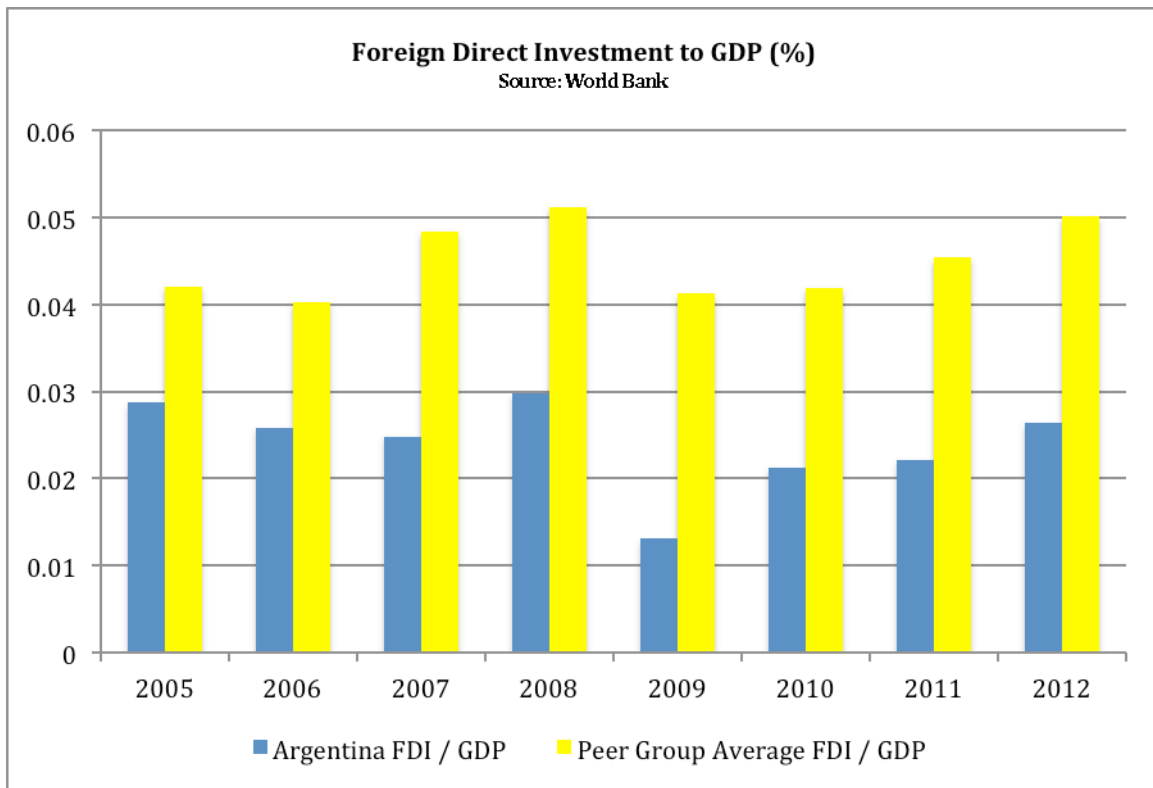
When polled on justifications for *not* paying those debts that remain as a result of the 2001 default, 61% of the public believed that paying the debts would weaken the economy.^{xxxv} However, they were not asked to consider whether the payments could be structured in a manner that would either avoid negative current economic impacts or whether they expected the short- to medium-term benefits would offset these costs. Beyond this sole concern, the majority of those questioned saw no other negative impact resulting from the settlement of these debts.

Of the other possible reasons that were offered to those polled as a basis for choosing not to pay these arrears, none found support from the majority. Most of the public disagreed that paying the debts would weaken the country's international position or economic sovereignty, that it would be destructive to the social progress of the past decade, that it would result in a return to neoliberal policies or that it could result in an economic crisis similar to 2001. Perhaps more interestingly, when asked the main reason that Argentina should not pay the debts still in default, only 8% of respondents felt that the creditors demands are excessive.^{xxxvi}

The Benefits are Clear

We now know that an overwhelming majority of Argentines strongly believe that the government should pay its debts in full, and few disagreed with the idea that the government should enter into negotiations with the necessary outcome being a resolution of its disputes. Still, there were differing views about the positive impacts those resolutions would have on the economy. **The majority of those who responded agreed that paying debts that**

were in default would help integrate Argentina into the world, provide improvements in the economy and support job creation, reduce inflation, re-activate the real-estate market, result in a removal of capital controls and drive investment in the country's infrastructure.^{xxxvii} These outcomes are all supportable and would be likely. For example, according to Graham Fisher & Company estimates, if the country had been able to attract the same levels of foreign direct investment as a percent of GDP, as its peer group average, it would have received an additional \$57 billion dollars of investment inflows since 2005.



Credit Ratings

More dramatically, **if the country settled its disputes, the reduction in the implied cost of capital or credit spreads would result in meaningful and immediate financial benefits to the country.** For example, if in the near term and before the economy deteriorated further, Argentina settled its disputes and took steps to create credible economic statistics, it is likely that the rating agencies would quickly move to review, and likely upgrade, the country's credit rating. Such ratings actions could conceivably come even before the country secured foreign investment or addressed capital controls and other domestic policy issues. This would provide extraordinary benefits to the federal government, to the provincial governments, the public pension funds, private companies and, as a result, to the public.

Last September, when Standard and Poor's downgraded Argentina's sovereign rating to CCC+ from B-, it cited "increased risks to debt service stemming from a lawsuit over the debt the government of Argentina still maintains in default." It also maintained a negative outlook^{xxxviii}. **As the Moody's sovereign credit analyst responsible for Argentina stated: "Argentina has enough money; it's a political decision not to pay... It's positive that political decisions are easier to change than a big fiscal deficit or excessive debt"**^{xxxix}. Importantly, this point is all too correct – the government can fix its economic outcome if it has the will.

In November, Fitch highlighted the risk of the Kirchner administration taking much longer to resolve the disputes and cited the deteriorating fundamentals in a clear and straightforward manner. In its release, Fitch warned "the affirmation of the FC IDR reflects the fact that Argentina's FC securities issued under international law continue to be subject to a high level of default risk given the ongoing legal dispute in U.S. Courts." Their analysis went on to highlight the uncoordinated, unpredictable and destructive economic policies pursued by the President's cabinet during her first term^{xl}:

Besides the legal dispute, Argentina's credit fundamentals continue to deteriorate with the emergence of 'twin deficits' in the context of extremely constrained financing sources. Highly distortive and unpredictable policies continue to weigh on its growth prospects. At the same time, inflation remains elevated, with private sector estimates significantly higher than the official statistics.

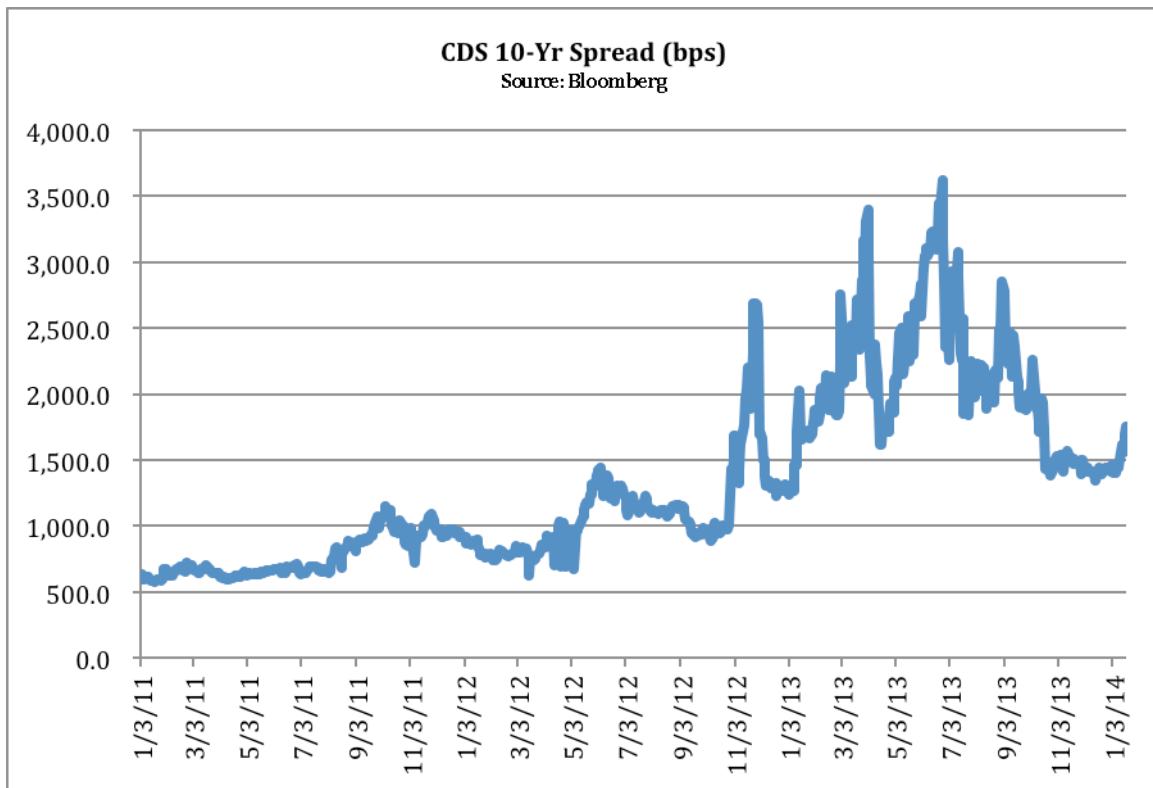
The most significant macroeconomic challenge confronting Argentina is the accelerated pace of decline of foreign exchange reserves despite existing capital and import controls, as well as the significant difference between official and parallel market exchange rates. International reserves have fallen by USD10.3 billion or over 20% so far this year and Fitch forecasts further declines for the next two years. These dynamics expose Argentina to a risk of disorderly adjustment in case of an external shock."

Argentina's high tax burden, cyclical tax intake and expansionary policies during the boom years have increased budgetary rigidities that are difficult to unwind. Debt dynamics will also be less favorable than in the past, as currency depreciation, emergence of primary deficits and weaker growth will reverse the trend of debt reduction seen in the past. Argentina's debt of 51.6% of GDP for 2013 estimated by Fitch is already above the 'B' median.

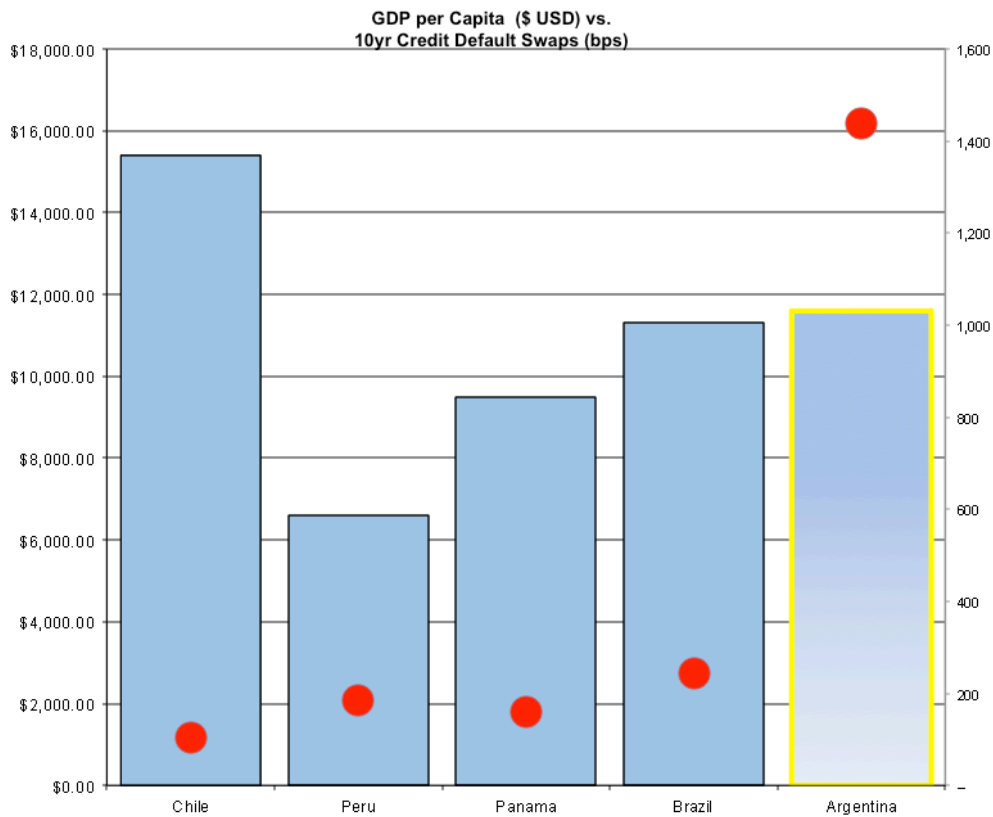
The sovereign's extremely limited sources of conventional financing are a credit concern. The government has relied increasingly on central bank direct financing which undermines the already weak quality of the country's institutions and at the same time engenders inflationary pressures.

Credit Spreads

In 2011, when we presented our analysis, we argued that if the country put its disputes behind it, then credit spreads would likely collapse by between 400 and 550 basis points and result in interest savings of between \$15 and \$22 billion^{xii}. Today, **specific and repeated threats by administration officials to ignore the judgments of U.S. courts, coupled with increasing economic strains, have exacerbated the volatility of the country's credit spreads and have caused them to widen more than threefold during the ensuing years.**



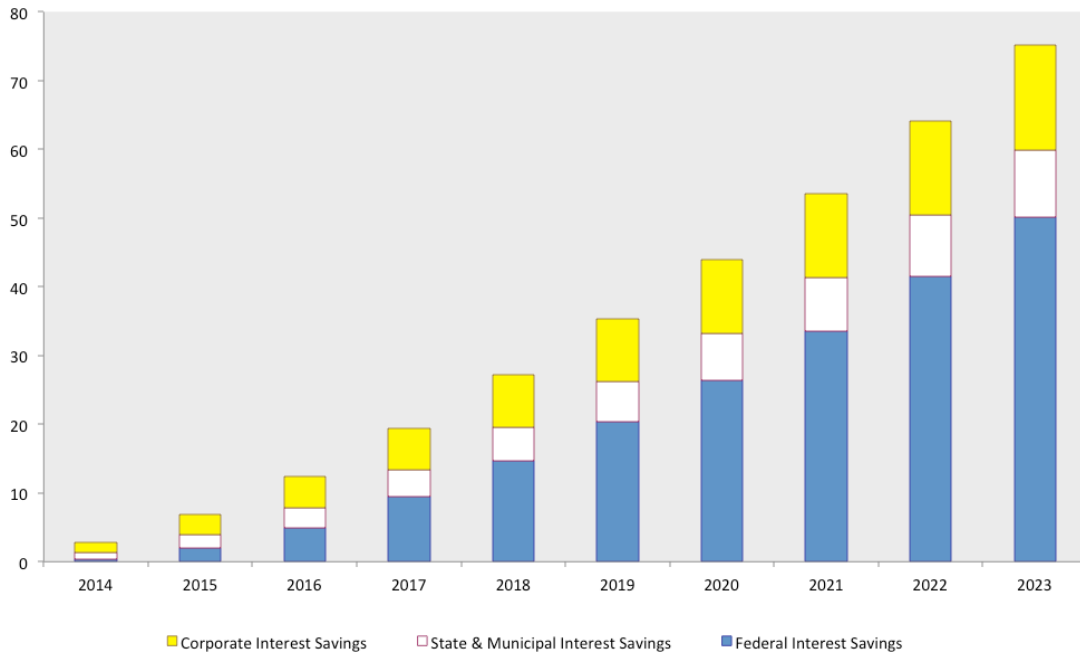
Our models suggest that **if the government resolved its outstanding debts, today, while its fundamental fiscal position remains stronger than many of its more highly rated peers, credit spreads could narrow by more than 1,000 basis points.**



Note: red dot is meant to show the credit spread, and the bars represent GDP/capita

This would translate into a CDS spread of about 400 basis points, still higher than its peer group average of 100-250 basis points but likely to narrow further as investors and trading partners recognized the government’s further movements toward economic normalization. **Without any increase in its total debt^{xliii}, the refinancing of existing debt, at lower credit spreads, would translate into federal government savings of between \$50 and \$70 billion U.S. dollars over the next decade.**

Cumulative Interest Savings at 300bps Credit Default Swap (\$ USD)
Source: GF&Co.



Provincial governments would realize savings of roughly \$1 billion dollars annually and interest savings to public companies could translate into an additional savings of \$1.5 billion per year.

The benefits extend beyond the savings. **Over time, assuming the country was able to achieve equity multiple-expansion toward 80% of that of Brazil’s Bovespa, that would translate into an additional \$10 to \$15 billion dollars for the country, which would improve the solvency of the public pension system (ANSES) by \$5 to \$10 billion dollars and help to bolster a system that has seen its dollars replaced by peso debt. This would improve the economic security of millions of Argentine retirees.** Equity appreciation would also increase federal corporate tax revenues by about \$0.5 billion dollars annually.

Conclusion to a Difficult Decade

As our surveys demonstrate, within Argentina, experts and the broader public recognize that the problems which the country faces are the result of distortionary, socially problematic and unnecessary economic policies that flow from the absence of a comprehensive economic plan. The results of this poor planning have been felt through rising crime rates, unmanageable inflation, the absence of critical local investment, declining reserves and policies that reduce freedoms while stifling development.

Fortunately, the public also recognizes that these problems are solvable through better policy coordination and resolutions to the outstanding legacy issues resulting from its 2001 default. Although the government has been slow to recognize the opportunities to address these issues, perhaps because of a fear of public backlash, the polls should provide the Kirchner administration with ample evidence that her image would not suffer. **In fact, if she chose this new road her image in Argentina would meaningfully improve.**

During the last decade, as a result of its approach to handling its default and debt exchanges, the government was able to reduce its costs by about \$80 billion dollars. However, since 2005, as a result of its chosen policies, it also lost close to \$60 billion in new foreign investment. Today, with mounting inflation and a lack of hard currency, the country is at a crossroads and there is little time left for them to choose a direction.

Today, it remains uncertain whether the government will choose the road that the public prefers. That choice would enable the development of a sustainable and vibrant economy which, though negotiating and settling its international disputes and normalizing relations with the global community, would be able to develop both the value-added products and the infrastructure necessary for domestic and international consumption. The resulting improvement in the country's social conditions would become a major part of President Kirchner's legacy. Alternatively, if the government fails to choose that road, then it will have chosen to continue down the road that many prior Argentine leaders have chosen – the path back to increasing isolation and a resulting social and economic crisis. What is clear from our surveys is that the public recognizes the opportunities and benefits of choosing the road less taken and understands how that would make all the difference to both society and the legacy of the country's twice-elected President.

ⁱ The respondents included five academics, four consultants, six economists, one congressman, two senators, three public officials, two politicians, two public banking officials, one private banking official, five financial sector businessmen, one construction sector businessman, one agricultural sector businessman, one media businessman, four journalists and two union leaders.

ⁱⁱ The identities of the interviewees will not be disclosed due to privacy concerns of the participants.

ⁱⁱⁱ “Should Argentina Pay its Bond Holders?”, CompassCayman, Richard W. Rahn, October 25, 2013, available at: <http://www.compasscayman.com/cfr/2013/10/25/Should-Argentina-pay-its-bond-holders/>

^{iv} “World Index of Economic Freedom”, The Wall Street Journal and The Heritage Foundation, January 7, 2014, available at: <http://www.heritage.org/index/>

^v “Argentina’s public attitudes towards the economic and political environment”, Poliarquia Consultores, Prepared for Graham Fisher & Company, September 2013 (hereafter: “Public Survey”), p.15

^{vi} “Argentina credit rating conditioned by poor credibility and unreliable stats, says Moody’s”, MercoPress, October 4, 2013, available at:

<http://en.mercopress.com/2013/10/04/argentina-credit-rating-conditioned-by-poor-credibility-and-unreliable-stats-says-moodys>

^{vii} “The Argentine Model, Part II: Avoiding Crisis and Securing the Future”, Joshua Rosner, November 11, 2011, available at: <http://www.scribd.com/doc/89812109/Rosner-Argentina>

^{viii} “El Modelo Argentino, Parte II: Previendo La Crisis y Asegurando el Futuro”, Joshua Rosner, Libertad y Progreso, November 11 2011, available at: <http://www.libertadyprogresonline.org/2011/11/09/“the-argentine-model-part-ii-avoiding-crisis-and-securing-the-future”/>

^{ix} “Public Survey”, p.11 (Note: The public prefers more state-owned enterprises and private investment could come in the form of joint ventures with the government or investment in private enterprise.)

^x “Argentina protests: up to half a million rally against Fernández de Kirchner”, The Guardian, Uki Goni and Jonathan Watts, November 9, 2012, available at:

<http://www.theguardian.com/world/2012/nov/09/argentina-protests-rally-fernandez-kirchner>

^{xi} “Two million Argentines across the country join the biggest anti-government protest in years”, MercoPress, April 19, 2013, available at:

<http://en.mercopress.com/2013/04/19/two-million-argentines-across-the-country-join-the-biggest-anti-government-protest-in-years>

^{xii} “Public Survey”

^{xiii} “Public Survey”, p.9

^{xiv} “Public Survey”, p.6

^{xv} “No hubo oferta formal al Club de París, pero se avanzó en las negociaciones”, La Nación, Luisa Corradini, January 21, 2014, available at: <http://www.lanacion.com.ar/1657103-no-hubo-oferta-formal-al-club-de-paris-pero-se-avanzo-en-las-negociaciones>

^{xvi} Statement by the IMF Executive Board on Argentina, Press Release No. 13/33,

February 1, 2013, available at: <http://www.imf.org/external/np/sec/pr/2013/pr1333.htm>

^{xvii} “Argentina’s Socioeconomic Statistics: Still Lying After All these Years”, *The Economist*, December 21, 2013, available at: <http://www.economist.com/news/americas/21591882-official-figures-paint-rosy-picture-so-why-are-argentinians-rioting-still-lying-after-all> (See: “INDEC is likely to cherry pick items for which the government has ordered price freezes and leave out those whose prices rise, thinks Juan Luis Bour of FIEL, a think-tank in Buenos Aires... The problem of dodgy statistics goes much wider. For example, while INDEC claims construction expanded by 4.7% in the first ten months of 2013, EconViews, a consultancy which makes its own calculations, puts this number at just 0.5%... Farm-watchers were confused when their estimates for the 2013 maize harvest of around 25.5m tonnes trailed that of the agriculture ministry by more than 6m tonnes. It turned out the ministry had quietly included maize retained by farmers to feed their livestock, contrary to its previous practice... The official inability to face the truth extends to crime. The justice ministry stopped publishing annual crime statistics in 2009. In its statistics the health ministry has reduced the murder count by two thirds by subtracting “deaths from outside aggression, of unknown intent”, of which there were 3,124 in 2011. The problem for President Cristina Fernández is that her government’s statistical solipsism no longer washes with Argentines. This month a dozen provinces were shaken by police strikes (settled with wage increases of over 30%) and looting. Argentines know perfectly well that inflation, poverty and crime bear little resemblance to the official statistics.”)

^{xviii} “Latin America Inches Forward”, Andre Loes, January 15, 2014, available at: http://finchannel.com/Main_News/Banks/129450_Latin_America_inches_forward/

^{xix} Country Analysis Briefs, Argentina, U.S. Energy Information Administration, July 24, 2012.

^{xx} “Why Argentina can’t keep the lights on in Buenos Aires”, Quartz, Karina Martinez-Carter, January 14, 2014, available at: <http://qz.com/166452/why-argentina-cant-keep-the-lights-on-in-buenos-aires/>

^{xxi} “Argentina Continues Fight With Utilities After Power Outages”, *Wall Street Journal*, Shane Romig, January 3, 2014, available at: <http://online.wsj.com/news/articles/SB10001424052702303370904579298821233190310>

^{xxii} IBID EIA

^{xxiii} WorldBank, Global Economic Prospects, Argentina, Current Account Balance as a Share of GDP, available at: <http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=global-economic-prospects#>

^{xxiv} “Analysts see decade-high inflation in Argentina this year”, Juliana Castilla, Reuters, January 14, 2014 available at: <http://www.reuters.com/article/2014/01/14/argentina-inflation-idUSL2N0KO1WP20140114> (See: “For this year, three of the analysts polled said they expect 30 percent inflation, while two forecast 28 percent.”)

^{xxv} “Argentina Price-Control Program Faces Tomato Challenge Supermarket Says Cost May Rise Amid Weather-Related Shortage”, *Wall Street Journal*, Ken Parks, January, 9 2014 available at <http://online.wsj.com/news/articles/SB10001424052702303393804579310673994180840>

(See: “The supermarkets that don't abide by the voluntary accord could face fines and store closures...” “While the supermarkets appear to be saying that tomato prices might go up, producers say tomato prices won't go up and there aren't supply problems. The government isn't going to accept modifications to the agreed prices,” [Economy Minister] Kicillof said in a televised news conference Thursday.”)

^{xxvi} “Argentina prepares to confiscate wheat stocks to ensure bread supply at ‘normal prices’”, MercoPress, July 5, 2013, available at: <http://en.mercopress.com/2013/07/05/argentina-prepares-to-confiscate-wheat-stocks-to-ensure-bread-supply-at-normal-prices>

^{xxvii} “Public Survey”, p.10

^{xxviii} “Public Survey”, p.20

^{xxix} “Public Survey”, p.25

^{xxx} “Public Survey”, p.22 (See: “Some people and institutions who held Argentinean bonds didn't accept the reduction proposed by the government of Nestor Kirchner during the debt exchange and are demanding to be paid the totality of what is owed. What do you believe the Government should do?”)

^{xxxi} “Public Survey”, p.22

^{xxxii} “Public Survey”, p.29

^{xxxiii} “Public Survey”, p.31

^{xxxiv} “Public Survey”, p.26

^{xxxv} “Public Survey”, p.34

^{xxxvi} “Public Survey”, p.33

^{xxxvii} “Public Survey”, p.32

^{xxxviii} “The Republic Of Argentina Unsolicited Ratings Lowered To 'CCC+/C' On Increasing Legal Risks; Outlook Negative”, Standard & Poor's, Sebastian Briozzo & John B Chambers, September 10, 2013, available at:

<http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245357098610> (See: “On Sept. 10, 2013, Standard & Poor's Ratings Services lowered its unsolicited long-term foreign and local currency sovereign credit ratings on the Republic of Argentina (Argentina) to 'CCC+' from 'B-'. At the same time, we lowered our unsolicited short-term ratings on Argentina to 'C' from 'B'. The outlook on the long-term ratings is negative. We are also revising our transfer and convertibility assessment on Argentina to 'CCC+' from 'B-'”)

^{xxxix} “Argentina credit rating conditioned by poor credibility and unreliable stats, says Moody's”, MercoPress, October 4, 2013, available at:

<http://en.mercopress.com/2013/10/04/argentina-credit-rating-conditioned-by-poor-credibility-and-unreliable-stats-says-moody-s>

^{xl} “Fitch Affirms Argentina's FC IDR at 'CC'; LC IDR at 'B-'; Outlook Negative”, BusinessWire, November 22, 2013, available at:

<http://www.businesswire.com/news/home/20131122005613/en/Fitch-Affirms-Argentinas-FC-IDR-CC-LC#.UthqBxZAYL4>

^{xlii} “Argentina: Opportunity or Renewed Crisis”, FT Tilt, Joshua Rosner, August 2, 2011, available at: <http://tilt.ft.com/posts/2011-08/26821/argentina-opportunity-renewed-crisis>

^{xlii} “Public Survey”, p.13 (Note: The majority of those surveyed prefer to finance the country with local capital. As a result, there may be less willingness to increase debt burdens through international capital markets. Refinancing of existing debt would nonetheless come at a reduced cost.)

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