

Argentina post-default

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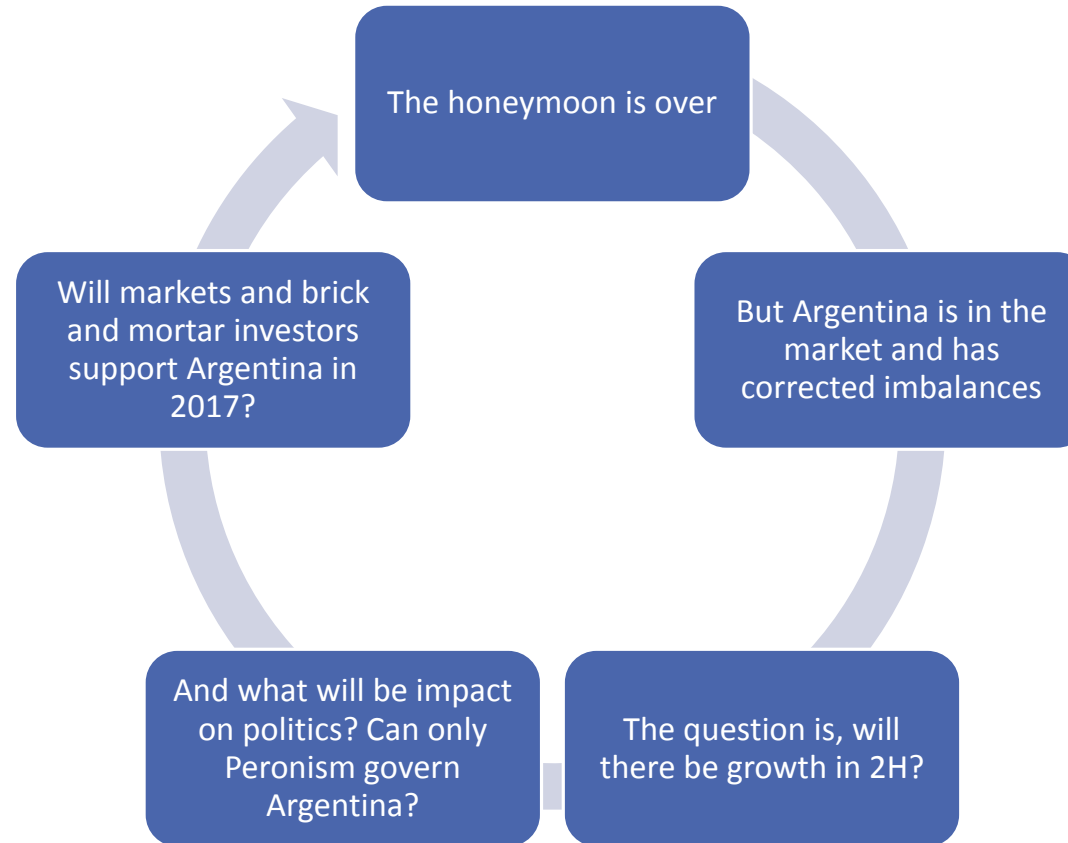
May 2016



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LATIN AMERICA / ECONOMICS / POLITICS / MARKETS

Outline



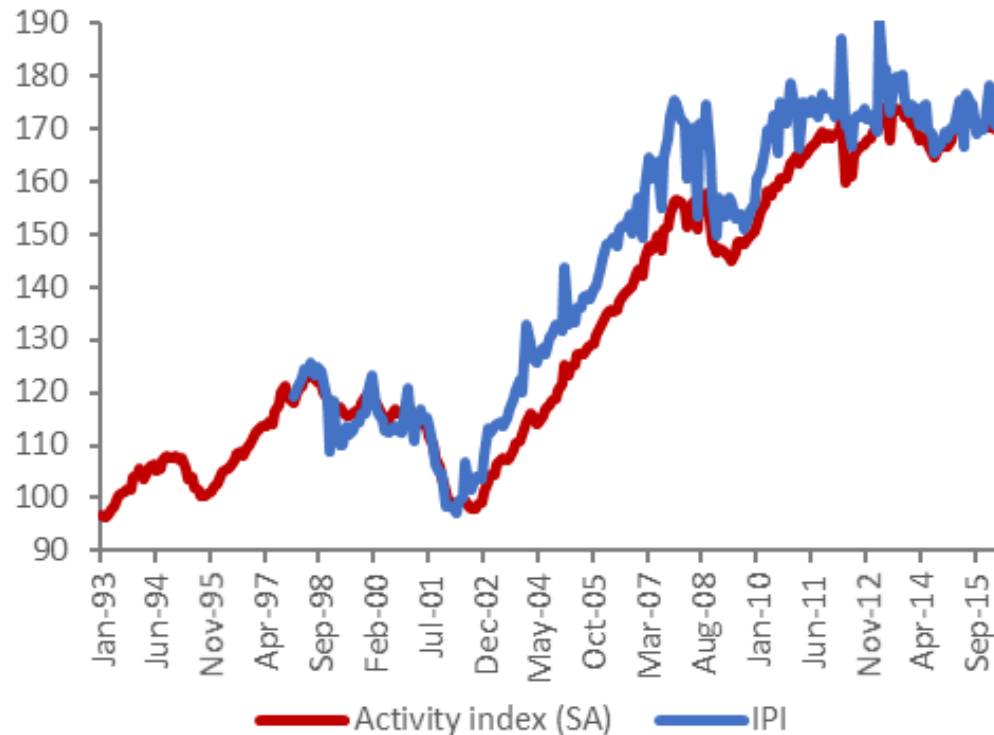
New government removed barriers to growth

1. Holdouts deal
2. Remove the “cepo” and devalue the peso
3. Eliminate or reduce export taxes
4. Correct regulated prices

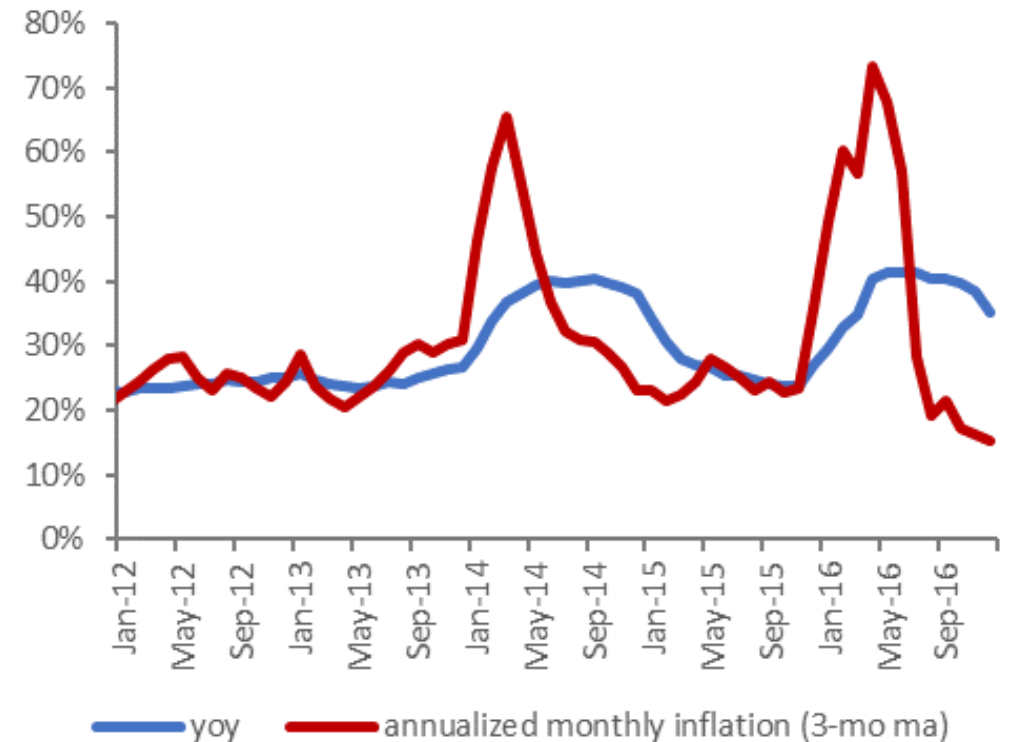
	Energy (4.7% CPI)			Water (0.6%)	Public Transit	Health Insur.	Landlines
	Elect.	Nat. Gas	Gas				
Jan-16	300%		6%			9%	
Feb-16			6%				
Mar-16			6%				
Apr-16		231%		297%	100%		
May-16			10%				192%
Jun-16					67%	15%	
Jul-16						5%	

The honeymoon is over

Activity is contracting and there are job losses



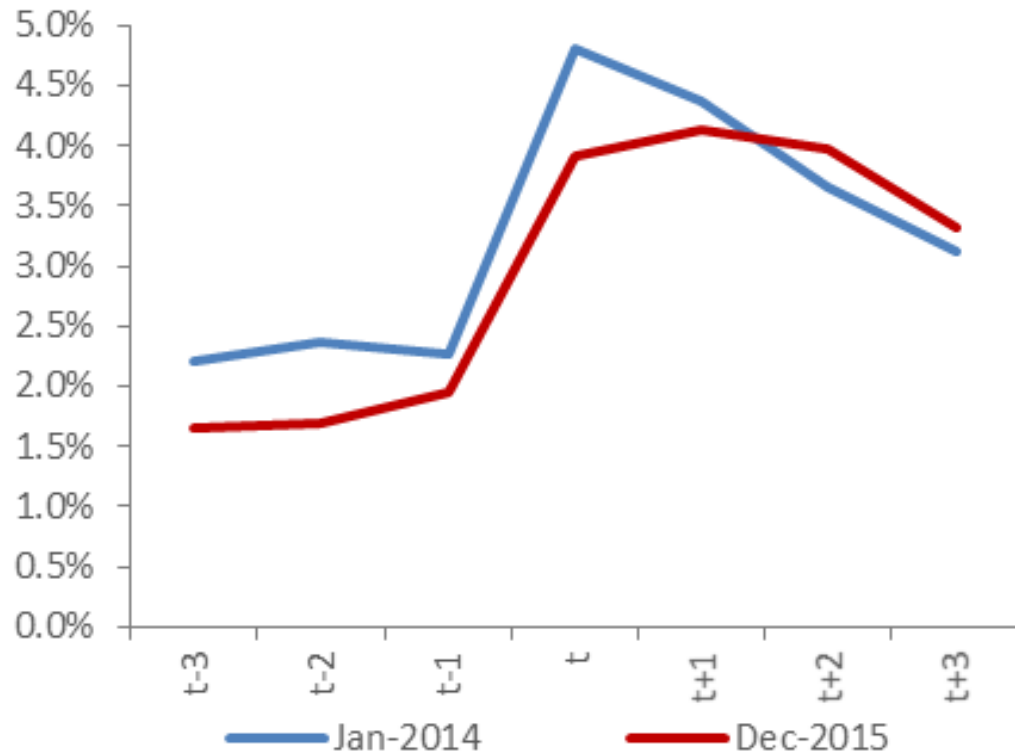
Inflation is hurting



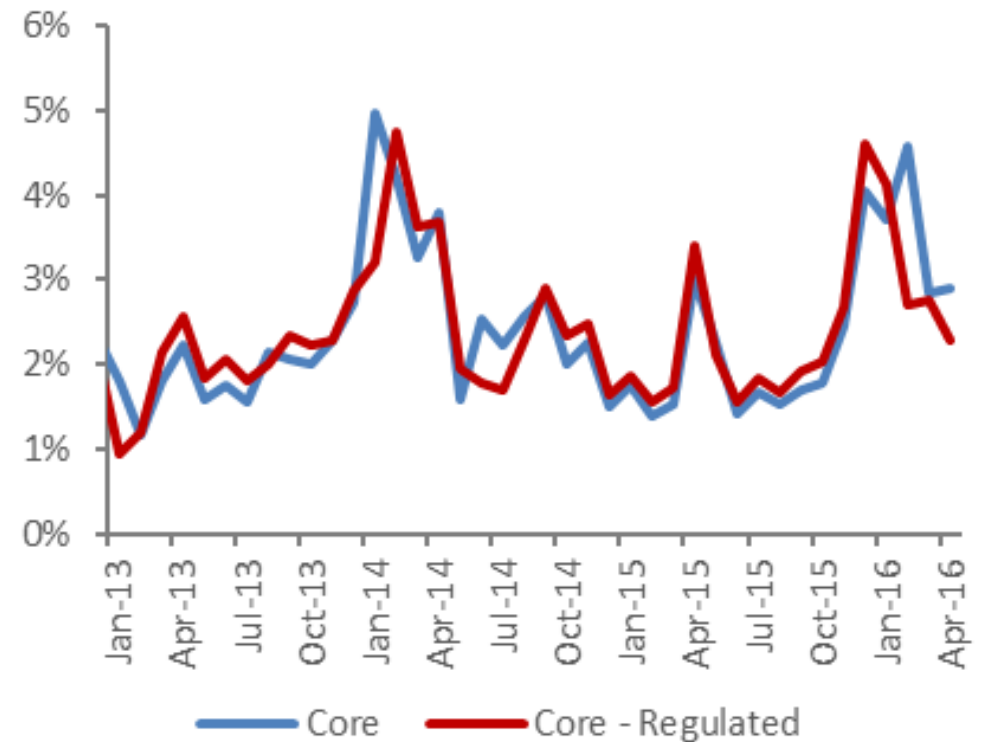
- Inflation above 6.5% mom in April, and above 3% in May

We expect inflation to slow down in coming months

Increased credibility = lower pass-through to inflation (%yoy)

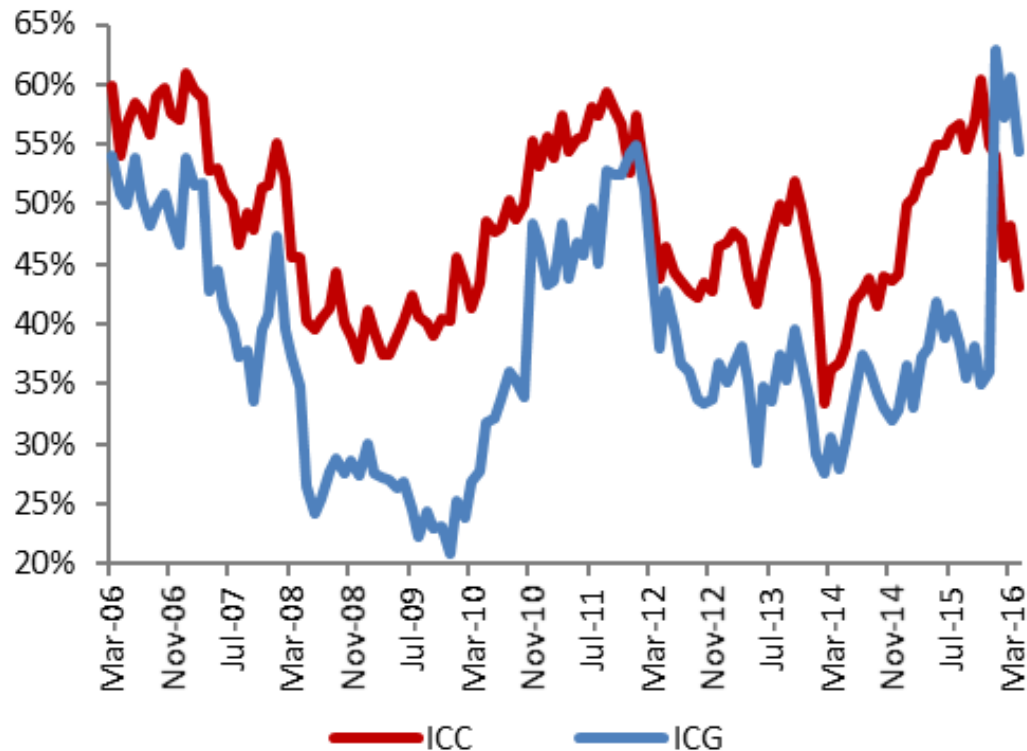


Core inflation stable but at a high level (%yoy)



Only stronger growth can avoid the loss of popularity

Not surprisingly, the president lost popularity



The key to the success of this administration rests on the capacity to jumpstart growth.

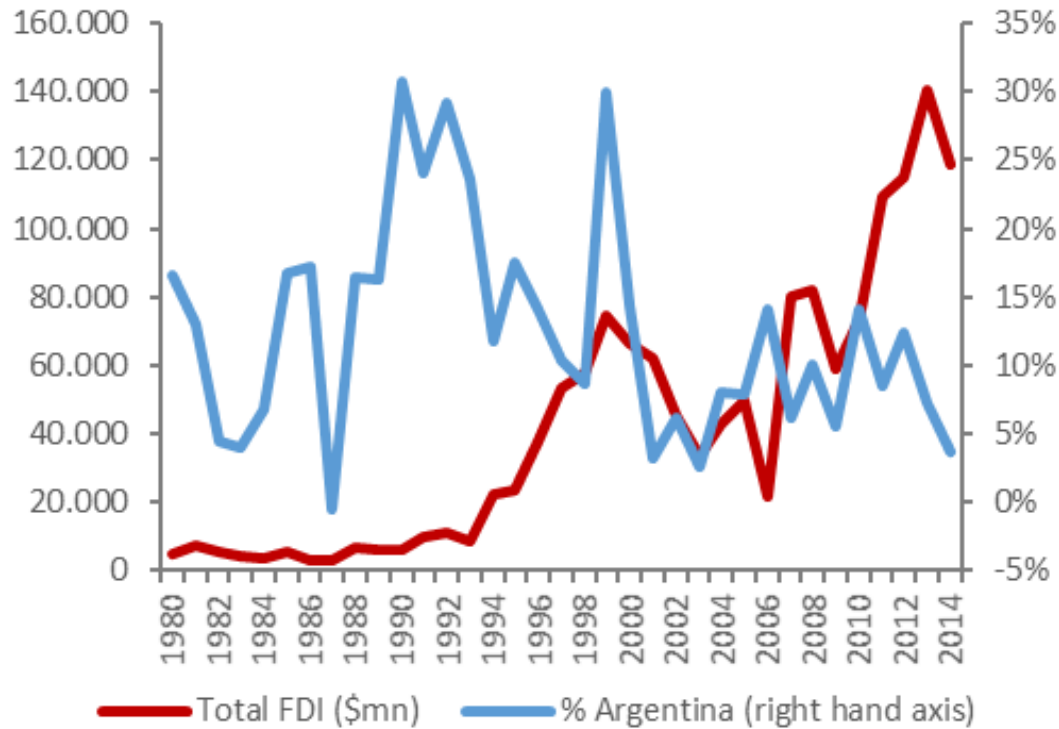
We know how to stop inflations. Bringing growth is more difficult, particularly with an overvalued exchange rate, higher tariffs and high financial costs.

We think growth will come back. Differently from Brazil, in Argentina there is:

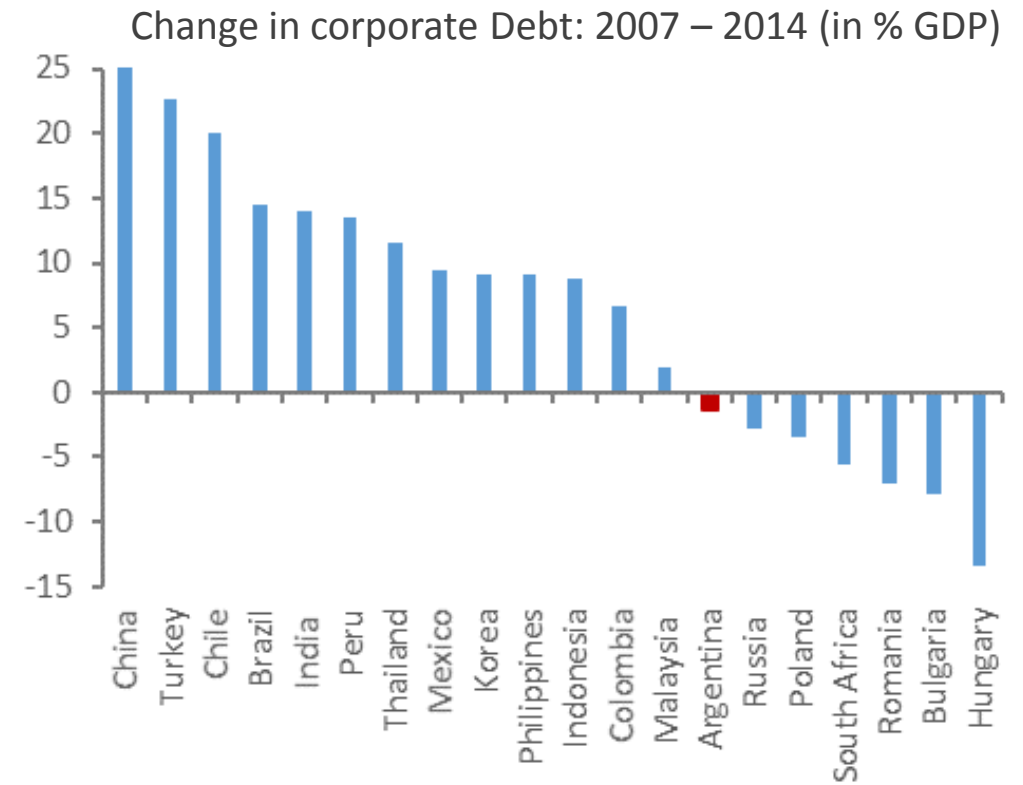
- better policymaking environment
- pent up investment
- low leverage
- big reduction in regulatory pressures

Pent-up investment and low leverage to support view there will be some growth

Low FDI in recent years compared to LatAm peers...



...low corporate leverage compared to other EM countries



How much can Argentina grow?

A simple growth accounting exercise

	Growth	Contribution of capital	Contribution of labor	TFP
1960-69	4.7%	1.4%	0.6%	2.7%
1970-79	3.0%	1.8%	0.6%	0.6%
1980-89	-0.7%	0.0%	0.9%	-1.6%
1990-99	4.0%	0.9%	1.0%	2.1%
2000-09	2.6%	0.9%	1.3%	0.4%
2010-15	2.5%	1.2%	0.6%	0.7%
2016-19 Scenario 1	3.8%	1.3%	0.5%	2.0%
2016-19 Scenario 2	2.3%	1.0%	0.3%	1.0%
2016-19 Scenario 3	1.0%	0.5%	0.0%	0.5%

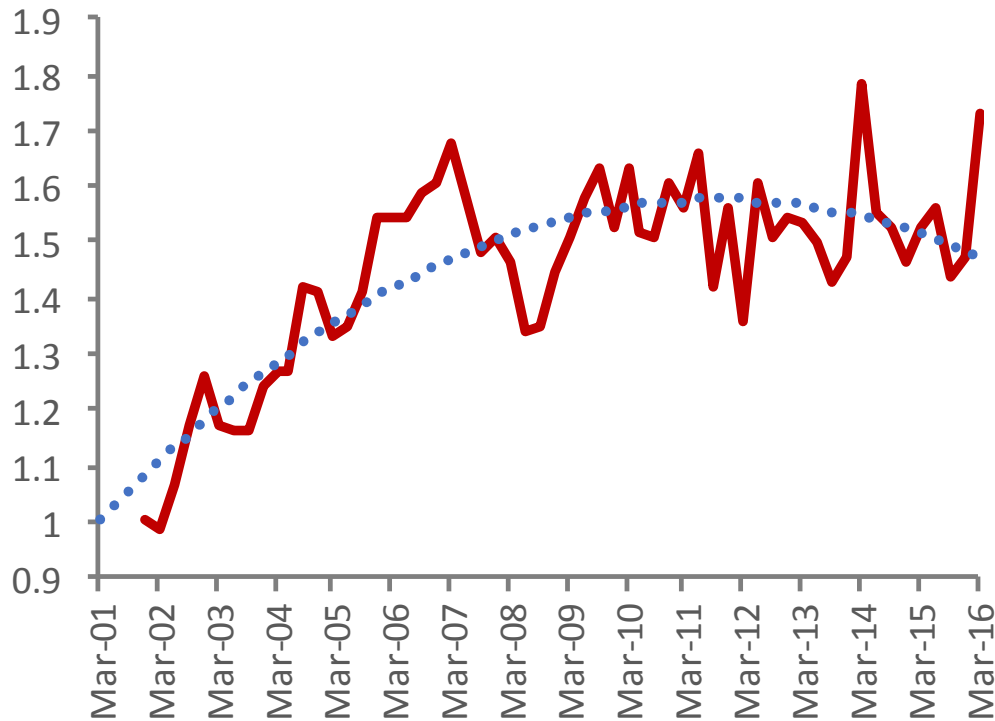
What sectors will drive growth?

- Drivers
 - Agro
 - Infrastructure (but beware of fiscal constraint)
 - Communications
 - Construction and real estate serv (ma non troppo)
 - Banking
 - Energy (but global prices deterrent)
- Laggards
 - Manufacturing

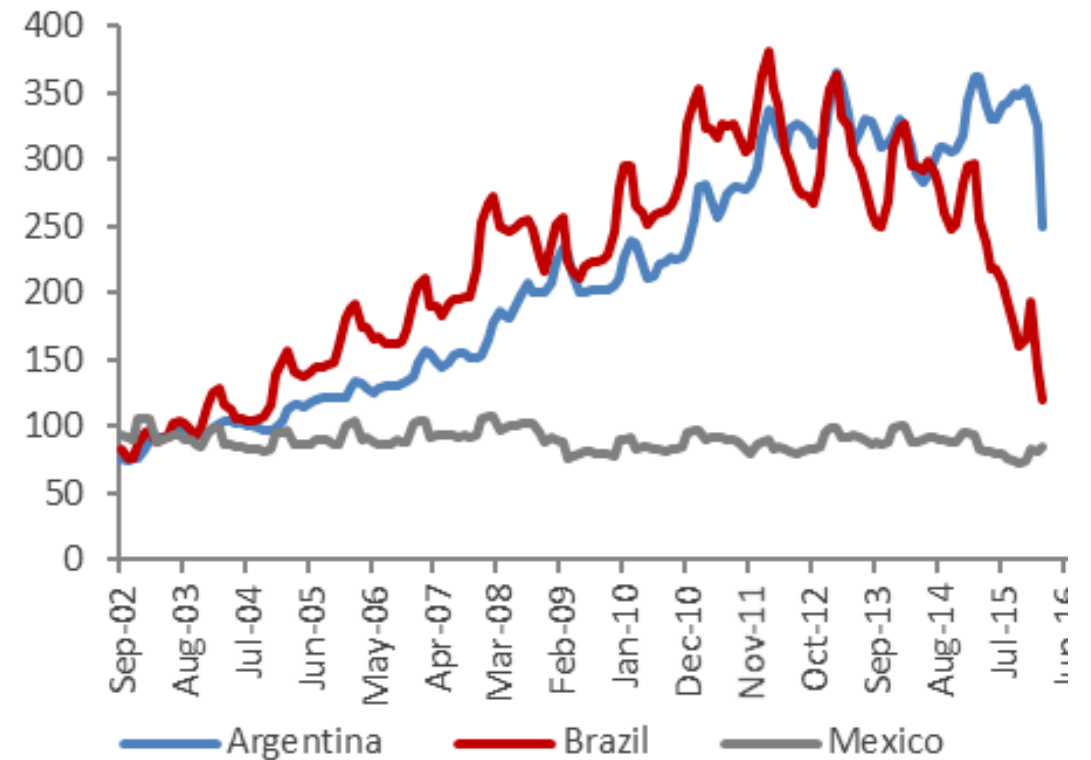
What sectors will drive growth?

Manufacturing will not drive growth. Unit labor costs (ULC) are high. Construction still uncertain but likely to expand (high Tobin's Q, but costs to increase)

Construction's Q (1=Dec01)

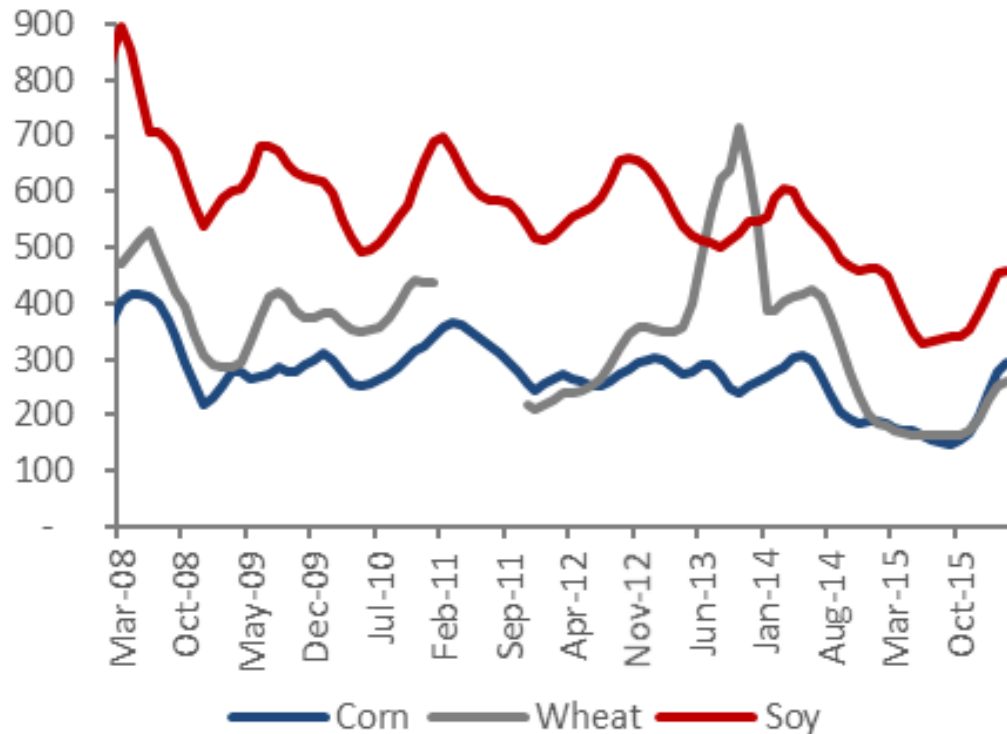


Unit Labor Cost (100=Jan01, 3mo-ma)

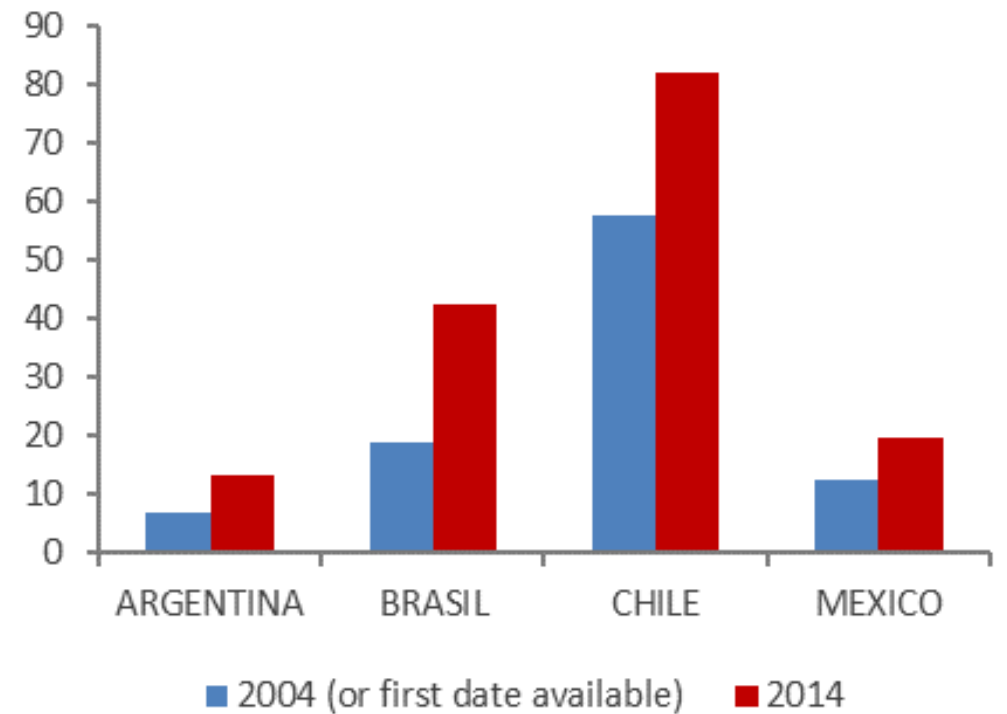


Opportunities: agro and banking

Agro prices have improved in relative terms
(deflated by CPI)

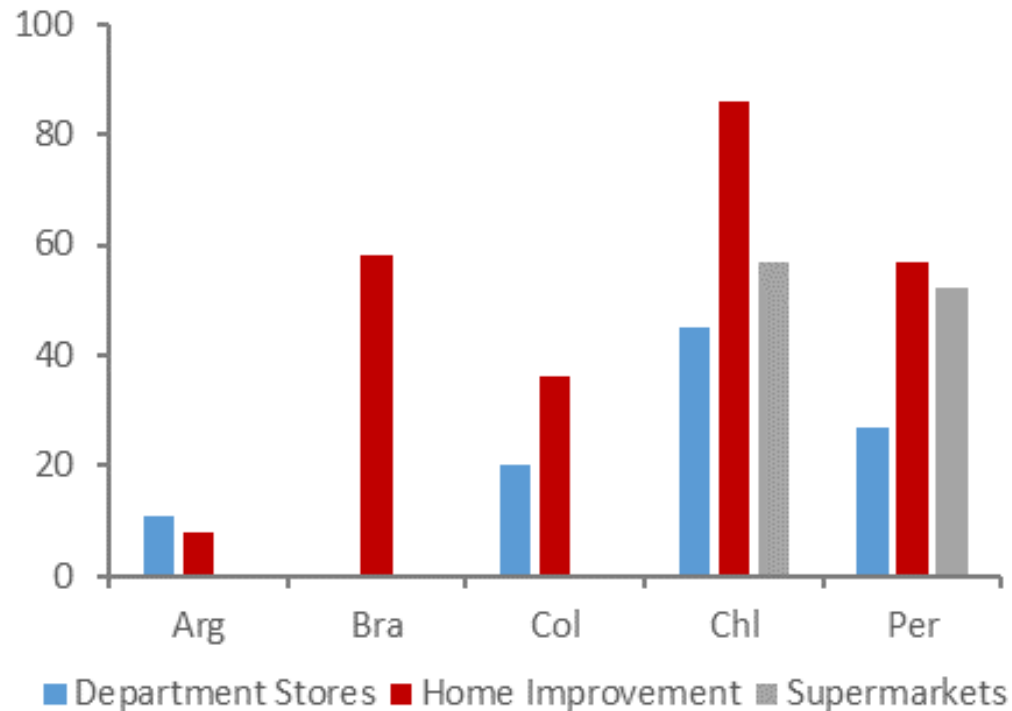


Argentina is the most underbanked country in
the region (loans from priv banks as % of GDP)

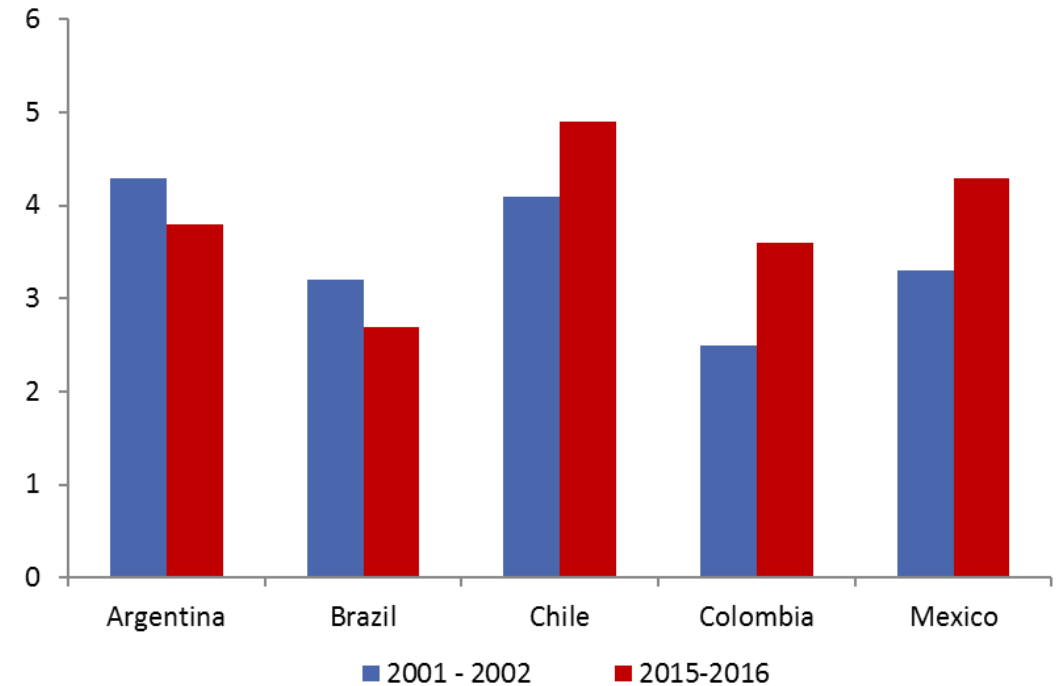


Opportunities: retail, infrastructure and telecom

Falabella's presence in LatAm



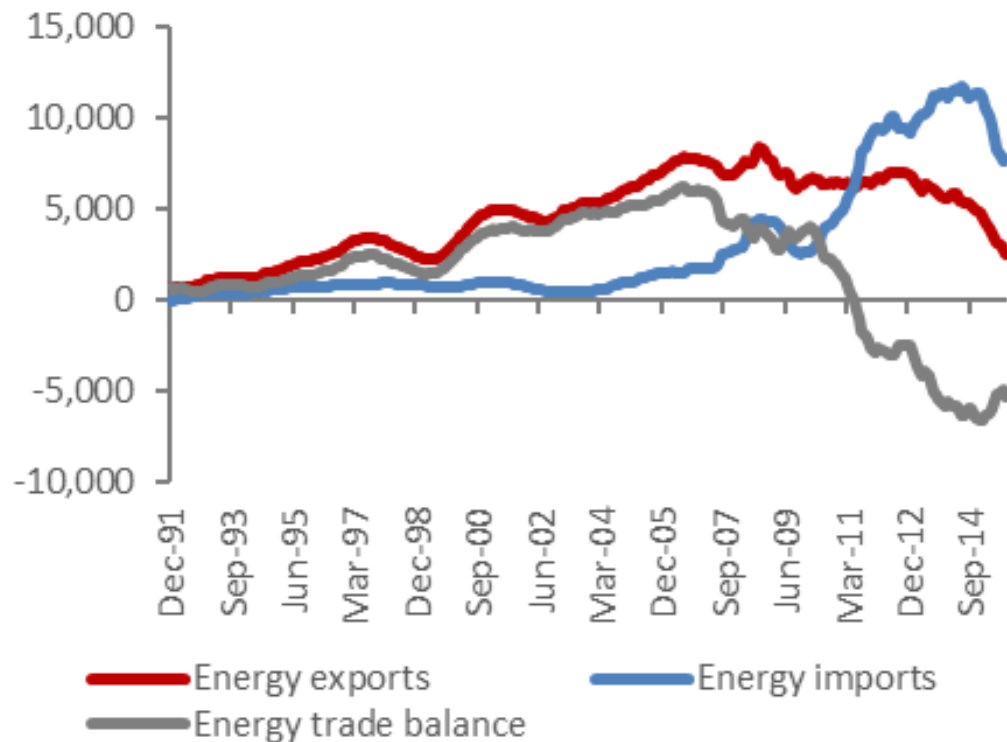
Low quality of the infrastructure, including telecommunications



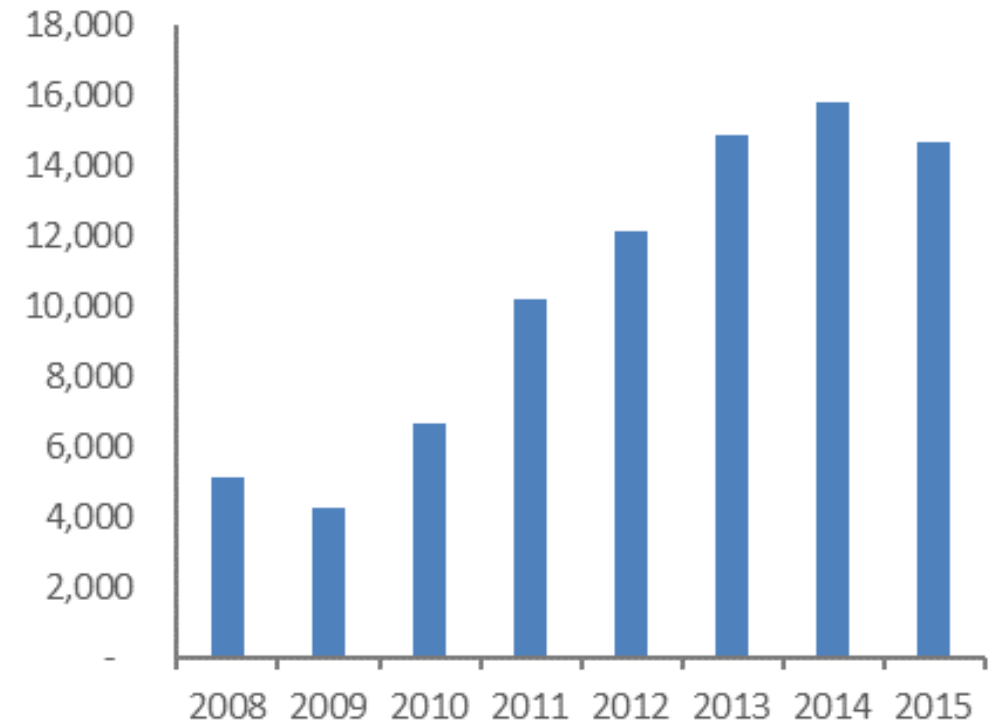
Opportunities: energy

85% of Pampa Energia users paid an electricity bill of only \$3 per month and the average user paid residential gas from \$0.9 to \$4.0 per MBTU. As a consequence, energy is a big external and fiscal problem.

Energy trade balance, US\$m



Government energy subsidies, US\$m



An unbalanced political system

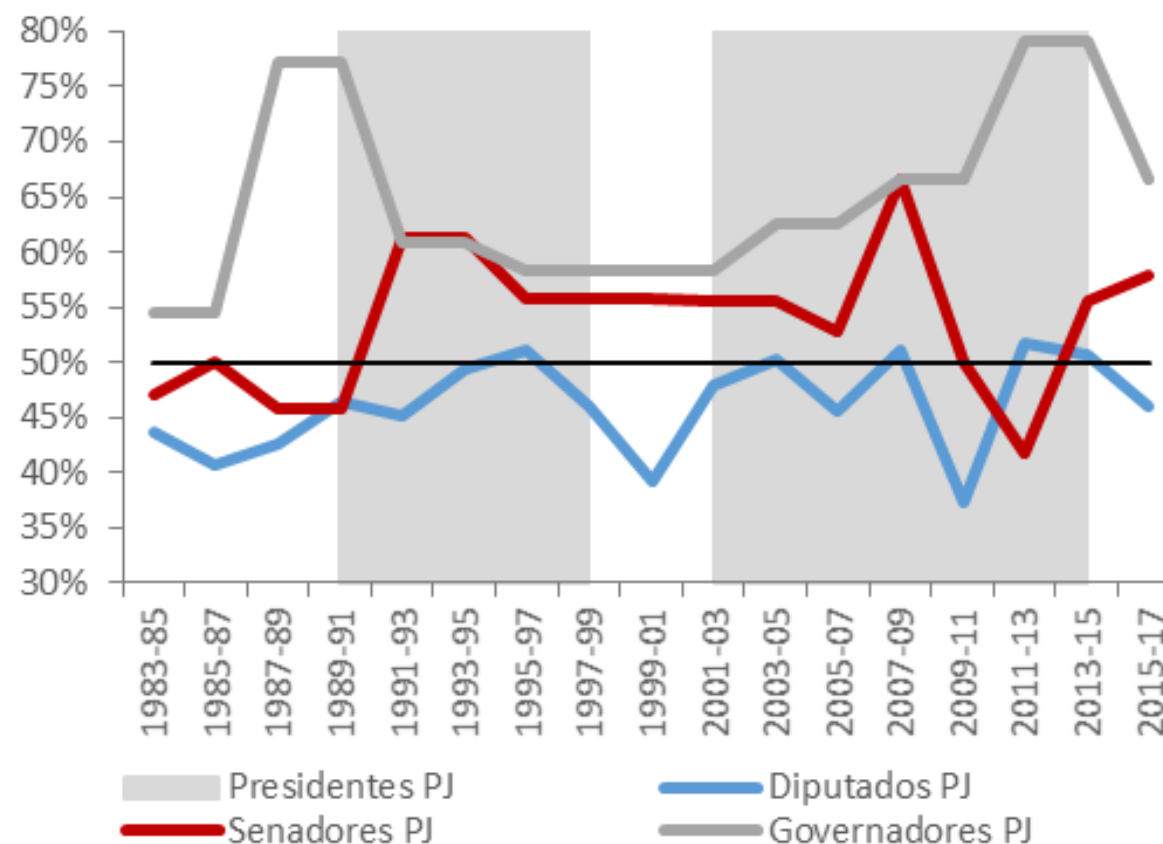
Small-backward provinces are over-represented in Congress. The Peronist party (PJ) is strongest in these provinces.

The political system is fragmented and territorialized. There were 79 parties in 1983, and more than 300 in 2005.

The Radical party (a centrist party) was the most affected by this process.

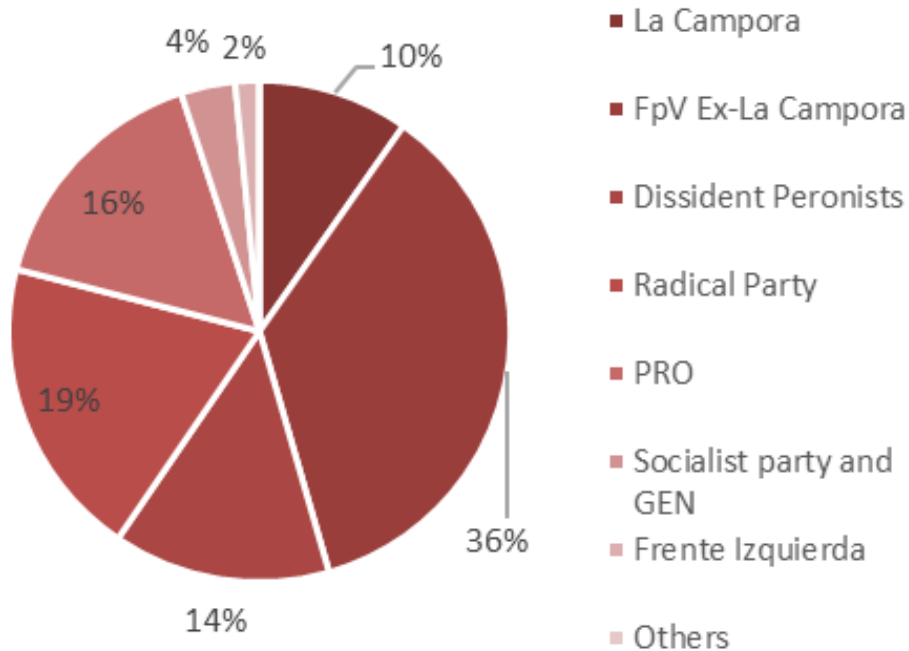
Representatives and Senators respond to the governors. These depend on the national government.

The political system is unbalanced: too much power for Peronist presidents, too little for non-Peronist presidents.

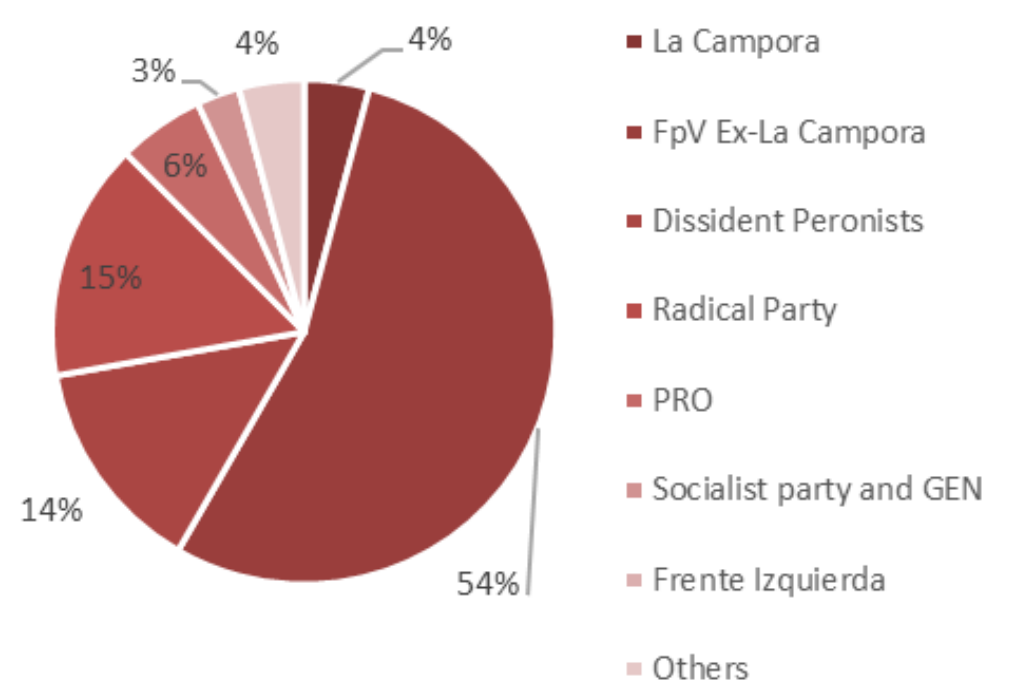


An unbalanced political system

Representatives



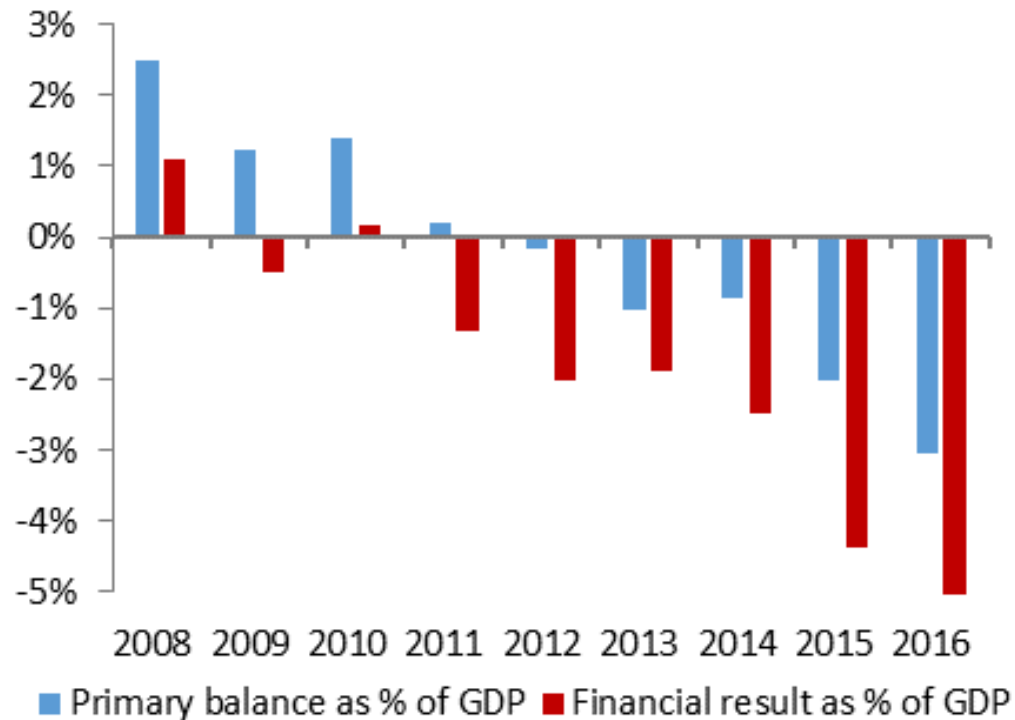
Senators



Do not panic: history shows that money and popularity are better predictors of the capacity of a president to advance his/her agenda than the # of Reps and Senators

Key risk is bad fiscal/policy mix

Borrowing requirements to remain high



PSBR

\$ bn	2016	2017	2018
Uses of funds	74.8	45.2	53.0
Primary deficit	13.5	6.7	0.0
Interest payments	15.2	15.7	12.2
Amortizations	29.4	22.8	36.7
Arrears	5.0	0.0	0.0
Holdouts & Other Below the Line	11.7	0.0	0.0
Warrant			4.0
Sources of funds	51.2	18.9	20.4
BCRA in \$	12.5	0.0	0.0
BCRA in ARS	6.5	5.2	4.7
IFIs (World Bank, IADB)	3.0	3.0	4.0
Intra-public sector	9.7	10.7	11.7
Other	2.0		
Issued in the year	17.5		
US\$ Global bonds	16.5		
Badlar adjusted	1.0		
Gap	23.6	26.3	32.6
<i>Gap as % of GDP</i>	<i>5.3%</i>	<i>5.9%</i>	<i>7.6%</i>

Where should Argentina trade?

	S&P:	●	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC+	CCC	CCC-	CC	C	SD/D	SDu		
	Fitch:	Δ	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	BB-	B+	B	B-	CCC+	CCC	CCC-	CC	C	SD/D	RD		
	Moody's:	□	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Ba1	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3	Ca	C				
Argentina																							●, Δ	
Bolivia																								
Brazil										Δ														
Chile			●, □		Δ																			
Colombia																								
Ecuador																								
Mexico																								
Paraguay																								
Peru																								
Uruguay																								
Venezuela																								

Where should Argentina trade?

Under a positive economic scenario, Argentina could be rated BB- in 2018

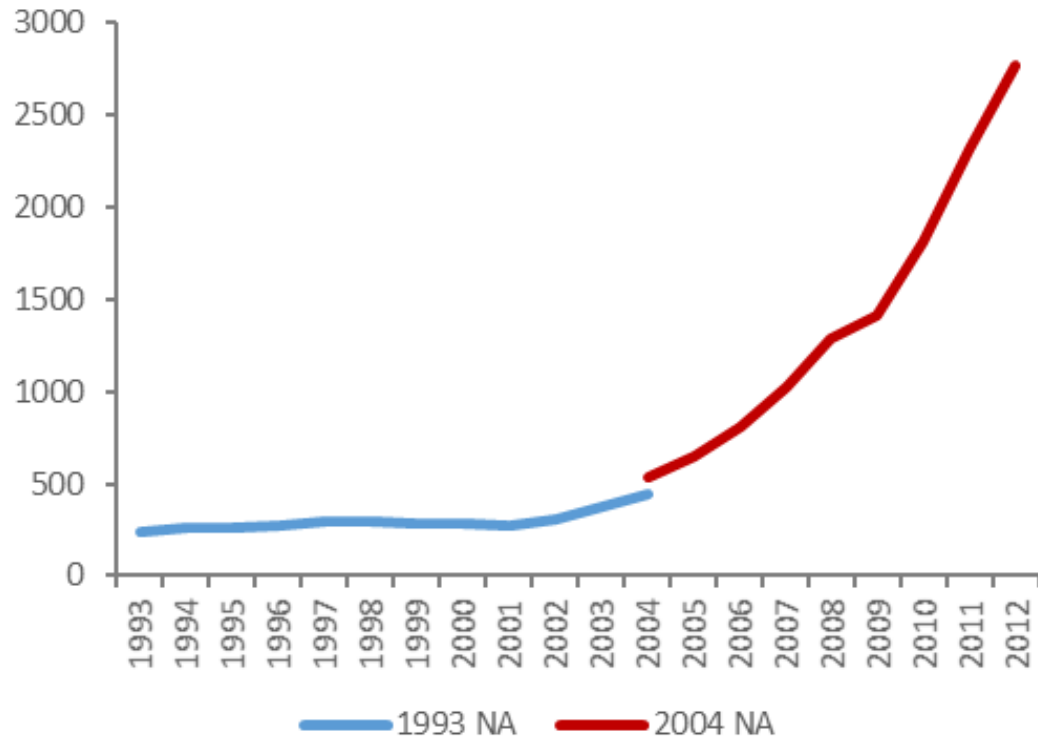
	2016	2017	2018
S&P	B/B+	B/B+	B+/BB-
Moody's	B2/B1	B2/B1	B1/Ba3
Rule of Law	-0.5	-0.3	0.0
GDP per capita (\$bn)	10.2	10.1	9.7
Real Growth (% yoy)	-1.3%	3.6%	3.8%
Inflation	33.8%	15.0%	9.0%
Fiscal Balance (% GDP)	-6.4%	-5.0%	-2.8%
Government Debt (% GDP)	60.1%	62.8%	67.6%
Net Government Debt (% GDP)	27.5%	30.0%	33.7%
Reserves (% GDP)	6.5%	7.4%	8.6%

And there could be an additional spread compression

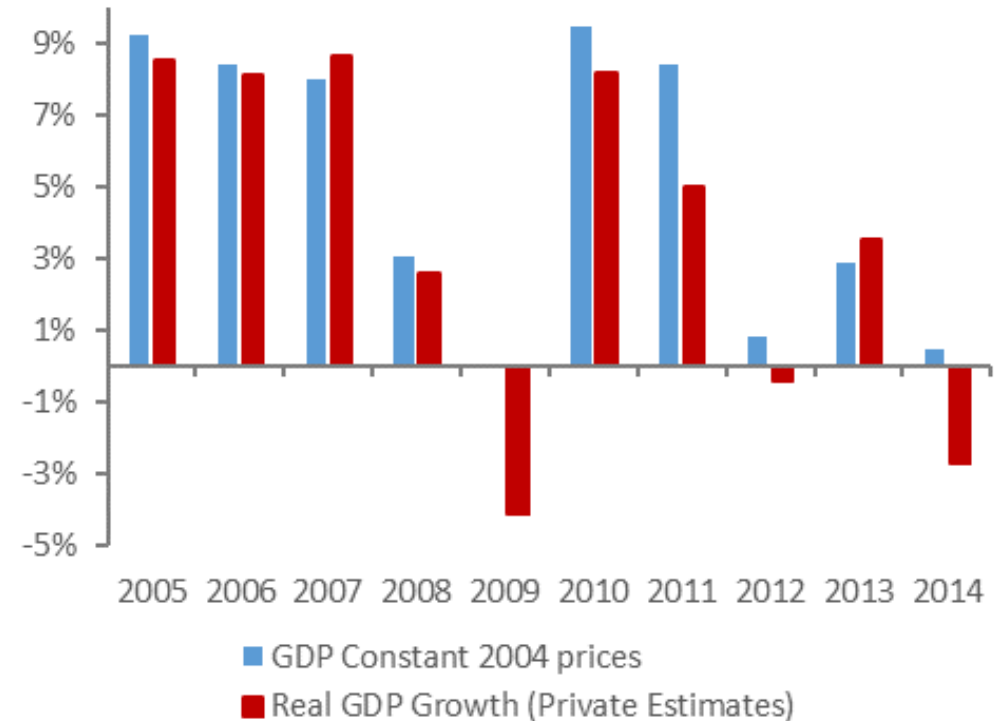
Issuer		Issuer Rating	Yield	Maturity (in years)	Bond Rating
Guatemala	2022	BB	3.92	6.1	BB
Costa Rica	2023	BB-	5.64	6.7	BB+
Dom. Republic	2023	BB-	5.93	7.3	-
El Salvador	2023	B+	7.66	6.7	B+
Bolivia	2023	BB	3.49	7.3	BB
Ecuador	2024	B	10.43	8.1	B
Paraguay	2023	BB	4.31	6.7	BB

An uncertain Warrant payment

Linking of GDP series uncertain

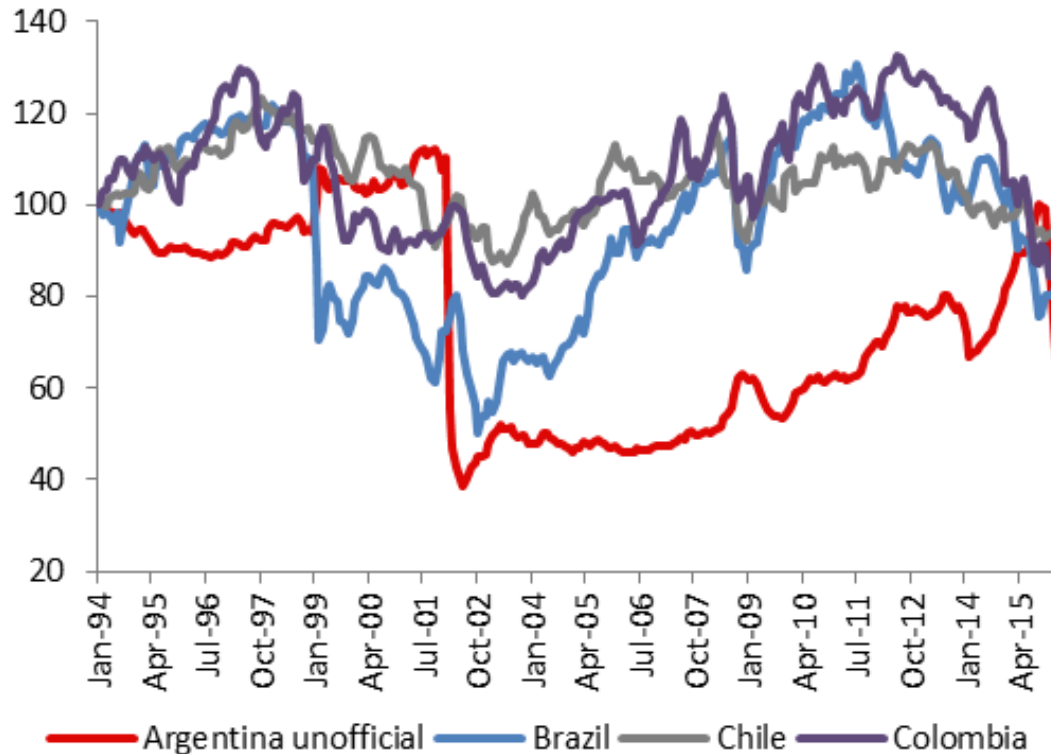


New GDP estimate likely to lower real growth, but also likely to increase GDP deflator

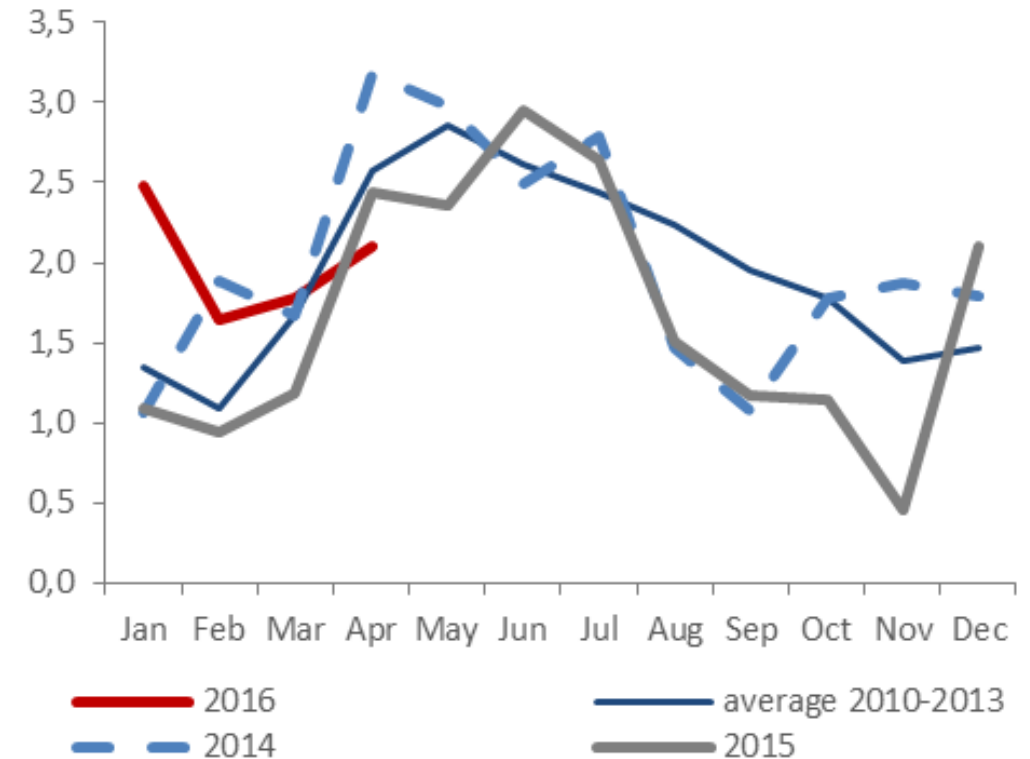


FX: weaker by yearend, with less pressures in the near term

LatAm currencies more undervalued than historical averages

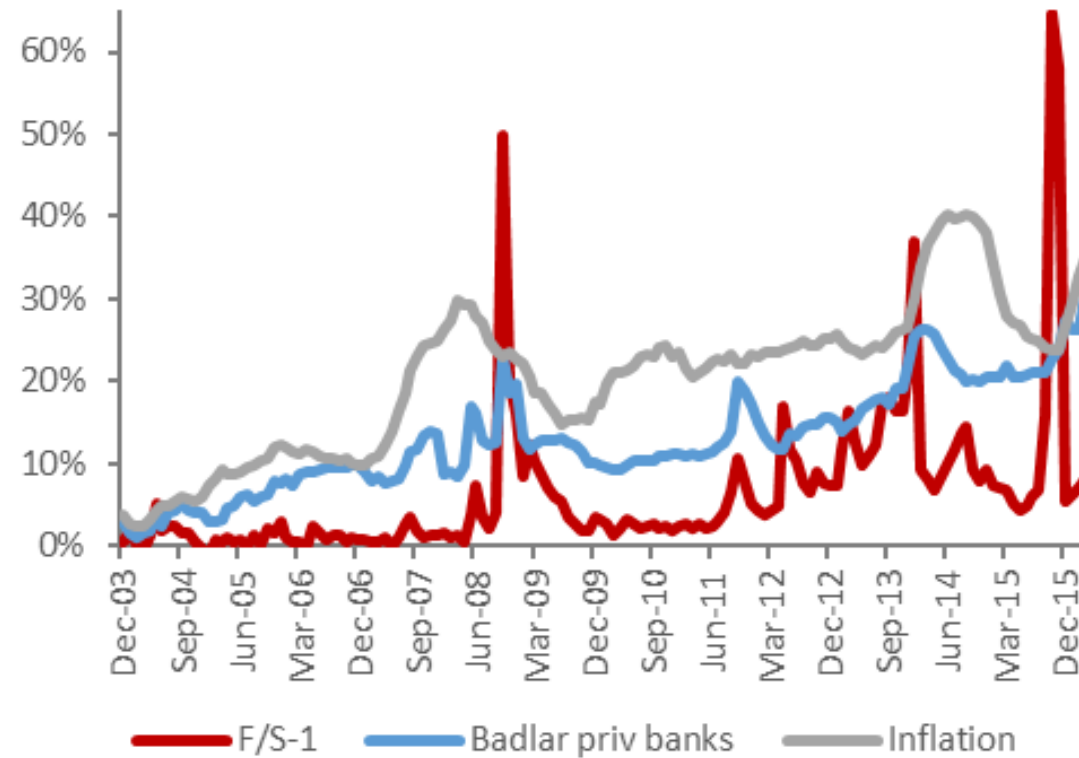


The seasonality of the harvest will keep pressures on the peso subdued in 2Q (\$bn)



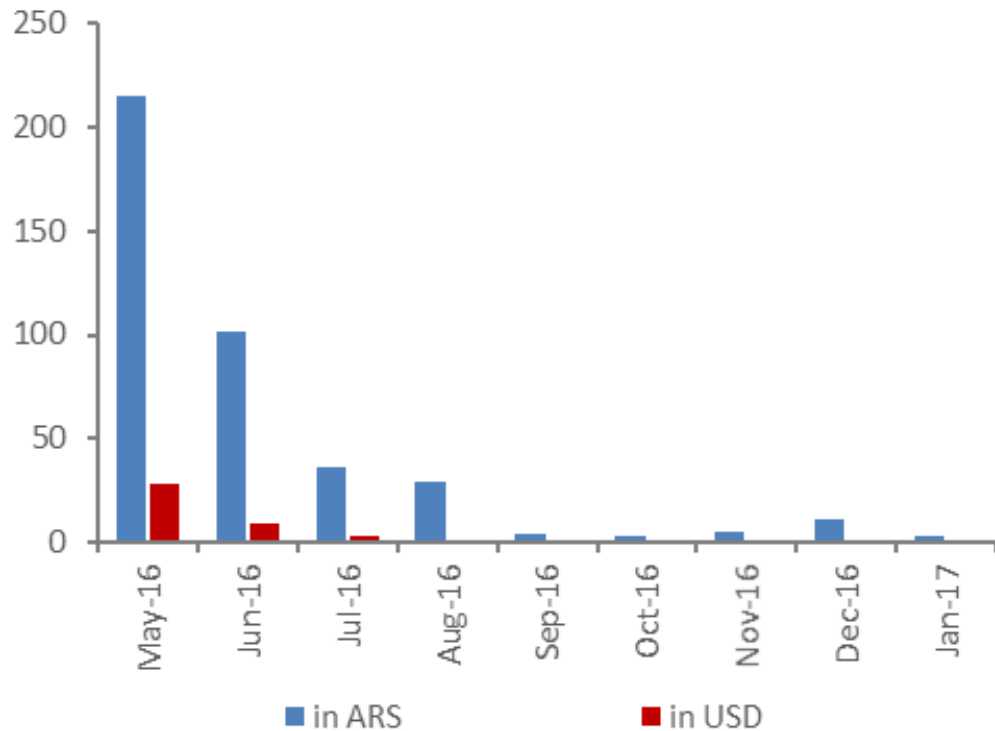
Peso rates: will start dropping anytime soon

With lower FX pressures in 2Q, interest rates should drop, but BCRA is reluctant to lower them by much given high inflation

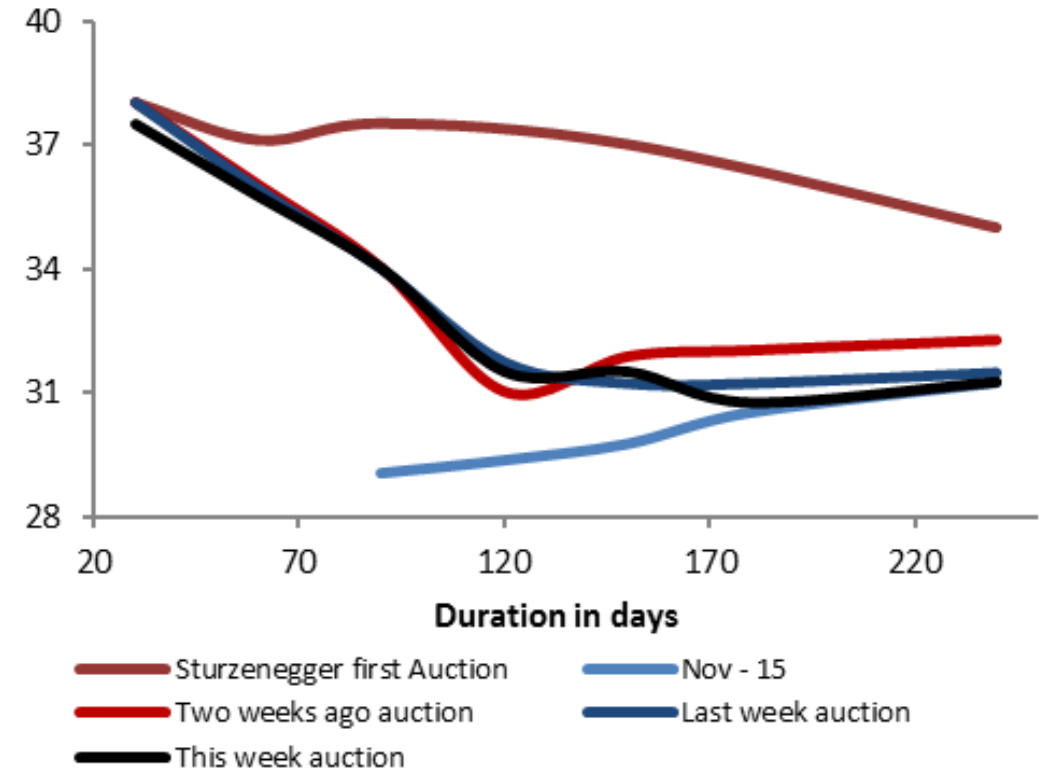


Lebac rates: something has to yield

A challenging amortization schedule (ARS bn)



Rates will start dropping soon



LatAm in numbers

	Growth		Inflation		MPR		FX	
	2015	2016	2015	2016	2015	2016	2015	2016
Argentina	2.1%	-1.3%	26.9%	33.5%			13.1	17.0
Bolivia	4.0%	3.3%	0.0%	0.0%			6.90	6.96
Brazil	-3.8%	-3.9%	10.7%	7.1%	14.25%	13.0%	3.9	3.7
Chile	2.0%	1.1%	4.4%	3.8%	3.50%	3.75%	704	765
Colombia	3.1%	2.2%	6.8%	7.2%	5.75%	7.00%	3,149	3,350
Ecuador	0.3%	-1.5%	3.4%	2.5%			1	1
Mexico	2.5%	2.5%	2.1%	2.8%	3.25%	4.25%	17.2	17.3
Paraguay	3.0%	1.5%	3.1%	5.0%			5,768	6,000
Peru	3.3%	3.6%	4.4%	3.8%	3.75%	4.25%	3.4	3.6
Uruguay	0.9%	0.1%	9.4%	10.2%			29.9	34.5
LatAm		-0.8%						

Bonus track: Brazil vs Argentina fiscal accounts

A drop in Selic rates to 11% and the cancellation of the FX swaps could reduce the fiscal deficit significantly

% of GDP	2015	2015	with confidence	2016
VERY PRELIMINARY	Brazil	Argentina	Brazil	Argentina
Total nominal fiscal deficit	11.2	9.7	6.4	11.4
Public banks	0.8		0.5	
Difference btw cash and accrual		1.1		0.3
Nominal deficit Brazil definition	10.4	8.6	5.9	11.1
- Regional governments	1.5	0.8	1.0	1.0
- Juros Bacen	-0.5		-0.5	
- Sterilization costs	2.1	1.3	1.5	2.0
- FX swaps or futures costs	1.5	0.5	0.0	0.7
Nominal deficit Argentina definition	5.8	6.0	3.9	7.4
Primary deficit (Federal govt ex CB)	2.0	3.7	1.0	3.9
Interest payments	3.8	2.3	2.9	3.5

Disclaimer: very preliminary work!!

Thanks!



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