

BIENVILLE GLOBAL REVIEW

Argentina: Cristina Pivots

September 2014





SUMMARY

On July 31st, by failing to first pay the holdouts as mandated by Griesa's judgment, Argentina went into selective default on the country's restructured bonds. The decision not to pay marked a decisive pivot by Cristina Kirchner. It stunned markets and undermined the administration's recent efforts to resolve Argentina's remaining creditor issues. Asset prices have since adjusted down, setting up the anticipated buying opportunity ahead of next year's political regime change...

- Once again, Cristina pivoted. The erratic nature of her policy decisions remains consistent with the divisive, populist strategy she has pursued for years
- Immediately following Argentina's default on restructured debt, Cristina torpedoed a private deal negotiated between the holdout bondholders and Argentine banks. And without assurances of getting paid in January (after the expiration of the RUFO clause), a private deal with international banks remains challenging
- To the rationally minded investor, defaulting was senseless and illogical. Had the government simply paid, the cost would have been more than offset by the benefits of foreign capital inflows into the country, reducing Argentina's country risk. But viewing Cristina's decision making from a purely economic perspective is misguided
- Given two paths, Cristina will choose the one that provides a bounce in political support, even if temporary. Encouraged by the population's frustration with the holdouts and Griesa, Cristina seized the political opportunity. When economic conditions force her, she will pivot again. And without a judicial waiver or stay in the next few weeks, another complex and costly restructuring is necessary
- Since the default, the Kirchner administration has begun pursuing policies suggesting radicalization (e.g., Supply Law) and isolationism (e.g., proposing to change the payment location). As we have previously detailed, Argentina cannot afford to isolate itself for another decade. As a result, the parallel currency—a measure of confidence in the direction of the government's policies—has weakened aggressively
- The breakout of the parallel currency to new highs has begun to pressure foreign currency reserves, the lynchpin of Cristina's flawed economic model. Without them, Argentina cannot import energy or other intermediate factors of production, nor can the government provide citizens with the dollars necessary to travel overseas
- To prevent a run on Argentina's low level of reserves, the central bank must hike interest rates. However, higher interest rates will slow growth and deepen the current recession. Any fiscal stimulus must be monetized by the central bank, leading to higher inflation. This is Argentina's central paradox under Cristina's administration. Without access to dollars, they have little policy flexibility



SUMMARY

- As economic pressures accelerate, the Kirchner administration could be forced to the negotiating table, utilizing domestic banks to orchestrate a deal. Sources suggest that Economy Minister Kicillof understands this and may be encouraging such a deal. That Cristina recently refused the resignation of central bank governor Fabrega—a more pragmatic voice in her cabinet—is also a positive sign
- The official peso rate needs to depreciate, despite continuous assurances from the administration that a step-devaluation similar to January is not on the agenda
- To the benefit of medium-term investors, the default removed previous optimism underpinning Argentine assets. Equity prices of a number of Argentine companies have fallen by 20 – 30%. The electoral scenario also remains largely unchanged. Mauricio Macri's prospects have improved, and both he and Sergio Massa (the current leading candidate) have been vocal in criticizing the administration's decision to default. Both understand the necessity of attracting foreign capital over the next decade
- In *Argentina: Restoring International Relations*, published in June, we suggested that “given both the complexity and urgency of the situation, the prospect of Argentina's default is rising, despite a willingness to pay. The uncertainty to ensue over the next few weeks could be setting up an extraordinary buying opportunity for patient investors.” That buying opportunity is presenting itself

ARGENTINA: CRISTINA PIVOTS

Restructured bonds had rallied aggressively following January's devaluation of the peso, reaching 95 in anticipation of a deal with the holdouts. But since the default, prices have traded back near 80...

NY Law Discount Bonds



— Argentine Republic Government International Bond

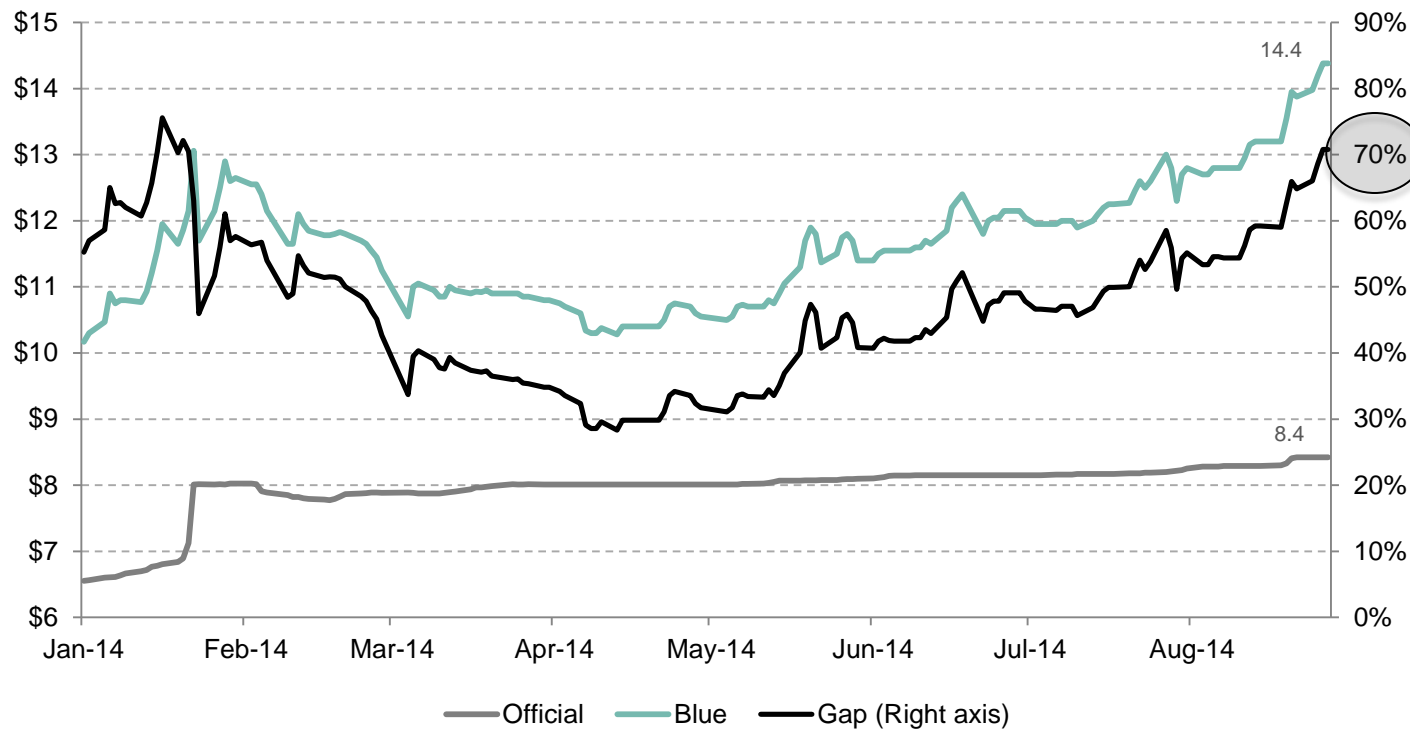
Source: Macrobond



ARGENTINA: CRISTINA PIVOTS

The parallel FX rate, or 'Blue Rate,' has weakened substantially in the past two weeks, causing the spread versus the official rate to widen to 70%. Either the Blue Rate will need to strengthen (from improving confidence), or the central bank will be forced to devalue the official rate. A wide ban encourages dollar accumulation, which reduces FX reserves...

Peso: Official vs. Parallel FX Rate



Recently, the 'Blue Rate' has weakened to 14.4 pesos per dollar...

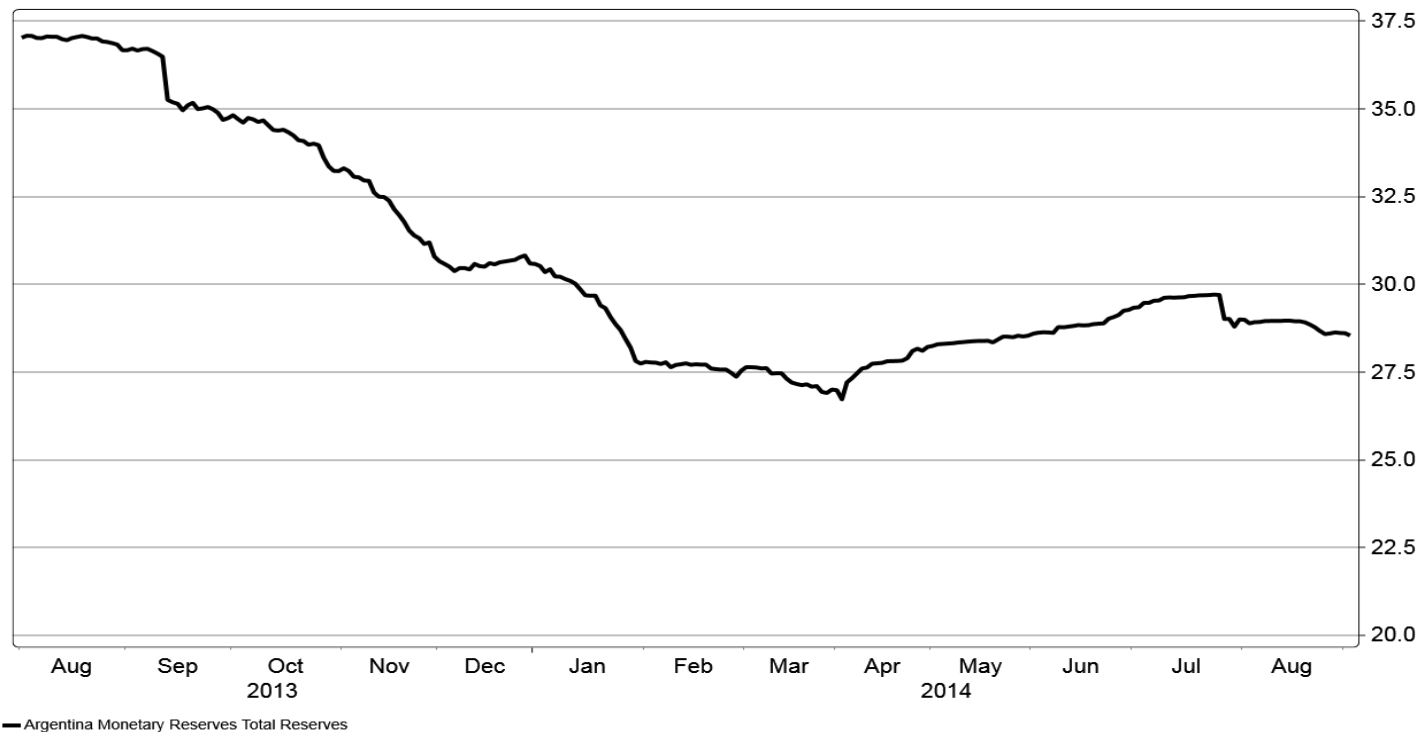
...while the central bank has allowed the official rate to weaken only marginally to 8.4...

...as a result, the gap has widened, which encourages more dollar accumulation (i.e., a vicious cycle)

ARGENTINA: CRISTINA PIVOTS

After a dangerous decline in foreign currency reserves at the end of 2013, in January the central bank was forced to devalue the peso and hike interest rates by 10%, stabilizing reserves at a critically low level. Reserves rose only modestly between February and July, despite seasonal inflows from agriculture. Recent declines have complicated policy decisions—if they hike rates again, the ongoing recession will intensify. Because they have no credibility, the Kirchner administration has little policy flexibility...

Argentina: International Reserves (\$, billions)



In the last two weeks of August, reserves declined by nearly \$400 million

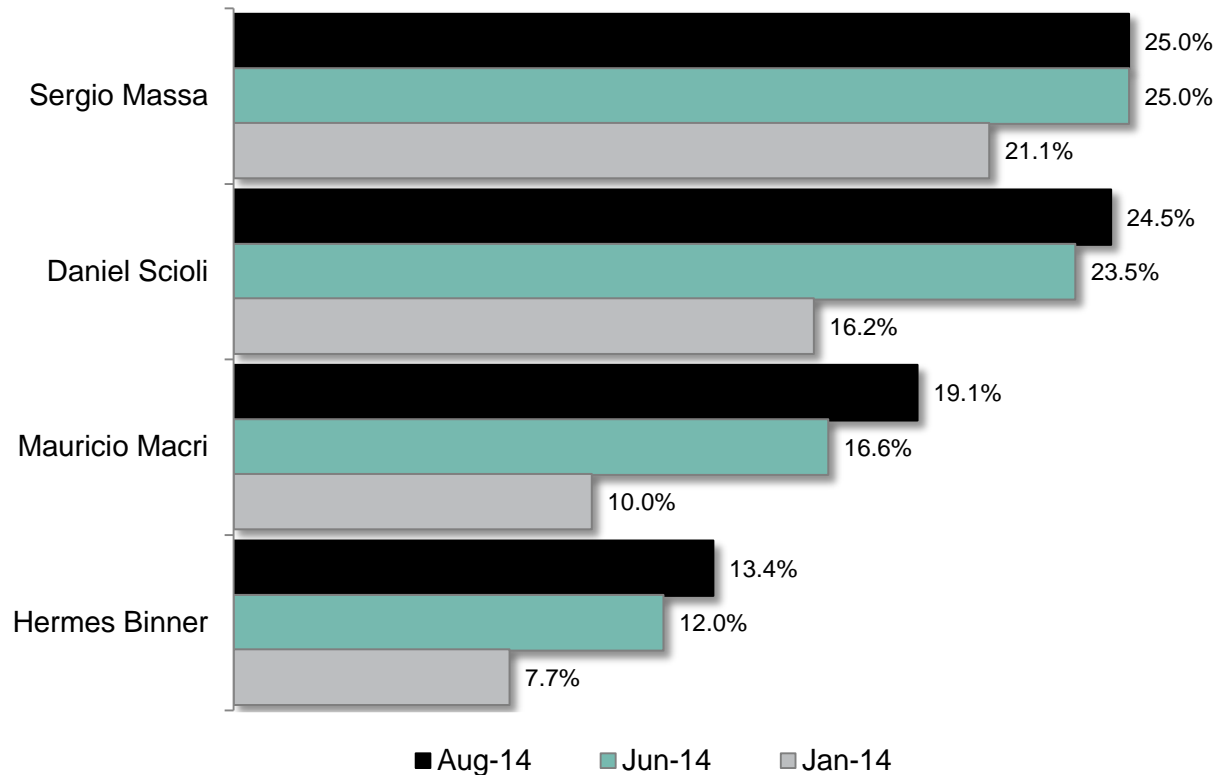
This figure would have been larger, however, the central bank has been refusing to supply dollars to importers, whose payments due are estimated to be around \$3.5 billion

Source: Macrobond

ARGENTINA: CRISTINA PIVOTS

Argentines were frustrated with the holdouts and Griesa, who they view as partial to them. So Cristina's strong stance against the holdouts was popular. However, any gains in her approval rating will be short-lived as the default will aggravate an already fragile economy. Importantly, there has been little change in expectations for next year's elections, although Macri's prospects continue to improve...

Voter Intentions, Presidential Candidates (October 2015)



Even though many Argentines supported a tougher stance against the holdouts, more than 60% polled believe the economy will continue to deteriorate under Kirchner

ARGENTINA: CRISTINA PIVOTS

The default removed all of the equity market's gains achieved over the summer. Many companies are now trading at similar levels to last year (following the legislative elections, which marked the end of 'Kirchnerism'). Yet we are now a year closer to the election. A buying opportunity is presenting itself...

MSCI Argentina Index (in USD)



— MSCI Argentina Index

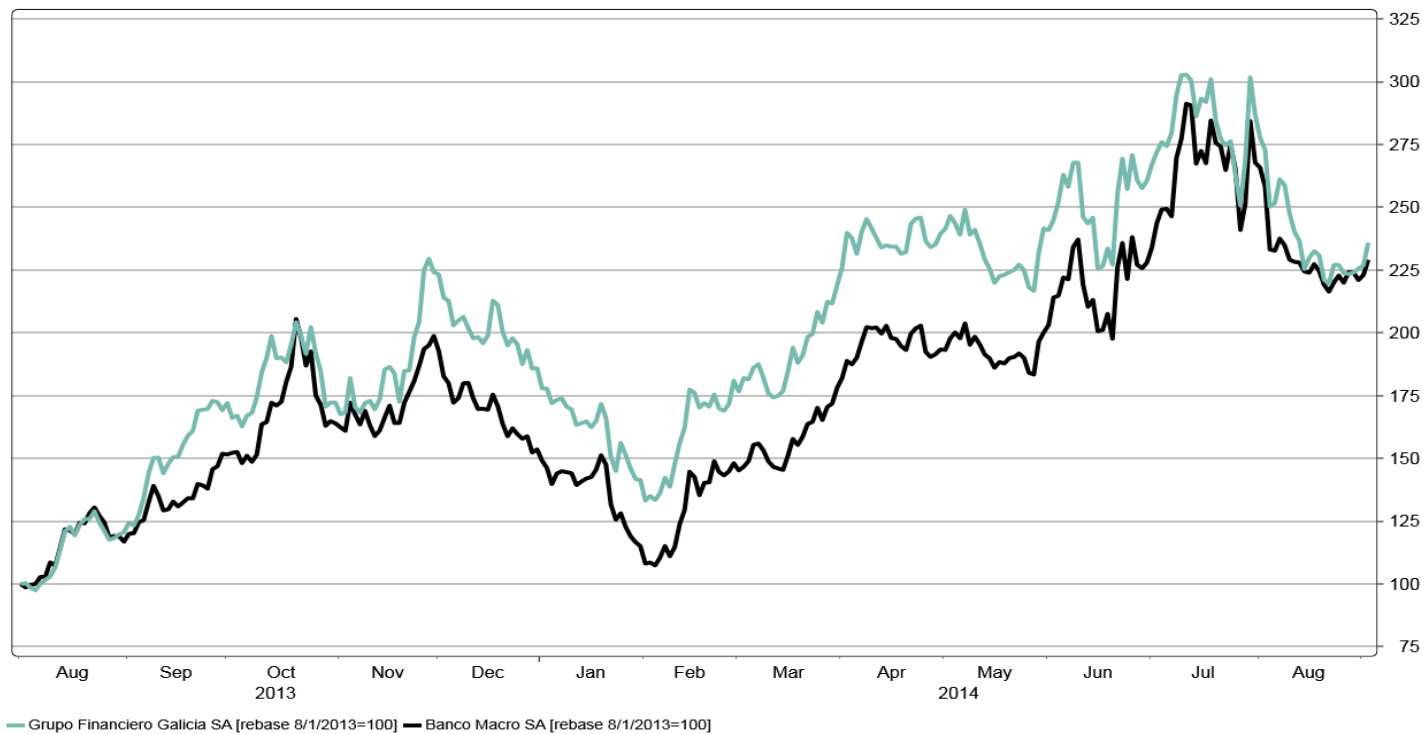
Source: Macrobond



ARGENTINA: CRISTINA PIVOTS

Banks have experienced a wild ride over the past year. Given the low level of both banking penetration and leverage in Argentina, banks are compelling on a medium-term basis under a more pragmatic administration. However, after a big rally, many banks traded to 2.5x book value, reflecting an overly optimistic outlook given the near-term headwinds (potential devaluation, negative real interest rates and regulatory pressures). Following the default, prices fell by nearly one-third...

Banks: Grupo Galicia & Banco Macro (August 1, 2013 = 100)



Source: Macrobond



DISCLAIMER

The Bienville Global Review (the “Presentation”) is a distribution which highlights the research of Bienville Capital Management, LLC (“Bienville”) in different areas of interest across the macro landscape. Bienville believes that understanding the global macroeconomic backdrop is a prerequisite to efficiently allocating capital.

The Presentation is not intended to be an all-encompassing review of the financial markets. Rather, it should serve as a concise summary, which provides clients with an update of Bienville’s areas of focus within its research process. We hope that the Presentation will create an ongoing dialogue with our investors on the global dynamics that drive the financial markets. The topics covered in the Presentation may or may not be related to Bienville’s active positions or investment strategies.

The content of the Presentation includes forward-looking statements, estimates, projections, assumptions, beliefs and opinions (collectively, “Projections”), which may prove to be substantially inaccurate or based upon flawed reasoning and assumptions. Moreover, Projections are inherently subject to significant risks and uncertainties beyond the control of Bienville and its affiliates, including Bienville Capital Partners, LP, Bienville Capital Partners Offshore, Ltd. and Gulf Coast Opportunities Fund, LP (and collectively with other private investment funds that Bienville or its affiliates may form and manage in the future, the “Funds”).

The information contained in the Presentation regarding Bienville and the Funds has been prepared solely for illustration and discussion purposes. Except where otherwise indicated, the Presentation speaks as of the date hereof, and Bienville undertakes no obligation to correct, update, or revise the Presentation, or to otherwise provide any additional materials. Although Bienville believes the Presentation is substantially accurate in all material respects and does not omit to state material facts necessary to make the statements herein not misleading, Bienville makes no representation or warranty, express or implied, as to the accuracy or completeness of the Presentation or any other written or oral communication it makes with respect to the tactical positions or investment strategies described herein. Bienville expressly disclaims any liability relating to the Presentation or such communications (or any inaccuracies or omissions herein). The Presentation merely constitutes an opinion or belief based upon the information set forth herein, which opinion or beliefs may prove to be wrong. The information and opinions contained in the Presentation are based on public information.

Neither Bienville nor the Funds makes any commitment or undertaking to take or refrain from taking any investment decision or other action with respect to the tactical positions or investment strategies described herein. Bienville may change its views about the tactical positions and investment strategies described in the Presentation at any time, for any reason. Bienville and the Funds may buy, sell, or otherwise change the form or substance of any of their investments at any time. Bienville disclaims any obligation to notify any recipient of this Presentation of any such changes.

The Presentation is not investment advice, or a recommendation or solicitation to buy or sell any securities mentioned herein or otherwise. If any offer of interests in any Fund is made, it shall be pursuant to one or more definitive private placement memoranda for such Fund which would contain material information not contained herein and which shall supersede this information in its entirety. Any decision to invest in a Fund should be made after reviewing the definitive private placement memoranda for the Fund, conducting such investigations as the investor deems necessary and consulting the investor’s own investment, legal, accounting, and tax advisors in order to make an independent determination of the suitability and consequences of an investment in the Fund.

This Presentation and its contents are confidential, and proprietary information of Bienville, and any reproduction of this information, in whole or in part, without the prior written consent of Bienville is prohibited. For additional information about Bienville, including fees and services, please see our disclosure statement as set forth on Form ADV. Additional information is available from Bienville upon request.