

# BIENVILLE GLOBAL REVIEW

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## Argentina: The Fast Track to Normalization

April 2016



# ARGENTINA: THE FAST TRACK TO NORMALIZATION

## Summary

Argentina's economy is rapidly emerging from the netherworld. In their first 100 days, the Macri administration exceeded expectations, unveiling promised reforms with remarkable speed and skill. With the economy now on the fast track to normalization, the international community has taken notice. Corporate profits should begin to recover. Reentry into the MSCI Emerging Market Index remains another potential catalyst for Argentine equities.

- Since taking office in December, Mauricio Macri, Argentina's center-right president, has tactfully balanced "shock therapy" on the external front with "gradualism" on the domestic side.
- With an approval rating of 70%, Argentines applaud his efforts. The international community has also taken notice. A recent visit by President Obama was symbolically important, signaling the end of the Kirchners' antagonistic stance and the reintegration of Argentina into the global community. Foreign investment now looks promising.
- Recently, Macri gained the support of Congress to settle with 'holdout' creditors, ending the 15-year saga that prevented the flow of capital into Argentina.
- On the external side of the economy, Macri's team successfully devalued the currency and slashed export taxes. Domestically, nonsensical subsidies have been scaled back, reducing the fiscal deficit and inflationary pressure.
- Argentina remains one of the world's most under-levered countries. As inflation declines, real interest rates rise, leading to deposit growth, the fuel for boosting private sector credit and economic activity. A nascent mortgage market should also benefit the housing sector, possibly as early as 2017.
- As for the public sector, access to international capital will help finance the administration's plan for \$60bn of infrastructure spending by 2019, equivalent to roughly 12% of GDP.
- Having met key criteria, Argentina is now eligible for promotion from Frontier to Emerging Market status. MSCI could put Argentina under review as early as May 2016, potentially leading to significant index and investor flows.

## ARGENTINA: THE FAST TRACK TO NORMALIZATION

On November 22, 2015 the Argentine people voted for change. Since, the private sector has been in a state of euphoria. Over a decade of antagonist, populist policies under the Kirchners came to an abrupt end...



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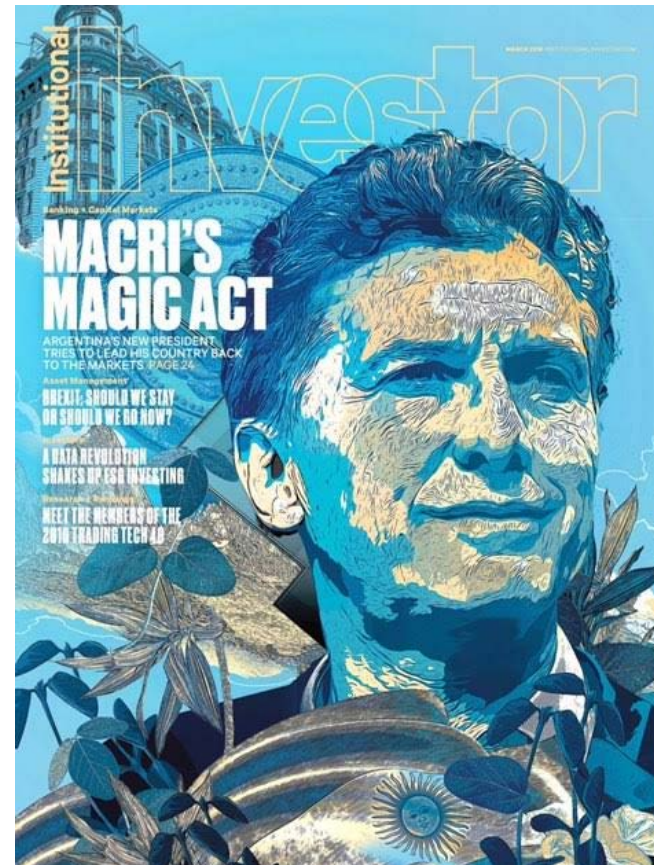
The world has taken notice. And the perceptual change could have incalculable benefits for the Argentine economy...

60 Minutes



Please [click here](#) to watch the 60 Minutes Interview

Institutional Investor



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Macri quickly normalized global relations. In March, President Obama was accompanied to Buenos Aires by hundreds of U.S. businessmen, who subsequently announced \$13.8bn of investment into Argentina...





# ARGENTINA: THE FAST TRACK TO NORMALIZATION

Much of Macri's global popularity derives from the sweeping economic reforms his highly capable, technocratic team has unveiled at breathtaking pace with flawless execution...

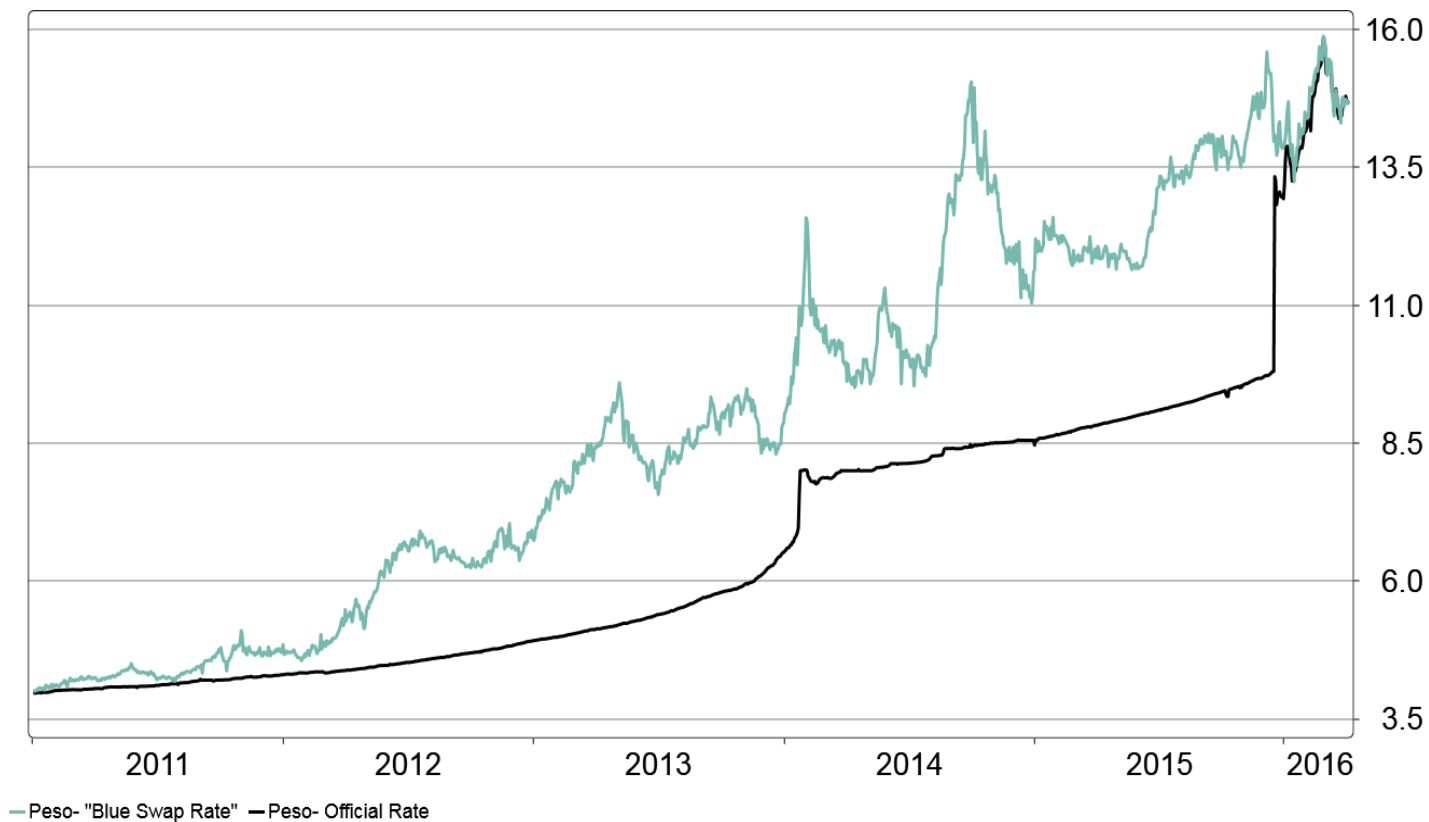
## Reform:

1. Currency: Allowed the peso to freely float, ending the extreme overvaluation that was hurting exports.
2. Capital Controls: Lifted controls, allowing for increased foreign investment.
3. Export Taxes: Eliminated taxes on corn, wheat, beef and introduced incremental reductions for taxes on soy, boosting the profitability of the agriculture sector.
4. Holdout Creditors: Settled, paving the way for international financing, eliminating the need for money-printing.
5. Subsidies: Reduced or eliminated subsidies for electricity, bus fares and landlines, necessary to reduce the fiscal deficit.

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After the Peso was floated freely last December, it closed the gap with the “parallel rate,” and has since remained stable, restoring much needed competitiveness for the export sector...

## ARS/USD Spot

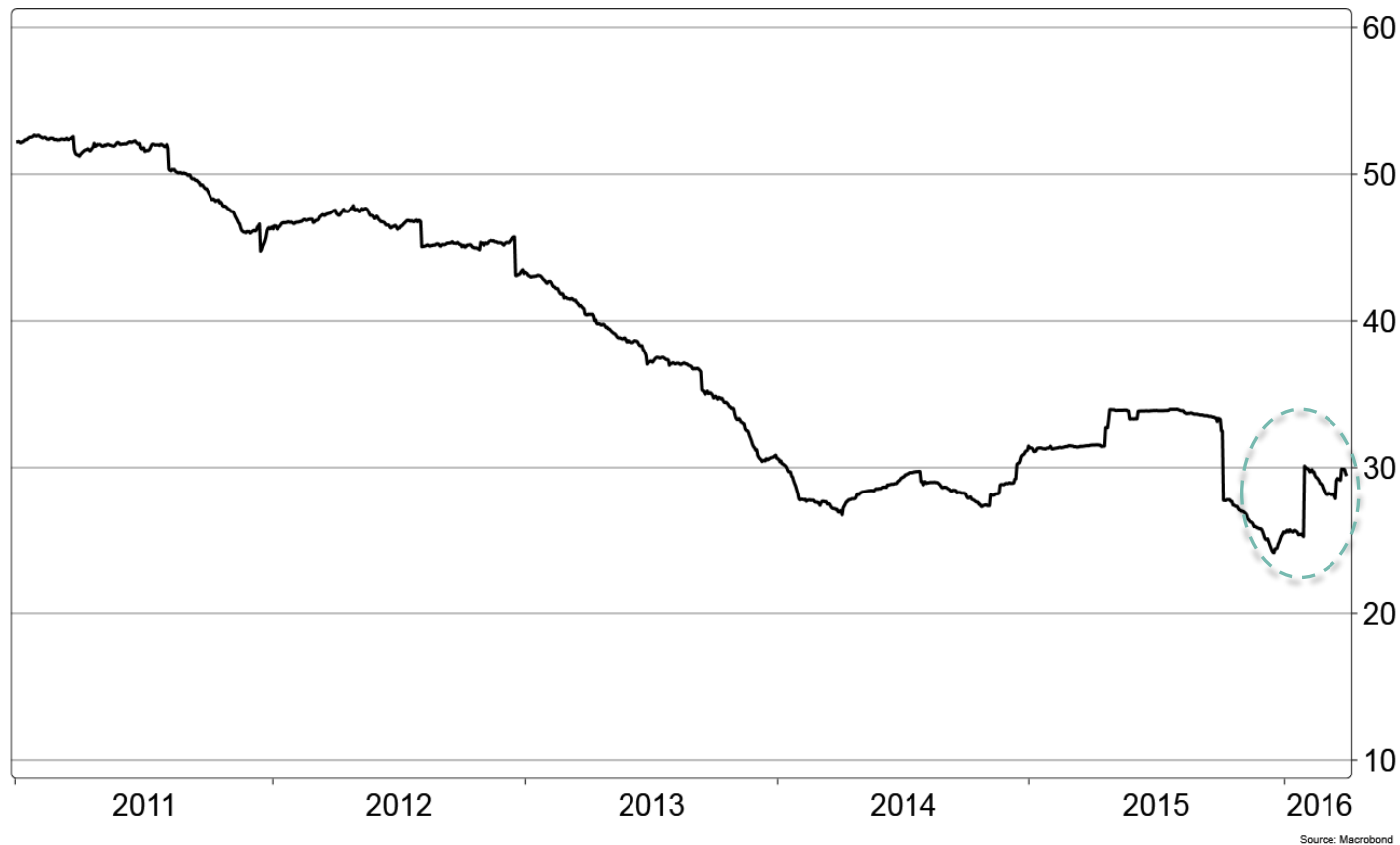


Source: Macrobond

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A competitive currency, positive real interest rates and improved international relations have enabled Argentina to slowly rebuild foreign exchange reserves...

## Central Bank Reserves (\$USD bn)

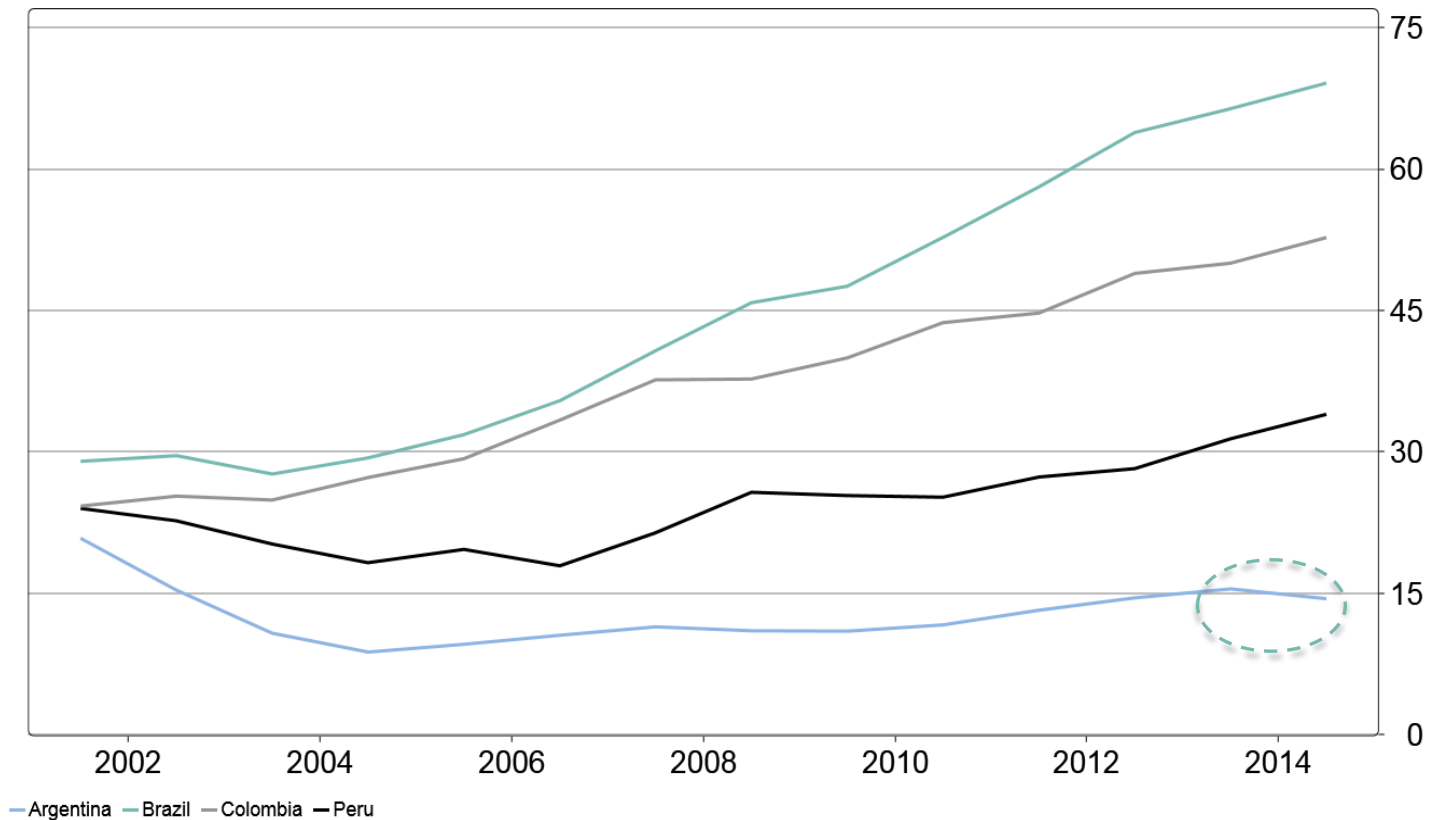




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Given low levels of debt, Argentina has significant room to borrow to finance both the deficit and productive infrastructure projects that could expand the country's output potential...

## Private Debt-to-GDP (%)



Source: Macrobond

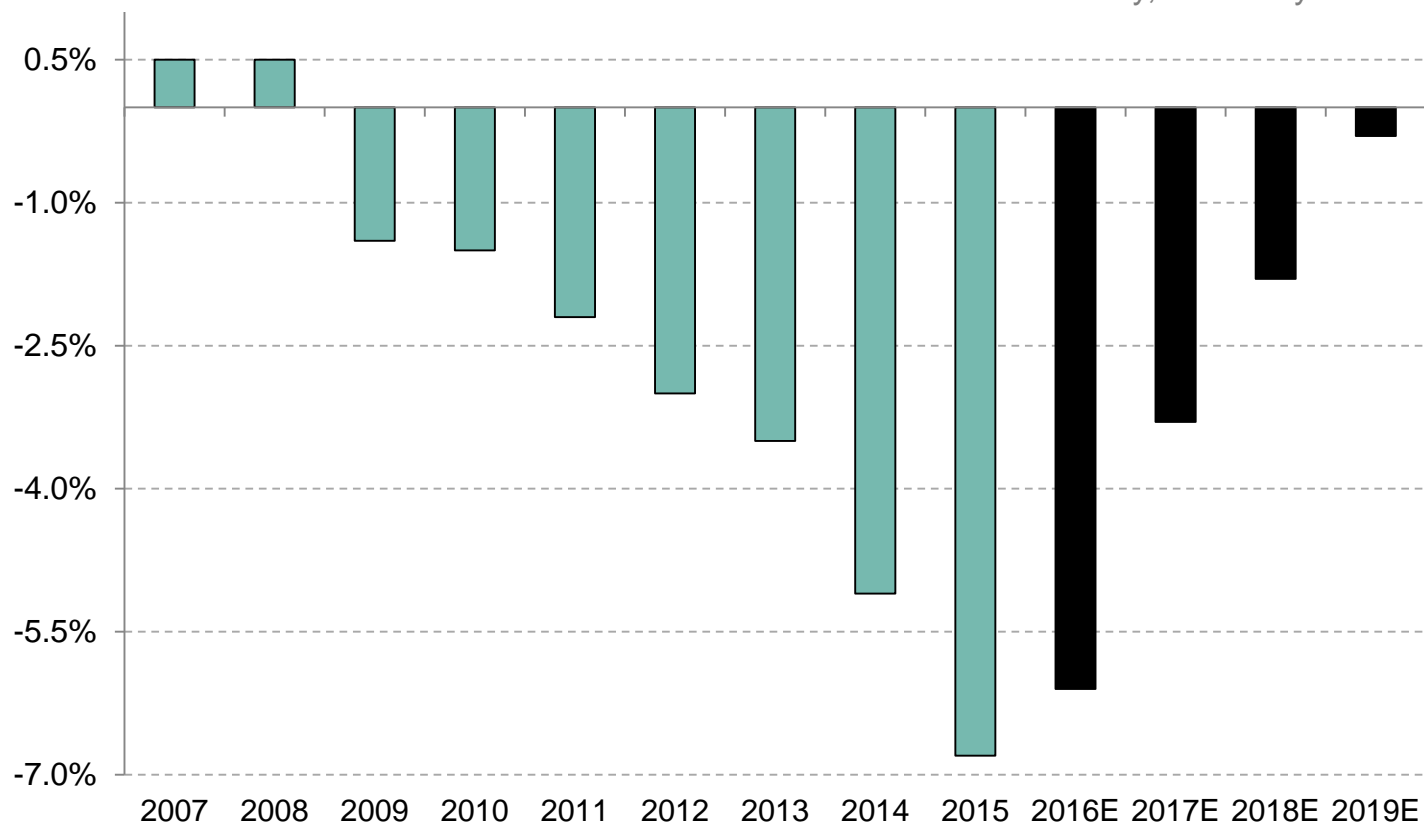
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By reducing unnecessary subsidies, the administration is tackling Argentina's budget deficit and restoring confidence in the country's fiscal policy. As the deficit falls, so should inflation expectations...

## Fiscal Deficit Forecasts

"We are taking tough decisions to make sure we are slaying the dragon, rather than putting it in a cage for a while."

– Alfonso Prat-Gay, Economy Minister



Prat-Gay announced a goal to reduce the fiscal deficit to -0.3% and the inflation rate to 5.0% by 2019.

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Despite the progress, Argentine equities are off their pre-election highs. As the adjustment process unfolds, corporations should begin to recapture historical levels of profitability, enticing 'real money' investors...

## MSCI Argentina Index (USD)



Source: Macrobond

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In fact, a majority of investors polled by Morgan Stanley indicated they would increase exposure to Argentine equities over the next 12 months, while most of those who had no exposure planned to initiate positions...

## Investor Intentions Over Next 12 Months

	Net Buyer	Remain Stable	Net Seller	
Prior 18 Months	Was a Net Buyer	55%	8%	1%
	Did not own	20%	12%	0%
	Remained stable	0%	1%	1%
	Was a Net Seller	0%	1%	0%
	<b>Total</b>	<b>75%</b>	<b>23%</b>	<b>3%</b>

Despite the reforms made to date, there have yet to be significant inflows into the market.



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With the removal of capital controls, Argentina now satisfies the criteria for reentry into the MSCI EM Index. Flows into the equity market accompanying inclusion could create a significant supply/demand imbalance...

## MSCI Upgrade to Emerging Market Status

Criteria	Argentina
Sustainability of Economic Development	✓
Market Size and Liquidity	✓
Openness to Foreign Ownership	✓
Ease of Capital Inflows/Outflows	✓
Efficiency of Operational Framework	✓
Stability of Institutional Framework	✓

Argentina once represented more than 5% of the MSCI EM Index, and 14% of the MSCI LatAm Index.

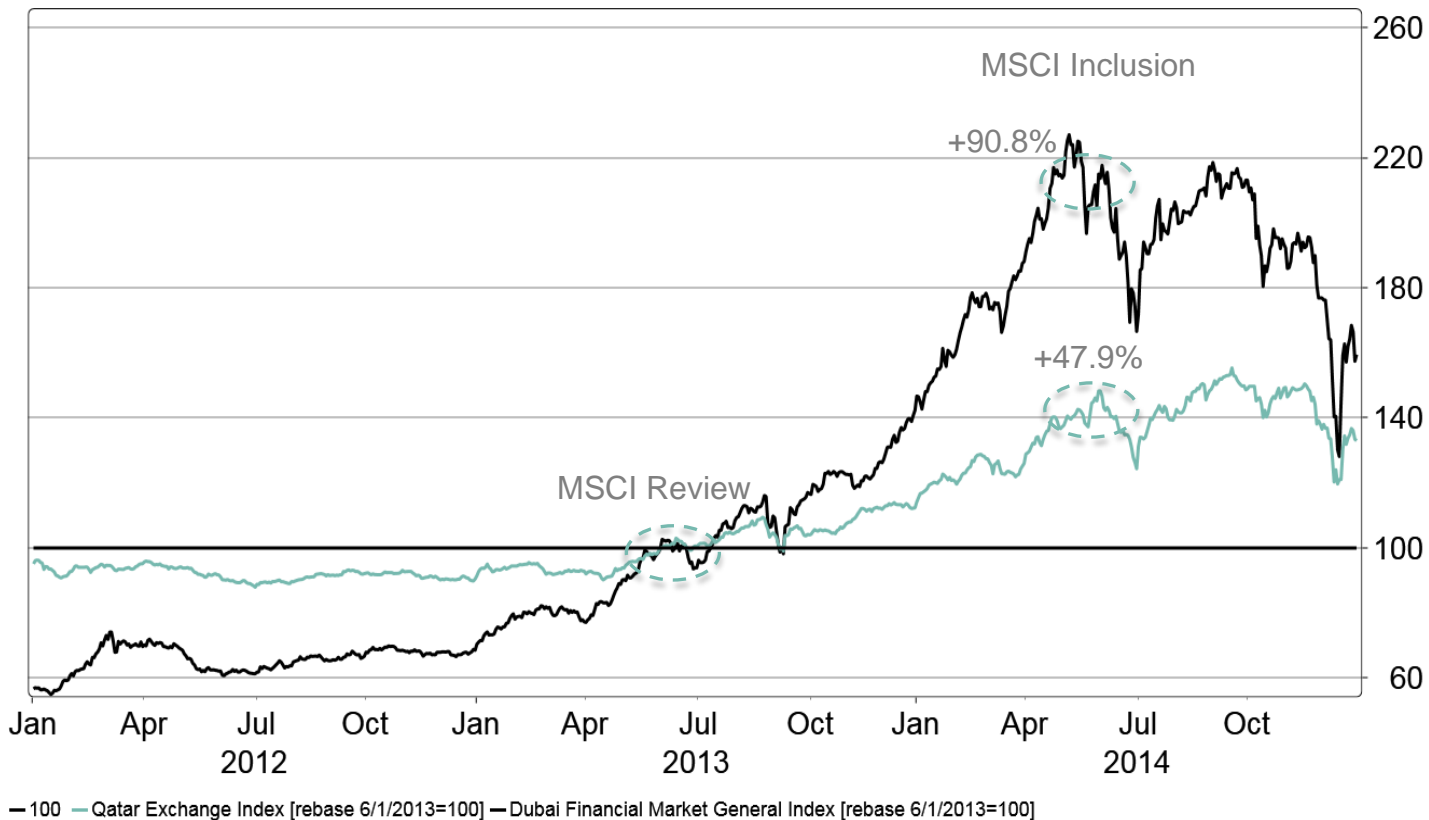
But in 2009, following the introduction of capital controls by Cristina, Argentina was downgraded to Frontier Market, where it has remained.

In May, MSCI could place Argentina under “review” for reentry at a later date.

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Other instances of MSCI EM upgrades provide compelling analogs. The most recent entrants, Qatar and UAE, both rallied significantly in the 12 months prior to their actual index inclusion...

## Qatar and Dubai Index



Source: Macrobond



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