

# **BIENVILLE GLOBAL REVIEW**

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## **From Normalization to Recovery: Argentina's Next Chapter**

February 2017





# ARGENTINA'S NEXT CHAPTER

## Summary

Following an aggressive shift to orthodox policies, Argentina now appears to be transitioning from a normalization phase to a broad-based recovery. Growth is improving, inflation is falling, and corporate profitability is rising. Primed for a return to the MSCI Emerging Market Index, Argentine equities still offer value.

- Aggressive macro normalization by the Macri administration led to a painful adjustment process, as expected. But those pressures are now abating. The recession likely ended in 4Q16, setting the stage for Argentina to return to economic growth in 2017.
- Recent data suggests broad improvement. Agriculture continues to expand while manufacturing is now recovering. Disinflation should boost real incomes and consumption.
- Inflation in January declined to 1.3% m/m, lower than expected, yet the battle is not over. Hikes in regulated prices and upcoming wage negotiations will keep the central bank vigilant.
- Nonetheless, lower inflation will ultimately allow for easier financial conditions and rising credit, a positive for banks and consumers. Argentina's private sector is one of the most under-levered in the world, boasting an astonishing low level of debt for a comparably highly educated workforce, so increased credit should underpin growth over the medium term.
- Macri has also taken measures to solidify the country's financing needs. For example, the tax amnesty is expected to attract \$130 - 140 billion of repatriated capital by the March 31<sup>st</sup> deadline. As FX reserves climb, the country finds itself on a strong financial foundation.
- As sentiment has improved, Argentine bonds and equities have rallied, narrowing the discount relative to emerging market and Latam peers. But as the macro adjustments flow through the corporate sector, profits are expected to double in 2017.
- Many ADRs have performed well of late, but local equities have lagged. They remain 50% below the levels of 2001, the year of Argentina's historic crisis. Yet both ADRs and local equities should benefit from Argentina's likely upgrade by MSCI from Frontier to Emerging Market status, expected this June.



# ARGENTINA'S NEXT CHAPTER

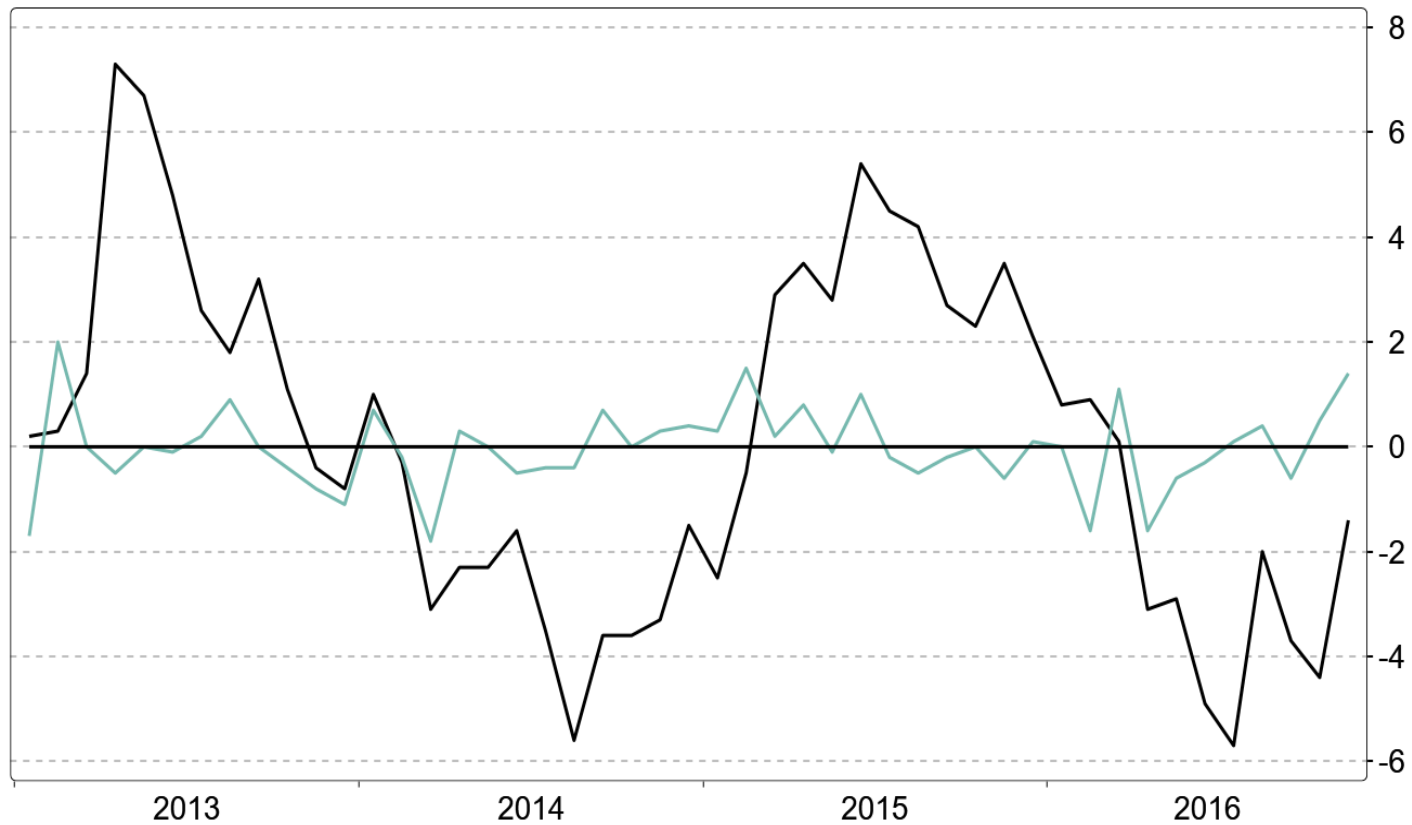
## Summary (continued)

- Despite increased attention, it seems the broader investment community still underappreciates the significance of the MSCI upgrade, specifically the amount of passive and active flows likely to result from it (relative to free float).
- Just recently, Blackrock announced a forthcoming iShares Argentina ETF. Once launched, such a product will make Argentine equities more accessible to retail investors.
- Argentina remains a highly undercapitalized economy. Twelve years of heterodox policies under the Kirchners resulted in a dearth of IPOs; however, this should soon change. Investment banks anticipate a significant jump in equity and bond issuance in 2017 and beyond.

# ARGENTINA'S NEXT CHAPTER

Following Macri's aggressive reforms, the economy has begun to recover, defying skeptics. As activity has improved, so has investor sentiment.

**Argentina Economic Activity - MoM (Green) and YoY (Black)**



GDP should accelerate from -2.0% in 2016 to 3.1% in 2017, according to Morgan Stanley. The 5% change in growth should prove a tailwind for corporate profits.

Source: Macrobond



# ARGENTINA'S NEXT CHAPTER

Inflation has begun to decline. Although the battle has not been won, the improvement is welcomed, helping to support real incomes.

## Inflation

Argentina January CPI +1.3% M/m; Est. +1.7%  
2017-02-09 19:06:05.624 GMT

By Kristy Scheuble

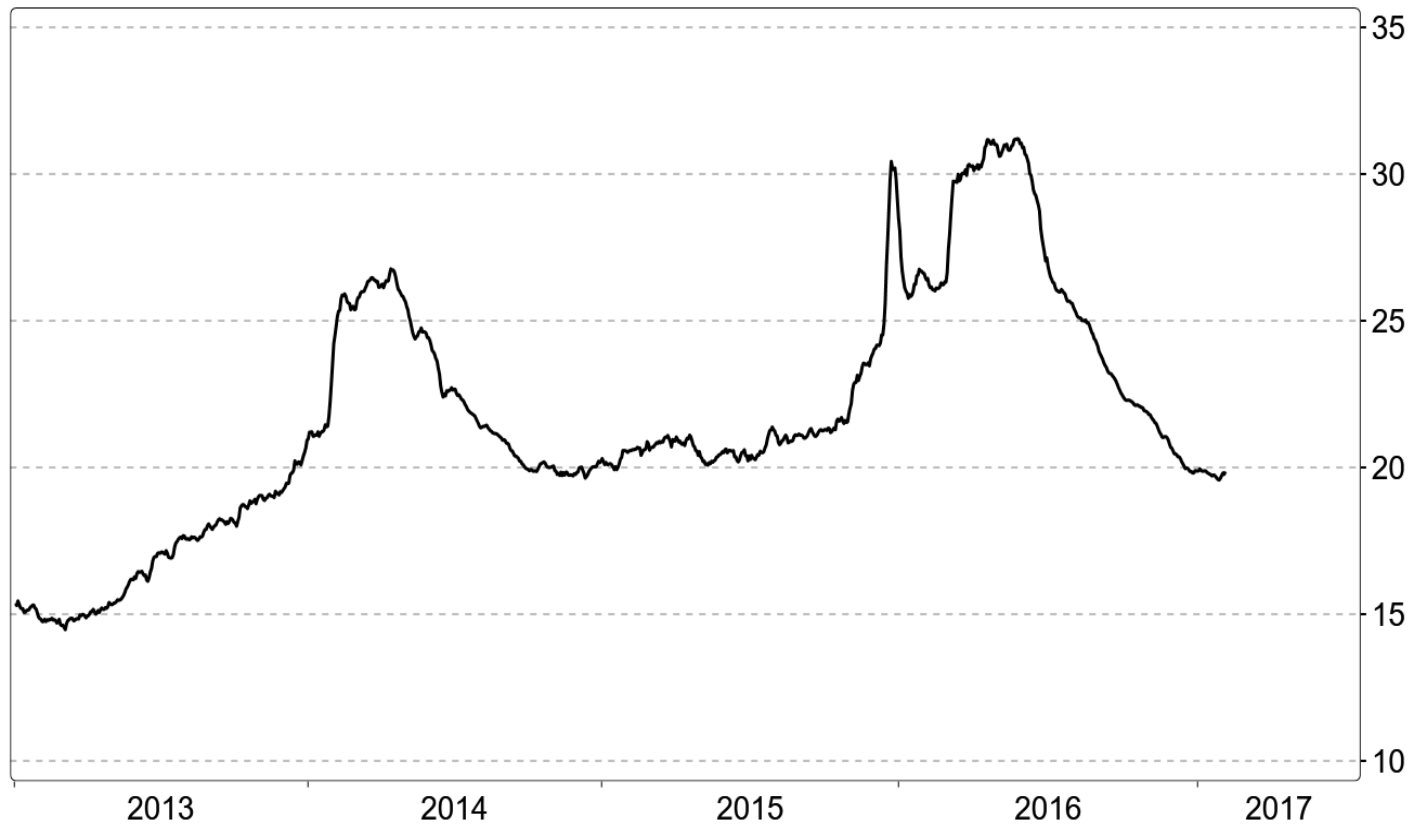
(Bloomberg) -- National statistics agency announces in Buenos Aires.

\* Forecasts range 1.6% m/m to 2% from 12 economists

## ARGENTINA'S NEXT CHAPTER

To fight inflation following the political transition, the Argentine Central Bank kept interest rates extraordinarily high. As inflation declines, rates are also heading lower, a trend likely to continue.

### Badlar (%)



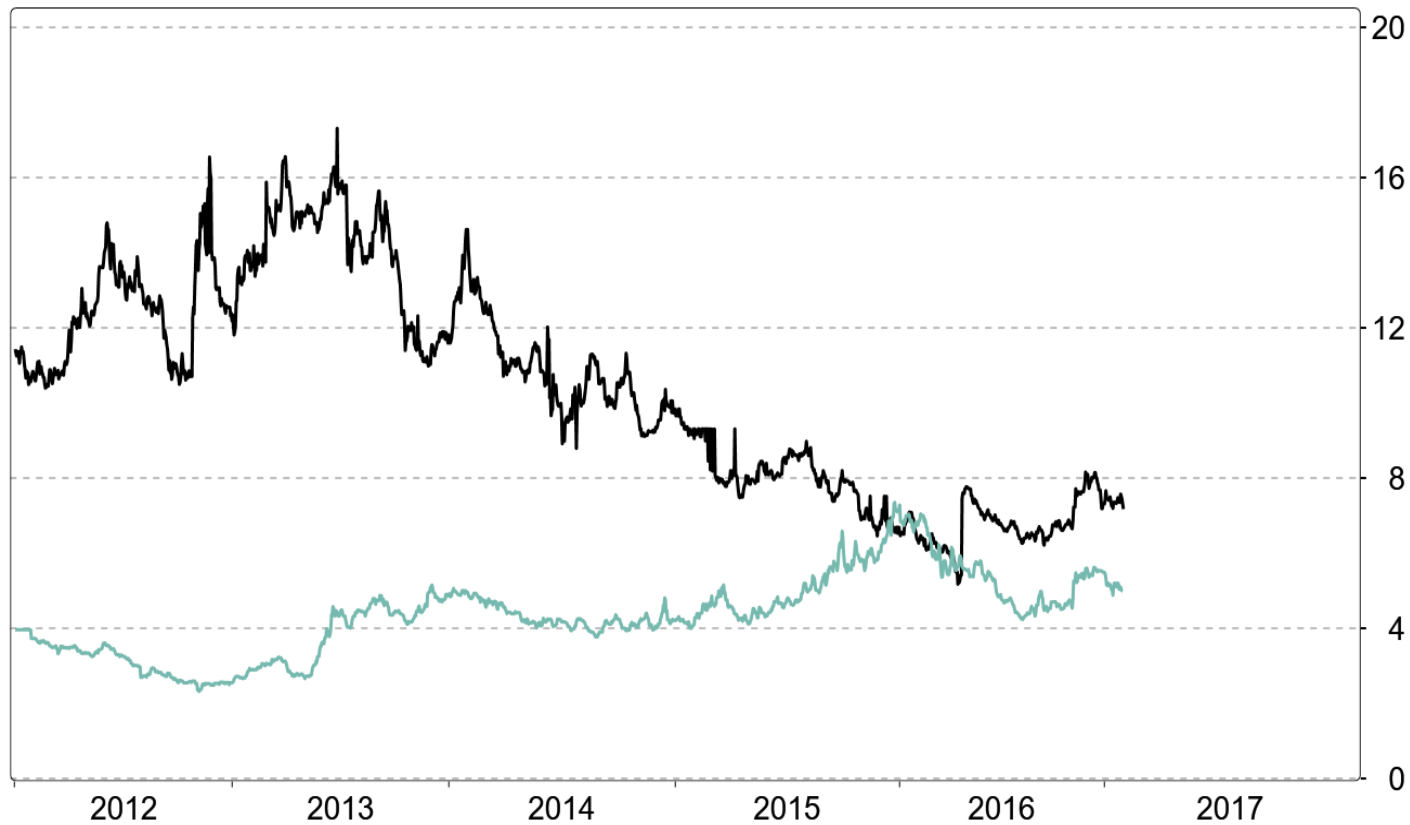
The economic improvements have brought down forward inflation expectations and allowed the Argentine Central Bank to adjust rates lower. A trend we believe will continue.

Source: Macrobond

# ARGENTINA'S NEXT CHAPTER

Although U.S. Dollar financing rates have fallen by half since investors began discounting the end of Kirchnerism, there is still room for improvement.

## Argentina USD Discount Bond Rate (Black) vs Brazil USD Discount Bond Rate (Green) (%)

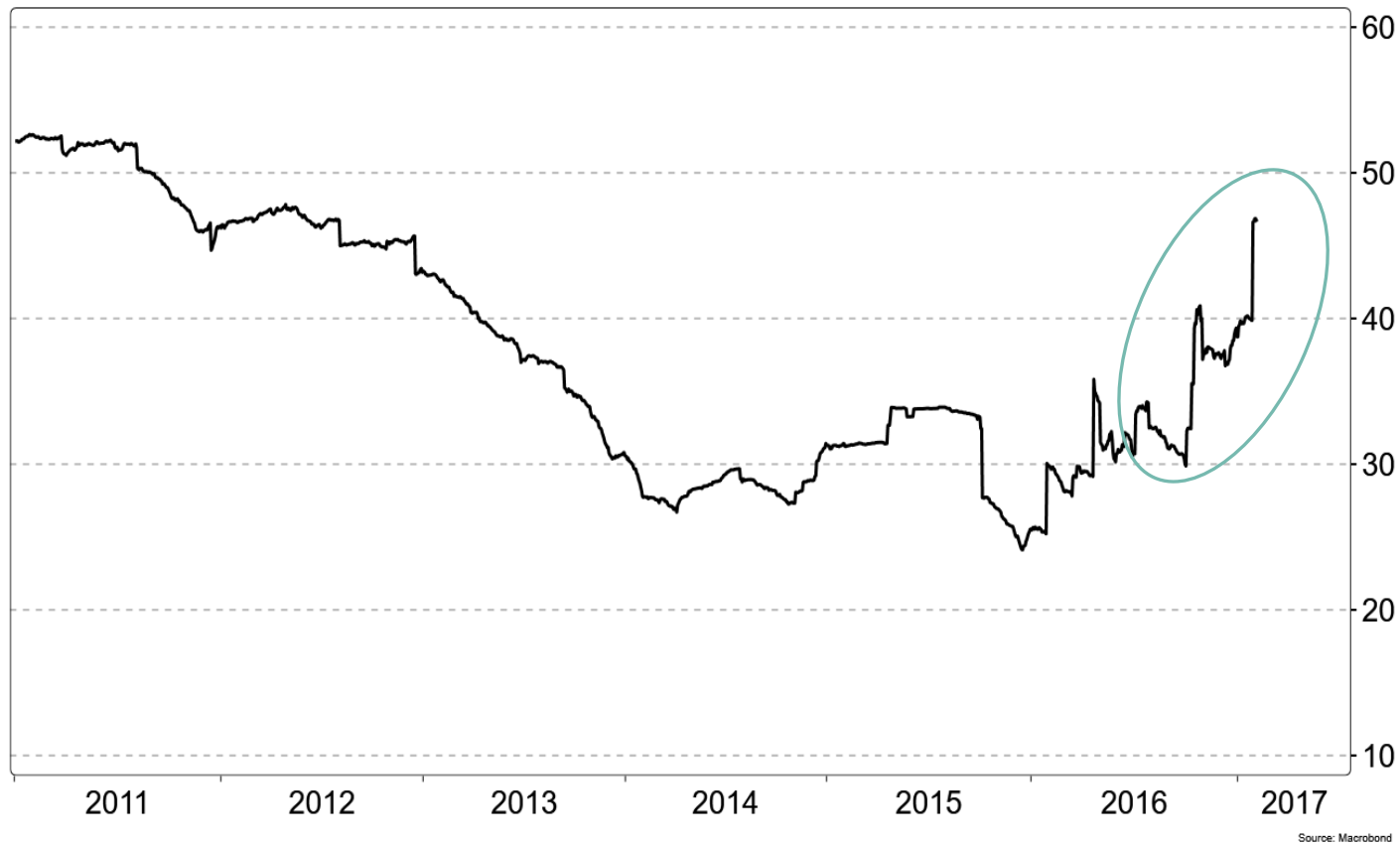


Source: Macrobond

# ARGENTINA'S NEXT CHAPTER

Argentina's foreign reserve balance continues to trend upward, stabilizing what was a precarious financial position.

## Argentine Central Bank Reserves (\$bn USD)

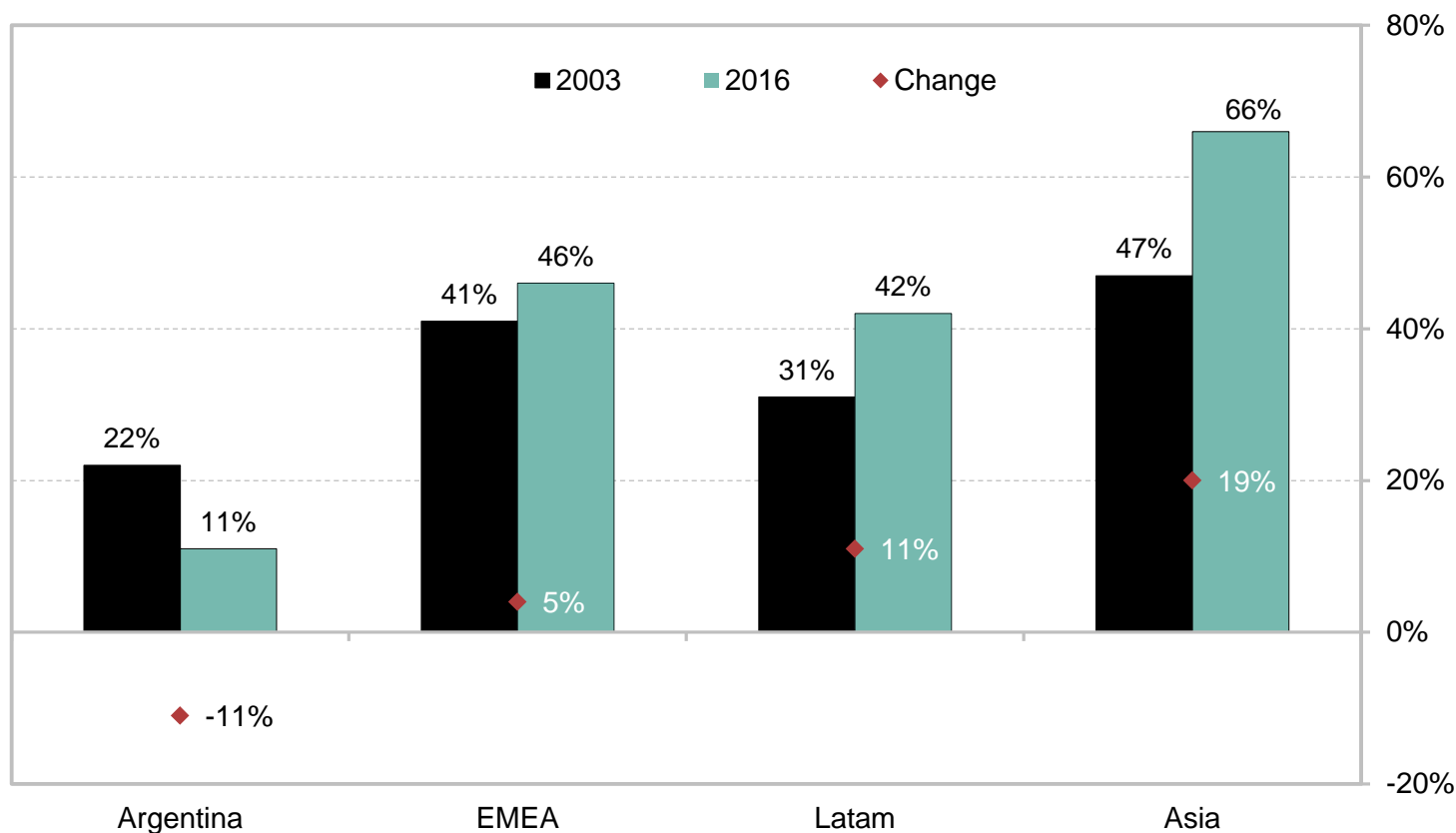




# ARGENTINA'S NEXT CHAPTER

Despite appreciation since Macri's election, when viewed relative to the economy, the equity market remains at half the level of 2003, and a fraction of peers.

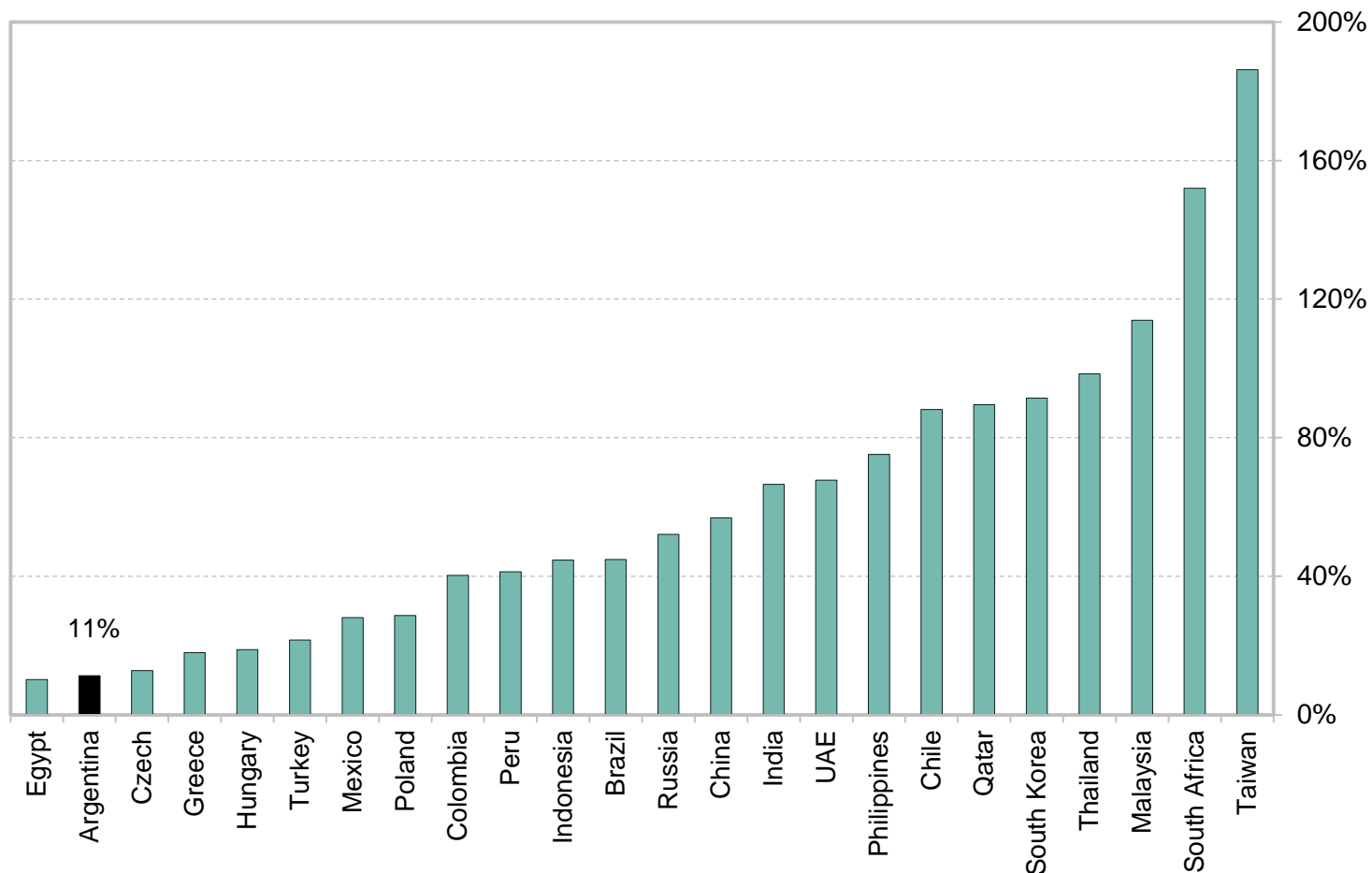
## Equity Market Cap-to-GDP Ratio



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The contrast is more pronounced when viewed on a country-by-country comparison.

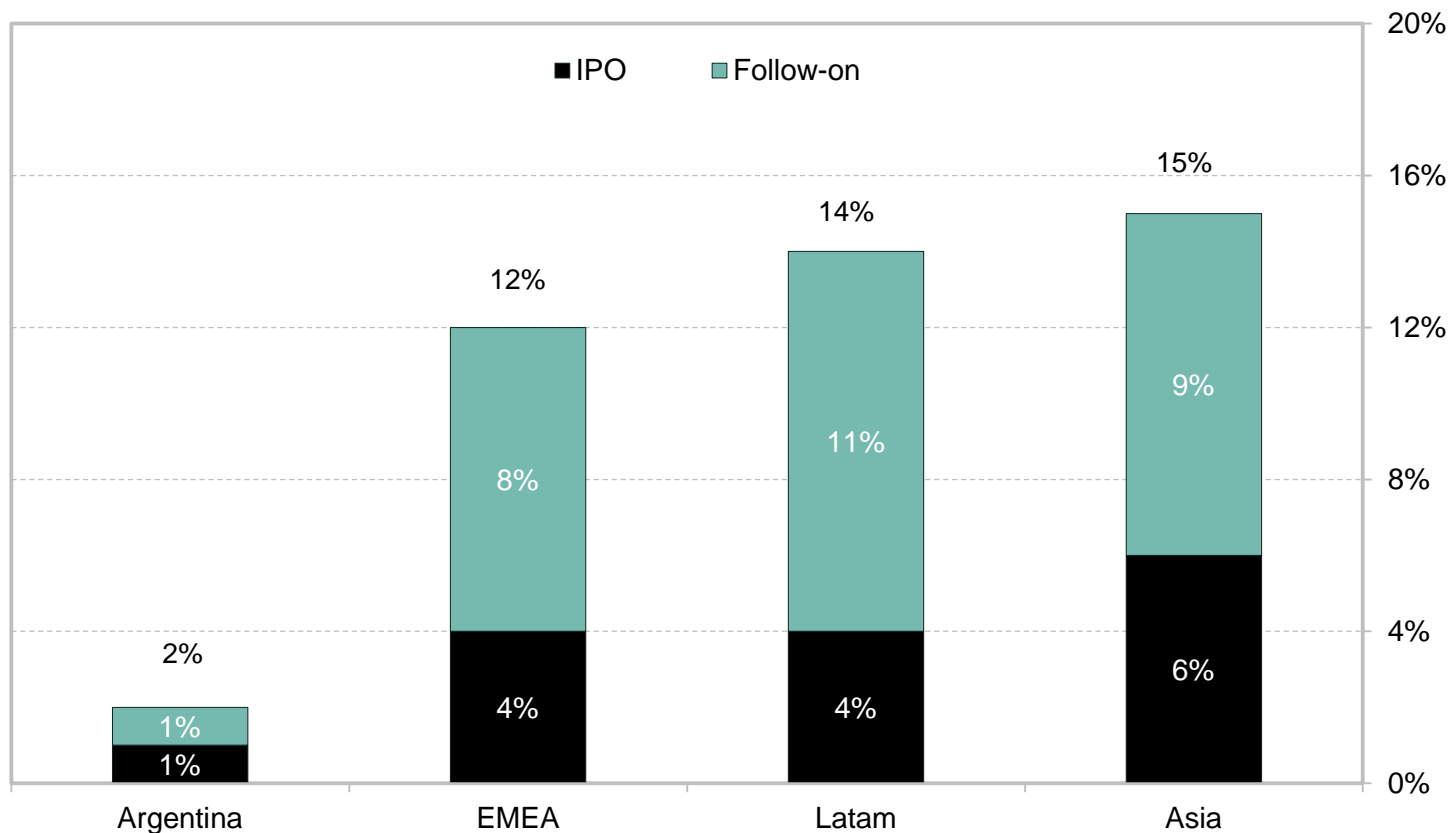
## Equity Market Cap-to-GDP Ratio



# ARGENTINA'S NEXT CHAPTER

Under the Kirchners, Argentina had little access to capital markets, especially foreign capital. As a result, equity offerings were limited, but that should soon change.

## Equity Offerings as % of GDP (2000 – 2016)





# ARGENTINA'S NEXT CHAPTER

Morgan Stanley estimates \$25 billion in new equity and \$58 billion of corporate debt issuance over the next five years.

## Estimated Inflows

Financing Category	USD bn	% GDP p.a.
Equity Issuance	\$25	0.8%
Corporate Debt Issuance	\$58	2.0%
o/w domestic	\$35	1.2%
o/w foreign	\$23	0.8%
Sovereign Debt Issuance	\$92	3.1%
o/w domestic	\$69	2.3%
o/w foreign take-up	\$23	0.8%
o/w foreign	\$23	0.8%
<b>Total</b>	<b>\$175</b>	<b>5.9%</b>



# ARGENTINA'S NEXT CHAPTER

An upgrade from Frontier status to the MSCI Emerging Market Index, expected this June, should result in \$2 to \$4 billion of inflows, a significant amount of buying relative to daily trading volume.

## MSCI Argentina Weighting Estimates

Ticker	Estimated Weighting	Estimated Inflows (USD)	Average Volume (USD)	Days to Buy (20% of volume)
YPF	21.7%	\$651,000,000	\$44,690,136	73
GGAL	16.5%	\$495,000,000	\$17,653,362	140
PAM	16.5%	\$495,000,000	\$28,186,673	88
BMA	16.3%	\$489,000,000	\$8,191,271	298
TEO	9.2%	\$276,000,000	\$3,186,283	433
AGRO	6.5%	\$195,000,000	\$8,759,406	111
BFR	4.8%	\$144,000,000	\$3,187,154	226
TGS	4.5%	\$135,000,000	\$2,410,484	280
EDN	4.0%	\$120,000,000	\$2,314,835	259
<b>Total</b>		<b>\$3,000,000,000</b>		

Expectations are for an announcement in June 2017 regarding Argentina's up-weighting to MSCI Emerging Markets status. It would be added in June 2018 (but potentially as soon as November 2017).

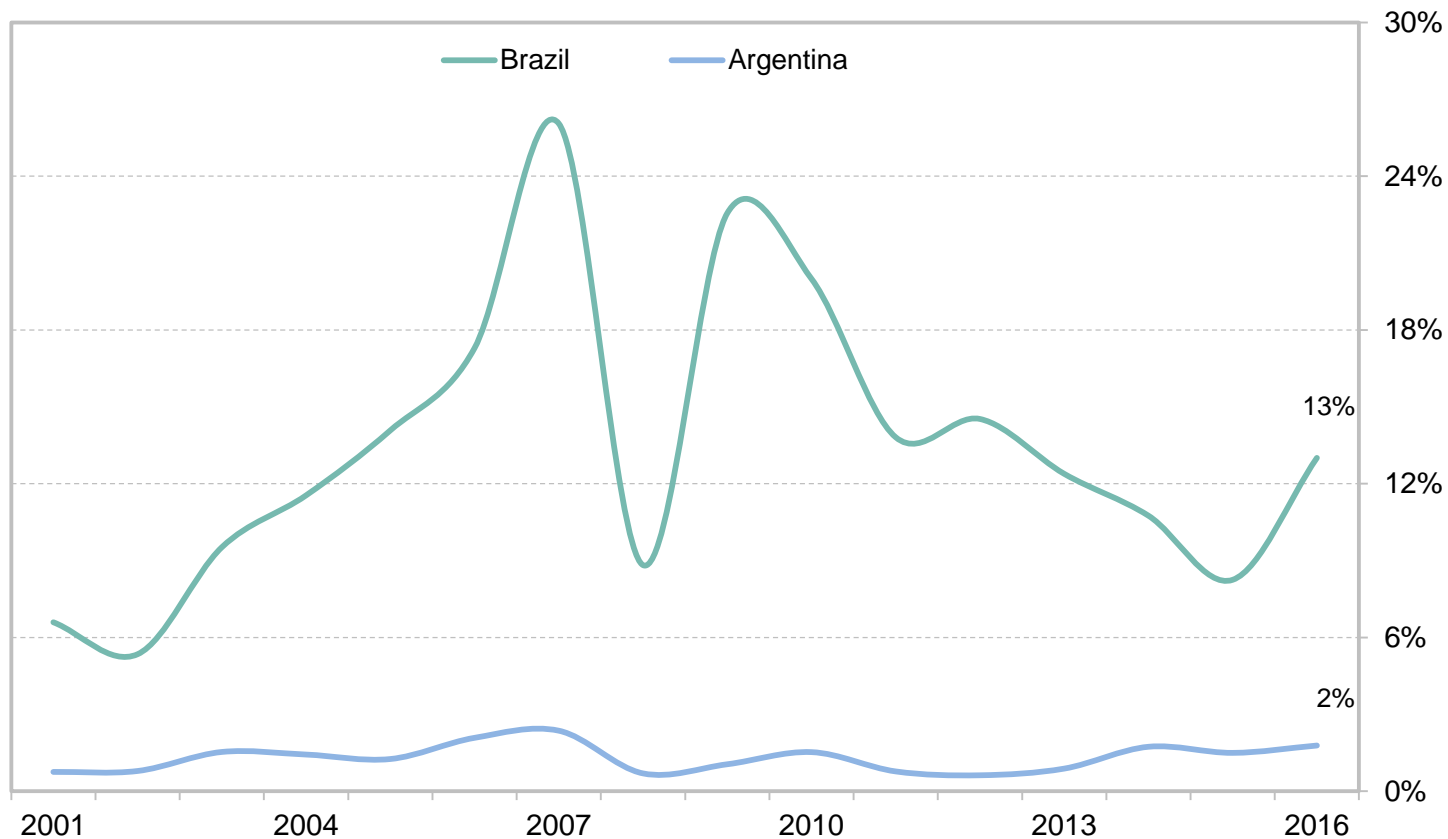
The range of expected passive and active inflows is anywhere between \$2-\$4bn.

The current trading volume is less than \$100m/day with half of that volume coming from the top 3 names, YPF, PAM and GGAL. These inflows will have a substantial impact on market prices.

# ARGENTINA'S NEXT CHAPTER

Today, Argentina's equity market has little foreign participation. But as the Argentine story evolves from "pariah," to "normalization," to "recovery," foreigners are likely to take greater interest.

## Foreign Portfolio Investment Into Equity Markets (% of GDP)





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