Analysis

Argentina – Unwinding 15 Years of Indiscipline

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Warren joined Muzinich in 2013. Prior to that he was the Senior Portfolio Manager for Global Emerging Markets at Schroders where he managed $2 billion and helped develop the firm's EM corporate capabilities. Warren has a B.Sc. in Mathematics for Business from Middlesex University London and an M.Sc. in Shipping Trade and Finance from CASS Business School. He holds the Chartered Financial Analyst designation.

The government faces an ongoing battle for reform

For decades Argentina has suffered military rule, recessions and dictatorships. The election of Mauricio Macri in 2015 appeared to mark a turning point for the country. Under his leadership, the government has focused strongly on economic and fiscal reform.

The 15-year battle with the debt holdouts of the 2001 sovereign default was resolved in 2016. This paved the way for the country's return to the sovereign bond market with a US$16.5bn sale that was heavily oversubscribed. A year later, a 100-year bond sale again saw strong demand, reflecting investors' faith in Macri's commitment to reform.

Indeed, up until the end of 2017, the market was comfortable with Macri's fiscal and economic policy. The central bank also appeared in control, effectively implementing inflation-fighting measures.

However, the start of 2018 marked a turning point; the central bank missed inflation targets and the government, mindful of the general election 18 months away, loosened fiscal policy.

The result was a crisis of confidence in the country and a significant devaluation of the peso.

The government and central bank fought back; the finance ministry stopped all foreign funding and, independently, the central bank raised interest rates.

Furthermore, in June the government agreed to a US$50bn bailout package with the IMF. While this move risked further ire from the general population, who largely blamed the IMF for the country's last sovereign default in 2001, it highlighted the government's ongoing commitment to getting the country back on its feet.

With IMF funding measures in place, accompanied by targets on fiscal reduction and inflation stability, matters appeared to improve.

Nevertheless, the peso's already weakened state and higher interest rates weighed on economic growth and the country headed back into recession. With the government's reputation already diminished following its IMF deal, the worsening economic situation weakened internal sentiment towards Macri's government still further.

A confluence of events, both internal and external, then resulted in ensuing panic and a rapid currency depreciation.

Earlier in August, amid fears of a resurgence in popularity of former president Christina Kirchner's party, the Macri government began their own bribery and corruption investigation, (similar to Brazil's Operation Car Wash) to discredit members of the opposition party prior to the general election.

While individuals (not companies) were the target, investors were reluctant to run the risk of any possible contamination of the corporate landscape and began selling Argentinean corporate assets (bonds and equities).

Meanwhile the ongoing crisis in Turkey, and another sell off in the Turkish lira, had already dampened investor sentiment to the broader emerging market asset class and led to outflows.

In addition, the general election campaign in Brazil was becoming more volatile, with the market's favoured candidate performing poorly in early polls.

Macri's surprise online statement towards the end of August was an attempt to provide assurances that the country was fully solvent until the end of 2019. While Macri had been negotiating behind the scenes with the IMF to increase their disbursements, his eagerness to make it public prior to the agreement being ratified by the IMF only made matters worse and led to the unintended collapse of the Argentinean peso.

We believe the government remains committed to its reform agenda, despite admitting its mistakes, and has since announced the implementation of austerity measures aimed at balancing the country's budget for 2019, including an increase in export taxes.

In our view the IMF is likely to speed up its disbursements. However, it may come with tighter fiscal conditions and result in a deepening of the recession.

For investors, political and economic uncertainties have increased. The country's longer-term financing needs are now firmly back in the spotlight. Next year's election will remain a Damocles Sword over Argentine investments until the results are announced.

In our view it is too early to make a call on the outcome, but a return to populist rule would undermine all the work achieved to date by Macri's government.

On a more upbeat note, recent market moves have some positive aspects for the country's longer-term economic health. The peso is now undervalued. The country, with a much weaker currency, is now export competitive. This would contribute to the reduction of the current account deficit. Argentina is also likely to benefit from the Chinese tariffs on US exports in areas such as soyabeans and beef, of which Argentina is a large producer. Meanwhile the IMF-imposed restrictions on fiscal spending may lead to the country moving towards becoming self-funded.

Over the last 17 years Argentina has undergone a period of significant stress and turmoil under the Kirchners, followed by a strong and willing desire for change under Mauricio Macri. Nevertheless, the economic imbalances and corruption that built up during the 14 years of the Kirchner regime will likely take a long time to unwind.

However, unfortunately, because the government relaxed its grip for political reasons, negative headwinds have taken control of public sentiment. We believe investors are now likely to remain on the side lines, at least until after next year's election.

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