# EM update: Argentina

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Argentina has faced many economic and political challenges over the last century. Over that period, it has slipped in world rankings of per capita GDP from 7th to at best around 60th now (depending on the exchange rate). The country has defaulted eight times on its sovereign debt since independence in 1816, including on USD100 billion of bonds in 2001, which at the time was the world's largest such event. The default was only properly resolved after the election of the current administration in late 2015, when a more market-friendly agenda was adopted and holdout creditors were persuaded to deal.

Argentina once again occupies the front pages of the world's financial press. Argentine asset prices have been tag-teaming with those of Turkey to lead year-to-date declines. Both currencies sold off 25% against the US dollar in August alone.

In response to the pressure on the peso, the President of Argentina Mauricio Macri last week announced that his government would ask the IMF to bring forward its planned disbursements from the second half of the three-year Stand-By Arrangement (SBA) and add them to those already scheduled for the period to end-2019. But at that stage, he was unable to specify what Argentina would offer in exchange to persuade the IMF to increase its exposure in this way. The resulting sense of panic induced further flight from the peso.

The debt burden in Argentina has climbed to troublesome levels as a result of this peso weakness, and there are scenarios where the debt/GDP ratio fails to stabilise – through a collapse in nominal growth, further real currency depreciation or insufficient fiscal adjustment, possibly triggered by the fall of the Macri government or its defeat in elections in October 2019. In such scenarios, a restructuring of the public debt stock becomes more of a risk. We do not expect the IMF to even discuss such a possibility publicly in the coming weeks while they negotiate a revision of the programme, but it remains a live concern for many.

Better late than never, President Macri and his finance minister Nicolas Dujovne announced major policy initiatives on Monday, kicking off the process of renegotiating the IMF SBA in the hope of accelerating the pace of IMF disbursements. President Macri met with senior government figures and coalition members over the weekend and subsequently decided on a significant revamp of his administration.

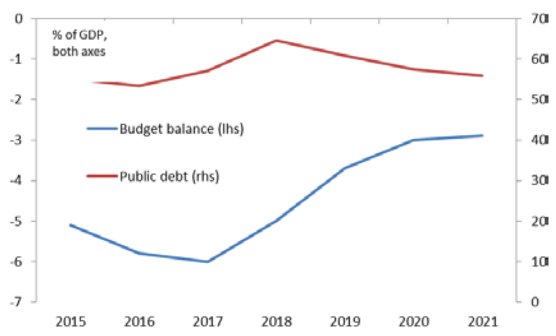
The number of ministries will be cut in half, which has two aims – to signal fiscal austerity and create more powerful individual ministries, including the finance ministry. More importantly, the pace of fiscal adjustment will be stepped up, with the government targeting a primary balance in 2019 (compared to a 1.3% of GDP primary deficit under the programme agreed with the IMF in June), and then a 1% primary surplus in 2020.

The burden of adjustment will fall on exporters, which will face a ARS3-4/USD tax on their revenues. This is not ideal policy, as the government itself recognises, but has the advantage of being easy to collect and claws back some of the windfall gain that commodity producers in particular have accrued from the peso depreciation. Other planned tax cuts will be delayed, and spending on transport subsidies and infrastructure investment will be trimmed further as well.

We believe that the government's external funding requirement is manageable if IMF disbursements are brought forward. The negotiations with the Fund over the coming weeks are going to focus on how to deliver a fiscal adjustment to put the debt path on a sustainable footing, rather than explore options for restructuring.

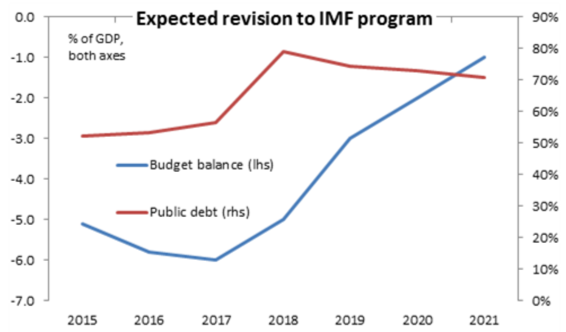
Nevertheless, currency weakness pushes up the debt/GDP ratio because around 80% of the public debt stock is in hard currency, and the pass-through from the nominal depreciation to nominal GDP growth (via the GDP deflator) is less than 100%, although pass-through is generally very high in Argentina's highly indexed economy. The chart on the left shows the base case in the current IMF programme, with public debt/GDP topping out around 60% and a fiscal adjustment that only brought the nominal deficit down to 3% of GDP by the end of the programme. We expect the government and the IMF to work towards a much more aggressive adjustment, as shown by the chart on the right, with debt-to-GDP already jumping to 80% as a result of peso weakness, and stabilising only with the nominal deficit declining to 1% of GDP by the end of the programme.

**Base case in IMF programme**




Source: IMF Staff Report, July 2018

**Scenario analysis**




Source: BlueBay, September 2018