



Insigneo Weekly Dispatch

Argentina: back to square one

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As has become customary, the situation in Argentina remains as relevant as ever for investors interested in having exposure to Latin America. Against the backdrop of fluid, changing developments, we deemed it fit to recap the latest affairs while gauging how those impact investors.

After Javier Milei took office in December of last year, the expectations of how long his honeymoon period with the markets would last were limited, but the opposition that Milei experienced with his Omnibus Bill was slightly above expectations. After it was initially announced at the beginning of his administration as the beginning of the “shock therapy” Argentina so desperately needed, the Omnibus Bill was extensively discussed in Congress to be later approved by the lower house on February 2. However, that initial approval came with several concessions from the executive, where Milei and his team had to give up some of the key points of the bill, like eliminating the privatization of YPF and reducing the duration of the emergency powers Milei had granted himself, to get it approved. Nonetheless, this watered-down version of the Bill still didn’t survive its remaining debates in Congress, where Milei’s party controls less than 15% of the lower house and solely depended on the support he could garner from the more moderate parties.

During the first week of February, protesters clashed with authorities to express their discomfort while the Omnibus Bill was still being discussed in Congress. It is worth keeping in mind that the bill, which also intended to eliminate several subsidies, was considered one of the key elements of Milei’s reformist agenda that came as a response to the challenging economic situation Argentina currently faces. On another note, it is worth keeping in mind that, in the Argentinian political space,

governors can influence Congress in a meaningful manner. Once the governing coalition realized it would be better to return the Bill to committee because it didn't have enough votes in the lower house to be approved, Milei accused several governors of having destroyed his reform package and, eventually, he decided to withdraw the entire bill, while touting the possibility of splitting it into several different bills that may ease its approval.

The initial market reaction to this ever-changing political situation was not positive. Foremost, the Milei administration's ineffectual handling of the situation betrayed its political inexperience which, when combined with his lack of representation in Congress, may pose additional challenges to getting approval for any of his proposed reforms. Moreover, the fact that the government swiftly modified its initial, more pragmatic stance to re-adopt a more radical approach, brings additional uncertainty to the market and forces some investors to wait and see how the proposed changes untangle before allocating capital to Argentinian assets, even if some key investors – like Elon Musk and BlackRock – have expressed their interest in investing in Argentina.

In the opinion of many, and ironically echoing Milei's campaign remarks, Argentina needs a dose of shock therapy to try and regain its footing as a country. Proof of that is the most recent inflation print that displayed a 20% MoM price increase in January, mainly due to the elimination of subsidies and price controls, together with the observed currency weakness. This print continues to put pressure on the administration to deliver a turnaround on the economy, and even if the January reading marks a slowdown from December's 25% print, it is providing the opposition with arguments to continue protesting, especially when Argentinians are getting poorer by the hour. This is relevant because, according to some market analysts, one of the main risks that the Milei administration faces stems from the ability of

Argentinians to endure the shock therapy pain while hoping to get the promised long-term benefits.

This inflationary surprise also comes amid Milei reinforcing his intentions to perform an aggressive fiscal adjustment while keeping the dollarization of the Argentinian economy as part of his plan. In a televised interview, the Argentinian president stated that the zero fiscal deficit target would be met via aggressive spending cuts since the initial funding source – the tax reform chapter of the omnibus bill – did not come through as planned. In this regard, and considering a scenario analysis presented by Barclays Latam economist Pilar Tavella, two of the main challenges the Milei administration faces are macroeconomic and political in nature. On the macroeconomic front, the main challenge stems from inflation being stickier than initially expected, which could further undermine Milei's popularity and revive the protests seen during the Omnibus bill discussion. If, on the contrary, inflation continues to recede, this should bode well for the economy to recover from the recessionary scenario it is currently experiencing while giving the Milei administration more wiggle room to implement some of its reforms, coupled with a more accepting society that would start to see some improvements in its economic stance.

Regarding the dollarization plan, and circling back to the scenarios presented by Tavella, it is relevant to acknowledge the importance of the reserve accumulation by the Central Bank – BCRA. The Argentinian economy's supply of dollars has been depleted, and even if the BCRA could continue accumulating reserves at its current pace, those would not be enough to dollarize the economy. What could end up happening for Argentina, according to Pilar, is that dollarization may come as a response to a hyperinflation scenario that depreciates the ARS even further, thus making this phenomenon the only possible alternative to achieving economic stability. Therefore,

Tavella suggests that the discussion around dollarization would be better received if it came after an economic stabilization rather than as a response to the economy going further south.

On the fixed income front, it is worth stressing that the most liquid USD-denominated bond, the ARGBON 2030, had a 2% decrease in its price when the omnibus bill withdrawal occurred. Afterward, it recuperated some of those losses. Meanwhile, the short end of the NY Law curve also exhibited a prominent yield tightening move during the last month. Moreover, regarding YPF, one of our preferred Argentinian corporate issuers, it is worth stressing that we continue to favor having exposure to the Oil & Gas sector as one of our preferred Argentinian plays, even if we are aware of the risks it entails. YPF recently performed a debt tender to repurchase its 2024 bonds while issuing a new 7-year paper that was well received by investors. Moreover, YPF recently announced its intention to focus specifically on its shale production from Vaca Muerta, its most profitable well, while performing a “sweeping asset sale,” according to Bloomberg. This is expected to streamline the company and increase YPF’s production and exports. According to market expectations, YPF’s upcoming earnings, which are scheduled for March 6, could report an increase in oil production in the Neuquen Basin amid what could be positive figures in terms of upstream production and realized prices despite facing headwinds from the company’s investment plan and the observed currency devaluation.

Translating those expectations to the rest of the YPF curve, it is worth stressing that, even if in relative value

terms most of the issues look expensive, the YPF 6.95% 2027s, YPF 10% 2028s, and YPF 8.5% 2029s look cheap when compared to their corresponding regression curve. It is also worth noting that we have been favoring the YPF 2029 bond since the tender for the 2024s was announced as an alternative to maintaining exposure to the name without sacrificing much carry.

We are aware of how fluid and ever-changing things tend to be with Argentina. As we have also stated on several previous occasions, investing should be dictated by our reasoning and not our feelings, and, in this case, we continue to consider that the fundamentals for YPF are solid enough to weather the current political storm. We will continue monitoring the political developments or potential changes proposed by the Milei administration. Still, after seeing how his initial reforms were sent back to square one, we, like the rest of the market, are starting to consider that Milei’s main focus now should be on delivering the macroeconomic improvements he promised during his campaign if he wants to have enough leverage to try again. ■



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