Argentine Peso — Short

Industrial Weakness and a heavy Debt Load raise bond default and currency depreciation risk; Initiate Short & $0.010 PT

Thesis

The Argentinian Economy is poised to enter into a major recession in the coming weeks - With heavy impacts from the Coronavirus on major Argentine industries, an unmanageable debt load, rejected restructure proposals, and major instability, it is all but a lost cause for Argentina. We strongly suggest a short on the Argentine Peso, with a price target of $0.010 USD/ARS to be achieved by August 1st.

- **The main issue that may bring about a recession in Argentina are their sky high interest payments** that they have been unable to repay. Warning signs emerged for Argentina in 2018 when its currency began declining in comparison to the dollar. However, during the current pandemic, Argentina looks as if it might default for the third time in just two decades. As the coronavirus attracts the central government's primary concern, the Argentine economy is consequentially suffering. This situation only got worse recently after negotiations broke down in restructuring talks for $65 billion in sovereign bonds. The terms would have provided over $40 billion in relief but the proposal was rejected. This issue is compounded further by existing issues with the International Monetary Fund to whom they currently owe $44 billion. This indicates - besides the fact that further levering would only work negatively in the long run - that the IMF will be unable to provide Argentina with further debt via the $13 billion left with the fund to pay off the country's current obligations.

- **Besides debt, there are also further industrial pieces to the puzzle that will bring about Argentina's downfall.** Many of their largest industries have become massively impacted by the Coronavirus epidemic. With almost 50% of their exports being in foodstuffs and vegetable products, a significant percentage of their economy is being practically halted. Additionally, failures to encourage consumption while holding an increasingly expansionary monetary policy are significantly lowering the value of the Peso. Even with a 34% increase in the number of Pesos held in the past month, around 619 billion, the publicly held amount only increased by 51 billion. The rest would be deposited back into the central bank at a 0% interest rate.

- **Furthermore, rejected restructuring proposals indicate further backing for our lack of faith in Argentine debt and Peso.** The central government has already admitted that it is impossible for them to fulfill the payments on the current timeline and have subsequently postponed over $10 billion dollars worth of payments until next year. Argentina is currently looking to restructure its existing debt and have asked their bondholders to wait until 2022 for their payments in order to avoid default. However, as this proposal was rejected, hope seems dim for Argentina. The country has even started offering bonds for record low prices in order to bring in cash, but with the state of the economy, most of these bonds will remain untouched.

Description

USD/ARS represents the value of one Argentine Peso in US Dollars, which underlyingly represents the country's economic strength and international trade value.

PRICE: $0.015
As of 4/25/2020
TARGET: $0.010
As of 4/25/2020

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Summary	Current
2018 GDP (Bn)	$519.872
2018 GDP Per Capita	$11,653.95
2018 GNP (Bn)	$550.33
2019 Inflation	53.8%

1-Year Chart:

Risks of PT & Recommendation

1. **Debt Restructure**
2. **Economic Recovery**
3. **IMF Bailout**

- **Coronavirus has also ravaged the Argentine economy by targeting one of its most valuable resources - grain.** Argentina heavily relies on exporting commodities like these, also including soybeans, corn seeds, and wheat. However, manufacturing and selling of these resources have been halted by coronavirus safety measures and normal buyers like China are going elsewhere. In addition, water levels have also been uncharacteristically low in rivers, which hurt grain harvests even more. As a result, and in addition to wide-spread fiscal weakness, the Argentine economy is expected to shrink 5.7% this year. The inability of the government to make bond payments and to export goods signal a chance for investors to short the Argentine peso as the country slips into default.

Debt Weakness, Default Risk, and Hyperinflation

In financial markets, and more specifically debt markets, a company or even a country's credibility is built upon its ability to repay its creditors in full. A country like the United States of America, which has achieved such a feat, as a result, enjoys the full faith of investors in the form of low credit rates. However, for a country such as Argentina, the opposite is evident - with its 9th debt default looming, the country finds itself paying out extreme risk premiums to investors. 10 year bonds, currently pricing a YTM of 28%, represent the nation's significant default risk - a risk that was recently reinforced when the S&P and Fitch downgraded its credit rating to 'SD' and 'C', respectively.

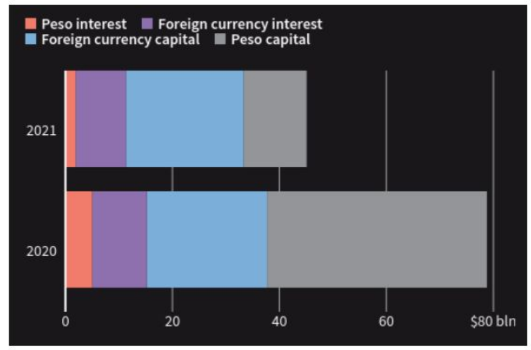
Nonetheless, beyond the market pricing in high risk premiums comes the government's demonstrated inability to manage its current capital obligations. Recently, the government failed to restructure over $100 billion in long term debt (see Graph 1.0), including that which was earlier issued in 2016, when major investors rejected proposals to defer interest payments and install a debt relief plan that would allow them to weather this financial crisis. As a result, their ability to sustain not only interest payments but considerable debt repayment in the near term highlights the country's underlying debt weakness.

In considering the central bank rate, currently at 38% (see Graph 1.1), we find further belief for the fact that the country faces a worsening debt crisis that will result in a disastrous default on at least some proportion of its $310 billion in national debt. With the country already having missed payment on $510 million in interest payments as of April 22nd, beginning a 30-day grace period to find a restructure proposal, we find it increasingly likely that the government may begin defaulting on debt packages. Coupled with the country's hyperinflation (inflation rate of ~54%, see Graph 1.3), there is undeniable reason for our belief that the ARS will incur strong depreciation in the coming months (with the mixture of inflation and default risk, we have consequently priced in a 33% move by early August).

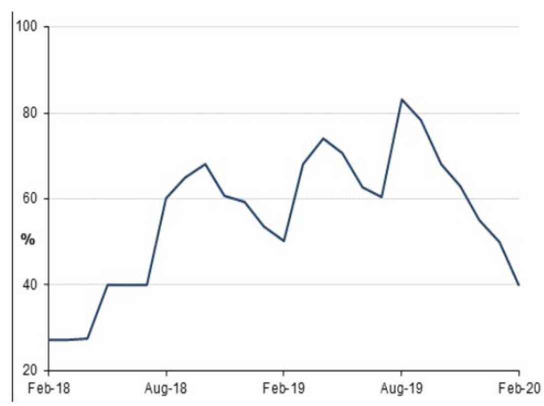
Notably, we factor in significant currency depreciation more so because the country has already exhausted half of its foreign reserve holdings (particularly of the USD, as seen in Graph 1.2) in an effort to hold off a prior forex dive in 2019. This considerably worsens their ability to halt or control any future depreciation, and in line with reducing national exports, falls in line with our short of the ARS.

Further support for Argentina's impending default (and subsequent currency depreciation) can also be seen in the implied probability of default exhibited in 5 year Credit Default Swaps on Argentine sovereign bonds of 100% - indicative of the market's concurring expectation of a debt default.

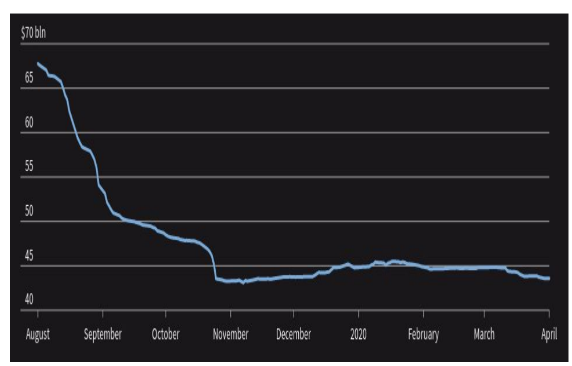
Graph 1.0: Total Debt Repayments by Type



Graph 1.1: Central Bank Interest Rates



Graph 1.2: Foreign Currency Reserves - USD



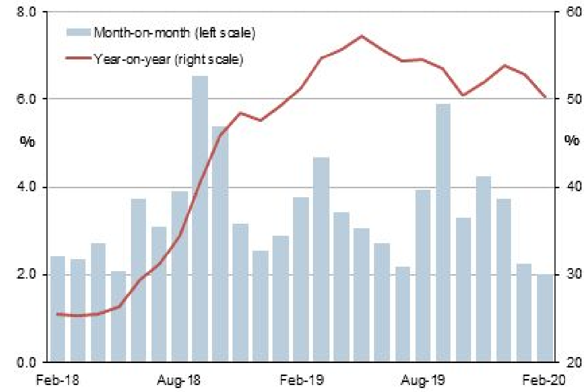
Industrial Weakness in the Argentine Economy

Industrially, Argentina has indeed suffered significantly as a result of the global impacts of COVID-19. The country is the world's largest exporter of soy products and corn products, which among other agricultural products account for a large part of the country's industrial production. Yet, exports began to fall in January when COVID-19 began spreading in China, one of the largest consumers of Aregnitian exports. More recently, the pandemic has also spread to European regions, which make up another large market for Argentinian exports. Exports make up approximately 14.8% of the country's GDP, so the current disruptions of international trade largely impact the country as a whole.

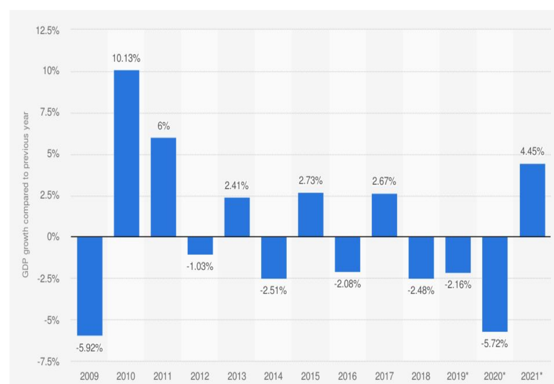
Agricultural exports are down 25.4%, industrial exports are down 31.4%, crude oil exports are down 44.8% and car exports are down 38.8%. These extreme drops in exports are in part due to lack of personnel in distribution facilities. Simply put, there are fewer people who are able to work in the distribution centers and handle international freight. Additionally, sourcing supplies is another challenge Argentina now faces. The rate at which vessels transport goods has decreased, which in turn has made the cost of storing goods on these ships even more expensive. This contraction in available personnel and overall exports, in lieu of expanding costs crucially highlights further problems for Argentine trade. The UN has also stated that COVID-19 may lead to global export restriction adding further potential pressures in the short term. Moreover, considering Argentina's significant energy trade, fluctuations in global oil demand and prices may also deepen the impact of COVID-19 on Argentina's economy.

Domestic production has also experienced serious declines in the past few months. Since February 28, 2020, steel production has been down 15%, food and beverage production has fallen 5%, soy production has fallen almost 6.9%, and oil and chemicals production has fallen 10% and 26%, respectively. Point blank - these wide-ranging industrial complications are heavily impacting the country as a whole and do not show signs of easing anytime soon, as indicated via the forecasted ~5% fall in Real GDP (See Graph 1.4). Such further industrial weakness will only reinforce weakness in the ARS as output across various industries falls off in line with reduced export demand.

Graph 1.3: Argentine Inflation Rates



Graph 1.4: Real Argentina GDP Growth

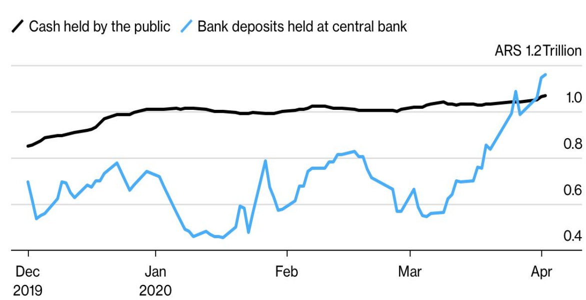


Ineffective Economic Policy Accommodation

Fiscal Policy

To evaluate the government's response to both currency depreciation and COVID-19, we must first look to Argentina's Fiscal Policies, which have also changed drastically. Over the past month, Argentina's food supply has shrunk in the face of social distancing measures and reduced farming capabilities. Medical supplies are also being exhausted, as expected. As a result, the government has implemented anti-price gouging policies on food supplies and medical equipment, as well as placing export restrictions on medical supplies. However, in lieu of extensive inflationary pressures, we find that these efforts may not be entirely effective -

Graph 1.5: Distribution of Monetary Base



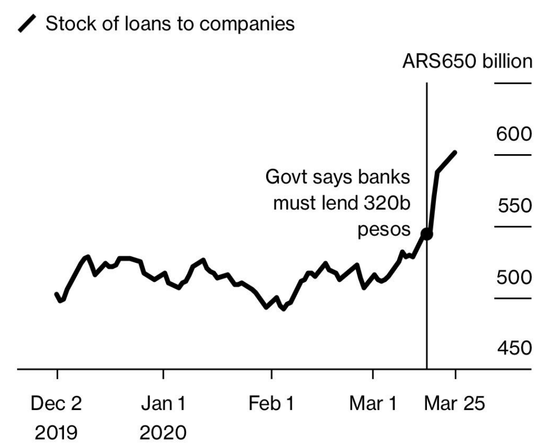
Source: Argentine central bank

instead, we find that they may be particularly detrimental to organizations and individuals in the space attempting to simply adjust prices to match inflationary pressures.

Monetary Policy

Monetary Policies have also been implemented amid a shortage of food and healthcare supplies. The stimulus package exercised by the government added about 619 billion peso of liquidity to the market. Nevertheless, only about 8% was distributed to the public. Particularly, in the last 30 days, Argentina's monetary base increased by 34% (619 billion pesos). Nonetheless, the money held by the public only increased by 51Bn - indicating clearly that the Argentine credit channel is broken. Nonetheless, there is a clear cut reason for this disparity, directly tied to the financial sector's recent hardships. The government, in recent months, has placed a flurry of legislation impacting the sector's credit lending operations - including, but not limited to, a 55% cap on annual nominal interest rates on credit card financing (which previously averaged more than 80%), and a lowering in the floor of the Leliq rate (7 day Liquidity Rate) from 63% to 38% (putting the real rate below 0%). Both of these instruments, specifically, were major sources of revenue for large banks, and the additional margin pressure incurred as a result of this legislation - as the government tries to induce cheap credit into the market - has instead led banks to redeposit a majority of their governmental financing back into the central bank at 0% interest. As a result, only a proportion of the increase in monetary base flowed back to the public.

Graph 1.6: Credit Lending to Corporate Insitutitions



These policies, which seem to be beneficial to the public in the short term, are too late to reduce the economic downturn for the Argentina currency value. The central bank is in dire need of cash, and without having a stable central bank, it will be near impossible to receive a loan from other nations, or even the International Monetary Fund (IMF), to stop an impending default on the country's excessive credit obligations.

Political Instability and Other Factors

Beyond the purely economic reasons for our positions, we find that Argentina's political instability has also exacerbated the debt crisis. The most recent example of the same can be found in 2019 when President Alberto Fernández came to office. Particularly, President Fernández's victory in itself greatly disrupted Argentine markets and led to a 15% fall off in the ARS when the national primary showed him to hold a strong lead over the then right-wing President Mauricio Macri. Specifically, as most investors found his ticket riskier due to both, his alignment to the 'Peronist' party and his running-mate selection. Particularly, having chosen former president Cristina Kirchner as his running-mate, he signaled to global markets, before the elections, his relative openness to enduring some economic weakness relative to President Macri, the at the time president who had, to a large degree, helped Argentina recover from prior defaults. Notably, those defaults which the country saw under President Kirchner, who held the office of president from 2007 to 2015. While a former president acting as running-mate - in most cases - would be a positive indicator to markets, under Ms. Kirchner's time in office, she had created substantial fiscal deficits and, as aforementioned, allowed the country to default on prior sovereign debt. Considering this prior history, and the country's financial situation even before being taxed by COVID-19, currency markets and debt markets reacted harshly. These political events alone hold the ability to significantly move markets.

With the outbreak of COVID-19, political instability within the government has only become more unsettling. The country is already dealing with high levels of poverty, governmental disputes with trade unions, and disagreement over the use of federal revenues - issues that are only projected to worsen with stay-at-home orders and a large number of people working in the 'informal' sector of the economy. President Fernández also clearly lacks the concerte economic policies needed to navigate the country's uphill battle against increasing debt - foreshadowing further instability down the road.