



Argentina: The beginning of the end

KEY MESSAGES

Following the announcement, we do not rule out an increasing demand to convert time deposits into US dollars. We expect potential dollarization of **USD16bn**, equivalent to more than 100% of the net liquid international reserves.

We see the possibility of demand for USD and capital flight picking up considerably.

The stock of Leliqs and the monetary framework in place are potential sources of vulnerability for the banking system, we think.

Thus, the announcement of FX controls and some restrictions to withdrawing money from banks are likely.

The mutual fund industry should be impacted negatively. Several Argentine Mutual funds suspended subscriptions and **redemptions** today.

The IMF statement, while explicitly saying that it will continue to stand with Argentina, shows a neutral position, avoiding references to the next review of the stand-by arrangement and USD5.4bn disbursement in October.

The *refiling* plan does not solve the problem of intertemporal solvency of the Argentinean public debt, which is more than 110% of GDP, according to our calculations.

Argentina is in a political transition. There are no incentives from the Congress or the opposition candidate Alberto Fernandez to endorse the proposal, we believe.

We thus see no catalyst for an improvement. We expect further ARS depreciation and FX controls.

In a nutshell

- Institutional investors to enter a enforced six-month extension on T-bills.
- Bondholders to be offered optional *refiling* without haircuts for 2020-23 bonds.
- Government will seek *refiling* of IMF debt also, likely transitioning to EFF program.
- The Republic was forced to make the announcements as the rollover on T-bills has tumbled to almost zero.

Details

There will be a compulsory extension for six months with partial capital payments on short-term Treasury bills held by institutional investor starting at the original maturity date. For individual investors, which account for 90% of the total holders, conditions remain unchanged.

Long-term bonds issued under local and foreign laws will be subject to an optional *refiling* with no haircuts on capital or interests.

For short-term T-bills, the *refiling* will be forced and only for institutional investors. According to Minister Lacunza, institutional investors only account for 10% of holders. The plan seems to exclude public-sector institutions (Anses mostly), which are likely enter the *refiling* as well.

For T-bills maturing this year the extension will be for six months, and bills maturing in 2020 will be extended three months. For those maturing this year, Argentina proposed to pay 15% of capital at the original maturity date, 25% three months later, and the remaining 60% at the end. The bills will continue to accrue interest at their corresponding rates until the final payment.

For bonds issued under local laws, the Ministry of Finance will send to Congress a bill with the aim to extend maturities of bonds paying their capital in 2020-2023 and with no haircuts.

For bonds under foreign law, the government will seek to *refile* under the framework of collective action clauses.

On the IMF deal, Lacunza said the goal is to negotiate a *refiling* of payments, but nothing was said about a Extended Fund Facility (EFF) programme. Negotiations have not started yet.

While explicitly saying that it will continue to stand with Argentina, the statement from the IMF shows a neutral position eluding references on the next review of the Stand-By Arrangement and USD5.4bn disbursement to be supposedly approved in September.

Regarding the announcement of the *refiling* of the bonds, the outcome is difficult to assess: there are no incentives from the Congress or the opposition candidate Alberto Fernandez to endorse or reject the proposal. Also, we need to consider that the optional nature of the offer wouldn't be straight forward.

Dollarization and short term debt

The case of Uruguay in 2002 and Argentina now

Uruguay embarked upon a friendly five-year extension of its sovereign debt in 2002 with no haircuts and without changes in coupon payments. In order to make the operation successful, Uruguay set up a level of acceptance of 90% from creditors.

We believe Argentina's case is different for the following reasons:

- Uruguay had a strong support from the IMF. It received a stand-by loan of USD769mn in March 2002 that was extended to USD1.5bn in H2 of the same year. It remains to be seen the level of involvement of the IMF with Argentina now after having already depleting USD44bn.
- Different from Uruguay, Argentina is in a political transition, two months away from the Presidential elections.
- Different from Uruguay, Argentina's low credibility in the international bond markets and uncertainty over its economic policy going forward rank high.

The problem of the Leliqs

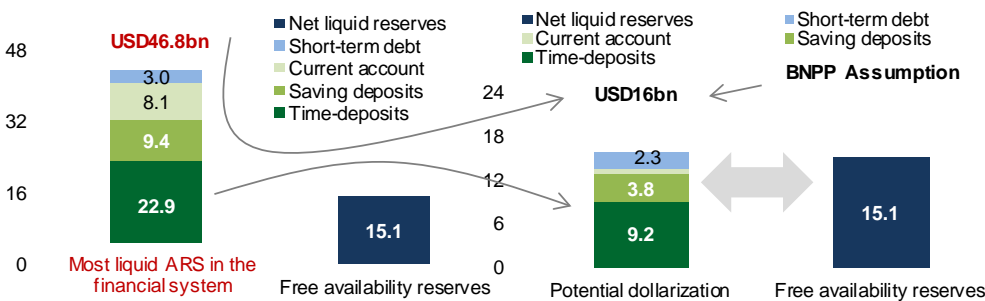
Leliqs are a time bomb as the stock already represents ~74% of ARS-denominated time and saving deposits (Fig. 3-4). Should a run on these deposits take place, we see two potential outcomes: (a) FX controls to prevent those flows to go into US dollars/capital flight; (b) restrictions on the amount of ARS deposits to be taken from banking accounts.

Potential dollarization

In order to assess the potential money available for dollarization, we gathered the most liquid ARS in the economy and compared it with the free availability international reserves. According to our calculations, there is around **USD16bn** of potential deposit dollarization. Meanwhile, the BCRA's net liquid international reserves are around **USD15.1bn** (Fig. 1-2).



Fig.1-2: Potential dollarization



Sources: BCRA, Bloomberg, BNP Paribas estimates

Reshaped short term debt

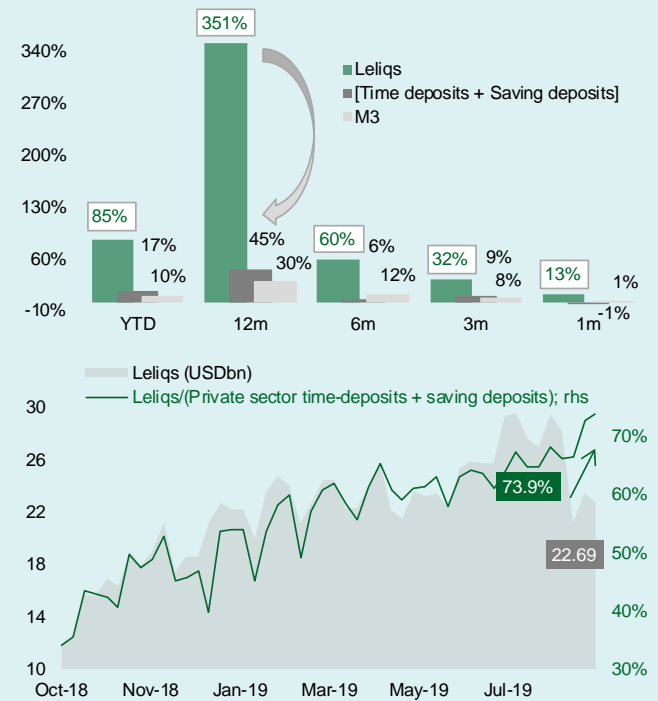
We assumed that the percentage of institutional investors in Letes and Lecaps are 85% and 90%, respectively. Also, we used an FX rate of 58. We estimate that these changes will ease short term liquidity by **USD11.1bn**.

Before*	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Until EOY
Letes	1,602	2,773	3,132	2,449	300	10,256
Lelink	0	331	439	242	426	1,439
Lecaps	898	1,959	1,758	780	0	5,394
LECER	148	771	0	0	0	919
Total	2,647	5,834	5,329	3,471	726	18,008

After*	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Until EOY
Letes	445	770	869	1,088	790	3,962
Lelink	0	78	103	57	189	427
Lecaps	211	460	413	426	529	2,039
LECER	35	181	0	40	208	464
Total	690	1,489	1,385	1,610	1,717	6,892

(*) does not include POMO coupon payment totalling **USD1bn**

Fig. 3-4: Leliqs monitor (variables variation)



Sources: BCRA, Bloomberg, BNP Paribas estimates

Mutual Funds and sovereign debt

The Mutual fund industry is severely hurt

Last year's FX exchange crisis has impacted the mutual fund industry severely, reducing the industry AUM almost by half.

We have also been tracking the impact on the industry since the results of Argentina's Primaries (PASO). According to data available in CAFCI, AUM from fixed income funds has dropped ARS100bn from ARS313bn since then.

Total outflows from money market and fixed income funds together has been ARS111bn since the PASO.

The announcements of yesterday should also have a negative impact on the mutual fund industry: 38% of the AUM is invested in public debt.

Several Argentine Mutual funds suspended subscriptions and redemptions Today.

Table 1: Mutual funds' industry – Portfolio composition

Total Industry AUM (ARSmn)	865,889.00	
Debt securities	465,239.00	53.7%
Public debt	326,642.00	37.7%
National debt	228,856.00	26.4%
Foreign debt	59,927.00	6.9%
Provincial debt	37,197.00	4.3%
Municipal debt	662.00	0.1%
Negotiable Obligations	67,076.00	7.7%
Corporate bonds	44,750.00	5.2%
Deferred Payment Checks	18,827.00	2.2%
Pagaré bursátil	7,694.00	0.9%
Short-term values	250.00	0.0%
Term operations	165,321.00	19.1%
Cash	153,847.00	17.8%
Collective Investment Vehicl	47,878.00	5.5%
Mutual funds	38,815.00	4.5%
Financial trusts	9,063.00	1.0%
Equities	31,472.00	3.6%
Others	2,138.00	0.2%
Derivatives	-6.00	0.0%

Sources: CAFCI, Bloomberg, BNP Paribas estimates

Update: Maturity extension vs. coupon reduction

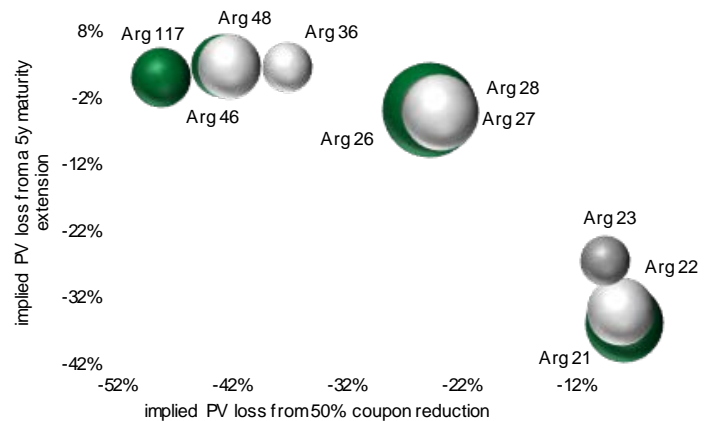
To put Argentina's debt back on a sustainable path, a **maturity extension alone won't be enough**, we believe.

A haircut would be also needed, as any tender with a high participation rate will have to remove as much default risk as possible going forward. This is because of Argentina's low credibility in the international bond markets and uncertainty over its economic policy going forward.

The analysis does not consider previously restructured bonds, even though a new re-profiling of the Argentinean sovereign debt is likely to include them. We did not made any assumption on exit yield either.

We simulated the trade off between a five year maturity extension and 50% haircut on coupons. Results are shown in Fig. 5.

Fig. 5: Theoretical impact on bonds



Sources: Bloomberg, BNP Paribas; as of 29 August 2019

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