



**FRONTIER MARKET**  
ASSET MANAGEMENT

## *Argentina under Cristina - Counting the Days*

By: Larry Speidell  
December 2014



*Plaza de Mayo, Buenos Aires*

*"Toute nation a le gouvernement qu'elle mérite"  
(Every country has the government it deserves)*

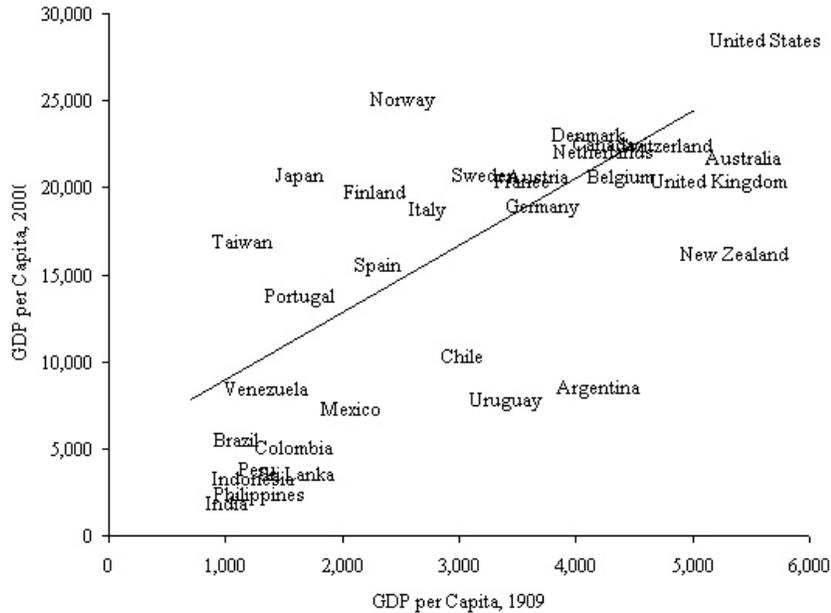
*Joseph de Maistre: Lettres et Opuscules Inédits vol. 1, letter 53, 15 August 1811*

Buenos Aires is a spectacularly beautiful city, aptly named and blessed with stately Belle Époque buildings that evoke the grandeur of Europe a century ago. These are complemented now by gleaming new chrome and glass office towers, with many more under construction. In the heart of the city, trendy shops line the pedestrian street of Calle Florida, which is filled with fashionable shoppers. Argentina beckons tourists with not only its sights and shops, but also with fabulous food, tango dancing, and low prices: a delicious diner of Argentine steak with wine for less than \$25.

But this façade masks the rot.

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For a century, Argentina has been a country at war with itself... and it has been losing:

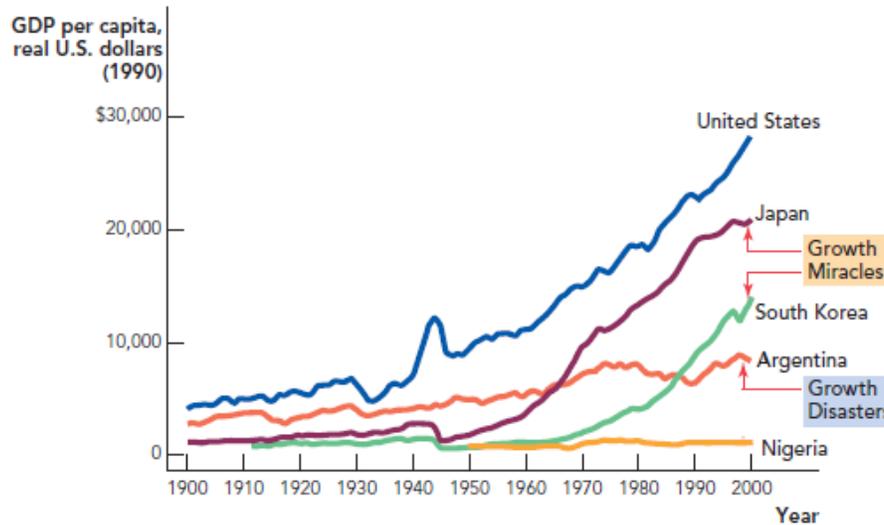


Edward L. Glaeser

*"What Happened to Argentina?", Edward L. Glaeser, New York Times, October 6, 2005*

The chart above shows that, in 1909, the GDP per Capita of Argentina was in the top third on the horizontal axis. But on the vertical axis of GDP per Capita in 2000, Argentina was in the bottom third. Meanwhile, Japan has gone from the bottom quartile to the top quartile, while Spain, Portugal, Taiwan, Finland and Norway have all shown dramatic gains as well.

Viewed from another perspective, the line chart below shows how Argentina has "flat-lined" while other countries have progressed. The chart ends in 2000, so it doesn't show how even Nigeria has recently accelerated to 5% GDP growth, while Argentina will be flat in 2014 and decline by 5% in 2015.



Source: Maddison, Angus. 2007. *Contours of the World Economy: 1-2030 AD*. Oxford University Press, Oxford.

From Evita and Juan Peron in the 1950s to the populist Peronista policies of the government today, Argentina has been losing ground on the back of an expanding, inefficient government bureaucracy, populist politicians, and powerful unions.

Yet despite a century of decline, Argentina is still wealthy. With 43 million people (97% are of European descent) and land-mass a third the size of the U.S., Argentina's natural resources are abundant. Exports of soybeans and wheat are drivers of the economy, providing foreign exchange to support the government's unbalanced budget. Oil exports have dried up due to maturing fields and under-investment. However, in the past two years, YPF, the national oil company, has succeeded in reversing the declines in oil and gas output. Furthermore, discovery of the world's third largest deposits of shale oil could make Argentina a net exporter at some point.



*Calle Florida, Buenos Aires*

	Argentina	Ukraine	Georgia	Latvia	Estonia
GDP Growth (2014 est)	0.0%	-5.0%	5.5%	4.0%	1.5%
Inflation	40.0%	15.0%	2.0%	0.2%	1.0%
Population (mil)	43.0	44.6	4.9	2.2	1.3
People / km sq	15	74	71	34	28
% Literate	98%	100%	100%	100%	100%
% Literate Female	98%	100%	100%	100%	100%
% under age 15	25%	14%	18%	14%	16%
Life expectancy	77.5	69.1	75.7	73.4	68.9
% Urban	92%	69%	53%	68%	70%
GDP / cap (PPP)	\$18,600	\$7,400	\$6,100	\$19,100	\$24,000
Electricity/cap kWh	2,583.7	3,933.1	1,900.5	2,956.1	6,318.0
% Unemployed	8%	8%	15%	10%	11%
Land (km sq)	2,780,400	603,550	69,700	64,589	45,228
Market Cap (\$ bil)	\$34.2	\$25.6	\$0.9	\$1.2	\$2.3
Market Cap/GDP	5%	15%	6%	4%	10%
GDP (Official Exch Rate)	\$709.7	\$175.5	\$16.0	\$30.4	\$24.3
GDP % Agriculture	9%	10%	9%	5%	4%
GDP % Industry	30%	30%	22%	26%	30%
GDP % Services	61%	61%	70%	69%	66%
Military exp % GDP	0.9%	0.6%	2.9%	0.9%	2.0%
Electricity Cons Bil kWh	111.1	175.3	9.4	6.4	7.9

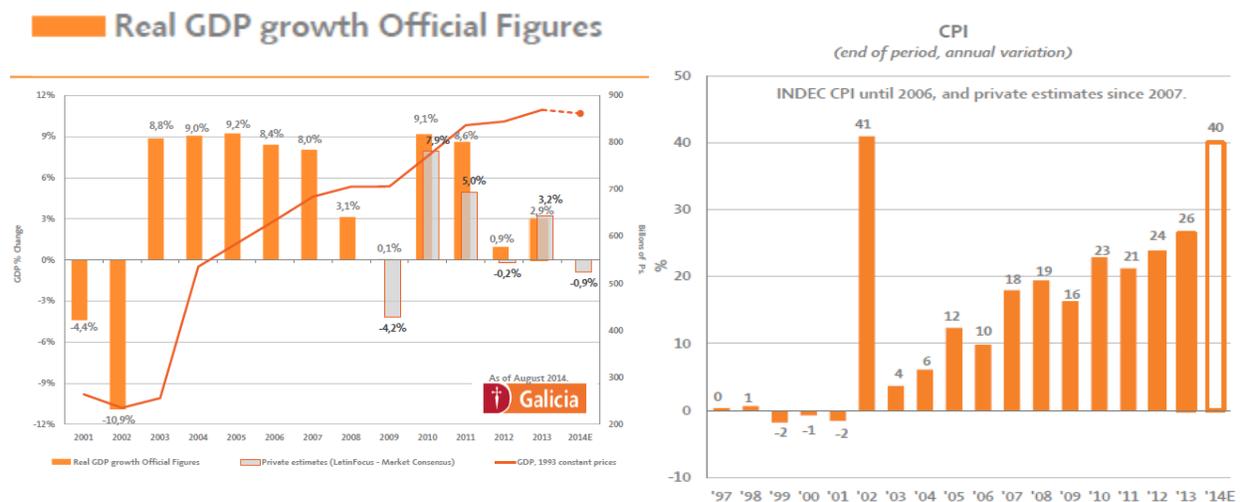
# Argentine Economics - Paradox, shrouded in a Conundrum, wrapped in Heterodoxy<sup>1</sup>

*"There are four sorts of countries:  
developed, undeveloped,  
Japan and Argentina"  
– Simon Kuznets*

The Argentine economy cannot function, but it does. The country overspends, underinvests, debases its currency and defaults on its debts but somehow avoids a revolution. Argentine economic policies are typically reactive, ad-hoc, and unpredictable.

Since 2007, Cristina Fernandez de Kirchner has clung to power and even managed to be re-elected while bringing the country to the brink of economic disaster. Her husband, Nestor, preceded her as president and they were a presidential couple until he died of a heart attack in 2010 (reportedly after an argument with a powerful union leader). During her regime, she has overseen the expropriation of Spanish oil company Repsol's 51% stake in YPF, the takeover of the nation's pension plan assets, the imposition of price controls, import restrictions and currency controls. Meanwhile, government spending has ballooned.

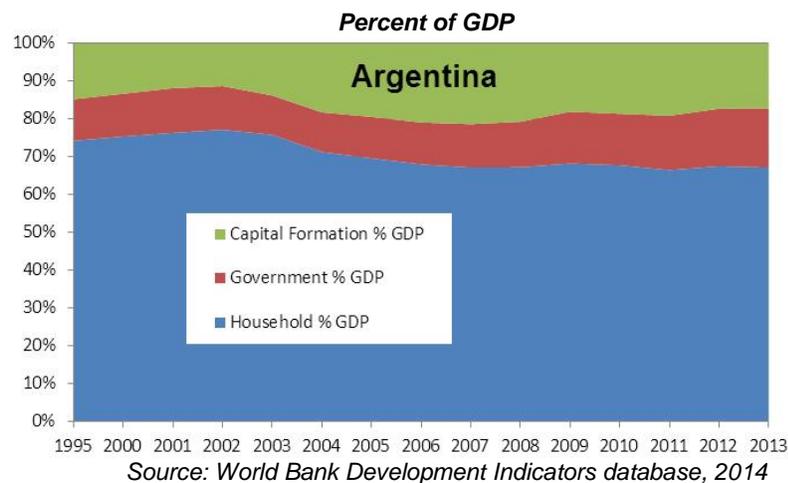
As shown below, the economy has had a wild ride. Back in 2001, the collapse was due to abandoning the US dollar parity of the peso and confiscating ¾ of citizens' US dollar deposits through "El Corralito" (the "little corral" froze deposits, devalued the peso, and then forced dollar deposits to convert to pesos at the old rate). Lately, however, volatility in growth has been due to the global financial crisis and plunging commodity prices. Inflation has been the result of powerful union demands backed up by strikes in transportation and elsewhere. The government's response? They understated inflation data and forbid private estimates of inflation. When inflation was 25% in 2012, the government claimed it was 10%. Still the unions received 25% hikes. Then the government put on price controls and even threatened McDonalds over Big Mac prices. In 2013, wage hikes were again 25% but inflation was 30% (while the government claimed 25%). Now the government admits to 40% inflation, yet 2014 wage hikes were "only" 30%. – now nobody is happy. In addition, as the left chart below shows, the government has overstated GDP growth.



<sup>1</sup> **Paradox:** a statement that apparently contradicts itself and yet might be true, **Conundrum:** a logical postulation that evades resolution, an intricate and difficult problem, **Heterodox** economics refers to a variety of separate unorthodox approaches.

Of course, with 40% inflation people would like to buy dollars, but the government has imposed limits of \$400 / month for most people (based on salary). So in a false boom, people bought cars and other goods as a store of value. Real estate used to be an alternative, but now sellers will take nothing but dollars, so there are no transactions. The banks have been caught in a vice. Government dictated quotas force them to make low interest loans to small businesses, while there is a mandatory hike in deposit rates from 20% to 23%. Also, government approval is needed for all bank fees. Finally, banks are now forbidden from investing more than 20% of their equity in foreign assets (i.e. dollars). This explains the new office buildings, as banks are building big headquarters towers as a hedge.

The chart below shows that government spending has risen from 10% of GDP in 2004 to 15% in 2013.



It may be that Argentina's dysfunctional government is the result of a dysfunctional constitution that vests too much power in the president, as both chief of state and head of government. One company executive says, "It's 'hyper-presidentialism'.... It makes the president king."

*"A government big enough to give you everything you want, is big enough to take away everything you have." – Gerald Ford, 1974*

The notion of an independent judiciary has been a myth since 2001, when the court gave in to "El Corralito". Now, the lack of an independent central bank was reinforced this September when governor Fabrega was forced out because he favored a weaker currency. Despite bringing in one of Cristina's cronies to the central bank, the official rate has sunk to 8.5 pesos per dollar (from 4.6 in 2012), and we paid for our \$25 steak dinner at the unofficial "blue rate" of 14.5.

Imported parts are in short supply because there is a scarcity of dollars, while farmers are stockpiling soya rather than sell it into the world export market at the official exchange rate. To make matters worse, the world price for soya has dropped 35% since July.

Adding to the country's woes, freedom of the press is threatened. Grupo Clarin had been allowed broadcasting and cable licenses when it was friendly with the government, but then Clarin supported farmers in opposition to the government's export exchange rate policies. A punitive Broadcast Media Law, passed in 2009, has now been approved by the courts and the government is forcibly breaking up Clarin.

There is trouble for Argentina across the border in Brazil, where populist leader Dilma Rousseff was re-elected in October. With weakness in the Brazilian Real, Argentine exports of manufactured goods to Brazil are in jeopardy. Meanwhile, Cristina's supporters are saying that the "re-election of Dilma is not just another electoral triumph, but reconfirmation of the path chosen by Latin American societies" (i.e. populism).

### Argentine Peso, Official Rate versus Free Rate



<http://dolarblue.net/historico/>, December 2014

### Something's Gotta Give – Fred Astaire, *Daddy Long Legs*, 1955

When traveling a lot in developing countries, a funny thing happens. No matter how bizarre local conditions, habits, or fashions may seem at first, after a day they seem perfectly normal. It can be walking boldly into a maelstrom of oncoming motorbikes on a Saigon street, taking a motorcycle taxi in Thailand, careening through Moscow traffic in a Volga with bad brakes, hailing a pedi-cab in Dhaka, or passing through a protest camp in Kiev. It's the way life is.

And so it is in Buenos Aires. Argentinians have known hyperinflation of a thousand percent. They have been threatened by the killing squads of a military government. To them 40% inflation is child's play - more of an inconvenience than a problem. This is a cash economy. With the largest bill only 100 pesos (~\$7), it takes fleets of armored cars moving bumper to bumper in the downtown financial district. People buy dollars when they can, borrow when they must, keep money under the mattress, and put some of it in the banks. Meanwhile the banks make loans at negative real interest rates, and pay depositors at much lower deposit rates. The farmers farm and then store, rather than export what they produce. And YPF, despite the stigma of the Repsol expropriation, has found Chevron as partner to develop the vast Vaca Muerta (dead cow) shale oil deposits.

Everyone is waiting for the election in October of 2015 and then Cristina's departure at the end of the year. Meanwhile, a billboard on one of the highways counts down the days until she is gone (perhaps not completely gone, as her cronies are likely to get her a place in the congress so that she will have immunity from prosecution).

Meanwhile, the market is volatile and devaluation rumors abound. Most think that the government will settle with the holdout bondholders in January – or could it be February? And most think there will be an official devaluation from 8.5 to 12 – or could it be 15?

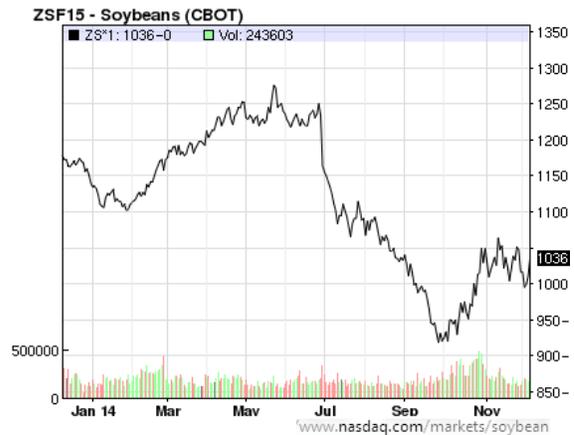
Regardless, ousting an incompetent government will do wonders for confidence; and though real reforms will take time, the prospect of them can move markets. Simply improving from a horrible government to a bad one would reduce the country risk significantly.

Beginning with 2015, legal conditions will change, making Argentina less exposed to cross-default claims when the Rights Upon Future Offers clause expires. Settlement with the holdout bondholders would not require making the same offer to the others. If Argentina settles, then new foreign borrowing would be possible. Also, possible devaluation of the peso would encourage farmers to export because they would receive a more realistic price at the new "official" rate. Another positive for exports is the recent bounce in global soybean prices, shown at the right.

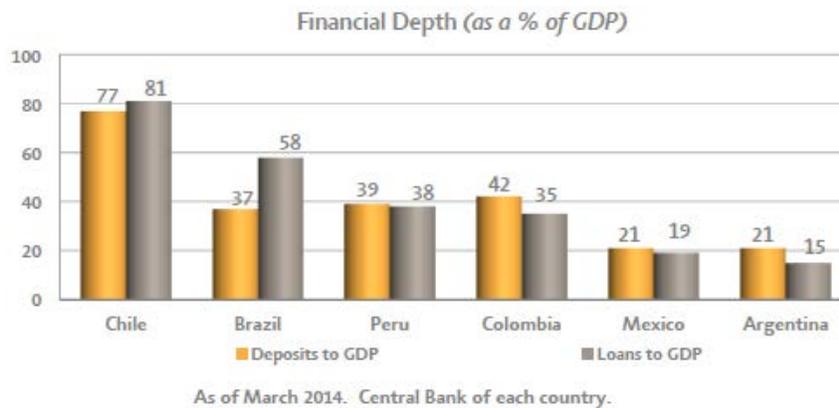
Of course, Cristina can do a lot of damage in her remaining term. Her latest diversion is to ban Proctor and Gamble from doing business in Argentina because of tax fraud. Other heterodox policies may lie ahead.

## Soybeans

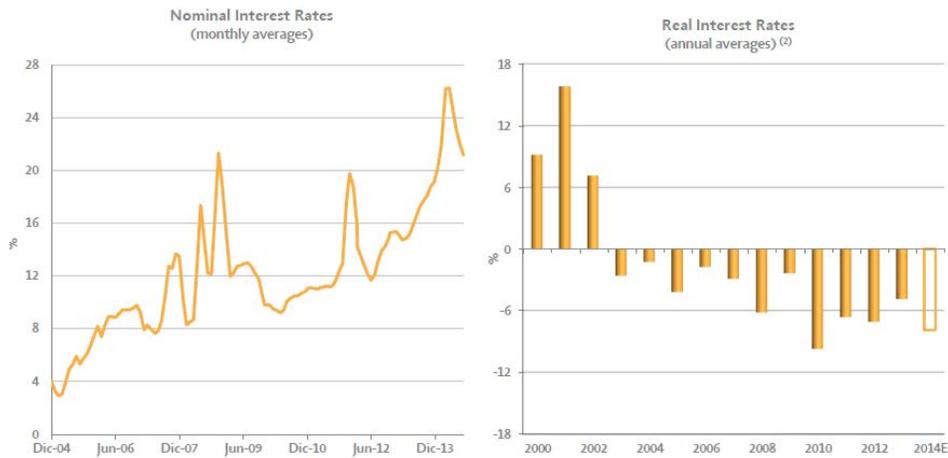
End of day Commodity Futures Price Quotes for Soybeans



Still, once she is gone, foreign investment should rise and some of this will help accelerate shale oil production. And the banking system could grow. The chart below shows that loans (15% of GDP) and deposits (21% of GDP) are low compared to other countries in Latin America. By comparison, in Nigeria loans and deposits are 12% and 21%, Zimbabwe, 21% and 25%, Botswana, 31% and 39%, Egypt, 31% and 75% and Morocco 85% and 78%.



The banking sector could grow dramatically if people gain confidence in the banks and especially if inflation comes down enough so that banks offer positive real interest rates. Loans and deposits could both move beyond the current durations of a year or less.



**Conclusion**

*“It’s always darkest before the dawn”  
-Anonymous*

In Shakespeare’s time a powerful storm was viewed as an omen – generally not good. As I left for Eziza airport, rain had begun. Streets were flooded, and lightening flashed in the sky. “Passing storm”, I thought... Then my 11:45pm flight was delayed... and delayed again. Ground crews were unable to fuel the planes due to ongoing lightening strikes. Finally at 4 am, a 22-hour flight delay was announced. Meanwhile, the baggage carousels had shorted out due to flooding and angry arriving passengers packed the baggage hall, some sleeping on the carousels. The pounding rain and high wind made a loud din in the terminal. As dawn broke, the wait for a taxi back to the city was an hour and a half.

Eventually, the rain stopped. And eventually, my flight took off.

Perhaps eventually, the economic storms in Argentina will abate as well. And perhaps there will be a new dawn for investors.

**About Frontier Market Asset Management**

*Founded in 2006, Frontier Market Asset Management holds more than 35 years’ worth of investment experience including work in Emerging and Frontier Markets since 1987. For more information, please contact us at (858) 456-1440.*

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