



Argentina Election Update: Positive Momentum Ahead of Midterms

October 19, 2017

At the end of August we shared an update on Argentina's primary elections, Primarias Abiertas Simultáneas y Obligatorias (PASO), noting that the strong PASO results were a good sign for the current administration's Cambiemos coalition going into the October midterm elections.

A lot has happened since the August primaries, but our positive outlook remains in place ahead of the midterms, which take place at the end of this week. While the elections themselves are important, our constructive outlook goes beyond the political landscape. Since the primaries, there has been encouraging progress not only on the political front, but also in economic and market activity. This activity supports our bullish view both on Argentina overall and on investment opportunities in the country.

The below highlights key activities that have taken place and notable data released since the primaries related to: 1) politics; 2) the economy; and 3) markets—and what recent activity means for investors going into the midterms.

1. POLITICS | Political Outlook Post-PASO

On October 22, Argentina will vote in midterm elections to fill major portions of the Lower House and Senate. As we mentioned in August, no party has a real chance to gain a controlling position in Congress; however, the midterms are still significant for President Mauricio Macri and his Cambiemos bloc. The elections are a chance for Macri to gain congressional support, which could increase the party's negotiating power and political sway as the group works to advance its pro-growth agenda.

*Recent polls suggest that **support for the current administration has continued to grow** since the primary elections in August.*

The midterms could also be viewed as a proxy for the country's overall opinion of Macri's leadership and his administration's progress to date on economic reforms. Based on the primary results, it appears Argentina's electorate is behind Macri and approve of his work

thus far. This approval indicates that the low- and middle-income population is beginning to feel the benefits of Macri's economic and political reforms, a fundamental shift in Argentina's society.

But while the PASO results alone were a strong indication of success for Cambiemos in the midterms, recent polling data suggest that the current administration continued to gain support over the last two months.

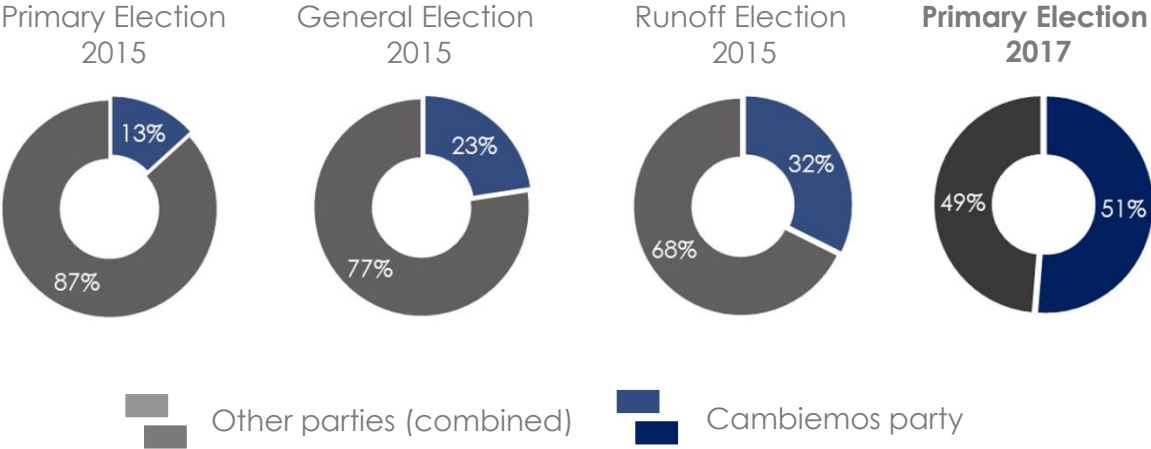
Positive Polling Data

Based on recent polls, the Cambiemos coalition is expected to improve its already strong PASO performance in the midterms. Most polls indicate more than 40% support for the current administration on a nationwide level, putting them well ahead of the most popular party within the opposition camp, which is forecast at only 20-25%.¹

As the below charts clearly show, support for the Cambiemos party has steadily spread throughout the country over the last two years. Polls suggest this trend will continue with the upcoming midterms.

Support Steadily Spreads Across the Country

Geographical Support for Cambiemos (by District) Since 2015



Source: Cámara Nacional Electoral (CNE)

¹ Source: Morgan Stanley Research, as of 10/12/2017

Securing Key Seats

Beyond the potential support for reforms and the symbolic validation at stake in the midterms, the elections include a number of high-profile races for congressional seats that are noteworthy within Argentina's political landscape.

The Senate seats in the Province of Buenos Aires, for instance, are a major focal point of the midterms. This is not only because the province represents close to 40% of the voting population, but it is also the race in which former president Cristina Fernandez de Kirchner is running.

Polling data are encouraging for the Cambiemos party in the Province of Buenos Aires. A recent poll released in early October shows Cambiemos candidate Esteban Bullrich ahead of Kirchner by four points.² (Of note, the two candidates tied in the primaries, and polls before those elections put Bullrich *behind* Kirchner.)

Impact on Reforms

A repeat of the primaries should advance the current administration's steady progress on reforms. In particular, a strong showing in the midterms would make Cambiemos well positioned in Congress to approve capital markets reform, which aims to increase transparency and quality in local capital markets. In addition, the reform would improve financing for small and medium-sized businesses. For example, it would directly benefit smaller companies that have been considering IPOs but have been deterred by excessive costs under current regulations.

A repeat of the primaries could make the current administration well positioned in Congress to pass key reforms to fuel economic growth and enhance markets.

Strength in the midterms would also increase the likelihood that Cambiemos could pass labor reform to spur job creation. These two reforms would augment existing economic progress, improve investor' access to the local market and thus expand the universe of investment opportunities in Argentina.

2. ECONOMY | Economic Milestones (aka Momentum for Macri)

Argentina's economy has seen steady improvement since Macri took office, and these economic trends reinforce the positive political outlook, serving as key wins that the

² Source: Opina Argentina

current administration can point to as evidence that their pro-growth policies are working. Much of the economic data released since the primaries continue to provide this kind of support.

GDP Growth

At the end of September, the second quarter GDP report was released, showing an expansion of 2.7% versus the same period last year.³ This strong figure provided tangible evidence post-PASO to validate the current administration's approach; not only did Argentina finally emerge from a recession under Macri, but the growth trend is moving in the right direction as the economic normalization process continues.

*Under Macri, Argentina has officially emerged from a recession, and **2Q17 GDP growth of 2.7% YoY** shows the growth trend continuing.*

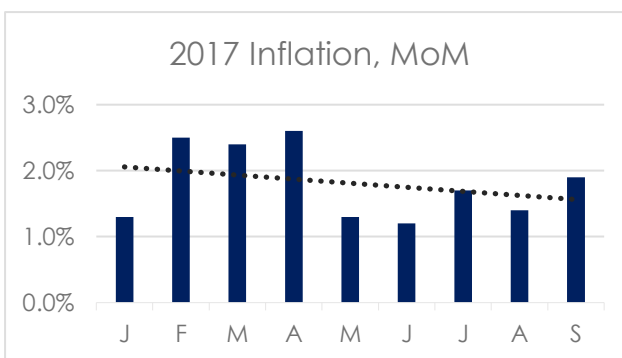
Notable Growth in Economic Activity

The manufacturing sector posted positive growth for 2Q17 for the first time in a year. The 2.5% manufacturing growth for the quarter was driven in large part by construction, which rose 9.7%.⁴

Economic activity growth extended well beyond the manufacturing sector; in fact, the most recent monthly data from July shows 13 out of 15 sectors expanding year over year.⁵

Still Room for Improvement in Inflation

Inflation remains one sluggish data point for Argentina. While progress has certainly been made under Macri—inflation is half of what it was last year—the rate of reduction in inflation has lagged other areas of economic progress. Monthly inflation data from September came in at 1.9% month over month, an increase of 50 basis points



Source: INDEC

³ Source: INDEC

⁴ Source: INDEC

⁵ Source: INDEC

from August. The September figure was noticeably above the 1.3-1.6% estimate.⁶

While it was a disappointing miss, the increase can be attributed to rising consumption, which is an overall positive for the economy.

That said, the monthly figure impacts other areas such as monetary policy activity. Due to higher than expected inflation, the central bank did not raise the Badlar rate, a decision that then has effects of its own. For example, with rates unchanged, loan growth is expected to stall for the month.

The miss also puts the current administration off track to meet its year-end inflation target; however, the progress should not be diminished by this one number. The fact that they have already reduced inflation so drastically is evidence that the economic normalization process is set in motion. As such, a temporary slowdown in one area has no material impact on our overall view.

3. **MARKETS | Officially Open for Business: 2017's Inaugural IPO Sets the Tone for Market Activity**

Market activity picked up after the primaries, suggesting that the PASO results provided the validation necessary for companies to go forward with major deals.

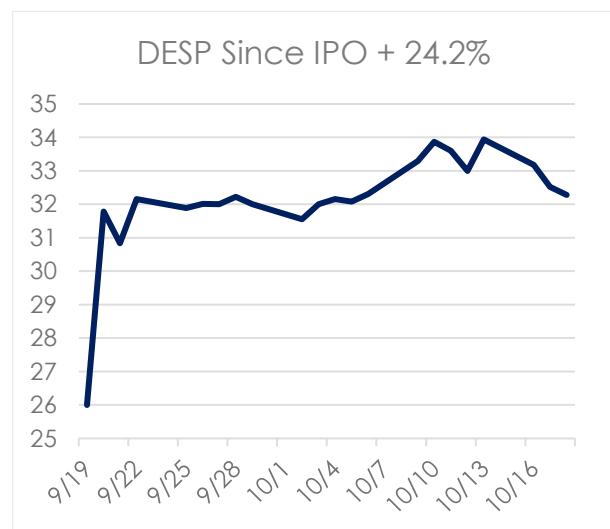
In the two months since the primaries, there has been new and follow-on IPO activity in the equity market as well as debt issuances. Collectively this flurry of post-PASO activity got a warm welcome from the market.

We believe this is just the beginning, and we expect IPOs and other financing activity to continue—and even increase—following the midterms and into 2018.

A Look at Recent Market Activity:

IPOs

After the primaries, Despegar (DESP), a Latin American focused online travel company, raised \$332 million in Argentina's first IPO of the year. With the decision from MSCI not to upgrade



Source: Bloomberg, as of 10/19/2017

⁶ Source: INDEC

Argentina to Emerging Market status this summer, the year's inaugural IPO was both highly anticipated and heavily scrutinized.

While we viewed the MSCI decision as an opportunity to further position ourselves in Argentine equities, it certainly deflated market expectations for IPO activity. But the DESP offering was a resounding success and paves the way for others to follow.

The offering was over 13 times oversubscribed and the stock is up more than 26% to date.⁷

Two other companies have filed their intent to sell shares in an IPO this year, and we expect activity to accelerate into 2018.

Follow-On Offerings

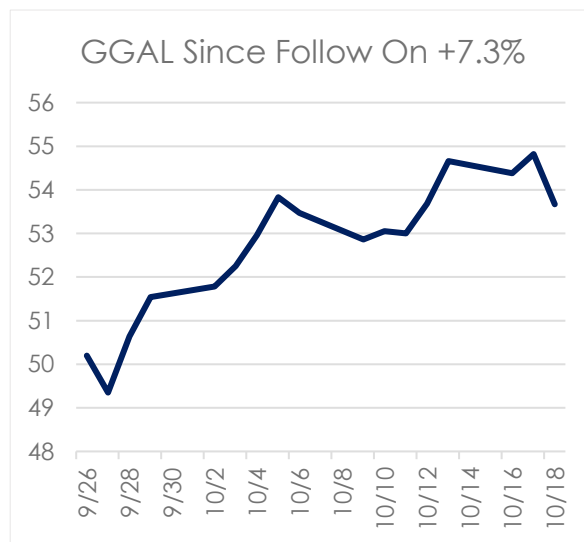
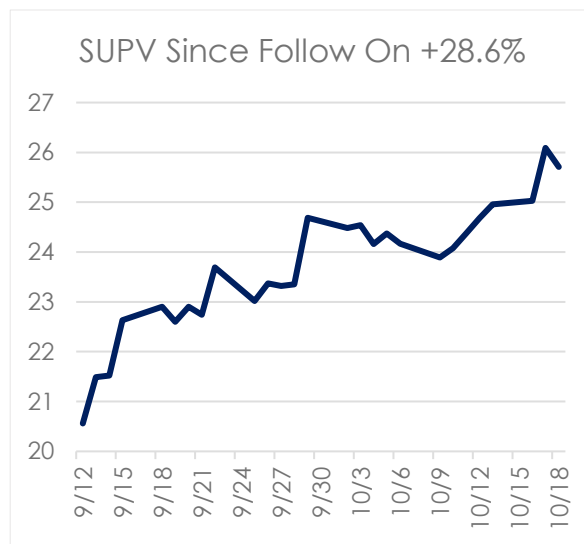
There have also been two notable follow-on equity offerings since the primaries that have likewise been well absorbed by the market and seen strong performance to date.

Grupo Supervielle (SUPV), one of the largest banks in Argentina, sold \$500 million in a follow-on offering. The stock is up more than 23% since the September sale.⁸

Grupo Financiero Galicia (GGAL), a financial services holding company, also completed a follow-on share sale of \$550 million. Following that deal, which priced at the end of September, GGAL is up 7.4%.⁹

Provincial Bond Issuance

Outside the equity space, there was notable activity in the provincial debt market following the primaries. Shortly after the August elections, the Province of Jujuy



Source: Bloomberg, as of 10/19/2017

⁷ Source: Bloomberg, as of 10/11/2017

⁸ Source: Bloomberg, as of 10/11/2017

⁹ Source: Bloomberg, as of 10/11/2017

issued a \$210 million 5-year bullet bond yielding 8.625% to finance one of the largest solar power plant in Latin America.

This end use made the bond particularly attractive; since the proceeds were intended for a renewable energy project, the bond was recognized within the Green Bond initiative framework. Per the framework, the bond is backed by royalties from the new solar park's power generation, providing supplementary payment assurance and therefore an additional layer of downside protection. This deal was five times oversubscribed, and the bond is currently yielding 6.86%, a compression of 175 basis points since the issuance in mid-September.

The Jujuy issuance was the last provincial debt deal to go through before such activity was halted by the government until after midterms—an encouraging measure that demonstrates the current administration's commitment to eliminate corruption and increase government transparency. Following the midterms, we expect to see more provinces looking to return to the market with compelling financing opportunities.

CONCLUSION | Argentina's Next Chapter

The current administration is in a strong position going into the midterm elections. The primaries were a resounding success for the Cambiemos party—and polls indicate that support has only increased since then. But while the midterms are certainly significant, our focus is on what to expect once this major political milestone is behind us.

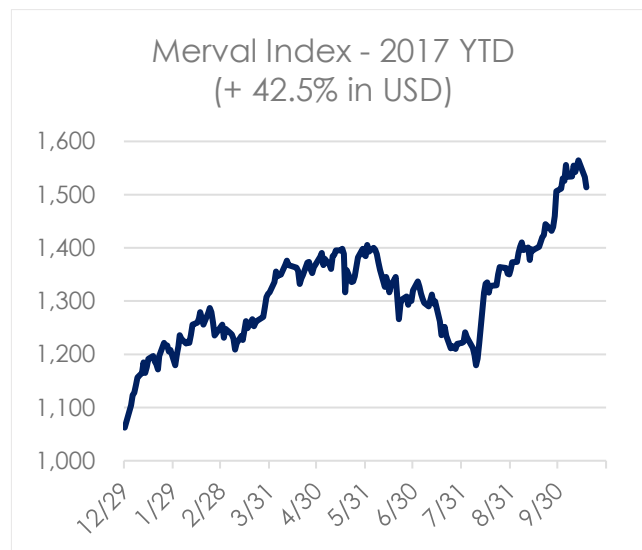
*We believe the midterm elections will mark **the beginning of the next chapter in Argentina's economic recovery and growth story.***

We think the midterms will mark the beginning of the next chapter in Argentina's economic recovery story. Progress on reforms is already noteworthy, evident in the economic growth and increased market activity year to date. But with support continuing to build for the current administration, the economic normalization process can accelerate once the political uncertainty and noise that comes with any election resides post-midterms.

We expect trends around economic growth to continue, the inflation outlook to improve and market activity to surge.

Don't Let the Rally Fool You

Many skeptics look at the performance in Argentine markets year to date and assume the rally is not sustainable, but we believe it is still in its early stages. True, Argentine equities, for example, have significantly outperformed Latin American peers this year; however, we believe there is still a great deal of capacity within Argentina's markets and economy, so we are constructive on the potential in the next phase of the country's growth and the read-through to investment opportunities.



Source: Bloomberg, as of 10/19/2017

Argentina in the Context of the Rest of the World

Like any investment thesis, it is necessary to evaluate this opportunity within the broader global macro context. In this case, the common threats often cited in EM—rising rates in the U.S., commodity price volatility, etc.—likewise apply to Argentina. That said, we believe that the forces behind global growth that are pushing rates up are also spurring economic growth in Argentina. This dynamic should allow spreads to continue to tighten and as a result, accelerate investor appetite for longer duration investments.

Further, after spending years in a repressive economic and political environment, the rate of growth and upside opportunity in Argentina can far outpace that of the rest of the world. As such, we believe that despite the unusually strong performance across Argentine investments year to date, the recovery and growth story in Argentina is still only beginning to unfold.

In the event the midterms don't play out in the current administration's favor, we still see plenty of opportunity in the country. Our view is first and foremost driven by the economic opportunity—not the political landscape—and the process of economic normalization has already been set in motion. A weaker Cambiemos representation in Congress, for example, would not hamper recovery trends like increasing consumer credit penetration and other economic developments that drive our investment view. So while we are optimistic about the prospects for Macri's party in the upcoming elections, it is the opportunity outside the political realm that we consider most attractive in Argentina.

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