

MSCI UPGRADES ARGENTINA TO EMERGING MARKETS STATUS

MSCI announced that Argentina will be included in its MSCI Emerging Markets Index in May 2019.

This reclassification of the MSCI Argentina Index from Frontier Markets (FM) to Emerging Markets (EM) status is positive news for Argentine stocks, as the reclassification could generate up to \$3.8 billion of potential inflows, given the estimated weight in EM.¹

The upgrade decision comes after an extended consultation period from MSCI. Many believed Argentina would be reclassified last year after the country demonstrated significant progress in economic normalization and market function under the new administration.

Last year, however, MSCI opted to delay the decision, extending the consultation period another year. In that announcement, MSCI noted that although Argentina's equity market met most of the accessibility criteria for EM, the permanence of the reforms remained to be seen.

A stronger dollar and rising rates in the U.S. put Argentina's reforms to the test over the last year. However, the resulting market retreat and EM weakness in 2018, along with Argentina's subsequent foreign exchange challenges, ended up substantiating the country's qualification for EM in this year's review. MSCI leadership noted the fact that Argentina did not resort to capital controls or other measures used in the past as a positive, as such actions had disrupted market access.

The current administration's proactive response to those challenges has inspired confidence, and clearly, MSCI sees the government's responsible management of the situation as evidence of its commitment to maintaining structural reforms, and thus its worthiness of the EM upgrade.

Investor support

Another vote of confidence came in the commentary MSCI shared from the investment community. In the announcement, MSCI specifically noted the investor support for the decision:

¹ Source: J.P. Morgan Latin America Equity Research, as of June 11, 2018.

“In particular, international institutional investors expressed their confidence in the country’s ability to maintain current equity market accessibility conditions, which is a key factor in MSCI’s classification framework.”²

Of course, current market conditions still pose some risk, and MSCI expressed such concerns:

“...In light of the most recent events impacting the country’s foreign exchange situation, MSCI also clarifies that it would review its reclassification decision were the Argentinian authorities to introduce any sort of market accessibility restrictions, such as capital or foreign exchange controls.”²

Historical context

Over the past 20 years, three countries were upgraded to EM from FM status. Based on those upgrades, the period between announcement and implementation can be a boon for equities, with those markets’ indices up 38% on average in that timeframe.

In addition, on a relative basis versus EM, local stocks also significantly outperformed their asset class peers during the same period.³

Outlook

We believe the upgrade, combined with an anticipated improvement in economic and political fundamentals in coming quarters, should have a positive impact on the Argentine equity market. That said we still expect to see volatility in the near future, especially through the third quarter.

The question of FX stability still presents risks, especially given the fact that the population almost inherently associates rapid declines in the Argentine peso (ARS) with crisis, causing the FX movements to have an outsized impact on President Macri’s popularity.

Additional upgrade details

The MSCI Argentina Index will be added to the MSCI Emerging Markets Index in May 2019 in conjunction with MSCI’s Semi-Annual Index Review. The upgrade applies only to foreign listings of Argentine companies like American Depositary Receipts (ADRs).

MSCI noted that liquidity across the domestic market will need to improve before considering onshore listings. MSCI plans to monitor liquidity conditions on the Buenos Aires Stock Exchange with this in mind.

Read the MSCI announcement - [RESULTS OF MSCI 2018 MARKET CLASSIFICATION REVIEW](#)

² Source: MSCI, Results of MSCI 2018 Market Classification Review, June 20, 2018.

³ Source: Morgan Stanley Research, April 2018. Includes performance of MSCI Qatar, UAE, and Pakistan indices.

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ID#14043