MOODY'S
INVESTORS SERVICE

CREDIT OPINION
23 April 2018

Update

Rate this Research

Contacts

Gabriel Torres +1.212.553.3769
VP-Sr Credit Officer
gabriel.torres@moodys.com

Gabriel Agostini +1.212.553.8882
Associate Analyst
gabriel.agostini@moodys.com

Mauro Leos +1.212.553.1947
Associate Managing Director
mauro.leos@moodys.com

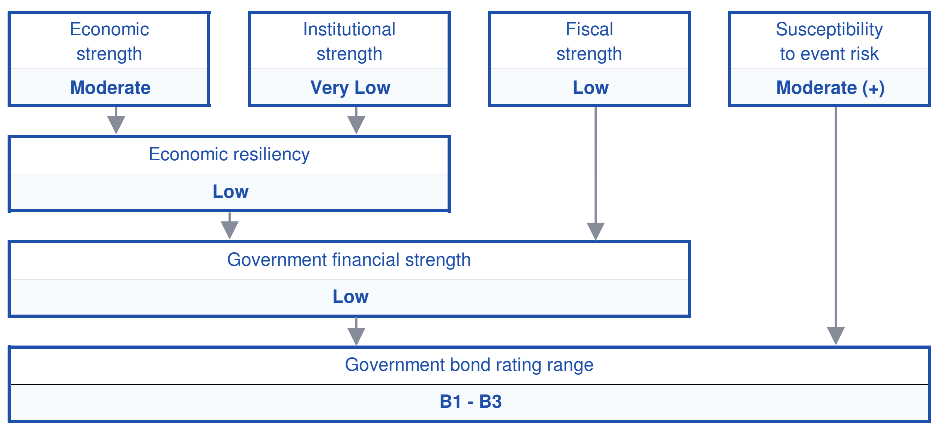
Government of Argentina – B2 Stable

Regular update

Summary

Argentina's credit profile balances high economic development and moderate government debt metrics with weaknesses resulting from a history of unsustainable economic policies. While the ongoing impact of years of inconsistent macroeconomic policymaking remains a key ratings constraint, credit positive policy adjustments since the Macri administration took office in 2015 supports continued and sustainable improvements in Argentina's fundamentals.

Exhibit 1
Argentina's credit profile is determined by four factors



Source: Moody's Investors Service

Credit strengths

» High economic development relative to rating peers

» Moderate roll-over risk due to high share of multilateral and intra-public sector debt

» A shift toward more sustainable economic policies by the Macri administration

Credit challenges

» A history of weak institutions that have resulted in macroeconomic imbalances

» High fiscal deficits and a rising debt burden

» Rising external imbalances and a high reliance on foreign funding

Rating outlook

The stable outlook on the B2 ratings balances Argentina's credit strengths of its large, diverse economy and comparatively high income levels against the credit challenges posed by still high fiscal deficits and a reliance on external financing, which increases its vulnerability to external event risk.

Factors that could lead to an upgrade

A further positive rating action would be dependent on a continuation and deepening of the credit positive policy stance that the Macri administration began implementing in December 2015. Particularly important will be sustained reductions in both the fiscal deficit and inflation.

Factors that could lead to a downgrade

We would consider taking a negative rating action if fiscal deficits do not reverse their upward trend, or if we observed an increase in external vulnerabilities, including a sharp drop in official international reserves.

Key indicators

Exhibit 2

Argentina	2012	2013	2014	2015	2016	2017E	2018F	2019F
Real GDP (% change)	-1.0	2.4	-2.5	2.7	-1.8	2.9	2.5	3.0
Inflation (CPI, % change, Dec/Dec)[1]	10.8	10.9	23.9	27.0	40.0	24.8	20.0	15.0
Gen. gov. financial balance/GDP (%)[2][3]	-2.1	-1.9	-2.4	-3.8	-5.8	-6.0	-5.5	-4.9
Gen. gov. primary balance/GDP (%)[2][3]	-0.2	-0.7	-0.8	-1.8	-4.2	-3.8	-3.2	-2.5
Gen. gov. debt/GDP (%)[2]	37.3	36.4	42.2	37.3	49.6	50.3	54.8	58.2
Gen. gov. debt/revenues (%)[2]	193.0	202.3	199.0	238.3	268.8	298.8	311.1	324.4
Gen. gov. interest payment/revenues (%)[2][3]	9.3	5.9	7.0	9.1	8.1	11.2	12.3	12.8
Current account balance/GDP (%)	-0.4	-2.1	-1.6	-2.7	-2.6	-5.0	-4.8	-4.8
External debt/CA receipts (%)[4]	158.0	163.8	181.6	223.4	236.7	274.9	264.9	290.3
External vulnerability indicator (EVI) [5]	141.6	153.3	206.7	187.5	356.8	163.0	139.7	143.7

[1] Series break in 2014
[2] Central Government
[3] Series break in 2016
[4] Current Account Receipts
[5] (Short-Term External Debt + Currently Maturing Long-Term External Debt + Total Nonresident Deposits Over One Year)/Official Foreign Exchange Reserves

Source: Moody's Investors Service

Detailed credit considerations

Argentina's "Moderate" **economic strength** is supported by its $20,875 GDP per capita (2017, PPP basis), significantly higher than the $6,610 median for B-rated sovereigns. Argentina's $638 billion (2017 estimate) economy is many times larger than the $25 billion peer median. We expect the economy to grow 2.5% this year and 3.0% in 2019, on the back of increased business and consumer confidence and higher investment rates. This would build upon Argentina's return to growth of 2.9% in 2017, an outcome that would be the country's first three consecutive years of positive economic performance since 2008.

The score for Argentina's **institutional strength** is set at "Very Low," below the indicative score of "Very Low (+)," to reflect the risk that recent credit positive policy changes could be reversed by a future administration. Argentina's institutional framework remains a key ratings constraint, reflecting years of inconsistent macroeconomic policymaking. In addition to Worldwide Governance Indicators that underpin our assessment, we rely on inflation results as a proxy for policy effectiveness. Inflation has trended downward since 2016, but it ended 2017 at a high 24.8% and we expect it to remain elevated through 2018. The central bank's December 2017 recalibration of its inflation targeting regime maintains an anti-inflationary policy stance that is gradually reducing core inflation, which we expect fall to around 18% in 2018 and to continue falling after that.

Argentina's "Low" **fiscal strength** reflects a rising debt burden and a high share of foreign currency debt. Reaching just over 50% of GDP in 2017, the debt ratio is similar to that of most rated peers, but the government debt ratio is mitigated in part by a relatively favorable debt structure. More than 60% of Argentine debt is owed to multilateral institutions and public sector entities, which significantly reduces rollover risk. However, at almost 70% of total government debt, foreign currency debt exposes the government's balance sheet to exchange rate risk.

Economic policies that until recently were on an unsustainable path, in addition to somewhat limited access to market funding, are key reasons behind Argentina's "Moderate (+)" **susceptibility to event risk.**

We assess the political risk that a new administration will overturn the current, pro-reform policy agenda as "Moderate (+)." The score reflects a recent history of haphazard policymaking, a highly contentious political process and an unwillingness to follow the rule of the law, which have affected the government's ability to meet its debt obligations.

We set government liquidity risk to "Low (+)" reflecting Argentina's recent return to international capital markets and the adoption of a flexible exchange rate, developments which have significantly reduced pressures on the use of official reserves to meet its dollar obligations.

We assess banking sector risk as "Very Low (-)," which incorporates a relatively small banking system (total domestic bank assets were just 32% of GDP in 2016) and limited refinancing and interest rate risks.

Finally, we set external vulnerability risk at "Moderate," above the indicative "Low (+)," in order to reflect the still low coverage of foreign-currency obligations as captured by our external vulnerability index (EVI). EVI measures the ratio of external debt payments and dollar deposits to official reserves, and Argentina's EVI averaged around 200% since 2012, above both the 2017 measure of 140% and B-rated median of 61%.

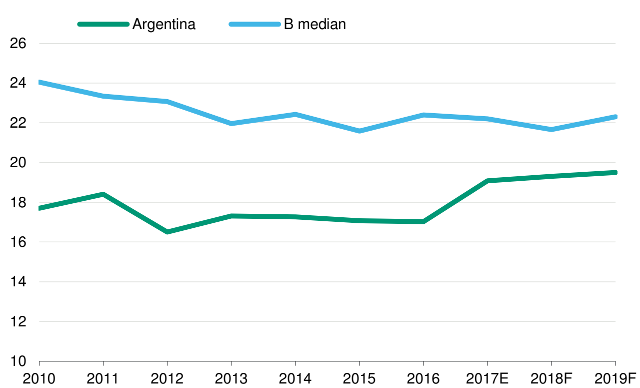
Recent developments

Economic growth returned in 2017...

We estimate that the Argentine economy grew by 2.9% in 2017, rebounding from a 2.2% contraction in 2016. Argentina's positive economic performance was largely investment-driven, with gross fixed capital formation growing by 20.1% year-over-year. Robust capital spending drove investment to an estimated 19.1% of GDP in 2017, up from 17.0% in 2016, but below the B-rated median of 22.2% (see Exhibit 2). Investment spending was primarily channeled into durable goods and construction, the latter of which outpaced other key sectors in its contribution to economic output in 2017 (see Exhibit 3). We expect healthier investment levels to continue to promote growth in 2018, as recently enacted tax reform and improving business confidence supports private investment.

Exhibit 3

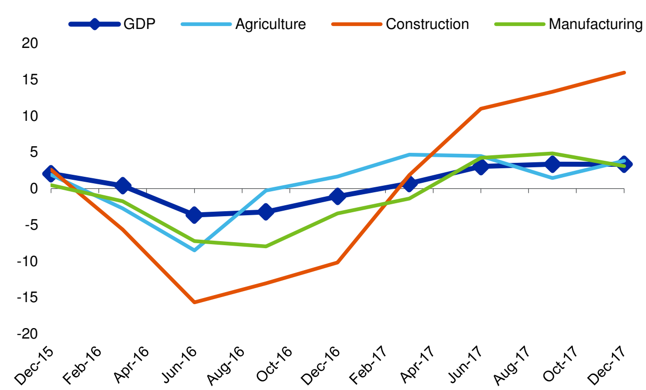
Investment grew healthily last year...
(Gross fixed capital formation, % of GDP)



Source: Moody's Investors Service

Exhibit 4

...boosting overall growth via investment in construction
(Gross value added by sector, annual % change)



Sources: Central Bank of Argentina and Moody's Investors Service

...but a severe drought will weigh negatively on growth this year...

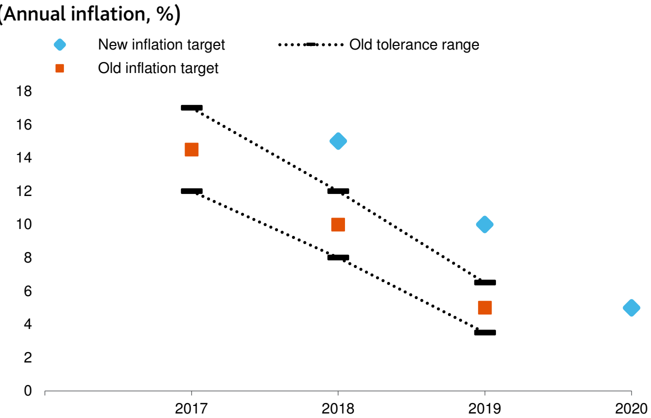
We expect growth to weaken to 2.5% this year, in part due to a severe drought that begun in November of last year. Argentina is the world's third largest exporter of soybean and corn, with both commodities and their derivate products accounting for 38% of the country's exports in 2016. While the Central Bank of Argentina notes that improved harvesting techniques and deep water deposits leave the agricultural better prepared for this drought than in previous episodes, they estimate that soy and corn output will fall by 17% and 7%, respectively, compared to last year's harvest. The government, who had been expecting a record soy harvest to boost growth this year, has subsequently revised their growth expectations to 3.0% for this year, down from the 3.5% projection originally envisioned as part of their 2018 budget. Nonetheless, we expect another year of positive growth, which would be the country's first two consecutive years of positive growth since 2011.

... as well as a persistent inflation ...

Inflation metrics have moved above the central bank's new inflation target for 2018, increasing the likelihood of a relatively more contractionary monetary policy stance this year. The central bank eased its inflation targets for 2018 and 2019 late last December, moving to 15% for 2018 and 10% for 2019, up from the previous targets of 10 ±2% and 5% ±1.5%, respectively. 2019's previous inflation 5% target has been pushed out to 2020, while none of the new targets include a tolerance range (see Exhibit 4). Central bank officials recalibrated the policy framework in an effort to better synchronize its inflation targeting regime with the ongoing adjustment of regulated prices, but the monetary authority was unable to close the gap between expected inflation and target inflation for 2018, as regulated prices increases and two consecutive rounds of monetary easing inflation expectations (see exhibit 5). While headline inflation remains relatively contained at 25.4% as of March, down from an average of 39% in 2016, regulated price increases and drought-related food inflation could further de-anchor inflation expectations from the target, a development that would likely facilitate a hike in the policy rate and introduce downside risk to our growth forecast for 2018.

Exhibit 5

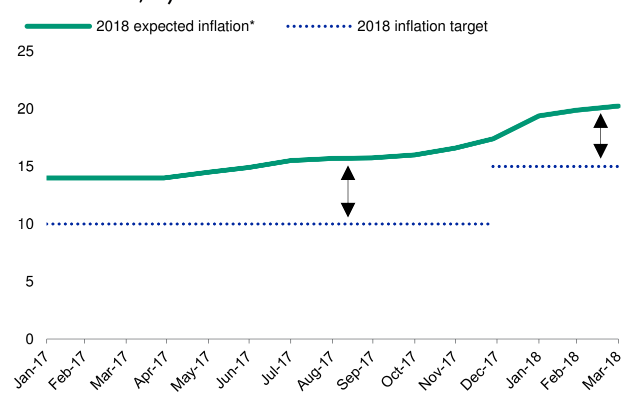
Argentina's central bank raised inflation targets for 2018-20...
(Annual inflation, %)



Source: Central Bank of Argentina

Exhibit 6

...but inflation expectations remain higher than target
(Annual inflation, %)



*Refers to the median local market participants' expectation for 2018 inflation in a given month
Sources: Central Bank of Argentina and Moody's Investors Service

Fiscal consolidation to continue, but a gradual pace

The government ended 2017 with a primary deficit of 3.8% of GDP, down from 4.3% in 2016 and below the 4.2% target. Government revenues grew 22.6% year-over-year, bolstered by the economic expansion, while expenditure rose only 21.8%, below the inflation rate. On the expenditure side, subsidy cuts to utilities and transportation have helped to rein in the deficit, but have also contributed to inflation. We expect the primary deficit to decline further this year to the government's target of 3.2% as subsidy cuts, growth-supported tax revenue collection and fiscal savings from pension reform support consolidation efforts.

The country's high fiscal deficit, which registered at 6% of GDP last year, remains the single largest unresolved macroeconomic imbalance for the Macri administration, but recent consolidation efforts and reform will help to reduce it over the next two years. In late December, Congress approved a reform that indexes future pension payments and other social expenditure to past inflation, as opposed to the previous mechanism that tied pension outlays to salary increases and changes in social security revenue. We estimate this change will generate fiscal savings of about 0.6% of GDP in 2018 contributing to government's efforts to assure continued – albeit gradual – improvement in the fiscal accounts.

We expect a deficit to decline gradually to 5.5% of GDP this year and 4.9% in 2019. The deficit would be more manageable if Argentina had a deeper domestic market. However, years of high inflation and a history of seizing private savings have left the banking system a fraction of the size of the banking systems of neighboring Chile or Brazil. The government relies on foreign funding which raises roll-over and exchange rate risks. We project that debt will increase to 54.8% of GDP in 2018, just below the B-rated median of 57.5%.

Rating methodology and scorecard factors

Rating factors grid - Argentina

Rating factors	Sub-factor weighting	Indicator	Indicative factor score	Final factor score
Factor 1: Economic strength			M	M
Growth Dynamics	**50%**			
Average real GDP growth (2012-2021F)		1.6		
Volatility in real GDP growth (standard deviation, 2007-2016)		5.2		
WEF Global Competitiveness index (2017)		4.0		
Scale of the economy	**25%**			
Nominal GDP (US$ billion, 2016)		554.9		
National income	**25%**			
GDP per capita (PPP, US$, 2016)		20,156		
Automatic adjustments	**[-3; 0]**	Scores applied		
Credit boom		0		
Factor 2: Institutional strength			VL+	VL
Institutional framework and effectiveness	**75%**			
Worldwide Government Effectiveness index (2016)		0.2		
Worldwide Rule of Law index (2016)		-0.3		
Worldwide Control of Corruption index (2016)		-0.3		
Policy credibility and effectiveness	**25%**			
Inflation level (%, 2012-2021F)		19.4		
Inflation volatility (standard deviation, 2007-2016)		9.3		
Automatic adjustments	**[-3; 0]**	Scores applied		
Track record of default		-3		
Economic Resiliency (F1xF2)			**L+**	**L**
Factor 3: Fiscal strength			L	L
Debt burden	**50%**			
General government debt/GDP (2016)		49.6		
General government debt/revenue (2016)		268.8		
Debt affordability	**50%**			
General government interest payments/revenue (2016)		8.1		
General government interest payments/GDP (2016)		1.6		
Automatic adjustments	**[-6; +4]**	Scores applied		
Debt trend (2013-2018F)		-1		
Foreign currency debt/general government debt (2016)		-6		
Other non-financial public sector debt/GDP (2016)		-1		
Public sector assets/general government debt (2016)		0		
Government financial strength (F1xF2xF3)			**L+**	**L**
Factor 4: Susceptibility to event risk	**Max. function**		M+	M+
Political risk			*M+*	*M+*
Worldwide voice & accountability index (2016)		0.5		
Government liquidity risk			*L+*	*L+*
Gross borrowing requirements/GDP		13.2		
Non-resident share of general government debt (%)		30.4		
Market-Implied Ratings		B1		
Banking sector risk			*VL-*	*VL-*
Average baseline credit assessment (BCA)		b2		
Total domestic bank assets/GDP		32		
Banking system loan-to-deposit ratio		90		
External vulnerability risk			*L+*	*M*
(Current account balance + FDI Inflows)/GDP		-2.1		
External vulnerability indicator (EVI)		139.7		
Net international investment position/GDP		9.2		
Government bond rating range (F1xF2xF3xF4)			**Ba3 - B2**	**B1 - B3**
Assigned foreign currency government bond rating		**B2**		

Note: While information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. For more information please see our Sovereign Bond Rating Methodology.

Footnotes: **(1) Indicative factor score:** rating sub-factors combine with the automatic adjustments to produce an Indicative factor score for every rating factor, as detailed in Moody's Sovereign Bond Methodology. **(2) Final factor score:** where additional analytical considerations exist, Indicative factor scores are augmented to produce a Final factor score. Guidance on additional factors typically considered can be found in Moody's Sovereign Bond Methodology; details on country-specific considerations are provided in Moody's research. **(3) Rating range:** Factors 1: Economic strength, and Factor 2: Institutional strength, combine with equal weight into a construct we designate as Economic Resiliency or ER. An aggregation function then combines ER and Factor 3: Fiscal strength (FS), following a non-linear pattern where FS has higher weight for countries with moderate ER and lower weight for countries with high or low ER. As a final step, Factor 4, a country's susceptibility to event risk, is a constraint which can only lower the preliminary government financial strength rating range as given by combining the first three factors. **(4) 15 Ranking categories:** VH+, VH, VH-, H+, H, H-, M+, M, M-, L+, L, L-, VL+, VL, VL- **(5) Indicator value:** if not explicitly stated otherwise, the indicator value corresponds to the latest data available.

Moody's related publications

- **Outlook:** Sovereigns – Latin America & Caribbean: 2018 outlook stable as growth momentum offsets rising debt and policy uncertainty, 9 January 2018
- **Issuer Comment:** Government of Argentina: Argentina's new pension law advances government's reform efforts, 21 December 2017
- **Issuer In-Depth:** Government of Argentina - B2 Stable: FAQ on economic and policy reform prospects, 18 December 2017
- **Rating Action**: Moody's Upgrades Argentina's Rating to B2; Outlook Stable, 29 November 2017
- **Country Statistics**: Argentina, Government of, 9 November 2017
- **Outlook:** Sovereigns – Global: 2018 outlook stable as healthy growth tempers high debt, geopolitical tensions, 08 November 2017
- **Issuer Comment**: Government of Argentina: Argentina's Midterm Election Results Will Likely Lead to More Credit-Positive Policy Reforms, 26 October 2017
- **Issuer In-Depth**: Government of Argentina – B3 positive: Annual credit analysis, 28 September 2017
- **Issuer Comment:** Government of Argentina: Argentina's Primary Election Results Support Macri Government's Credit-Positive Policy Reform Efforts, 17 August 2017
- **Rating Methodology**: Sovereign Bond Ratings, 22 December 2016

REPORT NUMBER 1121190

MOODY'S
INVESTORS SERVICE