Argentina Market Outlook
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China, USA and the new agreement between IMF and the Central Bank: ¿would it be enough?

During last week emerging markets have been under extreme pressure due to renewed tensions between China and the US regarding tariff negotiations. Today, Monday, the situation seems to have escalated to a higher level given that both sides have strengthened their positions. Markets have opened with a sharp selloff that impacted the S&P and almost every single ETF that replicates EM such as FXI (China), EEM (emerging markets), EWZ, etc. In this extreme environment, local currencies are also under significant pressure following the same pattern: markets are buying safe-haven assets and selling every possible carry trade available until a certainty new equilibrium is reached between The US and China. The US 10yr yield is currently at 2.41% and probabilities that the Fed will lower rates at its december meetting have raised from 50% last week to 70% today.

Evidently, under these conditions, those emerging economies that exhibit higher vulnerabilities like Argentina, could face a much harder punishment from FX markets. Having said this, the new agreement between the IMF and Argentina´ s Central Bank (BCRA) will be put to test under these tougher global conditions and it looks like the BCRA will have enough ammunition to cointain a potential run on the Peso unless the China-US saga triggers a much harder selloff in the S&P and EM equities causing higher risk aversion. In addition, the election results in Córdoba Province last Sunday causes a new source of uncertainty regarding the future of Argentina´ s Presidential elections. Moderate peronism has reached a historical victory and may have found in Schiaretti (Córdoba reelected Governor) the leader that could fill the gap between those who support Cambiemos and Kichnerism. Therefore, today will be a tough day for the BCRA in the sense that will face two waves of FX peso demand: 1) global turmoil, 2) increasing political uncertainty.

In this context, Argentina´ s 5yr CDS are also feeling the pressure quoting at 1170 points from 1137 as of last Friday. We think that the new agreement with the IMF will allow to reduce the "beta" that Argentina used to have, particularly in the last 12 months following the starting of the FX crisis in April 2018. The notion that this time the BCRA has enough reserves to intervene at any moment should prevent the market from building significant short positions in the peso. Definitely, this new agreement does not fix the long run but should be able to stabilize the short run for a country that faces an almost permanent state of crisis since April 2018.

If global conditions do not worsen significantly from current levels, Argentina should be able to exhibit some signs of recovery in the following weeks that may have a significant impact on FX dynamics. Inflation numbers due this week should show some sort of improvement regarding the last print of April. By April monthly inflation was over 4% and it looks like in May the new inflation numbers could be around 3.80% which should be considered as relatively good news in ther current environment. If this happens, provided that the EM selloff does not escalate to a new level, local FX pressure should decrease and may open the door for the BCRA to lower nominal rates in pesos which are currently at the astronomical level of 70%.

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2019 will be an extremely tough year for Argentina. Monetary and real economy tensions aggravated by huge political uncertainty will generate high levels of volatility at least until November when the new president will be elected. Volatility means opportunity and we think that if our base case scenario of President Macri being reelected holds, being patient, swallowing the pain and buying Argentine assets on dips will end up being a winning trade. No pain, no gain, no guts, no glory, specially in a country like Argentina. Fingers crossed.