

25th October 2024

Argentine Sovereign Bond Rally.

In our reports, we often emphasize the importance of prioritizing a global perspective when analyzing the dynamics of sovereign bonds. Changes in global rates and the credit spreads of comparable bonds tend to explain a significant portion of the movements in the prices of Argentine ARGENT and ARGBON. We frequently lose focus by searching for domestic explanatory variables, when, in reality, changes in the country risk are driven by the international context; factors exogenous to Argentina's economic policy.

That said, the excellent performance of bonds since last August has been driven almost exclusively by domestic factors. As shown in the table below, Argentine bonds have risen by an average of 31% since August to date. In contrast, a sample of comparable bonds shows a significantly smaller increase, around 4%. The Argentine rise was almost ten times greater related to comparable bonds (the discretion in selecting the sample does not alter the conclusions).

Clean Prices	1-ago-24	22-oct-24	%
ARGENT 2030	53,3	68,5	28,6%
ARGENT 2035	41,5	55,5	33,9%
ARGENT 2038	45,6	59,6	30,6%
ARGENT 2041	38,7	51,6	33,3%
Average			31,6%

Clean Prices	1-ago-24	22-oct-24	%
ECUA 2035	52,1	54,6	4,8%
PKSTAN 2031	79,8	84,0	5,3%
EGYPT 2032	83,9	87,0	3,7%
NGERIA 2031	93,1	96,5	3,7%
EMHY (EM HY ETF)	37,5	38,6	2,8%
Average			4,06%

Source: Cucchiara Research.

We feel comfortable with the GD41 and GD35. Based on the price movements of the past few weeks, the GD41 is currently our top pick.

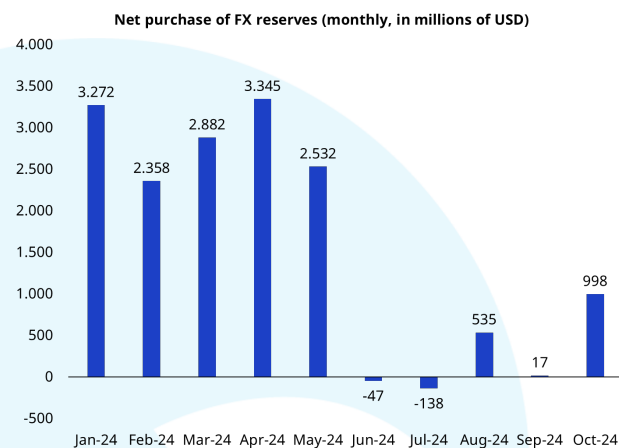
That said, we are still surprised by the speed and intensity of the price increases over the past three months, which have far outpaced comparable bonds. How can we explain the excellent relative performance of Argentine bonds? In our opinion, this behaviour is explained by the unexpected accumulation of reserves since August, a dynamic closely tied to the tax amnesty and the flow of dollars within the local financial system. This is the point we will emphasize in this report.

Before discussing the dynamics of the foreign exchange market, let's briefly mention the latest fiscal figures. Last month, the Treasury once again posted excellent fiscal results with a primary surplus of ARS 816bn. Although the market narrative often assumes a fiscal surplus, we believe that in a country that has been stagnant for over 15 years, largely due to fiscal dominance, the fiscal trajectory should continue to be highlighted. In the first nine months of the year, the primary surplus amounts to 1.7% of GDP. The

We have long considered sovereign bonds to be undervalued, [particularly after the 2021 midterm elections](#). In this [recent report](#), we analyzed the key points of the economic program and concluded that, despite concerns over the dynamics of the real exchange rate and the scarcity of reserves, the bonds appeared highly attractive due to the exceptional fiscal numbers and the President's strong commitment to honoring debt obligations. A clear example of these two points is the recent presidential vetoes, where fiscal discipline seems to have taken priority above all else. Regarding where to take place in the curve, [in this report](#) we explained why, considering various scenarios, we

fiscal improvement in the President's first year in office will be around 4.5 percentage points of GDP—truly remarkable.

Now, let's turn to the surprising dynamics of reserves in recent weeks. During a seasonally low period for dollars' inflows, the BCRA was able to purchase over USD 1.5 billion since August. There are several points to highlight here. First, the agricultural sector continued to sell at a good pace despite the seasonality. Exports of soybean oil and flour showed strong momentum in September and October. Another factor that supports the foreign exchange market is imports, where low activity levels play a decisive role. In 2024, shipped imports averaged USD 4.8bn per month, a level 13% below the average since 2011 (excluding the pandemic year of 2020).



Source: Cucchiara Research.

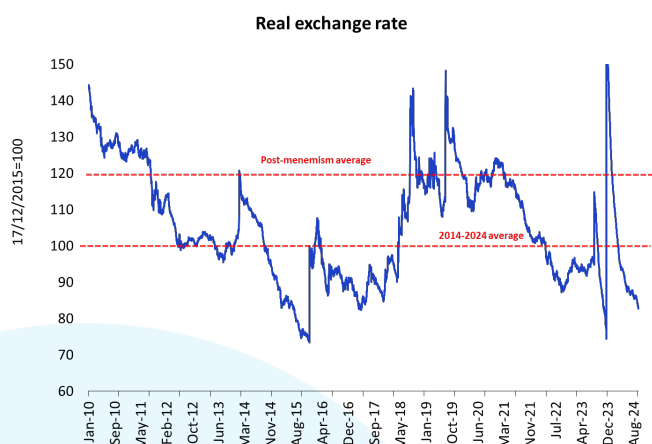
Now let's move on to the data from the BCRA's foreign exchange balance, specifically what has actually been traded in the FX market. In the first half of the year, the current account provided a supply of USD 8.9 billion. However, in the 3rd quarter, the current account turned negative by USD 3.6bn. Thus, the currency purchases in these months are linked to another supplier, which is also the private sector, but as a result of the tax amnesty. The tax amnesty resulted in a jump in dollar deposits of USD 12

billion from August to date. In response to the increase in funding, banks actively lend to exporters. However, the key factor is the rise in demand for dollar credit, and the valuable point here is that devaluation expectations are very contained. The Government has convinced the market that the 2% crawling peg is here to stay. As a result, exporters have a strong incentive to take loans in dollars and benefit from the peso interest rate. Similarly, the rates on dollar futures are very low, creating another incentive for exporters to sell in the spot market and repurchase futures at low rates.

How does this dynamic affect the Central Bank's reserves? Net reserves increase because exporters receive pesos from dollar loans, which creates a supply of dollars in the market. Does this mean that they will later have to repurchase dollars to repay the loans, resulting in a reduction of net reserves again? Not necessarily. The stock of dollar loans remains very low. As long as the stock of credits is maintained, the demand for foreign currency from old loans will be offset by the supply of FX from new loans. The increase in dollar loans to the private sector has reached USD 1.4 billion since August, almost the same amount of net purchases by the BCRA. Additionally, we must consider the dollar debt issuances by companies in the local market, which result in some of those dollars being offered in the foreign exchange market.

Long-term, we still find sovereign bonds attractive. When looking at the yields of comparable countries, we believe there is still room for yield compression and price appreciation. The tax amnesty has brought significant local demand, and the flows from the Buy Side are also beginning to materialize. That said,

the very rapid increase in prices over the past few weeks, combined with an exchange rate framework that we find inconsistent with the accumulation of reserves (excessive appreciation of the effective exchange rate), provides good reasons to be on the lookout.



Source: Cucchiara Research.

For this scenario, the GD41 ((ARGENT 41) seems like a good alternative. It is a New York law bond with a 2005 indenture and offers the lowest price on the curve, providing greater protection for the holder without sacrificing gains in a positive long-term scenario.

Kind regards,

Juan José Battaglia
juan@cucchiara.com.ar

Manuel Carvalho
manuel@cucchiara.com.ar

Ian Weber
ian@cucchiara.com.ar

Tomás Mangino
tomasmandino@cucchiara.com.ar