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COUNTRY RISK STUDY

Argentina

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1. INTRODUCTION

The purpose of this final project is to reflect the importance of sustainable long-term financing for a country, that is, assumable levels of country risk. If they are not, they may cause a country to fail, and spread to other countries with similar features, since countries are interdependent economic units in the international market.

In order to prepare this project, we will delve into the economic and financial field to assess country risk and the factors that determine it, as well as the consequences that may derive from country risk and the measures that can be implemented to prevent its negative aspects.

In particular, we will focus on Argentina, a country, as we will see, with many fields to improve on, which is currently experiencing the consequences of poor internal management. Throughout its history, Argentina has experienced numerous crises and, today, it is immersed in another great crisis caused by several factors that will become the subject of study of this end-of-degree project, along with the different measures and tools that will help us to obtain the country risk level of Argentina.

In this sense, Argentina is one of the most attractive emerging countries for this study since, nowadays, its economic, financial, social and political scenarios are highly weakened, something that we will discuss in depth later on.

According to the definition by Silvia Iranzo¹, country risk analysis is the study of the probability of failure of a country to comply with its payment obligations to external creditors.

Furthermore, “country risk includes sovereign risk, transfer risk and other risks arising from the international financial activity”²; commercial risk is therefore excluded from

¹ Iranzo, S., 2008. *Delving into country risk*, Banco de España. Documentos ocasionales N° 0802.

² Circular 4/2017, de 27 de noviembre.

the definition of country risk. In this sense, both public and private debt play an important role in the study of country risk.

As regards the causes that may generate non-payment to creditors, these range from the failure in the collection of taxes by a country, caused by the malfunctioning of the Administration, which is unable to collect all taxes citizens must pay (and, consequently, the generation of government revenues becomes inadequate), to the intentional non-payment by the country, or even natural disasters, such as an earthquake or a tsunami, where there may be a default by the private debtor due to restrictions on payment of foreign debt imposed by a state, when these types of events occur.

Once the definition of country risk has been determined, we can delimit its functionality and level of importance.

As we know, a high country risk may lead to default, which will cause global instability in the case of a systemic country. There are two common factors that would result in a high country risk: firstly, an excessive public deficit; and secondly, the impossibility of borrowing in foreign markets due to the lack of confidence of foreign investors in the ability of the borrower to repay debt. In the case of local currency-denominated debt, there could be a mistrust of that currency by investors because they believe that it could be depreciated, generating losses.

The first factor is easy to understand: if a country has no debt, country risk will be low or non-existent. Therefore, the accounts of a given state will reveal, in a first approximation to the assessment of its country risk, whether it is low or high. The second factor reveals that certain countries have what is known as seigniorage³. Thus, some countries, such as the United States, have the certainty that their currency will be accepted as a means of payment. This great world power (the United States) is followed by the European Union (EU), Japan and, to a lesser extent, the United Kingdom. All of them have the possibility to issue debt in international markets in their national

³ It is the power that some currencies have over others in the international economic and financial systems. This concept was explained by Professor Silvia Iranzo Gutiérrez in one of her classes at CUNEF.

currency because it is reliable, so investors will accept debt repayment in these currencies.

For all these reasons, the first step that investors will take when deciding on the country of destination of their investments will be to consult the country risk assessment or rating the debt issuer has. This is the way to avoid endangering wealth and ensure that investments will obtain the expected results. The reality is that financial globalization has allowed an integration of debt instruments, which makes the determination of the country risk of a specific state more important, and serves as a reference for the rest of the countries in terms of evaluation of the economic and financial situation of this state.

As for the selection of Argentina for the study of its country risk, the history of this country is short, in comparison with the history of other European countries such as Spain or the United Kingdom, but it is intense, as it has experienced numerous economic, financial and political events.

The truth is that the debt of emerging countries has increased rapidly and considerably in recent years. This is reflected by the World Bank which, in its study “Global Waves of Debt”⁴, establishes an increase of 54 percentage points in the debt ratio of emerging countries, reaching more than 160% since 2010, the year in which the accumulation of debt began. Therefore, Argentina is an emerging country with great relevance in the study of country risk.

On the other hand, as we will see further, Argentina has the ideal characteristics for country risk analysis, as it is facing great challenges to achieve stable economic growth. Among its most important characteristics, we will highlight that it is a relevant member of the G20⁵, and that it possesses considerable natural resources, such as oil⁶. In addition, Argentina has proved to be a bad payer throughout its history as it has failed

⁴ World Bank (2019).

⁵ This group consists of 19 countries (the United Kingdom, France, Germany, Italy, Russia, Australia, Japan, the US, Canada, China, Argentina, Mexico, Indonesia, Brazil, South Korea, India, Turkey, Saudi Arabia and South Africa), and the EU.

⁶ BP (2019).

to repay its creditors several times. A notable clear example of this can be found in 2001, when Argentina defaulted on payments of almost 100 billion dollars⁷. Another clear example occurred in 2005, when Argentina decided to pay in advance all the debt it owed to the International Monetary Fund (IMF) in order to stop depending on it, without showing the same commitment to the rest of its creditors, who were not being treated equally. This led to their anger and distrust. In 2006, Argentina had accumulated unpaid debts with the Spanish Company of Export Credit Insurance (CESCE) for an amount exceeding 300 million euros. Due to its debt problems and difficulties in facing payments with its own means and resources, Argentina has required the help, on numerous occasions, of different bodies, such as the IMF⁸, the Paris Club⁹ or the CESCE¹⁰.

2. MACROECONOMIC-FINANCIAL ANALYSIS

A wide range of variables affect country risk. In this project, we will represent those variables that will lead us to evaluate the country risk of Argentina.

2.1 ECONOMIC GROWTH

GDP growth indicates the capacity of a country to collect taxes. Therefore, its importance falls on the fact that, if the tax collection of a country decreases, the capacity of the state to finance public spending is equally reduced. This would pose a problem for the country, which could see an increase in its public deficit. Consequently, it would have to issue more debt, which would cause the increase of country risk. In addition, economic growth is also related to the evolution of the unemployment level. If unemployment increases, household consumption is reduced.

According to IMF data, and using as a basis the list of emerging countries reflected in the report on emerging markets of October 2019¹¹, Argentina was ranked the eleventh emerging economy of the world, with a GDP of 445.47 billion dollars (current prices)¹².

⁷ Iranzo, S. (2008), op. cit.

⁸ "Its main purpose is to ensure the stability of the international monetary system", International Monetary Fund (2019).

⁹ It tries to negotiate the foreign debt of countries that have problems paying it.

¹⁰ It protects countries, including Spain, against risks.

¹¹ Pérez-Gorozpe, J.M. & Lysenko, T. (2019).

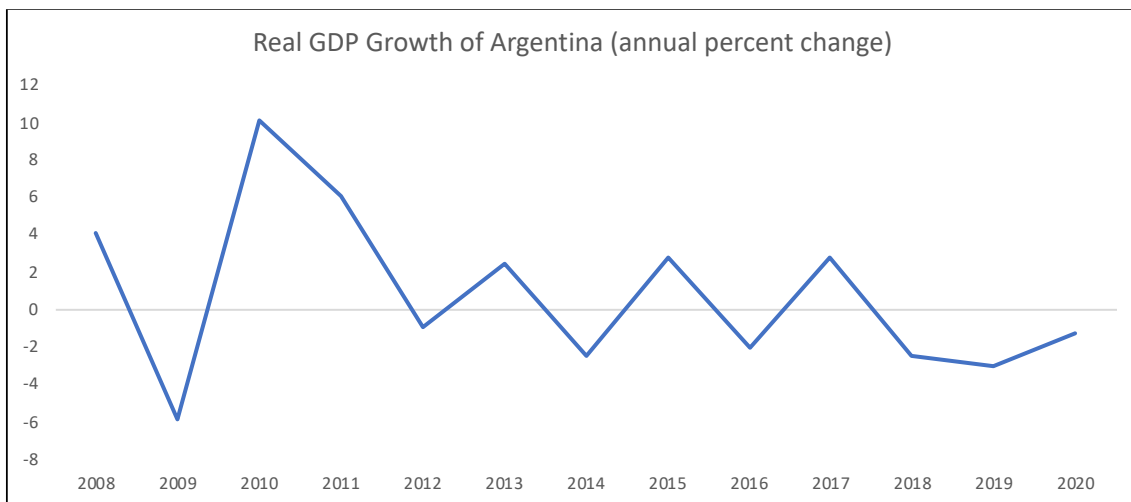
¹² International Monetary Fund (2019), op. cit.

China was in first position, with a GDP of 14,140 billion dollars, followed by India, with a GDP of 2,940 billion dollars.

On the other hand, as we may see in the following figure, the GDP of Argentina experienced a considerable decrease in 2009.

Chart 1

Real GDP Growth of Argentina from 2008 to 2020



Source: International Monetary Fund
The variables for 2020 are predictions

This decrease was due to the great world economic crisis that began in 2008 and whose origin was the United States. From then on, in 2012, it again suffered a decrease in GDP, which in this case was due to the general fall in prices of commodities. Argentina is an exporter of commodities, so the evolution of its economy depends, to a large extent, on their prices. Therefore, price fluctuations affect the country significantly. The decline in GDP of Argentina in 2014 was also a consequence of the general fall in commodity prices; oil prices, one of the most important natural resources of Argentina, fell. Regarding the decline of the Argentine economy in 2016, it was largely due to the economic crisis of Brazil, which caused a collapse of both Argentine consumption and exports, since Brazil is one of the main destinations of the Argentine exports¹³.

¹³ Justo, M. (2016).

Finally, the cause of the recession that began in Argentina in 2018 was an exchange crisis that led to an excessive devaluation of the Argentine currency. The reason for the devaluation was the mistrust of both foreign and Argentine investors, who withdrew their capital from Argentina. The causes of this mistrust were both internal and external. As an internal cause, we may highlight the excessive gradualism of President Mauricio Macri in reducing public deficit and inflation. As external causes, we may single out Trump's trade war and the increase in interest rates by the US Federal Reserve. The capital outflow led to the devaluation of the peso, in excess of 40%, and with that, an increase in inflation (due to the higher price of imports) and, consequently, a lower competitiveness of exports. This, in turn, generated a new devaluation of the Argentine peso, and so on in a vicious circle of devaluation, inflation, reduced competitiveness, devaluation, etc.¹⁴. Thus, GDP growth of Argentina was minus 2.5% in 2018.

On the other hand, in relation to the growth of the GDP of emerging countries, Argentina was in sixteenth position in 2019, with GDP growth of -3%, according to Standard & Poor's¹⁵.

Despite the fact that, according to Standard & Poor's forecasts for October 2019, other emerging economies will also experience negative GDP growth, Argentina was still the economy with the greatest decline this year; well above countries such as Saudi Arabia and Turkey (it doubles the rate of decline of both countries).

In relation to the remaining 193 countries recognized by the United Nations (UN), the economy of Argentina was in the 25th position in 2018¹⁶. Since 2018, according to the World Bank forecasts, its economy fell four positions, reaching the 29th position in 2019.

When analyzing GDP per capita and the distribution of income among the Argentine population, we observe a significant inequality among social classes. While in 2017 GDP

¹⁴ Thomson Reuters (2018).

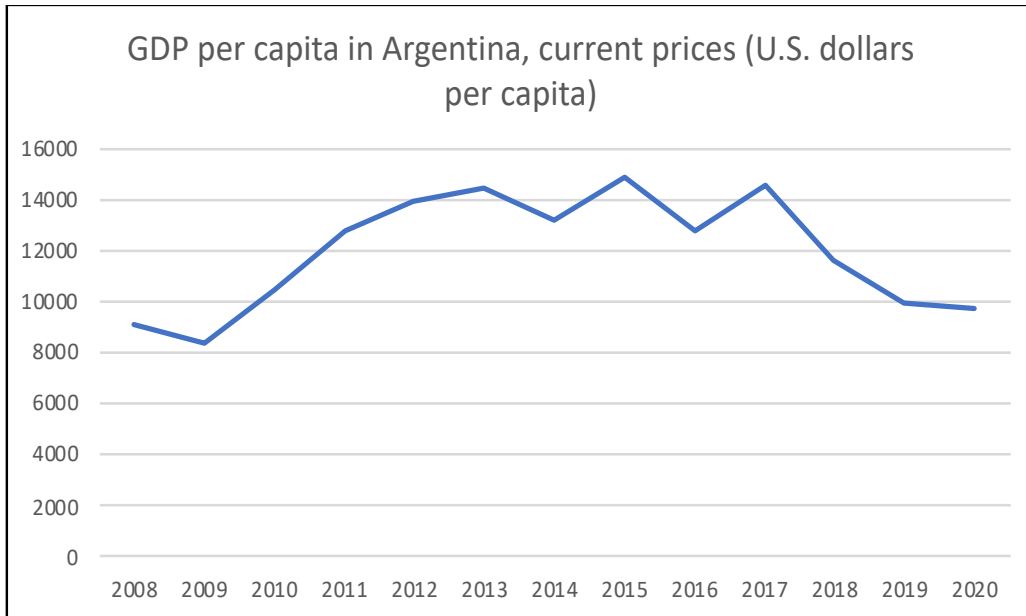
¹⁵ Standard & Poor's Financial Services LLC (2019).

¹⁶ International Monetary Fund (2019), op. cit.

per capita increased considerably with respect to the previous years, in 2018 and 2019 it decreased significantly.

Chart 2

GDP per capita in Argentina from 2008 to 2020



Source: International Monetary Fund
The variables for 2020 are predictions

The rate of poverty reduction in Argentina was very weak in the 2014-2018 period, and this was precisely because the average income per capita in 2017 and 2018 declined considerably and was volatile during the rest of the years. Specifically, this rate of poverty reduction was 1.4% in the 2008-2014 period and 0.5% during the 2014-2018 period. The reason why the rate was lower in this last period was, as previously noted, the existence of economic difficulties that the country was facing between the end of 2017 and 2018¹⁷.

On the other hand, Gini coefficient records¹⁸ show a level of income distribution inequality that exceeds 40% in 2019¹⁹. Despite the fact that during the 2002-2013 period the Gini coefficient of Argentina decreased gradually²⁰, records in 2017 show an

¹⁷ Economic Commission for Latin America and the Caribbean (2019).

¹⁸ Values range from 0 to 1, being 0 "absolute equality" and 1 "absolute inequality".

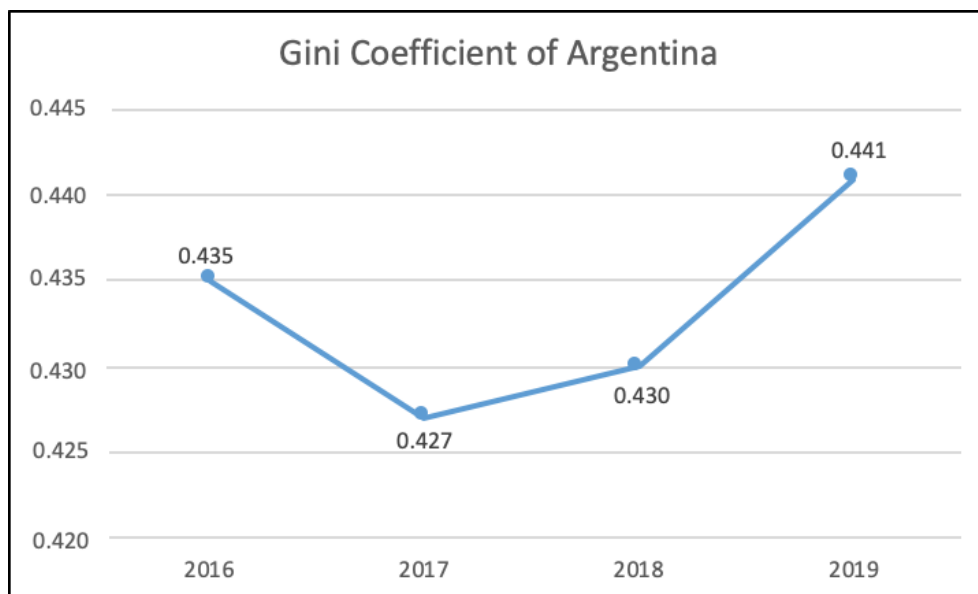
¹⁹ Instituto Nacional de Estadística y Censos de la República Argentina (2019).

²⁰ Inter-American Development Bank (2015).

increase²¹ with respect to 2013, which was followed by more increases in the 2018-2019 period. According to the UN²², a Gini coefficient above 0.4 represents a high level of inequality. Therefore, the figure for Argentina, which was 0.441 in the first and second quarters of 2019, represents a notable degree of inequality.

Chart 3

Gini Coefficient of Family Per Capita Income. Total: 31 urban conglomerations



Source: National Institute of Statistics and Censuses (INDEC)
2016, 2017, 2018 y 2019: average value of the sum of quarters
2016: 2th, 3rd and 4th quarters
2019: 1st and 2nd quarters

2.2 INFLATION

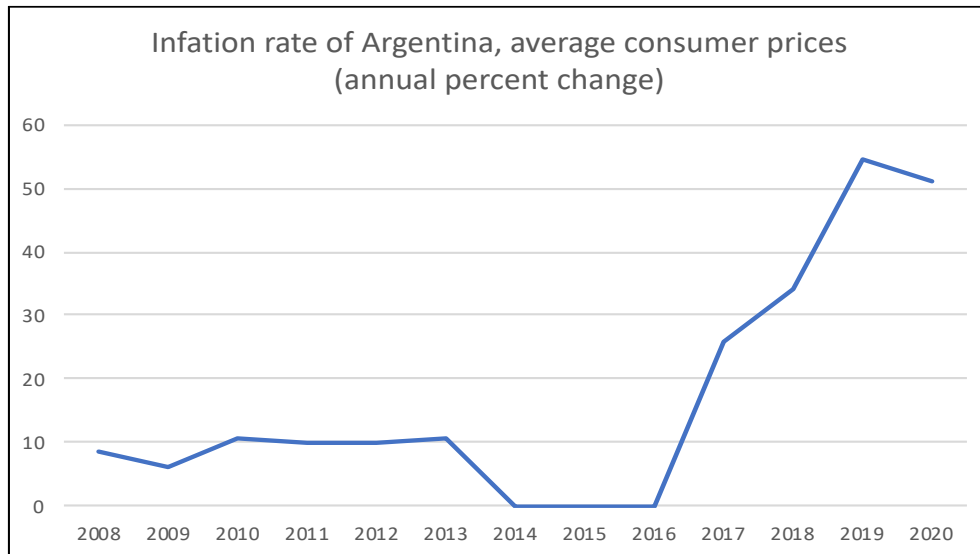
The study of the inflation rate in a country is very important because, if it rises relative to other countries, the country reduces its competitiveness level. Therefore, exports become less competitive.

²¹ World Bank (2019), op. cit.

²² United Nations Research Institute for Social Development (2013).

Chart 4

Inflation rate of Argentina from 2008 to 2020



Source: International Monetary Fund
2014-2016: no data
The variables for 2020 are predictions

As we can see in the figure, the inflation rate grew to its highest peak in 2019, which was one of the causes for the devaluation of the Argentine peso. However, as we will see later, the devaluation of the Argentine peso was not only due to the increase in the inflation rate.

Another reason for the incessant devaluation of the Argentine currency is the lack of reliability of the Argentine peso, which causes a fall in the borrowing capacity in the Argentine currency in foreign markets.

On the other hand, according to data from the Central Bank of the Argentine Republic (BCRA)²³, in December 2015, the interest rate (in nominal annual percentage rate) remained between 33% and 38%, and it varied between 25% and 38% between 2016 and 2017. However, as of May 2018, it increased to 40%, even reaching 73%. At the beginning of 2019, the interest rate was almost 60%, reaching 86% throughout the year and reaching 63% in December. If interest rates increase, debt also increases. This is due

²³ Central Bank of the Argentine Republic (2019).

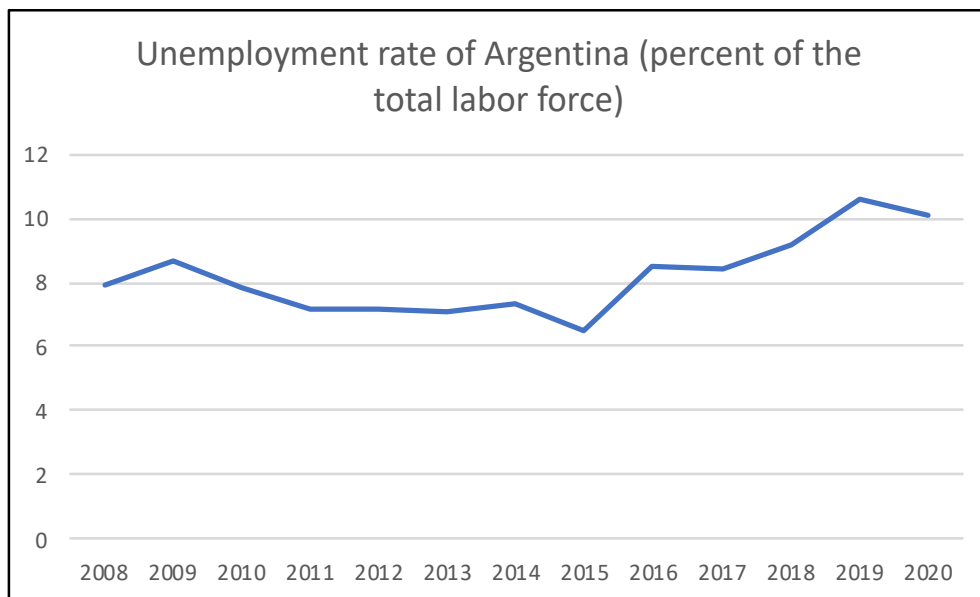
to the fact that more public money is needed to service debt, and therefore, public deficit increases.

2.3 UNEMPLOYMENT

As noted above, the level of unemployment in a country is closely related to the growth of its economy. On account of the economic decline that Argentina experienced in 2016 due to the aforementioned decrease in both the level of consumption in Argentina and exports, the unemployment rate varied from 6.5% in 2015 (the lowest unemployment rate recorded since 2008) to 8.5% in 2016. In 2017, it recovered slightly, since the economic indicators in that year were very favorable, with an economic growth of 2.7% with respect to the -2.1% it experienced in the previous year. However, the 2018 recession of Argentina caused the unemployment rate to rise, reaching 10.6% in 2019.

Chart 5

Unemployment rate of Argentina from 2008 to 2020



Source: International Monetary Fund
The variables for 2020 are predictions

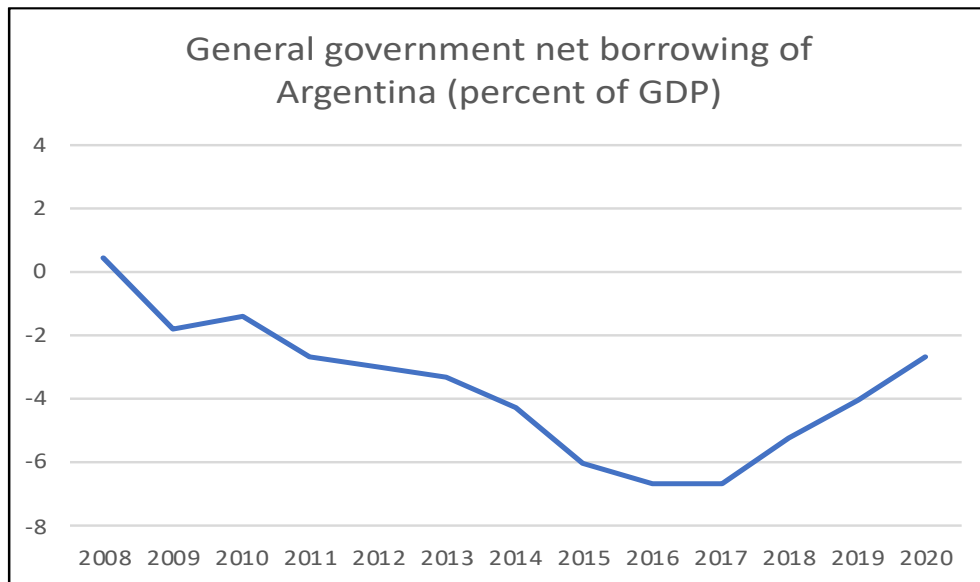
2.4 PUBLIC SECTOR

The economic and financial study of a country will show us if it has a public deficit or a surplus. In addition, we will be able to check the level of debt, and if it is public or private, and domestic or external.

In the case of Argentina, since 2009, state accounts show a public deficit²⁴ , that is currently at 4% of GDP. IMF records show a downward path during the last three years. However, the state has shown a public deficit situation over the last decade.

Chart 6

General government net borrowing of Argentina from 2008 to 2020



Source: International Monetary Fund
The variables for 2020 are predictions

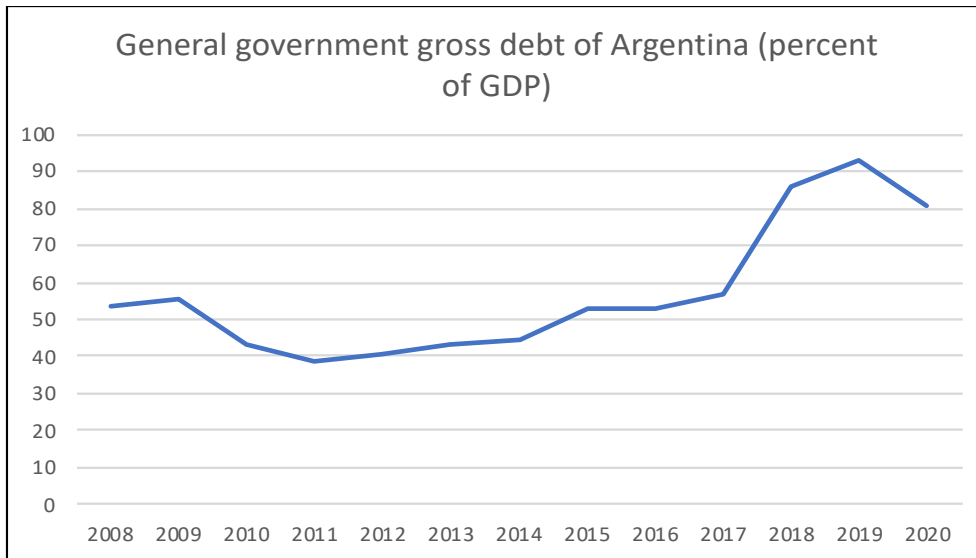
We observe the highest peak of gross government debt in the 2018-2019 period, where it reached 86.1% of GDP in the first year²⁵. In 2019, the debt ratio increased up to 93.3%.

²⁴ International Monetary Fund (2019), op. cit.

²⁵ A debt ratio above 80% would be considered an alarming figure.

Chart 7

General government gross debt of Argentina from 2008 to 2020



Source: International Monetary Fund
The variables for 2020 are predictions

Finally, there is a large quantity of subsidies in Argentina²⁶. This is one of the main causes of the public deficit the country is experiencing. The Argentine government subsidizes, to a large extent, gas and gasoline. These subsidies increased in the Kirchner era, and have remained high in the following years. Subsidies accounted for almost 6.7% of the public spending of the country in 2016, 5.9% of the public spending in 2017 and 6.6% in 2018 (the vast majority were earmarked for fossil fuels)²⁷. Presently, subsidies in Argentina are still high.

2.5 EXTERNAL SECTOR

The external sector of a country provides an idea of the export capacity and investment attraction of the country; exports are one of the potential sources of dollar inflows in Argentina. As explained before, if the inflation rate rises, the country reduces its competitiveness level. Consequently, exports decrease, damaging, in turn, foreign exchange earnings.

²⁶ Irigaray, J.I. (2015).

²⁷ Fundación Ambiente y Recursos Naturales (2019).

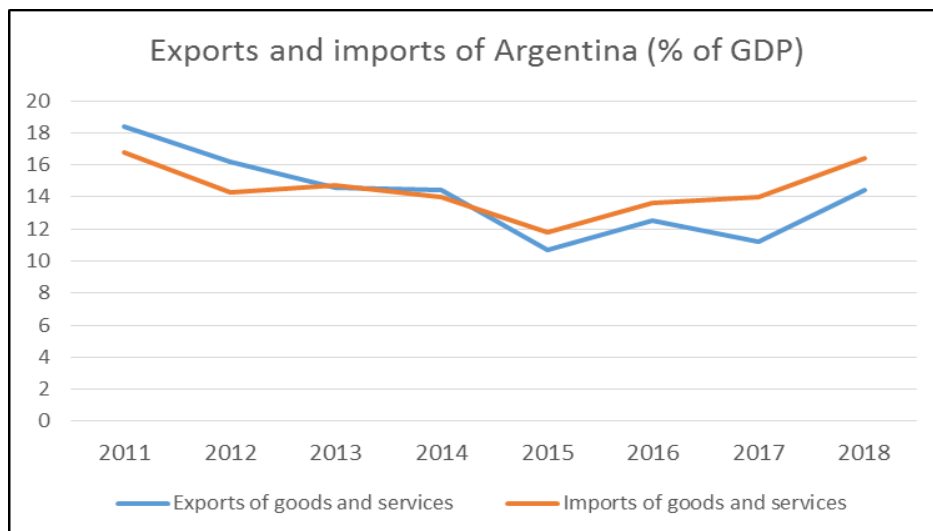
Although Argentina has proven to be very unstable, its exports of goods show a very favorable path over the years²⁸. They had a very good result in 2018, being the 44th economy in exports of goods of the world²⁹. Therefore, it is one of the most representative economies in Latin America, along with Mexico, which is also one of the countries that make up the G20.

The current account balance of Argentina was negative in 2018, as in the previous eight years³⁰, accounting for -2.71% in 2016 and -4.92% in 2017, reaching -5.29% in 2018 (the lowest from 1980, according to the World Bank databases). These figures indicate the large public deficit Argentina is experiencing at present.

In 2018, the trade balance of Argentina was negative, since imports were higher than exports, as well as in 2016 and 2017. This, as we know, does not imply a negative indicator of the economic activity of a country; it can also reflect high imports of investment goods to meet growth needs.

Chart 8

Exports and Imports of Argentina from 2011 to 2018



Source: World Bank

²⁸ World Bank (2019), op. cit.

²⁹ Taking as sample the list of 194 sovereign countries in the world established by the UN.

³⁰ World Bank (2019), op. cit.

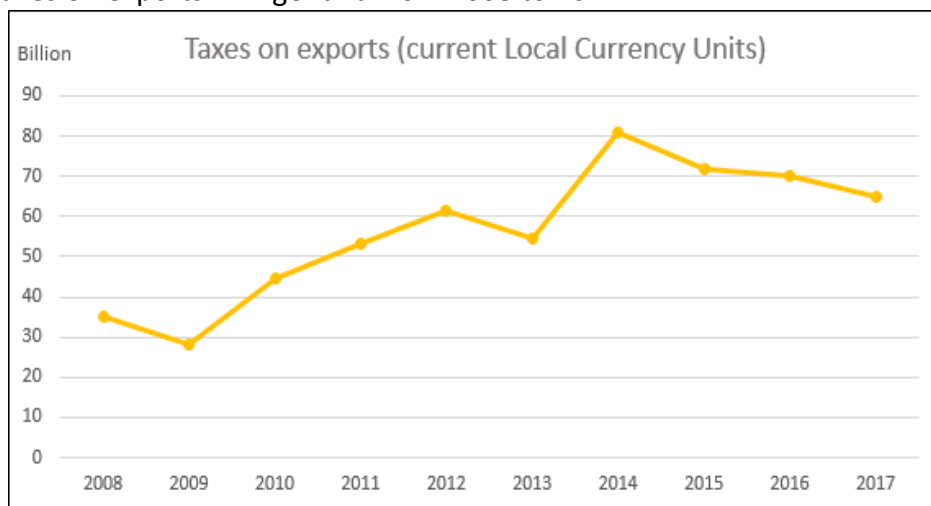
The main export goods are cereal, residues and waste from the food industries (fodder for animals), commodities, vehicles and fossil fuels (including oil), in this order³¹. As we may see, exports in Argentina are based mainly on commodities. According to the World Bank, Argentina exported 61.64 billion dollars in 2018³², accounting for 11.87% of GDP of that year³³. Due to its large commodity exports, the trade balance of Argentina is very sensitive to their price changes.

Regarding oil production in millions of tonnes, although from 2008 to 2018 it decreased in Argentina³⁴, it still represents a significant figure in its economy, with 27.6 million tonnes registered in 2018³⁵.

On the other hand, we may observe that export taxes³⁶ in Argentina have a clear influence on its trade balance. Although the arrival in power of President Macri did not mean the highest registered peak of export taxes (the highest peak occurred in 2014), they have had a very weak decline and have remained strong during the 2015-2017 period.

Chart 9

Taxes on exports in Argentina from 2008 to 2017



Source:
World Bank

³¹ International Trade Center (2019).

³² World Bank (2019), op. cit.

³³ International Monetary Fund (2019), op. cit.

³⁴ Production has declined in Argentina due to the lack of investment in exploration and production, as the government forces the investor to sell the oil below market prices.

³⁵ BP (2019), op. cit.

³⁶ Or “export restriction”, as they call it.

If we focus on data on tourism in Argentina provided by the World Tourism Organization (OMT), this sector does not represent a powerful source to generate dollars. Although tourism accounted for 8% of total exports in 2018, being equal to the same percentage of total exports of 2015 (it has not changed in those three years), this percentage does not represent a relevant figure regarding the income from total exports of the country. The reality is that tourism has never represented a strength of the country, since it has always reached a percentage between 6 and 8% of total exports in the previous years, specifically, in the 2005-2014 period³⁷. In this sense, Macri failed in his attempt to make Argentina a great tourism country.

Regarding the dollar reserves of Argentina, records from the BCRA show a pronounced decrease from the second week of January 2018 to the second week of December that year, due to the recession that began in 2018³⁸. The causes for the foreign currency reserves of a country to fall are diverse, such as the lack of government stability or uncertainty about the measures that a particular government will undertake. We will analyze these issues in detail later on. As an example, we have the case of the Argentine elections of 2015, where Mauricio Macri was elected. Before the holding of the Primary election, which took place on August 9th, dollar reserves in Argentina began to decrease³⁹. The first round of the Argentine general election took place on October 25th. Later, on November 22nd, the second round took place, when we may observe a reduction in the dollar reserves of Argentina. The uncertainty regarding the candidate who would head the presidency of the Argentine government led to a fall in the amount of US dollars in the country in 2015. We may also note a deterioration of dollar reserves in December, when Macri had already won the position of President of Argentina. Once again, the lack of certainty in relation to the policies and measures that the elected government would implement made it impossible to stop the decline of dollar reserves. In 2019, there was also a weakening of dollar reserves. In fact, something very similar to what happened in 2015 took place. As in 2015, Argentina experienced a deterioration of its foreign currency reserves (dollars) in 2019. After the Primary election of August

³⁷ World Tourism Organization (2019).

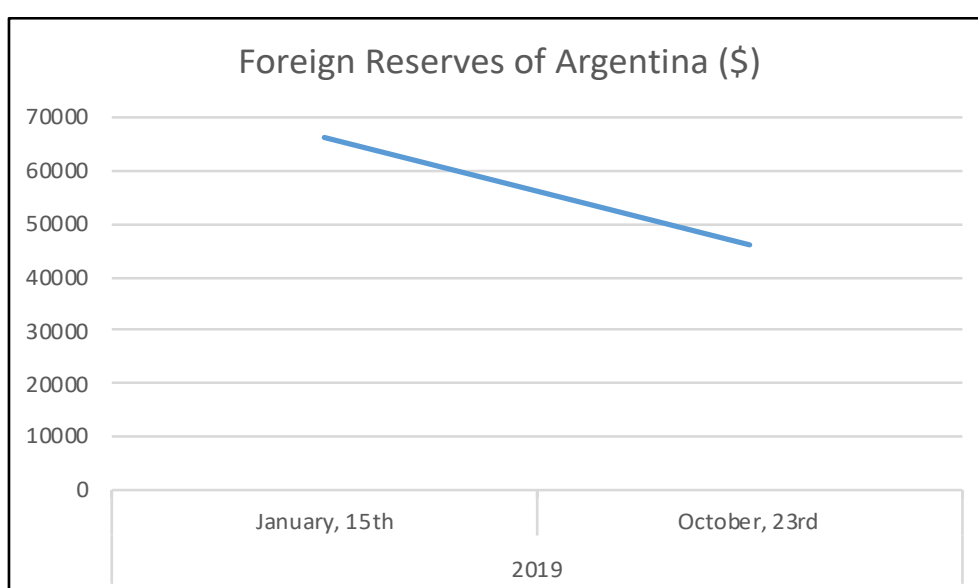
³⁸ Central Bank of the Argentine Republic (2019), op. cit.

³⁹ Central Bank of the Argentine Republic (2019), op. cit.

11th, the national currency was devalued and, in turn, the Central Bank attempted to raise interest rates to try to avoid a loss in the value of the national currency⁴⁰, so there was a reduction in dollar reserves. Due to political volatility and lack of certainty about the direction that the country would take in the political and economic fields, foreign investors decided to stop risking their money, so there was a huge capital flight⁴¹.

Chart 10

Foreign Reserves of Argentina from the second week of January to end October 2019
(Million dollars)



Source: Central Bank of the Argentine Republic

2.6 BANKING SECTOR

An insufficient capitalization of the banking sector causes a lower capacity of banks to lend money to the population. Considering that credit is a fundamental resource for the functioning of the economy of a country, this would pose a serious problem for economic growth.

A grave problem suffered by Argentine banks is the delinquency rate. According to the Financial Stability Report of May 2019 issued by the BCRA, between 2016 and 2018 there was an increase in the indebtedness of the Argentine families, which caused banks to

⁴⁰ Banco de España (2019).

⁴¹ Central Bank of the Argentine Republic (2019), op. cit.

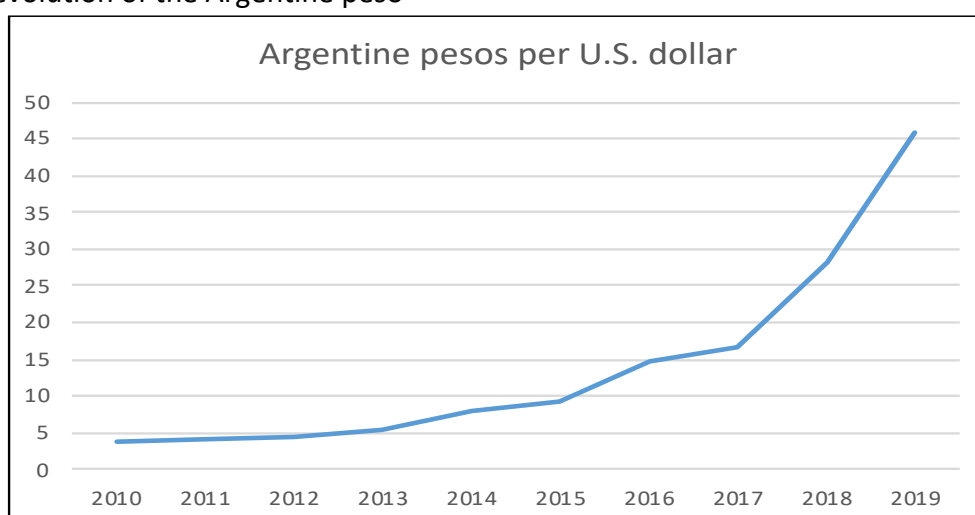
be less willing to lend money⁴². This harmed the profitability of banks and the financial stability of the country. These limitations of banks to provide an acceptable amount of financial services to the Argentine citizens represent, in turn, an obstacle to the economic development of Argentina.

Another problem that Argentina faces is that foreign investors do not trust the Argentine peso and prefer to hold their money in a more stable currency, specifically in dollars, since this currency has no acceptance problems in the international market.

This makes peso-denominated indebtedness in foreign markets unfeasible for Argentina. Therefore, the debt of Argentina is largely external.

Chart 11

The evolution of the Argentine peso



Source: European Central Bank
2019: from January to October

Argentine citizens, like those of the rest of Latin American countries, have a low savings rate, so they do not have a great capacity to buy the internal debt issued by the state. The Inter-American Development Bank (IDB)⁴³ has set the savings rate at less than 20% of GDP in recent decades in Latin America and the Caribbean⁴⁴. In addition to this obstacle for the Argentine citizens to buy the internal public debt, there is the low

⁴² Central Bank of the Argentine Republic (2019), op. cit.

⁴³ Inter-American Development Bank (2016).

⁴⁴ Inter-American Development Bank (2014) & Inter-American Development Bank (2018).

average income per capita in the last three years⁴⁵. The low willingness of the Argentine residents to save is due to the fact that in Argentina, financial education is poor compared to that of more developed countries and, in addition, there is still a low rate of financial inclusion of certain social groups, as described by the BCRA in its first report on financial inclusion in November 2019⁴⁶.

Consequently, the state needs to tap foreign investors in the issuance of its debt. However, as discussed above, it also needs to hold enough dollars in its coffers to be able to pay these foreign investors in dollars. According to the World Bank⁴⁷, net foreign direct investment stood at 2.28% of GDP in 2018, while it did not exceed 0.6% of GDP in 2016. In 2017, the evolution was quite positive with respect to the previous year, being 1.79% of the Argentine GDP.

As a conclusion to this macroeconomic-financial analysis, we could say that, despite the fact that the indicators of the economy of Argentina showed a good economic-financial situation of the country in 2017, on June 20th 2018 it was demonstrated that the economic-financial situation of Argentina was very unfavorable, when the IMF approved a stand-by loan agreement with Argentina of 57 billion dollars. This agreement authorized Argentina to have 15 billion dollars⁴⁸ at its disposal immediately. The IMF conditioned the financing, as it always does, on the fulfilment of economic and financial conditions to guarantee the recovery of the Argentine economy, the sustainability of its debt and the repayment of the funds to the IMF.

Up to that point, the IMF⁴⁹ had described a great progress of the Argentine economy, which had recovered from the recession in 2016. The IMF highlighted the great effort of the government to bring integrity and transparency back to the public sector, as well as “its efforts to avoid inflation”, with the consequent fall in inflation. In addition, the IMF also noted the growth of private consumption and domestic demand and made

⁴⁵ Reference to Chart 2: “GDP per capita in Argentina from 2008 to 2020”.

⁴⁶ Central Bank of the Argentine Republic (2019), op. cit.

⁴⁷ World Bank (2019), op. cit.

⁴⁸ International Monetary Fund (2018).

⁴⁹ International Monetary Fund (2017).

projections that can be summarized in the consolidation of GDP growth, an even greater decline in inflation and a level of imports higher than the level of exports, resulting in a trade deficit.

The encouraging predictions of the IMF for Argentina in 2017 gradually faded as the economic situation of the country changed. Thus, the IMF was forced to reduce the forecasts of the economic growth of the country in 2018 from 0.4% growth to a decrease of more than 2.5%⁵⁰.

3. POLITICAL SITUATION

The political situation of a country is crucial for foreign investors, as an unstable political situation with internal and external conflicts discourages such foreign investors from making debt purchases and investment decisions in the country in general.

The government of Argentina takes the form of a federal republic, with full autonomy recognized in the provinces that make up the country. Its form of government constitutes a representative democracy. The main political parties, according to the number of members in Argentina, are the Peronist⁵¹ Partido Justicialista⁵² and Unión Cívica Radical⁵³, although at the end of August 2019 the Argentine government recognized 44 national parties and 671 district parties⁵⁴.

In the latest Argentine election, which ended in 2019, the victory went to Alberto Fernández (Peronist ideology). His position as President of the Republic of Argentina officially began on the 10th of December of that year.

The predecessor of Alberto Fernández, Mauricio Macri, tried to liberalize the economy of the country, but he did it very gradually, which was a mistake. He tried to put an end to the increase in subsidies carried out by the Kirchners, when they tried to subsidize

⁵⁰ International Monetary Fund (2018), op. cit.

⁵¹ Partido populista.

⁵² Partido Justicialista (2019).

⁵³ Unión Cívica Radical (2019).

⁵⁴ Gobierno de la República Argentina (2019).

everything to keep Argentine society happy. However, Macri did not want to reduce the public deficit quickly, which made investors become impatient. This was the main failure in his intention to stabilize the economy of the country.

However, the general lines of the economic program of Alberto Fernández, which he has revealed in recent days, seem to be very far from the “conservative” practices carried out by Macri. The political measures described in his program seem to be appropriate to satisfy the needs of the economy, as they imply a rigorous economic adjustment. Some of the measures he has outlined are a 5% increase in fuel prices, a new 30% tax on the purchase of dollars, the unfreezing of utility tariffs, a six-month pension freezing, and debt restructuring (especially, the IMF debt maturities of 2021 and 2022)⁵⁵. These measures seem to have calmed down the tense atmosphere surrounding the Argentine economy only a few months ago due to the political and financial instability of the country; investors have welcomed them, and a rise of the Buenos Aires stock exchange has taken place as well as a stabilization of the peso.

As we know, financial stability is really important to transmit security to the foreign investor. According to the Worldwide Governance Indicators collected by the World Bank⁵⁶, political stability has decreased in the 2013-2018 period.

The lack of legal security of the country is a negative feature of the Argentine government system, which leads to a lack of protection for the foreign investor. As an example, we have the case of Repsol⁵⁷, to which Argentina expropriated its subsidiary YPF in the country in 2012. Similarly, the Marsans Group (a Spanish Company that no longer exists) also suffered the expropriation of its Argentine airline “Aerolíneas Argentinas SA” in 2008, and the government was sanctioned by the International Centre for Settlement of Investment Disputes (ICSID)⁵⁸, a World Bank institution, to pay a large amount of money to the plaintiffs with a final judgment taking place in 2019. It should

⁵⁵ BBC Mundo (2019).

⁵⁶ World Bank (2013-2018).

⁵⁷ Repsol (2012).

⁵⁸ Thomson Reuters (2017).

be noted that the expropriation is perfectly legal. However, a fair price must be paid when expropriating, something that Argentina did not do.

We must add to all this the high level of corruption suffered in Argentina. There are many cases of corruption in which the Argentine government has been involved, as well as public institutions in the country, such as the conviction of the former vice president in Argentina Amado Boudou for the appropriation of an Argentine paper money printing⁵⁹. We also find the famous case of the “corruption notebooks”, based on illegal campaign financing and bribes, in which the current vice president of Argentina, who also held the position of President of Argentina between 2007 and 2015, Cristina Kirchner, was linked to such corrupt acts⁶⁰. Despite the fact that the control of corruption has increased in Argentina in the 2013-2018 period, according to the aforementioned Global Governance Indicators available at the World Bank, it is still a pending task for the country⁶¹, since the registered percentile is still below 60%. The corruption index recorded in the Transparency International⁶², although not extremely high compared to the remaining 180 countries considered in this index, is still closer to the “highly corrupt” extreme and further from the opposite extreme⁶³. Transparency International gives Argentina a score of 40/100 in 2018, placing it in the 85th position within the index.

The consequence of these corruption cases is the damage to the image of the country with regard to the rest of the countries and investors all over the world. This only produces an increase in the already tangible country risk of Argentina.

4. COUNTRY RISK INDICATORS

There is a wide variety of information sources to which we can resort to, such as banks, rating agencies (Moody’s, Standard&Poor’s, Fitch), bodies such as the IMF or government data⁶⁴.

⁵⁹ The New York Times (2018).

⁶⁰ The New York Times (2019).

⁶¹ Freedom House (2019).

⁶² Transparency International (2018).

⁶³ Being 0 “highly corrupt” and 100 “totally clean”.

⁶⁴ Iranzo, S. (2008), op. cit.

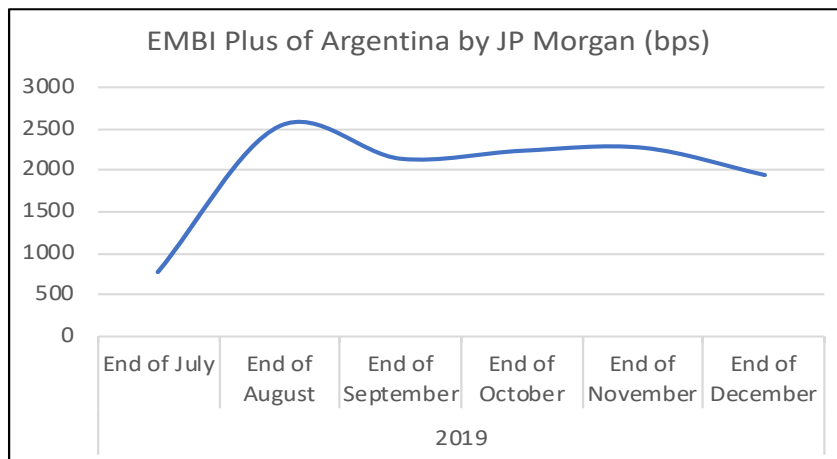
There are many types of indicators that show us country risk assessments. In this case, we will focus on the EMBI⁺ (Emerging Market Bond Index) of JP Morgan Chase, the rating agencies Moody's, S&P y FitchRatings, and the OECD country risk classification.

The EMBI of JP Morgan Chase, which encompasses an emerging country debt instruments pool, "is the difference between the interest rate on the sovereign debt of an emerging country (dollars) and the interest rate on 10-year US Treasury bonds"⁶⁵. The EMBI of JP Morgan Chase is the indicator used to measure country risk "from a market point of view"⁶⁶.

According to JP Morgan Chase, there was a large increase from August 1st to the end of August 2019 in the EMBI⁺ of Argentina, where the basis points varied from 815 to 2,532. By September 30th, the basis points record dropped, but by October 30th, it totaled 2,238 points, that is, the EMBI⁺ increased slightly again. The indicator became worse at the same time that the first round of the presidential election of the year approached, which was celebrated on October 27th.

Chart 12

EMBI⁺ of Argentina in 2019



Source: JP Morgan Chase

⁶⁵ Iranzo, S. (2008), op. cit.

⁶⁶ Ibid (2008).

On the other hand, focusing on the rating agencies, the long-term foreign currency rating of Argentina of S&P⁶⁷ on August 30th 2019 was CCC-, a very unfavorable result which, according to the definitions of its ratings, indicates that the country is vulnerable to default, due to its urgent needs of having the appropriate economic and financial conditions to meet its payment obligations and avoid default; otherwise, the country will not be able to respond adequately to these obligations. The qualifying framework is undoubtedly negative; the result is only three notches above the default scenario. Its previous rating, on August 16th, was B-.

According to FitchRatings, on August 16th, 2019, the long-term default rating of the issuer for Argentina was CCC, meaning that it was four notches above the default scenario. Previously, the rating was B⁶⁸. Later, on 30th August 2019, FitchRatings once again downgraded Argentina from CCC to Restrictive or “selective”⁶⁹ Default (RD). This implies that the country has begun to default on some of its debt obligations. FitchRatings shows a progressive deterioration during August 2019. The last record was CC in September; only two notches above the default scenario. Argentina is currently still experiencing this alarming deterioration⁷⁰.

Finally, Moody’s Rating, which has different notations, changed from B3 in mid-2017 to B2 at the end of November of 2017 (it improved). At the end of August of 2019, it became worse and reached Caa2⁷¹.

Table 1

Comparison of the ratings for Argentina of the three main rating agencies in 2019

2019					
Standard & Poor's		Fitch Ratings		Moody's	
Aug, second week	End of August	Aug, second week	End of August	End of July	End of August
B-	CCC-	CCC	RD	B2	Caa2

Sources: Standard & Poor's, FitchRatings and Moody's

⁶⁷ Standard & Poor's Financial Services LLC (2019), op. cit.

⁶⁸ FitchRatings (2019).

⁶⁹ Iranzo, S. (2008), op. cit.

⁷⁰ JP Morgan Chase & Co (2019), op. cit.

⁷¹ Moody's Investors Service (2019).

Regarding the OECD Country Risk Classification as of October 18th 2019⁷², Argentina has a score of 7 points, while its previous score was 6 points. In this classification prepared by the OECD, the best countries receive a score of 0 points, and the worst ones a score of 7 points. As we may see in the report, almost all sub-Saharan African countries, including some others such as Argentina, receive a score of 7 points, which indicates that these countries have a very high country risk.

The report by BBVA on the risk of default in Argentina in the third quarter of 2019 says that the risk of default in Argentina is presently high, despite the fact that the situation of the country has improved compared to the second quarter of 2019. This improvement is largely due to the formation of the government⁷³. On August 28th, 2019, the Argentine government announced a series of measures in the Official Bulletin of the Republic of Argentina for the payment of obligations contracted with holders of short-term national public debt securities⁷⁴. It also planned to negotiate with the IMF to extend the maturity of its debts⁷⁵. On the same day, on the 28th of August, the chief spokesman of the IMF, Gerry Rice, made a statement indicating that the IMF understood that the Argentine government had implemented these debt measures to address the lack of liquidity and safeguard its reserves⁷⁶. Therefore, the IMF is aware of the insufficient liquidity of Argentina and, consequently, of its low capacity to meet its short-term obligations. This risk is still present in the country.

5. POLICY RECOMMENDATIONS

Today, Argentina suffers from a large public deficit (due to rising interest rates), low exports and high inflation. As a way of solving its debt problems, Argentina tried to raise interest rates to attract foreign investment. However, it resulted in an increase in the deficit and therefore an increase in inflation because the public deficit is being monetized by the government through money creation, which is inflationary. This increase in inflation is a consequence of an increase in aggregate demand (in this case,

⁷² Organization for Economic Co-operation and Development (2019).

⁷³ BBVA Research (2019).

⁷⁴ Gobierno de Argentina (2019), op. cit.

⁷⁵ Banco de España (2019), op. cit.

⁷⁶ International Monetary Fund (2019), op. cit.

spending), which stimulates price increases and whose outcome is the devaluation of the Argentine peso. This leads to a situation of greater distrust of investors. Finally, there is a decrease in the level of exports, as competitiveness decreases. In turn, the price in pesos of imports rises due to the devaluation of the Argentine peso, which causes inflation to increase. Inflation reduces competitiveness and this damages exports, leading to the devaluation of the peso. This increases the imports bill, which again increases inflation. In short, an almost unbreakable “vicious circle” is generated.

Therefore, the potential measures to be implemented in Argentina to avoid debt default should focus on reducing inflation and the public deficit, as well as increasing the level of exports of the country and of investment, both domestic and foreign.

These measures would include the control of public spending. The government, in this regard, should reduce public spending and increase revenues. One way to reduce public spending would be to decrease subsidies in order to be credible to foreign investors, but with the necessary prudence so as not to produce social unrest. This would lead to a reduction of the public deficit.

On the other hand, it would also be necessary to increase the collection of public revenues, reinforcing the role of the Public Administration in Argentina (which is totally ineffective at present), reforming, in turn, the fiscal system to ensure the collection of taxes by the state and to combat tax fraud.

By improving the investment climate, through political predictability and transparency, and by establishing clear rules of the game, foreign investors would be attracted by the possibilities of making profitable investments in the country. Argentina should provide greater legal certainty to the investor, respecting property rights or, otherwise, ensuring a fair price in cases of expropriation. Similarly, the arrival of new companies in the country would bring down the unemployment rate⁷⁷, increasing the possibilities of

⁷⁷ Reference to Chart 5: “Unemployment rate of Argentina from 2008 to 2020”.

growth. The abundant natural resources of Argentina could attract foreign companies and, therefore, foreign currency (dollars).

In order to increase the level of exports, the first step to follow would be the reduction of inflation, decreasing the levels of money creation, since, as we have seen, an excessive inflation undermines competitiveness. In addition, it would be necessary to improve education, creating specific programs to promote external trade. This would lead to an increase in exports of services, by increasing the qualified labor force in the country.

On the other hand, as mentioned above, export taxes should be removed, as they discourage exports.

The restructuring of foreign debt of Argentina is also necessary for Argentina to be able to meet its payment obligations.

Finally, it is essential to promote a good financial education for Argentine citizens, as well as the financial inclusion of all social classes in order to encourage saving habits among Argentine residents so that they can contribute to the reduction of public debt through the purchase of bonds. This way, the state would not be so dependent on foreign investment.

6. CONCLUSION

The study of the economic situation and indicators of Argentina show us the problems that Argentina suffers nowadays regarding public deficit, inflation, devaluation of the Argentine peso, exports and foreign investment. It can be concluded that Argentina has a high country risk.

In this greatly complicated period of the history of Argentina, President Alberto Fernández will have to confront the public deficit by implementing new measures. These measures, which, as previously mentioned, have already been published, seem to go in the direction of reducing country risk in Argentina. In addition, the relationship of

Argentina with the IMF must be friendly to borrow funds to pay the debt, since liquidity is one of the main needs of Argentina⁷⁸.

A statement of the IMF in August of 2019 spoke of the close relationship it was maintaining with the Argentine government, including Alberto Fernández⁷⁹, which is very positive and implies full commitment from the IMF.

The restructuring of the debt of Argentina is an urgent action that has been slowed down by recent elections and government change. Negotiations can never be fully efficient if there is a situation of uncertainty in the country.

Argentina should take the appropriate measures to allow the stand-by arrangement with the IMF to continue while negotiations to stabilize its economic situation are under way, as Argentina may require flexibility in its debt payments to the IMF more than once, by extending the debt repayment schedule⁸⁰.

In conclusion, although there are current projects aimed at getting the Argentine economy back on track⁸¹, it is evident that a joint action plan involving both the Argentine government and international organizations such as the IMF, which is already acting accordingly, is required. The main executor of this action plan must be the Argentine government, which must implement economic measures while maintaining a long-term vision. Therefore, despite the enormous social pressure on politicians, they must act accordingly to achieve the general welfare of the country by implementing measures such as: reducing subsidies to diminish public expenditures; reforming the tax system and improving the efficiency of the public Administration to increase public revenues; improving political transparency and legal security to increase foreign investment; reducing money creation to lower inflation; abolishing export taxes and

⁷⁸ See the statements made by the IMF spokesman Gerry Rice on the lack of liquidity of Argentina, International Monetary Fund (2019), op. cit.

⁷⁹ IMF Communications Department (2019).

⁸⁰ As regards the negotiations for the extension of debt maturity, see the one carried out by Argentina with the IMF in August 2019, Banco de España (2019), op. cit.

⁸¹ Reference to Inter-American Development Bank (2018), op. cit.

providing export-focused education to increase the level of exports; and promoting financial education as well as the inclusion of Argentine citizens to increase savings within the Argentine families and, thus, increase domestic investment.

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