

11 FEB 2016 11:25 AM EST

Fitch: Argentina Moves to Address Rating Constraints

Fitch Ratings-New York-11 February 2016: President Mauricio Macri's government has demonstrated its willingness to reach an agreement with Argentina's holdout creditors, but the timing and terms of the eventual outcome remain uncertain, Fitch Ratings says. Implementation of an agreement with creditors is key to lifting Argentina out of default, but the degree to which the new administration can ease financing constraints and strengthen the consistency and credibility of the policy framework will determine Argentina's post-default rating and be important to the pace and scale of future changes.

Argentina's Long-Term Foreign Currency Issuer Default Rating has been in Restricted Default (RD) since July 2014 due to the sovereign's inability to resolve the default on external market debt. The resumption of timely debt service on the defaulted bonds could lead to an upgrade of the foreign currency rating. The extent of the upgrade would depend on Fitch's assessment of the government's progress in improving the policy mix and increasing financing sources. It would also depend on the country's solvency and external liquidity ratios at the time of the upgrade. Should Argentina exit default, policy and financing developments will continue to be important rating factors while the Macri government implements its economic plan.

During its first two months in office the Macri administration has also made progress with the removal of macroeconomic distortions and rebalancing Argentina's policy mix. The government removed FX controls in December, and the Argentine peso's depreciation reduced exchange rate distortions but did not lead to destabilizing FX pressures. The central bank tightened monetary policy and moved quickly to reduce excess liquidity resulting from the record fiscal expansion in 2015.

In addition, the central bank was able to secure a one-year loan of USD5 billion

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from international commercial banks, boosting Argentina's international reserves to USD30 billion. The government also proposed a gradual fiscal consolidation strategy that aims to reach a primary balance by 2019. The fiscal deficit topped 5% of GDP (including central bank and social security transfers) in 2015. A reduction in energy subsidies would support these efforts, but lower growth and expenditure pressures could challenge the speed of the consolidation.

The Macri administration's economic plan aims at maintaining inflation between 20% and 25% in 2016. However, a late-2015 inflation spike to nearly 30%, the Argentine peso depreciation and the rise in utility tariffs are likely to put upward pressure on the authorities' projections. Moreover, the outcome of salary negotiations with unions will determine policymakers' abilities to lower inflation and anchor expectations.

Last week, the Argentine government formally presented a two-pronged proposal to the holdout creditors. It includes a base offer to bondholders outside of the pari passu injunction equivalent to 150% of principal. The proposal also includes a pari passu offer that would pay bondholders up to 72.5% of claims or court awards that include penalty and accumulated interest in addition to principal. Earlier in the week Argentina reached an agreement with Italian bondholders (reportedly close to USD1.35 billion).

An agreement with the holdout creditors and Macri's fiscal proposals must be approved by Argentina's congress sometime after it resumes in March. Macri's coalition does not have a majority in the chamber, highlighting the need for the government to create alliances with opposition members to move the economic agenda forward. The reconfiguration of the Peronist party could foster an environment for dialogue between the government and opposition.

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The above article originally appeared as a post on the Fitch Wire credit market commentary page. The original article can be accessed at www.fitchratings.com. All opinions expressed are those of Fitch Ratings.

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