4 September 2019
For Client Use

Investment Event

Argentina: localised risks

Argentina's currency has fallen in response to concerns over a switch to a less market-friendly government

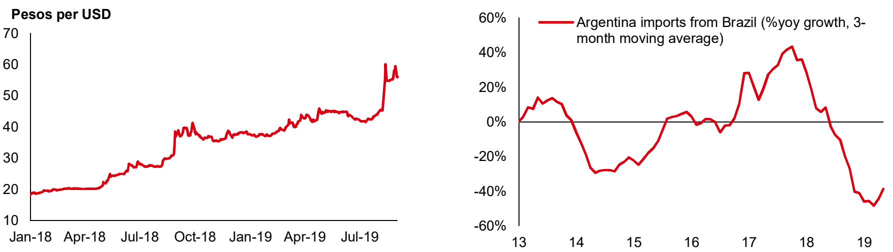
What's happened?

On 11 August, Argentina's President, Mauricio Macri, had a worse-than-expected performance in the country's primary elections (where Argentines decide who will officially be on the ballot of the 27 October presidential elections), coming second to opposition candidate Alberto Fernández. This makes it less likely Macri will win a second term.

The result saw a large sell-off in the country's currency, the peso (Figure 1), as investors feared a return to less market-friendly policies prevailing under previous President Cristina Fernández de Kirchner, who is running as vice-president under Fernández.

The latest developments in Argentina add to an already-difficult economic backdrop

Figures 1 and 2: Argentinian peso versus the US dollar; and Argentina imports from Brazil



Source: HSBC Global Asset Management, Figure 1 as at 3rd September 2019, Figure 2 as at May 2019.

Past performance is not an indication of future performance.

In response to the sell-off in the peso, Macri has recently announced a series of measures to extend the maturity of Argentina's government debt, including loans from the International Monetary Fund (IMF). In an attempt to support the peso, the government has also imposed capital controls, including restrictions on foreign exchange purchases.

Our views

For now, Argentina's economic difficulties are unlikely to have significant repercussions for the global economy. Furthermore, exposure to Argentina in our multi-asset portfolios is extremely limited. Therefore, we remain comfortable in our overweight stance on emerging market assets

An already-difficult economic backdrop

The latest developments in Argentina follow an already-difficult economic backdrop for the country. GDP declined by nearly 6% in the year to Q1 2019, whilst the official inflation rate has been running above 50% for most of this year, following peso weakness in 2018.

The latest decline in the currency is likely to add to inflationary pressure, further weighing on household consumption, and on the central bank's ability to cut interest rates to support economic activity.

Meanwhile the appetite for business investment may weaken if a Fernández administration implements unorthodox economic policies recently touted, such as reduced interest payments on certain bonds, and a weaker peso to boost competitiveness (which also raises the country's US dollar-denominated debt burden).

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Market considerations

Argentina is facing challenging times. However, we should bear in mind that Argentina's economy represents only circa 9% of Latin America's total GDP, and just 0.5% of global GDP. Moreover, the exposure to Argentina in our multi-asset portfolios is extremely limited. Therefore, recent price moves in Argentinian assets will have a negligible impact on our multi-asset fund performance.

Overall, we remain comfortable with our existing House View of being overweight on emerging market (EM) assets on a dynamic (i.e. longer-term) basis. Meanwhile, on a tactical (i.e. shorter) term basis, we still prefer EM local-currency government bonds to EM equities; with the former benefiting from relatively attractive valuations, and the latter facing headwinds from disappointing corporate profitability, amid global trade tensions and other geopolitical risks.

Nevertheless, it is worth considering the economic impact to Argentina's largest trading partners. Brazil (Latin America's largest economy) exports to Argentina account for approximately 6% of its total exports, but as Figure 2 shows volumes have contracted by around 50% year-on-year during 2019, weighing on its economic growth.

Despite this, we believe Brazil's growth outlook remains relatively positive, supported by stable inflation, which allows the country's central bank to cut interest rates further, and a recent government decree granting access to an unemployment benefit fund. Furthermore, investor sentiment toward Brazil's assets is also being buoyed by recent progress in crucial pension reforms.

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