Argentinean economy has emerged out of recession

Icy glaciers, arid deserts high in the mountains, vast grassy plains and a very long coastline, Argentina is a land of incredible natural beauty. Its name is derived from the Latin word for silver, in reference to an ancient legend about a land rich in the shiny metal, somewhere up in the Andes Mountains. Early European explorers searched in vain for this mythical land. Instead, they established their very own Provincias Unidas del Rio de la Plata, or the United Provinces of the Silver River – Argentina’s early name. They also built the fabulous city of Buenos Aires, in the image of the big cities they left behind in Europe.

Urban people passionate about soccer, juicy beef steaks and wine, Argentineans have experienced many economic swings during the last few decades, from financial crises, and hyperinflation to recessions and boom periods. The tide appeared to have turned early in this decade, when the Argentinean economy expanded rapidly. Unlike the many false dawns of the past, the recovery seemed more sustainable, as there was a significant improvement in political stability as well. However, that phase of fast growth ended with the global recession as the economy slipped again. Though the country has since recovered, the pace of growth has been disappointing, now lagging most other emerging economies.

A HISTORY OF BOOMS AND BUSTS

Not many people have seen economic booms and busts as often as the Argentineans have. During the first decade of the last century, they enjoyed the seventh highest income levels in the world – ahead of even the Germans and the French. By then, Argentina had completed nearly a century as an independent sovereign state. Buenos Aires, its capital, had well over a million inhabitants, and was the second largest city in the Americas after New York. Europeans flocked to the city for business and in search of work, marking an indelible stamp on the culture and demographics.

The two World Wars and the Great Depression led to a dramatic fall in export demand and foreign investments, spoiling the economic fortunes of Argentina. The post-war period was marked by political
Argentina is often called the sleeping giant in the global wine market. The country boasts of the greatest land area suitable for wine growing, most of it in the Andes mountain valleys. High-altitude growing imparts uniqueness to Argentinean grapes, like Malbec and Torrontes, an attribute which...
Policy inconsistency and concerns about poor economic governance have long affected investor perceptions about Argentina and have restricted capital inflows into the country. Successive Argentinean governments have always been ready to indulge their domestic constituencies at the cost of consistent economic policies that are crucial to ensure long-term growth.

KEY TAKEAWAY

Policy inconsistency and concerns about poor economic governance have long affected investor perceptions about Argentina and have restricted capital inflows into the country. Successive Argentinean governments have always been ready to indulge their domestic constituencies at the cost of consistent economic policies that are crucial to ensure long-term growth.

Many vineries in the region have now started exploiting. Yet, though Argentina is the fifth largest wine producer in the world, it exports only 10% of its production.

Mendoza, in west-central Argentina, is the undisputed wine capital of the country. With more than 800 vineries, the region accounts for nearly 80% of total wine production. Mendoza has vineyards at altitudes as high as 1,400 meters above sea level.

From near obscurity a decade back, Argentinean wines now occupy pride of place among New World wines and are enjoyed the world over.

Superior wines and the relatively improved political and economic conditions compared to the past should encourage Argentinean winemakers to take a longer term view and increase investment in vineyards. With demand for wine growing globally, the Argentinean wine industry holds a quite a bit of promise.

POLITICAL INSTABILITY AND RESTRICTIVE POLICIES HINDER GROWTH

The first wave of development happened towards the second half of the 19th century when increased export demand led to the establishment of immense livestock ranches and commercial farms. Large scale migration from Europe before the Great War ensured a steady supply of labor, essential for farm development. The country subsequently expanded its export basket to include corn and wheat, which eclipsed meat exports by the first quarter of the 20th century.

Large capital inflows, initially from Britain and subsequently from the U.S., facilitated the modernization of the farm sector and industrialization in the country. In the absence of domestic capital and credit, foreign investments financed the development of the meat packing industry and the railway network. Meanwhile, increased urbanization pushed up domestic consumption which became the primary driver of economic growth.

Foreign investment flows dried up after the Second World War and the Peron government, which came to power after the War, nationalized most of the economy. These policies remained for the next several decades and stifled long term economic growth.

To make matters worse, the second half of the 20th century was a period of heightened political instability in Argentina. Several governments were brought down in military coups and the uncertain environment hampered the overall development of the country. After political stability returned in 2003, the country saw average growth of close to 9% for the next few years. However, Argentina was one of the worst hit in South America by the global recession in 2008 and the recovery came slower and weaker than most of its neighbors.

Though Argentina’s economy has performed below par for the last several decades, its strengths and potential for growth are evident. It is largely self sufficient in food and energy. Only a small portion of its land area is under cultivation or livestock farming, which can be expanded with supportive government policies. Argentina relies heavily on natural gas which accounts for the bulk of domestic energy consumption. The country has the third largest reserves of natural gas in South America, but output has stagnated because of underinvestment. Most of Argentina’s electricity demand is met by gas-fired thermal plants and hydroelectric plants. With only 20% of its hydroelectric potential exploited, it can meet much of its future electricity demand by increasing investments in new hydroelectric plants.
Policy inconsistency and concerns about poor economic governance have long affected investor perceptions about Argentina and have restricted capital inflows into the country. Successive Argentinean governments have always been ready to indulge their domestic constituencies at the cost of consistent economic policies that are crucial to ensure long-term growth. Extended periods of political instability have also contributed to the country’s poor record in economic management, as the government turned more populist to gain political advantage.

Efforts to build and nurture independent economic institutions were undermined by politically expedient decisions for short-term gains. In the most recent of such instances, the country’s central bank chief was forced to resign for resisting the government’s decision to utilize part of the exchange reserves for debt servicing. Unless Argentina can build investor confidence in its economic institutions by freeing them from political pressures, it will continue to lag its regional competitors like Brazil in the ability to attract foreign capital.

THE DEBT DEFAULT THAT INITIALLY HELPED, BUT HURT LATER

Sovereign countries usually do not refuse to honor their debt obligations. Defaulting countries will be shut out of global credit markets and raising external finance will be extremely difficult in the future. Even then, Argentina did not have much of a choice but to default on its debt repayments to international creditors in 2001. The government’s finances were so bad that it could not have made the repayments even if it wanted to, as the IMF refused to provide additional loans. At over $90 billion, it remains the biggest ever sovereign debt default in history.

Three years later, Argentina offered to pay its creditors 30 cents to a dollar on total debt, which had increased to $103 billion including interest. More than three-fourths of the investors accepted the offer, as they saw no other way out, though some investors held out and challenged the settlement in U.S. and European courts. Though at a painful cost to its creditors, the debt restructuring helped Argentina significantly. As the total external debt declined after the default, lower demand on government finances for debt servicing helped improve fiscal health and supported economic growth.

However, the debt default and the recovery suits filed by the remaining creditors made it impossible for Argentina to raise money from international financial markets. Before the global recession, when domestic tax revenues were buoyant, this was not a major concern for the Argentinean government. But as the economy slipped, government finances also suffered and the fiscal deficit soared. As the country’s debt servicing needs are set to rise in the coming years, and domestic sources are unlikely to meet the requirements fully, Argentina may have to raise funds from international markets.

If the new proposal is accepted by a majority of the bond holders, Argentina’s long exile from international financial markets will end. The government’s controversial plan to set aside a part of its foreign currency reserves for debt repayment is aimed at reassuring international investors and encouraging them to subscribe to new bond issues.
TRADE TIES THAT BIND, THOUGH OFTEN FRACTIOUS

South American countries have deep economic relationships among themselves and hence their economic cycles often follow the same trends. For instance, Brazil, South America’s largest economy, accounts for 31% of Argentinean imports and 19% of exports. Bilateral trade between Brazil and Argentina now exceed $30 billion annually. Neighboring country Chile is the fourth biggest importer of Argentinean goods, with a 7% share.

A decade ago, trade between South American countries was even more important, which led to the formation of the regional trade group Mercosur. However, increasing demand for minerals and farm products in other parts of the world has led to a decline in the importance of trade within the Mercosur group. In the case of Argentina, exports to other Mercosur countries have steadily declined over the last decade.

China has emerged as Argentina’s second biggest trading partner, followed by the U.S. Though the Mercosur member countries are now less reliant on each other for trade, total trade in absolute terms within the group continued to expand until the 2008 global economic decline. As the regional economies emerge out of recession, growth in trade between them should also revive.

Efforts are being made by member countries to strengthen Mercosur, through further liberalization of trade between member countries, improving market access, and trade agreements with other countries. More countries may be added to the group, which currently has five full members and five associate members. After the formation of the Mercosur Parliament next year, observers feel the trade bloc can develop along the lines of the European Union template.

However, the relationship between countries in the region has often turned fractious and has led to trade disruptions. Most recently, a trade dispute between Argentina and Brazil caused a sharp decline in bilateral trade.

To protect domestic manufacturers hurt by the global recession, the Argentinean government imposed restrictions on imports and Brazil responded by preventing Argentinean trucks carrying farm produce from entering their territory. Realizing that trade disputes are harmful to the interests of both nations, Brazil and Argentina have agreed to resolve the problems and promote more trade and economic integration.

CANDIES TO ONLINE AUCTIONS

Most Americans wouldn’t suspect that the candies they crave for are probably made in Argentina. They could be, as the largest Argentinean confectionery group is a leading supplier to large American retailers and a contract manufacturer for some well-known American brands.

With a history of more than 50 years, Arcor Group has manufacturing plants in five countries and sells its products in more than 120 countries across the globe. It manufactures more than 1,500 different products and launches over 100 new products every year.

The Obelisk, built in a mere 31 days, is the most recognizable monument in Buenos Aires. It is a symbol of Argentina’s many rebirths and revivals.

KEY TAKEAWAY

South American countries have deep economic relationships among themselves and hence their economic cycles often follow the same trends. For instance, Brazil, South America’s largest economy, accounts for 31% of Argentinean imports and 19% of exports. Bilateral trade between Brazil and Argentina now exceed $30 billion annually.
Such success stories in non-traditional businesses are rare in Argentina, where commodity businesses thrive. Like neighboring Brazil, Argentina is a significant producer and exporter of farm products which remain the mainstay of the economy. Exports include soybean, vegetable oils, and cereals. Higher international food prices contributed significantly to the country’s economic growth, until the 2008 global recession led to weak export demand. To make it worse, the Argentinean government imposed import taxes on several farm products to improve their domestic availability and control inflation. This policy led to widespread protests by farmers and farm produce exports suffered. More recently, the global economic recovery lifted demand for agricultural produce, and prices became more remunerative. Increased revenues from farm produce exports, especially soybeans, will likely drive the country’s economic prospects.

As well, Argentina is a large exporter of copper and gold concentrates. Other mineral resources include lead, zinc, tin, iron ore, and manganese. American and Canadian companies have a large presence in the domestic mining industry. The upstream oil industry in Argentina was dominated by a state-owned firm, which was later privatized and subsequently merged with a Spanish oil company to become Repsol-YPF.

With changing global trends, Argentinean businesses are also evolving. Good education standards have helped the country emerge as a favored destination for outsourcing, largely comprised of call centers offering services in Spanish. Several global technology companies, including Microsoft, IBM and, HP, have back-office operations in Buenos Aires now. More recently, the country is attracting outsourced creative work, including graphic design and entertainment software. Such service businesses are estimated to have created tens of thousands of jobs and now generate annual revenues of billions of dollars.

Yet, the enterprise which should represent Argentina today and inspire its young citizens is a young technology company. Its founder was still in business school when he volunteered to chauffeur a well-known investor, in order to make a pitch for venture capital to start his own business. His company, MercadoLibre, is now the largest online auctioneer in Latin America and is listed on the NASDAQ. MercadoLibre has more than 25 million registered users, spread across 12 countries in the region. If Argentina can build the right economic environment for more firms like MercadoLibre to thrive, the country’s below par economic performance will be history.

Young, vibrant, adventurous, and full of life – that is the image the world had of Argentina. Unfortunately, the reality behind that colorful mask has often let the country and its citizens down. To bury the disappointments of the past and regain its glory days, the country has to work hard, strengthen its institutions, and rebuild confidence. However, Argentina may not get several more opportunities for revival and growth. With several countries in the region quickly recovering from the global recession and now starting to grow at a good pace, Argentina cannot afford to fall behind. If it does, the country risks that the label of a perennial laggard will forever remain.

---

**KEY TAKEAWAY**

To bury the disappointments of the past and regain its glory days, the country has to work hard, strengthen its institutions, and rebuild confidence. However, Argentina may not get several more opportunities for revival and growth. With several countries in the region quickly recovering from the global recession and now starting to grow at a good pace, Argentina cannot afford to fall behind.

---

This publication is for informational purposes only. This publication is not intended to provide tax, legal, insurance or other investment advice. Unless otherwise specified, you are solely responsible for determining whether any investment, security or other product or service is appropriate for you based on your personal investment objectives and financial situation. You should consult an attorney or tax professional regarding your specific legal or tax situation. The information contained in this publication does not, in any way, constitute investment advice and should not be considered a recommendation to buy or sell any security discussed herein. It should not be assumed that any investment will be profitable or will equal the performance of any security mentioned herein. Thomas White International, Ltd, may, from time to time, have a position or interest in, or may buy, sell or otherwise transact in, or with respect to, a particular security, issuer or market on our own behalf or on behalf of a client account.

**FORWARD LOOKING STATEMENTS**

Certain statements made in this publication may be forward looking. Actual future results or occurrences may differ significantly from those anticipated in any forward looking statements due to numerous factors. Thomas White International, Ltd. undertakes no responsibility to update publicly or revise any forward looking statements.
Are You Positioned for a World of Opportunities?

THE THOMAS WHITE DIFFERENCE

Thomas White International manages assets across multiple global, international and domestic equity mandates. The diverse client base spans public, corporate, endowment, Taft-Hartley, and separately managed account platforms.

Research is the heart of our company. At Thomas White, we believe that original research is the surest path to superior portfolio performance. That is why our disciplined investment process is supported solely by our in-house research.

Our investment process differs from the crowd. Our labor-intensive approach to valuing common stocks combines the patient collection of data, and the execution of thorough historical studies, with the application of fundamental securities analysis. These guidelines provide an investment framework, which is used in the process of determining a company’s current business worth. Valuing global stocks in nearly 50 countries, this industry-based stock selection process employs tailor-made valuation frameworks refined and tested over the 40-year history of the Thomas White organization and its predecessors.

Our veteran analysts, most with PhDs, on average have more than fourteen years of experience working together as a team. Our proprietary research is generated by our professionals, both in Chicago and in our Asia office in Bangalore, India, who have spent their entire careers at Thomas White.

Our investment approach seeks to benefit from buying undervalued stocks and selling them when they return to fair value. Our analysts find that investors tend to overvalue a company against its industry peers when the intermediate business environment is favorable, producing strong earnings growth and then undervalue a company when the environment depresses its business outlook. This pattern is a reflection of human behavior - it occurs in every industry and country around the world. It is this phenomenon that explains a stock’s wide price swings above and below its intrinsic value as a business.

For more information please contact:
Gabriel J. McNerney, CFA
(312) 663-8318
gmcnerney@thomaswhite.com
thomaswhite.com