INSIGHT: Argentina faces another default in '22

By Al Greenwood

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HOUSTON (ICIS)--Next year, Argentina is due to pay back part of the billions it borrowed from the International Monetary Fund (IMF), money the country does not have.

Argentina will have to negotiate a new payment schedule if it wants to avoid defaulting on the IMF loan.

Given the country's financial challenges, Argentine policy makers are likely to maintain the restrictions on imports and foreign exchange that has made it difficult for petrochemical companies to run their businesses.

BILLING DUE
Beginning in March 2022, Argentina is due to make the first of $17.6bn in payments to the International Monetary Fund (IMF) that are due that year, according to Fitch Ratings, a credit-rating agency.

Fitch is not optimistic about Argentina's prospects. It gave Argentina a rating of CCC, just above default. Moody's Investors Service's rating is Ca. S&P Global Ratings's is CCC+.

"There is no way, shape or form that Argentina can make the payments as presently scheduled," said Mark Jones, political science fellow at the Rice University's Baker Institute for Public Policy.

Argentina has signalled that it prefers not to default. However, an agreement with the IMF is likely to require the country to get its finances in order.

If the IMF demands are too onerous, Argentina may choose to default, Jones said.

The government wants to maintain what it considers popular policies such as its energy subsidies, Jones said. To pay for those expenses, the government is running a deficit. The central bank is funding that deficit by printing money, one of the reasons why inflation is running above 50% in the country.

Longer term, less spending would reduce the deficit and limit the need for financing by the central bank. That should lower inflation.

But the government has its eyes on the 2023 presidential elections. If the spending cuts are too severe, they could damage the government's prospects. In that scenario, the government would prefer a default over an election defeat.

This would be undesirable for the IMF, since Argentina makes up a large share of the money the group has lent out to countries, Jones said.

He expects Argentina and the IMF will reach something in between an agreement and a default. The two sides will come to terms, but Argentina will ignore the most demanding requirements of the agreement.

"It will be there on paper and then the Argentines simply will not comply with most of it," Jones said.
Argentina would essentially become a zombie sovereign, too big to fail but unwilling, if not unable, to make payments on its debt.

The IMF will resume talks after the elections either with the current administration or a new one.

**SUBSIDIES, PRICE CAPS TO PERSIST**

The problem with this outcome is that Argentina likely will maintain many of the policies that are damaging to its petrochemical and energy industries.

One of the largest contributors to the government's deficit is its subsidies for electricity and natural gas, Jones said.

Because the gas subsidies are so costly, the government has imposed price caps to limit the size of their expense, Jones said.

Those price caps are discouraging companies from producing more natural gas, since they make it more difficult to recover costs.

This is especially true in Argentina's shale-gas reserves in the Vaca Muerta.

Shale gas requires constant investment, making it more similar to manufacturing than to traditional energy production, Jones said.

Local gas producers have little choice but to continue drilling in Argentina. But multi-national ones can choose other countries over Argentina, Jones said.

He expects these companies to drill the minimum number of wells needed to maintain their leases in Argentina while focusing investments on those other countries.

For Argentina's petrochemical industry, the Vaca Muerta represents a lost opportunity. The country's crackers in Bahia Blanca rely on gas-based ethane as a feedstock, giving them cost advantage against much of the world, which relies on oil-based naphtha.

With the right policies, Argentina could have increased ethane production, provide its petrochemical industry with enough feedstock to expand.

The outlook for crude production is more promising, although Jones acknowledged the relatively high costs of labour in Argentina's oil industry.

**EXCHANGE RATES**

Another Argentine policy that is likely to persist is the government's restrictions on exchange rates and imports.

Because of the country's multiple defaults, it has lost access to foreign debt markets and, with it, the ability to obtain US dollars by issuing foreign bonds.

"Most observers believe liquid assets in the central bank are close to zero," Jones said.

To preserve its dollars, the government has made it difficult to import goods or exchange pesos under the official exchange rate.

An unofficial foreign-exchange market has developed to meet Argentine demand for US dollars. On 14 December, the so-called blue-dollar rate was about twice as high as the official exchange rate.
Expected monetary tightening in the US could put further pressure on the peso, although investors already consider Argentina a risky bet, Jones said. "At this point, I think Argentina has hit rock bottom."

**OUTLOOK FOR GDP**

Given Argentina's challenges, economists surveyed by the country's central bank expect GDP to grow by 2.5% in 2022, down from 9.7% in 2021.

The high growth rate of 2021 is distorted by the comparison to the recession in 2020. That year, GDP contracted by 9.9%. It was the third consecutive year that the economy shrank, according to the state statistical agency (INDEC).

Outside of Argentina, the country's two largest export markets, China and Brazil, are also contending with slower growth.

Brazil's central bank has adopted a significantly restrictive monetary policy, raising benchmark rates to 9.25%, in an attempt to get inflation under control. Economists have been lowering their estimates for 2022 GDP throughout the year. The latest forecasts calls for Brazil's economy to grow by just 0.50%.

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