



# Beyond Ratings Weekly Digest

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Your briefing on augmented financial risk analysis

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## ANALYST INSIGHT

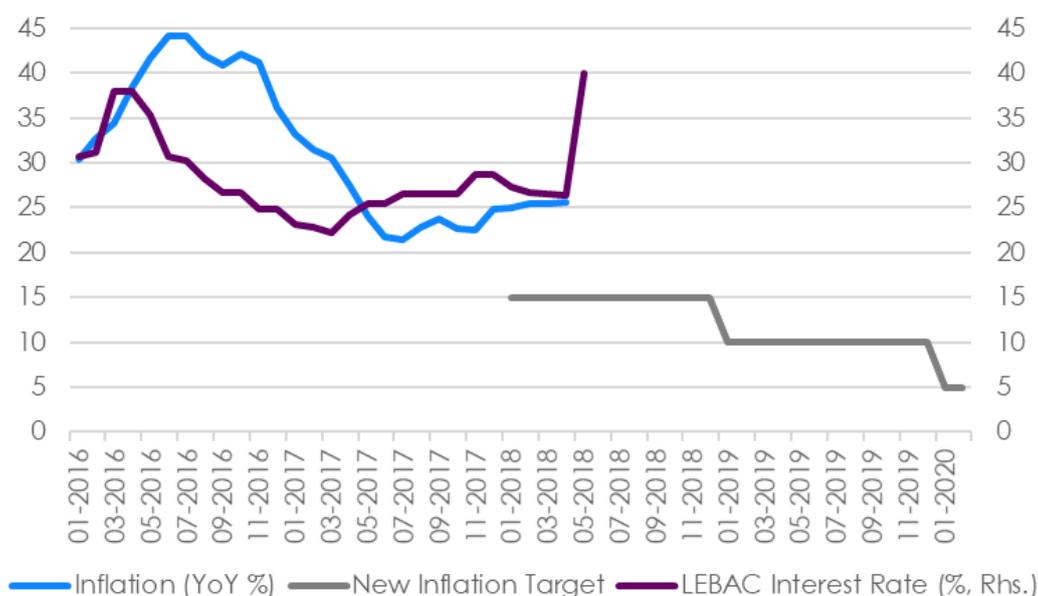
### Implications of the IMF arrangement with Argentina

The relationship between Argentina and the International Monetary Fund (IMF) has been complicated. It started in 1956 after Mr. Peron's Government, and it continued through many periods until 2006 when Mr. Kirchner refunded all the debt (USD9.8 billion). He claimed that "the attitude of the IMF has caused pain and injustice" to the country.

However, current President Mr. Macri is more optimistic regarding the IMF. In fact, he took advantage of his invitation to participate in the G7 meeting to take some pictures with Ms. Lagarde and to announce that negotiations to sign a Stand-By Arrangement (SBA) for about USD50 billion is almost confirmed. According to the government's officers, this agreement will allow Argentina to have more buffers against possible financial turmoil, to strengthen the economy and to protect well-being of most vulnerable sectors.

Conditions (or objectives) of the SBA are mostly clear: to reduce the primary deficit from 2,7% to 1,3% between 2019 and 2020, and to diminish the inflation rate from 17% in December 2019 to 5% in December 2022. The maximum duration of the SBA is 36 months and the first disbursement could be in July 2018 (these new inflation targets are softer than those presented in the in the Monetary Policy Report of April 2018: 15% in 2018, 10% in 2019 and 5% in 2020).

**Monetary Policy Rate vs. Inflation: The Argentine Puzzle**



Some political analysts argue that this is a strategic policy in which the President needs to finish his first mandate with a healthy economy that increases his popularity, to later be able to present himself in the next presidential elections. As political motivation always has many layers, it is difficult to know what the true motivation behind a political act is. However, what is also interesting to analyze is the economic

mechanism Argentina intends to use to control inflation and deficit. Furthermore, it is important to explore some potential political and social concerns that could impact sovereign risk.

In the last years, the Central Bank of Argentina (CBA) has been monetizing public finances which has increased the debt of the government vis-à-vis the CBA (according to the Balance sheet of the CBA it achieves 5.4% of the GDP). The use of the monetary authority as one of the public finance sources has prevented the CBA to control inflation that is currently around 25%.

One objective that comes into the USD50 billion package is to reform the CBA to give this institution more independency to accomplish target predicted inflation. Financial assistance to the treasury will be forbidden and it must pay its total debt to CBA, i.e., about USD 25 billion. The mechanism of the monetary policy to achieve target inflation will need to the treasury to absorb the surplus liquidity of the economy. In fact, if the treasury finances its activities in the financial market based on bonds, then the treasury must use part of the money obtained to pay back the CBA. If financial markets need funds, then financial agents could sell these bonds to the CBA. The objective at the end is to have less CBA bonds (LEBAC) and the necessary funds to fulfil the market's necessities LEBAC interest rate was used as a temporary monetary interest rate in 2016 in the process to change from a quantity monetary policy to an explicit inflation targeting monetary policy. In May 2018, more than USD 600 billion of LEBACs reached their maturity. The CBA negotiated with LEBAC holders an increase of the interest rate to 40%.

Fiscal policies will also be adjusted to contain fiscal deficit. Until now, the government reduced its spending (including public enterprises) and it will approve a decree which aims – among other things – to forbid further services contracts (employees and consultants) in the public sector.

Social aspects will also be impacted by this new reform. If the government applies an austerity policy that diminishes accounts to social assistance, then more vulnerable sectors in the economy will be very exposed and inequalities would rise (in the last years there was an increase in inequality, reversing the downward path it had in the last decade). However, the IMF argues that Argentina must rationalize social assistance spending and reduce administrative costs to better target assistance spending and avoid double programs.

Finally, governance obstacles must be considered. Opposition in the Congress has not seen the good side of the deal with the IMF and when set of policies (included the new legal framework of the CBA and the Budget for 2019) will be presented to the Congress many difficulties and issues could emerge.

Argentina has a huge opportunity to strengthen its economy and overpass cyclical turbulences. Even though, social challenges must be taken with the same responsibility since human capital (health and education), inequality and labor conditions will play an important role in the medium-term.

*Gabriela Aguilera-Lizarazu, Analyst*    *Sources: Beyond Ratings, INDEC, IMF, Stat. Office of Buenos Aires*

WEEKLY FOOD FOR THOUGHT

Sovereign Risk

FIFA World Cup in Russia: a tremendous cost...

The budget of the 2018 FIFA World Cup organized by Russia has evolved considerably. It was initially established at RUB 661.5 billion (currently EUR 9 billion), but following the economic crisis that happened there, the state voted a RUB 30 billion cut in June 2015. Finally, in 2017, to complete the budget, the organizing committee got two shots: RUB 19 billion in February and RUB 34.5 billion in October. As a result, a total cost of RUB 678 billion rubles, or EUR 9.2 billion (EUR 10 billion a few months ago but the RUB collapsed since then). More than 70 % of this budget is supported by the Russian state and Russian regions. In comparison, the budget of the 2006 FIFA World Cup in Germany amounted to "only" EUR 430 million!

EUR 9.2 BN

The organization of the FIFA World Cups is much more expensive for emerging countries than for developed countries. Indeed, emerging countries have less infrastructure (stadiums, hotels, transport, etc.) and need to make significant investments to host such a competition. In addition, the construction of monumental stadiums is often pointed out as very expensive and not profitable ex post. Indeed, maintenance is very expensive, and these stadiums are rarely used later. We speak in these cases of white elephants, i.e., a possession entailing great expenses out of proportion to its usefulness or value to the owner. What is certain is that the budget of the FIFA World Cup to be held in Qatar in 2022 should be endowed with a huge budget, today estimated between EUR 13 and 15 billion.

Julien Moussavi, Head of Economic Research

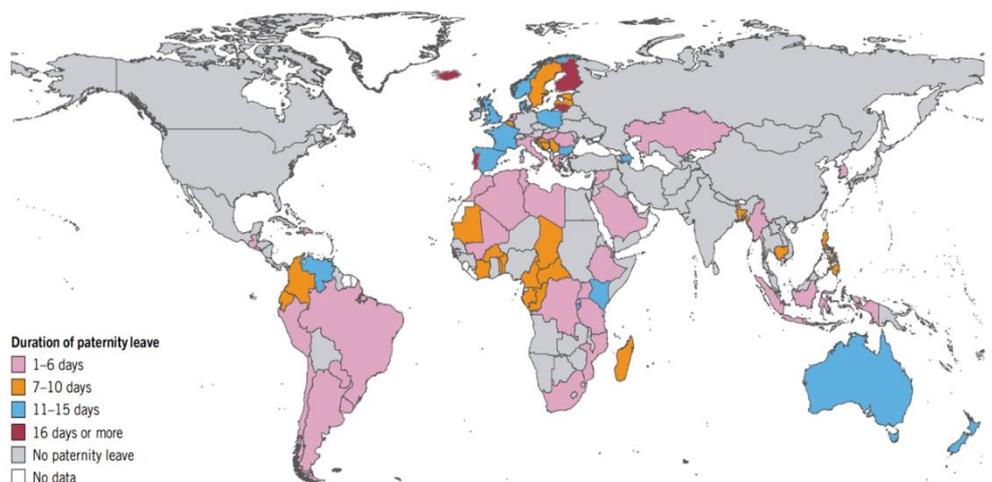
Source: Beyond Ratings

ESG

Parental leaves: baby-steps towards more equality

Paid maternity leaves are a key element for both infant and maternal health and an opportunity for female employment stability. Indeed, paid maternity leave facilitates breastfeeding, reduces risks of infection, increases emotional security, and secures the mother's employment as protected by laws. While details of these elements (i.e. leave durations and monetary compensations) largely vary across countries (from few days

Statutory duration of paternity leave, 2013



to 62 weeks in Estonia and from no legal cash provision for the United States of America to 100% of

previous earnings for other countries), the trend is globally positive and social protection is increasing overall. The International Labor Organization recommends at least a 12 week leave and income replacement standard stands at two-thirds of previous earnings.

For fathers, the situation is quite different. Where it exists, paternity leave duration ranges from one day in Tunisia to 90 in Iceland. Indeed, the standard is an absence of legislation that would allow new fathers to take care of his newly born child and his mother. This situation is the inheritance a patriarchal vision of society, in which men are not expected to actively participate in family life. In a future world with less work, this offers a good opportunity to rebalance work-private time and challenge this heritage for a better child development.

*Emeric Nicolas, Head of Statistics*

*Sources: Beyond Rating, ILO*

## Carbon/Climate Change

### In the eye of the storm

As of today, the precise impact of climate change on the frequency of extreme weather events has not yet been clarified. What we do already know is that climate change will create more intense rainfalls. A given volume of air contains a definite amount of water vapor. When the temperature rises, more water evaporates from warmer oceans and the quantity of vapor in the atmosphere increases. The air saturation threshold, at which vapor is turned back to liquid water, is thus reached sooner. Consequently, precipitations get more intense with greater volumes of rainfall pouring in shorter amounts of time. It is currently estimated that a global warming of 1°C will increase the level of atmosphere humidity by 7%.

# +50%

Storms are also expected to get stronger. According to the former vice-president of the IPCC Jean Jouzel, the number of lightning impacts should increase **by 50% by 2100**. In France for instance, May 2018 broke all records with 182,000 lightning impacts registered, the previous record standing at 84,000 impacts in May 2009. Another recent study carried out by James Kossin from NOAA reveals that the translation speed of tropical-cyclones has slowed by 10% between 1949 and 2016. This slower motion causes violent winds and heavy rainfalls to stay longer in one location, ultimately generating more disastrous inundations and worse storm damages.

*Claire Hugo, Analyst*

*Sources: Jean Jouzel (former IPCC VP), James Kossin (NOAA)*

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