



Market Flash

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ARGENTINA NATIONALIZES ITS PENSION SYSTEM

“The rest of the world is rescuing the banks, and we are going to rescue the pensioners.”

With those words, Argentina’s President Cristina Fernandez announced the nationalization of the country’s pension fund system, Administradora de Fondos de Jubilaciones y Pensiones (AFJPs), on Monday, October 20.

This nationalization was not surprising, given Argentina’s troubled history in accessing funds internationally, due to the country’s 2001 default. This has left them without access to the IMF funding, as well as strained relations with the Paris Club. The Paris Club is an informal group of creditors who work to help debtor nations that are having trouble meeting their obligations find a payment solution, through rescheduling and reduction of debt service.

The Argentinean market is currently trading at distressed levels, due to its need for approximately US \$9 billion in short-term financing. The takeover of the private pension system will provide Argentina with an additional US \$4.6 billion of cash flow, along with a much-needed US \$10 billion infusion of immediate cash currently held by the pension system. This should provide it enough liquidity to avoid a default for the next several months. However, the market’s reaction was ugly, with Argentinean stock markets slumping by over 24% last week.

The country’s sovereign bonds have lost about half their value over the past two weeks. Twenty-five-year, dollar-denominated, discount bonds are now trading at 25 cents (on the dollar) with a yield of 27%. Silvia Castañaga, CIO of a local insurance company commented on Wednesday, *“We were expecting measures from the government to create some cash to pay the country’s obligations, but we never imagined the nationalization of the AFJPs. The market has completely frozen, and there are neither buyers for bonds nor stocks.”*

Although the sweeping measure has been highly criticized around the world and by the Argentinean financial market, many Argentinean citizens favor its adoption. Government ministers and other pro-government entities have also supported the measure. According to an online local survey of more than 40,000 people conducted by La Nacion, the non-government newspaper, more than 60% of the public support the measure.

However, there are also many in Argentina that disagree with this populist approach. Some feel this is an extreme measure that seeks to provide short-term political gain for the ruling party in advance of next year’s election. But they also believe this measure harms the government’s credibility and creates mistrust in the market, reinforcing the belief that the government has a tendency to “change the rules” to suit its own needs, regardless of the long-term consequences.

As counterparties to pension funds, financial institutions and asset management companies can expect to feel the effects in the form of further liquidity problems and job cuts. There is also growing concern over how the government plans to execute this plan. Mass liquidation of Time Deposits to fund infrastructure spending may buffer the 2009 budget, but this poses strong risks to the banks. Unfettered equity sales could also wreak havoc on the markets, and there is concern that the government could use this as leverage to force closer economic ties with business interests, increasing the likelihood for conflicts of interest or corruption.

The approach to garnering control of the market has been heavy-handed to date. At the time of President Fernandez’s announcement, Argentinean courts ordered a freeze on all trading of stocks or bonds by the AFJPs for a period of seven days. On October 22, the police raided the 10 AFJPs’ offices, claiming that AFJP traders had been performing speculative trades on October 20.

The privatization bill will enter the Congress for discussion when it convenes on Tuesday, October 28. The government holds the majority of votes in both houses of Congress, so the Argentine Chamber of Deputies will most likely approve the measure. While financial markets have priced in this measure passing, there is the chance that it could get rejected in the Senate.

It is our view that Argentina’s president has run out of cash and is not willing to cut government expenses. Issuing new debt has been extremely difficult, and soy and grain prices have been cut in half over the past several months, limiting tax revenues. To make matters worse, Venezuela is one of Argentina’s major sources of funding. Falling oil prices have compromised Venezuela’s liquidity, thereby reducing Argentina’s access to cash. Clearly, President Fernandez is struggling to raise her approval rating from its current low of 20%.

President Fernandez hopes to solidify the budget by nationalizing the pension system. With this takeover, the government obtains additional annual flows of about 1.3% of GDP. Since 55% of the AFJPs assets are in public bonds and loans, there is concern that the government might reduce public expenditures by cutting interests payments on these obligations.

Impact on Other Markets in Latin America

Argentina has been off the radar since it defaulted in 2001. Most investment strategies have been underweight Argentina for some time, and year-to-date flows have been negative.

Argentina's measures have been criticized by Chilean and Peruvian authorities, and it is highly improbable that these countries would take similar measures. Andres Velasco, Chilean Minister of the Interior, denies any chance that the government will take control of the pension funds saying, *"The system is working correctly, and we have risk control process and fiscalizations [sic]; additionally we have a well-supported institutionalility [sic]."*

Although the Peruvian President is considered a populist and has low approval ratings of approximately 25%, Peruvian authorities have made it clear that the pension funds belong to the people and are not for the taking by the nation's government. According to Alberto Vazquez, CIO of Peruvian Insurance company Pacifico Vida, *"There is neither political nor popular support to privatize pension funds. We [Peru] already had a public pension fund system, and the returns from the strategies were awful. The people still remember this."*

According to Moshe Soruco, Investment and Financial Operations Manager at AIG Colombia Seguros de Vida, *"There's not much press coverage on the Argentina situation, it is just another financial news story."*

However, Santiago Montenegro, president of the Colombian Association of Pension Funds, commented, *"The Argentinean measure of nationalizing the pension funds is a populist measure, taken because the government doesn't have enough cash, and what they really want to do is use the assets of the pensioners to pay their public debt."*

In Brazil, the Argentinean measure was also interpreted to have been of little local consequence. According to Stacy Steimel, Latin American Portfolio Manager at AIG Investments, *"This is a typical knee-jerk reaction to the difficult situation in Argentina, although there is so much other negative news that could explain underperformance in this environment. In 2001, the BOVESPA was impacted heavily by the Argentine devaluation."*

Bottom Line

This action by the Argentinean government, taken in conjunction with their continued intervention in their local economy, has created negative risk perception across global emerging markets. In this market environment, little distinction is made between the stronger and the weaker economies, and steps such as these only heighten investors' concerns. However, we do not expect ancillary effects or copycat nationalization efforts in other countries in the region – or elsewhere in emerging markets. ■

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