Fitch: "Chaco Effect" Reduces Liquidity, Financing Alternatives

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The recent settlement in pesos of dollar-denominated debt issued under Argentine law by the province of Chaco has sparked speculation of growing "pesofication," according to Fitch Ratings. Seeking to preserve its relatively comfortable level of hard currency reserves, the Argentine government has been tightening foreign exchange restrictions since October 2011. The latest manifestation of this trend was the refusal by the Central Bank to grant the province of Chaco access to the local exchange market (known locally as the MULC) to purchase a relatively small amount of USD to service its dollar-denominated debt, leading the Province to settle the debt in pesos at the official exchange rate. A majority of our ratings on Argentine corporate issuers are at 'B+' or below, which reflects a difficult operating environment. We do not anticipate a general downward trend in corporate ratings as a function of market turmoil derived from the province of Chaco's failure to serve its locally issues dollar-denominated in foreign currency. However, we note that access to the foreign exchange market has become increasingly restrictive and believe this trend is likely to continue for the foreseeable future. We point out that there have been no new rules governing the access to foreign exchange markets to pay down debt over the past few months and note the existing legal framework for purchasing hard currency for debt service has been in place since 2009. Under current regulation, access to the MULC for purchasing USD with local currency is limited to those servicing debt contracted abroad under non-Argentine law. Debt denominated in USD issued under local law must, effectively, be settled in pesos at the official exchange rate. The tightening of exchange controls over time has led to corporates decreasing their reliance on foreign currency-denominated debt. Of the more than 75 Argentine companies covered by Fitch, only a few have foreign-denominated debt subject to Argentine law, with the bulk of corporate issuance in the domestic market payable in pesos. While access to foreign exchange continues in place for cross-border debt service, in those cases where a local issuance was dollar-denominated, the terms and conditions of the respective Indentures allow for alternative settlement if/when there is no access to local foreign exchange markets; generally, these clauses allow settlement either by the sale of foreign currency, cross border acquired in Argentina, or, when this is not practical, in pesos. As a result, locally issued dollar denominated debt is seldom a material part of corporates' capital structures. Over the past six months, corporates have been prevented from distributing dividends in dollars and from accessing local exchange markets to settle other types of cross-border, nondebt transactions, such as royalties. In our opinion, exchange controls limit the financial flexibility of managers by reducing investments both of local companies and foreign direct investment in the country and increasing the refinancing risk as lending options decrease. Systemic risk is certainly affecting liquidity and the ability to improve the debt structure of most corporates. Argentine corporates have been reducing exposure to dollar-denominated debt, albeit at higher nominal interest rates. Uncertainty has caused loan duration for the corporate sector to remain short (below two years on average) and, despite adequate liquidity in the baking system, growth in loans to the private sector has slowed versus 2011. As a result, interest expenses have been increasing and causing the debt structure for most corporates to deteriorate. Argentine companies have been managing their financial strategy in a more conservative way than regional peers and we believe they will need to maintain that strategy in order to mitigate certain risks including inflation pressure, operational difficulties derived from a tightened foreign exchange market, and restricted financial alternatives. We have already factored these challenges into the existing ratings and will continue to monitor them. Contact: Cecilia Minguillon Senior Director Corporates, Latin America Buenos Aires, Argentina +54 11 5235 8123 Daniel Kastholm Managing Director Corporates, Latin America +1 312 368-2070 Kellie Geressy-Nilsen Senior Director Fitch Wire +1 212 908-9123 Fitch, Inc. One State Street Plaza New York, NY 10004 Media Relations: Brian Bertsch,