

10 of July 2023¹

Provincia de Buenos Aires 2037

Behind sovereign bonds, BUENOS 37A (BA37D) is the most traded Argentine bond in the international market. In fact, this bond has even more liquidity than many other sovereign bonds. For this reason, the Province of Buenos Aires (PBA) attracts a lot of interest from foreign investors. The Province has three US dollar bonds under New York law as a result of the latest debt exchange: BUENOS 37A, BUENOS 37B (BB37D), and BUENOS 37C (BC37D). BUENOS 37A is a liquid bond with a significant issuance size of USD 6.2 billion. On the other hand, the issuances of BUENOS 37B and BUENOS 37C are considerably smaller, with USD 778 million and USD 153 million, respectively.

The Province accounts for about 35% of Argentina's GDP and nearly 40% of the country's population. Its bonds do not trade exactly like sovereign bonds, but they also do not behave like the rest of the provincial yield curve. Due to their characteristics (issuance size, payment structure, coupons, duration, last restructuring treatment, etc.), BUENOS 37A appears to be closer to sovereign bonds than the rest of the provincial bonds. In this report, we will review the fiscal and debt numbers of the Province, some particularities of this year's elections, and provide a brief comparative analysis against sovereign bonds.

Fiscal balance and provincial debt

The Kicillof administration inherited a significant primary fiscal surplus from the previous administration. From 2016 to 2019, the primary balance improved significantly, following the necessary adjustment starting in 2018. However, the current administration also inherited a financial deficit due to the burden of debt interest and challenging short-term maturities. As we will see, the problem was the possibility of rollover rather than the size of the debt itself; with completely closed markets, any debt looks unpayable.

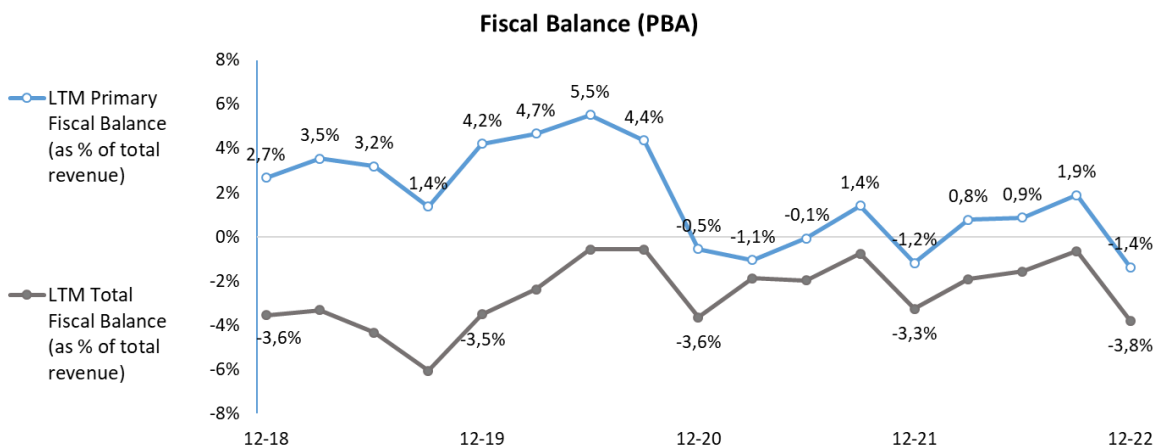
Upon assuming office, the Kicillof administration had two options: the first was to adjust expenses toward a better financial result and seek the possibility of accessing the voluntary debt market. The second option was to default, defer maturities, and lower coupons to reduce the interest burden. As expected, following the path of the national treasury, the administration chose the second option. Political leaders in Argentina usually do not consider reputational costs. Not honoring contracts has long-term effects on funding costs, investment flows, and economic growth. Unfortunately, the current administration tends to prioritize the short term. By contrast, reputational costs matter in private companies, and the strong performance of Argentine corporate bonds in recent years is a clear reflection of this.

The province lost its primary surplus during the pandemic and has not recovered it since. The primary balance has been closer to equilibrium since then. When considering interest payments, the financial deficit represents between 3 and 4 percentage points of fiscal revenues. In summary, while the Kicillof administration could not maintain the inherited primary surplus, provincial public finances have

¹ Prices as of 5 of July.

remained close to a balanced budget. However, the aggregated numbers hide an important fact. The province benefited from the National Government's decision to take away approximately 2 percentage points of the Federal Tax Co-participation (“Coparticipación”) from the City of Buenos Aires (CABA) during the last quarter of 2020. More than half of those funds went to the Province of Buenos Aires. In December of last year, the Supreme Court ruled in favor of CABA in the dispute over Tax Co-participation funds. Although the Court's ruling does not directly affect the Province, at the end of the day, the tax regime is a zero-sum game. The key, as usual, will lie in the political alignment between the Nation and the Province starting from December 2023. Beyond the regime, discretionary transfers from the Nation to the provinces end up being the adjustment variable.

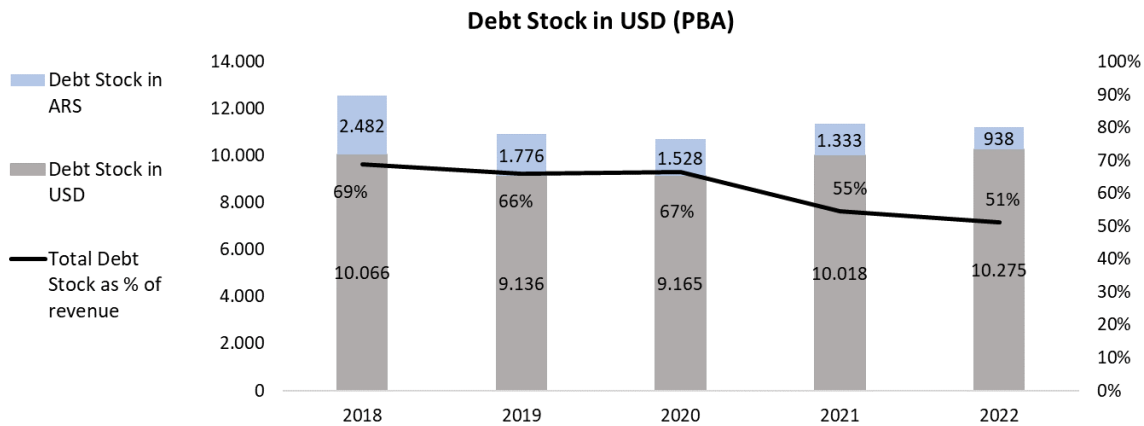
In comparative terms, PBA is among the worst provinces in fiscal terms. While, as mentioned, fiscal numbers appear healthier compared to the national treasury's fiscal balance, Buenos Aires is far from the financial surplus exhibited by other large provinces such as Córdoba, Santa Fe, or CABA. It is worth noting that, broadly speaking, three groups of provinces issue bonds. The first group consists of large and highly productive provinces (Buenos Aires, CABA, Santa Fe, Córdoba, and Mendoza), where a significant portion of revenues comes from their provincial taxes. The second group includes oil and gas provinces (Chubut, Tierra del Fuego, and Neuquén), whose bonds have guarantees, and where fiscal revenues are enhanced by royalties. The third group comprises the rest (Entre Rios, La Rioja, Salta, Río Negro, Chaco, and Jujuy), a very heterogeneous group where the shared characteristic is a strong dependence on federal revenues.



Source: Sekoia Research based on DNAP and PBA data.

Returning to Buenos Aires, in terms of indebtedness, the weight of provincial debt on total revenues is slightly higher than the average of the other provinces. On the other hand, the debt-to-geographic GDP ratio is around the provincial average. The debt has decreased in recent years relative to the Province's revenues. It represents around 50% of total revenues, compared to 68% in 2018. This number is somewhat misleading due to the exchange rate lag. As seen in the graph below, the majority of the debt is denominated in foreign currency. Therefore, in the event of a real exchange rate adjustment, the level of debt would increase, both in relation to revenues and geographic GDP. That said, even assuming a correction of the real exchange rate, the Province's debt would still be below 10% of the geographic GDP.

In summary, the level of debt does not appear to be the problem; the main issue is the possibility of rollover. Please excuse the repetition, but any debt appears unsustainable with closed markets.



Source: Sekoia Research based on DNAP and PBA data.

Electoral system, political risk, and polls.

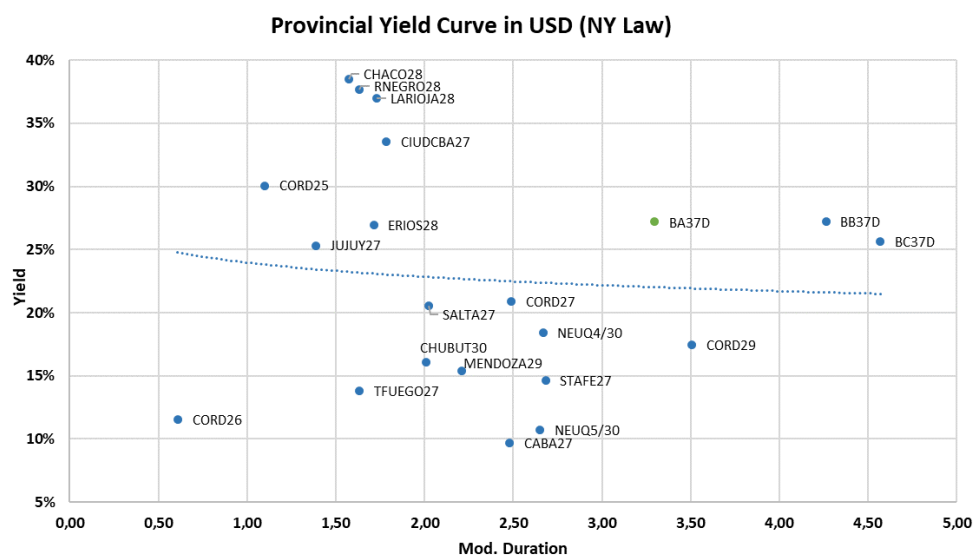
The electoral system in the Province of Buenos Aires differs from the national system. At the national level, there is a runoff election if no candidate obtains more than 45% of the positive votes, or more than 40% of the votes with a 10-point difference over the second candidate. In the Province, however, there is no runoff election. Therefore, the candidate who finishes first in the October election will be the next Governor. As a result, the provincial ruling party (Unión por la Patria) appears to have a better chance of reelection than the national ruling party. Current polls in the Province indicate a closely contested election. Since the provincial elections are held on the same day as the national elections, split-ticket voting in the province and the presidential result of Milei will be key determinants of the provincial outcome. The strong likelihood of Kicillof remaining in the Governorship is an important factor for the fixed-income market.

Date	Consultant	Unión por la Patria	Juntos por el Cambio
27-30 June 2023	Circuitos	27,4%	30,6%
28 de June 2023	Proyección Consultores	37,3%	32,2%
2-5 de June 2023	Consultora Tendencias	27,9%	27,3%
1-5 de June 2023	Federico Gonzáles & Asociados	29,1%	29,4%
		29,1%	28,7%
2-7 de May 2023	Analía del Franco Consultores	29,0%	29,4%
		37,6%	28,6%
3-6 de May 2023	Federico Gonzáles & Asociados	28,5%	27,3%
12-14 de April 2023	Circuitos	29,7%	44,3%
	Average	30,6%	30,9%

Source: Sekoia Research based on local newspapers.

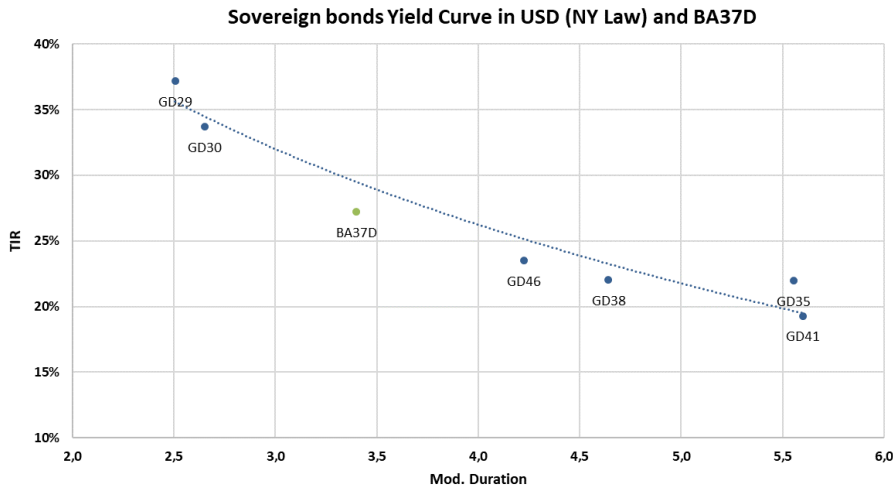
BA37D vs Sovereign Bonds

The provincial yield curve exhibits many disparities, not only due to the credit risk of different provinces but also due to the parity effect. The short end of the curve shows very high yields due to the convergence effect at maturity. In short-term bonds, the low parity increases the yield. This often leads to confusing readings, as the assumption that bonds will be paid on time and in full is a strong one for Argentine provincial and sovereign bonds. With this clarification, Buenos Aires bonds appear quite attractive within the provincial curve, not only due to their yield but also due to their parity. Given the country's tendency for contract non-compliance, lower parity serves as a good hedge against potential defaults. The fiscal health that the provinces currently enjoy will likely be threatened next year, as part of the significant fiscal adjustment that the Nation must face will have to be shared with the provinces. Although it is almost impossible to modify the Coparticipación regime, the Nation has other mechanisms to share the adjustment, such as discretionary transfers. We believe there will be considerable conflict between the Nation and the provinces in this regard.



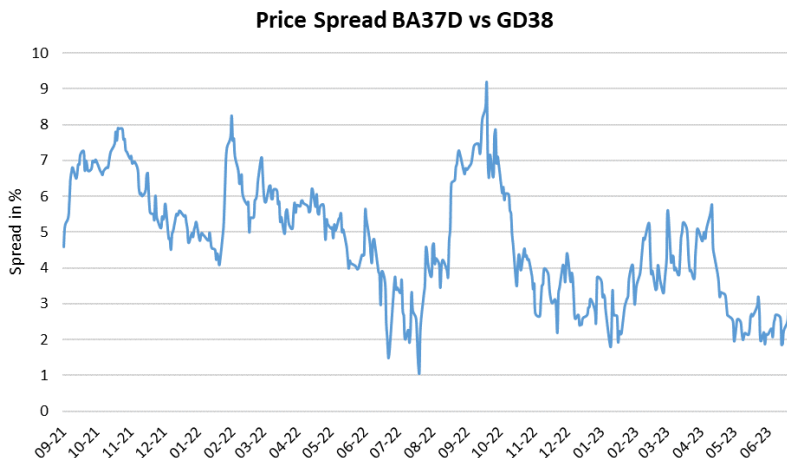
Source: Sekoia Research based on Bloomberg.

As mentioned earlier, the bonds of the Province of Buenos Aires resemble sovereign bonds more than the rest of the provinces for several reasons: amortization structure, coupons, tenors, issuance size, and conditions of the last restructuring. As shown below, BUENOS 37A closely tracks the sovereign curve. To facilitate the analysis, we will focus on the comparison with ARGENT 38 (GD38), which has the most similar cash flow. The conclusions can be extrapolated to the rest of the sovereign curve governed by New York law.



Source: Sekoia Research based on Bloomberg.

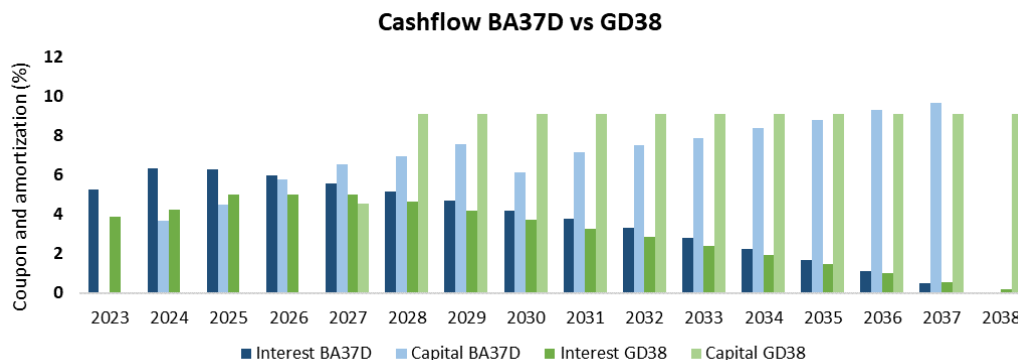
The first point is price dynamics. The graph below shows the spread between BUENOS 37A and ARGENT 38. Currently, this spread is near its lows, making BUENOS 37A look cheap relative to the past few months. Since mid-April, sovereign bonds have shown much better performance.



Source: Sekoia Research based on Bloomberg.

BUENOS 37A pays higher coupons compared to ARGENT 38. The provincial annual coupon is 6.375% for 2024 and 6.625% from 2025 onwards, while in the case of ARGENT 38, the annual coupon is 4.25% for 2024 and 5% from 2025 onwards. Additionally, BUENOS 37A begins amortization in 2024, while ARGENT

38 only starts amortizing in 2027. As shown in the following cash flow, the total cash flows are considerably higher for the provincial bond.



Source: Sekoia Research based on Bloomberg.

As we know, not all bonds respond in the same way to a decrease in market-required yields; each bond has a different modified duration. The table below details what would happen to bond prices with changes in market-perceived risk. In a potential scenario of a decline in country risk, the potential increase in BUENOS 37A appears more attractive than in ARGENT 38. BUENOS 37A is a worthy bond for those who want to position themselves in light of the country's macroeconomic normalization scenario.

Simulation of prices after yield changes

	BA37D	GD38
Actual Price	41,15	38,89
Actual Yield	28,6%	22,6%
Yield	22%	39,73
	20%	43,39
	18%	47,63
	16%	52,68

Simulation of returns after yield changes

	BA37D	GD38
Yield	23%	2%
	32%	12%
	43%	22%
	56%	35%

Source: Sekoia Research based on Bloomberg.

In summary, the current spreads between BUENOS 37A and the sovereign bonds governed by New York law are near their lows, providing a good entry point into the provincial bond. Taking ARGENT 38 as an example, the cash flow of each bond should result in a greater price difference. BUENOS 37A appears very attractive. In our view, the compression of the spread can be explained by the elections, with Kicillof being more competitive than Massa at the national level. A potentially tense relationship between a future Kicillof government in the Province and Cambiemos at the national level could explain part of the spread narrowing. However, even in this scenario, we do not foresee a dissociation between the Nation and the Province regarding potential debt restructuring. In other words, if the Nation opens the voluntary

market, we believe the Province would also gain access. If the Nation restructures its debt, the Province will likely have to restructure as well. On the other hand, BUENOS 37A has an additional appeal in the event that Cambiemos manages to succeed in the Province of Buenos Aires.

In general, we see provincial bonds as expensive compared to sovereign bonds, and we believe that the fiscal health of the provinces will be threatened next year. Part of the significant fiscal adjustment that the Nation must face will have to be shared with the provinces. Without a doubt, among the provincial bonds our preferred one is BUENOS 37 A.

Kind regards,

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