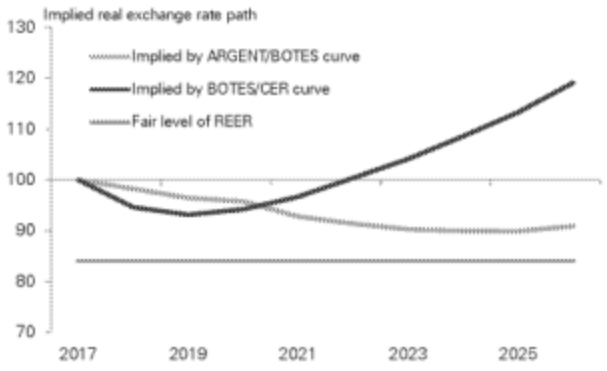
Figure 1: Real exchange path implied by market curves and a trend inflation of 5%



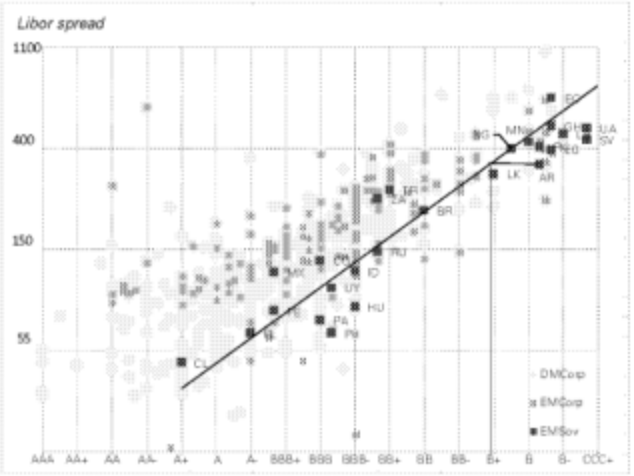
Source: Deutsche Bank

When we assume that inflation follows the implied breakeven rates priced in linkers, the cushion is a lot less and substantial real appreciation is required to balance returns as time goes by – again, in contrast with our expectation and with our view that the peso is already overvalued.

Credit – Scope for further tightening

In terms of the external markets, as the long term picture seems intact, market should continue to price a likely second mandate of Macri administration with a strong reform agenda and ascension in credit standings, and associated ratings upgrade to BB levels over the medium term, in our view.

One-notch upgrade is priced in Argentina credit; potential for more if politics stay on track

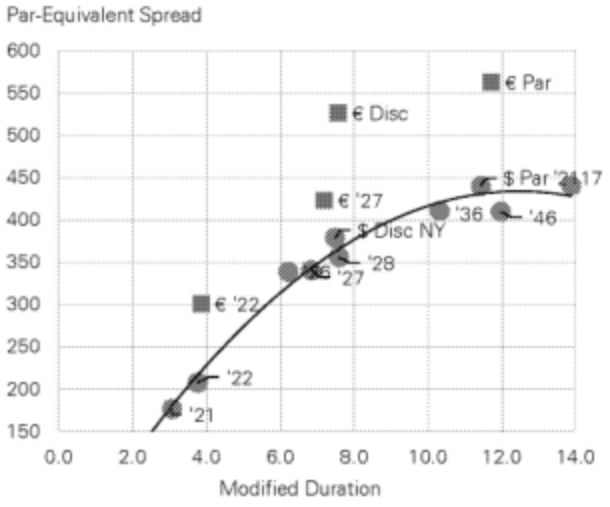


Source: Deutsche Bank

While valuation looks tight vs. its current credit rating after its outperformance this year, there is still scope for spread to tighter further due to a). Market's perception of multiple notches credit ascension if politics stay on track; b). The flattening of spread / quality curve in EM credit markets under the constructive external backdrop with continued inflows; and c). Opportunities offered by EUR-denominated bonds, local law USD bonds, and select provincial bonds, even if one does not like the valuation on the NY law USD bonds.

EUR bonds vs. USD bonds - Argentina is due to issue USD2.65bn more bonds denominated in EUR, CHF, or JPY in the coming weeks. In our view, Argentina should issue in EUR to boost the liquidity of the EUR bonds curve despite initially unfavorable pricing for the sovereign. Any supplies to that markets, if priced properly, would only help - not hurt - the performance of those bonds, in our view. On fx-hedged basis, the EUR bonds remain significantly cheap to their USD counterparts, especially the EUR Discounts in comparison with USD Discounts (at FX-hedged spread differential of 175bp).

EUR denominated bonds remain substantially cheap to USD counterparts, especially the EUR Discounts



Source: Deutsche Bank

The USD curve - On the back of recent outperformance of the Pars, we have taken profit in Pars vs. 5Y CDS and Pars vs. 46s despite that the Pars remain substantially cheap to the curve. But we, nevertheless, look to switch out of bullets to the Pars on any meaningful dip of the latter.

While the Pars continue to offer good value, the bullet bond curve (10s30s) has flattened from recent peak; we retain curve flatteners 46s vs. 27s but only for any

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