



Rabobank

Country Report Argentina

Country Report
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Argentina's huge macroeconomic imbalances worsened in 2014 and little improvement is expected in 2015, at least not until a new cabinet takes office in December 2015 after the elections.

Strengths (+) and weaknesses (-)

(+) Competitive agricultural sector

Argentina has a well-developed and dynamic agricultural sector. The sector benefits from the good quality of the Argentine soil, a favourable climate and good access to sea transport.

(-) Macroeconomic imbalances

Ultra-loose monetary and fiscal policies have caused huge macroeconomic distortions. Double digit inflation has led to a deterioration of the current account balance, which has eroded FX reserves.

(-) Unpredictable economic policy

To contain the growing macroeconomic imbalances, the government has implemented tight import and currency controls and has implemented various interventionist measures, thereby hurting investor confidence and exacerbating economic woes.

(-) Lack of access to external financing

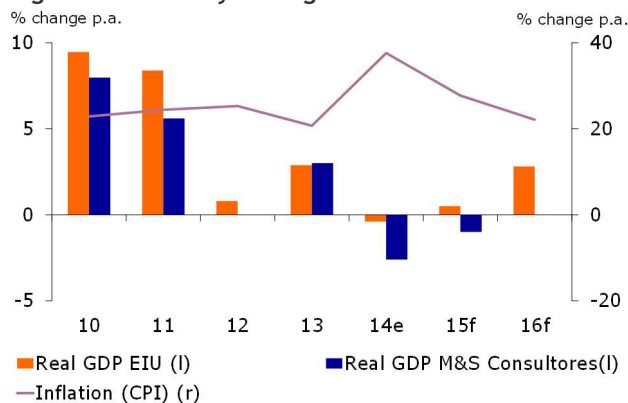
Following the still disputed default in 2001, Argentina lacks good access to external financing. The recent technical default of the sovereign reduces perspectives of a return to international markets and failing to solve it could worsen the situation.

Key developments

1. Stagflation stepped up

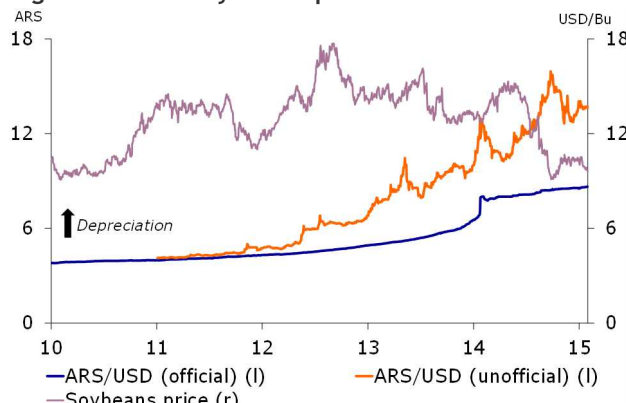
The Argentine economy contracted in 2014, while inflation remained high and this stagflationary environment is expected to persist in 2015. Years of erratic policies have hurt investment growth and led to huge macroeconomic distortions, such as double digit inflation. In 2014, inflation jumped from 21% in 2013, as the government adopted a loose fiscal policy to stimulate domestic demand, which it financed monetarily. In 2014, the budget deficit soared to 4.8% of GDP, from 3.6% of GDP in 2013, pushing public debt to 49% of GDP, from 41% of GDP in 2013.

Figure 1: Economy in stagflation



Source: EIU, M&S Consultores

Figure 2: Currency under pressure



Source: Macrobond, CBOT

In 2014, real GDP contracted by an estimated 0-3%. Private consumption contracted for the first time in a decade, as lingering macroeconomic distortions and government interventions took their toll on the economy (e.g. tightening import controls hurt output in import dependent sectors such as the important automotive industry), while the external environment weakened due to lower commodity prices and a sluggish Brazilian economy. As policy is expected to continue on the same foot, unemployment is picking up vigorously, from 7% in 2013 to 8.8% in 2014, and the external environment remains weak, stagflation is set to persist in 2015 and could lead to bouts of social unrest such as those seen at the end of 2013.

2. Quick fixes do not reduce high pressures on the exchange rate and the FX reserves

Double-digit inflation and capital flight due to unorthodox and ad-hoc policies have led to a deterioration of the current account balance and a rapid decline of the stock of foreign exchange (FX) reserves. FX reserves fell by 42% to USD 28bn, or 4 month of import cover, between 2010 and 2014. FX and import controls have been in place for years to contain these pressures. Still, the government was forced to devalue the peso in January 2014. After that, the government managed to stabilize the level of FX reserves on the back of tighter controls, interventions, such as rejecting USD 4bn worth of exports, and one-off FX income, such as receipts from a swap deal with the Chinese government and the sale of 4G licences. An attempt to extend the maturity of debt through a bond issuance and swap in December 2014 failed. Given falling export revenues and an estimated foreign currency public debt service of at least USD 12bn in 2015, it is a matter of time before FX reserves fall below critical levels and the government is forced to devalue the peso again. The large and growing gap between the official and unofficial exchange rate, currently around 60% (fig. 2) reflects the high pressures on the currency. Consequently, the risk of a balance of payment crisis remains high.

3. Another (technical) default, but the economic impact is muted

Argentina defaulted on USD 95bn of sovereign debt in 2001, the largest sovereign default in history. 93% of it was restructured by 2010. Hedge funds, which Argentina calls “vulture funds” and which are known as the holdouts, bought the remaining 7%. They also enforced parri passu treatment on Argentina through a New York

court ruling that was reinforced by the US Supreme Court in 2014. Consequently, Argentina can only pay the restructured debt if it also pays the holdouts. But Argentina had bound itself to equal treatment of all creditors through the RUFO clause, so payment to the holdouts would de-facto cancel previous debt restructuring agreements. A coupon payment due on 30 June 2014 pushed the country into a selective technical default, as the country refused to pay the holdouts and thereby trigger the RUFO clause. As Argentina has not had access to international capital markets since 2001, the economic impact of the default was muted and merely exacerbated existing macroeconomic imbalances as it pushed the government towards more interventionism. The RUFO clause expired on 1 January 2015, but President Kirchner's radical attitude makes a deal unlikely until after the October 2015 elections.

4. Political scandal changes the outlook for presidential elections

A federal prosecutor that had accused President Kirchner of conspiring with the Iranian intelligence service to hide their involvement in a 1994 terrorist attack was found dead on 18 January, one day before his testimony on the case. The information he held was later released by the media. In response, President Kirchner accused the Argentinian and Iranian intelligence services of setting up a plot against her. Argentinians took the streets demanding transparent investigations. This scandal seems to be part of an open battle between the government and the judiciary that was started by the president in 2013 when she unsuccessfully attempted to reform the justice system. This attempt was presumably motivated by her fear of being persecuted for corruption once she would lose the presidential prerogatives (the law does not allow a third consecutive presidential term). How this scandal will evolve is uncertain, but it is poised to hurt the chances of Daniel Scioli, candidate of the ruling Frente para la Victoria, to win in the October 2015 elections. Thus, this scandal has improved the likelihood of a more moderate and business-friendly government thereafter.

Factsheet of Argentina

Argentina					
National facts		Social and governance indicators		rank / total	
Type of government	Republic	Human Development Index (rank)	49 / 187		
Capital	Buenos Aires	Ease of Doing Business Index (rank)	124 / 189		
Surface area (thousand sq km)	2,780	WEF Global Competitiveness Index (rank)	104 / 144		
Population (millions)	42.7	Corruption Perceptions Index (rank)	107 / 175		
Main languages	Spanish	Press Freedom Index (rank)	55 / 180		
Main religions	Roman Catholic (92%)	Gini index (income distribution)	43.57		
	Protestant (2%)	Population below \$1.25 per day (PPP)	1.41		
	Jewish (2%)				
Head of State (president)	Cristina Kirchner	Foreign trade 2013			
Head of Gov (president)	Cristina Kirchner	Main export partners (%)		Main import partners (%)	
Monetary unit	Argentina peso (ARS)	Brazil	20	Brazil	29
		China	7	China	15
		Chile	5	US	13
		US	4	Germany	5
Economy 2014		Main export products (%) 2014			
Economic size		bn USD		% world total	
Nominal GDP	525	0.68		Processed agricultural products	36
Nominal GDP at PPP	889	0.83		Manufactures	35
Export value of goods and services	86	0.37		Primary	23
IMF quotum (in m SDR, 2013)	2,117	0.97		Fuel and energy	7
Economic structure 2014		5-year av.		Main import products (%)	
Real GDP growth (%)	-0.4	4.3		Intermediate goods	33
Agriculture (% of GDP)	10	9		Capital goods	21
Industry (% of GDP)	29	31		Consumer goods	16
Services (% of GDP)	61	60		Fuels	10
Standards of living		USD		Openness of the economy	
Nominal GDP per head	12,297	106		Export value of G&S (% of GDP)	16
Nominal GDP per head at PPP	20,839	129		Import value of G&S (% of GDP)	15
Real GDP per head (in 2005 prices)	7,724	89		Inward FDI (% of GDP)	0.7

Source: EIU, CIA World Factbook, UN, World Economic Forum, Transparency International, Reporters Without Borders, World Bank.

Background information

Argentina has experienced many political and macroeconomic crises. From the mid-1970s to the early 1980s, the country was under military rule, which was ended when Argentina lost the Falklands war. In the 1980s, high inflation turned into hyperinflation. With a tight dollar peg introduced in 1991, the Menem government managed to bring inflation under control. However, in the late 1990s this peg left Argentina unable to deal with the combined impact of low commodity prices, an appreciating USD, substantial dollarization and pro-cyclical fiscal policies; the country was heading for a big economic, political and social crisis. In 2001/2002, Argentina had to abandon the peg and at the same time declared the biggest sovereign default in history. Argentina has been excluded from international financial markets ever since. Afterwards, the country managed to recover quickly and benefitted from the commodity boom. However, Argentina's economic policies have become increasingly interventionist, ad-hoc and unsustainable. Inflation has been high and severely underreported for many years, resulting in balance of payments pressures, which the government is trying to fight with tight import, currency and capital controls. Argentina's institutions have remained weak and its politics are centred on persons, with party loyalty and, in particular, ideology playing a much smaller role. The country has a very dynamic and advanced agricultural sector, which accounts for 55% of total exports. Soybeans and soybean products are the most important agricultural export commodity and account for roughly one-third of Argentina's exports. Manufacturing, largely accounted for by the automotive sector, is another important pillar of the economy. The most important export market for Argentina's products is Brazil. With a nominal GDP of USD 11,779 per capita, Argentina remains one of the richest countries of Latin America.

Economic indicators of Argentina

Argentina							
Selection of economic indicators	2010	2011	2012	2013	2014e	2015f	2016f
Key country risk indicators							
GDP (% real change pa)	9.5	8.4	0.8	2.9	-0.4	0.5	2.8
GDP (% real change pa) *	8.0	5.6	0.0	3.0	-2.6	-1.0	n.a.
Consumer prices (average % change pa)	22.9	24.4	25.3	20.7	37.6	27.7	22.1
Current account balance (% of GDP)	0.3	-0.4	-0.2	-0.8	-1.0	-0.8	-0.8
Total foreign exchange reserves (m USD)	49,734	43,227	39,920	28,143	28,811	26,020	26,280
Economic growth							
GDP (% real change pa)	9.5	8.4	0.8	2.9	-0.4	0.5	2.8
Gross fixed investment (% real change pa)	21.2	18.2	-5.2	3.0	-4.2	0.6	5.4
Private consumption (real % change pa)	8.1	10.2	4.3	4.3	-1.3	0.2	1.8
Government consumption (% real change pa)	7.2	8.8	5.9	4.2	2.7	2.8	2.0
Exports of G&S (% real change pa)	14.0	5.6	-5.6	-4.0	-7.2	1.1	3.9
Imports of G&S (% real change pa)	34.8	22.6	-6.1	3.6	-9.0	-1.3	2.1
GDP (% real change pa) *	8.0	5.6	0.0	3.0	-2.6	-1.0	n.a.
Consumption *	6.4	4.3	0.6	2.0	-3.0	-1.5	n.a.
Investments*	23.7	15.1	-8.0	7.7	-7.0	-5.0	n.a.
Economic policy							
Budget balance (% of GDP)**	-0.8	-3.7	-3.6	-3.6	-4.8	-5.2	-5.9
Public debt (% of GDP)**	39	36	38	41	49	54	56
Money market interest rate (%)	9.1	10.0	9.8	13.1	18.2	20.3	17.8
M2 growth (% change pa)	33	26	35	27	34	27	19
Consumer prices (average % change pa)	22.9	24.4	25.3	20.7	37.6	27.7	22.1
Exchange rate LCU to USD (average)	3.9	4.1	4.5	5.5	8.1	10.2	13.1
Recorded unemployment (%)**	7.8	7.2	7.2	7.1	8.8	9.0	9.2
Balance of payments (m USD)							
Current account balance	1,360	-2,271	-1,167	-4,813	-5,438	-4,290	-3,790
Trade balance	14,286	12,870	15,158	11,063	9,895	10,650	11,970
Export value of goods	68,154	83,996	80,246	81,603	72,540	72,700	76,200
Import value of goods	53,868	71,126	65,088	70,541	62,644	62,050	64,240
Services balance	-1,180	-2,191	-3,075	-4,063	-3,803	-3,030	-3,450
Income balance	-11,341	-12,402	-12,761	-10,981	-11,199	-11,580	-11,890
Transfer balance	-405	-547	-489	-832	-332	-330	-410
Net direct investment flows	6,881	9,232	13,889	10,256	1,655	7,240	8,650
Net portfolio investment flows	12,189	-99	1,455	1,698	6,392	5,240	5,460
Net debt flows	-6,727	8,059	-2,709	-3,733	2,581	-3,310	6,130
Other capital flows (negative is flight)	-9,496	-20,798	-14,576	-16,122	-4,594	-7,670	-16,200
Change in international reserves	4,206	-5,877	-3,108	-12,714	595	-2,790	260
External position (m USD)							
Total foreign debt	120,791	132,743	133,042	136,272	138,442	131,590	136,350
Short-term debt	16,999	26,333	25,852	22,166	21,502	22,140	24,060
Total debt service due, incl. short-term debt	64,800	52,510	59,438	59,568	56,287	52,810	52,560
Total foreign exchange reserves	49,734	43,227	39,920	28,143	28,811	26,020	26,280
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	3.1	2.3	2.5	1.8	1.9	2.0	2.4
Current account balance (% of GDP)	0.3	-0.4	-0.2	-0.8	-1.0	-0.8	-0.8
Inward FDI (% of GDP)	1.7	1.9	2.5	1.8	0.7	1.6	2.0
Foreign debt (% of GDP)	26	24	22	22	26	25	28
Foreign debt (% of XGSIT)	140	126	133	135	153	145	145
International investment position (% of GDP)	9.7	9.3	n.a.	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	75	50	59	59	62	58	56
Interest service ratio incl. arrears (% of XGSIT)	17	9	10	10	12	11	11
FX-reserves import cover (months)	8.7	5.8	5.8	3.8	4.3	4.0	3.9
FX-reserves debt service cover (%)	77	82	67	47	51	49	50
Liquidity ratio	110	103	100	89	90	88	90

Source: EIU, M&S Consultores (*), IMF(**); EIU growth data is based on official data

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