Country update **ARGENTINA**

Summary

After two years of rapid growth, Argentina's economy will grow less quickly in 2012. President Kirchner's popularity has fallen after her recent re-election. High public spending resulted in a deterioration of the government budget to a deficit of 1.7% of GDP and the government has extended its abilities to use central bank resources. In an attempt to ease balance of payments pressures, the government has further tightened its trade, capital and foreign exchange controls. Meanwhile, the underlying drivers of the deterioration of the balance of payments have not been taken away. The government's energy policies are possibly even more unsustainable. In mid-April, the government announced the partial nationalization of YPF, Argentina's largest energy company. Earlier the government had already revoked a number of concessions from energy companies. Overall, the country risk profile of Argentina has thus deteriorated further.

Things to watch:

- Balance of payment pressures and new government measures
- Fall out of the partial nationalization of YPF.
- Prices of soy and other important agricultural export products.

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Argentina

National facts		
Type of government	Republic	
Capital	Buenos Aires	
Surface area (thousand sq km)	2,780	
Population (millions)	40.5	
Main languages	Spanish	
Main religions	Roman Catholic (92%)	
	Protestant (2%)	
	Jewish (2%)	
Head of State (president)	Cristina Kirchner	
Head of Government	Cristina Kirchner	
Monetary unit	peso (ARS)	
Economy		*2011*
Economic size	*bn USD*	*% world total*
Nominal GDP	448	0.65
Nominal GDP at PPP	717	0.91
Export value of goods and services	98	0.45
IMF quotum (in mln SDR)	2117	0.97
Economic structure	*2011*	*5-year av.*
Real GDP growth (%)	8.9	6.8
Agriculture (% of GDP)	11	9
Industry (% of GDP)	31	33
Services (% of GDP)	58	58
Standards of living	*USD*	*% world av.*
Nominal GDP per head	10958	102
Nominal GDP per head at PPP	17538	142
Real GDP per head	6756	83

Social and governance indicators	rank / total
Human Development Index (rank)	45 / 187
Ease of doing business (rank)	113 / 183
Economic freedom index (rank)	158 / 179
Corruption perceptions index (rank)	100 / 183
Press freedom index (rank)	47 / 178
Gini index (income distribution)	45.84
Population below $1.25 per day (PPP)	0.9%

Foreign trade			*2011*
Main export partners (%)		*Main import partners (%)*	
Brazil	21	Brazil	37
Chile	9	US	16
US	7	China	13
China	5	Germany	7
Main export products (%)			
Manufactures			35
Processed agricultural products			34
Primary			24
Fuel and energy			7
Main import products (%)			
Intermediate goods			30
Capital goods			20
Consumer goods			11
Fuels			13
Openness of the economy			
Export value of G&S (% of GDP)			22
Import value of G&S (% of GDP)			19
Inward FDI (% of GDP)			1.4

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Introduction and update

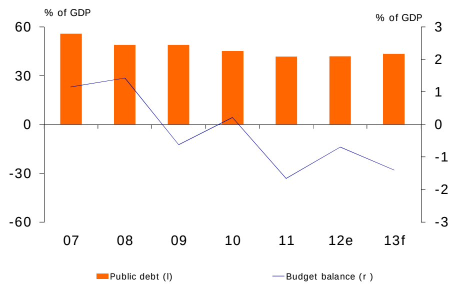
After two years with rapid (although statistically overstated) economic growth of roughly 9%, Argentina's economy is likely to grow at a much lower speed in the near future. The global economic conditions have deteriorated and Argentina's economic policy framework is resulting in increasing pressures, with the government resorting to more and more distortive controls. Economic growth in 2012 may thus be limited to roughly 3%. Meanwhile, the 2012 soy crop will be smaller due to a drought which hit Argentina and its neighbors. However, the impact of this drought will be mitigated by the latest soy price developments. The price of soy has increased rapidly to levels not seen since mid-2008, after a strong fall of the soy price in the second half of 2011.

Meanwhile, Argentina's primary surplus has all but disappeared and the budget deficit grew to 1.7% in 2011 (see chart 1). The government has reacted by increasing its abilities to use central bank financing. In March 2012 Congress approved a bill which changed the mandate of the central bank and allowed the government to take more cash from the central bank and to use the central bank's foreign reserves more freely. Until the approval, the central bank was obliged to hold a specific amount of foreign reserves, which limited the amount of reserves the government could use to pay off foreign debt.

In March 2012, the popularity of president Cristina Kirchner fell to 42%, the lowest level in 13 months. The president resorted to stirring nationalist sentiment by devoting a lot of attention to the disputed Falkland Islands, or, as Argentineans call them, the Malvinas. In the past, Argentinean governments under pressure also tried to boost their popularity by rallying the country around the Malvinas cause. Similarly, the government has also attacked the energy companies, another popular target of nationalist sentiment in Argentina, in particular the largest company YPF (see below).

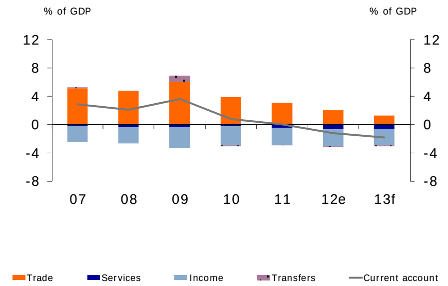
Meanwhile, the relation between the government and the trade unions is under pressure. During her first term in office, Cristina Kirchner had good relations with the trade unions, as yearly nominal wages increases of almost 30% compensated workers for the high inflation rate. However, the decision of the newly elected government to reduce subsidies on energy and public transport was not popular with the unions. Even more importantly, the government is now pressuring for more moderate wage growth.

Figure 1: Fiscal position



Source: EIU

Figure 2: Current account



Source: EIU

Battling balance of payment troubles

One of Christina Kirchner's biggest problems is Argentina's balance of payments position. As we explained in our full report, maintaining a surplus on the current account is crucial for Argentina, given its poor access to foreign capital. However, the growth maximizing policies of the government continue to fuel domestic demand and import growth and erode the competitiveness of Argentina's industry, as they lead to high inflation. As a result, Argentina's current account surplus has disappeared. According to recently published central bank data, the current account balance fell from 3.6% of GDP in 2009 to 0.8% of GDP in 2010 and to 0% of GDP in 2011 (see chart 2). In the coming years, the current account balance is expected to turn negative.

In response, the government has further tightened its restrictions on trade and capital flows. For example, it has made it more difficult for companies with foreign owners to repatriate profits. Also, Argentineans with peso accounts can no longer withdraw cash from their accounts when they are abroad. Furthermore, the trade regime, which was already very protectionist, became even more restrictive when the government implemented a new import regime in early 2012. From now on, companies have to get government approval for all imports in advance. In late March a group of 14 countries led by the US and the EU delivered a complaint at a meeting of the Council for Trade in Goods of the World Trade Organization. The measures have also soured relations with its neighboring countries. The restrictions are very burdensome for the private sector and they contribute to shortages. The increased role of the government in trade may also lead to more corruption and may further erode Argentina's institutions.

Thanks to the tighter restrictions Argentina has been able to halt the large capital flight that gathered speed in mid-2011. While capital flight amounted to USD 8.4bn in the third quarter of 2011, it fell to USD 3.3bn in the fourth quarter. Foreign reserves have grown in the first three months of this year from USD 46.1bn to 47.1bn, but the reserves level may come under pressure later this year after the end of the agricultural export season. Meanwhile, the underlying drivers of the balance of payment pressures have not been taken away. Inflation has remained above 20% and the government is unwilling to let the peso depreciate rapidly.

Meanwhile, the US government has announced that it will suspend trade preferences for Argentina. The US wants to punish Argentina for its failure to pay two US companies about USD 300m. The ICSID, the arbitration tribunal of the World Bank, had ruled that Argentina has to pay this amount. Together with Belarus, Sudan and Syria, Argentina is now one of the few countries not to get US trade preferences. The direct impact is limited, as until now the preferences allowed USD 477mln in export to enter the US duty free, resulting in a saving of only USD 20mln in duty fees. However, it is still not helpful for a country struggling with balance of payment problems, while it also underlines the pariah status of Argentina.

Blame it on YPF

Recently, Argentina's energy policies have become even more unsustainable than they already were. Argentina's energy policies boost demand by keeping energy prices low through price controls and energy subsidies. At the same time, these price controls limit the production of energy. As a result, oil production has decreased by almost a third since 1999, while gas production has fallen by 9% since 2006. Thus, the country became a net energy importer in 2011, with energy imports increasing to USD 9.4bn, which contributed to Argentina's balance of payments problems. The government subsidy bill has also increased dramatically, although the government has reduced energy subsidies somewhat after the fall 2011 elections.

The government has reacted by putting pressure on energy companies to invest more in exploration. This pressure culminated in the announcement that the government would partially nationalize YPF, Argentina's main energy company, in mid-April. According to a bill sent to Congress, the Argentinean government will get a 51% share in YPF, which implies that Spanish Repsol, which used to have a 57% share, will be ousted as majority owner. It seems that the government is willing to pay only a limited amount in compensation. Earlier, a number of provinces revoked energy concessions. So far, this has resulted in YPF losing about 18% of its energy production and provincial governments have threatened to revoke more concessions. In early April, provincial governments also also revoked concessions held by Petrobras and a Canadian energy company.

In order to keep concessions, the existing energy producers may increase their short-term investment somewhat. However, in the medium- and long-term, the recent government actions are likely to be very damaging. Large discoveries of shale oil and gas have been made in recent years. Getting these fields into production will be difficult and will require a lot of (foreign) investment and technology. The increased uncertainty resulting from the recent government actions will make foreign energy companies less willing to do these investments. Meanwhile, the government's abilities to invest are limited. Furthermore, YPF's partial nationalization may also have political repercussions, as Spain already warned Argentina's government before the announcement. The measure may also result, if possible, in further reputational damage to Argentina among investors.

Argentina

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)*	8.7	6.8	0.9	9.2	8.9	3.8	4.0
Consumer prices (average % change pa)*	8.8	8.6	6.3	10.5	9.8	9.9	9.2
GDP (% real change pa) (unofficial)	n.a.	4.4	-2.6	7.6	5.5	3.0	n.a.
Current account balance (% of GDP)	2.8	2.1	3.6	0.8	0.0	-1.2	-1.8
Total foreign exchange reserves (mln USD)	44682	44855	46093	49734	43227	42420	45480
Economic growth							
GDP (% real change pa)*	8.7	6.8	0.9	9.2	8.9	3.8	4.0
Gross fixed investment (% real change pa)	13.6	9.1	-10.2	21.2	16.6	3.1	4.9
Private consumption (real % change pa)	9.0	6.5	0.5	9.0	10.7	5.4	4.3
Government consumption (% real change pa)	7.6	6.9	7.2	9.4	10.9	2.8	3.8
Exports of G&S (% real change pa)	9.1	1.2	-6.4	14.6	4.3	2.8	6.7
Imports of G&S (% real change pa)	20.5	14.1	-19.0	34.0	17.8	9.6	9.5
Economic policy							
Budget balance (% of GDP)*	1.1	1.4	-0.6	0.2	-1.7	-0.7	-1.4
Public debt (% of GDP)	56	49	49	45	41	42	43
Money market interest rate (%)	8.7	10.1	10.2	9.1	10.0	11.3	11.5
M2 growth (% change pa)	24	8	17	33	26	26	19
Consumer prices (average % change pa)*	8.8	8.6	6.3	10.5	9.8	9.9	9.2
Consumer prices (average % change pa) (unofficial)	20.1	21.4	14.8	26.8	24.2	25.0	n.a.
Exchange rate LCU to USD (average)	3.1	3.1	3.7	3.9	4.1	4.6	4.8
Recorded unemployment (%)	8.5	7.9	8.7	7.8	7.2	7.1	7.3
Balance of payments (mln USD)							
Current account balance	7354	6755	11049	2819	18	-5600	-8880
Trade balance	13457	15423	18525	14266	13541	9310	6030
Export value of goods	55982	70019	55672	68134	84269	85560	90840
Import value of goods	42525	54596	37147	53868	70728	76250	84820
Services balance	-512	-1283	-1220	-1114	-2231	-3200	-3160
Income balance	-5942	-7552	-8955	-9939	-10744	-11260	-11280
Transfer balance	354	170	2698	-396	-465	-450	-470
Net direct investment flows	4970	8334	3306	6091	5020	5700	8000
Net portfolio investment flows	2752	-7088	-2059	12097	-520	-1490	-6190
Net debt flows	-5121	3120	-1593	11775	6826	720	5710
Other capital flows (negative is flight)	4135	-10868	-9047	-28576	-17222	-1260	4420
Change in international reserves	14089	253	1656	4206	-5877	-1940	3060
External position (mln USD)							
Total foreign debt	117317	118902	120283	127850	136725	135280	140250
Short-term debt	19260	19977	19632	35005	38955	39030	40120
Total debt service due, incl. short-term debt	62853	55453	62501	64069	59164	64450	66580
Total foreign exchange reserves	44682	44855	46093	49734	43227	42420	45480
International investment position	34444	57816	54919	46201	n.a.	n.a.	n.a.
Total assets	206097	210703	223735	238442	n.a.	n.a.	n.a.
Total liabilities	171653	152887	168816	192241	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	5.1	4.7	6.0	3.9	3.0	2.0	1.2
Current account balance (% of GDP)	2.8	2.1	3.6	0.8	0.0	-1.2	-1.8
Inward FDI (% of GDP)	2.5	3.0	1.3	1.9	1.4	1.5	2.0
Foreign debt (% of GDP)	45	36	39	35	31	29	29
Foreign debt (% of XGSIT)	157	133	167	149	132	131	129
International investment position (% of GDP)	13.1	17.6	17.8	12.5	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	84	62	87	75	57	63	61
Interest service ratio incl. arrears (% of XGSIT)	18	15	20	17	9	9	9
FX-reserves import cover (months)	10.0	7.9	11.2	8.8	6.0	5.5	5.3
FX-reserves debt service cover (%)	71	81	74	78	73	66	68
Liquidity ratio	111	118	120	112	100	93	92

Source: EIU, M&S consultores, Rabobank estimates

*Official data, unofficial estimates may deviate.