



Summary

Argentina's self-contradictory and interventionist macroeconomic policy mix is under more and more pressure. Mainly due to the introduction of strong import controls, Argentina has entered recession-like conditions. In particular investment in capital goods has fallen strongly. As the years of high growth seem to have ended, president's Cristina Kirchner's popularity has been falling rapidly. There have been two mass street protests recently, pointing at increasing risks of political and social instability.

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Argentina			
National facts		Social and governance indicators	
Type of government	Republic	Human Development Index (rank)	rank / total 45 / 187
Capital	Buenos Aires	Ease of doing business (rank)	124 / 185
Surface area (thousand sq km)	2,780	Economic freedom index (rank)	158 / 179
Population (millions)	40.5	Corruption perceptions index (rank)	100 / 183
Main languages	Spanish	Press freedom index (rank)	47 / 178
		Gini index (income distribution)	44.49
Main religions	Roman Catholic (92%) Protestant (2%) Jewish (2%)	Population below \$1 per day (PPP)	0.9%
Head of State (president)	Cristina Kirchner	Foreign trade	
Head of Government	Cristina Kirchner	2011	
Monetary unit	Argentina peso (ARS)	Main export partners (%)	Main import partners (%)
		Brazil 20	Brazil 37
		China 7	US 16
		Chile 5	China 14
		US 5	Germany 5
Economy		2011	
Economic size		Main export products (%)	
	<i>bn USD</i>	<i>% world total</i>	2011
Nominal GDP	448	0.65	Manufactures 35
Nominal GDP at PPP	717	0.90	Processed agricultural products 34
Export value of goods and services	99	0.45	Primary 24
IMF quatum (in mln SDR)	2117	0.97	Fuel and energy 7
Economic structure		Main import products (%)	
	2011	5-year av.	2011
Real GDP growth (%)	8.9	6.8	Intermediate goods 33
Agriculture (% of GDP)	11	9	Capital goods 22
Industry (% of GDP)	31	33	Fuels 14
Services (% of GDP)	58	58	Consumer goods 12
Standards of living		Openness of the economy	
	<i>USD</i>	<i>% world av.</i>	
Nominal GDP per head	10958	101	Export value of G&S (% of GDP) 22
Nominal GDP per head at PPP	17536	141	Import value of G&S (% of GDP) 20
Real GDP per head	6756	83	Inward FDI (% of GDP) 1.6

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

Economic structure and growth

After two years of rapid growth, the Argentine economy entered recession-like conditions in 2012. Although a severe drought and weaker growth in Brazil were partially responsible, the sharp slowdown is to a large extent due to the government's own policies. Years of extremely loose fiscal and monetary policies have resulted in strong balance of payments and fiscal pressures. The government's response to these pressures, primarily the introduction of more and more controls and interventions, has hit the economy hard. In particular investment has suffered from the introduction of tight imports and capital controls. There has been a strong fall of imports of capital goods in particular and there have been shortages of different types of products. As a result, the economy, which grew rapidly in the past decade (except in 2009), is likely to stagnate in 2012. The government seems to hope that 2013 will be better year, as the total 2012/2013 harvest is expected to be 25% larger than the 2011/2012 one, and seems to expect a repetition of 2010, when the economy recovered vigorously after the 2009 crisis. However, even as a good harvest may lead to an increase in economic activity, the high economic growth of the past decade will not return, as the policy mix of the government is self-contradictory and unsustainable and the country has experienced a strong real appreciation. As inflation is likely to remain elevated, the economy is expected to remain in a more or less stagflationary mode. Meanwhile, the business environment may become even more complicated.

From a structural point of view, Argentina has a very dynamic and advanced agricultural sector which accounts for 19% of GDP, if one includes industries and services which are directly linked to the sector, 58% of total exports and 14% of fiscal revenue. The sector benefits from the good quality of the Argentine soil, a favorable climate and good access to sea transport. Soybeans and soybean products are the most important agricultural export commodity and account for roughly one-third of Argentina's exports. Other important agricultural products are wheat and beef. Manufacturing is another important pillar of the economy. A large part of Argentina's industry is related to the processing of agricultural products and the country also has a relatively large steel and automobile industry. The most important export market for Argentina's products is Brazil. The importance of agricultural exports and exports to Brazil mean that commodity prices and economic activity in Brazil are important external factors that determine economic growth in Argentina. With private sector debt accounting for only 16% of GDP in 2011, the financial sector in Argentina is small. This is due to the distrust of banks following the heavy losses during the 2001 default and the negative real interest rates, which encouraged people to save in unconventional ways, such as by buying and storing cars as a preserver of value.

Political and social situation

While the economic policies of Argentina's government are extremely short-term oriented, regarding her own political future President Christina Fernandez de Kirchner has taken a much more forward looking approach. The president seems intent on being re-elected in 2015. She was already re-elected in late 2011, when she convincingly won with 54% of the votes in the first round of the presidential elections. Re-election would allow Kirchnerism, which began in 2003 when Cristina Kirchner's deceased husband Nestor Kirchner became president, to rule Argentina for more than 15 years. Kirchner's re-election will face big hurdles, as she needs to get a two-thirds majority in both houses of congress (she currently lacks such a majority) during the 2013 parliamentary elections to be able to change the constitution, which currently does not allow her to run again. This will be very difficult. If she succeeds, she will then still stand the challenge of being re-elected. Still, it is too soon to say that such a scenario is therefore unrealistic. Kirchner is an extremely good campaigner, and is able to manage expectations very well.

Recently, though, President Kirchner seems to be rapidly losing support. A poll showed that her approval rating fell from 64% at the time of her re-election in late 2011 to only 28% in October. According to a poll published in early November in an opposition newspaper, more than 80% of Argentina's population is opposed to her re-election. Discontent about the present economic situation is growing, while people have also become more critical about crime and corruption. Both in September and in early November there have been mass street protests against the Kirchner government. However, the problem for the opposition is that it does not have a strong candidate to rally around. We expect that political change is most likely to come from Peronist governors and/or the trade unions, as is usual in Argentine history. Kirchner's relationship with the latter has become more difficult, as the trade union has become divided, with one leading trade union leader now opposing the government. Meanwhile, the position of most Peronist governors does not seem very strong. Although Cristina Kirchner belongs to Victory Front faction of the ruling Justicialist or Peronist Party, she has been trying to build a new and alternative powerbase among younger people through the La Campora youth movement. The government has for example staffed the higher ranks of state controlled companies such as YPF and Aerolineas Argentinas with people from this movement. The central government is thereby trying to centralize government finances and while the recession is hurting the income of provincial governments, the central government continues to benefit from high soy prices. Overall, we expect that political and social instability may

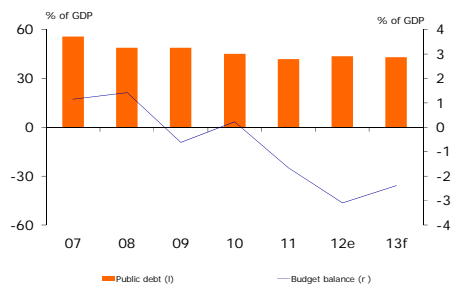
increase, as the position of Christina Kirchner is likely to weaken further, while the polarization of Argentine society is growing.

Economic policy

The economic policies of the Argentina government are extremely short-term oriented, unpredictable and interventionist. What is more, in the past year, the policy mix has become even more radical. The most remarkable development was the partial nationalization of energy firm YPF, Argentina’s largest enterprise. The government nationalized the biggest part of the stake of Spanish oil major Repsol in YPF in April 2012, but has so far failed to pay Repsol anything in compensation. Interventions in other parts of the economy have also increased. As the government tries to limit the outflow of dollars, it has become impossible for foreign companies to repatriate profits, while access to dollars for Argentineans has been strongly restricted. Meanwhile Chaco, a province in northern Argentina, had to pay holders of dollar debt issued under local law in pesos, after the central bank declined to give the province dollars. Although most of the loans such as those issued by Chaco contain a clause that states that repayment is possible in pesos, the recent events have increased fears that the government will pesify more dollar loans issued under local law.

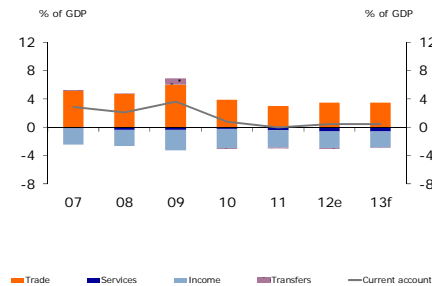
We already mentioned how import controls are a burden for business. This is also related to the way the government manages the control regime. Instead of implementing clear formal rules, high ranking officials such as Commerce Secretary Guillermo Moreno to a large extent decide which goods can enter the country and which cannot. This has resulted in a lot of uncertainty and complications for companies. For example, to be able to import cars, BMW is now exporting processed rice from Argentina, while the Porsche importer is exporting wine and Hyundai is exporting soy flour. The government has also ordered supermarkets to offer 300 basic products at low prices and has increased the control over investment decisions of insurers.

Figure 1: Public finances



Source: EIU

Figure 2: Current account



Source: EIU

Meanwhile, the fiscal and monetary policies remain extremely loose. Despite some attempts by the government to control public spending by reducing some energy subsidies and limiting wage growth in the public sector, the government deficit is likely to increase from 1.7% of GDP in 2011 to 3.1% in 2012. The government has thereby resorted to monetary financing of fiscal deficits. 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. All these policies have kept inflation at roughly 25% a year, even after the country entered recession-like conditions in 2012, and results in strongly negative real interest rates. The government thereby continues to grossly underreport inflation. According to widely discredited official statistics, inflation is only roughly 10%. In September 2012, the IMF stated that

Argentina has until 17 December to respond to concerns about the quality of its inflation statistics and that the country can be sanctioned if it fails to meet the deadline.

The government has been unwilling to let the peso depreciate at the same pace as the inflation, even as the pace of depreciation has increased somewhat during 2012 from roughly 10% per year to roughly 15% per year. This means that the underlying problems remain unresolved. Instead, the government may introduce new controls and interventions. One measure that the government may take is the (formal) introduction of a dual exchange rate (the informal peso is already trading at a 25% discount). This may help to protect the manufacturing sector temporarily against high inflation, and is likely to result in practice in an additional tax on agriculture.

Balance of Payments

The combination of 25% inflation and a depreciation of the peso of only 10% results in a continuous erosion of the price competitiveness of Argentine producers. Thus, the current account surplus that Argentina got after the 2001 crisis has all but disappeared. Through the introduction of the tight import and other foreign exchange controls, the government has managed to pause the deterioration of the current account balance this year. It seems that the current account will even improve from a deficit of 0.1% in 2011 to a surplus of 0.4% in 2012. Furthermore, the next agricultural crop is likely to be good, which will boost the export income from agricultural exports.

However, we note that this will only provide temporary relief, as long as nothing is done to resolve the underlying imbalances. As long as the inflation surpasses the depreciation rate of the peso, balance of payments pressures will remain very high. Given its dependence on the export of agricultural products, Argentina is thereby very vulnerable to a prolonged period of low agricultural prices. Meanwhile, the balance of payments position is further constrained by the fact that Argentina hardly has access to foreign finance. Inward FDI flows are small and likely to fall to only 1.3% of GDP. Access to financing in the form of loans is also fairly limited. The country uses its foreign reserves to repay foreign loans. Overall balance of payments risks are therefore elevated.

External position

Thanks to the tight import and foreign exchange reserves, Argentina has so far managed to avoid a depletion of its foreign reserves. However, reserve levels have become less comfortable, as the import cover is likely to fall to less than 6 months of imports in 2012. What is more, the government is only able to maintain these reserves thanks to the earlier mentioned tight controls on imports and foreign exchange. Meanwhile, foreign debt is likely to fall from 39% of GDP in 2009 to 26% of GDP in 2012. Although this trend looks favorable, it mainly reflects a substitution of foreign government debt by domestic government debt financed by lending of the central bank and nationalized pension funds. Furthermore, recently a United States Court of Appeal affirmed a previous ruling which stated that Argentina was discriminating against the holdouts in the restructuring of the debt on which the country defaulted in 2001. This ruling may increase the foreign liabilities of the government.

Argentina							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)*	8.7	6.8	0.9	9.2	8.9	2.1	3.7
Consumer prices (average % change pa)*	8.8	8.6	6.3	10.5	9.8	9.9	10.3
GDP (% real change pa) (unofficial)	n.a.	4.4	-2.6	7.6	5.7	0.5	2.5
Current account balance (% of GDP)	2.8	2.1	3.6	0.8	-0.1	0.4	0.4
Total foreign exchange reserves (m USD)	44682	44855	46093	49734	43227	39590	37810
<i>Economic growth</i>							
GDP (% real change pa)*	8.7	6.8	0.9	9.2	8.9	2.1	3.7
Gross fixed investment (% real change pa)	13.6	9.1	-10.2	21.2	16.6	-9.4	6.2
Private consumption (real % change pa)	9.0	6.5	0.5	9.0	10.7	4.3	3.8
Government consumption (% real change pa)	7.6	6.9	7.2	9.4	10.9	7.3	4.4
Exports of G&S (% real change pa)	9.1	1.2	-6.4	14.6	4.3	-6.6	8.7
Imports of G&S (% real change pa)	20.5	14.1	-19.0	34.0	17.8	-9.5	11.2
<i>Economic policy</i>							
Budget balance (% of GDP)*	1.1	1.4	-0.6	0.2	-1.7	-3.1	-2.4
Public debt (% of GDP)	56	49	49	45	42	44	43
Money market interest rate (%)	8.7	10.1	10.2	9.1	10.0	10.2	10.8
M2 growth (% change pa)	24	8	17	33	26	35	28
Consumer prices (average % change pa)*	8.8	8.6	6.3	10.5	9.8	9.9	10.3
Consumer prices (average % change pa) (unofficial)	9.8	21.1	14.6	26.8	24.0	25.0	27.5
Exchange rate LCU to USD (average)	3.1	3.1	3.7	3.9	4.1	4.6	5.1
Recorded unemployment (%)	8.5	7.9	8.7	7.8	7.2	7.2	7.4
<i>Balance of payments (m USD)</i>							
Current account balance	7355	6755	10995	2829	-244	1840	2220
Trade balance	13457	15423	18525	14266	13207	16700	17650
Export value of goods	55982	70019	55672	68134	83950	83150	88210
Import value of goods	42525	54596	37147	53868	70743	66450	70570
Services balance	-512	-1283	-1284	-1101	-2133	-3050	-3270
Income balance	-5942	-7552	-8955	-9939	-10793	-11340	-11660
Transfer balance	354	170	2710	-398	-526	-470	-500
Net direct investment flows	4970	8334	3306	6091	5755	5050	5700
Net portfolio investment flows	2752	-7088	-2059	12097	-2795	-730	3500
Net debt flows	-5121	3120	-1593	11775	2402	-2930	1930
Other capital flows (negative is flight)	4133	-10868	-8993	-28586	-10995	-6590	-15110
Change in international reserves	14089	253	1656	4206	-5877	-3370	-1770
<i>External position (m USD)</i>							
Total foreign debt	117317	118902	120283	127850	132182	126900	128270
Short-term debt	19260	19977	19632	35005	33031	30240	32250
Total debt service due, incl. short-term debt	62853	55453	62501	64072	59203	58650	57710
Total foreign exchange reserves	44682	44855	46093	49734	43227	39590	37810
International investment position	34444	57816	n.a.	n.a.	n.a.	n.a.	n.a.
Total assets	206097	210703	n.a.	n.a.	n.a.	n.a.	n.a.
Total liabilities	171653	152887	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	5.1	4.7	6.0	3.9	2.9	3.5	3.4
Current account balance (% of GDP)	2.8	2.1	3.6	0.8	-0.1	0.4	0.4
Inward FDI (% of GDP)	2.5	3.0	1.3	1.9	1.6	1.3	1.4
Foreign debt (% of GDP)	45	36	39	35	29	26	25
Foreign debt (% of XGSIT)	157	133	167	149	127	123	118
International investment position (% of GDP)	13.1	17.6	n.a.	n.a.	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	84	62	87	75	57	57	53
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	5.9	5.6	5.0
FX-reserves debt service cover (%)	71	81	74	78	73	67	66
Liquidity ratio	111	118	120	112	100	100	100

Source: EIU, M&S consultores, Rabobank estimates

*Official data, unofficial estimates may deviate.

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