

Argentina Business Forecast Report Q2 2014

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Abstracts

Core Views

We have revised up our 2013 real GDP growth estimate for Argentina from 3.2% to 4.9%, as base effects saw stronger economic activity than we initially anticipated, but we maintain our view for a slowdown in 2014. The January 23 currency devaluation and subsequent collapse in consumer sentiment underpin our view that real growth this year will slow to 2.2%, with risks to the downside.

We believe that Argentina's balance of payments position remains precarious at best, with the potential for additional currency instability this year. While we currently forecast a slight narrowing in the current account deficit and expect an improving business environment to stabilise the financial account, we see risks as weighted to the downside on both fronts.

While we do not anticipate significant exchange rate volatility in the short term, we believe that the Argentine central bank will be forced to resume its crawling peg policy of gradually weakening the peso in order to manage depreciatory pressure on the unit, a return to the policy of the last several years that we expect to play out in the coming months. However, before that happens we believe that a brief respite in the multi-year drop in foreign currency reserves will allow the central bank to hold the peso fairly steady against the dollar.

We have revised our fiscal forecasts for Argentina to reflect much more rapid growth in both revenue and expenditure. While revenue growth should see something of an added boost from stronger grains shipments, we believe expenditures will rise even faster, widening the nominal budget deficit from 2.6% of GDP last year to 3.4% in 2014.

We believe that the recent devaluation of the Argentine peso will only exacerbate a

decline in confidence in the government and President Cristina Fernández de Kirchner's approval ratings. Moreover, a further deterioration in public sentiment is likely to complicate efforts by the Fernández administration to manage pressure on the external accounts.

Key Risks To Outlook

The main downside risk to our view is that the Argentine government is unable to stem the loss of foreign currency reserves in the short term, prompting another peso devaluation. Such a scenario could be caused by either a dramatic widening in the current account deficit amidst weak capital inflows, a higher-than-expected spike in domestic inflation, or a further loss of confidence in the peso. We believe another devaluation would have the effect of further eroding growth, potentially even pushing the economy into recession this year.

Argentina is attempting a rapprochement with the international financial community that, if successful, could lead to an inflow of lending that could boost the economy and drive investment in the oil and gas sector higher. While not our core view, we believe this scenario would provide a tailwind to growth and help further narrow the current account.

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Low Confidence In Government Will Increase Pressure On FX Policy

We believe that the recent devaluation of the Argentine peso will only exacerbate a decline in confidence in the government and President Cristina Fernández de Kirchner's approval ratings. Moreover, a further deterioration in public sentiment is likely to complicate efforts by the Fernández administration to manage pressure on the external accounts.

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Significant Structural Challenges Ahead

Argentina scores above average for Latin America in our Long-Term Political Risk Ratings, but we see growing policy challenges that the country must confront over the next decade. Moreover, Argentina's increasing international isolation and the continued dominance of the ruling Frente Para la Victoria party limit policy options going forward. If the government cannot address high inflation and a weakened business environment, we believe it will likely face a sharp macroeconomic adjustment over the next decade.

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We have revised up our 2013 real GDP growth estimate for Argentina from 3.2% to 4.9%, as base effects saw stronger economic activity than we initially anticipated, but we maintain our view for a slowdown in 2014. The January 23 currency devaluation and subsequent collapse in consumer sentiment underpin our view that real growth this year will slow to 2.2%, with risks to the downside.

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Following the January 23 currency devaluation, we have revised our fiscal forecasts for Argentina to reflect much more rapid growth in both revenue and expenditure. While revenue growth should see something of an added boost from stronger grains shipments, we believe expenditures will rise even faster, widening the nominal budget deficit from 2.6% of GDP last year to 3.4% in 2014.

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