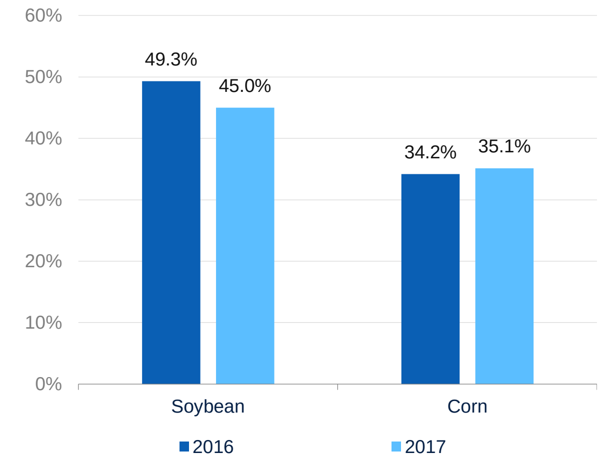
7. The greater external imbalance will not be reversed until reforms that improve competitiveness begin to mature

In line with expectations, imports have begun to expand at a rate more in keeping with the pace of growth and registered an increase of 12.4% YoY in the accumulated period from January to May 2017, of which 9.4% corresponds to an increase in the quantities imported. In contrast, exports have grown only by 1.6% YoY in the same period with a fall of 4.1% in the volumes exported. Although part of this contraction is due to the fact that in the first half of 2016 exports retained during the period of the currency exchange control were settled for USD 2 billion, exports of primary products and manufactured goods of agricultural origin in the key months of April and May still show strong declines in 2017, despite the fact that the harvest is expected to be similar to that of 2016. Exchange rate stability, the recent fall in the price of soybeans and the availability of funding at low rates in dollars could also have contributed to the fact that producers of corn and soybeans have not settled exports in the same proportion as in other years, waiting for better conditions (Figure 7.1).

Despite the fact we believe that this delay will be compensated in part in the second half of the year, exports will be less dynamic than expected over the whole year, leading us to revise the trade balance downward to a deficit (FOB-CIF) of USD 2550 million. We continue to expect that the terms of trade will not favour Argentina's external balance in 2017 (-2.7%), taking into account the expected recovery in import prices (oil-driven) in the second half of 2017 and the mildly downward outlook for prices of soybeans and derivatives.

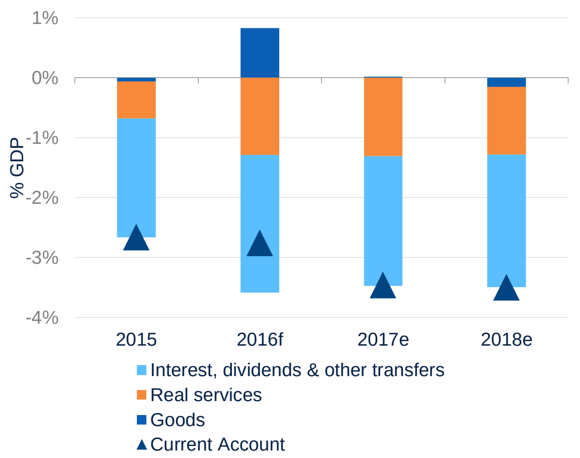
We believe that the trade balance will continue to deteriorate gradually over the next few years basically due to the recovery of the economy. Linked to this, investment will lead to a greater need for capital goods and inputs that are not produced in the country, while the pace of growth of exports will recover more slowly as it depends on the improvements in transportation infrastructure and productivity coming to maturity. We do not expect a significant reduction in the deficit in real services (in large part due to outbound Tourism) that will remain above 1% of GDP in 2017 and 2018, reflecting the appreciation of the real exchange rate. Adding the interest burden and remission of dividends, the current account deficit will be at 3.5% of GDP this year and next (Figure 7.2). Its gradual reduction to levels of lower future vulnerability will depend crucially on improving the competitiveness of exports, in both goods and services, since the economy will need to maintain a certain level of imports in order to support a strong growth rate. Despite the lifting of foreign exchange restrictions and a favourable business climate, foreign direct investment still stands at 1%, well below the rest of the region and the levels reached during Convertibility in which it averaged 2% of GDP.

Figure 7.1 Purchases of grains from exporters and industry as a % of the total harvest



Source: BBVA Research based on Ministry of Agro-Industry data

Figure 7.2 Current account balance by components (% of GDP)



Source: BBVA Research based on INDEC data

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