

# Navigator

Now, next and how for business

Argentina report

# Argentina

## A brightening future, but challenges remain

Argentinian businesses are optimistic about the future, as the economy undergoes a rapid recovery following the painful macroeconomic adjustment of 2016. With a more stable political environment at home and a buoyant global economy the prospects for trade growth look bright (particularly in Asia). A potential Mercosur-EU trade deal offers potential for further gains.

### Short-Term Snapshot

Argentina’s economy is expanding at a keen pace, and will likely continue to do so in the coming years as Macri’s administration continues with its gradualist approach to economic reforms. But not everything is rosy. Inflation has decelerated substantially but remains very high at 25%, causing an almost continuous depreciation of the peso.

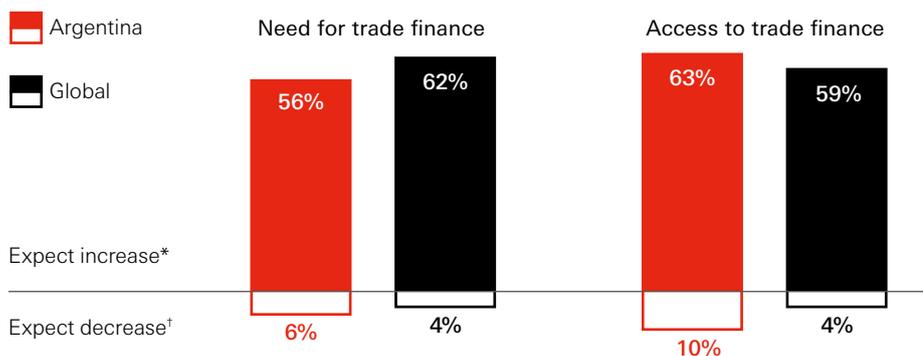
Survey data suggest that 84% of Argentinian firms expect an increase in trade volumes in 2018, significantly more optimistic than the global average of 77%. In addition to strong global trade growth, Argentina’s trade outlook is supported by an ongoing cyclical recovery across South America. Brazil’s deserves a special mention as one of Argentina’s top trading partners, given that the country went through its deepest recession in recorded history and its recovery is now in full swing. The European Union is currently negotiating a trade deal with Mercosur, which could provide an additional boost to Argentina’s beef exports and manufacture imports if approved.

Most Argentinian firms (56%) expect trade-related financing needs to increase in 2018, slightly below the global average of 62%. But Argentinian firms are more optimistic than the rest of the world regarding their ability to access financing (63% vs 59%). Optimism is likely driven by the relaxation of an extensive set of controls on the financial sector (including interest rate caps) which inhibited banks’ ability to lend under the previous government.

### Action points for business

- ◆ Firms should urge the government to continue its efforts to ensure the recovery is sustainable this time around. by pursuing sound macroeconomic policies and making further progress on microeconomic reforms.
- ◆ Given Argentina’s history of exchange rate volatility, and the importance of commodities to the export mix, firms should consider using financial instruments to hedge their exposure to both exchange rate and commodity price volatility.

### Outlook for trade finance need and access in the next 12 months



\*Expect increase = Increase significantly + Increase slightly  
 †Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

### Which are the top 3 markets where your business will look to expand in the next 3-5 years?



Source: TNS Kantar

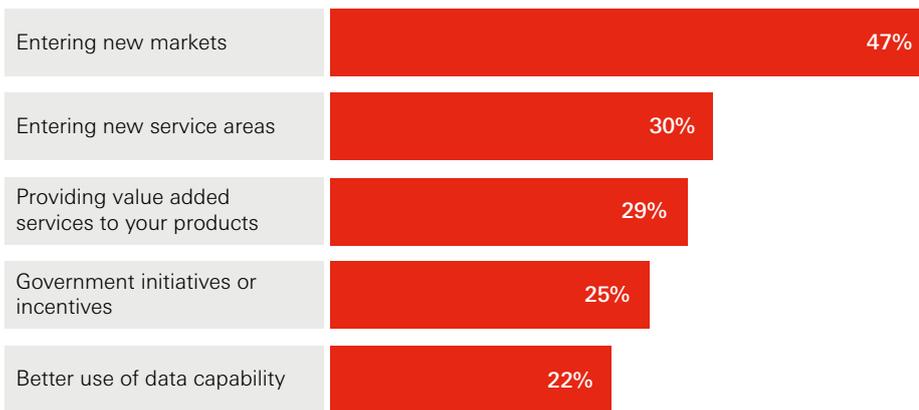
The political environment and exchange rate volatility are the two main challenges to meeting firm’s trade finance needs. A re-election of President Macri in 2019 is a strong possibility given his success in the mid-term elections, which would secure a continued but gradual improvement of the economic and political environment at home. Inflation should fall to single digits towards the end of 2020. Lower inflation will translate into a more stable currency and allow the relatively small local financial system to prosper, easing firm’s credit conditions further.

Services have become an increasingly important component of Argentina’s trade. Service exports rose to 20% of total exports in 2017 from 16% in 2010, while the share of service imports in total imports went from 21% to 28% in the same period. Yet, Argentinian firms are less optimistic about the outlook for services than for trade overall, with 68% expecting an increase in the volume of trade in services, which is still higher than the global average of 61%.

Three-quarters of Argentinian firms think that digitisation is creating a more level playing field with a similar share regarding cybersecurity as an increasing concern. A majority 56% think that data regulation will create barriers to cross-border service delivery, while a minority of 42% see big data as a potential barrier to open competition.

Following economic growth in 2017, more than eight in ten (84%) businesses remain optimistic about further growth in trade volume in the next twelve months.

**How do you plan to grow your services business?**



Source: TNS Kantar

Most Argentinian firms (51%) think a favourable economic environment is the main driver of service growth.



## Trade Policy Developments

Argentina continues to benefit from a gradual process of trade liberalisation, with most export duties and import licenses eliminated. But gaps remain, including non-automatic licenses for imports of vehicles, electrical appliances, and textiles. An emerging dispute with the USA over biofuels dumping could pose risks for trade, as this is one of Argentina's top five exports.

This background chimes with business' experiences of protectionism in Argentina. 41% of respondents to our survey felt that protective policies made cross-border business costlier, slightly above the global average. Moreover, with the current US administration making more protectionist threats than in the past, 63% of businesses surveyed felt that governments are becoming more protective overall.

Meanwhile, Argentina's membership of the Mercosur trading bloc means it cannot easily benefit from other free trade agreements. An EU-Mercosur trade deal is under negotiation, with all parties hoping to strike a deal before Brazil's election in October. Failure to reach a deal in 2018 would likely delay negotiations into 2020, as the EU will elect new commissioners and parliamentarians in 2019, while Argentina will hold a presidential election in the same year. As such we do not explicitly factor this deal into our forecast. However the potential payoff from an EU-Mercosur agreement could be very substantial - the EU thinks the potential gains from this deal could be three times larger than EU-Japan and EU-Canada combined.

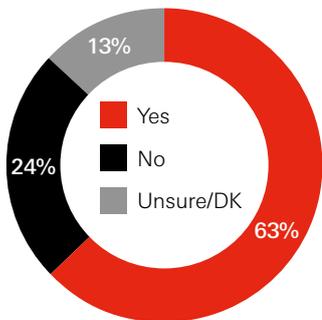
Our survey reinforces this picture, as no more than 31% of businesses felt any outside trade agreement is relevant to them. Despite the widely-discussed uncertainty surrounding NAFTA renegotiations, as exports shift towards Asia, Argentinian businesses report that ASEAN is the most relevant among current global trade agreements.

### Action points for business

- ◆ Firms should push for further trade liberalisation and for the approval of the EU-Mercosur agreement, which would greatly benefit the agricultural sector, as well as lower costs of capital across the economy.
- ◆ Given that the combination of high inflation/interest rates and a large fiscal deficit are the source of an overvalued currency that ultimately harms exporters competitiveness, firms should push for a growth-friendly fiscal consolidation.

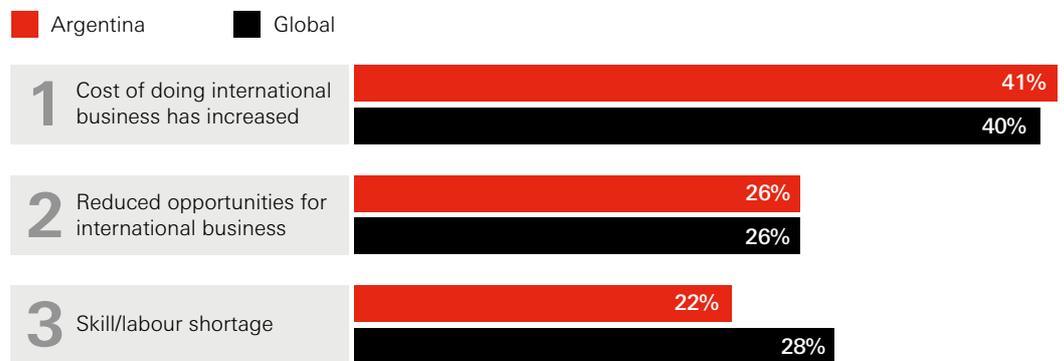
An EU-Mercosur trade agreement would greatly improve an already positive trade outlook.

#### Are governments becoming more protective of their domestic business?



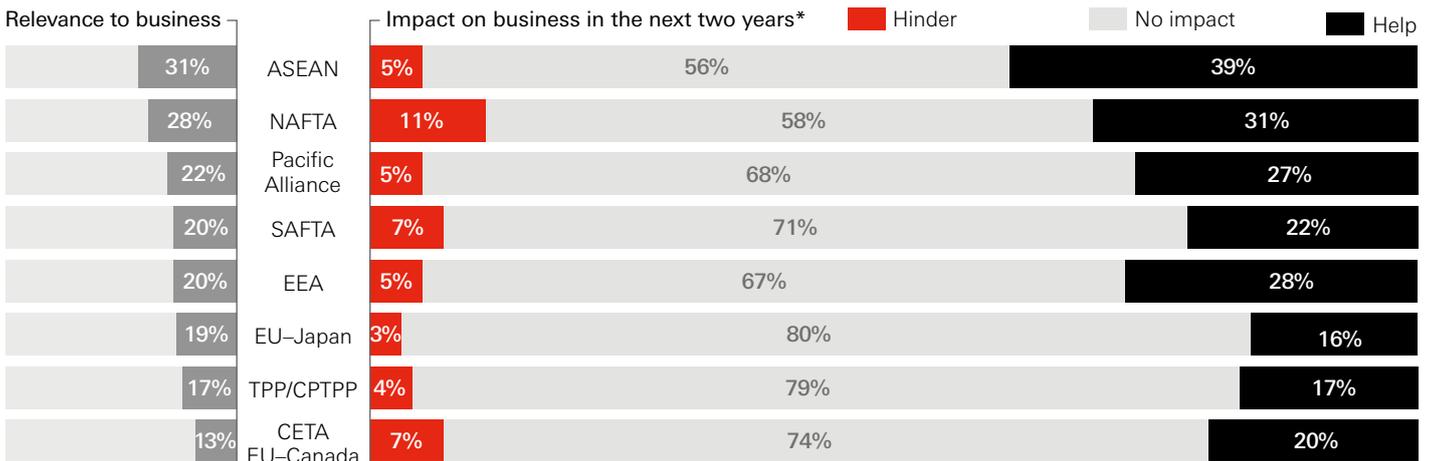
Note: may not total 100% due to rounding  
Source: TNS Kantar

#### Top 3 impacts of protective policies on my business



Source: TNS Kantar

#### Relevance and impact of trade agreements



Source: TNS Kantar

\*May not total 100% due to rounding

## Long-Term Outlook for Trade

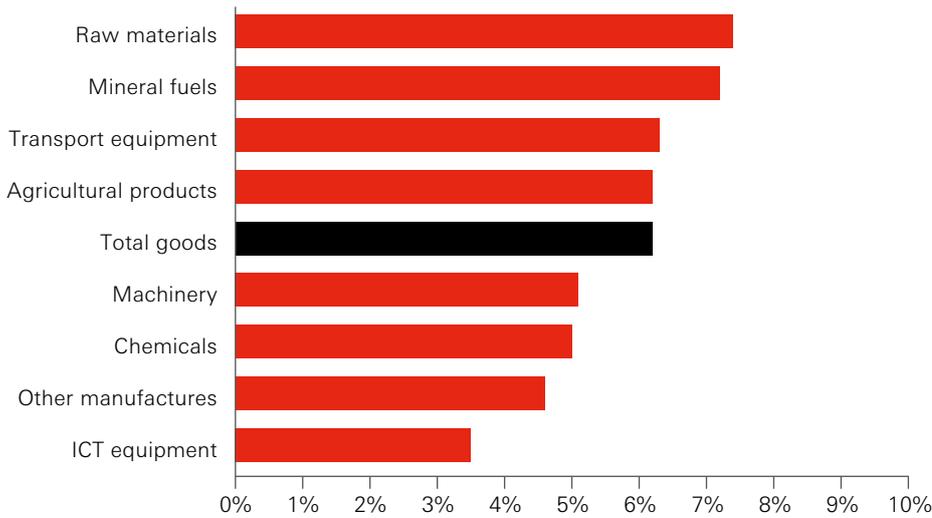
### A buoyant outlook for agricultural exports

Agricultural goods are set to remain the dominant long-term driver for Argentinian exports, reflecting the country’s well-known endowment of vast fertile lands. Animal products are forecast to account for over 30% of projected growth in merchandise exports in the decade to 2030, with cereals the next largest category, contributing 15% of overall growth. The expected recovery in commodity prices should also provide a boost to Argentina’s oil & gas exports in value terms, as well as other raw materials, with growth in both categories forecast to average 7% pa in 2021-30.

However, with labour costs expected to remain high, persistent double-digit inflation deterring investors, and an overvalued exchange rate, we think it is unlikely that Argentina will expand exports significantly in high-value manufactured goods.

Asia is forecast to be the main growth market for Argentinian goods exports, its share of the total rising from 25% in 2017 to a forecast 32% by 2030 – overtaking Latin America. Within this total, India, China and Vietnam will be the most important national markets (among the 24 trading partners considered in the trade forecast). Indeed, by 2030 China is forecast to overtake the USA to become Argentina’s second-largest export market, behind only neighbouring Brazil.

### Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

### Action points for business

- ◆ Firms should look to expand their business towards Asian markets, as they offer the fastest growth outlook. Yet, traditional customers should not be neglected, as Brazil, the US and Europe will remain key partners.
- ◆ Currency overvaluation is likely to persist for now, but firms should stand ready to benefit of a potentially competitive peso after 2020 (when inflation falls to single digits) by investing in relatively neglected sectors like tourism

### Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	Brazil	Brazil
2	USA	China
3	China	USA
4	Vietnam	Vietnam
5	India	India

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

The future looks bright for Argentinian farmers.

**Argentina’s import demand composition to remain broadly stable**

We forecast continuity in the composition of goods imports to Argentina, which reflects the country’s ongoing difficulties in diversifying its own industrial base amid exchange rate overvaluation and high labour costs. As a result, the top five import sectors in 2016 are projected to remain the same in 2030.

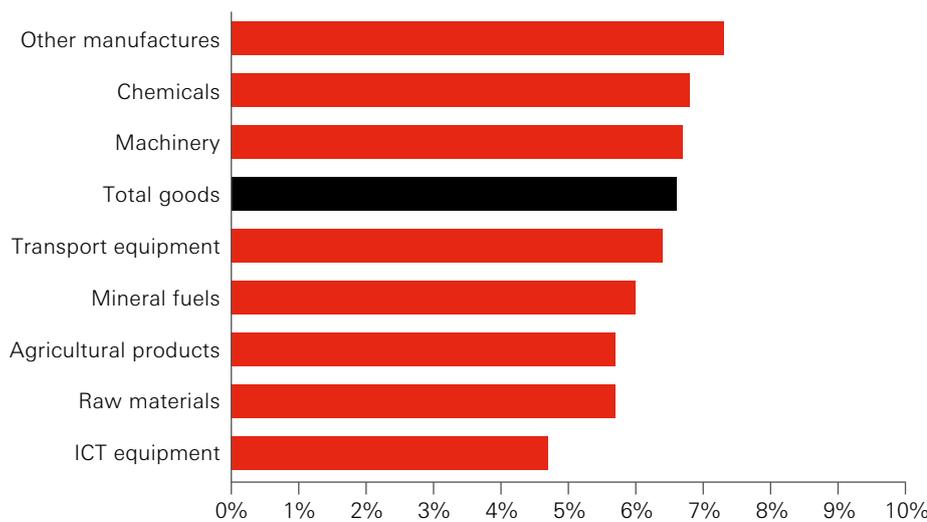
The car industry in Argentina heavily relies on imported components and parts for the assembly of vehicles it produces. As a result, transport equipment will be the main driver of imports, contributing just over a fifth of the projected increase in imports in the decade to 2030. Industrial machinery and chemicals will also make strong contributions to overall growth. But the most rapid projected growth will occur in final consumer goods, reflecting demand from Argentina’s growing middle class.

Just as it offers the greatest demand for exports, neighbouring Brazil looks set to supply the biggest share of imports for Argentina well into the future. Latin America as a region also remains Argentina’s largest supplier of imports all the way to 2030 in our forecasts.

Nevertheless, there is a clear shift in momentum towards Asia in the long run. China is set to overtake the USA as the second-largest seller of imports to Argentina by 2030, while rapidly-industrializing Vietnam is projected to displace Mexico as Argentina’s fifth-biggest import supplier.

Exchange rate overvaluation is likely to persist in the medium term, damaging manufacturing competitiveness.

**Imports of goods by sector, 2017-30 (average annual growth)**



Source: Oxford Economics

**Top 5 Hotlist origins of goods imports**

Rank	2016	2030
1	Brazil	Brazil
2	USA	China
3	China	USA
4	Germany	Germany
5	Mexico	Vietnam

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

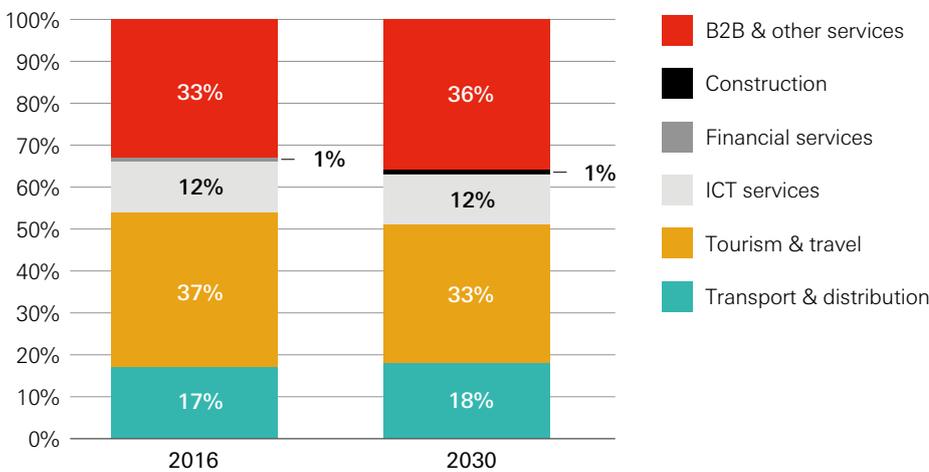
**B2B services are set to outperform, while tourism will face challenges**

Argentina’s service export mix is well-diversified, with tourism contributing 37% fifth of the total, professional services accounting for a third, transport 17% and ICT services 12%. Transport and business-to-business (B2B) services are expected to be the main drivers of growth in coming years, with robust growth of 7% a year between 2017 and 2030. Both are forecast to increase their share of service exports, with B2B accounting for 36% of total service exports by 2030 and transport 18%.

On average, we expect tourism revenues to grow 6% a year between now and 2030. Exchange rate overvaluation is one of the main reasons for the expected relative underperformance of tourism in a country with otherwise plenty of potential in this sector, as it makes the country expensive by regional standards. Tourism & travel accounted for 37% of service exports in 2016, but its share is projected to fall back slightly to 33% by 2030.

Tourism’s share of service exports is bound to fall by 7ppt by 2030 as Argentina looks too expensive when compared to other Latin American destinations

**Sectoral shares in total services exports**



Source: Oxford Economics

**Top 5 Hotlist destinations of services exports**

Rank	2016	2030
1	USA	USA
2	China	China
3	France	France
4	UK	Germany
5	Germany	UK

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

As in the case of goods exports, most of Argentina’s highest-growth markets for service exports are in Asia. Over the decade to 2030, service exports to India are expected to grow fastest, at an average pace of 10% pa. Exports to China are also expected to grow at a robust pace of 9% a year, on average.

The top three service export markets are expected to remain the US, China and France over this period. The prospect of a Mercosur-EU free trade agreement would not necessarily improve the outlook for services trade, as previous deals with Canada and South Korea did not extend to the services sector.

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## About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- ◆ For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- ◆ For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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