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The Economist Intelligence Unit

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"0 or 0.0" means nil or negligible; "n/a" means not available; "-" means not applicable

Argentina

Summary

2 [Briefing sheet](#)

Outlook for 2018-22

4 [Political stability](#)
5 [Election watch](#)
5 [International relations](#)
6 [Policy trends](#)
6 [Fiscal policy](#)
7 [Monetary policy](#)
7 [International assumptions](#)
8 [Economic growth](#)
8 [Inflation](#)
9 [Exchange rates](#)
9 [External sector](#)
9 [Forecast summary](#)
10 [Quarterly forecasts](#)

Data and charts

11 [Annual data and forecast](#)
12 [Quarterly data](#)
13 [Monthly data](#)
14 [Annual trends charts](#)
15 [Quarterly trends charts](#)
16 [Monthly trends charts](#)
17 [Comparative economic indicators](#)

Summary

17 [Basic data](#)
19 [Political structure](#)

Recent analysis

Politics

22 [Forecast updates](#)
23 [Analysis](#)

Economy

29 [Forecast updates](#)
32 [Analysis](#)

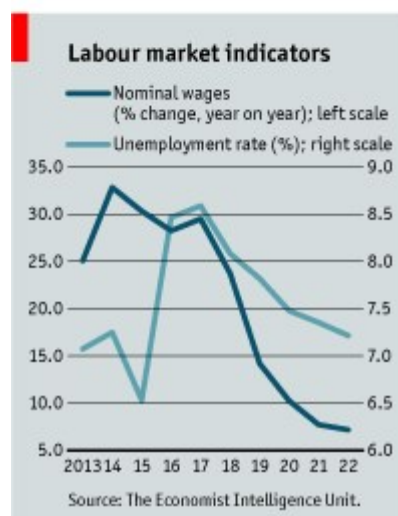
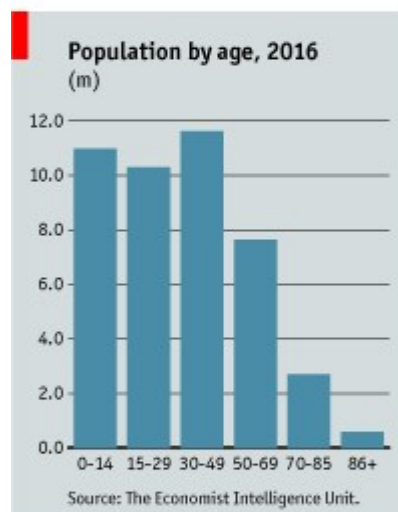
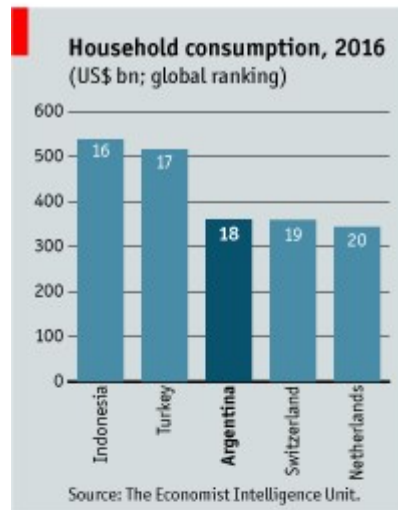
Briefing sheet

Editor: **Fiona Mackie**
 Forecast Closing Date: **January 31, 2018**

Political and economic outlook

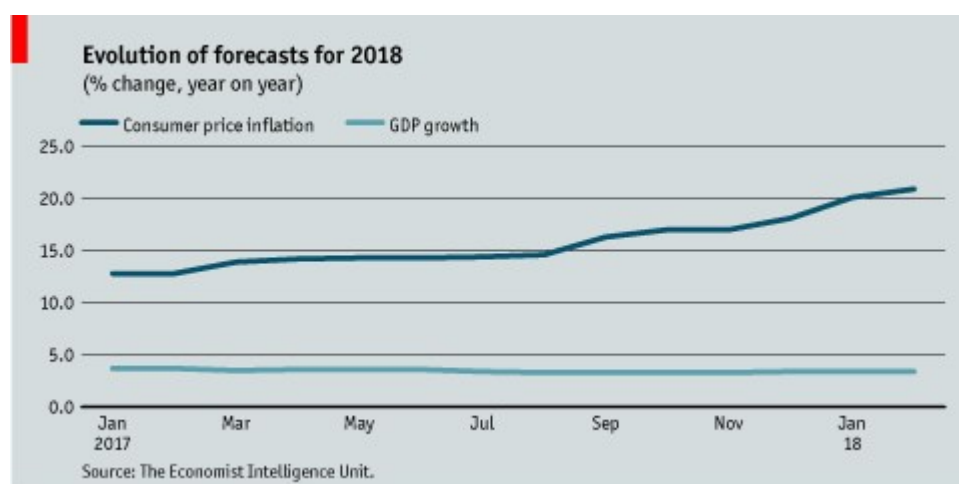
- The president, Mauricio Macri of the centre-right Propuesta Republicana party, made political gains at mid-term legislative elections in October and will maintain a programme of policy adjustments to reduce distortions and return the economy to sustainable growth.
- The next presidential election is due in October 2019. Based on The Economist Intelligence Unit's assumption of moderate GDP growth and a reduction in inflation, we currently expect Mr Macri to win a second four-year term.
- Macroeconomic adjustments will continue in the coming years, but there will also be an increased emphasis on structural reforms intended to raise productivity. There has been progress on tax and pension reform; labour market reforms will prove trickier.
- As the economy continues to recover, GDP growth will accelerate to 3.4% in 2018. As the initial momentum from the recovery fades, growth will dip below 3% in 2019-20, before accelerating again on the assumption of successful implementation of structural reforms.
- After a post-devaluation spike in inflation in 2016, disinflation is expected in 2018-22 on the back of fiscal tightening and increased domestic output. The introduction of an inflation-targeting framework in 2017 will support greater price stability.
- The peso will continue to depreciate in nominal terms in 2018-22. Peso weakening will be limited by large capital inflows. There is a persistent risk of currency volatility as the central bank gradually reduces interest rates.
- A moderate current-account deficit will be comfortably covered by inflows of portfolio capital and foreign direct investment, directed towards infrastructure and agriculture.

Market opportunities



Key indicators

	2017 ^a	2018 ^b	2019 ^b	2020 ^b	2021 ^b	2022 ^b
Real GDP growth (%)	2.8	3.4	2.8	2.8	3.3	3.4
Consumer price inflation (av; %)	26.5 ^c	20.9	12.3	8.7	6.3	5.2
Government balance (% of GDP)	-5.8	-5.3	-5.2	-4.5	-3.2	-2.4
Current-account balance (% of GDP)	-4.5	-4.3	-4.4	-4.4	-4.3	-4.1
Money market rate (av; %)	26.3 ^c	23.3	14.9	9.4	8.4	7.3



Key changes since January 12th

- We have revised upward our forecasts for producer price inflation on the back of recent peso depreciation. On the assumption of limited pass-through to consumer prices, we have made only modest adjustments to our forecasts for consumer price inflation.
- Recently released full-year fiscal data was in line with our expectations. Although revenue was slightly below our projections, expenditure was also slightly lower than expected; our forecast for a further narrowing of the deficit in 2018 and beyond remains unchanged.
- We have made a further revision to our current account forecast, to show a wider than expected deficit in 2017 (of an estimated 4.5% of GDP). We assume that the deficit will gradually narrow from this level but remain substantial.

The month ahead

- **February 15th—Consumer price index, January:** Price pressures are expected to remain substantial in the light of recent currency depreciation, although inflation is likely to be lower than the December regulated price spike.
- **February 27th—Monthly economic activity index, December 2017:** The monthly economic activity index, which is a rough proxy for the national accounts data, showed solid growth in January–November; our expectation is for further moderate growth in December.
- **TBC—Talks on labour market reform:** the government is attempting to garner support for a labour market reform from unions and opposition parties before presenting a bill to Congress in March. Progress in these talks in the next month would help to prepare the ground for an easier passage of the bill through Congress.

Major risks to our forecast

Scenarios, Q4 2017	Probability	Impact	Intensity
The authorities fail to rein in the fiscal deficit	Moderate	Very high	15
Deterioration of provincial finances forces further ad hoc revenue-raising measures	Moderate	High	12
Reversals in Congress or in the courts prevent the development of stable contract rights	Moderate	High	12
The legislature seeks to limit presidential power to rule by decree, creating the possibility of legislative gridlock and a stalled reform agenda	Moderate	High	12

Note: Scenarios and scores are taken from our Risk Briefing product. Risk scenarios are potential developments that might substantially change the business operating environment over the coming two years. Risk intensity is a product of probability and impact, on a 25-point scale.

Source: The Economist Intelligence Unit.

Outlook for 2018-22

Political stability

The president, Mauricio Macri, will press on in the second half of his four-year term with economic adjustment measures designed to raise the long-term growth rate and reduce the economy's vulnerability to boom-and-bust cycles. He will be bolstered in this effort by the convincing victory of his ruling Cambiemos coalition in the mid-term legislative election in October 2017. Cambiemos gained seats in both the Senate (the upper house) and the Chamber of Deputies (the lower house). Meanwhile, the Partido Justicialista (PJ, the Peronist party), which dominated politics for decades before Mr Macri's election victory in 2015, is struggling to regroup from that defeat and is beset by internal divisions. The party is currently split between a left-wing, populist faction under the leadership of the former president, Cristina Fernández de Kirchner (2007-15), and a centrist faction that as yet has no single, clear leader.

The good mid-term result notwithstanding, Mr Macri will continue to lack a congressional majority, and his administration will have to negotiate support for its legislative agenda on an ad hoc basis with various factions of the PJ. Assuming that the economy continues to strengthen and helps the government to maintain its popularity, this support is likely to be forthcoming, at least until politicians begin to gear up for the October 2019 presidential race, at which point obstructionism is likely to increase. In the interim, mutual interest will ensure some continuing cooperation between Cambiemos and moderate Peronists. The president will also retain influence with powerful provincial governors who largely control the agenda in the Senate, but who are in turn reliant on central government transfers, some of which are discretionary. As a result, The Economist Intelligence Unit expects some continued progress on the government agenda.

The government has a relatively limited window of opportunity this year to take advantage of the political capital gained from the mid-term elections, before campaigning for the presidential elections begins in 2019, and it has already pressed ahead quickly, passing reforms in December to the tax system, capital markets, pensions and competition policy. It has also agreed a fiscal pact with the provinces that should improve the provincial finances while reducing the use of distortionary taxes at the local level. However, there was substantial public opposition in December to pension reform, indicating that support for the Macri administration is not unconditional, and a sensitive labour market reform set for 2018 faces difficult negotiations and will be subject to delays and amendments. Most difficult and time-consuming of all will be efforts to reduce corruption and enhance the effectiveness and independence of the judiciary, to boost investor confidence in institutions and contract rights.

Election watch

Cambios put in an extremely good performance in the October 2017 legislative mid-terms, garnering just under 42% of the vote nationwide. The coalition was bolstered by strong campaign support from key politicians such as María Eugenia Vidal, the Buenos Aires province governor and a rising star in Argentina's political landscape. But more fundamentally, Cambios's good performance is likely to reflect the fact that economic recovery is gathering pace and becoming more broad-based, bolstering support for the president's economic adjustment measures.

The next presidential election is due in October 2019. Based on our assumption of moderate GDP growth and substantial reduction of inflation by then, we currently expect Mr Macri to win a second four-year term. There are considerable risks to this forecast. Reflecting the difficulties faced by minority governments in Argentina, no non-Peronist government has won a second consecutive term since the end of the military dictatorship in the 1980s. In this context, the emergence of a strong challenger from the Peronist party remains likely, and the election will be closely fought.

International relations

Efforts by the Macri government to repair relations with trade and investment partners in the region and elsewhere have achieved rapid results, and we expect these relations to remain strong. Demonstrating the success of Argentina's efforts to rehabilitate itself in the eyes of investors and diplomatic partners, the country took over the rotating presidency of the G20 in December 2017 and will host the 2018 G20 summit, where it will pursue an agenda centred on the future of jobs, infrastructure and food security. The government is keen to seek trade deals under the auspices of Mercosur (the Southern Cone customs union). The problem for Argentina and its Mercosur partners is that, just as the grouping has started to reverse its own protectionist tendencies, anti-globalisation sentiment has grown in the OECD. However, Mr Macri is continuing to seek support for an EU-Mercosur trade deal from his counterparts in Europe, and negotiations are continuing. Our forecasts do not currently assume a successful conclusion of free-trade talks with the EU, but there is some upside risk to this forecast. At the least, the workings of intra-Mercosur trade are likely to improve in the forecast period. Efforts at joining the Pacific Alliance, a regional trading bloc including Chile, Peru, Colombia and Mexico, may also make progress, although this is not currently reflected in our five-year economic forecasts.

Policy trends

Two years into office, the Macri administration is continuing to grapple with the task of restoring macroeconomic stability while improving conditions for business. Macroeconomic adjustment remains incomplete: inflation ended 2017 at 24.8% amid continued utilities tariff rises (intended to reduce the fiscal burden of subsidies and promote investment by bringing utilities prices towards market rates), and the fiscal deficit remained substantial (at almost 6% of GDP in 2017). Although fiscal tightening is under way, the gradual pace of the adjustment (intended to support economic growth) is complicating the efforts of the monetary authorities to bring inflation under control, an effort that is vital to reducing wage expectations, tackling the external competitiveness problem and promoting long-term investment. The overall public debt level is not yet a major cause for concern, but there is limited scope for further growth in the debt without introducing fresh market questions over Argentina's long-term creditworthiness. We assume that tighter fiscal policy and lower wage expectations will gradually reduce inflation and engender macroeconomic stability over time; however, failure to show signs of progress in 2018 would have serious negative implications for creditworthiness and the economic outlook.

With macroeconomic adjustment measures continuing, the government is turning its attention to the structural reform agenda and to reforms to improve the business environment, and we expect a growing policy emphasis on these areas. More recently, the government has passed capital market reform intended to spur the development of long-term finance and the deepening of Argentina's currently shallow capital markets; a tax reform bill that should help to reduce distortions and promote investment while reducing overall tax pressure marginally (although there is still some way to go to make the system less complex); and a pension reform that will help to deal with a growing pension liability. Also on the agenda is labour market reform to increase flexibility and formality. This reform will prove particularly complicated politically, and its passage is less certain, although even in the event that a broad reform is blocked, we would expect some piecemeal progress.

Fiscal policy

The government has managed to reduce the fiscal burden of energy subsidies substantially in the past year; it has also benefited from extraordinary revenue from a tax amnesty on undeclared foreign financial assets. But there have been expenditure pressures on social benefits and on interest payments, and both the primary and the overall fiscal deficit remain large. In this context, the Treasury will be under pressure in 2018 to produce results in the form of a primary deficit in line with its target of 3.2% of GDP (a bigger adjustment to the bottom line than it produced in either 2016 or 2017). Supporting the outlook for 2018, the government has managed to secure a social security reform that will de-link the automatic rise in pension and benefit payouts from backward-looking inflation measures, in a move that should produce substantial savings (0.4% of GDP per year from 2018). Further cuts in energy subsidies are also on the cards, and capital spending restraint is likely.

The biggest risk to the fiscal target is likely to come from two areas: public-sector wage restraint, in a context of above-target inflation in 2017 and strong public-sector union power, and below-target revenue, if recently approved tax reforms end up reducing the tax take by more than currently expected. The Treasury minister, Nicolás Dujovne, has a reputation as a fiscal hawk, and we currently expect the government to meet its 2018 target, and for the primary deficit to continue to narrow towards 1% of GDP by the end of the forecast period (reflecting similar trends as in 2018).

Any signs of failure on the deficit reduction front in 2018 would start to seriously test market patience with Argentina's adjustment process, with knock-on effects for the cost of finance. For now, due to the sovereign's exit from default in 2016, we assume that the government's ability to finance fiscal deficits will be good. A still-manageable, although rising, public debt/GDP ratio (and low levels of external indebtedness), combined with the attractiveness of Argentina's still-high yields, should facilitate international bond issuance in 2018-22. As a percentage of GDP, the public debt will peak at 57% in 2019 before trending down to 52% by the end of the forecast period.

Monetary policy

The policy interest rate will decline in 2018 from its extremely high levels. The first rate cut since November 2016 took place on January 9th, from 28.75% to 28%, followed by another 75-basis-point cut on January 23rd. This followed a loosening of inflation targets at the end of 2017. The government's upward adjustment to the inflation target (to 15% in 2018 and 10% for 2019; the 2020 target of 5% is unchanged) was unexpected and somewhat controversial. In our view, rate cuts will continue to be gradual. This view rests on two main factors: an attempt by the central bank governor, Federico Sturzenegger, to reassert the operational independence of the Banco Central de la República Argentina (BCRA, the central bank) following recalibration of targets by the government, and the strong depreciation of the peso that followed the government's announcements on targets, which will complicate the disinflation process.

The government states that the new targets are more realistic, and this is true. The government is probably also keen for real interest rates, which are extremely high, to come down to support the durability of the economic recovery. However, a perception of discord between the executive and the BCRA will not help to instil confidence in the inflation-targeting framework. In the short term, monetary policy will be further complicated by continued regulated price increases. However, notwithstanding the substantial monetary policy challenges, we currently expect monthly inflation to start to fall towards 1% on a more consistent basis, allowing for continued monetary easing over the course of 2018, taking the nominal policy rate close to 20% by year-end. Our forecasts assume moderately positive real interest rates in the medium term, consistent with a deepening of credit and the development of long-term lending.

International assumptions

	2017	2018	2019	2020	2021	2022
Economic growth (%)						
US GDP	2.2	2.3	2.4	0.9	2.1	2.0
OECD GDP	2.3	2.1	2.1	1.3	2.0	1.9
World GDP	3.0	2.9	2.9	2.4	2.8	2.8
World trade	4.6	4.3	4.0	2.8	3.8	3.7
Inflation indicators (% unless otherwise indicated)						
US CPI	2.1	2.2	2.3	1.3	1.8	1.9
OECD CPI	2.1	2.1	2.1	1.7	1.9	1.9
Soya beans (measured in US\$)	-3.3	1.1	3.0	2.2	2.0	2.4
Oil (Brent; US\$/b)	54.4	63.0	60.0	57.8	60.6	63.3
Non-oil commodities (measured in US\$)	7.6	2.0	1.3	-3.1	2.1	1.4
Financial variables						
US\$ 3-month commercial paper rate (av; %)	1.1	1.7	2.5	2.3	1.5	1.8
Exchange rate Ps:US\$ (av)	16.56	19.90	21.92	23.54	24.99	26.37

Economic growth

Argentina's growth outlook appears good. The latest data suggest that economic recovery is gathering pace and becoming more broad-based, with agriculture, construction, manufacturing and retail all picking up. On this basis, we project that real GDP will accelerate from an estimated 2.8% in 2017 to 3.4% in 2018. In 2019-20 we expect growth to soften to slightly below 3% per year as the initial momentum of the economic recovery wanes and as moderate global headwinds appear in the form of a cyclical downturn in the US economy in 2020. Our assumption that implementation of recently passed and ongoing structural reforms will feed through into economic activity underpins our assumption that GDP growth will move back above 3% in 2021-22.

By component of demand, gross fixed investment will be a key driver of growth in the forecast period. On average it is likely to grow by over 4% per year in the five-year forecast period. This is a solid growth rate that will help fixed investment to rise as a percentage of GDP from a recent historical low of just under 15% in 2016 to (a still-low) 17% by 2022. Private consumption will be supported by job growth and rising real incomes, and should grow fairly steadily in 2018-22, although it will weaken moderately mid-way through the forecast period as a dip in investment hits employment. Government consumption growth is likely to peak around 2019, reflecting spending surrounding the 2019 election period, as well as some countercyclical expenditure. All this implies that domestic demand will, on aggregate, be relatively firm throughout the forecast period. It will, however, be dragged down by a negative contribution to growth from net exports of goods and services as recovery draws in imports amid ongoing external competitiveness issues.

Economic growth

%	2017 ^a	2018 ^b	2019 ^b	2020 ^b	2021 ^b	2022 ^b
GDP	2.8	3.4	2.8	2.8	3.3	3.4
Private consumption	3.8	3.9	2.8	3.1	3.5	3.5
Government consumption	2.4	-0.2	3.6	2.9	2.1	2.1
Gross fixed investment	9.5	6.8	4.0	3.7	5.0	4.3
Exports of goods & services	-0.5	2.9	1.9	2.9	3.4	4.3
Imports of goods & services	8.4	3.4	3.3	4.5	4.5	4.5
Domestic demand	4.9	3.5	3.1	3.2	3.6	3.5
Agriculture	6.0	5.5	4.8	4.6	4.7	4.7
Industry	2.4	3.5	2.6	3.2	3.5	3.5
Services	2.5	3.0	2.6	2.3	2.9	3.1

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts.

Inflation

The reduction of inflation will continue to be complicated in 2018-22 by gradual increases in utilities tariffs as these are brought closer in line with market prices. However, assuming that macroeconomic policy remains tight, domestic demand remains subdued relative to the boom years of 2004-11, and domestic supply strengthens on the back of an improved regulatory environment for agricultural and other producers, we continue to expect gradual disinflation in the medium term. The main risks to this forecast stem from possible failure to tighten fiscal policy as projected, a weaker than expected peso and potential difficulties in reining in nominal wage growth owing to union pressure.

Exchange rates

Currency weakening since December at year-end associated with concerns over an adjustment to inflation targets left the peso around Ps19.5:US\$1 in late January. In nominal terms the currency depreciated by 11% in 2017. However, in real trade-weighted terms the currency appreciated by 8%, highlighting the fact that the peso remains overvalued compared with its long-term average. In 2017 the real effective exchange rate was 14% stronger than the average of the previous 20 years. We assume that there will be gradual, steady nominal weakening of the peso in 2018–22, particularly in 2018 as domestic interest rates decline more rapidly and the Federal Reserve (the US central bank) continues a monetary tightening cycle. However, the positive outlook for foreign direct investment (FDI) inflows, and especially for portfolio capital, will continue to dampen depreciation pressure. In nominal terms, we expect the peso to end 2018 at Ps21:US\$1 and 2022 at Ps27.1:US\$1.

External sector

Amid a rapid rise in imports drawn in by economic recovery, the goods and services deficits deteriorated in 2017 and will remain large in 2018. However, our assumption of continued currency weakening implies an eventual boost to external competitiveness and a relative improvement in the goods and services deficits later in the forecast period (bolstered by increased volumes of energy exports as ongoing investments bear fruit). This will be offset by a widening of the income deficit amid increased profit repatriation and rising interest payments on a growing stock of external debt; however, trends in the goods and services balances suggest that the current account deficit will fall gradually to 4.1% of GDP by 2022.

The country's ability to finance moderate current-account deficits has improved and, assuming that portfolio and FDI inflows rise as investor confidence grows, the result will be a rise in foreign reserves in nominal terms. Our forecasts currently assume FDI inflows averaging just under 2% of GDP in 2018–22, with foreign reserves equivalent to an annual average of close to eight months of import cover.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2017 ^a	2018 ^b	2019 ^b	2020 ^b	2021 ^b	2022 ^b
Real GDP growth	2.8	3.4	2.8	2.8	3.3	3.4
Industrial production growth	2.4	3.5	2.6	3.2	3.5	3.5
Gross agricultural production growth	6.0	5.5	4.8	4.6	4.7	4.7
Unemployment rate (av)	8.6	8.1	7.8	7.5	7.4	7.2
Consumer price inflation (av)	26.5 ^c	20.9	12.3	8.7	6.3	5.2
Consumer price inflation (end-period)	24.8 ^c	16.2	10.5	7.1	5.9	4.9
Prime lending rate	25.6	22.7	15.3	10.8	9.8	8.7
NFPS balance excl privatisation (% of GDP)	-5.8	-5.3	-5.2	-4.5	-3.2	-2.4
Exports of goods fob (US\$ bn)	58.4	61.5	62.2	65.9	71.0	77.9
Imports of goods fob (US\$ bn)	63.4	68.2	71.9	75.3	80.1	85.3
Current-account balance (US\$ bn)	-29.3	-29.7	-33.2	-34.5	-34.7	-34.2
Current-account balance (% of GDP)	-4.5	-4.3	-4.4	-4.4	-4.3	-4.1
External debt (year-end; US\$ bn)	213.8	228.7	241.8	255.0	267.5	279.3
Exchange rate Ps:US\$ (av)	16.56	19.90	21.92	23.54	24.99	26.37
Exchange rate Ps:US\$ (end period)	18.60	21.01	22.84	24.25	25.74	27.12
Exchange rate Ps:€ (av)	18.70	23.68	25.87	28.36	30.12	32.63
Exchange rate Ps:€ (end-period)	22.31	24.79	27.17	29.10	31.40	33.90

^a Economist Intelligence Unit estimates. ^b Economist Intelligence Unit forecasts. ^c Actual.

Quarterly forecasts

Quarterly forecasts

	2017				2018				2019			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	1.3	0.8	0.9	0.8	0.9	0.8	0.8	0.7	0.7	0.6	0.6	0.6
% change, year on year	0.2	3.1	3.9	3.9	3.5	3.5	3.3	3.2	3.0	2.8	2.7	2.6
Private consumption												
% change, quarter on quarter	1.9	4.0	-2.2	2.7	0.8	0.7	0.5	1.6	0.6	0.8	0.8	-1.7
% change, year on year	-0.6	6.1	3.1	6.5	5.3	1.9	4.7	3.6	3.4	3.5	3.8	0.4
Government consumption												
% change, quarter on quarter	2.4	1.1	0.5	-0.7	-0.7	0.2	0.3	0.7	1.6	1.1	1.1	-0.7
% change, year on year	0.8	4.2	1.3	3.4	0.2	-0.7	-0.9	0.5	2.9	3.8	4.6	3.1
Gross fixed investment												
% change, quarter on quarter	4.0	5.1	2.5	1.7	1.4	1.2	0.8	0.9	0.8	0.8	0.6	3.6
% change, year on year	0.4	9.6	14.6	13.9	11.1	7.0	5.2	4.3	3.7	3.3	3.1	5.9
Exports of goods & services												
% change, quarter on quarter	3.0	-6.2	2.4	-0.7	2.0	2.0	0.4	0.5	0.5	0.5	0.0	-0.4
% change, year on year	-2.2	0.1	2.2	-1.8	-2.8	5.8	3.7	5.0	3.4	1.9	1.5	0.6
Imports of goods & services												
% change, quarter on quarter	4.0	5.1	4.6	-11.6	5.0	3.5	2.0	2.8	0.4	0.1	-1.0	-2.2
% change, year on year	4.5	9.7	18.8	1.1	2.0	0.5	-2.0	13.9	8.9	5.3	2.2	-2.7
Domestic demand												
% change, quarter on quarter	1.7	4.3	1.0	-2.6	2.7	0.7	0.5	1.8	0.4	0.7	0.9	-0.5
% change, year on year	0.3	7.5	7.5	4.3	5.3	1.7	1.2	5.9	3.5	3.5	3.9	1.5
Consumer prices												
% change, quarter on quarter	5.3	6.4	4.6	5.3	5.8	4.2	3.9	3.1	2.9	2.5	2.4	2.4
% change, year on year	35.5	25.1	23.6	23.5	24.0	21.5	20.6	18.1	14.8	12.9	11.3	10.6
Producer prices												
% change, quarter on quarter	3.3	2.0	6.1	4.6	4.7	4.3	2.5	2.3	2.1	2.0	2.0	2.0
% change, year on year	20.8	13.7	13.5	16.9	18.5	21.2	17.2	14.5	11.6	9.1	8.5	8.2
Exchange rate R:US\$												
Average	15.67	15.73	17.29	17.55	19.13	19.65	20.11	20.73	21.23	21.69	22.15	22.62
End-period	15.40	16.60	17.30	18.60	19.39	19.88	20.42	21.01	21.46	21.92	22.38	22.84
Interest rate (%; av)												
Money market rate	24.8	26.1	26.3	28.0	27.8	24.0	21.7	19.8	18.0	16.0	14.0	11.6

Data and charts

Annual data and forecast

	2013 ^a	2014 ^a	2015 ^a	2016 ^a	2017 ^b	2018 ^c	2019 ^c
GDP							
Nominal GDP (US\$ bn)	613.2	566.6	633.8	545.1	654.4	698.1	750.7
Nominal GDP (Ps bn)	3,347	4,575	5,852	8,044	10,838	13,894	16,455
Real GDP growth (%)	2.4	-2.5	2.6	-2.2	2.8	3.4	2.8
Expenditure on GDP (% real change)							
Private consumption	3.6	-4.4	3.5	-1.4	3.8	3.9	2.8
Government consumption	5.3	2.9	6.8	0.3	2.4	-0.2	3.6
Gross fixed investment	2.3	-6.8	3.8	-5.1	9.5	6.8	4.0
Exports of goods & services	-3.5	-7.0	-0.6	3.7	-0.5	2.9	1.9
Imports of goods & services	3.9	-11.5	5.7	5.7	8.4	3.4	3.3
Origin of GDP (% real change)							
Agriculture	11.5	3.1	7.6	-5.4	6.0	5.5	4.8
Industry	0.6	-3.5	1.5	-5.8	2.4	3.5	2.6
Services	1.9	-1.6	2.6	0.0	2.5	3.0	2.6
Population and income							
Population (m)	42.5	43.0	43.4 ^b	43.8 ^b	44.3	44.7	45.1
GDP per head (US\$ at PPP)	21,500	21,117	21,691 ^b	21,264 ^b	22,032	23,084	23,862
Recorded unemployment (av; %)	7.1	7.3	6.5 ^b	8.5 ^b	8.6	8.1	7.8
Fiscal indicators (% of GDP)							
Public-sector balance	-1.9	-2.7	-4.8	-5.9	-5.8	-5.3	-5.2
Public-sector debt interest payments	1.3	1.6	2.1	1.6	2.1	2.3	2.8
Public-sector primary balance	-0.7	-1.1	-2.8	-4.3	-3.7	-3.0	-2.4
Net public debt	39.4	41.3	54.0	54.5	56.3	56.5	57.1
Prices and financial indicators							
Exchange rate Ps:US\$ (av)	5.46	8.08	9.23	14.76	16.56	19.90	21.92
Consumer prices (end-period; % change)	26.0	38.0	26.9	41.0	24.8 ^a	16.2	10.5
Producer prices (av; % change)	14.9	26.5	11.9	37.2	16.1 ^a	17.8	9.3
Stock of money M1 (% change)	26.5	31.6	28.0	36.9	30.5	26.6	15.9
Stock of money M2 (% change)	27.1	29.8	39.6	41.5	35.4	34.8	20.5
Lending interest rate (av; %)	17.1	24.0	24.9	31.2	25.6	22.7	15.3
Current account (US\$ m)							
Trade balance	4,635	5,542	-785	4,426	-5,000	-6,689	-9,683
Goods: exports fob	75,928	68,441	56,809	57,930	58,405	61,461	62,233
Goods: imports fob	-71,293	-62,899	-57,594	-53,505	-63,405	-68,150	-71,916
Services balance	-5,329	-4,641	-5,815	-8,190	-9,959	-10,167	-9,065
Primary income balance	-13,165	-11,614	-12,105	-12,105	-15,910	-14,485	-16,478
Secondary income balance	734	1,535	1,083	1,176	1,543	1,646	1,995
Current-account balance	-13,124	-9,179	-17,622	-14,693	-29,326	-29,696	-33,231
External debt (US\$ m)							
Debt stock	146,569	145,472	173,457	190,490	213,760	228,713	241,763
Debt service paid	15,485	16,625	17,825	25,675	15,365	18,743	21,224
Debt service due	15,911	16,625	18,165	25,675	15,365	18,743	21,224
International reserves (US\$ m)							
Total international reserves	30,532	31,404	25,524	38,425	55,330	59,197	59,823

^a Actual. ^b Economist Intelligence Unit estimates. ^c Economist Intelligence Unit forecasts.

Source: IMF, International Financial Statistics.

Quarterly data

	2016				2017			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
Non-financial public sector finance (Ps m)								
Revenue excl privatisation	331,130	385,222	405,148	507,810	467,685	478,143	520,325	531,929
Expenditure	395,696	498,878	520,503	689,018	538,322	663,052	635,768	789,990
Interest payments	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Balance	-64,566	-	-	-	-70,637	-	-	-
		113,656	115,355	181,208		184,909	115,443	258,060
Output								
GDP at constant 1993 prices (annual rates; Ps bn)	713.8	699.4	699.8	705.8	715.0	721.0	727.4	n/a
GDP at constant 1993 prices (% change, year on year)	0.2	-3.5	-3.6	-2.0	0.2	3.1	3.9	n/a
Manufacturing at constant 1993 prices (annual rates; Ps m)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Manufacturing (% change, year on year)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production index (2004=100)	94.6	98.7	99.7	101.0	92.2	100.9	104.1	n/a
Industrial production index (% change, year on year)	-1.0	-5.4	-7.0	-4.9	-2.5	2.2	4.4	n/a
Prices								
Consumer prices (Dec 16=100)	76.6	88.3	93.5	98.5	103.8	110.4	116	122
Consumer prices (% change, year on year)	32.5	44.0	44.6	43.5	35.5	25.1	23.6	23.5
Producer prices (Dec 2015=100)	113.9	123.4	131.1	133.2	137.6	140.3	148.9	155.7
Producer prices (% change, year on year)	30.9	38.8	41.5	37.2	20.8	13.7	13.5	16.9
Financial indicators								
Exchange rate Ps:US\$ (av)	14.44	14.23	14.94	15.42	15.67	15.73	17.29	n/a
Exchange rate Ps:US\$ (end-period)	14.60	15.00	15.30	15.90	15.40	16.60	17.30	n/a
Deposit rate (av; %)	25.9	28.0	23.4	19.9	18.4	18.0	18.8	n/a
Lending rate (av; %)	31.5	36.8	29.8	26.9	24.9	25.4	25.0	n/a
Money market rate (av; %)	33.2	35.7	28.9	25.8	24.8	26.1	26.3	28.0
M1 (% change, year on year)	30.5	21.7	25.3	36.9	32.3	n/a	n/a	n/a
M2 (% change, year on year)	37.9	34.1	34.7	41.5	38.8	n/a	n/a	n/a
Merval stockmarket index (end-period; June 30th 1986=US\$0.01)	12,992	14,683	16,676	16,918	20,265	21,913	26,078	30,066
Merval stockmarket index (% change, year on year)	19.9	26.0	69.9	44.9	56.0	49.2	56.4	77.7
Sectoral trends								
ISAC construction activity index (seas adjusted; % change, year on year)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Crude oil production (m barrels/day)	0.62	0.62	0.63	0.63	0.62	0.63	0.64	0.64
Crude oil production (% change, year on year)	-4.6	-1.6	-0.7	-0.8	0.3	1.2	1.6	1.6
Foreign trade (US\$ m)								
Exports fob	12,444	15,427	15,803	14,205	12,752	15,503	15,774	14,398
Imports cif	-12,777	-14,345	-14,688	-14,101	-13,931	-16,941	-18,318	-17,709
Trade balance	-333	1,082	1,115	104	-1,179	-1,438	-2,544	-3,311
Foreign payments (US\$ m)								
Merchandise trade balance fob-fob	197	1,701	1,792	737	-593	-707	-1,712	n/a
Services balance	-2,546	-1,782	-2,153	-1,710	-3,086	-2,141	-2,769	n/a
Primary income balance	-2,876	-2,963	-2,837	-3,428	-3,760	-4,023	-4,158	n/a
Net transfer payments	312	318	304	243	281	236	-44	n/a
Current-account balance	-4,914	-2,726	-2,895	-4,158	-7,158	-6,635	-8,684	n/a
Reserves excl gold (end-period)	27,094	27,898	27,327	36,323	48,573	45,453	47,622	53,031

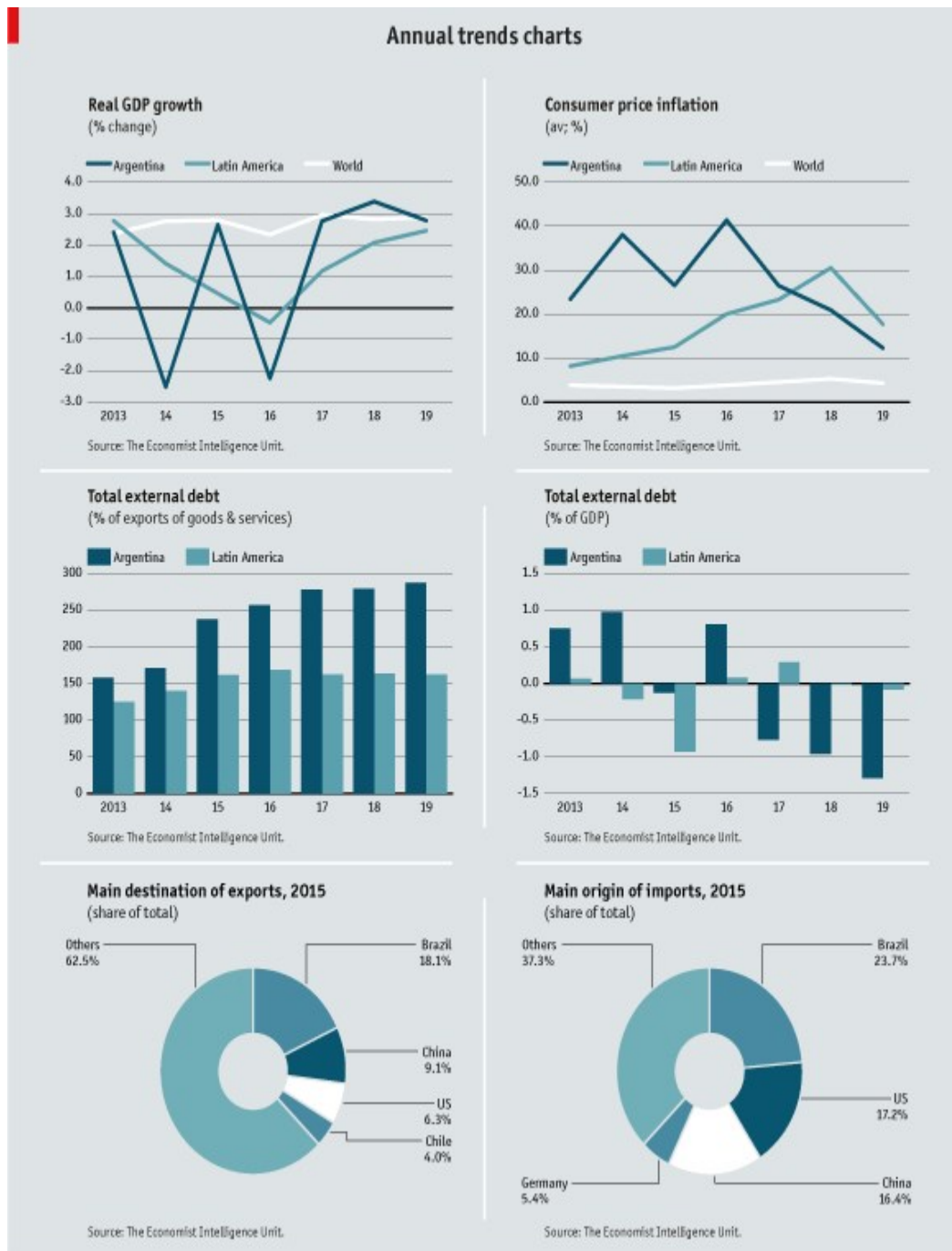
Sources: Ministerio de Economía; IEA, Monthly Oil Market Report; IMF, International Financial Statistics; Instituto Nacional de Estadística y Censos.

Monthly data

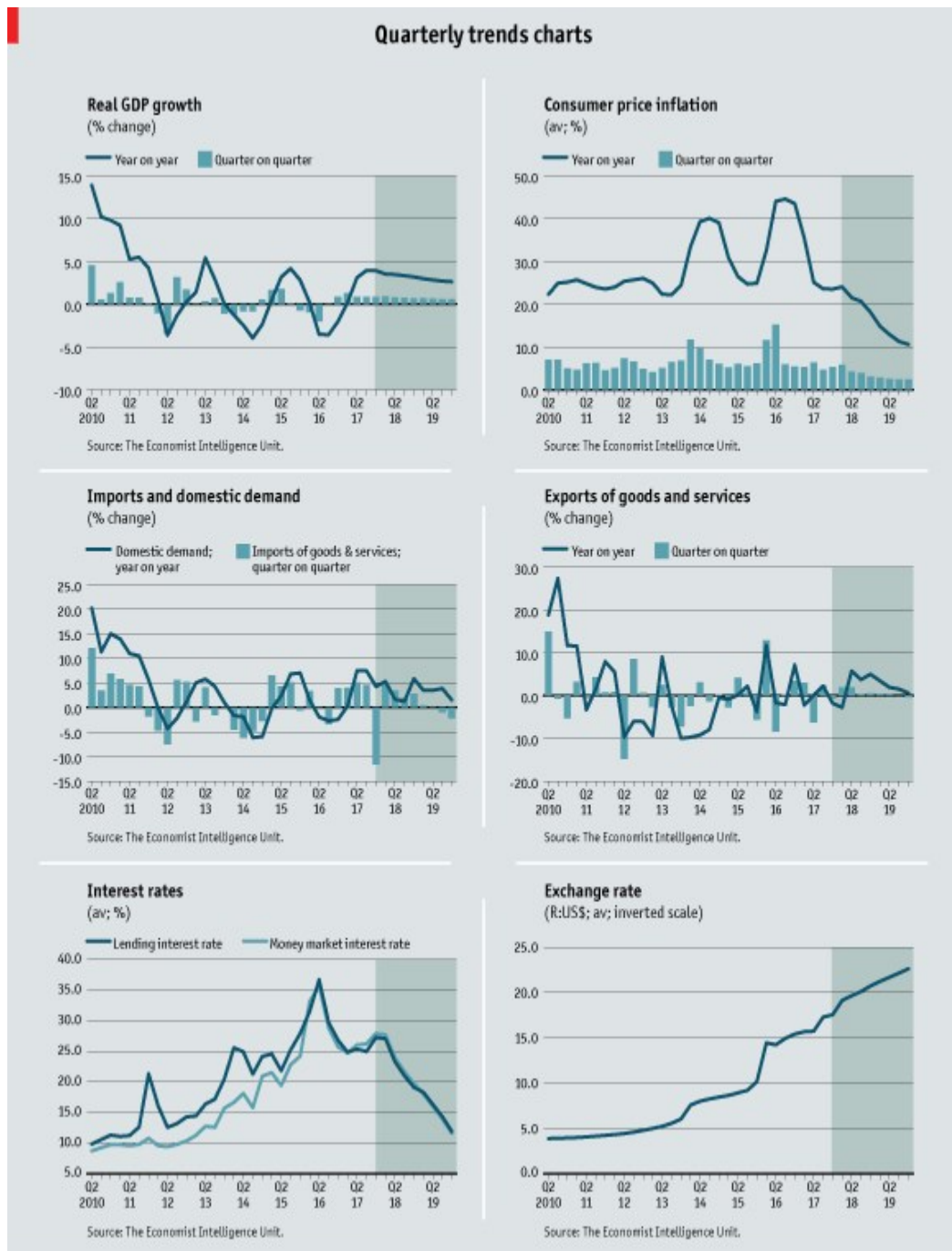
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate Ps:US\$ (av)												
2015	8.556	8.639	8.738	8.819	8.903	9.040	9.097	9.198	9.322	9.445	9.583	11.459
2016	13.592	14.779	14.948	14.390	14.124	14.183	14.878	14.839	15.114	15.180	15.340	15.733
2017	15.909	15.594	15.516	15.353	15.732	16.117	17.197	17.419	17.245	17.469	17.483	n/a
Exchange rate Ps:US\$ (end-period)												
2015	8.595	8.680	8.770	8.860	8.945	9.040	9.145	9.250	9.375	9.505	9.645	13.100
2016	13.780	15.700	14.600	14.300	14.000	15.000	15.000	14.900	15.300	15.200	15.900	15.900
2017	15.900	15.500	15.400	15.400	16.100	16.600	17.650	17.300	17.300	17.650	17.300	18.600
M1 (% change, year on year)												
2015	21.7	32.1	40.4	45.8	44.4	38.4	38.0	38.3	37.2	35.3	35.4	28.0
2016	41.2	42.2	30.5	24.2	21.8	21.7	22.2	27.7	25.3	30.7	25.7	36.9
2017	33.4	24.5	32.3	33.7	34.3	n/a	n/a	n/a	n/a	n/a	n/a	n/a
M2 (% change, year on year)												
2015	29.0	31.5	33.7	35.5	35.5	37.1	37.1	36.0	36.5	36.9	37.0	39.6
2016	41.2	40.9	37.9	33.3	32.1	34.1	34.4	35.5	34.7	39.4	43.8	41.5
2017	38.2	39.6	38.8	41.2	41.0	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production (% change, year on year)												
2015	-2.1	-2.2	-1.6	-1.5	-0.9	0.9	0.7	0.5	0.2	-2.6	-1.6	-1.6
2016	1.2	-0.1	-3.8	-5.2	-4.5	-6.4	-7.9	-5.7	-7.3	-8.0	-4.1	-2.3
2017	-1.1	-6.0	-0.4	-2.6	2.7	6.6	5.9	5.1	2.3	4.4	3.5	n/a
Deposit rate (av; %)												
2015	18.8	20.0	20.1	20.6	20.3	20.5	20.3	20.8	21.2	21.5	23.3	26.6
2016	25.4	24.8	27.5	28.0	28.6	27.3	24.9	23.5	21.7	20.8	19.9	19.0
2017	18.6	18.5	18.2	17.7	18.1	18.2	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2015	25.6	24.3	23.9	21.0	24.4	20.2	26.2	25.2	24.5	27.9	25.6	30.3
2016	29.3	27.6	37.8	38.7	37.2	34.4	30.8	30.1	28.5	27.4	27.2	25.9
2017	25.4	25.0	24.3	25.0	25.5	25.7	n/a	n/a	n/a	n/a	n/a	n/a
Merval stockmarket index (end-period; June 30th 1986=US\$0.01)												
2015	8,490	9,602	10,837	12,050	10,801	11,657	11,101	11,033	9,815	12,461	12,972	11,675
2016	11,306	13,116	12,992	13,724	12,682	14,683	15,804	15,649	16,676	17,610	17,442	16,918
2017	19,063	19,117	20,265	21,020	22,349	21,913	21,582	23,589	26,078	27,935	26,905	30,066
Consumer prices (% change, year on year; av)^a												
2015	34.3	30.5	28.0	27.1	26.7	25.5	25.3	24.8	24.0	23.8	23.9	26.9
2016	29.6	32.9	35.0	40.5	44.4	47.1	47.2	43.5	43.1	44.7	44.8	41.0
2017	37.6	35.1	33.8	29.0	24.5	22.1	21.6	24.2	24.9	23.2	22.5	24.8
Producer prices (% change, year on year; av)												
2015	19.6	13.2	10.9	9.9	9.7	9.6	10.5	10.6	11.1	11.5	11.6	15.1
2016	25.6	32.2	34.9	36.6	38.1	41.6	43.2	41.8	39.5	38.9	38.5	34.3
2017	24.8	20.2	17.6	15.6	13.8	11.9	11.8	13.6	15.2	16.2	16.7	17.9
Total exports fob (US\$ m)												
2015	3,796	3,872	4,381	5,155	5,206	6,046	5,569	5,136	5,162	5,033	3,999	3,429
2016	3,875	4,143	4,426	4,743	5,377	5,307	4,991	5,770	5,042	4,729	4,848	4,628
2017	4,289	3,899	4,564	4,863	5,490	5,150	5,293	5,243	5,238	5,241	4,642	4,515
Total imports cif (US\$ m)												
2015	4,197	3,991	5,055	4,953	4,992	5,760	5,670	5,435	5,520	4,932	4,738	4,516
2016	4,124	4,097	4,556	4,423	4,874	5,048	4,713	5,175	4,800	4,783	4,723	4,595
2017	4,341	4,116	5,474	4,975	6,066	5,900	6,041	6,314	5,963	6,196	6,151	5,362
Trade balance fob-cif (US\$ m)												
2015	-401	-119	-674	202	214	286	-101	-299	-358	101	-739	-1,087
2016	-249	46	-130	320	503	259	278	595	242	-54	125	33
2017	-52	-217	-910	-112	-576	-750	-748	-1,071	-725	-955	-1,509	-847
Foreign-exchange reserves excl gold (US\$ m)												
2015	28,900	29,023	29,114	31,529	30,905	31,501	31,728	31,326	31,021	24,670	23,463	23,417
2016	27,861	25,951	27,094	31,802	27,735	27,898	29,857	28,548	27,327	34,814	34,927	36,323
2017	44,547	48,370	48,573	45,597	43,784	45,453	44,975	46,637	47,622	49,251	52,412	53,031

Sources: IMF, International Financial Statistics; Haver Analytics.

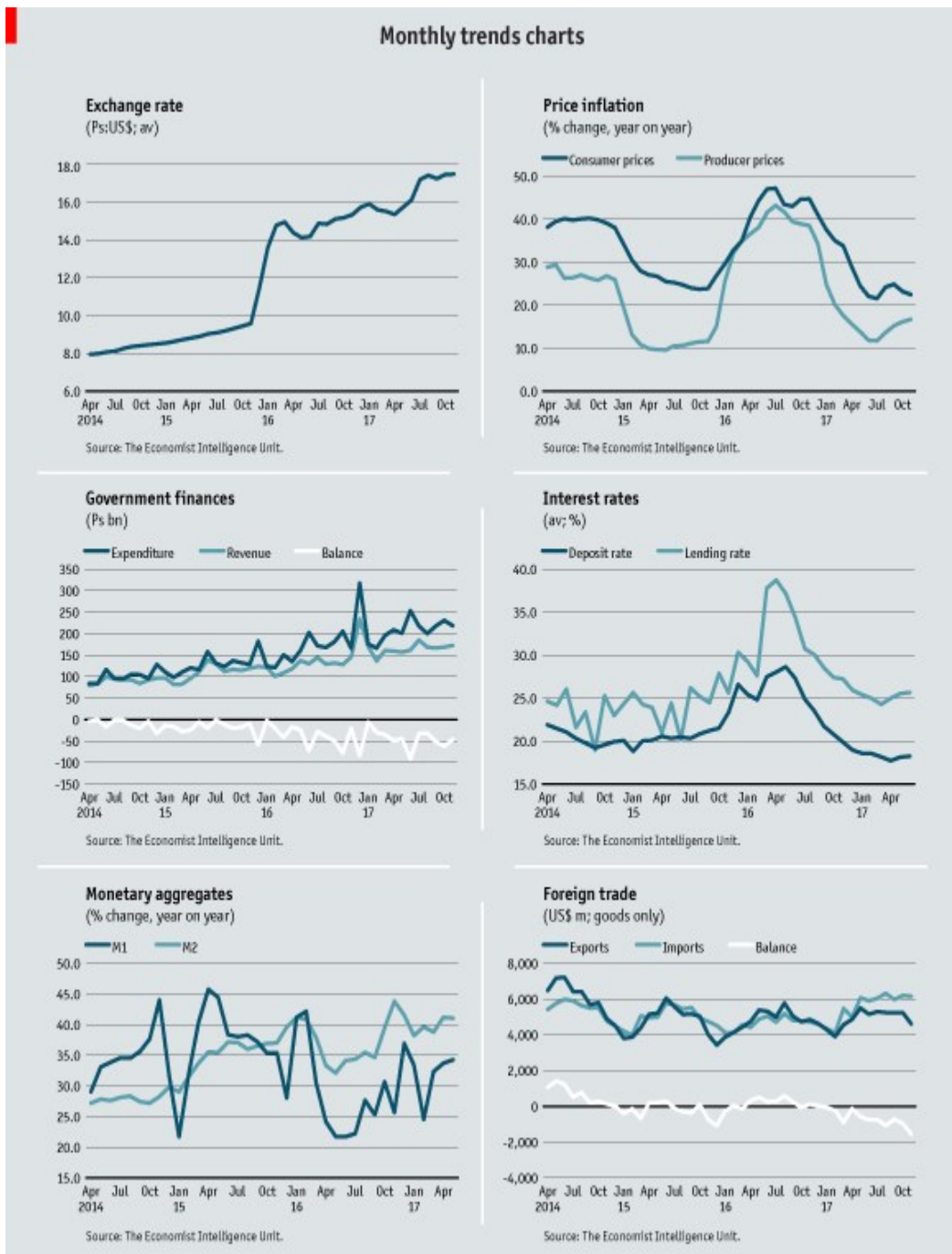
Annual trends charts



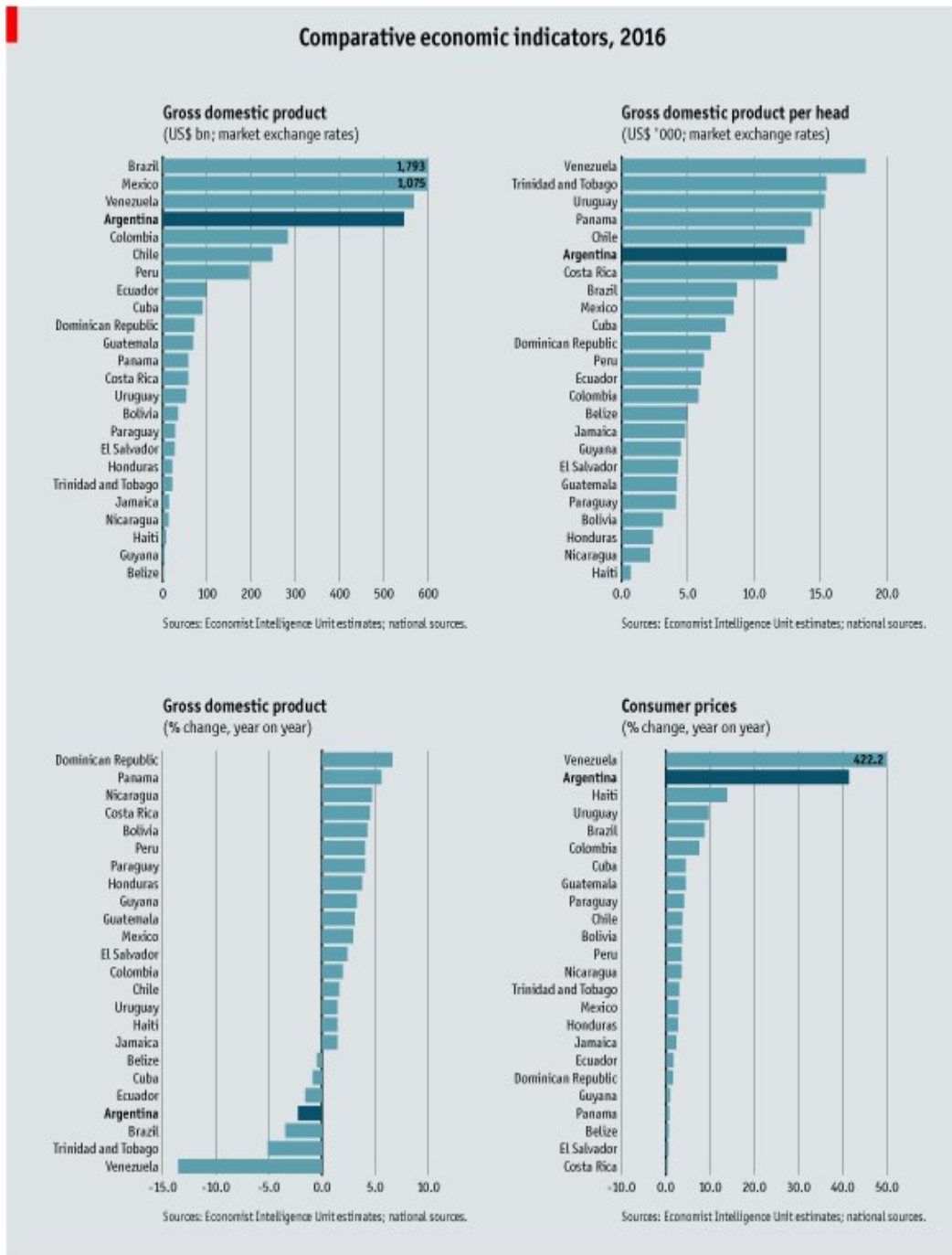
Quarterly trends charts



Monthly trends charts



Comparative economic indicators



Basic data

Land area

2,737,000 sq km

Population

43.13m (2015)

Main towns

Population (m; 2010 census)

Federal district & Buenos Aires province: 18.5

Córdoba: 3.3

Santa Fe: 3.2

Mendoza: 1.7

Tucumán: 1.4

Climate

Varies from subtropical in the north to sub-arctic in the south

Weather in Buenos Aires (altitude 27 metres)

Hottest month, January, 17-29°C (average daily minimum and maximum); coldest month, June, 5-14°C; driest month, July, 56 mm average rainfall; wettest month, March, 109 mm average rainfall

Language

Spanish

Measures

Metric system. Among other measures in use are: fanega = 3.77 bushels; quintal = 100 kg

Currency

Argentinian peso (Ps). Average exchange rate in 2016: Ps14.76:US\$1.

Fiscal year

January-December

Time

3 hours behind GMT

Public holidays

January 1st (New Year's Day); February 12th and 13th (Carnival/Shrove Tuesday); March 24th (Memorial Day); April 2nd (Veterans' Day); March 30th (Good Friday); May 1st (Labour Day) and 25th (National Day); June 20th (Flag Day); July 9th (Independence Day); August 21st (Assumption); October 15th (Day of Respect for Cultural Diversity); November 19th (National Sovereignty Day); December 8th (Feast of the Immaculate Conception) and 25th (Christmas Day)



Political structure

Official name

Republic of Argentina

Form of state

Federal republic

The executive

The president, who serves as head of state and commander in chief of the armed forces, is elected for a four-year term and can be re-elected for one consecutive term. The president appoints a cabinet and a chief of cabinet, who can be removed by a majority vote in each chamber

National legislature

Bicameral Congress: 257-member Chamber of Deputies (the lower house), directly elected for a four-year term; half of the lower house stands for re-election every two years. Seventy-two member Senate (the upper house), directly elected for a six-year term; three senators are elected per state, two from the leading party and one from the runner-up; one-third of the upper house stands for re-election every two years

Regional legislatures

Twenty-three states and an autonomous federal district

Legal system

Federal judges appointed by a Council of the Magistracy; Supreme Court system both nationally and in the provinces; national Supreme Court members require the endorsement of two-thirds of the upper house

National elections

Last elections were on October 25th 2015 (legislative and first-round presidential) and November 22nd 2015 (second-round presidential). Next legislative election (half of lower house and one-third of upper house) will be held on October 22nd 2017; next presidential election in October 2019

National government

Mauricio Macri took office as president for a four-year term beginning on December 10th 2015

Main political organisations

Government: Cambiemos alliance, which includes Propuesta Republicana (Pro); Unión Cívica Radical (UCR); Coalición Cívica (CC)

Main opposition: Partido Justicialista (PJ, the Peronist party). The Peronist party includes several factions, the largest of which is the Frente para la Victoria (FV); other factions of the Peronist party may give the government support on an ad hoc basis

Key ministers

President: Mauricio Macri

Vice-president: Gabriela Michetti

Cabinet chief: Marcos Peña

Agro-industry: Ricardo Buryaile

Defence: Julio César Martínez

Energy & mining: Juan José Aranguren

Finance: Luis Caputo

Foreign affairs: Jorge Faurie

Interior, public works & housing: Rogelio Frigerio

Justice & human rights: Germán Carlos Garavano

Labour, employment & social security: Jorge Alberto Triaca

Production: Francisco Adolfo Cabrera

Security: Patricia Bullrich

Social development: Carolina Stanley

Treasury: Nicolás Dujovne

Central bank president

Federico Sturzenegger

Recent analysis

Generated on March 6th 2018

The following articles have been written in response to events occurring since our most recent forecast was released, and indicate how we expect these events to affect our next forecast.

Politics

Forecast updates

Lima group criticises Venezuelan elections

February 15, 2018: International relations

Event

On February 13th the group of [12 countries that signed the Lima Declaration](#) in August 2017 (the Lima group), along with Guyana and St Lucia, reconvened in the Peruvian capital, Lima, to take a stand on the Venezuelan government's decision to move forward presidential elections to April 22nd.

Analysis

The foreign ministers and representatives of the Lima group of countries, along with those from Guyana and St Lucia, strongly rejected the decision by the National Electoral Council of Venezuela to hold presidential elections in the absence of an agreement between the government and the opposition. They stated that the Venezuelan elections "will lack all legitimacy and credibility", given the government's engagement in rampant voter suppression, imprisonment of political opponents and disbarment of opposition parties.

The delegation also highlighted the human rights abuses being carried out by the Venezuelan government, as evidenced by a report put forth by the Inter-American Commission on Human Rights (IACHR) on February 12th. The IACHR report revealed that the ongoing socio-economic crisis in Venezuela was being aggravated by the erosion of democratic institutions and political rights. The Lima group also noted the decision of the general prosecutor of the International Criminal Court to open preliminary probes into the use of excessive force by security forces in Venezuela to subdue [protests that took place in early 2017](#).

The Peruvian foreign affairs minister, Cayetana Aljovín, also announced that the Peruvian government would rescind its initial invitation to Venezuelan president, Nicolás Maduro, for the upcoming Summit of the Americas in mid-April. Although this was already a likely outcome, given [mounting pressure by the Peruvian legislature](#) to do the same, the endorsement of the Lima group allowed Ms Aljovín to present this as a collective decision.

Impact on the forecast

Irrespective of the Lima group's denunciation, we expect the Venezuelan government to press ahead with its plans to hold elections in April. Our forecasts remain unchanged: the main external threat to the survival of the regime is possible US sanctions.

Argentina improves its anti-corruption ranking

February 28, 2018: Political stability

Event

Argentina improved sharply in the latest annual corruption perceptions index (CPI), published by Transparency International, an anticorruption lobby group: it gained ten positions, to rank 85th out of 180 countries.

Analysis

The CPI ranks countries according to how they score on a scale of 0 (most corrupt) to 100 (least corrupt). In the index for 2017, which has just been published, Argentina is ranked 85th, with a score of 39. This means that Argentina is seen to be more corrupt than the average; it comes in below the global and regional average scores of 43 and 44 respectively. But there is clear evidence of improvement. The country's ranking has risen by 22 places in two years, and is up from 107th in 2015. For the first time in two decades, Argentina did better than neighbouring Brazil, which fell 17 positions to rank 96th.

For the current administration, in office since December 2015, the improved ranking will be seen as a sign that some of its initiatives are paying off. Among other things, the government has provided clear support to the anticorruption agency; issued a decree tackling nepotism in government departments (in part it prevents ministers from appointing members of their families to public posts); and introduced an anticorruption law, which was approved in December. The latter makes corporate compliance programmes obligatory, and establishes corporate criminal liability for corrupt acts. Plans for labour reform may increase scrutiny over the management of trade union funds.

Yet there remains a lot to do. Although claiming to be better than the previous government, the administration has not entirely avoided controversy. In February, for example, the deputy general secretary to the presidency resigned after questions were asked about the provenance of a US\$1.2m deposit in a bank in Andorra. The president, Mauricio Macri, who at one stage was himself charged with improperly using a tax haven (the case was dismissed), says that the point is that there should be scrutiny and due process. Big challenges ahead will include a reform of the country's slowmoving and highly politicised judiciary, and the introduction of an ethics code for public servants.

Impact on the forecast

Argentina's improvement in the CPI ranking sends a positive signal to investors and supports our economic growth forecast. Corruption, nevertheless, will remain a hot political issue, and the government will be under pressure to make further progress.

Analysis

Another year of deterioration for Latin American democracy

February 6, 2018

Latin America and the Caribbean registered a second year of decline in The Economist Intelligence Unit's annual Democracy Index. The region's average score fell slightly, from 6.33 in 2016 to 6.26 in 2017. Although the region remains the most democratic in the developing world, its score suffered amid continued issues with corruption, which helped to erode popular confidence in democracy and democratically elected leaders. Two countries shifted categories this year: Venezuela's score fell to the extent that the country is now classified as an authoritarian regime, while Ecuador's score improved, moving it up from a "hybrid regime" to a "flawed democracy".

In the latest scoring, the region counts just one full democracy—Uruguay, ranked 18th globally of the 165 countries measured in the Democracy Index. The majority of the region's countries—16 of 24—fall into the category of "flawed democracy", with an additional five classified as hybrid regimes. Just two countries—Venezuela and Cuba—are classified as authoritarian. This makes

Latin America the most democratic region of the developing world, and globally puts it behind only Western Europe and North America (although by score, the region remains considerably behind both).

However, the overall picture masks serious discrepancies in the region's performance in the five categories that make up our Democracy Index. Although Latin America scores well above the global average for *electoral process and pluralism* and *civil liberties*, its performance is more middling in those pillars related to the exercise of democracy and quality of political culture. Latin America's average score is only slightly ahead of the global average (and fourth globally) for *functioning of government*. The region also performs poorly in the category of *political participation*, reflecting the region's issues with corruption, transnational organised crime (the murder rate related to drug-trafficking rose throughout the region in 2017) and low levels of political engagement. The region falls below the global average in just one category, *political culture*, owing to the region's relatively low level of popular confidence in democracy. According to Latinobarómetro, a Chilean pollster that publishes annual assessments of public perceptions of democracy in eight Latin American countries, public support for democracy has steadily declined since polling began in 1995, falling to 53% in 2017. (The largest expansion has been seen among those who are indifferent, accounting for 25%—support for authoritarian rule has also declined over time.)

Democracy Index 2017



Source: The Economist Intelligence Unit.

Corruption erodes trust in democracy

Corruption was the major story of the region this year. Corruption investigations continued to engulf Brazil's political class, exposing malfeasance between politicians and several of the country's largest companies, mainly entailing kickbacks in return for government contracts and other political favours. Brazil's president, Michel Temer, narrowly avoided a trial over corruption charges, after his allies in Congress voted to block two separate requests by the prosecutor-general to open a trial at the Supreme Court. The decline in trust in democracy and revelation of the widespread nature of corruption caused Brazil's score to fall from 6.9 in 2016 to 6.86 in 2017.

The fallout from corrupt practices by Odebrecht, a Brazilian engineering firm at the centre of the scandal, was also felt across the region, reflecting its operations over the years in several countries. These allegations nearly cost the Peruvian president, Pedro Pablo Kuczynski, his job as he faced possible impeachment in December (he survived), and led to the forced removal from office of the Ecuadorean vice-president, Jorge Glas. Investigations of possible bribes received by politicians from Odebrecht continue in Peru, Colombia, Panama, the Dominican Republic and elsewhere.

Political malfeasance affected scores elsewhere

Many countries saw a deterioration in their scores owing to departures from democratic norms in 2017. Guatemala's score declined from 5.92 to 5.86, as the president, Jimmy Morales, sparked a political crisis when he attempted to expel Iván Velázquez, the head of the UN-backed International Commission against Impunity in Guatemala, as the body moved to investigate allegations that a drug-trafficking cartel had illegally funded Mr Morales' presidential campaign. The Supreme Court vetoed Mr Velázquez's expulsion, but Congress upheld Mr Morales' presidential immunity.

Honduras also saw a decline in its score—from 5.92 to 5.72—after a presidential election in November revealed serious irregularities in the voting process. Our sister publication, *The Economist*, reported having access to secret recordings among members of the party of the incumbent president, Juan Orlando Hernández, discussing vote-rigging techniques to keep him in office; an initial lead for his rival, Salvador Nasralla, was reversed in later returns, leading many to suspect fraud. Despite objections from the opposition and a partial recount, the result was certified and Mr Hernández was sworn in as the country's president in early 2018. Nevertheless, the episode undermined the country's score for *electoral process and pluralism*.

Questionable elections also occurred in Nicaragua, where the ruling Frente Sandinista de Liberación Nacional (the Sandinistas) won a sweeping victory at municipal elections in November that the Organisation of American States criticised as unfair. And in Bolivia, the president, Evo Morales, overrode the result of a 2016 referendum that rejected an extension of presidential term limits, before the Supreme Court (dominated by Morales loyalists) declared him eligible for a fourth presidential run in 2019.

Venezuela moves down, but Ecuador moves up

The most marked erosion in democracy this year came in Venezuela, which has suffered a gradual deterioration in our index over the years: from a score of 5.34 (and 95th place globally in 2008), the country now has a score of 3.87 (down precipitously from 4.68 in 2016) and places 117th globally. For the first time, Venezuela is now classified as an authoritarian regime in our index. This reflects the country's continued slide towards dictatorship as the government sidelined the opposition-dominated National Assembly, jailed or disenfranchised leading opposition politicians, and violently suppressed opposition protests. Despite dialogue between the government and opposition, there has been little progress in restoring democratic norms. The government has now called a presidential election for April—ahead of schedule—but has disqualified the major opposition grouping, the Mesa de la Unidad Democrática, from participating. Further deterioration appears likely. The country joins Cuba (only slightly behind Venezuela in its score, with 3.31) as the only authoritarian regimes in the Americas.

On a more positive note, Ecuador moved up in our rankings, its score improving from 5.81 in 2016 to 6.02 in 2017. This had the effect of helping the country to shift categories, from "hybrid regime" to "flawed democracy". The upgrade reflects efforts by the newly inaugurated president, Lenín Moreno, who took office in May 2017, to undo some of the more controversial encroachments on the rule of law and freedom of expression made by his predecessor, Rafael Correa (2007–17). This

included taking steps to remove or at least relax some of Mr Correa's restrictions on the media, and steps to enforce the rule of law surrounding corruption. These efforts saw the removal from office and, subsequently, prison time for the former vice-president, Jorge Glas (charged with illicit association with Odebrecht), as well as investigations into other ministers. In February a referendum proposed by Mr Moreno passed with overwhelming support for measures that will undo more of Mr Correa's "excesses", including reinstating presidential term limits, restructuring the Council of Citizen Participation and Social Control, a state entity with power over judicial appointments (headed by Correa loyalists), and demanding more stringent punishments for corrupt officials.

Challenges ahead, but causes for optimism

Although scores declined for the region as a whole, there is some cause for optimism. Although there were shortcomings in elections in Nicaragua and Honduras—and elections can be expected to be neither free nor fair in Venezuela this year—Latin America will host six other elections this year that should be both free and fair. As the regional drive against corruption proceeds, countries should be able to "clean house" and deter future corruption. What will require work is the ongoing consolidation of democracy, particularly in building political culture and improving good governance to build popular support for democracy. Until this is done, Latin America is unlikely to record any major improvements in its position in The Economist Intelligence Unit's Democracy Index.

Tillerson's Latin American tour misses the mark

February 8, 2018

The US secretary of state, Rex Tillerson, has completed his first major Latin American tour since taking office a year ago. It took him to Mexico, Argentina, Peru, Colombia and Jamaica on February 1st-7th. The trip appears to have advanced US-led efforts to increase pressure for democracy in Venezuela, a country undergoing a deep political and economic crisis under the authoritarian leftist government led by Nicolás Maduro. Mr Tillerson said that his hosts had agreed to keep in touch to study various mitigation and coordination measures, should the US president, Donald Trump, decide to widen sanctions against Venezuela, including the possible imposition of an oil embargo. More widely, however, the trip failed to clarify whether the Trump administration is ready, or indeed willing, to adopt an active leadership role in the region.

It has taken some time for the Trump administration's policy towards Latin America to crystallise, partly because the region appears to be a relatively low priority for the "America First" president. A number of experienced Latin America experts have also recently left the State Department, which has not helped. But publication of Mr Trump's National Security Strategy in December and a keynote speech by Mr Tillerson at the University of Texas ahead of his tour have been informative. Both demonstrate a neo-Cold War tone, proposing a vigorous pursuit of US interests in a competitive win-lose world. Mr Tillerson reiterated the traditional US interest in promoting economic growth, security and democratic governance in the hemisphere. Yet he focused most sharply on perceived adversaries: Venezuela and Cuba, seen by the current US administration as anti-democratic rogue states inside the region, and China and Russia, seen as global rivals prepared to stir up trouble in a region historically under US influence.

Unanswered questions

The traditional response to such a situation is for Washington to rally US allies in the region around a common democratic vision, and to take concerted actions. But Mr Tillerson has been able to do only part of that job, and many questions remain unanswered. There are a number of centre-right governments in the region that are deeply concerned over the Venezuelan crisis and are also potential diplomatic allies of the Trump administration. Yet, for a variety of reasons, they are nervous about following the US's lead. Some regional presidents were deeply alarmed after a dinner in Washington DC in September last year, when Mr Trump talked loosely of invading Venezuela: according to press leaks, they considered him "dangerously unpredictable". Mr Tillerson's visit appears to have reassured leaders that there will be a more measured and consultative approach.

Yet other issues also get in the way. Mr Trump's comments on Latin America have been

remorselessly negative, stressing drugs and crime, and have disconcerted his country's natural allies. As was the case during a Latin American tour by the US vice-president, Mike Pence, last year, Mr Tillerson failed to visit Brazil, the largest country in the region. Relations with Mexico, the second most important regional power and a traditional ally, are deeply strained because of US plans to build a border wall, deport Mexican immigrants and impose protectionist trade policies. Relations with Argentina are good, but the US imposition of punitive tariffs on Argentina's bio-diesel exports is a significant irritant. Relations with Peru and Colombia are also firm, but remain troubled by uncertainty over the direction of the US government's "war against drugs" policies. Mr Trump recently rattled the Colombian government by again suggesting that the US would cut economic aid to drug-producing countries. More diplomatically, Mr Tillerson acknowledged that the US is the main consumer of illicit drugs produced in the region, and that both producing and consuming countries must work together.

Leaving a door open for China

Perhaps the key problem is a leadership deficit on economic policy issues. US economic growth has been good for the Latin American economies over the past year, and the US is still the region's main trading partner (in 2015, US-Latin American trade was just under US\$700bn). Yet the US's shift away from globalisation and towards protectionism has left its allies perplexed. To some extent this has opened the door for China. China-Latin America trade has been growing at a rapid rate in the past decade, reaching just under US\$250bn in 2015. Although Mr Tillerson acknowledged that trade with China had brought some benefits to Latin America, he claimed that China had imperial ambitions and that its unfair trading practices were harming Latin American countries, eroding manufacturing, generating unemployment and lowering wages.

However, many regional governments do not share this assessment. For them, China is a valuable ally in the struggle to diversify exports. More than the US, it currently seems to have a clear economic vision of the benefits of globalisation, stressing win-win trade and major infrastructure investment and development through the Belt and Road Initiative (BRI). China formally invited Latin America to join the BRI in January. In comparison, Mr Tillerson had few specific trade and investment initiatives to offer his Latin American counterparts. For this reason, although there was some commitment to coordinate policy towards Venezuela, Mr Tillerson's visit appears to have fallen short of the mark.

Large protest highlights union power

February 23, 2018

On February 21st Hugo Moyano, an influential unionist, led a large protest against the Argentinian government's economic and social policies, in a warmup to what are likely to be tricky collective wage bargaining rounds in most industries starting in March. Relations between the government and organised labour have deteriorated in recent weeks, as the government has taken a less conciliatory stance towards unions that are being damaged by a series of corruption allegations. Although The Economist Intelligence Unit's expectations for wage negotiations are unchanged in the light of these recent developments, we see growing risks that the government will be unable to pass any sort of labour reform when the next congressional session begins in March.

Attendance at the protest, which took place in the centre of Buenos Aires, the capital, was estimated at around 140,000 by the Ministry of Security and at around 500,000 by the protest's organisers. The protest itself served two purposes: to demonstrate Mr Moyano's power to other union leaders amid ongoing internal conflicts in the sector, and to send a warning signal to the government ahead of a potentially conflictive period of annual wage bargaining, which typically begins in March (although exact timings depend on the particular industry). The protest, together with a recent strike by bank workers over pay and conditions, and the possibility of a politically damaging teachers' strike that would impede the beginning of school classes in Buenos Aires province in March (as occurred last year), highlights the persistent risk of disruptive labour conflict in the country.

Moyano versus Macri

The demonstration was supported by left-wing political parties, social organisations and several other unions. It was not supported by two other leading union figures, Luis Barrionuevo and Victor Santa Maria; the fact that there was nonetheless a large turnout cements Mr Moyano's position as the main union opponent of the president, Mauricio Macri, and his government. (Mr Moyano had at one point been a supporter of Mr Macri, and was also at various points a supporter and an opponent of the previous government; his primary goal is generally to secure his own power base.)

Although it remains divided, the union movement now has a clearer leader, and this will complicate the government's negotiating stance. The administration has recently taken advantage of union weakness, stemming partly from a spate of corruption investigations into members of the labour movement (for activities including money laundering and tax evasion), to adopt a harder line in its dealings with the unions. The day after the protest Mr Moyano stated that he was keen to resume dialogue with the government. However, maintaining its hard line, the Macri administration has rejected this for now, probably banking on the possibility that corruption investigations will erode public opinion towards organised labour. Even so, there is clearly the strong possibility of increased strike activity in the short term.

Strikes and protests are not unusual around the time of wage bargaining rounds, and the latest protest does not alter our political forecasts or our expectation that wage rises will slow in nominal terms but remain above the government's target for wage negotiations of 15%. However, worsening relations between the unions and government put labour reform to increase labour market flexibility more at risk. We already expect reforms to be partial; there is now some risk that the government will be unable to push reform through at all when Congress returns from its summer break in March.

Economy

Forecast updates

Provincial indebtedness grows

February 8, 2018: Fiscal policy outlook

Event

A recent gaffe by the governor of Chubut, Mariano Arcioni, has shone a spotlight on the state of the provincial finances. At the end of January Mr Arcioni erroneously suggested that Chubut would seek to restructure its debts. He later clarified that the provincial government would merely like to refinance its debts to improve its maturity and interest-rate profile, but in the meantime, the price of Chubut's dollar-denominated bonds sank by 6% in secondary markets.

Analysis

Although Mr Arcioni's mistake quickly became clear, the episode has had more lasting consequences by highlighting increasing provincial public indebtedness at a time of broader global market volatility. In the aftermath of the sovereign's exit from default in April 2016, the provinces have taken advantage of improved financing conditions to increase their external debt issuance substantially.

Data on the provincial finances are available only with a considerable lag. Official figures for the first quarter of 2017—the latest available—showed total provincial debt at Ps516bn (US\$33bn; 4.8% of full-year GDP). The provincial primary deficit of the provinces came in at Ps3bn in the first half of 2017 (latest available), reversing a Ps7bn primary surplus registered in the year-earlier period. Reflecting a growing burden of interest payments, the overall provincial deficit climbed to Ps26bn (0.2% of full-year GDP, and up from Ps3bn in 2016).

Although these sums are currently manageable, growing primary and overall fiscal deficits, along with a rising public debt burden, increase provinces' exposure to sudden changes in investor risk appetite. The growing interest payment burden in particular also increases the inflexibility of provincial expenditure. This will in turn make it more difficult to comply with commitments made by the provinces as part of a fiscal pact agreed in late 2017 with the federal government (which includes a commitment to reducing provincial tax pressure). The structure of the debt is also somewhat problematic: around half of provincial debts are now US dollar denominated, heightening exposure to currency risk and raising investor concerns, given the substantial weakening of the peso since mid-December 2017.

Impact on the forecast

The latest developments do not materially change our forecasts. However, in a broader context of rising public indebtedness in recent years (albeit from a low base), trends in the provincial finances provide further evidence of the need for greater progress on fiscal consolidation in 2018/19. We assume that this will happen; if it does not, perceptions of Argentina's creditworthiness could quickly deteriorate.

Government approval ratings fall

February 8, 2018: Inflation

Event

Recent opinion polls have shown a decline in the government's approval ratings and suggest increasing pessimism on the state of the economy, prompted at least in part by an increase in inflation expectations early in the year.

Analysis

In an opinion poll conducted in January by a local consultancy, Management & Fit, 45% of respondents thought that the country's economic situation in coming months would be worse, compared with only 30% who thought it would be better. These shares were 34% and 40% respectively in October 2017, when Cambiemos, the ruling coalition, registered a convincing victory in the mid-term legislative election. In the same poll, the government's approval rating fell from 50% in October to 41% in January.

A clue to voter unease on the economy came in the latest market expectations survey conducted by the Banco Central de la República Argentina (BCRA, the central bank) in late January. This survey of economic analysts showed a dramatic rise in inflation expectations, which stemmed in turn from the unexpected upward adjustment of the inflation targets at the end of 2017. In the latest survey, inflation expectations for end-2018 climbed to 19.4%, up from 17.4% just one month before, and well above the revised inflation target for 2018 of 15%. Inflation expectations for 2019 and 2020 have also risen to 13.5% (versus a target of 10%) and 9.1% (versus a target of 5%) respectively.

Weak confidence in the inflation target is problematic, as unanchored expectations will increase pass-through from ongoing currency depreciation to consumer prices. Over the course of the past two months, the peso has depreciated against the dollar by some 12%, in a partial correction of recent currency overvaluation. Although the contribution to inflation from subsidy cuts will be much lower in 2018 than in 2017, currency depreciation this year could nonetheless continue to complicate the disinflation process.

Impact on the forecast

We think some of the local concern regarding inflation dynamics is overdone, and our inflation forecasts, which were revised moderately upwards last month, remain unchanged. The disinflation process will continue, albeit less quickly than the government would like. That said, the policymaking environment is difficult and the government has conflicting goals of sustaining growth, narrowing the fiscal deficit by eliminating costly subsidies, controlling inflation, and promoting external competitiveness. In this context, and with the government under pressure from voters to produce more rapid results, there are risks to our inflation and our growth forecasts.

Low-cost airlines take off

February 19, 2018: Economic growth

Event

A new airport for budget airlines began operating at El Palomar, outside the capital, Buenos Aires, on February 9th, followed six days later by the inauguration of a low-cost, long-haul service between Buenos Aires and London, the UK capital, operated by Norwegian Air.

Analysis

These two developments signal that, rather late in the day, the low-cost air travel revolution is finally arriving in Argentina. For years the industry has been heavily regulated; domestic air travel has been largely controlled by a duopoly formed by the state-owned airline, Aerolíneas Argentinas, and a privately owned regional airline, LATAM. Flying has been expensive and for the few. By one calculation, Argentinian travellers pay US\$120 for each hour they spend in the air, compared with an average of US\$60-65 elsewhere in Latin America. Only 25 out of every 100 Argentinians are regular flyers, less than half the rate in neighbouring Chile, where 56 out of every 100 take to the air. Until recently, passenger numbers have been growing at low single-digit rates: in Brazil, meanwhile, there has been double-digit percentage growth for more than a decade.

To try to change this, since 2016 the government has been deregulating and offering 15-year licences to new low-cost carriers to operate domestic and international routes. Avianca Argentina will start operating 14-18 new domestic routes this year. A new Argentina-based company, Flybondi, which has won further routes and plans to offer flights to Chile, Uruguay and Paraguay, operated the first flight into El Palomar from Córdoba in central Argentina. The biggest new arrival is Norwegian Air, which says that it is to base over 60 aircraft in the country, operating 72 local and 80 international routes. The government says that airlines have overall pledged US\$6.8bn in new investment over the next four years.

This is all good news, but a successful low-cost revolution (with the ultimate aim of increasing connectivity to the benefit of the economy) will require progress in many areas: investment in infrastructure, lighter-touch (but still effective) regulation and a more competitive state airline.

Impact on the forecast

Recent developments follow more than a year of efforts to develop the sector in line with an objective of improving connectivity; we had already pencilled these improvements into our forecasts, which consequently remain unchanged. There is some upside risk to our growth forecasts in the medium term if rapid results in the consumer aviation sector continue, and are replicated elsewhere in logistics and transport infrastructure.

Drought hits harvest

February 20, 2018: External sector

Event

Amid a drought in key agricultural areas, forecasts for the upcoming soya and maize harvests are being revised downward.

Analysis

Weather patterns have been volatile in recent years, during which time farmers have had to cope with a combination of floods, frost, drought and fires. For much of 2017 excessive rain and floods posed the biggest problem, affecting up to 20% of the cultivated area. But in November the weather turned again in many parts of the country, and drought is now affecting up to 40% of Argentina's cultivated area and seriously reducing the predicted soya harvest for the 2017/18 season. The wheat harvest, which was completed in January, escaped the worst: at 18m tonnes it was still up by 3% year on year. But the Buenos Aires Grain Exchange is now expecting the soya harvest, which will be completed in July, to come in at 50m tonnes, down from an earlier forecast of 51m tonnes. This would represent a substantial fall of 13% in year-on-year terms. The maize forecast has been cut to 39m tonnes, down from 41m tonnes previously. This is broadly comparable with the 2016/17 harvest.

News of the drought has led to a rise in international soya prices in recent weeks. But the price increase is unlikely to make up for the loss in farmers' revenue stemming from lower export volumes, and export earnings will suffer. In 2017 a quarter of export earnings came from agriculture and over a third came from processed agricultural products, including oilseeds. Given the importance of the sector, brighter prospects for industrial exports in 2018 amid a pick-up in the Brazilian economy and recent peso weakening seem unlikely to entirely offset this year's agricultural difficulties.

Impact on the forecast

Although recent peso weakening and clearer signs of a recovery in Brazilian demand will support Argentina's industrial exports, agricultural exports remain extremely important to the trade and current accounts, and the ongoing drought will prompt a moderate downward revision to our trade forecasts in 2018.

Analysis

EIU global forecast - Higher interest rates are coming

February 13, 2018

After an encouraging 2017 for the global economy, The Economist Intelligence Unit expects 2018 to proceed along similar lines. The US economy will continue to motor along; the euro area will absorb more of labour market slack; the Chinese government will manage its economic slowdown carefully; and Japan's economy will grow by 1.5%. Higher commodity prices will prove a fillip for emerging-market exporters, as will strong external demand from developed markets. However, 2018 will also be characterised by tightening monetary policy and credit conditions. On balance, the global economy is forecast to expand by 3% in 2018 and 2.9% in 2019, from an estimated 3% in 2017.

Over the next two years the European Central Bank (ECB) will continue to taper its quantitative easing (QE) purchases ahead of a first interest-rate rise in 2020, and we believe that the Bank of Japan (BOJ) will also begin to wind down QE, beginning in 2019. Over these two years there will also be monetary tightening in Canada, the UK and Australasia. Higher borrowing costs in major economies will force other central banks in emerging markets to fall into line. By reducing long-term yields through QE, investors have been forced to look elsewhere for attractive returns. This excess liquidity has pushed up the prices of all manner of assets, including bonds, stocks and property, generating a major risk for the health of the global economy.

It also needs stressing that the effects on financial markets of withdrawing huge amounts of

monetary stimulus are not well understood. The Federal Reserve (Fed, the US central bank) is doing its bit to minimise the disruption by outlining how it will taper its QE programme. The ECB and the BOJ are likely to use the same strategy, but the impact on financial markets remains unclear. February's jitters are likely to represent the end of a period of unusual calm in financial markets. We expect there to be further short-lived periods of volatility as global markets adjust to the gradual shift away from easy money.

The business-cycle downturn that we expect in the US in 2020 has become the defining event in our forecast period. It is likely that the long period of economic growth will be interrupted in the coming years. The unemployment rate that is consistent with non-accelerating inflation is very low, at between 3.5% and 4%. Our view of this rate is lower than that assumed by the Fed (4.5%), meaning that inflationary pressures will take longer to build, even allowing for the mild stimulatory effect of the tax-reform package passed in late 2017. With inflation and the pace of monetary policy tightening accelerating, the pressure will be greater than the economy can bear, and we expect private consumption and investment to contract for two quarters in early 2020. Our core forecast is that the dip will be shallow and the rebound relatively rapid, owing to the Fed cutting interest rates aggressively in response to the contraction and some support from fiscal stimulus measures. This means that the recovery in 2021–22 will be brisk.

Against the backdrop of a healthy global economy lies the highest level of political risk in years. The US is sending an ambivalent message to its traditional allies, following its withdrawal from the Paris climate agreement and the Trans-Pacific Partnership, and its stance towards NATO. It is, however, the US's heated rhetoric towards North Korea that could have the greatest potential consequences. Although both sides have a strong incentive not to escalate the situation, we note the small risk of North Korea unleashing its nuclear capability under the belief that a US assault was imminent, or the US attempting to warn off North Korea through a "bloody nose" attack.

Developed world

The US economy is in good shape, and we have revised up economic growth in 2018 to 2.5%, from 2.3% previously. Wage growth is showing signs of accelerating, and the unemployment rate is at its lowest level since 2000. We expect the US economy to show signs of overheating in the next two years, as a result of which the Fed will quicken the pace of monetary tightening, especially given the recent tax changes. Unable to cope with this, the economy will face a downturn in early 2020. The recent revival of the euro zone economy is likely to be sustained, but political risk will remain high. EU leaders are currently boosting the region's resilience to shocks, in part by renewing their push for further integration of the economic and monetary union. A decision on reform proposals will be made at the EU summit in June 2018. Following the renewed landslide secured by the ruling Liberal Democratic Party (LDP) in Japan, Shinzo Abe is in a strong position to secure another term as LDP leader when the party votes in late 2018. This comes in the context of the country's mild economic recovery under the prime minister's recovery plan.

Emerging markets

We expect conditions for emerging markets to become more challenging in the first half of the forecast period as US interest rates continue to rise. India will be Asia's fastest-growing large economy in 2018–22, expanding at an average annual rate of 7.9%. Growth will also remain on track in the Association of South-East Asian Nations (ASEAN) member states, with an average annual expansion of 4.8%. Vietnam, Cambodia and Myanmar, in particular, will continue to record growth rates above 6%, owing to relatively low wage costs and advantageous geographic locations.

We expect the Chinese economy to slowly slightly in 2018, to 6.4%, from an estimated 6.9% in 2017. The government's long-held target of doubling real GDP between 2010 and 2020 is within its grasp; it requires annual average GDP growth of 6.3% in 2018–20. We believe that it will meet this target without requiring significant economic stimulus. We expect China to move away from GDP targeting in the next decade. This is ideologically consistent with the call of the president, Xi Jinping, for more inclusive growth in his landmark speech at the party congress at the end of 2017. As such, we expect growth to continue to slow steadily in the forecast period, reaching 5.2% in 2022.

The ongoing economic recovery in Latin America is forecast to gather momentum in 2018–19, after several years dominated by macroeconomic policy adjustments to the end of the commodities

boom of the previous decade. Sustained Chinese growth will continue to provide a favourable external environment for the region, particularly for commodity exporters such as Brazil and Argentina. This, combined with a rise in global risk appetite, as reflected in lower sovereign credit default swap rates (except for Venezuela, which defaulted on some external debt obligations in late 2017, taking the country further into economic and financial crisis), has generated strong growth in local stockmarkets.

At present, seven countries in the Middle East that collectively account for a quarter of the regional population are either torn by civil war or destabilised by Shia-Sunni rivalry. Geopolitical risk has also risen rapidly within the Gulf Cooperation Council (GCC). We expect the boycott of Qatar by some of the GCC countries and Egypt to continue until at least 2021. In this period divisions will harden between Qatar, Turkey and Iran on one side, and Saudi Arabia, the UAE and Egypt on the other. The long-term rivalry between Saudi Arabia and Iran is likely to destabilise a group of other countries in the Middle East, including Iraq, Syria, Lebanon and Yemen. Tensions are likely to increase rather than diminish in the region in the coming months.

Following a dismal performance in Sub-Saharan Africa over 2016–17, we expect a lacklustre recovery to take hold from 2018. This will be driven by a favourable external environment as export prices strengthen and trade gathers pace. However, policy mismanagement, unsupportive political dynamics and gradual tightening of credit conditions in developed economies will weigh on future prospects. On balance, the region is forecast to grow by 3.3% a year in 2018–22.

Exchange rates

The US dollar has continued to depreciate in early 2018, in spite of solid economic data, major tax reform and a clear commitment by the Fed to raising interest rates. Previously, markets did not believe monetary tightening by the Fed to be credible. However, this changed in early February when global stockmarkets fell sharply in response to suggestions of faster US wage growth. Regular interest-rate increases should provide the dollar with fresh support over the next two years, but any rally in 2018–19 will be modest at most. Among G10 currencies, the euro made the biggest gains against the dollar in 2017 as economic data went from strength to strength and some political risk receded. Further supporting the currency, the ECB is slowly becoming more upbeat in its communication. However, we believe that the first interest-rate rise is still two years away, and the euro zone continues to face considerable political challenges, which will limit economic momentum. On balance, we expect the euro to hold steady against the dollar in 2018–19. The yen is expected to appreciate further against the dollar in 2018–19 owing to its safe-haven appeal, and as the BOJ slows the pace of its asset purchases over dwindling bond-market liquidity concerns.

Commodities

The price of crude oil is likely to remain range-bound, at US\$60–70/barrel in 2018–19 for dated Brent Blend, despite the efforts of OPEC and its partners, notably Russia, to constrain global supply by extending the existing production-cut deal until the end of 2018. These efforts will be largely offset by US shale, which will provide both a price ceiling and a floor. Industrial raw materials prices are set to rise for a second successive year in 2018 on the back of strong growth in China and strict environmental controls restricting supply. We expect marginal growth in food, feedstuffs and beverages prices, reflecting rising population, incomes and rapid urbanisation.

World economy: Forecast summary

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Real GDP growth (%)										
World (PPP* exchange rates)	3.4	3.6	3.4	3.2	3.7	3.8	3.8	3.5	3.8	3.8
World (market exchange rates)	2.4	2.8	2.8	2.3	3.0	3.0	2.9	2.4	2.8	2.8
US	1.7	2.6	2.9	1.5	2.3	2.5	2.3	0.8	1.9	1.8
Euro area	-0.2	1.4	2.0	1.8	2.5	2.2	1.9	1.7	1.7	1.7

Europe	0.8	1.9	2.0	1.8	2.6	2.3	2.0	1.8	1.9	1.9
China	7.8	7.3	6.9	6.7	6.9	6.4	6.3	6.2	5.5	5.2
Asia & Australasia	4.6	4.1	4.3	4.1	4.5	4.3	4.4	4.0	4.2	4.2
Latin America	2.8	1.4	0.5	-0.5	1.2	2.1	2.3	2.4	2.8	2.8
Middle East & Africa	2.2	2.7	2.4	4.2	2.2	2.8	3.3	3.5	3.9	4.1
Sub-Saharan Africa	4.8	4.5	3.0	1.0	2.3	2.9	2.9	2.9	3.6	4.0
World inflation (%; av)	3.8	3.5	3.2	3.8	4.5	5.3	4.4	3.1	3.1	3.1
World trade growth (%)	3.3	3.1	2.3	2.3	4.6	4.3	3.9	2.8	3.8	3.7
Commodities										
Oil (US\$/barrel; Brent)	108.9	98.9	52.4	44.0	54.4	63.0	60.0	57.8	60.6	63.3
Industrial raw materials (US\$; % change)	-6.8	-5.1	-15.2	-2.2	20.2	5.7	-0.2	-4.7	1.0	-1.7
Food, feedstuffs & beverages (US\$; % change)	-7.4	-5.2	-18.7	-3.5	-0.9	0.9	2.8	1.8	0.7	1.6
Exchange rates (av)										
¥:US\$	97.56	105.86	121.02	108.76	112.14	111.26	109.06	104.00	100.00	100.20
US\$:€	1.33	1.33	1.11	1.11	1.13	1.20	1.18	1.21	1.21	1.24

*PPP = purchasing power parity

Source: The Economist Intelligence Unit.

A complicated monetary policy outlook

February 28, 2018

At its latest meeting on February 27th, the Banco Central de la República Argentina (BCRA, the central bank) left the policy interest rate on hold, at 27.25%. Scope for further rate cuts in the short term will be limited, given the impact of currency depreciation and subsidy cuts on inflation expectations and core inflation. However, assuming subsidy adjustments wind down at mid-year, inflation should start to trend down again, creating room for fresh rate cuts. The main risks to this assumption stem from above-inflation wage rises in annual collective wage negotiations, and slippage on fiscal targets, which would raise deeper questions about the macroeconomic policy framework.

The BCRA's decision to remain on hold was unsurprising. The bank meets twice per month to decide on movements in the policy rate; it went on hold at its meeting in early February, after two consecutive rate cuts in January. Those cuts, of a cumulative 150 basis points, came after the government controversially adjusted the inflation targets for 2018 and 2019 upwards, to 15% and 10% respectively, from previous upper limits of 12% in 2018 and 7% in 2019. That adjustment came amid internal government debate over the monetary policy stance, after the bank raised rates in late 2017 to 28.75%, taking the real *ex ante* policy rate to over 10%.

Currency depreciation and subsidy cuts complicate the disinflation process

Scope for further cuts will be limited in the short term by two main factors: persistent currency depreciation since mid-December after several months of nominal stability, and continued subsidy cuts that will cause utilities prices to rise. In the press release accompanying its decision, the BCRA noted that producer prices rose by 5% month on month in January in response to currency depreciation (along with rising global commodity prices). In a context of inflation expectations that are not well anchored to the inflation target of 15%, there is likely to be significant pass-through into consumer prices in February; utilities tariff increases in February (and again in April) will exacerbate this problem and make it difficult to bring core inflation down from its January level of 1.5% month on month and 21.1% year on year.

Based on past statements by the central bank governor, Federico Sturzenegger, the bank is likely to be looking for the core inflation reading to fall to around 1.2% on a consistent, rolling three-month basis (in line with the end-2018 target) before cutting rates, and this is unlikely to happen until around mid-year. That said, since introducing the inflation-targeting regime, the bank not always acted in line with expectations; by Mr Sturzenegger's own admission, the bank cut rates too aggressively in late 2016 and was forced as a result to reverse course in early 2017; it then raised rates substantially above expectations in late 2017, pointing to some signalling problems as inflation-targeting beds in.

Tight fiscal policy crucial to the inflation target

All this said, the bigger picture remains largely unchanged: once the subsidy cuts that have been a major driver of inflation in the past year wind down in mid-2018, the inflation trajectory will be more firmly downwards and rate cuts (while real interest rates are maintained at moderately positive levels) will become possible later this year and in 2019. The main risks to this scenario include the collective wage bargaining rounds that are set to take place in coming weeks amid stubbornly above-target inflation. There are early indications that some unions may accept the 15% nominal wage rise that the government is targeting, but only if clauses allowing for renegotiations in the event of higher than targeted inflation are included in the deal.

Meanwhile, continued progress on reducing the primary fiscal deficit in line with the target will be crucial to retaining confidence in macroeconomic policymaking as a whole. If there is slippage on fiscal targets, deeper questions will be raised about the policy mix, and about the ability of the central bank to bring inflation down to single-digit levels in the medium term. In this context, it seems clear that the inflation issue is just as much of a problem for the Ministry of the Treasury as it is for the central bank.