



LATIN AMERICA ECONOMICS UPDATE

Drought to push Argentina’s economy into deep recession

- **The historic drought afflicting Argentina will cause a steeper contraction in GDP than most expect this year and intensify balance of payments strains by reducing export earnings to the tune of 2-3% of GDP. That will make it hard to meet the IMF’s (downwardly revised) FX reserve target and increases the risk of a disorderly devaluation.**
- The worst drought in 60 years is wreaking havoc in the Argentina’s agricultural sector and has prompted the Rosario and the [Buenos Aires Grain Exchanges](#) to drastically slash their production forecasts for soy, corn and wheat. Production of these commodities is now expected to be 30-40% lower this year than last, which is particularly bad news given that exports of these products combined amounted to \$39bn – around 45% of Argentina’s total exports or 6% of GDP – last year. (See Chart 1.)
- And despite the decline in Argentine production, we expect the prices of these commodities to fall over the coming months because strong supply from other major producers should more than compensate for Argentina’s lost output and because demand will weaken as advanced economies fall into recession.
- The drought will have several adverse effects on Argentina’s economy. The first is that **a lower volume of agricultural production will weigh on real GDP growth this year.** The expected fall in soy, corn and wheat production points to a plunge in Argentina’s agricultural value added of around 20%. (See Chart 2.) Given that the sector accounts for 7-8% of Argentina’s GDP, **this could shave 1.5%-pts off overall GDP.**
- **And the impact is likely to be even larger when knock-on effects on other sectors of the economy are taken into account.** For one thing, **balance of payments strains are likely to intensify.** The Rosario Grain Exchange [expects](#) export revenues to plunge by more than 30% this year, which means that running the current account surpluses needed to rebuild Argentina’s foreign exchange reserves – and meet the IMF’s net FX reserves targets – will be even more challenging.
- Admittedly, the IMF accepted Argentina’s request to lower this year’s net FX reserves targets in light of the drought (the end-23 target was lowered to \$8bn, from \$9.8bn previously). But this will still be a tall order – net FX reserves stand at just over \$1bn. Imports, and by extension domestic demand, will need to weaken further to swing the current account into surplus. In the meantime, low reserve coverage will limit the central bank’s ability to support the [unsustainably strong peso](#), raising the risk of a disorderly devaluation.
- **There will be fiscal implications too.** The government levies high taxes on agricultural exports, making them an important source of government revenues. [Academic estimates](#) suggest that **the loss in government revenues could amount to 0.5-1.0% of GDP this year.** To meet the IMF’s 2023 primary budget target of 1.9% of GDP, even larger expenditure cuts are needed. But with the election creeping closer, there are big question marks about policymakers’ willingness to push these through.
- And finally, a drop in agricultural output is likely to feed through to higher prices of many food products which, in turn, will put further upward pressure on inflation. **All told, we expect the drought and its ripple effects to cause Argentina’s economy to contract by 2.8% this year. This would be one of the steepest contractions over the past two decades (outside of the pandemic and the GFC).**

Chart 1: Argentina Exports by Sector
(% of Total Exports, 2022)

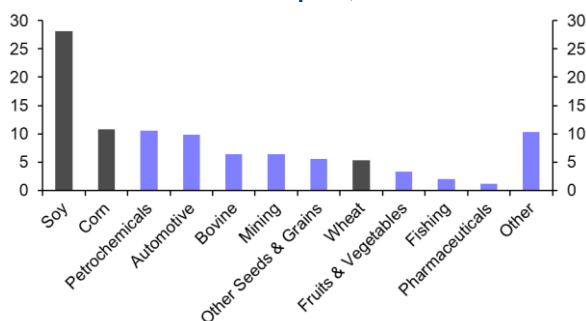
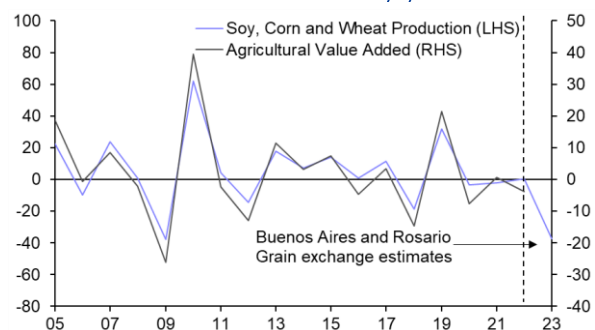


Chart 2: Soy, Corn & Wheat Production & Agricultural Value Added (% y/y)



Sources: Refinitiv, Local Grain Exchanges, MAGYP, Indec, CE



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