LATIN AMERICA ECONOMICS UPDATE

Will a "Dead Cow" become Argentina's life saver?

- **The Vaca Muerta shale formation will alleviate some of the pressure on Argentina's fragile balance of payments position by substantially reducing the country's gas import bill and raising oil export revenues. While this is good news for the crisis-ridden economy, it won't let the next administration off the hook when it comes to addressing the misaligned exchange rate and pushing through the measures needed to stabilise the economy. The risks of the next government putting all the eggs in the Vaca Muerta basket are highest if current Economy Minister and Peronist Sergio Massa becomes president.**

- Vaca Muerta ("Dead Cow" in Spanish) has been one the few bright spots in Argentina, with politicians from across the spectrum hoping that the shale formation will help to pull the country out of its crisis. And it's easy to see why. After all, according to the Energy Information Administration (EIA), Argentina possesses the world's second largest shale gas reserves and the fourth largest shale oil reserves. (See Chart 1.)

- **But, despite these large reserves, Argentina remains a large net energy *importer*, in particular of gas – something it paid dearly for last year.** The surge in prices following the war in Ukraine caused the country to rack up an energy trade deficit in 2022 equal to $4.5bn, or 0.7% of GDP. (See Chart 2). That caused the broader current account position to deteriorate and, as officials tried to prop up the peso, weighed on the country's already low FX reserves. (See Chart 3.)

- **Efforts to exploit Vaca Muerta are making progress**. A key breakthrough came in July with the completion of the first section of the *President Néstor Kirchner Gas Pipeline* (GPNK), which connects Vaca Muerta with the province of Buenos Aires (the country's largest province by population). The pipeline is expected to add 11mn cubic metres of gas per day (mcm/d) to Argentina's current average production of c.134 mcm/d this year, with the number set to double in 2024 once new compressors are installed.

- **We estimate that this will reduce Argentina's dependence on imported gas – and costlier liquified natural gas (LNG) in particular – by around 2bn cubic metres (bcm) from 2024** (for context, Argentina's total gas imports amounted to more than 6bcm last year). In other words, provided that the pipeline operates at capacity, Argentina would probably only need to import relatively small quantities of LNG in some of the winter months from next year (see Chart 4), which in turn, **would bring some welcome relief to Argentina's fragile economy.**

- **For one thing, it would reduce government spending on energy subsidies.** Although the government has reduced subsidies as part of the current IMF deal, energy remains heavily subsidised – we estimate that energy subsidies have amounted to $5.8bn (c.1% of GDP) so far this year, which has put further pressure on Argentina's shaky public finances. According to CEPA, an Argentine think tank, swapping imported energy for domestically-produced energy could lead to fiscal savings of ~$3bn (0.6% of GDP) per year.

- **The bigger impact will arguably come from an improvement in Argentina's external position**. We estimate that the above-mentioned reduction in LNG imports could lower Argentina's import bill by as much as $1.2bn (0.2% of GDP) next year. Spending on gas imports could fall even further if the second part of the section of the Nestor Kirchner pipeline (GNPK II) and the reversal of the *Gasoducto Norte* are completed which would supply the northern provinces with gas from Vaca Muerta and reduce the dependence on imported gas from Bolivia. (More on this below.)

- **Argentina's external position will receive a further boost from oil exports**. With the linking of the Vaca Muerta North Pipeline with the Trans Andean Pipeline (which is scheduled to be completed by the end of the year), Argentina will be able to export up to 110,000 barrels per day (bpd). Exports could rise further if other pipeline projects, such as the Oldelval system, are finished. **The increase in oil exports could lead to additional export income of $3bn (0.6% of GDP) next year.**

- **All told, the reduction in gas imports combined with the revenue from oil exports should help to swing the current account balance back into surplus from next year and will ease some of the pressure on Argentina's perilously low FX reserves.**

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- **In the medium-term, the boost to the external position could be even larger if Argentina manages to put the infrastructure in place to ramp up its export capacity, in particular of gas.** Key to this will be the construction of LNG terminals as well as the construction of the second section of the Nestor Kirchner pipeline (GNPK II) – i.e. an extension of the current pipeline (which terminates in the province of Buenos Aires) to the northern province of Santa Fe – and the reversal of the *Gasoducto Norte*. These projects are necessary to export gas to Brazil.
- **But this is likely to take some time.** Plans to construct LNG plants are still in their infancy – Argentina's state energy company (YPF) and Petronas, Malaysia's state energy company, have only just started to conduct feasibility studies of a LNG plant in Bahía Balance in the province of Buenos Aires. And even if the construction does eventually go ahead, it will take several years to complete.
- **The construction of the GPNK II and the reversal of the *Gasoducto Norte* aren't too far off but, here too, there are hurdles to be overcome.** Crucially, financing from the private sector is needed – local media have reported that c.$2bn are needed to complete both projects. Given Argentina's fragile economic and political situation as well as its history of expropriation, there are question marks about whether Argentina will be able to attract the necessary investment. This is especially the case if current Economy Minister and Peronist candidate Sergio Massa becomes president.
- Overall, then, the likely improvement in Argentina's external position due to the progress made on Vaca Muerta so far is undoubtedly good news. But it will still take several years and a large amount of investment to reap the full benefits of the shale formation.
- **And, crucially, it won't let the next administration off the hook when it comes to addressing the country's deep-seated economic issues, including a devaluation of the overvalued peso, which is necessary to make Argentina's non-energy exports more competitive. With the development of Argentina's hydrocarbon sector at the centre of Massa's plans to rebuild reserves and strengthen the peso, there's a risk that he shies away from carrying out the reforms needed to put the economy on a more sustainable footing.**

Chart 1: Technically Recoverable Shale Oil & Gas Resources by Country

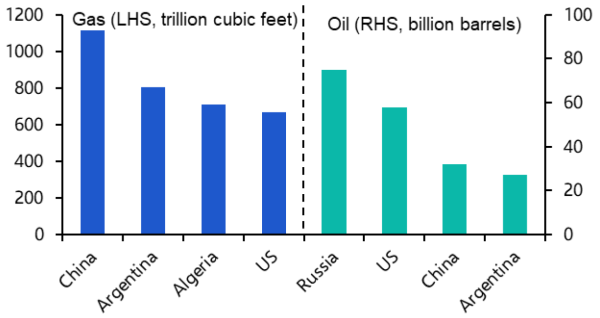


Chart 2: Argentina Energy Trade Balance

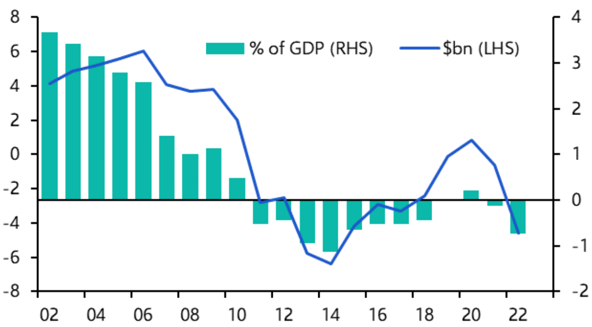


Chart 3: Argentina FX Reserves ($bn)

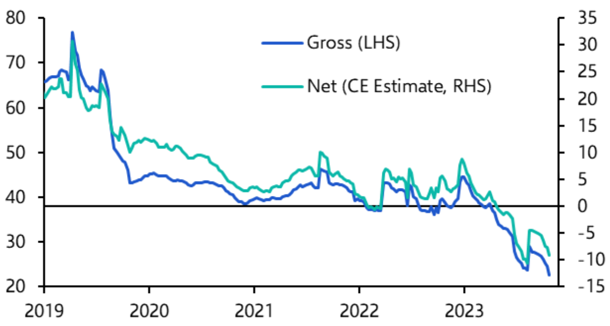
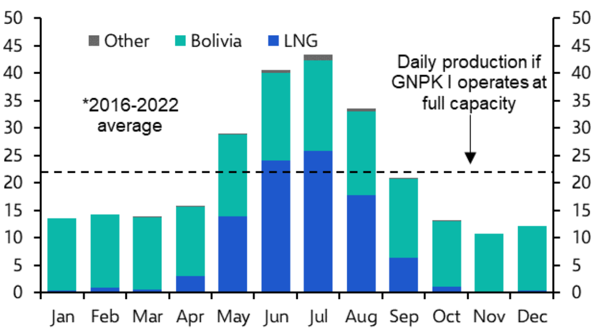


Chart 4: Argentina Average* Daily Gas Imports (mcm)



Sources: EIA, ENARGAS, Refinitiv, Capital Economics

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