July 2004
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Argentina: First Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance and Applicability of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Argentina

In the context of the first review under the Stand-By Arrangement and request for waiver of nonobservance and applicability of performance criteria with Argentina, the following documents have been released and are included in this package:

- the staff report for the first review under the Stand-By Arrangement and request for waiver of nonobservance and applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **December 23, 2003**, with the officials of Argentina on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 21, 2004**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **January 28, 2004** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its January 28, 2004 discussion** of the staff report that completed the request and review.

- a statement by the Executive Director for Argentina.

The document listed below has been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Argentina*

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

ARGENTINA

First Review Under the Stand-By Arrangement and Request for Waiver of Nonobservance and Applicability of Performance Criteria

Prepared by the Western Hemisphere Department
(In consultation with other departments)

Approved by John Dodsworth and G. Russell Kincaid

January 21, 2004

Stand-By Arrangement. A three-year arrangement for almost SDR 9 billion (US$12½ billion, or 424 percent of quota) was approved by the Executive Board on September 20, 2003. In addition, repurchase expectations arising during the first year of the arrangement (about SDR 1.8 billion) were extended to an obligations basis. The first tranche, in an amount equivalent to SDR 1.83 billion (US$2.5 billion), was disbursed upon approval; completion of the review would allow a purchase of SDR 241million (US$334 million) (Table 1).

Discussions. Discussions were held in Buenos Aires during November 6–14 and December 19–23 with Minister of Economy and Production Lavagna, Central Bank President Prat-Gay, and other senior officials and private sector representatives. The staff team comprised J. Thornton, A. Cebotari, L. Giorgianni, J. Nelmes, E. Pinillos (Assistant) (all WHD), A. Arvanitis (PDR), P. Breuer (ICM), and D. Lombardo (FAD). The discussions were led by J. Dodsworth, senior resident representative, and the mission was assisted by L. Cubeddu, Fund resident representative. There were overlapping MFD missions, led by Mr. Hoelscher in November and Mr. Fiechter in December. Mr. Zoccali (former Alternate Executive Director) attended the key policy meetings.

Political situation. President Kirchner's power base has been strengthened as a result of congressional and provincial elections. Following the elections, the Peronist Party controls about ⅔ of the provincial governorships and commands a strong majority in both houses of the new Congress.

Economic developments. The recovery is stronger than anticipated, with real GDP in 2003 estimated to have increased by at least 7½ percent, or about 2 percentage points above program projections. Inflation remains subdued (prices are up only 3.7 percent in the year to December, compared with 5.6 percent in the program) and the trade surplus remains strong (US$14.7 billion in the first 11 months of 2003).

Letter of Intent (LOI): In their January 9, 2004 LOI, the authorities reaffirm their commitment to the program's key objectives and develop further their plans for strengthening the banking system and advancing the discussions on sovereign debt restructuring.

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I. Background

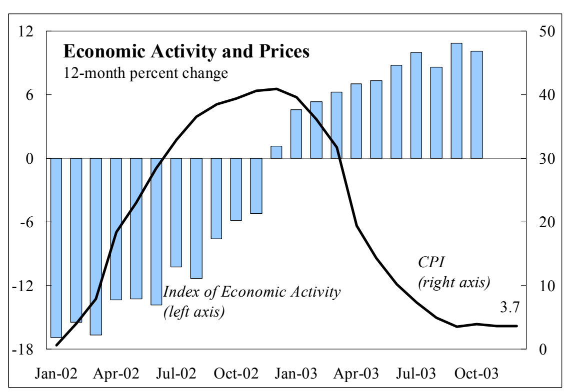
1. **Performance with respect to program targets was good**. All quantitative performance criteria for end-October 2003 were observed (Table 2) and indications are that the end-December criteria were met.[1] Several important structural measures were also implemented (Box 1). In particular, by end-December, congressional approval was obtained for: (i) the 2004 federal budget in line with the program; (ii) anti-tax evasion legislation (with a short delay); (iii) legislation providing for the elimination of all remaining competitiveness plans (but effective with a short delay); and (iv) a framework for renegotiation of utility concessions. In addition: (i) the central bank eliminated by end-2003 temporary forbearance on the classification and provisioning of private loans; and (ii) the Government announced the scope of public debt to be restructured and provided general guidelines in Dubai.

2. **There were, however, slippages or delays in the implementation of some structural performance criteria**, necessitating requests for waivers as follows: (i) an involuntary suspension of creditors' rights related to nonbank mortgage creditors (see ¶10 below); (ii) congressional approval of tax administration reform legislation (implemented with a delay); (iii) elimination of all competitiveness plans (for which relevant legislation approved by Congress in December became effective from January 21, 2004); and (iv) finalization of compensation to banks for losses associated with asymmetric indexation (now scheduled for end-March 2004) and asymmetric *pesoization* (now largely complete). In addition, a waiver is sought for the applicability of the end-December 2003 quantitative performance criteria related to the cumulative primary balance and the debt stock of the federal government. Other slippages included a short delay in reporting information on provincial government finances, and a delay of one month to end-January 2004 in the report of the working group on insolvency law reform (both structural benchmarks).

II. Recent Developments and Policy Implementation

A. Macroeconomic Developments

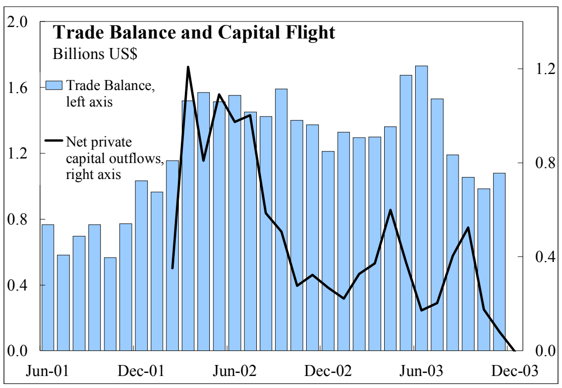
3. **Argentina's recovery remains strong and inflation low** (Table 3 and Annex I). In the first ten months of 2003, real GDP expanded at an 8 percent annual rate, making it likely that the 2003 program projection of 5½ percent will be exceeded by at least 2 percentage points. Unemployment has declined to about 16.3 percent and the number of beneficiaries under the *Heads of Household* program has also fallen. Consumer prices



[1] The relevant fiscal data will be available only at end-January 2004.

increased by 3.7 percent in the year to December 2003, reflecting the still large output gap, the ongoing freeze in utility prices, and a cautious monetary policy.

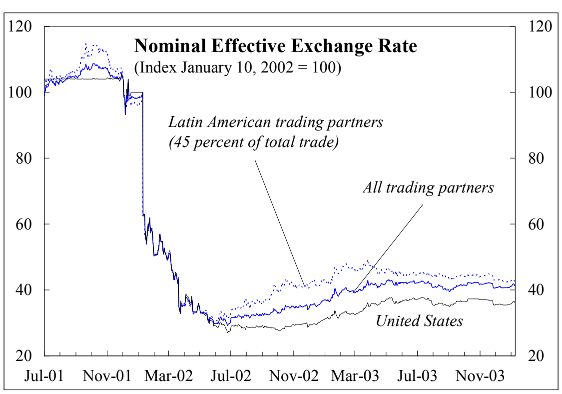
4. **Favorable conditions allowed a further strengthening of the external position, though external arrears continued to increase**. The trade surplus reached US$14.7 billion in the first 11 months of 2003, with high soybean and petroleum prices pushing export receipts to record levels and largely offsetting a sharper than projected rise in imports (50 percent, Text Table A). Capital flight appears to have abated significantly, but there is no recovery as yet in foreign direct investment. Despite some progress in private bank and corporate debt restructuring, cumulative private external arrears increased to US$5.4 billion at end-September 2003, up by US$720 million from June (Tables 4 and 5).

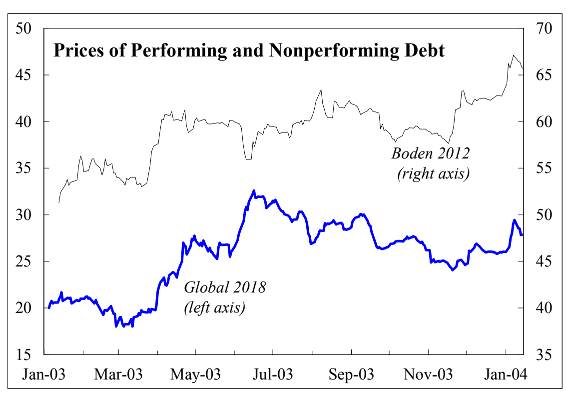


Text Table A. Export and Import Growth, Jan.-Nov. 2003

	Percent change from Jan.-Nov. 2002		
	Values	Prices	Volumes
Exports	**14**	**9**	**5**
Primary products	23	17	5
Manufactured goods of agric. origin	22	10	11
Manufactured goods	-1	-1	0
Fuels and energy	12	16	-3
Imports	**50**	**1**	**48**
Capital goods	80	-3	86
Intermediate goods	43	2	40
Spare parts for capital goods	44	-3	49
Consumer goods	66	2	62
Fuels	13	14	-1

5. **Domestic financial indicators have improved substantially**. Since the original LOI was signed on September 10, stock prices have increased by over 50 percent and the prices of performing government debt (*Bodens*) are up by about 8 percent. The exchange rate has been stable at around 2.9 pesos per U.S. dollar, despite sharply lower interest rates, with the central bank continuing to rebuild international reserves through purchases of foreign exchange.[2] Gross reserves stood at US$14½ billion in early January 2004; net payments to the IFIs in 2003 totaled about US$2½ billion, including US$1.6 billion of interest (Table 6).





[2] Central bank purchases of foreign exchange averaged US$440 million a month during January–September 2003 and increased to about US$600 million a month in the final quarter.

B. Fiscal and Monetary Policies

6. **Fiscal performance continues to exceed expectations** (Tables 7 and 8). Based on preliminary data, in 2003, the federal government recorded a primary surplus of Arg$8.7 billion (2.4 percent of GDP), which was Arg$0.9 billion (11.4 percent) above the program target. The overperformance mainly reflected buoyancy of revenues from income and trade taxes (Text Table B). Although well within the program in the year to November, primary spending for the year as a whole is estimated to have exceeded the program on account of the advancement of payments from 2004 (see ¶16 below). Federal government arrears on VAT refunds to exporters have been eliminated ahead of the program target of end-March 2004. Provincial finances have also performed better than expected, with a cumulative primary surplus of Arg$2.6 billion in the first nine months of the year compared to Arg$2.3 billion in the program. The better-than-expected performance of the provincial finances is attributable to improvements in own-tax revenues and coparticipated revenues.

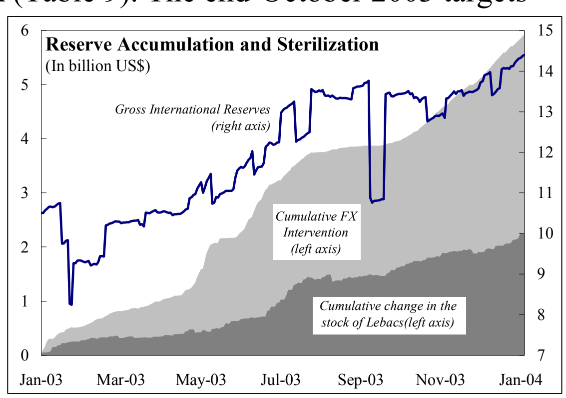
Text Table B. Federal Revenues (in Arg$bn) 1/

		2003	
	2002	Actual	Prog.
Total tax revenues	**52.8**	**74.9**	**72.0**
Income tax	8.9	14.8	13.7
VAT	15.2	20.9	20.5
Excise and fuel taxes	6.1	7.2	7.0
Financial transaction tax	4.9	5.9	5.8
Trade taxes	6.3	11.4	10.8
Social security revenues	9.4	11.0	10.8
Memorandum item:			
Tax revenues in percent of GDP	16.9	20.4	19.6

1/ Based on AFIP revenue classification.

7. **Congress has approved all the components of the government's anti-tax evasion package**, including the tightening of rules on invoicing by commodity exporters, providing tax tribunals in Buenos Aires with federal jurisdiction, and introducing new penalties to reduce tax evasion.

8. **The monetary program is well on track** (Table 9). The end-October 2003 targets for net international reserves and net domestic assets of the central bank were met with wide margins, and those for end-December 2003 are also expected to have been met. The growth of the augmented base money has been maintained broadly in line with the program. In recent months, the central bank has increased foreign exchange purchases, but these have been partly offset by higher net sales of central bank bonds. Interest rates have declined—the rates on 90- and 360-day central bank paper have fallen to 2 percent and 8¼ percent, respectively—and the central bank has been able to place the majority of recent bond issues at maturities of 180 days or longer.[3] By end-2003,

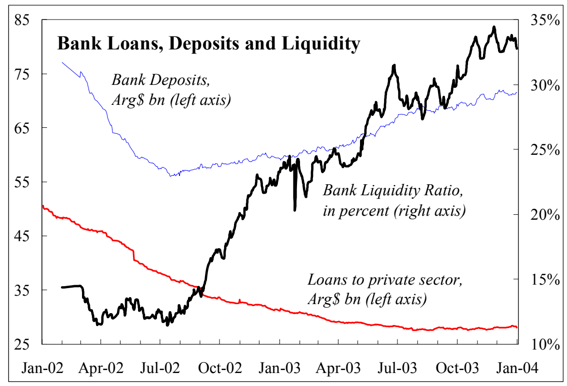


[3] The central bank has recently successfully auctioned three-year inflation indexed notes (*nobacs*).

almost all the quasi-monies in circulation (about Arg$7.8 billion at the start of 2003) had been redeemed in an orderly manner, a significant achievement for the authorities.

C. Banking Developments

9. **Confidence is returning to the banking system, and operating losses have diminished** (Annex II). Private deposits increased by 21 percent in 2003, notwithstanding sharply lower interest rates and the continued high level of the financial transactions tax. There are also some signs of recovery in consumer lending (which rose by over 13 percent during the last quarter of 2003, while total lending to the private sector rose by less than 2 percent). Nevertheless, banks have been reporting significant—but falling—losses (about Arg$5 billion in the year to November) resulting mainly from: (i) high nonperforming loans; (ii) an interest rate mismatch between assets and liabilities; (iii) the asymmetric indexation of bank assets and liabilities; and (iv) ongoing *amparos*. However, losses have been falling steadily since mid-2003, mainly reflecting progress in cutting administrative costs (down by about ⅓ in the last two years), the restructuring of some nonperforming loans and, especially, the decline in deposit rates, which lowered banks' funding costs.



10. **Congress approved legislation that should help further improve banks' financial position**:

- **Compensation to banks for losses resulting from the asymmetric indexation of their balance sheets was approved on October 29, 2003**. The compensation payments—expected to be about US$1 billion—will be in the form of government bonds earning yields linked to banks' cost of funds. Implementing regulations have, however, still to be issued and the placement of the bonds is expected to be completed only by end-March 2004 (a proposed new structural performance criterion), rather than by end-December 2003, as envisaged originally in the program. The legislation links the payment of compensation to new lending or refinancing by the banks. Although the exact modalities of this linkage have yet to be defined, the authorities indicated that the implementing regulations will not introduce new distortions in lending practices.

- **A mortgage refinancing law was approved on November 6, 2003**. It provides for a government trust fund to assume eligible mortgages in arrears with an original value of Arg$100,000 or less, and that fell in default between January 2001 and

- September 11, 2003.[4] Creditors participating in the scheme forgo their ability to recover interest in arrears, plus any penalties, fees or other expenses, but are generally guaranteed full recovery of the principal value and of future contractual interest payments (except where the loan value exceeds the property value, in which case the government trust fund's repayments are limited to current property value). While participation in the scheme is voluntary for bank creditors, it may be mandated at the sole instigation of the debtor for nonbank creditors. As such, the scheme infringes on the rights of nonbank creditors and results in a breach of the program's continuous performance criterion on creditor rights, since nonbank creditors could be forced to forgo their contractual rights: (i) to receive interest, expenses, or fees that are in arrears; and (ii) to receive repayment of loans that exceeds the current property value.

D. Debt Restructuring

11. **The authorities announced the broad outline of a debt restructuring proposal in Dubai in September 2003 and elaborated it further in October 2003 at a presentation to the consultative groups**. The outline included: (i) a 75 percent average reduction in the nominal eligible debt (about US$81.2 billion); (ii) nonpayment of past due interest; [5] and (iii) the exchange of old bonds for a small set of new instruments.[6] The authorities purposefully did not include full details of their proposal—they did not, for example, specify coupons or maturities of the new instruments. Following the Dubai announcement, the authorities held meetings with consultative creditor groups in October, and convened a meeting in New York on December 3, 2003, to provide creditors with an opportunity to present proposals or ask for clarification of the authorities' position. The authorities also invited investment banks to submit their interest in acting as regional managers for launching the debt exchange offer. Annex III reports on these recent developments and updates the debt sustainability and sovereign debt restructuring analysis presented to the Executive Board (IMF Country Report No. 03/392).

12. **Private creditors have responded critically to the authorities' debt restructuring proposal and have begun to coordinate their actions**. Such coordination includes the formation of several committees (ABC, for U.S. institutional bondholders, and TFA for

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[4] Eligibility is restricted to sole-family home debtors. Since debtors would still retain an obligation to the government, the long-term fiscal cost will depend on compliance. On the assumption that about Arg$1.2 billion in mortgages are acquired by the trust, the authorities estimate the initial financing need of the trust on the order of Arg$400 million, with cumulative losses by the seventh year of operation ranging from zero (assuming no default on refinanced loans) to Arg$300 million (assuming a 25 percent default rate).

[5] The authorities later stated that the 75 percent reduction applies to debt including past due interest, which was about US$18 billion at the time of the announcement.

[6] The authorities plan to offer investors a choice of bonds, including a par bond, a discount bond, and a capitalization bond. The choice may also include a variation of these bonds that links payments to GDP growth. Details of the authorities' debt restructuring guidelines have been posted on the authorities' website, together with a spreadsheet-based model that allows users to assess Argentina's capacity to pay debt to be restructured.

Italian retail investors), and the setting up of a special purpose vehicle (ABRA) mainly for European retail bondholders. Only one counterproposal has been received from creditors so far. However, certain creditors and creditor representatives have recently announced the creation of a global creditor committee (Global Committee of Argentina Bondholders, GCAB) which, at present, includes representatives of non-Argentine institutional and retail creditors, mainly in the United States, Italy, Germany, and Japan. The GCAB has stated that it is open to institutions that represent a significant number of bondholders and that have neither a conflict of interest, nor are engaged in litigation pertaining to Argentine bonds. Separately, litigation by creditors has increased, as discussed in Box 2.

E. Utility/Public Services Reform

13. **Congress approved, ahead of schedule, key legislation on utilities/public services** (an end-2003 structural performance criterion). The law, which was approved on October 1: (i) extends the period for the renegotiation of concessions to end-2004; (ii) allows the executive to implement interim tariff increases; and (iii) grants the executive fast track powers to renegotiate concessions. Initial discussions have been held with some of the major utilities, but no tariff increases have yet been signaled. The law is generally agreeable to the stakeholders and, as such, is supported by the World Bank.

III. Report on the Discussions

A. Macroeconomic Framework

14. **It was agreed that it was too early to revise the 2004 macroeconomic framework or adjust the quantitative program targets**. For 2003, growth and inflation substantially outperformed the program targets and it looks as if 2004 could also be better than programmed (the latest consensus forecasts for growth and inflation are, respectively, 5¼ percent and 7½ percent, compared with 4 percent and 10½ percent in the program). However, many uncertainties remain that could jeopardize such an outcome, especially any prolonged impasse with private creditors. Accordingly, any revisions to the macroeconomic framework will be discussed at the next program review.

B. Fiscal, Monetary, and Exchange Rate Policies

15. **The authorities reaffirmed their commitment to achieving the nominal fiscal targets under the program**. They expected tax revenues to remain buoyant, reflecting faster than projected economic recovery, and continuing improvements in tax administration. On expenditures, the authorities reaffirmed their intention to contain primary spending while maintaining core social and capital expenditures.

16. **Staff urged the authorities to use the cushion in the 2003 primary balance to bring forward a reduction in the financial transactions tax**.[7] The authorities preferred, however, to bring forward to December 2003 payments of civil servant bonuses that were to be paid originally in January 2004, to award a small one-time bonus to beneficiaries under the *Heads of Household* program, and to bring forward the clearance of federal government arrears on VAT refunds to exporters (originally envisaged for March 2004). About half of the resulting savings in the 2004 budget (of Arg$1 billion) will be used to finance an increase in minimum wages and pensions (of about 17 and 9 percent, respectively) that was announced in December 2003. Nonetheless, the 2003 consolidated primary surplus is estimated at 2.8 percent of GDP, slightly above the target.

17. **Fiscal discipline at the provincial level will continue to be supported by the 2004 bilateral agreements**. Given that 10 (out of a total of 24) such agreements have already been signed by provincial governors, the authorities were confident that ratification of the bilateral agreements would proceed to completion as scheduled by March.

18. **Progress is also being made in advancing the fiscal structural agenda.**

- In September 2003, the government created a commission to coordinate proposals for *intergovernmental reform* with the aim of reaching formal agreement with the provincial governors on the main elements of the reform by end-March 2004. In spite of initial delays in the work of the commission due to changes in its composition, the authorities remain committed to the original timing of this key measure under the program.

- *Tax reform* was also initiated in December with the submission to Congress of proposals to: (i) increase excises on cigarettes and include them in the VAT base; and (ii) extend the income taxation of export credits to end-2004. The measures are expected to yield Arg$1.4 billion (0.3 percent of GDP), though only the latter has been approved so far. A more comprehensive tax reform will be developed during the first half of 2004 which, in line with program commitments, is expected to be submitted to Congress in September along with the 2005 budget.

- In late December, Congress approved legislation to eliminate all remaining *competitiveness plans*. However, due to delays related to the holiday period, the legislation was made effective only on January 21, 2004 resulting in the nonobservance of the related end-December 2003 structural performance criterion. The staff proposes that a waiver be granted for the small delay in observing this performance criterion.

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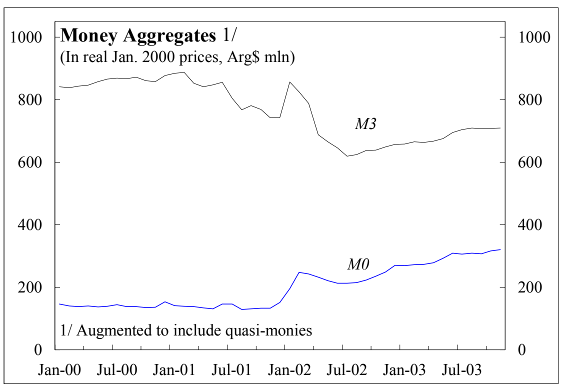
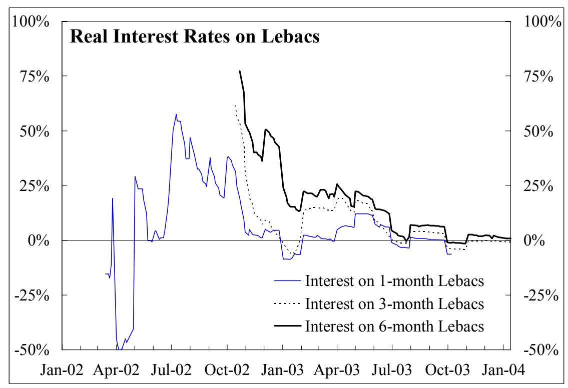
[7] Planned for mid-2004.

- As regards *pension reform*, an inter-ministerial working group was created in November to develop the guiding principles, and legislation is expected to be submitted to Congress by March 2004.

19. **The monetary program has been carefully managed to support the improved economic outlook while resisting any inflationary pressures**. The authorities viewed the combination of deposit growth, low interest rates, and the stable peso-U.S. dollar exchange rate as evidence of the continuing strong recovery in money demand that could warrant some easing of the indicative target for base money in 2004. Staff concurred with the assessment of a recovering money demand. However, the rapidly declining output gap, and eventual increases in utility tariffs, could well lead to pressures for higher real wages, and could make some tightening of monetary conditions appropriate later in 2004.[8]





20. **An updated safeguards assessment of the BCRA is being finalized**. The principal recommendations of the on-site assessment are: (i) a speedy move towards the adoption of International Financial Reporting Standards (IFRS); (ii) the publication of IFRS-based financial statements; and (iii) continued assurance to the Fund that all monetary data under the program are consistent with the Technical Memorandum of Understandings. The authorities are currently considering these and other staff recommendations. Specific measures and the agreed time schedule for their implementation will be detailed in the context of the next program review.

C. Banking System Policies

21. **The banking strategy relies on regulatory forbearance to give banks time to restore profitability and ultimately encourage new private capital injections**. The main elements of the strategy include: (i) putting in place a stable regulatory framework, building on the elimination in December 2003 of the temporary forbearance on the classification and provisioning of private loans; (ii) completing by March 2004 (three months later than originally intended) the compensation payments to banks for the asymmetric indexation of

[8] The consensus forecast for inflation in 2004 is within the 7–11 percent consultation band under the program.

their balance sheets, and finalizing the outstanding compensation payments for asymmetric *pesoization*;[9] (iii) reducing impediments to financial intermediation, such as high reserve requirements and the financial transactions tax; and (iv) reaching agreement with individual banks on a strategy to ensure their viability, including by strengthening profitability and capital. Reaching understandings with the authorities on some of these elements contributed to delays in the first program review being brought for Board consideration.

22. **Staff estimates that, even under such a strategy, it will likely take several years to adequately recapitalize all banks**. Under such conditions, there is a critical need for bank supervisors to remain vigilant to prevent weaker banks from trying to boost profitability through rapid loan growth accompanied by unsound banking practices.[10] As an added safeguard, the authorities were also urged to act promptly to subject banks that are unable to implement an acceptable business plan to the resolution process embedded in the revised Financial Institutions Law.

23. **Public bank reform has been delayed by difficulties in the procurement process for funding the due diligence and strategic review of the two largest public banks**.[11] Frustrated with the delays, the authorities have decided to fund the reviews themselves (using the same terms of reference agreed upon earlier) and will begin the bidding process by end-February 2004. The authorities have asked Fund staff to closely monitor the bidding and subsequent reform process.

D. Debt Restructuring Strategy and Financing Assurances

24. **The authorities indicated that they are working toward finalizing their debt-exchange offer by end-February 2004**. They explained that, since the approval of the Stand-By Arrangement, they had stepped up their dialogue with private creditors and had taken the opportunity of additional contacts with them to further clarify their debt strategy. In particular, at the December 3, 2003 meeting in New York the authorities indicated: (i) their intention to secure broad participation in the restructuring and to safeguard intercreditor equity; (ii) that there was no understanding with the IFIs—in particular the Fund—that their exposure to Argentina would be held constant beyond 2006 as assumed in the authorities' Dubai presentation; (iii) that they were fully committed to achieving a primary surplus beyond 2004 that would be sufficient to service both currently performing debt and the obligations resulting from the restructuring; and (iv) that they were open to receive and

[9] While banks have booked Arg$28 billion of compensation for asymmetric *pesoization*, only about 80 percent of that has been actually paid, with the remaining amount subject to revision by the central bank.

[10] Banks are also highly exposed to interest rate shocks as their liabilities are very short-term and pay market rates, while the bulk of their assets are long-term and pay fixed low yields.

[11] The bidding process was suspended when the IDB and the authorities disagreedon a shortlist of qualified consulting firms.

consider feedback from creditor groups. The authorities have also stated in the latest LOI their willingness to continue engagement with private creditors, and have since indicated that they expect to appoint soon the investment banks to act as regional managers for launching a debt exchange offer. Thus, the authorities see their efforts to intensify their dialogue with private creditors as consistent with the requirements of the Fund's lending into arrears (LIA) policy.

25. **Looking ahead, staff and management have emphasized the importance of deepening the exchange with creditors and have urged the authorities to engage in a close dialogue with private creditors on the terms of an eventual offer**. The LIA policy provides that, in complex restructurings, there is an expectation that a debtor would enter into "negotiations" with a representative creditor committee if one were formed on a timely basis. Regarding such a committee, the composition of the Global Committee of Argentina Bondholders (GCAB) is still evolving. In the authorities' view, the GCAB is not representative and an assessment in this regard would require a better understanding of the composition of bondholders and the underlying mandate of the members of the committee. Towards this end, the authorities have launched a registration process to secure updated information on actual holders of Argentine defaulted bonds.

26. **Extended discussions on LIA-related topics were the main reason for the delay in the first review being brought for Board consideration**. In the LOI, the authorities reiterate their commitment to paragraph 8 of the original MEFP, which indicates their intention to produce primary surpluses sufficient to cover net payments on performing debt and obligations that may result under a debt restructuring agreement. They also indicate that they will continue to consider the suggestions of private creditors and engage in further discussions with them, and develop with their advisors modalities to achieve a high creditor participation in the debt restructuring.

27. **As regards bilateral official debt, the Paris Club secretariat has written to the authorities stating its willingness to invite them to a negotiating session**, and reminding them that, before there can be such a session, the authorities need to make a formal request specifying the scope and type of treatment being sought. The authorities have yet to make a formal request in this regard.

E. Utility Reforms

28. **The authorities were unable to commit to a detailed timetable for the implementation of utility reforms and the needed tariff increases**. Although they indicated that they expect to complete the renegotiation of 54 out of 62 existing concession contracts by end-June 2004 (including those for electricity and gas, inter-urban roads, freight railways, urban road access, ports, airports, bus terminals, water and sanitation, and waterways), they would not commit to a specific timeframe for an increase in tariffs. At the same time, the World Bank staff has informed Fund staff that, instead of seeking a more active role, the government only requested limited, nonbinding technical advice and

comments from the Bank. Bank staff has commented on a draft legislation expected to be sent to Congress on a general regulatory framework for utilities, in addition to existing sector-specific regulatory frameworks, and has expressed serious concerns. In particular, the draft law could discourage private participation in the provision of public services and politicize future tariff setting. The draft legislation would reduce legal certainty by allowing consumer groups to petition for concession contracts to be reopened, and the government or regulatory body to change the terms of the contracts more or less at will, and would deny the utility company access to arbitration. In addition, tariffs would only be revised following a consultative process led by the federal government and involving the utility company, the relevant province, and consumer groups. Bank staff has also indicated that the authorities' plans to shield the poor from tariff increases may entail prohibitive fiscal costs. The mission pointed out that a track record of business-friendly policies and legal certainty was needed to attract the investment needed to sustain the recovery. Early resolution of the difficulties of the utility sector was an important test in this regard.

IV. Staff Appraisal

29. The stronger-than-expected recovery reflects much reduced political uncertainties, disciplined fiscal and monetary policies, and favorable external factors. Despite the absence of credit flows, both consumption and investment have expanded and there has been a strong resurgence of imports, though from a low base. The trade surplus has, nevertheless, remained substantial, benefiting from high export prices, the still undervalued exchange rate, and the growing world economy. Fiscal and monetary program targets continue to be met with comfortable margins and inflation has stayed low. Unemployment and the poverty situation are gradually improving, though both remain at very high levels.

30. **Prospects for 2004 are promising, but maintaining the growth momentum will depend critically on developing policies that will further encourage investment**. The authorities not only need to maintain their recent record of prudent macroeconomic policies, but also to press forward with restoring a sound financial system, restructuring the sovereign debt in a sustainable manner and normalizing relations with creditors, and fostering a predictable legal and institutional environment that is conducive to business confidence and investment. These are the main components of the policy framework supported by the stand-by arrangement.

31. **The 2004 federal budget as approved by Congress provides a solid foundation for macroeconomic policies.** The budget extends for a third consecutive year a rising trend in the primary surplus as envisaged under the program. The overachievement of revenue targets in 2003, and the approval by Congress of all elements of the authorities' anti-tax evasion package bode well for compliance with the new budget, though the authorities' intention to begin phasing out the distortive financial transactions tax will necessitate further discretionary tax measures in the near future. In addition, the authorities will need to continue to resist spending pressures, including for higher wages, and ensure that the envisaged reforms to the pension system and in the utility sector do not add to the public debt burden.

32. **Maintaining fiscal discipline at the provincial level will be an essential element of securing the targeted consolidated primary surplus**. The progress made toward finalizing federal-provincial bilateral agreements is an encouraging sign that the provincial governments will continue their recent good record of curbing deficits. Looking beyond 2004, however, there is consensus that the underlying financial relations between provinces and the federal government need to be reformed. The program calls for progress in this area in the coming months and the authorities are urged to maintain the schedule, beginning with an agreement with the governors of provinces on a new coparticipation law by March 2004.

33. **Monetary and exchange rate policies, while appropriate so far, need to be closely monitored to keep inflation low**. Given the large output gap and the strong balance of payments, the authorities have been able to bring down interest rates, steadily accumulate international reserves, contain the appreciation of the peso, and keep inflation low. As the trade surplus diminishes and the declining output gap translates into pressures for higher real wages, the authorities' ability to follow the current monetary/exchange rate policy mix will gradually narrow. During 2004, in line with their intention to move toward an inflation targeting regime, there would be a need to balance the further strengthening of their net international reserve position against additional exchange rate appreciation and lower inflation.

34. **A banking strategy is beginning to take shape**. However, given the underlying lack of capital, individual banks remain at risk and the system will take some years to recover. The financial performance of banks has improved steadily through the year, in part reflecting lower interest rates, but also efforts by banks to reduce costs, and—in the last quarter of 2003—an incipient rise in credit to the private sector. In this context, it is disappointing that the expected compensation for asymmetric indexation was not implemented on schedule. The staff hopes that this situation is soon rectified and has emphasized that the regulations linking compensation to lending be finalized in a manner that does not distort lending practices. Beyond this, however, the banking system needs to be recapitalized and will require further restructuring and enhanced profitability. In this context, the authorities should lower the financial transactions tax as soon as possible to foster greater bank intermediation. At the same time, there is a critical need for close bank supervision to ensure that banks are viable and do not take inordinate risks in their lending policy.

35. **The banking crisis has resulted in a larger share of the system under the public banks, making it all the more urgent to move firmly ahead with their restructuring**. The further delay in the selection of international advisors to carry out their due diligence and strategic reviews is highly disappointing. The authorities have now taken full ownership of this process and are no longer requesting financing from the multilateral development banks for this purpose. The staff hopes that this signals a revitalization of the process and that there will be no further delays in this key area of the banking strategy.

36. **To expand investment and sustain growth, the authorities need to establish a track record of consistent business-friendly policies and greater legal certainty**. The

attraction of investment—both local and foreign—constitutes a difficult challenge because of the persistent failure of past governments to sustain growth and the manner in which legal certainty has been eroded. The Government needs to establish a consistent track record of policies that support the rule of law, protect the rights of creditors, and carry forward its stated intention to combat corruption. In this regard, the staff regrets the erosion of nonbank creditor rights from the introduction of the mortgage refinancing law but, nonetheless, is prepared to support the request for a waiver on the ground that relatively few nonbank creditors are affected. The authorities are urged to move rapidly to finalize the delayed report on whether changes are needed in the Insolvency Law to support debt restructuring. In the meantime, it will be important for the authorities to resist any new congressional initiatives that would erode the carefully restored bankruptcy framework.

37. **A key policy test will be the manner in which the authorities address the issues of renegotiation of utility concessions and tariff increases**. The authorities moved quickly to put legislation in place to allow fast-track renegotiation of concessions and allow interim tariff increases and, in the program, they commit to dealing with the bulk of the concessions in the first half of 2004. It will be important for the renegotiations to be conducted in a fair and transparent manner, and for any proposed new regulatory framework to take account of the sustainability of the public/private partnership, the maintenance and quality of services, financial viability, and the access of the poor to basic services. In the energy sector, the authorities are encouraged to preserve the strength of the current legal and regulatory framework. The authorities need to be cognizant of the need for substantial additional capital to be invested in these sectors in order to maintain the quality of services and, to that end, an efficient balance needs to be found to ensure profitability of enterprises while taking account of the social dimensions of the provision of these services. The staff welcomes the authorities' renewed commitment to work in close cooperation with the World Bank in developing policies in these areas.

38. **The staff encourages the authorities to deepen the effort with private creditors in order to reach a collaborative, comprehensive, and sustainable debt restructuring.** Early normalization of relations with private creditors is essential for Argentina to emerge from crisis conditions. Argentina needs to launch an offer that is embraced by its creditors and enhances the authorities' ability to regain market access. This is particularly relevant given the fact that the financing assurances reviews are intended to enable the Fund to determine whether there are adequate safeguards for its resources. The staff urges that the debt exchange offer be structured to achieve the authorities' stated objective of broad creditor participation while ensuring debt sustainability. The staff looks forward to further actions by the authorities to enhance the probability of a successful and comprehensive restructuring.

39. **The staff recommends completion of the first program review and financing assurances review, including the granting of the necessary waivers**. These waivers relate to: congressional approval of tax administration reform legislation, which was approved shortly after the end-November 2003 target date; the finalization of the compensation associated with asymmetric indexation, which was regrettably delayed, but is now scheduled

for end-March 2004; the involuntary restraint of the rights of nonbank creditors resulting from the operation of the government trust fund established to facilitate the refinancing of mortgages subject to foreclosure; the elimination of the competitiveness plans, which was slightly delayed; and for the applicability of the end-December 2003 quantitative performance criteria on the primary balance and debt stocks of the federal government, which will be relevant performance criteria for the second review.

Box 1. Structural Performance Criteria and Structural Benchmarks: September 2003–March 2004	**Status**
I. Performance Criteria	
Continuous performance criteria	
40. Nonaccumulation of arrears to bilateral and multilateral creditors.	Observed
41. No new tax amnesties (MEFP ¶29).[1]	Observed
42. No statute or other legal instrument will be adopted that provides a means for any involuntary suspension or other restraint of creditors' rights (MEFP ¶50).	Waiver requested
End-November 2003	
43. Congressional approval of tax administration reform legislation (MEFP ¶29).	Waiver requested (legislation approved Dec. 2003)
End-December 2003	
44. Congressional approval of 2004 federal budget that is consistent with a primary surplus target of 2.4 percent of GDP in 2004 for the federal government (MEFP ¶12).	Observed
45. All competitiveness plans to be eliminated (MEFP ¶12).	Waiver requested (legislation enactment slightly delayed)
46. Finalize the compensation to banks for losses associated with asymmetric *pesoization* and indexation (MEFP ¶39).	Waiver requested, proposed to be reset to end-March 2004
47. Terminating temporary forbearance on private loan classification and provisioning (MEFP ¶41).	Observed
48. Congressional approval of legislation on the framework for utility concessions (MEFP ¶45).	Observed
End-March 2004	
49. The federal government and a critical mass of provincial governors to reach agreement on the principles for intergovernmental reform and fiscal responsibility legislation (MEFP ¶31).	Pending
50. Federal-provincial bilateral agreements shall become effective through their ratification by the provincial legislatures representing at least 100 percent of 2002 consolidated provincial deficit (MEFP ¶17).	Pending
II. Structural Benchmarks	
Continuous	
51. Provide Fund staff with monthly information on provincial government financing with a delay of less than 55 days.	October data reported with minor delay
End-October 2003	
52. Government to announce the scope of public debt to be restructured, the treatment of initial claims and past due interest, and the general terms of the new debt instruments to be issued in the exchange (MEFP ¶19).	Observed
End-December 2003	
53. Report of working group on Insolvency Law reform (MEFP ¶48).	Proposed to be moved to end-January
End-February 2004	
54. Complete selection of accounting and consulting firms to begin the strategic review of the two largest public banks (MEFP ¶38).	Proposed to be moved to end-April
End-March 2004	
55. Working group charged with the design of reforms of the central bank charter to publish report containing its key findings and recommendations (MEFP ¶34).	Pending
56. Launch of second tax administration reform focusing on improving customs administration and social security collections (MEFP ¶29).	Pending
57. Elimination of arrears on VAT refunds to exporters (MEFP ¶13).	Arrears eliminated by end-November 2003

Box 2. Litigation Against Argentina[1]

Argentina's default on its international bonds has resulted in extensive creditor litigation in Europe and in the United States.

Europe—Over 30 lawsuits have been brought by individual retail investors in Germany and Italy. The cases typically involve amounts of under US$1 million dollars. While a number of these litigating creditors have obtained court judgments, it appears that none have successfully enforced their claims against Argentina's assets.

United States—Nearly 20 lawsuits have been filed in New York, falling into the following three main categories:

- **Four lawsuits brought by distressed debt funds have led to court judgments in favor of the plaintiffs for amounts totaling around US$750 million**. The largest of these New York court judgments is for US$700 million, plus interest, in favor of the Cayman Islands based distressed debt fund, EML (reportedly controlled by the Dart family that initiated sovereign debt litigation in the 1990s against Brazil). Although the judgments were rendered beginning from April 2003, the court stayed enforcement proceedings until the earlier of January 30, 2004 or the launching of an exchange offer in order to provide time for a voluntary restructuring between Argentina and its creditors.

- **A number of lawsuits followed Argentina's announcement of proposed restructuring parameters in September 2003**. These cases have been brought by Argentine and foreign retail investors and distressed debt funds. The total amounts of claims exceed US$200 million. None of these cases has yet to reach court judgment on liability.

- **Four class actions have been filed against Argentina**. Two initial class actions have been dismissed because of the court's concern that their scope was excessively broad and ill-defined. However, one of the two subsequent class actions has been recently certified to proceed by the court. That action is spearheaded by a German retail investor. The plaintiff class is open to all bondholders that have purchased bonds in two identified series before July 22, 2003 (the date upon which the class action was filed). The outstanding principal amounts of the bonds in these two series is US$3½ billion. The class certification mechanism was set as an opt-in.

Pari Passu Clause Arguments—With the stay against enforcement of the judgments expiring on January 30, 2004, the proceedings by the judgment creditors in New York have reached an important stage. Argentina anticipated that the plaintiff judgment creditors would attempt to rely on a broad interpretation of the "*pari passu*" provision in the bonds, so as to limit Argentina from making payments to any creditors (including the Fund) unless ratable payments are made to the judgment creditors.[2] It asked the court to rule in favor of a narrow interpretation that would preclude such enforcement on the basis of the clause.

The U.S. government, the New York Federal Reserve Bank and the New York Clearing House Association (representing major commercial banks) each filed briefs supporting Argentina's argument against a broad construction of the *pari passu* provision. In its brief, the U.S. government stated that, to the extent that a broad interpretation of the *pari passu* provision interrupted payments to the IFIs, including the Fund, it would be contrary to U.S. policy interests. The U.S. government also noted that any injunctive relief would be constrained by the U.S. Foreign Sovereign Immunities Act. In their own brief, judgment creditors argued that, since no creditor has yet to seek enforcement of the *pari passu* provision, the court should not rule on the issue on the grounds that it was not justiciable.[3] In a January 15 hearing, the New York court deferred determination of the correct interpretation of the *pari passu* provision. The court reasoned that its order requiring plaintiffs to give 30 days' notice before they invoke the *pari passu* clause would allow the court time to rule should the issue arise.

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[1] Prepared by the Legal Department.

[2] This litigation strategy was first adopted by Elliott Associates in obtaining a Brussels court order to prevent payment on Peru's restructured bonds. See *Involving the Private Sector in the Resolution of Financial Crises—Restructuring International Sovereign Bonds*.

[3] The Emerging Markets Creditors Association supported the plaintiffs' position tht the *pari passu* clause was not yet in issue, and further noted the diversity of views among market participants on the legal effect of the *pari passu* clause.

Table 1. Argentina: Schedule of Purchases Under the SBA, 2003–06

Date	Purchases: In Millions of SDRs	In Percent of Quota	In Millions of U.S. dollars 1/	Conditions 2/
Scheduled purchases	8,981.0	424.2	12,461	
2003				
September 22, 2003	1,830.0	86.4	2,539	Disbursed upon Board approval of SBA
2004				
January 28, 2004	241.0	11.4	334	First review; end-October 2003 performance criteria
March 15, 2004	2,100.0	99.2	2,914	Second review; end-December 2003 performance criteria
June 15, 2004	500.0	23.6	694	Third review; end-March 2004 performance criteria
September 15, 2004	740.0	35.0	1,027	Fourth review; end-June 2004 performance criteria
December 15, 2004	490.0	23.1	680	Fifth review; end-September 2004 performance criteria
2005				
March 15, 2005	532.5	25.2	739	Sixth review; end-December 2004 performance criteria
June 15, 2005	532.5	25.2	739	Seventh review; end-March 2005 performance criteria
September 15, 2005	532.5	25.2	739	Eighth review; end-June 2005 performance criteria
December 15, 2005	432.5	20.4	600	Ninth review; end-September 2005 performance criteria
2006				
March 15, 2006	366.7	17.3	509	Tenth review; end-December 2005 performance criteria
June 15, 2006	366.7	17.3	509	Eleventh review; end-March 2006 performance criteria
September 15, 2006	316.6	15.0	439	End-June 2006 performance criteria
Memorandum items:				
2003	1,830.0	86.4	2,539	
2004	4,071.0	192.3	5,649	
2005	2,030.0	95.9	2,817	
2006	1,050.0	49.6	1,457	
Quota	2,117.1	100.0	2,937	

1/ Assumes an exchange rate of US$1.3875 per SDR.

2/ All purchases are subject to adherence to the continuous performance criteria. In addition, and for the period that sovereign arrears to private external creditors persist, purchases will be subject to financing assurances reviews.

Table 2. Argentina: Quantitative Performance Criteria and Indicative Targets, 2003–04 1/

(In millions of Argentine *pesos* , unless otherwise noted)

	Actual	End-October 2003			Performance Criteria			Indicative Targets	
	End-Sept. 2003	Target	Adjusted Target 2/	Actual	End-Dec. 2003	End-Mar. 2004	End-Jun. 2004	End-Sep. 2004	End-Dec. 2004
Fiscal targets									
1 Cumulative primary balance of the federal government (floor)	7,137	6,940	6,940	8,100	7,790	1,100	5,550	7,780	10,000
2 Cumulative overall cash balance of the federal government (indicative target)	1,736	600	600	2,227	350	-670	2,130	2,560	3,150
3 Federal government debt stock (ceiling, in billions of *pesos*) 3/	438	520	497	494	530	540	550	560	570
4 Stock of federal government arrears (indicative target)	4,625	4,590	4,590	3,965	5,000	4,170	5,070	3,970	4,660
5 Cumulative primary balance of the provincial governments (indicative target)	2,646	...	...	...	1,480	180	1,290	2,230	2,480
6 Consolidated public sector debt stock (indicative target, in billions of *pesos*)	494	542	519	516	552	563	574	584	594
Monetary targets									
7 Stock of net international reserves of the central bank (in millions of U.S. dollars) (floor) 3/ 4/	...	-4,500	-5,118	-4,189	-4,400	-4,350	-3,500	-3,300	-2,400
8 Stock of augmented monetary base (indicative target) 5/	...	44,305	44,305	44,379	47,770	46,260	49,320	49,625	53,805
9 Stock of augmented net domestic assets of the central bank (ceiling)	...	57,355	59,147	56,527	60,530	58,875	59,470	59,195	60,765
10 Consultation mechanism on projected end-2004 inflation (indicative target)									
Upper limit (in percent)	...	...	...	...	11.0	11.0	11.0	11.0	...
Lower limit (in percent)	...	...	...	...	7.0	7.0	7.0	7.0	...

1/ As defined in the Technical Memorandum of Understanding attached to the September 10, 2003, Letter of Intent.
2/ The targets have been adjusted in line with the Technical Memorandum of Understanding.
3/ The following accounting exchange rates apply: Arg$/US$=2.9, US$/SDR=1.3875, Euro/US$=0.869, CAD$/US$=1.347, CHF/US$=1.351, JPY/US$=119.78, GBP/US$=0.604, Gold ($ per ounce)=371.0.
4/ End-October GIR data exclude Uruguay bond holdings.
5/ Includes quasi-monies in circulation.

Table 3. Argentina: Selected Economic and Financial Indicators, 1999–2004

					Program			
					2003		2004	
	1999	2000	2001	2002	Original	Est.	Original	Revised
		(Annual percentage changes; unless otherwise indicated)						
National income and prices								
GDP at constant prices	-3.4	-0.8	-4.4	-10.9	5.5	7.8	4.0	4.0
Consumer prices (average)	-1.2	-0.9	-1.1	25.9	14.4	13.4	9.4	8.3
Consumer prices (end-of-period)	-1.8	-0.7	-1.5	41.0	5.6	3.7	10.5	10.5
Social indicators 1/								
Population below poverty line (in percent)	27.1	29.7	35.4	53.0	…	54.7	…	…
Population below extreme poverty line (in percent)	7.6	7.5	12.2	24.8	…	26.3	…	…
Unemployment rate 2/	13.8	14.7	18.3	20.8	…	16.3	…	…
External sector								
Exports, f.o.b. (U.S. dollars)	-11.8	13.0	0.8	-3.1	11.7	12.3	3.3	3.2
Imports, c.i.f. (U.S. dollars)	-18.8	-1.0	-19.5	-55.8	48.7	50.1	16.9	16.9
Export volume	-0.7	2.7	4.6	-0.3	5.2	5.2	6.9	6.8
Import volume	-13.9	-0.9	-17.3	-54.5	44.5	46.0	15.4	15.4
Terms of trade (deterioration -)	-1.7	9.6	-0.6	-1.8	4.8	5.4	-4.6	-4.6
Real effective exchange rate								
Average (depreciation -)	11.1	-0.7	5.9	-55.7	14.2	13.3	9.3	8.2
Money and credit								
Net domestic assets of the financial system 3/	8.6	-0.9	14.9	57.6	2.2	1.2	3.9	3.9
Credit to the private sector	-2.3	-3.8	-17.6	-14.5	-16.2	-15.6	3.4	3.4
Augmented broad money 4/	3.2	3.2	-16.5	24.7	26.3	16.5	17.6	27.6
Augmented broad money/GDP (in percent)	29.5	31.0	28.6	26.4	30.1	29.3	30.6	30.6
Interest rate (30-day deposit rate, in percent)	10.2	11.3	15.7	39.1	...	3.9	...	...
		(In percent of GDP)						
Public sector savings	-2.2	-2.1	-5.2	-16.5	-4.2	-2.3	-2.3	-2.3
Consolidated public sector primary balance	-0.8	0.4	-1.3	0.9	2.5	3.1	3.0	3.0
of which : Federal government	0.4	1.0	0.2	0.9	2.1	2.4	2.4	2.4
Consolidated public sector overall balance	-4.2	-3.6	-5.9	-1.5	0.1	0.8	0.9	0.9
Revenues	24.3	24.6	23.7	22.9	25.3	26.4	25.3	25.3
Expenditures 5/	28.5	28.2	29.6	24.4	25.2	25.5	24.4	24.4
Gross domestic investment	18.0	16.2	14.2	12.0	16.6	14.8	18.8	17.4
Gross national savings	13.8	13.1	12.5	21.4	22.8	21.2	23.8	22.4
Current account balance 6/	-4.2	-3.1	-1.7	9.5	6.2	6.4	5.0	5.1
Public sector total debt (end-of-year) 7/	47.4	50.8	62.4	164.5	149.4	151.3	...	...
Public sector external debt (end-of-year) 7/	29.9	29.9	32.9	96.1	87.3	86.0	...	...
		(In percent of exports of goods and nonfactor services; unless otherwise indicated)						
Outstanding use of Fund resources								
(in percent of quota at end-of-period)	154.1	183.2	525.3	498.2	504.8	493.4	510.2	510.2
Gross international reserves, baseline 8/	27.3	26.9	14.9	10.5	13.6	14.1	15.7	16.2
In months of imports of goods and services	10.0	9.8	6.5	9.7	9.2	9.5	9.2	9.4
Nominal GDP (in billions of Arg $)	283.5	284.2	268.7	312.6	367.6	367.6	416.9	416.9
(In billions of U.S. dollars)	283.5	284.2	268.7	101.5	124.9	124.5	146.6	146.6

Sources: Ministry of Economy; Central Bank of the Republic of Argentina; and Fund staff estimates.

1/ Unemployment data are as of end-October, other data are as of end-May.
2/ 2002 and revised 2003 data are based on new survey methodology. Under the old methodology, the 2003 unemployment rate would be 14.3 percent.
3/ Historical data differ from previous presentation due to corrections in recording of foreign liabilities data.
4/ Includes quasi-monies in circulation.
5/ Excludes interest due on nonperforming debt.
6/ Includes payments on unrestructured public and private debt.
7/ Staff estimates based on authorities' data. Data differ from previous presentations reflecting the use of end of period (as opposed to average) exchange rates for the conversion into *pesos* of foreign currency debt.
8/ In billions of U.S. dollars. Historical figures include foreign securities repoed by the BCRA to banks. Revised program data exclude BCRA holdings of Uruguay bonds from GIR from September 2003.

Table 4. Argentina: Summary Balance of Payments, 1999–2004

	1999	2000	2001	2002	2003 Sep.	2003 Est.	Projection 2004
(In billions of U.S. dollars)							
Current account 1/	**-11.9**	**-8.8**	**-4.5**	**9.6**	**6.3**	**7.9**	**7.4**
Trade balance	-2.2	1.1	6.2	16.7	12.5	15.5	14.2
Exports f.o.b.	23.3	26.3	26.5	25.7	22.0	28.9	29.8
Imports c.i.f.	-25.5	-25.3	-20.3	-9.0	-9.5	-13.4	-15.6
Services and transfers	-9.7	-9.9	-10.7	-7.1	-6.1	-7.6	-6.8
Of which: net interest payments 1/	-5.9	-5.9	-7.4	-7.1	-5.5	-7.1	-5.1
Capital and financial account	**14.0**	**7.8**	**-16.5**	**-25.9**	**-12.0**	**-17.2**	**-19.0**
Net public sector capital	10.6	8.1	-2.1	-6.0	-5.0	-8.5	-8.6
Direct investment	7.2	8.4	3.4	1.7	-0.7	-0.5	0.5
Other net private sector capital 2/	-3.9	-8.7	-17.8	-21.6	-6.3	-8.2	-10.9
Overall balance	**2.1**	**-1.0**	**-20.9**	**-16.3**	**-5.7**	**-9.4**	**-11.6**
Financing	**-2.1**	**1.0**	**20.9**	**16.3**	**5.7**	**9.4**	**11.6**
Net international reserves (increase -) 3/	-2.1	1.0	20.9	4.8	-2.8	-3.7	-1.6
Change in gross reserves	-1.1	0.4	12.0	4.4	-2.9	-3.6	-2.1
Change in reserve liabilities (IMF)	1.0	-0.6	-8.9	-0.4	-0.1	0.1	-0.5
Purchases	0.0	2.1	10.6	0.0	5.6	5.6	5.6
Repurchases	1.0	1.5	1.6	-0.4	5.4	5.7	5.2
Exceptional financing	0.0	0.0	0.0	11.5	8.5	13.1	13.2
Arrears	0.0	0.0	0.0	11.5	7.9	12.1	12.1
Rescheduling (official bilateral)	...	...	...	...	0.6	1.0	1.1
(In percent of GDP, unless otherwise specified)							
Current account	**-4.2**	**-3.1**	**-1.7**	**9.5**	**5.1**	**6.4**	**5.1**
Trade account	-0.8	0.4	2.3	16.5	10.0	12.4	9.7
Exports, f.o.b.	8.2	9.3	9.9	25.3	17.6	23.1	20.3
Imports c.i.f.	-9.0	-8.9	-7.6	-8.9	-4.9	-10.7	-10.7
External debt service ratio 4/	100.3	105.2	108.4	98.4	...	...	...
Of which : public sector debt	49.4	54.8	65.0	46.8	...	...	...
Memorandum items:							
Current account excluding interest payments on nonperforming debt, in percent of GDP	-4.2	-3.1	-1.7	13.7	7.6	9.5	7.6
Export volumes, percent change	-0.7	2.7	4.6	-0.3	4.0	5.2	6.8
Import volumes, percent change	-13.9	-0.9	-17.3	-54.5	45.0	46.0	15.4
LIBOR (6-month U.S. dollar deposits)	5.5	6.6	3.7	1.9	1.1	1.2	1.6

Sources: Ministry of Economy; and Fund staff estimates.

1/ Includes interest due on nonperforming debt, but excludes interest on arrears.

2/ Includes errors and omissions.

3/ Gross reserves before 2002 include foreign currency securities repoed by BCRA to banks, and from September 2003 exclude BCRA holdings of Uruguay bonds. Fund repurchases are on an obligations basis.

4/ As percentage of exports of goods and nonfactor services.

Table 5. Argentina: External Financing Requirements and Sources, 2001–04
(In billions of U.S. dollars)

	2001	2002	2003 Sep.	2003 Est.	Proj. 2004
Gross financing requirements	59.3	31.7	24.7	32.5	30.5
Current account deficit 1/	4.5	-9.6	-6.3	-7.9	-7.4
Capital outflows	54.8	41.2	31.0	40.4	37.9
Public sector amortization	21.7	7.3	13.6	18.8	15.3
IMF	1.6	0.4	5.4	5.7	5.2
Multilateral loans	0.9	2.6	3.5	5.3	1.2
Official bilateral creditors	0.5	0.5	0.4	0.7	1.1
Bonds and notes	7.2	3.1	3.5	6.3	7.8
Other	11.5	0.8	0.7	0.7	0.1
Private sector amortization	17.0	20.0	12.3	14.5	14.4
Other private sector flows, net (+ outflows) 2/	16.1	14.0	5.0	7.2	8.2
Available financing	59.3	31.7	24.7	32.5	30.5
Capital inflows	47.3	15.7	19.1	23.0	19.4
Foreign direct investment	3.4	1.7	-0.7	-0.5	0.5
Disbursements to public sector	28.6	0.8	8.8	10.1	7.2
IMF	10.6	0.0	5.6	5.6	5.6
World Bank and IDB	1.8	0.8	3.3	4.6	1.6
Other	16.2	0.0	0.0	0.0	0.0
Private sector borrowing	15.3	13.2	11.0	13.4	11.6
Exceptional financing, arrears	0.0	11.5	7.9	12.1	12.1
Gross reserves accumulation (- increase)	12.0	4.4	-2.9	-3.6	-2.1
Rescheduling official bilateral	...	...	0.6	1.0	1.1

Sources: BCRA; and Fund staff estimates.
1/ Includes interest on nonperforming debt.
2/ Includes errors and omissions.

Table 6. Argentina: Net Debt Service to the IFIs, 2003–06

(In billions of U.S. dollars)

	2003			2004	2005	2006			Sep. 2003-
	Jan.-Aug.	Sep.-Dec.	Year			Jan.-Aug. 1/	Sep.-Dec.	Year	Aug. 2006 2/
IMF 3/									
A. Debt service	3.0	3.4	6.4	5.7	3.6	1.7	1.0	2.6	14.3
Principal 4/	2.5	3.2	5.7	5.2	3.0	1.1	0.8	1.9	12.5
Interest	0.5	0.2	0.7	0.5	0.6	0.5	0.2	0.7	1.8
B. Disbursements	3.0	2.5	5.6	5.6	2.8	1.5	0.0	1.5	12.5
C. Net debt service (A-B)	0.0	0.8	0.8	0.0	0.7	0.2	1.0	1.2	1.8
D. Credit outstanding	15.2	14.5	14.5	15.0	14.8	15.2	14.4	14.4	
World Bank									
A. Debt service	2.1	1.2	3.3	1.1	1.3	1.0	0.5	1.5	4.6
Principal	1.1	1.1	2.2	0.8	0.9	0.7	0.4	1.1	3.5
Interest	0.2	0.1	0.4	0.3	0.4	0.3	0.2	0.5	1.1
Arrears clearance	0.8	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0
B. Disbursements	1.3	0.7	1.9	1.2	0.9	0.7	0.4	1.1	3.5
C. Net debt service (A-B)	0.9	0.5	1.4	-0.1	0.4	0.3	0.2	0.5	1.1
D. Credit outstanding	7.9	7.5	7.5	7.9	7.9	7.9	7.9	7.9	
IDB									
A. Debt service	2.0	1.0	3.0	0.9	1.1	1.2	0.6	1.8	4.2
Principal	0.8	0.8	1.7	0.4	0.6	0.9	0.4	1.3	2.7
Interest	0.4	0.2	0.6	0.5	0.5	0.3	0.2	0.5	1.5
Arrears clearance	0.7	0.0	0.7	0.0	0.0	0.0	0.0	0.0	0.0
B. Disbursements	1.9	0.8	2.7	0.4	0.6	0.9	0.4	1.3	2.7
C. Net debt service (A-B)	0.1	0.2	0.3	0.5	0.5	0.3	0.2	0.5	1.5
D. Credit outstanding	8.8	8.8	8.8	8.8	8.8	8.8	8.8	8.8	

1/ For the Fund, January–September 15.
2/ Figures for the Fund are for the period of the arrangement (September 1, 2003–September 15, 2006).
3/ Assumes an exchange rate of US$1.3875 per SDR.
4/ Repurchases are on an obligations basis.

Table 7. Argentina: Consolidated Public Sector Operations, 1999-2004 1/

	1999	2000	2001	2002	2003 Prelim. 6/	2003 Original Prog.	Original Prog. 2004
(In billions of Argentine *pesos*)							
Revenues	**69.0**	**70.0**	**63.6**	**71.5**	**96.9**	**92.9**	**105.4**
Tax revenues	49.7	51.5	47.2	52.4	74.9	71.9	81.7
Social security contributions	10.9	10.7	9.6	9.7	11.7	11.5	13.0
Other revenues	8.4	7.7	6.8	9.4	10.2	9.6	10.7
Primary expenditures	**71.1**	**68.7**	**67.2**	**68.8**	**85.6**	**83.6**	**92.8**
Wages	26.6	26.6	26.4	26.2	29.5	29.3	32.2
Goods and services	6.8	6.0	6.3	6.3	9.1	8.3	8.7
Transfers to the private sector	27.2	26.8	25.7	28.6	34.5	33.9	35.7
of which: federal pensions	17.4	17.4	16.6	16.5	19.5	18.8	20.6
Capital spending	5.6	4.3	3.9	2.8	5.6	5.3	7.9
Other	4.9	5.0	4.9	5.0	6.9	6.8	8.3
Primary balance	**-2.1**	**1.3**	**-3.6**	**2.7**	**11.3**	**9.3**	**12.5**
Interest cash	9.7	11.5	12.4	7.5	8.4	8.9	8.8
Overall balance	**-11.8**	**-10.3**	**-16.0**	**-4.8**	**3.0**	**0.4**	**3.7**
Arrears and interest capitalization 2/	0.0	0.0	1.8	49.4	17.0	21.3	21.2
Debt recognition 3/	1.9	1.6	1.6	0.5	2.7	6.1	4.5
Bank compensation 4/	0.0	0.0	0.0	48.2	5.6	17.2	0.0
Augmented overall balance	**-13.6**	**-11.8**	**-19.3**	**-103.0**	**-22.4**	**-44.1**	**-22.0**
(In percent of GDP)							
Revenues	**24.3**	**24.6**	**23.7**	**22.9**	**26.4**	**25.3**	**25.3**
Tax revenues	17.5	18.1	17.6	16.8	20.4	19.6	19.6
Social security contributions	3.8	3.8	3.6	3.1	3.2	3.1	3.1
Other revenues	3.0	2.7	2.5	3.0	2.8	2.6	2.6
Primary expenditures	**25.1**	**24.2**	**25.0**	**22.0**	**23.3**	**22.7**	**22.3**
Wages	9.4	9.4	9.8	8.4	8.0	8.0	7.7
Goods and services	2.4	2.1	2.3	2.0	2.5	2.2	2.1
Transfers to the private sector	9.6	9.4	9.6	9.2	9.4	9.2	8.6
of which: federal pensions	6.1	6.1	6.2	5.3	5.3	5.1	4.9
Capital spending	2.0	1.5	1.5	0.9	1.5	1.5	1.9
Other	1.7	1.8	1.8	1.6	1.9	1.8	2.0
Primary balance	**-0.8**	**0.4**	**-1.3**	**0.9**	**3.1**	**2.5**	**3.0**
Interest cash	3.4	4.1	4.6	2.4	2.3	2.4	2.1
Overall balance	**-4.2**	**-3.6**	**-5.9**	**-1.5**	**0.8**	**0.1**	**0.9**
Arrears and interest capitalization 2/	0.0	0.0	0.7	15.8	4.6	5.8	5.1
Debt recognition 3/	0.7	0.6	0.6	0.1	0.7	1.6	1.1
Bank compensation 4/	0.0	0.0	0.0	15.4	1.5	4.7	0.0
Augmented overall balance	**-4.8**	**-4.2**	**-7.2**	**-32.9**	**-6.1**	**-12.0**	**-5.3**
Memorandum items:							
Real primary spending (percent change) 5/	3.3	-2.5	-1.1	-18.6	9.6	7.1	2.6

Sources: Ministry of Economy; and Fund staff estimates.

1/ Revenues and primary spending before 2003 include payments with bonds.
2/ Includes interest (arrears) on non-performing debt.
3/ Reflects the settlement of obligations in bonds, often as a result of judicial rulings.
4/ Compensation to banks for asymmetric pesoization and asymmetric indexation of balance sheets.
5/ Real spending is calculated as nominal spending deflated by the consumer price index.
6/ Data for interest capitalization, arrears, debt recognition and bank compensation are estimates.

Table 8. Argentina: Federal Government Operations, 1999-2004 1/

	1999	2000	2001	2002	2003 Prelim. 5/	2003 Original Prog.	Original Prog. 2004
	(In billions of Argentine *pesos*)						
Revenues	**55.0**	**55.5**	**50.6**	**56.8**	**77.2**	**74.6**	**84.8**
Tax revenues	38.6	40.7	37.4	41.8	60.7	58.4	66.4
Social security contributions	10.9	10.7	9.6	9.7	11.7	11.5	13.0
Non-tax revenues	5.5	4.1	3.6	5.3	4.7	4.8	5.4
Primary expenditures	**54.0**	**52.7**	**50.0**	**53.8**	**68.5**	**66.8**	**74.7**
Primary expenditures (excluding provinces)	36.1	34.7	33.1	36.3	45.8	45.0	50.0
Wages	8.5	8.1	7.7	8.0	10.3	10.1	11.1
Goods and services	2.6	2.3	2.2	2.5	3.2	3.0	3.4
Pensions	17.4	17.4	16.6	16.5	19.5	18.8	20.6
Transfers to private sector	6.4	6.2	5.8	8.7	11.1	11.2	11.0
Capital	1.0	0.7	0.6	0.5	1.1	1.4	2.6
Other	0.1	0.1	0.1	0.1	0.5	0.5	1.3
Transfers to provinces	17.8	18.0	17.0	17.5	22.7	21.7	24.7
Primary cash balance	**1.1**	**2.7**	**0.6**	**3.0**	**8.7**	**7.9**	**10.1**
Interest cash	8.2	9.7	10.2	6.8	6.9	7.4	6.9
Overall cash balance	**-7.2**	**-6.9**	**-9.6**	**-3.8**	**1.8**	**0.4**	**3.2**
Interest capitalization	0.0	0.0	0.4	32.6	4.2	7.5	10.3
Accumulation of arrears 2/	0.0	0.0	1.4	16.0	11.8	12.7	10.2
Debt recognition 3/	1.9	1.6	1.6	0.5	2.5	5.7	2.9
Bank compensation 4/	0.0	0.0	0.0	48.2	5.6	17.2	0.0
Augmented overall balance	**-9.0**	**-8.5**	**-13.0**	**-101.1**	**-22.3**	**-42.7**	**-20.2**
	(In percent of GDP)						
Revenues	**19.4**	**19.5**	**18.8**	**18.2**	**21.0**	**20.3**	**20.3**
Tax revenues	13.6	14.3	13.9	13.4	16.5	15.9	15.9
Social security contributions	3.8	3.8	3.6	3.1	3.2	3.1	3.1
Non-tax revenues	1.9	1.4	1.3	1.7	1.3	1.3	1.3
Primary expenditures	**19.0**	**18.6**	**18.6**	**17.2**	**18.6**	**18.2**	**17.9**
Primary expenditures (excluding provinces)	12.7	12.2	12.3	11.6	12.5	12.2	12.0
Wages	3.0	2.8	2.9	2.6	2.8	2.8	2.7
Goods and services	0.9	0.8	0.8	0.8	0.9	0.8	0.8
Pensions	6.1	6.1	6.2	5.3	5.3	5.1	4.9
Private sector transfers	2.3	2.2	2.2	2.8	3.0	3.0	2.6
Capital	0.3	0.2	0.2	0.1	0.3	0.4	0.6
Other	0.0	0.0	0.0	0.0	0.1	0.1	0.3
Transfers to provinces	6.3	6.3	6.3	5.6	6.2	5.9	5.9
Primary cash balance	**0.4**	**1.0**	**0.2**	**0.9**	**2.4**	**2.1**	**2.4**
Interest cash	2.9	3.4	3.8	2.2	1.9	2.0	1.6
Overall cash balance	**-2.5**	**-2.4**	**-3.6**	**-1.2**	**0.5**	**0.1**	**0.8**
Interest capitalization	0.0	0.0	0.1	10.4	1.1	2.0	2.5
Accumulation of arrears 2/	0.0	0.0	0.5	5.1	3.2	3.5	2.5
Debt recognition 3/	0.7	0.6	0.6	0.1	0.7	1.5	0.7
Bank compensation 4/	0.0	0.0	0.0	15.4	1.5	4.7	0.0
Augmented overall balance	**-3.2**	**-3.0**	**-4.8**	**-32.4**	**-6.1**	**-11.6**	**-4.8**

Sources: Ministry of Economy; and Fund staff estimates.

1/ Revenues and primary spending before 2003 include payments with bonds.
2/ Includes interest (arrears) on non-performing debt.
3/ Reflects the settlement of obligations in bonds, often as a result of judicial rulings.
4/ Compensation to banks for asymmetric pesoization and asymmetric indexation of balance sheets.
5/ Data for interest capitalization, arrears, debt recognition and bank compensation are estimates.

Table 9. Argentina: Summary Operations of the Financial System, 1999–2004

(In billions of pesos, end of period, unless indicated otherwise) 1/

	1999	2000	2001	2002	2003 Sep.	2003 Dec.	2004 Proj. Dec.
I. Central Bank							
Net international reserves 2/	13.2	12.1	-7.1	-20.7	-12.6	-11.9	-7.3
Net domestic assets	3.3	3.0	19.0	49.9	53.1	58.3	61.1
Credit to the public sector (net)	5.4	5.7	15.7	54.1	56.0	61.2	61.5
Credit to the financial sector (net)	1.4	1.0	5.0	23.4	17.7	17.8	17.8
Central bank bonds (*Lebacs*)	...	...	...	-3.2	-7.6	-9.6	-8.0
Official capital and other items (net)	-3.5	-3.7	-1.7	-24.5	-13.1	-11.1	-10.2
Monetary base	16.5	15.1	11.9	29.2	40.5	46.4	53.8
Currency issued	16.5	15.1	11.0	18.8	25.3	30.3	34.1
Bank deposits at the central bank	...	...	0.9	10.3	15.2	16.1	19.7
II. Banks and Non-Bank Financial Institutions							
Net foreign assets	-2.1	2.4	-6.2	-27.4	-20.6	-15.5	3.8
Net domestic assets	72.0	71.3	66.4	92.9	94.9	92.5	98.5
Credit to the public sector (net)	18.8	19.7	24.1	85.1	78.4	77.0	79.3
Credit to the private sector	70.6	67.9	56.0	47.8	40.4	40.4	41.8
Claims on the central bank (net)	3.8	3.5	4.7	-12.6	-3.8	-0.9	1.1
Capital and reserves	-16.9	-17.3	-16.5	-26.0	-21.8	-21.8	-21.8
Other	-4.3	-2.5	-1.9	-1.5	1.7	-2.2	-1.9
Private sector deposits	69.9	73.7	60.2	65.5	74.3	77.0	102.3
Local currency	26.7	26.0	15.9	63.3	70.1	74.3	98.7
Foreign currency	43.2	47.7	44.2	2.2	4.2	2.7	3.6
III. Consolidated Financial System							
Net foreign assets 2/	11.1	14.4	-13.3	-48.1	-33.2	-27.4	-3.5
Net domestic assets	72.5	71.8	82.5	130.1	129.8	131.7	136.9
Credit to the public sector (net)	24.3	25.4	39.8	139.3	134.4	138.2	140.8
Credit to the private sector	70.6	67.9	56.0	47.8	40.4	40.4	41.8
Net capital, reserves, and other assets	-22.3	-21.5	-13.2	-57.0	-45.0	-46.9	-45.7
Liabilities to the private sector (broad money)	83.6	86.3	69.3	81.9	96.6	104.2	133.4
Currency in circulation	13.7	12.6	9.1	16.4	22.3	27.3	31.1
Local currency deposits	26.7	26.0	15.9	63.3	70.1	74.3	98.7
Foreign currency deposits	43.2	47.7	44.2	2.2	4.2	2.7	3.6
Memorandum items:							
M1 3/	20.1	18.7	20.8	35.7	38.0	42.2	49.0
M3 4/	83.6	86.3	72.0	89.8	99.2	104.6	133.4
(Annual percent change)							
Augmented monetary base 5/	0.8	-8.8	-3.0	152.9	42.6	26.3	15.2
M1	-1.8	-6.8	10.7	71.9	23.7	18.3	16.1
M3	3.2	3.2	-16.5	24.7	15.0	16.5	27.6
Credit to the private sector	-2.3	-3.8	-17.6	-14.5	-21.2	-15.6	3.4

Sources: Central Bank of the Republic of Argentina; and Fund staff estimates.

1/ Projections based on data to October 2003 for banks and non-banks, data to December for the BCRA. Foreign currency items in projections are valued at an exchange rate of Arg$2.93 per U.S. dollar.

2/ Historical figures exclude foreign currency securities repoed by the BCRA to banks. Historical data differ from previous presentations due to corrections in recording of foreign liabilities. Projections exclude BCRA holdings of Uruguay bonds from GIR from September 2003.

3/ Currency in circulation plus demand deposits plus quasi-monies in circulation.

4/ M1 as defined in footnote 3, plus foreign- and domestic-currency time and savings deposits.

5/ Monetary base plus quasi-monies in circulation.

Table 10. Argentina: Consolidated Public Debt: 2001-03
(In US$ billions, end period)

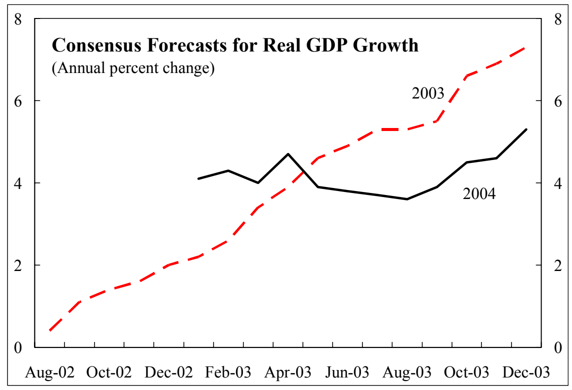
	2001	2002	Est. 2003
Total debt (I+II)	**167.8**	**152.9**	**191.1**
In percent of GDP	*62.4*	*164.5*	*151.3*
I. Federal government	**144.5**	**137.3**	**184.0**
A. Official debt	36.8	36.0	36.2
1. Multilaterals	32.4	31.1	30.9
IMF	14.0	14.3	14.5
World Bank	9.7	8.5	7.5
IADB	8.7	8.4	8.8
2. Bilateral	4.5	4.9	5.3
B. Private creditors	42.3	98.4	140.6
1. Performing debt	42.3	37.0	42.6
a. Banks (Bodens), compensation for:	0.0	8.9	9.7
Asymmetric pesoization	0.0	0.0	6.4
Foreign exchange exposure (Cobertura bonds)	0.0	2.4	2.4
Asymmetric indexation	0.0	0.0	1.0
b. Depositors (Bodens)	0.0	5.3	7.4
Exchange of deposits for bonds	0.0	...	6.1
Compensation associated with deposit liberalization	0.0	...	1.3
c. Civil servants (compensation for 2001 13 percent wage cut)	0.0	0.0	1.2
d. Phase 1 debt 1/	42.3	22.8	24.3
2. Nonperforming (Phase 2) debt	...	61.4	98.0
C. BCRA (Quasi-monies bonds)	0.0	0.0	2.7
D. Other	65.4	2.9	4.6
Treasury bills, bonds and other short-term instruments	61.8	0.0	0.3
Central bank short-term financing	0.0	1.1	2.2
Banks and other	3.6	1.8	2.1
II. Provincial governments (net of intergovernmental debt)	**23.3**	**15.6**	**7.1**
Memorandum items:			
Nonperforming debt 2/	...	92.8	109.0
Performing debt	167.8	60.1	82.1
Multilaterals 3/	32.4	14.3	30.9
Private creditors, BCRA, and other	135.4	38.1	47.7
of which: Bodens	0.0	14.2	21.0

Source: Argentine authorities and staff projections.

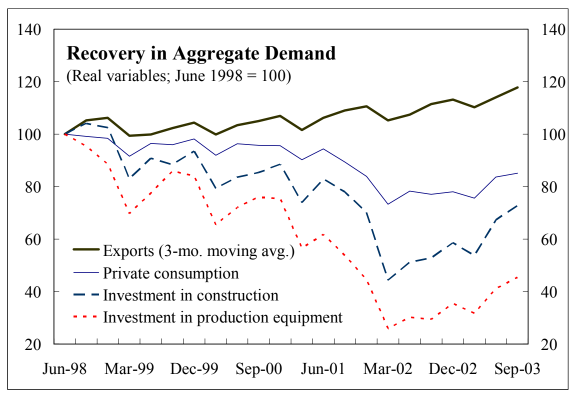
1/ Includes provincial debt assumed by the federal government.
2/ This includes the sum of non-performing Phase 2 debt, bilateral, bank and other debt, and assumes half of provincial debt is non-performing.
3/ Reflects arrears to multilateral development banks at end 2002.

THE STATE OF THE ECONOMY

The economy is rebounding sharply from the 2002 crisis, with six consecutive quarters of expansion. After falling by a cumulative 20 percent since its peak in 1998, real GDP is estimated to have risen by almost 8 percent in 2003. Although such growth performance is not unprecedented for Argentina (the economy expanded by over 8 percent in each of 1991, 1992 and 1997), the strength of the recovery has caught market participants by surprise, and consensus forecasts for real GDP growth have been progressively marked up during 2003.



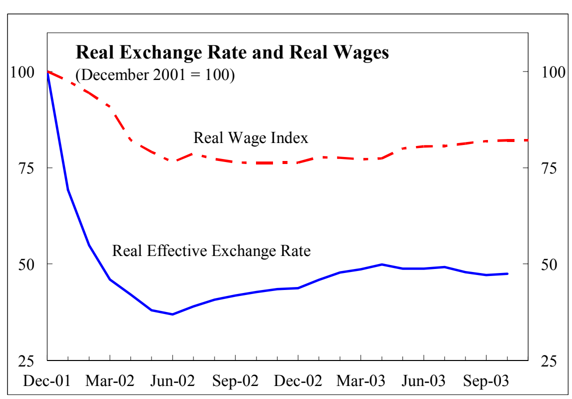
Recent indicators point to a broadening of the base of the economic recovery. Initially it was led by the release of pent-up demand for consumption and a pickup in construction investment; but, more recently, exports and productive investment in machinery and equipment have also gathered strength. However, despite the ongoing recovery in exports, the external sector is expected to contribute negatively to real GDP growth in 2003, as import volume growth has, thus far, outpaced the growth in export volumes. The sharp pick up in imports is, however, from a low base and is mostly driven by a robust recovery in the demand for externally-produced capital goods and parts.

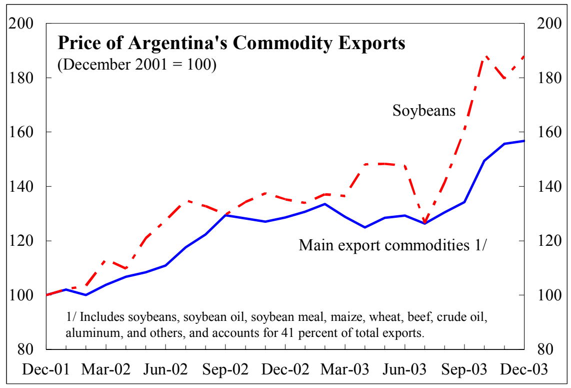


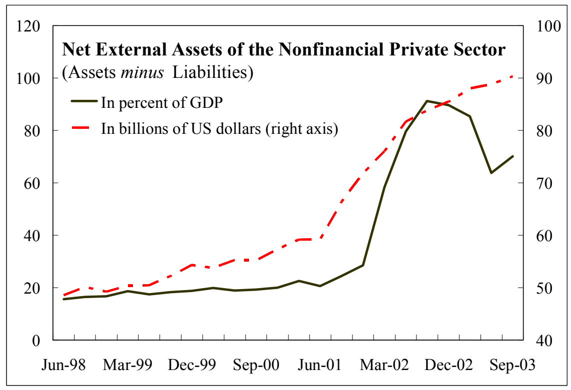
A number of concomitant factors have contributed to the strong economic revival:

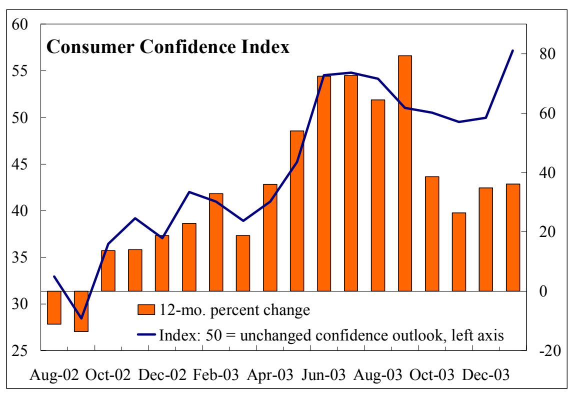
- The underutilization of installed productive capacity has enabled short-run increases in production simply through higher employment;

- The sizeable depreciation of the *peso* and subdued inflation and wage responses have improved the competitiveness of exports and labor-intensive industries (such as machinery and textiles), and also encouraged significant import substitution;









- The more depreciated exchange rate and low domestic and world interest rates have resulted in a wealth-effect induced boost to consumer and construction-related spending financed by the repatriation of external assets hoarded before the crisis;

- Highly favorable external conditions, including high export prices, low world interest rates, and recovering activity in the region and beyond have supported the export upturn, especially for agricultural products;

- Strong consumer sentiment and lower political uncertainty following the presidential elections have also played a role in the recovery of consumption;

- A cautious management of monetary and fiscal policies has enabled significant reductions in interest rates and a stable inflation environment;

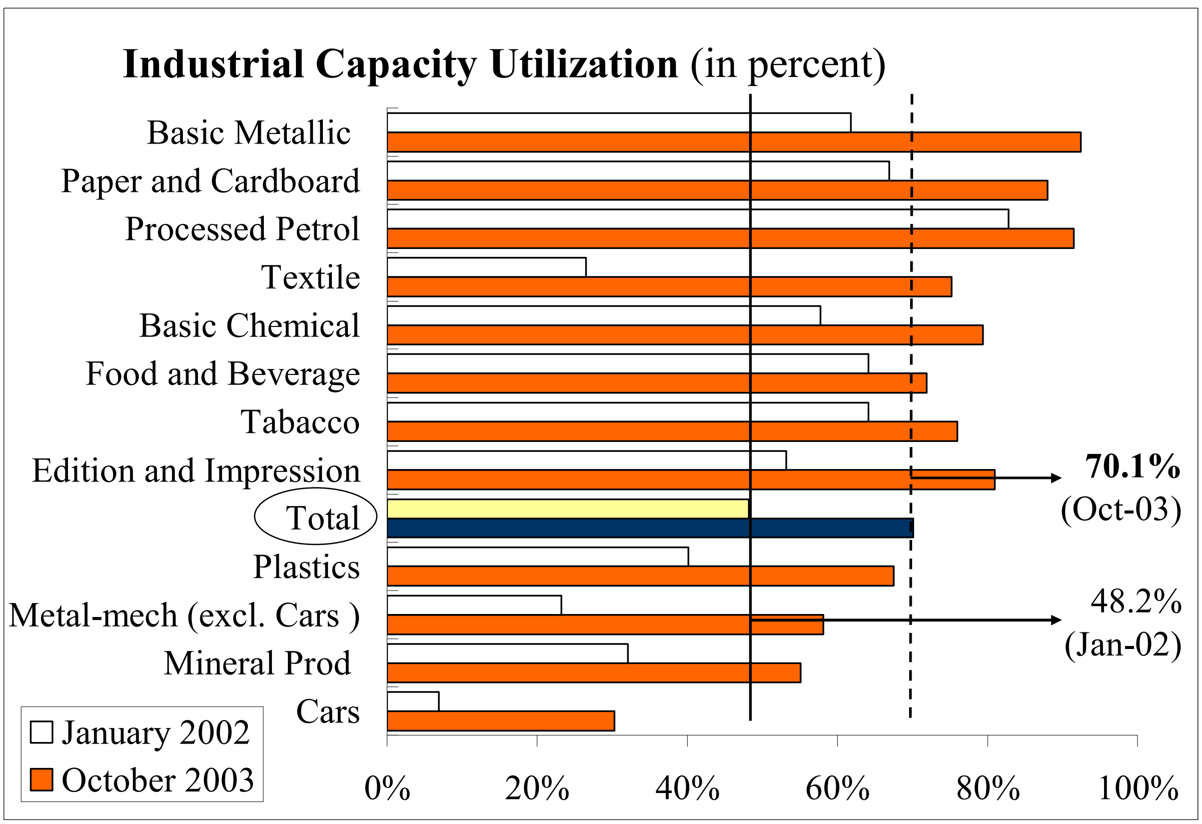
- The structural improvements in the economic environment that have taken place over the last year, including the elimination of deposit restrictions and of quasi-monies and increased fiscal prudence—both at the provincial and federal government levels—have supported the recovery from the crisis and augur well for sustaining growth in the future.

This combination of factors—together with official international support—has underpinned the recovery notwithstanding the absence, thus far, of significant new credit flows. In response, some firms have been able to rely on retained earnings, the diversion of funds from debt service, and the repatriation of external savings.

While the near-term prospects remain favorable, some moderation of growth is likely in the period ahead. A reassessment of the growth outlook for 2004 and beyond will be made at the time of the second review of the program. And, while the program growth target of

4 percent for 2004 (against a consensus forecast of 5¼ percent) is likely to be revised upward, some deceleration of growth from its current sustained pace would be natural as a number of transitory factors that have contributed to the recovery cease to play a role and potential bottlenecks emerge (as discussed in Annex III of IMF Country Report No. 03/392).

As Argentina uses up the existing slack in the economy, maintaining above-trend growth beyond 2003 will require sustained investment and productivity gains. Raising the growth potential of Argentina's service-oriented economy will require significant new investment to expand productive capacity in the traded goods sector and labor-intensive industries as the economy retools itself to fully benefit from the realignment of relative prices following the devaluation. This fundamental renewal of the economy will require further progress in restoring a sound financial system, placing the public debt on a sustainable path and normalizing relations with external creditors, ensuring a predictable legal and institutional environment, and resolving the problems of the utility companies—which accounted for the largest share of new private investment in recent years. Progress in these areas could lead to renewed bank lending and inflows of FDI, which have traditionally supported growth and productivity gains in Argentina. In contrast, policy reversals in any of these areas could renew macroeconomic instability and risk stopping growth, heightening the problems of unemployment and poverty.



THE BANKING SECTOR: FINANCIAL CONDITIONS AND RECOVERY STRATEGY[1]

A. Current Financial Conditions

Financial conditions of the banking system stabilized in 2003. The November 2003 financial statements report a liquid and solvent banking system. Liquid assets increased to 14.2 percent of total assets, compared with 8.7 percent at end-2002. Reported bank capital fell slightly in the first eleven months of 2003, but remained high at 11.9 percent of total assets at end-November 2003, compared with 13.9 percent at end-2002 (Table II.1 and II.2). The erosion in net worth reflects continuing operational losses, including provisioning.

Deposits continue to expand, growing by 21 percent during 2003 mainly in the form of sight deposits. For the system as a whole, these resources were largely held as precautionary reserves, given the lack of demand for credit and the banking system's cautious credit stance. However, there has been a nascent recovery in credit expansion recently. The credit to private sector grew by 1.7 percent in the last quarter of 2003, reflecting the increase in personal and credit card loans. After increasing sharply in the first half of the year, nonperforming loans have stabilized.

Banks continued to report significant losses. Banks reported cumulative losses of Arg$5.1 billion during the first eleven months of 2003. Losses averaged Arg$600 million per month in the first half of 2003, but eased to Arg$350 million in the third quarter. November 2003 was the first time since the crisis that the banking system as a whole reported monthly profits (Arg$45 million), reflecting the combined impact of a reduction in domestic interest rates, the stability of the exchange rate, the decline in loss provisioning, and lower operational costs.

Important differences exist among the segments of the banking system. The reported capital-asset ratio was the largest for domestic private banks (14.7 percent), followed by foreign banks (12.4 percent) and public banks (9.5 percent). The main reasons for the higher ratio in the domestic private banks are smaller write-offs from *amparos* (due to their lower deposit base) and a less aggressive provisioning compared to the other groups of banks. Moreover, operational losses differed among segments of the banking system reflecting the liability structure of different groups—i.e., greater reliance on foreign credit lines by foreign banks and greater reliance on BCRA assistance by domestic banks—and the incidence of losses from *amparos*, which is highest for the foreign banks. Thus, while monthly losses generated by the public banks have not abated, the domestic private banks and, more recently, the foreign banks have begun to generate profits.

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[1] Prepared by David Hoelscher, Ceyla Pazarbasioglu, and Jorge Cayazzo (all MFD).

Table II.1. Balance Sheet of the Banking System
(In billions of Argentine pesos)

	2000	2001	2002	Nov. 2003
Total assets	160.6	124.0	187.5	190.7
Liquid assets	9.2	9.9	15.9	27.0
Public exposure	28.8	28.3	92.9	92.5
Bodens	0.0	0.0	34.1	27.5
Other public securities	13.7	5.7	16.0	33.8
Guaranteed loans	0.0	11.6	17.8	17.4
Other loans	15.1	11.1	25.0	13.7
Loans to private sector, gross	66.5	54.6	39.1	34.1
Provisions	-7.2	-7.1	-10.6	-8.4
Financial instruments	50.2	23.0	23.2	16.0
Other assets	13.1	15.3	27.0	29.4
Total liabilities	143.9	107.7	161.5	168.0
Deposits	86.6	66.4	75.0	94.7
Public sector	7.3	4.3	8.5	15.8
Private sector	79.2	62.1	66.5	78.9
BCRA assistance	0.0	8.9	24.9	24.3
Foreign credit lines	8.9	8.1	25.7	16.9
Other liabilities	48.4	24.3	35.9	32.1
Net worth	16.7	16.3	26.1	22.7

Source: BCRA.

Table II.2. Banking System Indicators
(In percent)

	2001	2002	Nov. 2003
Solvency			
Net worth/assets	13.2	13.9	11.9
Asset quality			
Provisions/gross loans	4.5	27.1	24.5
Net private sector loans/assets	38.1	15.2	13.5
Non-performing loans/loans	17.5	18.3	33.7
Government exposure/assets	22.9	49.5	48.5
Government exposure (excl. LEBAC)/Assets	22.9	49.5	45.2
Government exposure/net worth	174.0	355.9	408.2
Government exposure (excl. LEBAC)/net worth	174.0	355.9	380.6
Liquidity			
Liquid funds/total deposits	14.8	21.2	28.5
Official deposits/total deposits	4.2	10.6	16.7
Profitability			
Return on assets	-0.2	-9.7	-2.7
Return on equity	-1.5	-69.9	-22.5
Administrative expenses/average assets	5.8	5.0	3.7
Financial income/average assets	12.4	24.9	6.2

Source: Staff calculations on BCRA data.

Steps have been taken to strengthen bank profitability during 2003. The central bank changed the maturities and interest rates on existing emergency rediscounts to match the yields and maturities on government bonds. In addition, reserve requirements were cut in half during 2003 and further cuts are planned for 2004. While banks hold excess liquidity, the reduction in reserve requirements permits banks to hold less precautionary balances. Banks have submitted 12-month business plans and multi-year business plans will be submitted by March 2004. The BCRA is coordinating efforts to ensure that the business plans are implemented and that banks adhere to the new capital adequacy rules that are effective as of January 1, 2004.

The authorities have taken steps to strengthen the public banking system. Agreement was reached with both *Banco de la Nacion* and *Banco de la Provincia de Buenos Aires* on conducting a due diligence and strategic review. These reviews will assist in developing a strategy for the public banking system. While the contracting process has been delayed, the bidding process is expected to begin by end-February 2004. Fund staff will closely monitor this initiative.

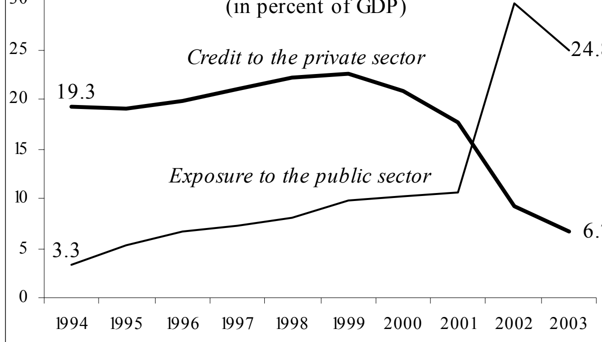
B. Banking System Vulnerabilities

Notwithstanding the progress in stabilizing Argentina's banking system, a number of vulnerabilities remain. The low credit growth limits the banking sector's role in financial intermediation. At the same time, policy-related losses have not been fully compensated and banks continue to defer recognition of the losses from *amparos*. While local regulations allow the deferred recognition over a five-year period, banks will have to generate sufficient capital to meet the schedule. Bank assets are highly concentrated in low-yielding government assets, exposing the economic value of banks to the fluctuations in prices of government bonds.

The banks carry a large duration mismatch and a significant portion of their assets is illiquid (public exposure). More than eighty percent of deposits are very short term (less than 60 days) and move in line with market rates, while the interest rates the banks earn on government exposure move only gradually with the rate of inflation. Thus, a sharp change in market interest rates could create liquidity problems for the banks due to the repricing risk.

The credit to the private sector accounts for only 18 percent of total assets compared with 44 percent in 2001. Total private sector credit has fallen to historical lows of 6.7 percent of GDP (Figure 1). This sharp reduction reflects a combination of net repayment of loans by borrowers (taking advantage of the windfall gains from 1:1 conversion of foreign currency loans), write-off of non-performing loans, and the concern of banks to maintain high liquidity levels in the face of economic uncertainties.

Figure 1. Bank Credit to Private and Public Sector
(in percent of GDP)



Compensation for policy-related measures remains incomplete. Total compensation for the *asymmetric pesoization* was estimated to be Arg$28 billion. While the full compensation has been booked by the banks in 2002, only 80 percent of the compensation has been issued, with the remaining amount subject to revision by the BCRA. In October 2003, the Congress approved compensation for the *asymmetric indexation*, estimated to amount to Arg$2.8 billion. However, compensation will be disbursed *pari pasu* with new lending, including restructured and refinanced loans. This requirement raises a concern that banks may accept risky lending or relatively generous restructuring terms in order to accelerate disbursement of the compensation.

Losses from judicial injunctions (*amparos*) are uncompensated and continue unabated. Although the stock of *amparos* declined significantly between 2002 and 2003 (from a yearly total of Arg$12 billion in 2002 to Arg$4.4 billion in 2003), monthly *amparos* during 2003 consistently averaged Arg$350–400 billion. The continued losses reflect a combination of first-time injunctions and "second-generation" injunctions, whereby depositors who had withdrawn deposits at a relatively appreciated exchange rate seek compensation at the current exchange rate. In considering these losses, Congress decided not to compensate banks for costs arising from *amparos*, pending a final ruling of the Supreme Court.

Adjusting the balance sheets for the effect of one-time policy-induced losses (the asymmetric *pesoization*, the asymmetric indexation and the writing off of *amparos*), the adjusted net worth of the banks declines to Arg$17.5 billion (9.2 percent of assets) from the reported Arg$22.7 billion (Table II.3).[2]

Table II.3. Argentine Banks: Adjustments to Net Worth
(In billion Argentine pesos, unless indicated)

	All Banks	State	Domestic	Foreign
Reported net worth	**22.7**	**7.1**	**7.6**	**7.8**
Reported net worth / assets (percent)	11.9	9.5	14.7	12.4
Compensation for indexation	2.8	0.8	0.9	1.1
Elimination of overcompensation	-1.8	-0.6	-0.6	-0.6
Writing off of *amparos*	-6.2	-2.1	-0.7	-3.4
Adjusted net worth	**17.5**	**5.2**	**7.2**	**4.9**
Adjusted net worth / assets (percent)	9.2	6.9	13.9	7.7

Source: Fund staff estimates based on BCRA data.

[2] The net present value of the future cash flows of the banks declined by about 30 percent or Arg$4.8 billion as a result of the swap of government securities into guaranteed loans (Phase 1 debt). The prospect of lower yields does not require banks to provision. In future years, however, external auditors of the banks will assess the fair value of the guaranteed loans and the debt servicing track record of the borrower.

A series of adjustments were made to estimate the economic value of capital and to analyze the impact of a potential restructuring of government debt held by banks. The economic value of capital is an important element in determining the fragility of a bank and the time and effort necessary to strengthen it, and its movement overtime provides insights regarding the incentives of the major shareholders. The adjustments included the mark-to-market of government exposure, mark-to-market of government securities only, a restructuring of phase 1 debt and a restructuring of the "patriotic bonds."[3] The results are very sensitive to valuation assumptions (the market value of government securities appreciated from 45 to 66 percent of face value in 2003) and are summarized below (Table II.4).

Table II.4. Selected Stress Tests

(In billion Argentine pesos, unless indicated)

	All Banks	State	Domestic	Foreign
Reported net worth	**22.7**	**7.1**	**7.6**	**7.8**
Adjusted net worth	**17.5**	**5.2**	**7.2**	**4.9**
Erosion in net worth due to:				
Mark-to-market of government exposure	-28.0	-10.4	-8.1	-9.4
Mark-to-market of government bonds	-14.0	-3.8	-4.5	-5.7
Restructuring of phase 1 debt	-13.4	-3.6	-5.2	-4.7
Restructuring of patriotic bonds	-1.5	0.0	-0.6	-0.9

Source: Fund staff estimates based on BCRA data.

- **Mark-to-market of government exposure.** If banks were to discount their government exposure (securities and loans) in line with market prices[4], net worth would decline by Arg$28 billion and the entire banking system would become insolvent.

- **Marking to market only government securities** similarly implies a severely undercapitalized banking system, with the greatest impact on the foreign banks.

- **Restructuring of the guaranteed loans (phase 1 debt)** would reduce bank capital by Arg$13.4 billion. (The authorities have argued consistently that phase 1 debt would not be restructured.)

[3] About US$2 billion of "patriotic bonds" was issued mainly to banks in 2001 to secure government financing on the eve of the crisis. To encourage banks to purchase the bonds, the government guaranteed that the bonds could be used to offset future tax liabilities.

[4] On January 9, 2004, performing government securities traded at a 33 percent discount.

- **Restructuring of the "patriotic bonds."** Commercial banks hold about US$2 billion of patriotic bonds issued in 2001 that the authorities have indicated are to be included in the sovereign debt restructuring. A restructuring of these bonds consistent with the market value of defaulted debt (currently 25 percent) would reduce bank capital by Arg$1.5 billion.

C. Strategy Going Forward

The Argentine banking system remains fragile and is highly dependent on future profits to regain its strength. Future performance will mirror developments in the Argentine economy. If strong economic growth continues, most Argentine banks will continue to recover and capital will flow back into them. If the economy falters, if interest rates rise sharply, or if additional government debt held by the banks is restructured, then most private banks will not be able to continue to operate without another round of massive supervisory forbearance.

The potential exists for the banking system to grow out of its current financial difficulties through a recovery in credit demand. Creditors with dollar-denominated loans received a windfall gain from the conversion of their loans at an exchange rate of Arg$1=US$1. Furthermore, a large number of borrowers have paid back their loans, and reduced their leverage ratio.[5] Under the assumption that annual private sector credit grows by 15 percent, that the loan portfolio produces a return of 2 percent (implying a return on assets of 1 percent), and that losses from *amparos* are recognized over a five-year period, the banking system will generate profits in 2005.[6] The domestic private banks will achieve profitability after the first year, followed by the public banks after two years and the foreign banks after four years. During this period, banking system capital would decline but would remain above 8 percent of unweighted assets.[7]

Bank supervision should be strengthened in order to minimize the risks associated with the weak banking system. Steps should include:

- Careful supervisory oversight and prompt corrective actions for banks adopting unsafe and unsound banking practices;

- Monitoring interest rates and credit growth of banks to identify unsafe banking practices;

[5] It should be noted that this effect was offset for the companies with external debt holdings.

[6] The results are sensitive to the assumptions: with a credit growth of 10 percent and a return on assets of 0.8 percent, the banking sector will reach profitability with a further two-year delay. On the other hand, a 25 percent credit growth and a return on assets of 1 percent implies profitability for the sector in 2004 with the foreign banks following in two years.

[7] The leverage ratio is only an approximation of regulatory capital, as the assets are not risk weighted.

- Meeting regularly with the banks to monitor the implementation of their business plans (both the one-year business plans and the medium-term business plans, once there is more certainty regarding *amparos* and government restructuring); and

- Development of a methodology for assessing banks' long-term viability (i.e., distinguishing the impact of regulatory forbearance on bank financial statements from the bank's underlying viability).

Few other options remain, given the limited fiscal resources for further recapitalization. Additional steps could include further reduction in, and remuneration of, reserve requirements; reduction in the distortionary financial transactions tax; and continued progress on assessing, and then addressing, the problems in the major state banks.

PUBLIC DEBT RESTRUCTURING

This Annex reports on recent developments with regard to restructuring Argentina's sovereign debt and updates the debt sustainability analysis reported in IMF Country Report No. 03/392.

D. Recent Developments

The key recent developments have been as follows:

- **In September 2003, during the meetings in Dubai the authorities presented their debt restructuring plan**. Subsequently, during October and December 2003, they held meetings with consultative group creditors in Buenos Aires, New York, Frankfurt, Rome, Zurich, and Tokyo. The authorities' presentations to private creditors are available at their official website *(www.argentinedebtinfo.gov.ar)*.

- **In October 2003, the authorities invited expressions of interest from 15 banks to advise on and manage the debt exchange offer**. In early December, 12 banks expressed interest and the authorities have indicated that they will make a final selection shortly.

- **In December 2003, a meeting with private creditors was convened in New York at which the authorities**: (i) stated their intention to secure broad participation in the restructuring and to safeguard intercreditor equity; (ii) stated that there was no understanding with the IFIs—in particular the Fund—that their exposure to Argentina would be held constant beyond 2006; (iii) confirmed their commitment to a primary surplus beyond 2004 that would be sufficient to service both currently performing debt and the obligations resulting from the restructuring; and (iv) welcomed feedback from creditor groups.[1]

- **The authorities also posted on their web site a spreadsheet-based model projecting current performing debt servicing flows of the federal government**. The model estimates a resource envelope available after servicing current debt, thereby outlining, under various assumptions, the payment capacity for the debt to be restructured.

- **In January 2004, certain creditors and creditor representatives founded a Global Committee of Argentina Bondholders** (GCAB), composed of bondholder representatives of the United States, Germany, Italy, Japan and open to other creditors who have not initiated litigation, nor have conflict of interest with the explicit aim of initiating negotiations with the government on a debt restructuring proposal. GCAB

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[1] See also the speech of Secretary of Finance Nielsen at the Emerging Markets Traders Association http://www.argentinedebtinfo.gov.ar/documentos/emta-gn-4-12-2003-english.pdf

has written to the authorities about the formation of the committee, requesting an early meeting. *The authorities have expressed concerns about the degree to which the committee is representative and have announced the creation of a bondholder registry.*

- **As regards bilateral debt, the Paris Club secretariat has written to the authorities stating its willingness to invite them to a negotiating session**, and reminding them that, before there can be such a session, the authorities need to make a formal request specifying the scope and type of treatment being sought. The authorities have yet to make a formal request in this regard.

E. Baseline Scenario—Debt sustainability analysis

The staff's baseline debt sustainability analysis is based on the following key assumptions:

- A macroeconomic framework for 2004–10 as in the program (IMF Country Report No. 03/392).

- A broadly constant exposure to IFIs during the program period. After the current arrangement expires, this scenario assumes: (i) no further use of Fund resources; and (ii) disbursements of project loans amounting to US$650 million a year from the World Bank and the Inter-American Development Bank, which would reduce their exposure to Argentina gradually over time.[2]

- Rescheduling of arrears and claims to the official bilateral creditors during the program period on classic terms (at 5 percent interest rate with 3 year grace and 12 year maximum repayment period).

On these assumptions, Table III.1 shows that:

- The financing needs (after the primary surplus) average US$18 billion (12 percent of GDP) during 2004–06, and over US$20 billion (10 percent of GDP) in 2007–10.

- As indicated in previous staff reports, it is difficult to envisage a scenario that would allow sustained servicing of all debt on a contractual basis.

F. Argentina's Restructuring Guidelines

The restructuring framework presented by the authorities in Dubai and elaborated subsequently is based on several key features:

[2] The assumptions regarding future IFI financing differentiate this scenario, and the derived estimates, from that in Annex II of IMF Country Report No. 03/392.

- An eligible stock of private debt of US$99.4 billion to be restructured, of which US$18.2 billion represents past due interest (PDI). The authorities have indicated that they will not pay PDI accumulated since the default in December 2001.

- The restructuring seeks to reduce the nominal stock of eligible debt (later clarified to include PDI) by 75 percent.

- The defaulted debt would be restructured into three different types of bonds, each offered with an upside option on GDP growth but with lower coupon payments. The offered bonds include:

    - A discount bond with a principal reduction of 75 percent and a step-up coupon rising from 1 to 5 percent over an average life of 8 to 32 years.

    - A par bond with no principal reduction and a fixed coupon between ½ to 1 percent over an average life of 20 to 42 years.

    - A quasi-par bond with a principal reduction of 30 percent, paying a fixed coupon of between 1 and 2 percent over an average life of 20 to 42 years.

- **Market analysts and various creditor groups estimate that this proposal implies a very large NPV reduction for creditors in the 90–93 percent range**.[3] These estimates, however, are based on market or unofficial assumptions about key characteristics of the bonds, as the Dubai guidelines are not sufficiently detailed to allow precise calculations.

- **The payment capacity identified by the authorities in their presentation posted on the web differs from the Fund staff projections above in several key respects**: (i) there are some, relatively small, differences in macroeconomic assumptions (growth and inflation); (ii) the authorities assume no net principal payments to IFIs through 2013; (iii) the authorities assume that bilateral debt is included in the stock to be restructured; and (iv) the authorities assume a higher rollover rate of domestic performing debt.

[3] Estimates by the Argentine Bondholders Committee (ABC), December 3, 2003.

Table III.1. Argentina: Medium-Term Consolidated Government Financing Projections

	2004	2005	2006	2007	2008	2009	2010
(In billions of US$, unless stated otherwise)							
A. Financing Needs	**23.5**	**23.3**	**23.1**	**26.9**	**26.9**	**27.6**	**24.3**
Total cash interest	6.6	7.1	7.9	7.6	7.0	6.6	6.5
Official	1.3	1.8	2.0	1.9	1.5	1.3	1.1
IMF	0.5	0.6	0.7	0.7	0.4	0.2	0.1
World Bank and IDB	0.7	0.9	1.0	1.0	0.9	0.9	0.9
Bilateral	0.1	0.3	0.3	0.3	0.2	0.2	0.2
Debt held by private creditors	5.2	5.3	5.9	5.7	5.5	5.3	5.4
Performing debt	1.6	2.2	2.7	3.1	3.4	3.6	4.0
Non-performing (Phase 2) 1/	3.6	3.1	3.1	2.5	2.1	1.6	1.4
Quasi-money bonds	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Amortizations	17.0	16.2	15.2	19.3	19.8	21.0	17.8
Official	6.4	4.5	4.3	7.3	7.7	5.5	4.2
IMF	5.2	3.0	1.9	4.3	5.1	3.1	1.6
World Bank and IDB	1.2	1.5	2.4	2.4	2.1	1.9	2.0
Bilateral	0.0	0.0	0.0	0.6	0.6	0.6	0.6
Debt held by private creditors	10.3	11.3	10.5	11.5	11.6	15.0	13.0
Performing debt	1.3	4.8	6.5	7.2	7.4	11.9	11.0
Non-performing (Phase 2) 1/	9.0	6.5	4.0	4.3	4.2	3.0	2.0
Quasi-money bonds	0.3	0.4	0.5	0.5	0.5	0.5	0.5
B. Primary balance (authorities' baseline scenario)	**4.4**	**4.8**	**5.3**	**5.6**	**6.0**	**6.3**	**6.5**
In percent of GDP	*3.0*	*3.0*	*3.0*	*3.0*	*3.0*	*3.0*	*3.0*
C. Financing needs after primary surplus	**19.2**	**18.5**	**17.9**	**21.3**	**20.9**	**21.3**	**17.8**
In percent of GDP	*13.1*	*11.5*	*10.2*	*11.4*	*10.5*	*10.2*	*8.2*
D. Consolidated government debt	**186**	**188**	**190**	**190**	**189**	**187**	**186**
In percent of GDP	*127*	*117*	*108*	*101*	*95*	*90*	*86*
Memo items:							
Total cash interest (in percent of GDP)	*4.5*	*4.4*	*4.5*	*4.1*	*3.5*	*3.1*	*3.0*
of which excluding phase 2 interest payments	*2.0*	*2.5*	*2.7*	*2.7*	*2.5*	*2.4*	*2.4*
Interest capitalization (in percent of GDP)	*2.4*	*1.8*	*1.5*	*1.1*	*0.8*	*0.6*	*0.5*

Source: Fund staff estimates

1/ Excludes cash interest and amortization payment needs arising from principal and interest arrears.

FUND RELATIONS
(As of November 30, 2003)

I. Membership Status: Joined September 20, 1956, Article VIII

A. Financial Relations

II. General Resources Account:	**In Millions of SDRs**	**In Percent of Quota**
Quota	2,117.10	100.00
Fund holdings of currency	12,584.57	594.42
Reserve position in Fund	0.05	0.00

III. SDR Department:	**In Millions of SDRs**	**Percent of Allocation**
Net cumulative allocation	318.37	100.00
Holdings	678.68	213.17

IV. Outstanding Purchases and Loans:	**In Millions of SDRs**	**In Percent of Quota**
Extended Fund arrangements	491.02	23.19
Stand-By Arrangements	9,976.50	471.23

V. Latest Financial Arrangements

			SDR Millions	
Type	**Approval Date**	**Expiration Date**	**Amount Approved**	**Amount Drawn**
Stand-By	09/20/03	09/19/06	8,981.00	1,830.00
Stand-By	01/24/03	08/31/03	2,174.50	2,174.50
Stand-By	03/10/00	01/23/03	16,936.80	9,756.31
Of which: SRF	01/12/01	01/11/02	6,086.66	5,874.95

VI. Projected Obligations to the Fund: (Under the Repurchase Expectation Assumptions) (SDR millions; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2003	**2004**	**2005**	**2006**	**2007**
Principal	21.35	4,397.76	2,794.69	2,023.60	1,230.11
Charges/interest		252.08	118.24	57.39	15.76
Total	21.35	4,649.85	2,912.93	2,080.99	1,245.87

VII. Safeguards Assessments: The Central Bank of Argentina (BCRA) is subject to a safeguards assessment under the current Stand-By Arrangement. An on-site assessment of the BCRA was performed in December 2003 and the report is in the final stages of preparation. This assessment included a follow up on the status of recommendations made under the previous assessment of the BCRA, completed on September 05, 2002. The principal recommendations of the on-site assessment, reflecting identified vulnerabilities, are: (i) a speedy move towards the adoption of International Financial Reporting Standards (IFRS); (ii) the publication of IFRS-based financial statements; and (iii) continued assurance to the Fund that all monetary data under the program reflect the TMU. The authorities are currently considering these and other staff recommendations. Specific measures and the agreed time schedule for their implementation will be detailed in the context of the second review.

B. Nonfinancial Relations

VIII. Exchange rate: On March 27, 1991, a law was passed guaranteeing the full convertibility of the austral under a currency board arrangement and pegging the austral at ₳10,000 per U.S. dollar. On January l, l992 the *peso* was substituted for the austral at a rate of l peso per 10,000 australes. On January 7, 2002, the currency board arrangement was abandoned in favor of a dual exchange rate regime with an official rate of Arg$1.4 per U.S. dollar for most trade, trade finance, and public sector transactions; remaining transactions were at a market floating rate. On February 11, 2002, the dual exchange rate regime was abolished and substituted by a floating regime with no pre-announced rate of the exchange rate.

All Article VIII restrictions have been removed other than: (i) the restriction arising from the freezing of deposits pursuant to the *corralón* (which has been approved by the Board until the earlier of March 2004 or the conclusion of the next Article IV consultation with Argentina); and (ii) a restriction arising from limitations on the ability of financial institutions to make moderate loan amortization payments.

IX. Last Article IV consultation: The 2002 Article IV consultation was concluded by the Executive Board on January 8, 2003 (IMF Country Report No. 03/226).

X. Fourth Amendment: Argentina has accepted the Fourth Amendment to the Articles of Agreement.

XI. Technical Assistance, 2002–03

Missions	**Purpose**	**Time of Delivery**
FAD	Tax Administration	January 2002
LEG	Insolvency Law and Other Legal Issues	March 2002
MFD	Bank Restructuring	March 2002
LEG	Insolvency Law and Other Legal Issues	April 2002
MFD	Bank Restructuring	April 2002
MFD	Bank Restructuring	May 2002
MFD	Bank Restructuring	June 2002
MFD	Bank Restructuring	July 2002
MFD	Bank Restructuring	August 2002
MFD	Bank Restructuring	September 2002
FAD	Public Expenditure Management	September 2002
LEG	Insolvency Law and Other Legal Issues	November 2002
FAD	Customs Administration	November 2002
MFD	Development of Banking Model	November 2002
FAD	Tax Policy	February 2003
MFD	Bank Restructuring	March 2003
FAD	Intergovernmental Relations	April 2003
MFD	Bank Restructuring	May 2003
MFD	Bank Restructuring	July 2003
MFD	Bank Restructuring	August 2003
MFD	Banking Strategy	October 2003

XII. Resident Representative: Mr. John Dodsworth has been the senior resident representative in Buenos Aires since July 2003. Mr. Luis Cubeddu has been the resident representative since September 2002.

RELATIONS WITH THE WORLD BANK GROUP[1]

The total current Bank portfolio in Argentina is composed of 32 loans totaling US$4.6 billion in commitments. Twenty-eight loans correspond to investment projects totaling US$3.2 billion in commitments, of which US$1.1 remain undisbursed. The remaining four are adjustment operations totaling US$1.5 billion in commitments, of which US$526 million remain undisbursed. The latter category includes the Provincial Maternal-Child Health Sector Adjustment Loan, for US$750 million, signed on October 31, 2003. Upon effectiveness of the loan declared on November 6, 2003, US$450 million of the first tranche were disbursed. The current level of exposure of the Bank in Argentina stands at US$7.5 billion.

The last Country Assistance Strategy (CAS) Report was discussed at the Board on June 27, 2000 and was subsequently updated via a CAS Progress Report dated October 1, 2001. Bank's strategy has been somewhat overcome by the crisis that erupted in end 2001. The Bank has since then adjusted its proposed strategy to respond to the needs emerging from the acute increase in poverty and to support the transition towards the normalization of the economic and social conditions.

The Bank's response to the crisis situation included three major steps: (i) US$270 million were re-allocated from existing projects to emergency social programs in the areas of nutrition, health, and education; (ii) in January 2003 the Board approved the Heads of Household loan for US$600 million, the main program to assist the unemployed, benefiting about 2 million households; and (iii) in May 2003, the Board approved a US$500 million Economic and Social Transition Loan that supported the redemption of the quasi-monies issued by the provinces and ensured continued execution of programs dealing with the provision of essential social services.

On October 28, 2003 the Bank approved a $750 million loan to support the Government's Health Sector Reform Program that aims to increase the availability and effectiveness of public subsidies in improving the health status of the poor. This loan will specifically support the implementation of a Maternal and Child Health Insurance Program, initiate a major effort to reach the lowest income provinces in Argentina and shift public subsidies from the non-poor to the poor who are largely uninsured. The Loan will be disbursed in three tranches over a period of approximately one year.

Efforts to improve performance of the Bank's investment portfolio have fallen short of expectations. About half of the Bank's investment portfolio continues to be rated as unsatisfactory for implementation progress. There has been a pickup in disbursements during the last quarter of calendar year 2003, that ended with total disbursements reaching US$618 million, of which US$352 million correspond to the Heads of Household Program,

[1] Prepared by the staff of the World Bank on January 15, 2003.

and US$98 million to reallocations made in support of the social emergency. The adjustment portfolio consists of four loans with an amount of $526 million remaining undisbursed. The last tranches of the Córdoba, Santa Fe and Catamarca PRLs, totaling US$226 million, are expected to be disbursed during the first semester of calendar year 2004. The two remaining tranches of the Provincial Maternal-Child Health Sector Adjustment Loan are expected to be disbursed during the calendar year.

A new Country Assistance Strategy is expected to be presented to the Board early in calander year 2004, together with a structural adjustment loan to support economic recovery.

Financial Relations with the World Bank

(In millions of U.S. dollars)

		Commitments (Net of Cancellations)	Disburse- ments	Undisbursed Amount
I. IBRD Operations (as of January 15, 2004)				
Fully disbursed loans		14,429.6	14,429.6	0.0
Loans in process of disbursement		4,588.6	2,955.3	1,633.3
A. Investment operations				
Agriculture and Rural Development		246.5	106.1	140.4
Power		30.0	2.8	27.2
Municipal/Provincial Development		430.9	392.1	38.9
Water sector		30.0	5.7	24.3
Social sector		1,155.3	762.7	392.6
Finance, infrastructure, and natural resources	1,192.0	742.7	449.3	
Public administration		50.8	16.1	34.7
B. Adjustment operations [1]		1453. 0	927.0	526.00
Total loans		19,018.1	17,384.9	1,633.3

II. IFC Operations (as of December 31, 2003)

	Loans	Equity	Quasi	Partici- pation
Held	541.2	169.1	164.4	747.4
Disbursed	535.2	110.2	164.4	747.4

III. IBRD Loan Transactions

	Actuals (Calendar Year)					
	1998	1999	2000	2001	2002	2003
Disbursements	2,030.6	1,572.9	1,018.8	1,328.8	424.5	1,962.9
Debt service payments	350.2	445.0	538.1	675.5	1,869.8	2,968.1
Net transfers	1,684.4	1,127.9	480.7	653.2	-1,445.3	-1,005.2

[1] Includes the Provincial Maternal-Child Health Sector Adjustment Loan approved by the Executive Board of Directors on October 28, 2003.

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[1]

Portfolio

The Bank adjusted its activities in Argentina in 2002 and 2003 to better respond to a new economic, social and political context. In particular it:

- Tightened supervision of its portfolio to take into account harsher fiscal constraints;
- Reformulated its social and productive sector portfolios in order to better respond to the government's priority areas as well as to improve portfolio performance. To this end, in March 2002, board authorization was given to redirect US$694.2 million from low-performing operations of lesser priority to support the Argentine government's Social Emergency Plan for social protection and containment programs, with special emphasis on food, medicines, and education programs. Results to date have been positive both in terms of physical and disbursement targets. In November 2003, the Board approved the reformulation of the Bank's productive sector portfolio in order to help revitalize economic activity and improve the competitiveness of the productive sectors. This has resulted in the redirectioning of US$296 million toward programs that support small and microenterprises and small rural producers.

Early in 2003 the second tranches of two sector loans were reformulated in order to better respond to new needs: the Financial Sector Program in the amount of US$243 million, and the Sector Program to Support the Federal Pact for Growth and Fiscal Discipline in the amount of US$246.7 million. Each of these second tranches was split into two, conditionalities were met and the loans were fully disbursed by the end of 2003.

As of December 31, 2003 IDB disbursements for the year totaled US$2.664 billion, of which US$1.9 billion were for emergengy loans, US$490 million for policy-based loans and US$274.61 million for investment loans. For the year as a whole, the net loan flow of resources to the country was positive in US$296 million, the net cash flow was negative in US$305 million.

Lending Program and Country Strategy

Under the umbrella of the Transition Program and the three-year stand by agreement between Argentina and the IMF, approved in January and September 2003 respectively, the Bank approved two emergency loans for US$1.9 billion to protect social expenditure. These loans have been fully disbursed.

[1] Prepared by IDB staff, January 2004.

Additionally, two direct investment loans to the provinces of Salta and Río Negro were approved in 2003, for a total of US$86 million, with the objective of revitalizing economic growth by supporting productive sectors with greater comparative advantages.

The Bank has carried out dialogue missions to discuss its future lending program with the authorities as well as the priorities for the country strategy for the period 2004–08. Work on this strategy was initiated through a series of internal workshops and through the preparation of sector-specific studies. Discussions and a series of workshops are planned with the government, private sector and civil society in the coming month, with the aim of approving the strategy early in 2004.

Ministro de Economía y Producción

Buenos Aires, January 9, 2004

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington D.C.

Dear Mr. Köhler:

Considerable progress has been made in implementing the economic program that has been supported by a stand-by arrangement with the IMF since September 2003. Macroeconomic developments continue to be favorable and well in line with the program's macroeconomic framework for 2003 04. The end-October quantitative performance criteria were met with significant margins. Based on recent data, we expect, for 2003, real GDP to grow by at least 7.8 percent and inflation to be 3.7 percent. Growth in 2004 has the potential to be again better than programmed, and the 2004 macroeconomic framework will be reassessed at the next program reviews.

Fiscal and Monetary Policies

Fiscal policy is in line with the program, with tax collections outperforming projections, and spending remaining tightly controlled. The 2004 budget was approved by Congress on November 28 in a manner consistent with the fiscal targets of the program. Fiscal performance is expected to be further strengthened as a result of the approval by Congress of the anti-tax evasion package shortly after the expected end-November date, for which we request a waiver. The outturn for provincial finances in recent months also has been better than expected, mainly reflecting higher own-tax revenues and co-participation transfers. Bilateral agreements for 2004 have already been signed by ten provincial governors of provinces accounting for over 79 percent of the 2002 consolidated provincial deficit.

As regards the monetary program, performance criteria for end-October 2003 were met with wide margins and the growth of augmented base money was in line with the program's indicative target. The redemption of quasi monies is proceeding rapidly, with only about Arg$300 million, of an original stock of Arg$7.5 billion, remaining in circulation. Full monetary unification is expected by end-March 2004. During the coming year, the central bank intends to strengthen its ability to conduct discretionary monetary policy through the development of a repurchase market in central bank instruments.

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At this stage, the fiscal and monetary targets of the program remain unchanged, and the end-June 2004 indicative targets for the primary balance of the federal government, the federal government debt stock, and central bank NDA and NIR are proposed to be converted to performance criteria.

Structural Fiscal Reforms

Technical preparations for the implementation of structural fiscal reforms envisaged under the program are being advanced. An initial step toward the reforms of intergovernmental relations was taken with the creation, in September 2003, of a commission to coordinate proposals for a revised co-participation law, and to develop a fiscal responsibility law. In addition, an inter-ministerial working group has been created to develop guiding principles for reform of the pension system. Finally, in December 2003 Congress approved legislation eliminating all remaining competitiveness plans.

The Banking Strategy

Several measures have been taken recently to strengthen the banking system. The compensation to banks for the asymmetric pesoization (Arg$24 billion) is substantially complete, and the few pending decisions—related to auditing—on payments to banks will be taken by end-December 2003. Compensation for the asymmetric indexation (up to Arg$2.8 billion) has been approved by congress and the implementing decree will be issued promptly. The government undertakes to proceed with the completion of the placement of the compensation bonds by end-March 2004 (a structural performance criterion) rather than end-December 2003, as originally intended, for which we request a waiver. The legislation provides for individual banks to be issued government bonds. Accordingly, they will receive principal payments and be able to dispose of the bonds pari passu with new lending and refinancing, as already established in the law, while they receive interest payments independently of their lending policy. Congress also has approved the mortgage refinancing law, which should address uncertainties surrounding extended stays on creditor rights. This legislation ensures a fair solution to this sensitive social problem with only a minimal restraint on the rights of nonbank creditors, for which we request a waiver. Finally, all banks have submitted to the central bank their business and cash flow projections for the next 12 months.

The strategy to strengthen the banking system further will continue to focus on: (i) improving the policy framework for bank profitability; (ii) strengthening supervisory oversight; and (iii) developing an approach to resolving difficulties in weak banks. This strategy should allow banks to increase lending in proportion with the high liquidity they built-up in the last semester, rebuild capital through retained earnings, and create the conditions that will elicit commitments of new private shareholder capital. The central bank expects that by end-2003, the only remaining losses for the system as a whole will be attributable to the amortization of deferred losses linked to *amparos*.

Ministerio de Economía y Producción

The main aspects involved in carrying the banking strategy forward are:

- Putting in place a stable regulatory framework, including the elimination in December 2003 of temporary forbearance on the classification and provisioning of private loans and restructured loans, and the new capital adequacy rules that come into force in January 2004. These actions are providing additional incentives for banks to rebuild their capital.

- Steps to reduce impediments to financial intermediation, including through: (i) a continuing reduction in deposit reserve requirements (which have been reduced by about half over the last 12 months); and (ii) a reduction in the financial transactions tax during the first half of 2004, once Congress approves compensating revenue measures.

- Bank-by-bank analysis of multi-year business plans and cash-flow projections that include time-bound recapitalization plans in line with the scheduled increase in minimum capital requirements. These plans are to be submitted to the central bank by private and public banks by March 2004. Following on from this, the central bank will aim to reach agreement with each bank on a strategy to ensure the viability of operations, including by strengthening profitability and the capital base.

The initial step in the reforms of public banks will be to conduct due diligence examinations and strategic reviews for *Banco de la Nación* and *Banco de la Provincia de Buenos Aires*. Terms of reference have been agreed with Fund staff and the bids to conduct the reviews are to be relaunched by end-February 2004. We expect to select the consultants by end-April 2004 and to carry out the work by end-August 2004. Based on the resulting recommendations, an agreed strategy will be developed for strengthening the public banking sector by end-October 2004. In the meantime, the Superintendency of Banks will monitor the operations and adherence to regulatory standards of all public banks.

Utility Services

In line with commitments under the program, the Congress approved Law 25790 on October 1, 2003, which (i) extends the renegotiation period for the utility concessions to end-2004; (ii) gives the executive the power to renegotiate the concessions on a fast-track basis; and (iii) permits the executive to agree on amendments of the concession contracts, and to introduce temporary adjustments in the financial conditions of the contracts. A newly created Unit for Renegotiation and Analysis of Public Service Contracts, co-chaired by the Ministry of Economy and Production and the Ministry of Federal Planning, Public Investment and Services, is responsible for carrying out the renegotiation of 62 contracts. The government expects to complete the renegotiation of 54 contracts by end-June 2004, including those for electricity and gas, inter-urban roads, freight railways, urban road access ports, airports, bus terminals, water and sanitation, and waterways. The renegotiation of the remaining concessions is expected to be completed in the second half of 2004, including those for urban railways, and telecommunications. The renegotiated agreements will reflect the long term commitment of the government to supporting sustainable public-private partnerships.

The renegotiation process will require an accompanying effort to strengthen the regulatory framework and institutions. A bill has been drafted and is to be sent to Congress soon that establishes: (i) clear rules to assert the committed investments and the quality and sustainability of offered services; and (ii) effective mechanisms for the monitoring of the contracts and to allow their amendment in accordance with the evolution of services. Upon completion of the renegotiation process, the existing sectorial regulatory frameworks will regain full effect, modified to refer to the new general framework and to reflect the renegotiated concession contract. In addition, the government is preparing legislation aimed at ensuring the accessibility to, and affordability of, basic electricity, gas, and water services. Submission of legislation in both these areas is expected by end-March, 2004. The work in this area will be carried out in cooperation with the World Bank.

Corporate Restructuring and Legal Reforms

Progress has been made in corporate debt restructuring. We expect to have completed a detailed survey of corporate debt restructuring by end-January 2004, and to have developed nonstatutory workout principles for restructuring by end-March 2004. In addition, a working party reviewing the framework for corporate debt restructuring is scheduled to report by end-January 2004 on whether changes are needed in the insolvency law to support debt restructuring, and if the exemptions from the "cramdown" provision of the insolvency law need to be more limited in scope. No fiscal resources will be made available to support corporate debt restructuring.

Program Financing Assurances

The government wishes to reiterate its determination to promptly complete a comprehensive public debt restructuring consistent with the elimination of financing gaps and achieving medium-term debt sustainability. Recent steps taken toward this end are as follows:

- In September, immediately following approval of the stand-by arrangement, the broad outline of a debt restructuring proposal was announced, further details of which are posted on the website of the Ministry of Economy and Production which includes facilities for users to assess the implications of different assumptions and projections.

- Meetings were held with creditor consultative groups and financial institutions during October-December in Buenos Aires, Frankfurt, Los Angeles, New York,

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Rome, Tokyo, and Zurich to elicit their views ahead of finalizing a more detailed public debt restructuring proposal.

- In addition, expressions of interest were elicited from 15 banks (of which 12 were foreign-owned) to operate as regional managers and provide advice with regard to the modalities of the offer. Ten of the banks solicited have expressed their interest in participating, and the government is moving rapidly to conclude the selection of the banks that will help the Republic with this transaction..

Following on from the presentation outlined in Dubai, and the approach taken in the subsequent meetings, the government intends to launch a debt exchange offer that aims at attracting broad creditor support. We will be developing modalities with advisors to achieve participation in the debt restructuring as envisaged in paragraph 18 of the September 10, 2003 Memorandum of Economic and Financial Policies (MEFP). We will continue to consider the suggestions of private creditors, and will provide feedback and engage in further discussions with them, on Argentina's payments capacity, the coverage of the debt restructuring, and the design of debt instruments.

In regard to payments capacity, the government reaffirms that its position with regard to the primary surplus for 2004 and beyond is consistent with the commitment set out in paragraph 8 of the September 10, 2003 MEFP. The primary surplus contained in 2004 budget passed by Congress exemplifies our intention to fulfill the pledge made in this regard, to be continued in future years.

The government expects that, during the period of the current arrangement, relations with private creditors will be normalized permitting the eventual responsible reaccess to financial markets, and the economy and its external position strengthened. These conditions should allow a reduction in obligations to the Fund. However, discussions on policies and access under a possible successor arrangement with the Fund, if any, must wait until mid-2006 so as to benefit from a reasonable assessment of the then prevailing economic situation and prospects.

As regards debt to Paris Club creditors, we have written to the Paris Club secretariat indicating our wish and preparedness to begin debt restructuring negotiations. This process has been delayed at the request of some Paris Club members, but we would hope that negotiations can begin in March 2004.

In view of the progress made under the program, we request completion of the first review under the SBA. We anticipate that only the end-October fiscal data will be available by the time of the Board meeting for the first review, and although we expect the end-December fiscal quantitative performance criteria to have been met, we request a waiver of their applicability for the purchase associated with the review. Observance of the end-December performance criteria will remain a condition for the purchase pursuant to the Second Review under the arrangement.

Ministro de Economía y Producción

As we implement our program, we will continue to maintain a close policy dialogue with the Fund and the rest of the international community.

Yours sincerely,

/s/

Dr. Roberto Lavagna
Minister of Economy and Production

PEDRO LACOSTE
ACTING AS PRESIDENT
/s/

Lic. Alfonso Prat Gay
President of the Central Bank of Argentina

Statement by the IMF Staff Representative
January 28, 2004

1. The following information on recent developments and policy implementation has become available since the circulation of the staff paper on the first review under the Stand-By Arrangement. The thrust of the staff appraisal remains unchanged.

I. Recent Developments and Indicators

2. **Recent data point to continued rapid economic growth, rising confidence, and stable financial variables**.

- The monthly indicator of economic activity increased by 0.7 percent in November 2003, bringing the year-on-year increase to 8.7 percent. For 2003 as a whole, industrial production rose by 16.3 percent—even though production slightly fell in December—and is now about 7 percent below the pre-crisis level (Figure 1).

- According to a Ministry of Labor study, roughly 120,000 (out of a total of 2.1 million) beneficiaries of the *Heads of Household* employment support program had found formal sector jobs during 2003.

- Consumer and business confidence continue to strengthen, on the back of high approval ratings of President Kirchner (Figure 2).

- On January 19, 2004, the consensus forecast for growth in 2004 was raised to 6.1 percent (from 5.3 percent a month earlier), while the 2004 inflation forecast was slightly reduced to 7.3 percent (from 7.6 percent).

- During the month of January, the peso has traded narrowly in the range of Arg$2.86 to 2.93 per U.S. dollar; the central bank has made net purchases of about US$480 million; interest rates have continued to inch downward; and stock prices have risen (Figure 3).

II. Policy Implementation

3. **The following developments have taken place with respect to policy implementation**.

- **The end-December monetary performance criteria on net domestic assets and net international reserves of the BCRA were met with wide margins** (Table 1). At end-December 2003, the augmented monetary base was slightly below the program indicative target. On January 21, the BCRA issued the second quarterly inflation report in an effort to guide inflation expectations and lay the foundations for an inflation targeting framework.

- **The end-December 2003 performance criterion on the cumulative primary balance of the federal government was met** by a margin of about ¼ percent of GDP (taking the federal primary surplus to 2.4 percent of GDP). This outcome, together with lower-than-programmed interest payments, contributed to a 0.4 percent of GDP overperformance with respect to the end-December 2003 indicative target for the (cumulative) overall cash balance of the federal government. A waiver of applicability of the debt-related performance criterion is sought, as actual data are not yet available.

- **On preliminary data, the end-December 2003 cumulative provincial primary surplus was better than programmed by about 0.3 percent of GDP**, bringing the 2003 provincial primary surplus to an estimated 0.7 percent of GDP. Half of the 0.6 percent of GDP revenue overperformance is estimated to have been used to finance higher-than-planned capital and current primary spending. The continuous structural benchmark on the timely provision of financing data for the provinces was met with respect to the end-November data.

- **The 2003 consolidated primary surplus is now estimated at about 3 percent of GDP, or ½ percent of GDP above the program target**. The overperformance can be roughly attributed in equal measures to better-than-expected outturns for the federal and provincial accounts.

- **Additional progress has been made in finalizing the 2004 *bilateral agreements***. Thus far, 11 out of 24 provinces have signed bilateral agreements with the federal government, and four of these, which represent over 90 percent of the 2002 overall provincial deficit, have been ratified by the provincial legislatures.[1]

- **On January 23, the BCRA further eased remaining exchange controls**. The amount of foreign currency that individuals and companies can purchase without previous authorization was doubled to US$1 million per month, and the time period for importers to provide evidence on purchases of foreign currency to finance the pre-payment of imports was extended from 180 to 360 days.

4. **Certain provisions in the authorities' anti-tax evasion legislation create, in the staff's view, a new tax amnesty, thereby breaching a continuous structural performance criterion** (Box 1). The authorities do not agree that the legislation contains a tax amnesty, but is rather an arrears regularization program. In the staff's view there is an amnesty element, but this is of minor importance and, for this reason, the staff proposes that a waiver be granted. Specifically, law 25,865, which was recently introduced to strengthen the small taxpayer regime and reduce abuses, provides for a reduction of interest accrued on late payments and a waiver of penalties to encourage

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[1] The ratification of bilateral agreements by provinces representing at least 100 percent of their 2002 deficit is an end-March 2004 structural performance criterion.

these taxpayers to pay their overdue tax arrears and register to pay taxes.[2] Staff considers that this law, which was made effective on January 15, 2004, introduces many positive elements that would help reduce tax evasion and strengthen future compliance and revenues. Moreover, the scope of the tax amnesty is limited both in its duration (1 year) and coverage (the small taxpayers regime contributes only about 1 percent of federal tax revenues).

5. **On January 26, 2004 the government issued implementing regulations on the compensation to banks for losses from the asymmetric indexation of balance sheets**. As envisaged in the enabling law: (i) compensation will be in the form of a *peso*-denominated bond paying a variable rate comparable to that of banks' funding costs; and (ii) compensation will be effected in the same measure as the increase in banks' gross lending (including certain types of refinancing) since February 3, 2002. Staff is studying the implementing regulations and, particularly, the significance of the link of compensation to lending and refinancing, and its impact on different banks.

[2] Overdue interest payments were reduced by 50 percent and were capped at 30 percent of the principal value of tax obligations. Principal obligations were made payable up to five years, at an annual interest rate of up to 6 percent. Further interest rate reductions are envisaged, in the event tax arrears are paid ahead of schedule or through automatic bank debit.

Box 1. Structural Performance Criteria and Structural Benchmarks: September 2003–March 2004

I. Performance Criteria	
Continuous performance criteria	
• Nonaccumulation of arrears to bilateral and multilateral creditors.	Observed
• No new tax amnesties (MEFP ¶29). 1/	Waiver proposed
• No statute or other legal instrument will be adopted that provides a means for any involuntary suspension or other restraint of creditors rights (MEFP ¶50).	Waiver proposed
End-November 2003	
• Congressional approval of tax administration reform legislation (MEFP ¶39).	Waiver proposed (legislation approved in December 2003)
End-December 2003	
• Congressional approval of 2004 federal budget that is consistent with a primary surplus target of 2.4 percent of GDP in 2004 for the federal government (MEFP ¶12).	Observed
• All competitiveness plans to be eliminated (MEFP ¶12).	Waiver proposed (legislation passed in December, made effective from January 21, 2004)
• Finalize the compensation to banks for losses associated with asymmetric *pesoization* and indexation (MEFP ¶12).	Waiver proposed (reset to end-March 2004)
• Terminating temporary forbearance on private loan classification and provisioning (MEFP ¶39).	Observed
• Congressional approval of legislation on the framework for utility concessions (MEFP ¶45).	Observed
End-March 2004	
• The federal government and a critical mass of provincial governors to reach agreement on the principles for intergovernmental reform and fiscal responsibility legislation (MEFP ¶31)	Pending
• Federal-provincial bilateral agreements shall become effective through their ratification by the provincial legislatures representing at least 100 percent of 2002 consolidated provincial deficit (MEFP ¶17).	Pending
II. Structural Benchmarks	
Continuous	
• Provide Fund staff with monthly information on provincial government financing with a delay of less than 55 days.	October data reported with minor delay. Observed for November data
End-October 2003	
• Government to announce the scope of public debt to be restructured, the treatment of initial claims and past due interest, and the general terms of the new debt instruments to be issued in the exchange (MEFP ¶19).	Observed
End-December 2003	
• Report of working group on Insolvency Law reform (MEFP ¶48)	Proposed to be moved to end-January
End-February 2004	
• Complete selection of accounting and consulting firms to begin the strategic review of the two largest public banks (MEFP ¶38).	Proposed to be moved to end-April
End-March 2004	
• Working group charged with the design of reforms of the central bank charter to publish report containing its key findings and recommendations (MEFP ¶34).	Pending
• Launch of second tax administration reform focusing on improving customs administration and social security collections (MEFP ¶29).	Pending
• Elimination of arrears on VAT refunds to exporters (MEFP ¶13).	Arrears eliminated by end-November 2003

1/ Refers to the MEFP dated September 10, 2003.

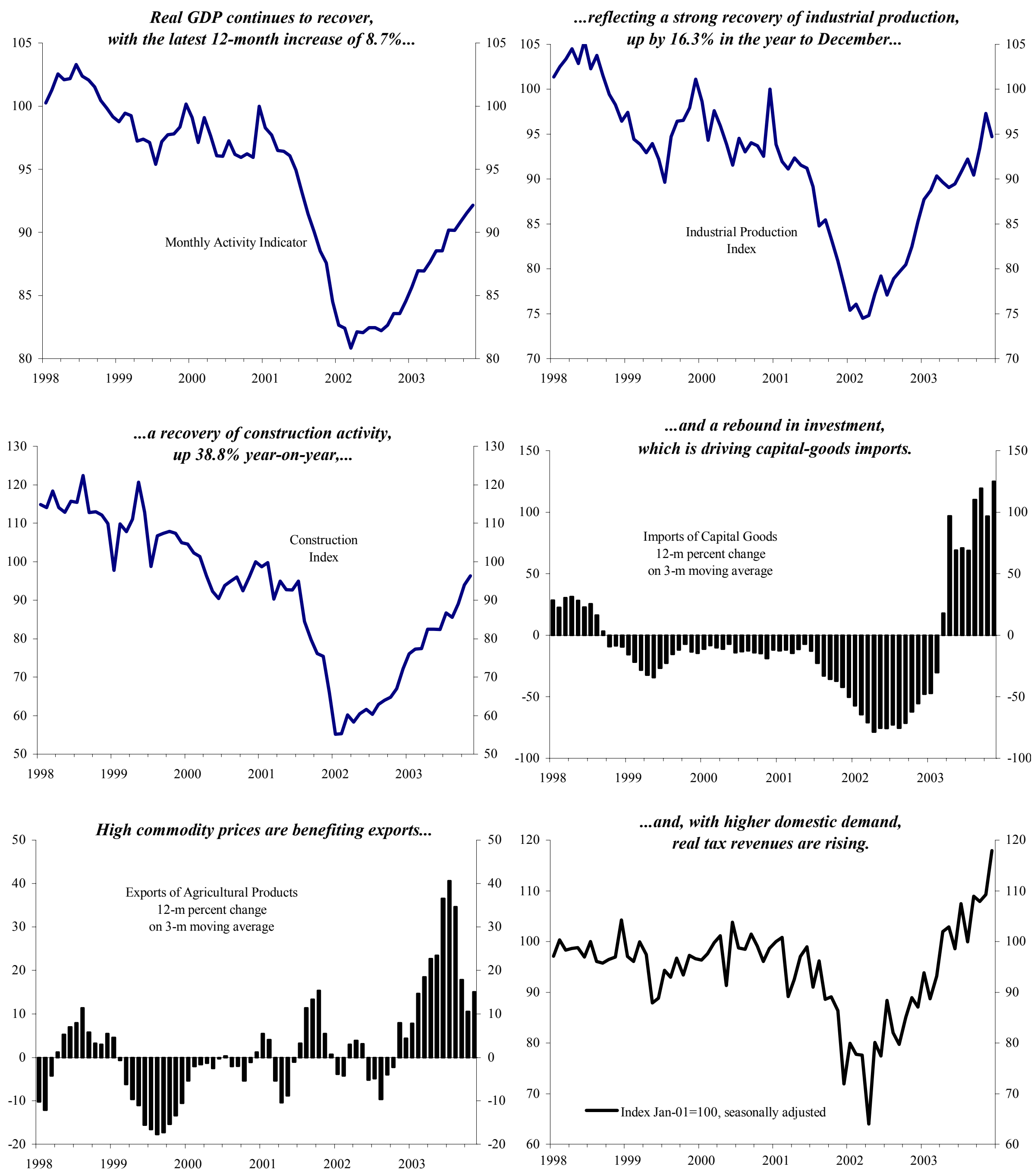
Table 1. Argentina: Quantitative Performance Criteria and Indicative Targets, 2003–04 1/

(In millions of Argentine *pesos* , unless otherwise noted)

	Actual	End-October 2003			End-December 2003			Performance Criteria		Indicative Targets	
	End-Sept. 2003	Target	Adjusted Target 2/	Actual	Target	Adjusted Target 2/	Actual	End-Mar. 2004	End-Jun. 2004	End-Sep. 2004	End-Dec. 2004
Fiscal targets											
1 Cumulative primary balance of the federal government (floor)	7,137	6,940	6,940	8,100	7,790	7,790	8,677	1,100	5,550	7,780	10,000
2 Cumulative overall cash balance of the federal government (indicative target)	1,736	600	600	2,227	350	350	1,886	-670	2,130	2,560	3,150
3 Federal government debt stock (ceiling, in billions of *pesos*) 3/	438	520	497	494	530	...	...	540	550	560	570
4 Stock of federal government arrears (indicative target)	4,625	4,590	4,590	3,965	5,000	5,000	3,786	4,170	5,070	3,970	4,660
5 Cumulative primary balance of the provincial governments (indicative target)	2,646	...	...	...	1,480	1,480	...	180	1,290	2,230	2,480
6 Consolidated public sector debt stock (indicative target, in billions of *pesos*)	494	542	519	516	552	...	...	563	574	584	594
Monetary targets											
7 Stock of net international reserves of the central bank (in millions of U.S. dollars) (floor) 3/ 4/	...	-4,500	-5,118	-4,189	-4,400	-5,060	-3,178	-4,350	-3,500	-3,300	-2,400
8 Stock of augmented monetary base (indicative target) 5/	...	44,305	44,305	44,379	47,770	47,770	46,892	46,260	49,320	49,625	53,805
9 Stock of augmented net domestic assets of the central bank (ceiling)	...	57,355	59,147	56,527	60,530	62,443	56,108	58,875	59,470	59,195	60,765
10 Consultation mechanism on projected end-2004 inflation (indicative target)											
Upper limit (in percent)	...	...	...	...	11.0	11.0	...	11.0	11.0	11.0	...
Lower limit (in percent)	...	...	...	...	7.0	7.0	...	7.0	7.0	7.0	...

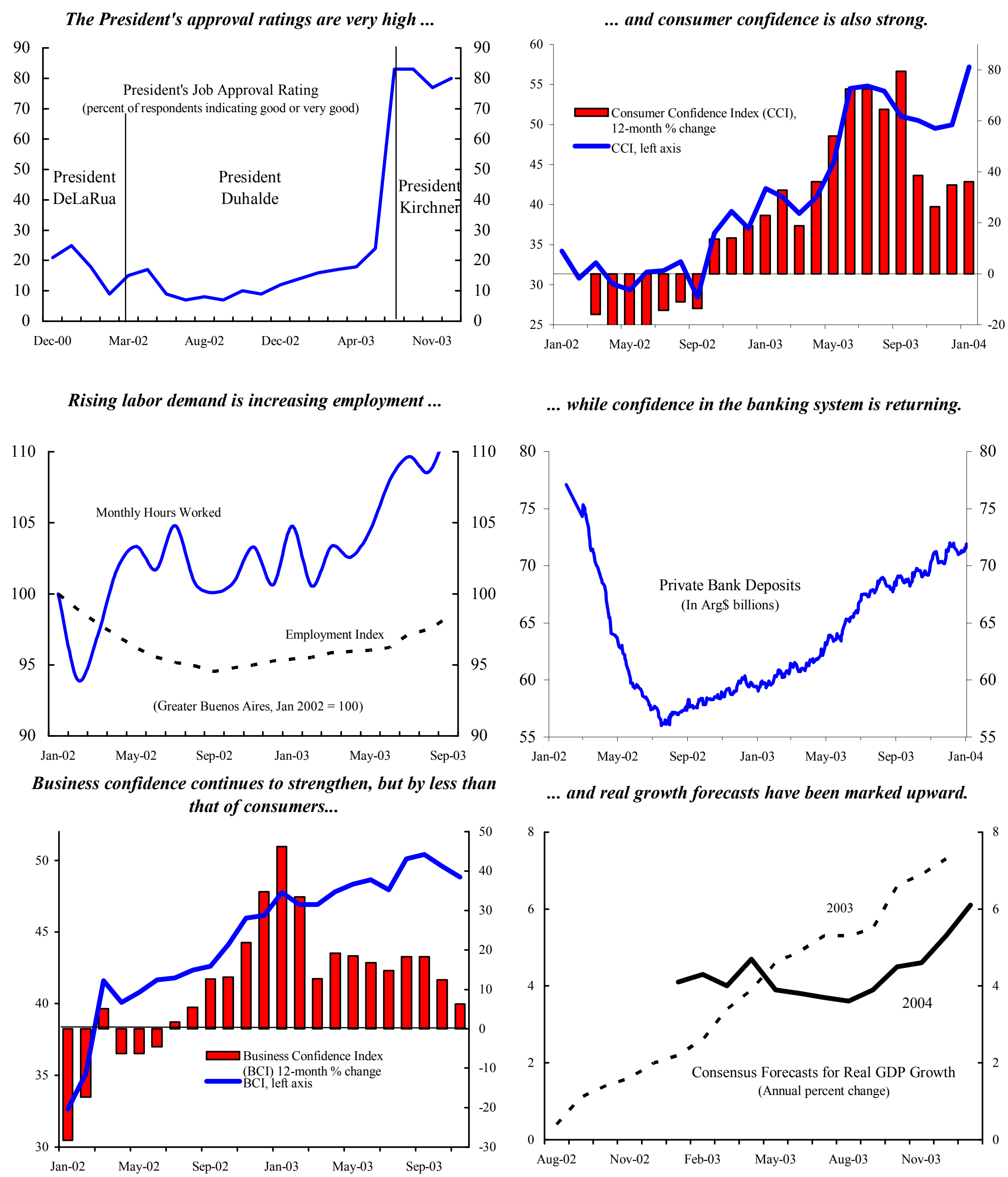
1/ As defined in the Technical Memorandum of Understanding attached to the September 10, 2003, Letter of Intent.
2/ The targets have been adjusted in line with the Technical Memorandum of Understanding.
3/ The following accounting exchange rates apply: Arg$/US$=2.9, US$/SDR=1.3875, Euro/US$=0.869, CAD$/US$=1.347, CHF/US$=1.351, JPY/US$=119.78, GBP/US$=0.604, Gold ($ per ounce)=371.0
4/ End-October GIR data exclude Uruguay bond holdings.
5/ Includes quasi-monies in circulation.

Figure 1. Argentina: Indicators of Real Activity
Index Dec-2000 = 100, except where noted



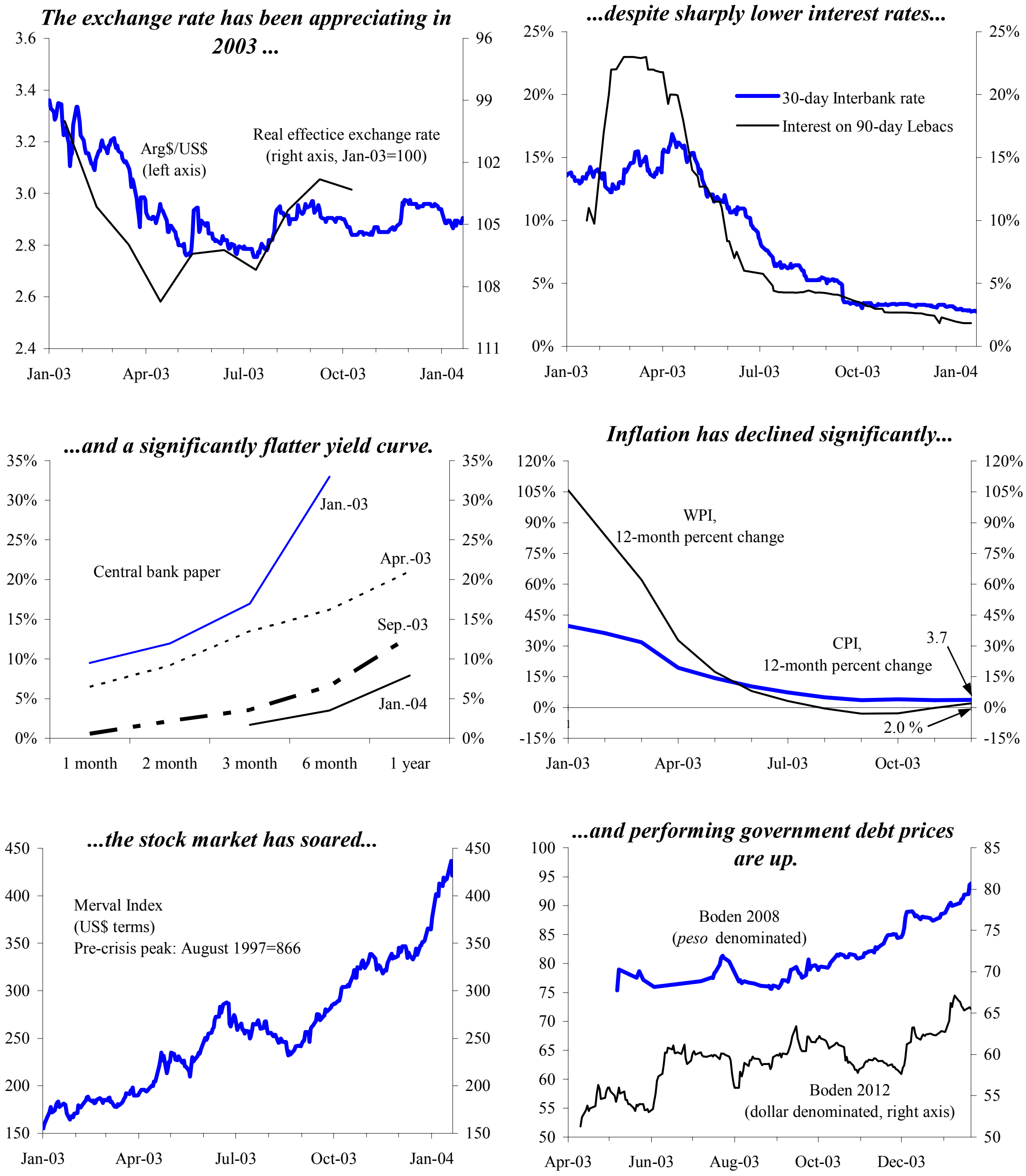
Sources: Ministry of Economy of Argentina; and INDEC.

Figure 2. Argentina: Confidence Indicators



Sources: Ministry of Economy of Argentina; INDEC; IPSOS-MORA y ARAUJO; JP Morgan.

Figure 3. Argentina: Recent Financial Indicators



Sources: Central Bank of Argentina; Ministry of Economy; INDEC; and Bloomberg.

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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January 28, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes First Review of Argentina's Stand-By and Grants Waivers

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Argentina's performance under a three-year SDR 8.98 billion (about US$13.3 billion) Stand-By Arrangement that was approved in September 20, 2003 (see Press Release No. 03/160). Completion of the review will entitle Argentina to a disbursement of the equivalent of SDR 241 million (about US$358 million).

In completing the review, the Executive Board approved waivers for the nonobservance and applicability of certain performance criteria.

Following the Executive Board discussion on Argentina, Horst Köhler, Managing Director and Chairman, stated:

"Argentina's ongoing economic recovery has been strong, with growth of real GDP expected to be at least 7½ percent in 2003. Inflation has remained low, and the unemployment and the poverty situation have gradually improved. This performance reflects disciplined fiscal and monetary policies, the strengthening of consumer confidence, as well as favorable external conditions and continued official international support.

"Federal and provincial fiscal performance has been evolving more strongly than programmed. Extending this performance and building sustainability are key objectives of the authorities under the program. In the near term, for the coming review, a key task is to develop further the reforms of the tax structure and of intergovernmental financial relations envisaged under the program.

"The financial performance of banks has also strengthened over the past year. Looking forward, the authorities intend to sustain this performance and, to this end, as envisaged in their program, should take steps that would strengthen bank capital, ensure tight prudential supervision, reduce the distortive financial transactions tax, and commence diagnostic reviews of the two largest public banks.

"The restructuring of Argentina's sovereign defaulted debt remains the most critical task for the coming period. The authorities' intention is to launch a debt exchange offer that aims at attracting broad creditor support and, toward this end, they are expected to deepen their dialogue with private creditors in order to reach a collaborative, comprehensive, and sustainable sovereign debt restructuring.

“The much improved economic outlook gives Argentina an important opportunity to put in place policies that will strengthen domestic and international confidence, thereby sustaining growth and allowing the authorities’ employment and poverty reduction goals to be achieved. The key commitments under the program relate to steps to restore fiscal sustainability, strengthen the banking system further, address the issues confronting the utilities, and build a business environment that encourages investment. It is hoped that completion of the first review will be used by the authorities as an opportunity to move forcefully forward in these areas, as well as in deepening their relations with private creditors, ahead of the second program review. The Fund continues to stand ready to help Argentina achieve these goals.

“The success of Argentina’s program will depend on good understanding and cooperation between Argentina, the Fund, and Argentina’s creditors in a spirit of mutual trust and improved communications,” Mr. Köhler said.

Statement by Jose Antonio Costa, Senior Advisor to Executive Director for Argentina
January 28, 2004

1. Argentina is facing complex challenges in dealing with its worst crisis in more than a century, linked to a large extent to the rigidities and inconsistencies of the economic policies followed during the 90s. As a result of these, 50 percent of the population is now living in poverty and many are without gainful employment, particularly a great number of youngsters which are also out of school. My authorities are focused in solving these challenges aiming at a broad social inclusion through a sustained process of equitable, non-inflationary growth and improved educational and health services. At the same time, they aim at maintaining a harmonious, predictable and mutually beneficial engagement with the international community.

2. My authorities appreciate the efforts of the management and staff and of the Directors that took a direct interest in the negotiations to bring the first review of the present Stand-By program to the consideration of the Board, with the expectation of a successful conclusion last December. It goes without saying that they would have preferred a more rapid resolution of this review, considering the close connection between the advance of the Stand-By program and that of the debt restructuring process and also of the timely financing of the economic program. The fact that macroeconomic targets of the program continue to be met with considerable margins, and that substantial progress is being achieved in the structural front, support my authorities' expectation that future reviews of the program should go smoother than this one.

3. Rather than repeating the information of the Letter of Intent, where a review of compliance with program conditionality, particularly in the structural area, is presented, and of the Staff Report, which offers all the relevant analytical and quantitative information, this buff will be limited to highlight some of the arguments underlying the thrust of my authorities' policies.

4. The strength of the economic recovery in Argentina has surprised many, including within the Fund. What in the beginning of the upturn, back in the second half of 2002, was erroneously characterized by some as an "Indian summer", has become a firm and entrenched growth trend that is now in its sixth quarter of positive strong growth.

5. Many explanations are offered, linking the extraordinary performance of the economy, with an estimated GDP growth of at least 7.8 percent during 2003, to exogenous factors, unrelated to the policy decisions taken by the authorities. The favorable external climate is usually one of them. Although my authorities are cognizant of the importance of external factors, they question the view that attaches almost all the relevance to them. In fact, positive terms of trade and low interest rates were there for other countries to take advantage of and not many performed as Argentina did. In addition, we should not forget that the slowdown in Brazil

represented a serious negative and equivalent external shock to the Argentine economy during 2003.

6. Some attribute Argentina's growth performance to the fact that it is not paying its debt obligations when in fact almost 50 percent of its debt has already been restructured and is performing. The view that negatively correlates debt service to growth prospects is at odds with the more conventional one that debt default impairs investment and growth. Although my authorities share this latter view and are keen to normalize relations with external creditors, they are also aware of the fact that debt service burdens may negatively impact on growth prospects and should be avoided, a principle that has been sustained in the Monterrey Declaration this month.

7. Another explanation that focuses on exogenous factors is the one relying on the large output gap. It is worth noting that some of those who now hold this view are the same who previously held the "chaos" and later the "Indian summer" one. They state that notwithstanding the sharp rebound in growth, GDP level is considerably below those preceding the crisis and that it is merely catching up with past performance helped by a large output gap and pent-up consumer demand. The argument continues stating that once capacity levels are reached, bottlenecks will appear leading to a slowdown in growth and even to inflationary pressures. This argument does not in fact represent much of an explanation since excess capacity was there also during the four years of recession. For the economy to start moving again you need something more than just excess capacity and even more so considering the magnitude of the rebound and the seriousness of the disruption in Argentina's social fabric that had to be overcome.

8. In addition, to affirm that the strong growth dynamics will go on only until capacity is reached is equivalent to say that no new investment will reinforce existing capacity. The latter, in turn is attributed to the frailties of the domestic financial system and the lack of external financing in the context of a delayed debt restructuring. Leaving aside for a moment my authorities' commitment to address diligently these two important issues, the fact is that investment is already revamping with important recent announcements of investment plans from both domestic and international companies. This questions the often-heard view that a sustained growth dynamic in Argentina is not achievable without previously solving a list of problems such as the two just mentioned. The solution to these issues will come hand in hand with sustainable growth, which is the overarching objective of the present arrangement with the Fund.

9. My authorities welcome the staff's acknowledgment that responsible macroeconomic management predicated on strict control of expenditures, improved tax administration and prudent monetary policy as well as the speedy market-based handling of the deposits freeze, the elimination of the quasi-monies and the maintenance of an appropriate level of the exchange rate have been important factors that supported the recovery. We should also highlight the positive impact of the greatly improved financial relations between the federal government and the provinces after the 2001

crisis, as confirmed by the excellent compliance with the bilateral agreements — so called "orderly financing programs"— during 2003. So far 11 provinces, accounting for more than 100 percent of the 2002 deficit, have already signed agreements for the present year, thus opening the way to fully meet these performance criteria on time, once the ratification process is completed.

10. Notwithstanding the key role played by the factors just listed, my authorities also want to emphasize other critical aspects that are favorably impacting, and will continue to do so, on confidence and investment decisions in Argentina. In particular, as repeatedly stressed here in the Fund and elsewhere, good governance, transparency and the rule of law are considered to be key determinants of a friendly investment climate. In this regard, the new administration of President Kirchner has made of these principles its overriding concern and critical decisions have already been taken in areas such as security, justice and tax evasion.

11. On the question of the restructuring of the non-performing debt, my authorities have stated from mid-2002 that only in the context of a medium-term program with the Fund negotiations with private creditors could be addressed in a credible way. This approach was not refuted by anyone at that time. Immediately after such a program was agreed, almost two years after the declaration of default, a general proposal was presented in Dubai and a speedy process of consultations was initiated, creditor consultative groups were created and a process to select regional manager banks to help Argentina with the transaction is about to be completed.

12. My authorities show no hesitation in adhering to the lending into arrears policy as their willingness to share information and to engage creditors in many forums confirms. Of course, the issue has now turned into the acceptability of the proposal on the part of creditors since the broad elements of the proposal, that are already known, are questioned by some. On this point, it is important not to confuse willingness to pay, on which there should be no doubt, with capacity to pay which is naturally open to discussion, particularly considering the overriding need to address the social consequences of the crisis, to ensure sustained growth and in particular to avoid creating the conditions that would undoubtedly lead to future debt restructurings. Linking payments to future growth could offer a way, in fact the most relevant way, to solve disagreements regarding payment capacity. We should not forget that the debt overhang was consistently built up throughout the 1990s, without much concern of market participants and Institutions at the time this was taking place.

13. Another element that should be kept in mind, which has been extensively discussed in the recent newspaper article written by Minister Lavagna, distributed to Directors on January 15, is that Argentina has been cut-off from private and official financing. The latter in net terms, but only after substantial net repurchases were made by Argentina at the most critical time of the crisis. My authorities do not expect to increase their payment capacity with net resources from the IFIs, but they are not in a position to repeat in the near future net repurchases to the IFIs either, as it is implicitly acknowledged by the financing structure of the several programs in place. A group of

Directors has made the observation that linking repurchases to approval of reviews is not acceptable. In this regard my authorities fully ratify the principle that approval of reviews should be linked to compliance with conditionality, and not be made liable to unnecessary delays.

14. Payment capacity is linked to the level of primary surplus, GDP growth, interest rates and the real exchange rate. Primary surplus as a percentage of GDP has taken, however, an unwarranted importance since, for other things equal, payment capacity is critically determined by GDP growth. Hence, it is not only a matter of excessive payments undermining growth prospects but, and more importantly, that low growth directly undermines payment capacity.

15. The fiscal effort Argentina is making, and is willing to continuously make, should not be viewed as low or insufficient. The level of primary surplus committed by Argentina largely surpasses its past fiscal performance. In fact, there is no recent memory of Argentina producing a primary surplus this large not even in one year, and much less so in a successive number of years. My authorities want to emphasize the fact that debt restructurings that are insufficient to recover solvency can only lead to future debt crisis, and should therefore be avoided.

16. As to the critical importance of GDP growth to determine payment capacity, there is the intention, as announced in Dubai, of offering bonds linking future payments to the evolution of GDP thus allowing creditors to participate in the benefits of the expected continued strength of growth in Argentina. Finally, on the assumed path of the exchange rate looking forward, my authorities are determined to avoid the distorted relationship of relative prices of tradeables and non-tradeables that prevailed during the Convertibility years. This should also be taken into account at the moment of formulating debt sustainability assessments.

17. Regarding Argentina's growth prospects, Annex III of the September staff paper, EBS/03/130 Supp. 1, considers the 4 percent growth a year for Argentina assumed in the medium-term macroeconomic framework, optimistic. This conclusion is reached on the basis of the much lower average growth observed during the 1968-2001 period, 2 percent. This conclusion could be questioned if we consider that Argentina has not yet been able to tap all of its growth potential. There have been important lessons that have been learned during that period which cannot help but unleash this potential in the future. In the first place, democratic institutions are firmly consolidated. Last December, 20 years of uninterrupted democratic process was reached. Most noteworthy has been the strength of the democratic institutions during the 2001 crisis and the smooth political transition observed in May 2003 when President Kirchner took office and confirmed the continuity of the present economic team that has led the recovery since mid 2002.

18. In the second place, reliance on inflationary financing of the budget is no more an alternative. The crisis unleashed in December 2001 has served, in turn, to warn against unbridled debt financing of the budget and the principle of fiscal discipline is

now overwhelmingly accepted. The 2001 crisis has also taught the important lesson that sustainable growth can only be achieved when accompanied by social equity and good governance which have come to Argentina to stay. Finally, relying mainly on exchange rate strategies as a way to stabilize the economy have also been abandoned for good in the case of Argentina.

19. The banking strategy that my authorities have consistently implemented since 2002 of giving banks time to restore their profitability and capital is showing its strength. Deposits continue to grow, credit has started to move up again, nonperforming loans have started to decline, and losses are in a clear declining trend. In addition, important progress in the restructuring of banks' external debt and new capital injections have taken place during the past year. All of this augurs well for the future soundness of the system. It should be highlighted, in particular, that the financial losses of the system are beginning to be reverted. November 2003 became the first month, after two years, in which the financial system showed profits in the aggregate. This is attributed to both an increase in lending activity and to the reduction in non-performing loans. The likelihood of consolidating this trend is high considering the liquidity available in the banks and the high pent up demand for credit both at the personal and companies levels. An upward trend of loans to the private sector is already ensuing. Particularly strong has been the growth of personal credits and a similar recovery is expected of credit to enterprises in the coming months to finance projected businesses expansions. It is also worth noting the reappearance of mortgage credits in domestic currency at fixed interest rates of around 12 percent per annum.

20. After having compensated banks for asymmetric pesoization, a presidential decree has already been issued implementing the compensation to banks for asymmetric indexation of banks' assets and liabilities, indexed by nominal wages and consumer prices respectively. Regarding this particular compensation, it is worth noting that, in the first place, it only represents a tenth of the compensation for asymmetric pesoization which is already largely completed. Second, although banks will only be able to dispose of the compensating bonds pari-passu with new lending and refinancing, this will not represent in fact a major restriction since the cut-off date to start measuring new credit will be February 2002. Third, not only new loans will be counted but also refinancing operations of existing credits. Lastly, even if a particular bank is still lagging in terms of new lending and refinancing it will still be entailed to receive interest payments for the compensating bonds allocated to it.

21. On the mortgage refinancing law recently approved and the need to request a waiver for the embedded restraint in creditor rights, it is important to clarify that such law addresses the mortgage loans that fell in default during the crisis and that were granted to sole-family home debtors valued Arg $ 100.000 or less. Taking advantage of this system will be voluntary for creditors that are financial institutions but it will be obligatory in the reduced number of cases in which creditors are not financial institutions. Thus, the extent of the restraint in nonbank creditor rights will be quite limited and will not impinge on their rights to recover, to a large extent, the value of

their financial assets. This has been conceived as an equitable solution to a serious social problem caused by the crisis.

22. The program commitment to obtain by end-march 2004 an agreement toward the reform of the financial relations between the federal government and the provinces, to be followed, later in the year, by a submission of a revised coparticipation law and a fiscal responsibility law to congress and subsequent approval by the federal and provincial legislatures has received a renewed momentum as of late. The cycle of provincial and legislative elections, completed by end-2003, afforded the federal government considerable political support to advance with this undertaking. The new legislation aims at introducing distribution criteria that will consider not only economic and social condition in different provinces but also those related with fiscal responsibility.

23. To conclude, my authorities are committed to build a competitive market economy with social justice, where transparent and consistent government policies set the basis for market participants to assume balanced risk in productive investments that ensure sustainable medium-term growth of output and employment. This is the most effective way to counter poverty and to consolidate social and political stability.