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Argentina: 2005 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Argentina

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2005 Article IV consultation with Argentina, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 12, 2005, 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 May 31, 2005. 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 supplement of June 17, 2005 updating information on recent developments.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 20, 2005 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Argentina.

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

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INTERNATIONAL MONETARY FUND

ARGENTINA

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representative for the 2005 Consultation with Argentina
(in consultation with other Departments)

Approved by John Dodsworth and G. Russell Kincaid

May 31, 2005

Consultation process

- **The last Article IV consultation was concluded on January 8, 2003**. During the Board discussion, Directors emphasized the importance of (i) establishing a robust fiscal framework; (ii) implementing a bank restructuring strategy; (iii) completing a comprehensive debt restructuring; and (iv) restoring legal certainty to catalyze new credit flows, investment and growth. Directors have returned to these issues consistently—in the course of the 14 Board meetings and 11 informal Board briefings that were held since then.

- **Main issues for the 2005 consultation**. The discussions focused on identifying factors underlying the recovery and the near-term financing and inflation risks, assessing the main vulnerabilities going forward, and identifying structural reform priorities that would be required to transform the recovery into sustainable growth and poverty reduction in the medium term. In addition, there was a broad discussion of debt sustainability and the experience of the recent debt restructuring process.

- **Staff discussions**. The staff team met with the authorities in Washington from March 14–18, April 16–18, and May 10–12 and held several videoconferences between Washington and Buenos Aires. The ground work for the discussions was laid in Buenos Aires by the resident representative office. The authorities included Minister of Economy Lavagna, Secretary Nielsen, BCRA President Redrado and other officials. The staff team comprised, at various times, J. Dodsworth (head and senior resident representative), R. Benelli, A. Cebotari, N. Chalk, L. Giorgianni, and R. Luzio (all WHD), D. Lombardo (FAD), W. Brown (PDR), C. H. Lim and M. Vera Martin (ICM) and E. Ramirez Rigo (resident representative). Mr. Singh (WHD) attended many of the meetings. An MFD technical assistance team comprising C. Pazarbasioglu (head), A. Santos, and J. Cayazzo also met with the authorities. H. Torres (OED) attended the policy meetings.

Fund support

- The current three-year Stand-By Arrangement (SBA) was approved on September 20, 2003 with access of SDR 8,981 million (424 percent of quota). Three purchases have been made totaling SDR 4,171 million. On May 18, 2005, repurchase expectations of SDR 1.68 billion arising during May 20, 2005 to April 28, 2006 were extended by one year to an obligations basis.

Exchange system

- Argentina has accepted the obligations of Article VIII, sections 2, 3, and 4 of the Fund's Articles of Agreement. Argentina maintains an exchange restriction subject to approval under Article VIII, section 2(a) arising from a freeze on reprogrammed bank deposits (the *corralón*). The Executive Board temporarily approved this restriction until the 2005 Article IV consultation. Staff recommends continued approval of this exchange restriction until September 30, 2005.

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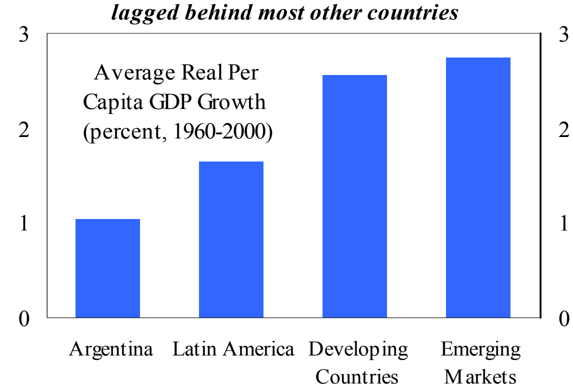
I. Background

1. **Since the last Article IV consultation in January 2003, Argentina has recovered strongly from the financial crisis that erupted in late 2001** (Figure 1). The crisis imposed severe economic and social costs but, after 2½ years of vigorous growth, real output has reached the peak level achieved prior to the crisis, labor market conditions are improving, financial markets are stable, inroads have been made in reducing poverty, and the authorities have made important progress toward normalizing relations with creditors.

2. **The 2005 Article IV consultation focuses on Argentina's emergence from crisis and the policy choices to complete this process**. Against the background of Argentina's poor long-term record of economic growth (Text Figure), the clear challenge is to maintain the economy's current momentum. The discussions, therefore, centered on identifying factors underlying the recovery, addressing key vulnerabilities, and identifying structural reform priorities to sustain growth into the medium term. In this context, there was an intensive discussion of debt sustainability and the experience of the recent debt restructuring process.

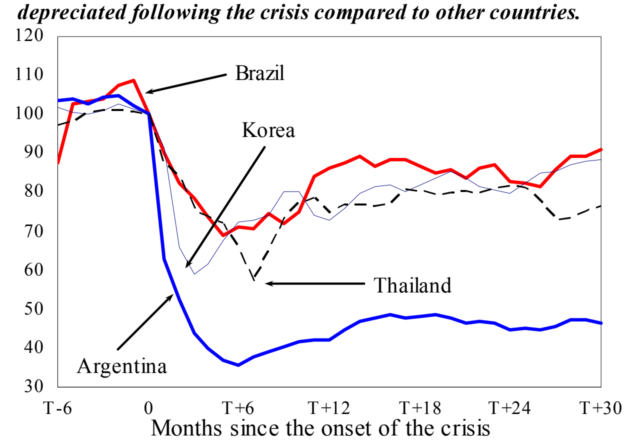
Argentina's average real per capita GDP growth has lagged behind most other countries



II. The Recovery Phase

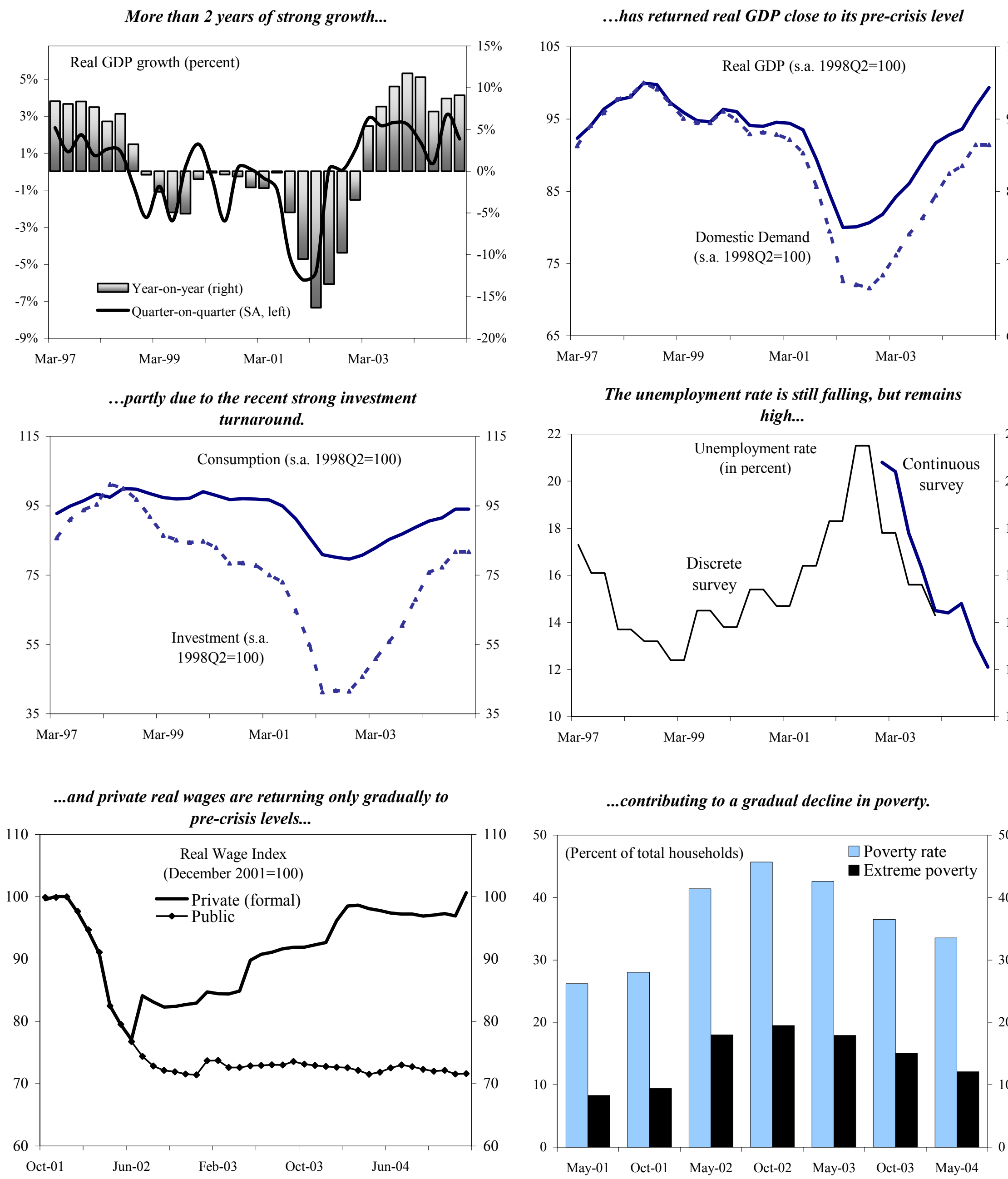
3. **The strength of Argentina's economic recovery has exceeded expectations but, in many respects, it shares similarities with recovering from other recent crises** (Figure 1 and Box 1). From early 2003, confidence rose steadily, and both private consumption and investment rebounded. Reflecting buoyant domestic demand, real GDP grew by almost 9 percent in both 2003 and 2004. Export receipts also increased—initially reflecting higher commodity prices as export volumes responded only slowly to the large depreciation—while imports grew, but remained below pre-crisis levels. International reserves began to recover, and bank deposit and external payments restrictions were progressively dismantled. The robust recovery in money demand, contrary to most expectations, was a key aspect of the recovery. In contrast to some other countries emerging from crisis, inflation—after spiking in 2002—remained very moderate (reaching only 3¾ percent in 2003 and

Argentina's real effective exchange rate has remained highly depreciated following the crisis compared to other countries.



6 percent in 2004) despite the almost 300 percent depreciation of the currency. In part, this was a result of a freeze on public service prices. Given the softness of labor markets, real wages recovered only slowly and, unlike several other crisis countries, the real exchange rate remained at a highly depreciated level (Text Figure).

Figure 1. Recovery from the Crisis



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

Box 1. Cross-Country Comparison of Recoveries from Capital Account Crises[1]

The impact of the financial crisis on Argentina's economy shares similarities with that of other countries that faced large capital account crises in the last decade, although the adjustment path has been different in a few aspects (see Box 1 Figure below):

- **Large exchange rate depreciations,** both in nominal and real effective terms. While in most countries the real effective exchange rate recovered gradually the real depreciation in Argentina has proved more persistent. By end-2004, Argentina's real effective exchange rate was still over 50 percent below its pre-crisis average.

- **Sharp drop in real GDP after the currency crisis, followed by a strong rebound in activity**. While the drop in real GDP in Argentina was similar to that in Korea, Thailand and Turkey, its recovery was somewhat slower than in these countries (except Thailand).

- **Sizeable current account corrections.** Following the depreciations and the declines in economic activity, imports contracted strongly. In most countries there was also a strong export response, which contributed to large current account reversals and drove the initial stages of the recovery. In Argentina, by contrast, export volume growth has been sluggish, despite the relatively large real exchange rate depreciation, the favorable terms of trade and the strong growth experienced by its trading partners. This reflects Argentina's lower degree of openness and concentration on commodity and agricultural exports, but also the distortions created by the export taxes.

- **Large fiscal consolidations**. In all the countries considered—except Korea and Thailand, where the headline debt-to-GDP ratios were very low prior to the crisis—fiscal policy had to be tightened considerably in the aftermath of the crisis either to correct pre-existing imbalances or to bring down debt ratios following their dramatic increases on the back of large exchange rate depreciations.

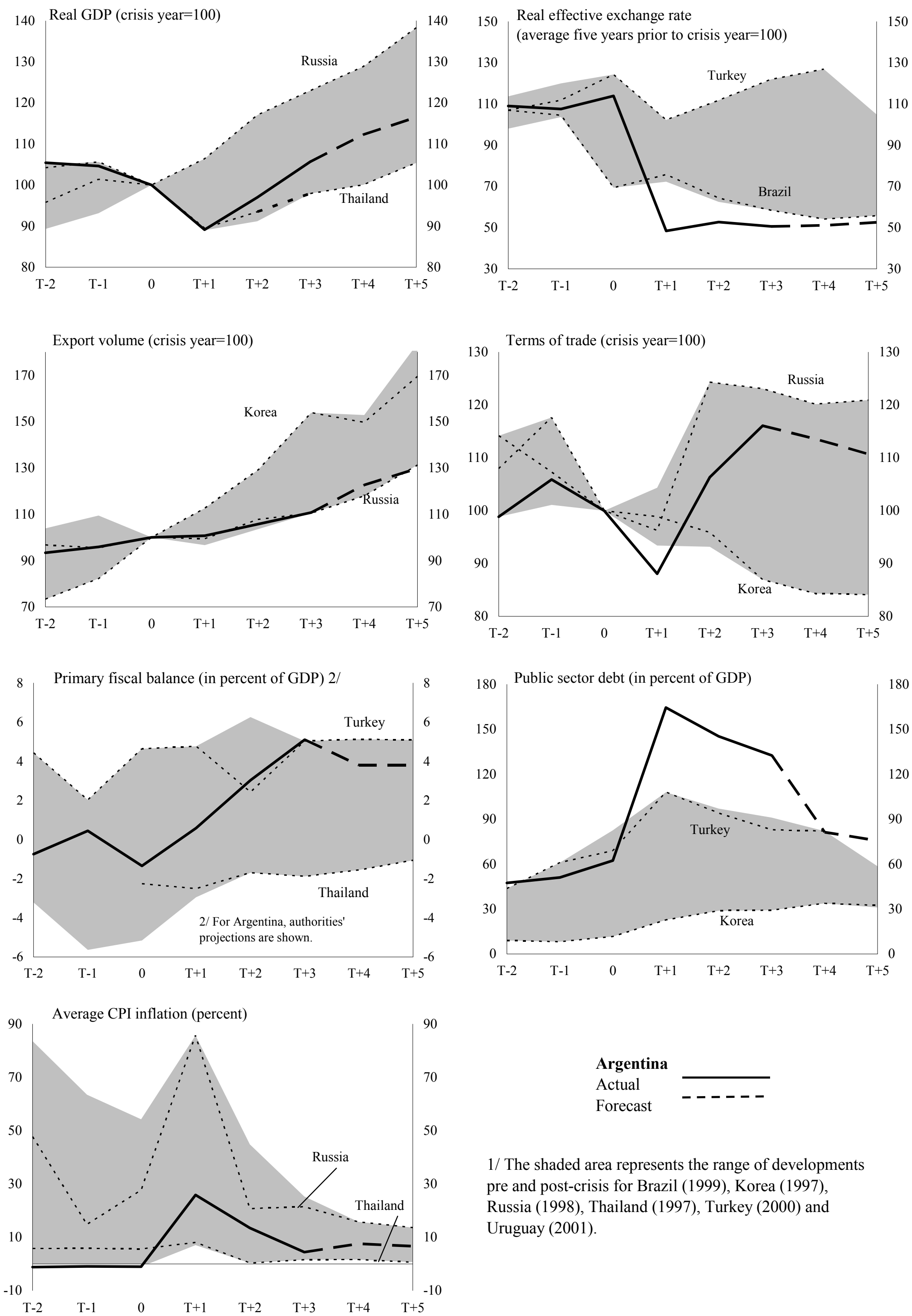
- **Banking crises accompanied the currency crises** (except in Brazil), as banks carried unhedged foreign exchange exposures to the government or nontradable sectors with local currency earnings.

- **Inflation.** Unlike in some other countries emerging from crisis, inflation remained moderate in Argentina after spiking in 2002, despite the almost 300 percent nominal depreciation of the currency.

Argentina's recovery, in contrast to some other countries, has benefited from strong terms of trade. While the large improvement in the terms of trade in the aftermath of the crisis has helped Argentina to sustain its recovery and strengthen its fiscal position and external balance, other countries' recoveries took place against weakening terms of trade, with Russia and—to a lesser extent—Uruguay being notable exceptions. The reliance of the recovery on favorable terms of trade underscores the need for Argentina to advance structural reforms which would provide a firmer foundation for continued macroeconomic stability and robust growth and boost external competitiveness, especially in a less supportive external environment.

[1] The comparisons are made by focusing on the behavior of selected economic variables around the time of the crises in Argentina, Brazil, Korea, Russia, Thailand, Turkey, and Uruguay. In the figures, time is rescaled by defining year *T* as the year when the crisis erupted, year *T+1* as the first post-crisis year, and so on. The crisis years are 1997 for Korea and Thailand, 1998 for Russia, 1999 for Brazil, 2000 for Turkey, and 2001 for Argentina and Uruguay.

Box 1. Figure: Cross-Country Comparison of Selected Indicators 1/

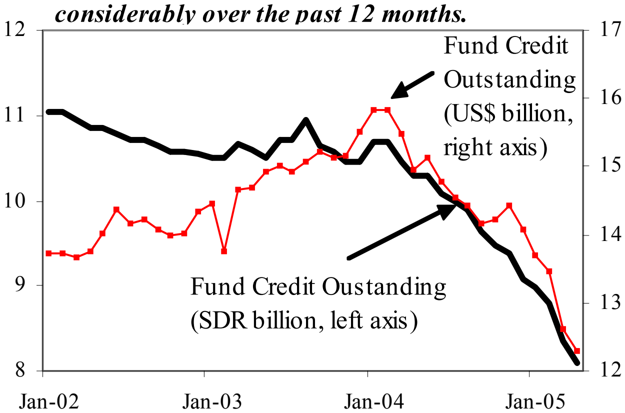


1/ The shaded area represents the range of developments pre and post-crisis for Brazil (1999), Korea (1997), Russia (1998), Thailand (1997), Turkey (2000) and Uruguay (2001).

4. **The recovery was supported by a combination of political stability, prudent macroeconomic policies, and favorable external conditions**. The smooth political transition following the May 2003 presidential elections was critical. President Kirchner, while only receiving 22 percent of the national vote in the first round of the elections, quickly gathered exceptionally high approval ratings and popularity. In his public statements, he gave prominence to the mistakes of the 1990's, to human rights issues, to denouncing corruption and vested interests, and to the government's support for labor groups, pensioners, and the unemployed. At the same time, the firm implementation of fiscal and monetary policies was key to rebuilding consumer and business confidence. These helped stabilize financial markets and allowed a steady reduction of interest rates. Domestic confidence was further bolstered by the unwinding of restrictions on bank deposits, the lifting of exchange controls, and the redemption of federal and provincial *quasi-monies*. Argentina also benefited from a supportive external environment, including an improvement in the terms of trade (by 10 percent during 2002–04) largely reflecting higher prices for key export commodities, robust economic activity in Argentina's main trading partners (especially Brazil), and low world interest rates. The nominal bilateral exchange rate against the dollar has remained within a 7 percent range since the first quarter of 2003.

5. **Social indicators began to improve from end-2002 at a steady, but gradual pace** (Box 2). The headline unemployment rate fell to about 13 percent in March 2005 from 17.8 percent in December 2002, though an additional 4.1 percent of the labor force was employed under emergency social assistance programs. The share of the population living in extreme poverty fell to 17 percent in June 2004 (from 24.8 percent two years earlier), while the share of the population below the poverty line declined from a peak of 58 percent to 44 percent in June 2004.

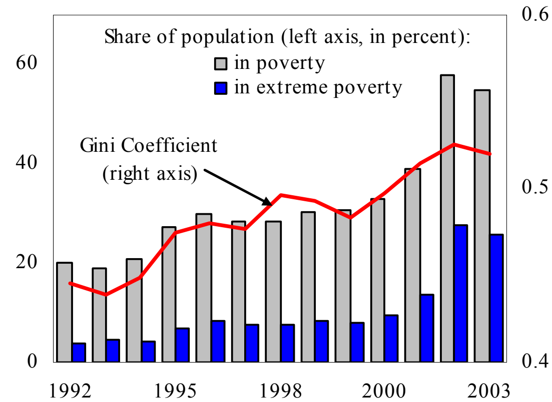
Fund exposure to Argentina was reduced considerably over the past 12 months.



6. **The recovery was helped for some time by net financial support from the international community, as well as by nonpayment to private creditors** (Table 2). After increasing its exposure to Argentina by almost SDR 8 billion during 2000–01, the Fund agreed to support the authorities' economic program by approving two arrangements in 2003 that aimed to maintain exposure to the Fund broadly unchanged. The other IFI's also agreed on the objective of maintaining their exposure. However, since the failure to complete the third review of the three-year Stand-By Arrangement, the authorities have been making sizeable net debt service payments to the Fund. Since 2003, Argentina has made net principal payments to the Fund of SDR 2.4 billion (about US$3.7 billion) and paid charges of SDR 0.9 billion (about US$1.3 billion). In the same period, net debt service to the World Bank and IDB has amounted to US$3.1 billion. In regard to other debt obligations, significant breathing room was provided by the

long interruption in payments on private and official bilateral creditors that resulted in an accumulation of arrears of about US$40–45 billion during 2002–04.

Box 2. Impact of the Crisis on Social Indicators[1]



Argentina's social indicators were already deteriorating for some time prior to the financial crisis. Unemployment rose from 6.3 percent in 1992 to 18.3 percent in 2001, partly as a result of a structural increase in female labor market participation. At the same time, the percentage of the population below the official poverty line almost doubled (from 19.9 to 38.8 percent) and income inequality increased.

The 2001-02 crisis exacerbated the social situation. Poverty peaked at 58 percent of the population and the incidence of extreme poverty doubled, mainly due to a further spike in unemployment and a 31 percent contraction of real household incomes.

The recent economic recovery has brought some alleviation, but it will take considerable time before the social dislocations can be fully reversed. While unemployment has fallen by 6.2 points from its peak—and is now at 1998 levels— poverty still remains well above pre-crisis levels.

The government has responded to the crisis by expanding its social safety net, including through the introduction of the Unemployed Heads of Household program (PJD). The PJD provides a monthly transfer of Arg$150 to unemployed heads of household with children under 18 years, in exchange for their participation in training or community development activities. The program has had a cost of ¾ to 1 percent of GDP per year over the last 3 years and serves some 1.6 million beneficiaries (around 20 percent below the peak in May 2003).

The latest World Bank assessment is broadly supportive of the PJD but suggests a progressive transformation of the program. Monitoring and internal controls have been strengthened and the program seems to be reasonably well targeted—75 percent of beneficiaries are below the 40th income percentile—although there is room for improvement (8 percent of program recipients are in the richest 40 percent of the population). The government is now working with the World Bank and IDB on a gradual exit strategy from the PJD which would transfer some beneficiaries to other social programs and would also expand training and job search support to allow the remaining program participants to transition to the labor market.

[1] This box draws on Leonardo Gasparini, "Monitoring the Socio-Economic Conditions in Argentina," January 2005 (which is, in turn, based on the Permanent Household Survey).

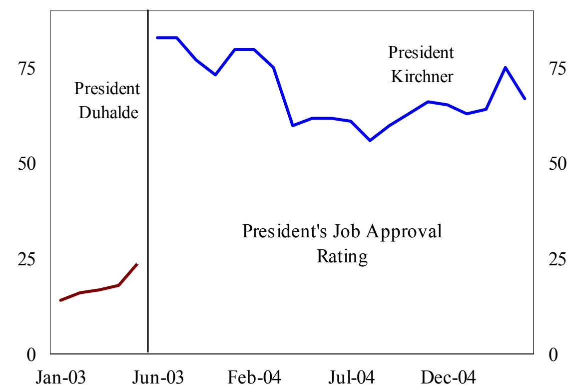
III. Recent Political and Economic Developments

A. Political Developments

7. **Two years after his election, President Kirchner's popularity ratings remain high**. The ratings have benefited from a generally tough line taken with foreign investors and multilateral institutions on a number of policy issues including the debt exchange, the renegotiation of utility concessions, and bank compensation. After initial attempts to build

his own political base by reaching out to the left-of-center wing of Congress, President Kirchner has more recently focused on broadening his power base within the traditional *Peronist* party through alliances with provincial governors. The coming period is likely to be devoted to galvanizing support for candidates in the congressional elections to be held in October 2005. A clear victory for his own candidates would help secure President Kirchner the *Peronist* party's presidential nomination for 2007.

President Kirchner's popular support remains high

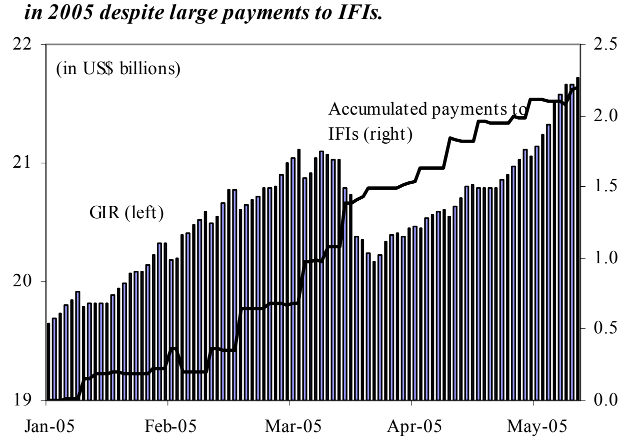


B. Macroeconomic Developments

8. **Economic conditions have remained generally favorable during the first part of 2005**. Growth has continued to be strong in the first quarter (estimated at about 9 percent year-on-year) and consumer and business confidence indicators remain at very high levels. Inflation, however, has accelerated amid rising demand, tighter capacity constraints, growing wage pressures and monetary accommodation; consumer prices rose by 4.5 percent during the first four months of 2005, bringing the annual inflation rate to 8.8 percent in April.

9. **A strong trade balance and a significant reduction in private capital outflows have facilitated a sharp rise in international reserves** (Table 3 and Box 3). The trade surplus has been declining, but is still substantial (an estimated US$2.3 billion in Q1, 2005). Export volume growth has finally begun to pick up and commodity prices generally remain favorable. There has been a decline in private sector capital outflows and some incipient signs of recovery in net foreign direct investment. Despite large net debt service payments to the IFIs, gross reserves have increased to nearly US$22 billion and net reserves are about US$4.8 billion under the program definition (Tables 4 and 5).

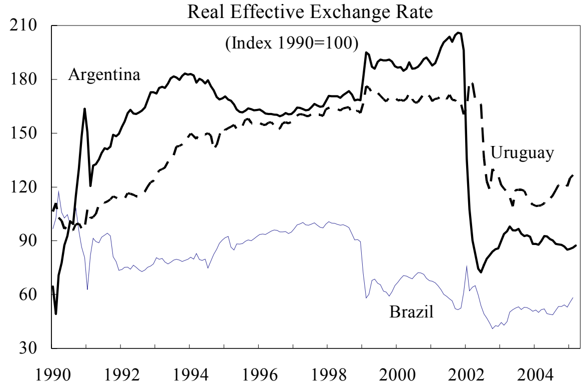
Gross international reserves have risen over US$2.2 billion so far in 2005 despite large payments to IFIs.



Box 3. Export Performance and Competitiveness

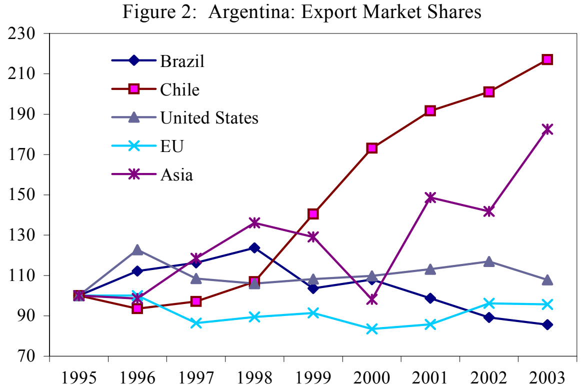
The correction that occurred after the floating of the currency in early 2002 has placed the Argentine *peso* in a range that is broadly consistent with other currencies in the region (Figure 1). Over the last few decades, Argentina's real effective exchange rate has been extremely volatile, which makes precise estimation of the equilibrium real exchange rate difficult. However, the correction in the Argentine Peso – which is currently at 50 percent of its peak prior to the devaluation of the Brazilian Real - has been larger than that of both the Real and Uruguayan Peso, which are at 60 and 70 percent of their pre-crisis peaks respectively. Moreover, since early 2004 the BCRA has actively intervened to maintain a stable nominal exchange rate, while both the Uruguayan Peso and Real have appreciated against the dollar. All this would suggest the current value of the Argentine Peso is competitive, and may even be somewhat undervalued.

Figure 1. Argentina, Brazil and Uruguay: Real Effective Exchange Rate



The response of total exports to the large currency depreciation has nonetheless been moderate, but this is due to a number of factors which have constrained the supply side. Poor harvests contributed to negative volume growth on average for 2002–04 for primary products (Table 1). Export taxes discouraged investment and increases in production. The banking sector crisis may have also constrained financing for investment, particularly for smaller producers dependent on domestic finance. Finally, government actions to secure domestic energy supplies have contributed to negative volume growth for energy exports, despite increases in international prices over this period.

Figure 2: Argentina: Export Market Shares



Volume growth in manufactured exports has been more robust. Volumes of agro-industrial products grew 11 percent each year on average over 2002–04, and immediately rebounded following the devaluation with growth of almost 15 percent in 2002 alone. The volume growth of industrial exports has averaged 14.5 percent each quarter from 2003-Q2 to end-2004, and preliminary data for 2005 show this trend is continuing. Available data on market shares of Argentine exports show a more mixed picture, although these data do not yet include information for 2004 (Figure 2). The large increases of market shares in Asia and Chile were largely due to a new pipelines for hydrocarbon products (Chile) and increased agricultural exports (Asia), and do not necessarily reflect improved competitiveness.

Table 1: Export volume growth rates

	2000	2001	2002	2003	2004
Total exports	2.7	4.3	0.7	5.0	6.6
Primary products	5.3	16.0	-11.6	5.9	-1.4
Agro-industry	-4.5	-6.6	14.9	9.4	9.9
Manufactures	14.3	4.6	-4.6	3.0	15.0
Fuels	-6.3	15.9	1.5	-6.9	-7.2

Source: Argentine authorities

In conclusion, while the current exchange rate level appears competitive, long-term export growth will require steps to remove supply side constraints. Because total exports are still relatively small (23 percent of GDP), a sustained and stable contribution of net exports to real GDP growth will depend on continued high volume growth rates. These, in turn, will require further measures, including the phasing out of export taxes, to entrench a supportive climate for exports and investment in the export sector.

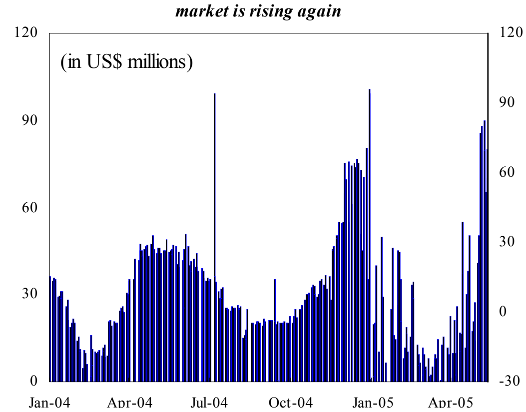
C. Fiscal Policy Developments

10. **Fiscal policy is targeted to become more expansionary in 2005** (Tables 6–9). The good performance in 2004 (when a record 5.1 percent of GDP consolidated primary surplus was achieved) mainly reflected buoyant revenues—that rose to 29 percent of GDP, from 26 percent in 2003. Tax administration has been strengthened, and VAT and income taxes have performed well. However, there continues to be a high reliance on distortive taxes (export and financial transactions taxes) which account for some 4 percent of GDP of revenues. The primary surplus would have been higher in 2004 but for an acceleration in social and capital spending toward the end of the year that resulted in end-year expenditures exceeding original budget targets by considerable margins. The approved budget for 2005 aims for a consolidated primary surplus of 3.8 percent of GDP on a cash basis. As in the previous year, however, the outcome may be significantly higher; during the first quarter of 2005, the federal primary surplus was 0.8 percent of annual GDP and in line with the 2004 outcome, representing an overperformance of 0.2 percent of GDP compared with the authorities' own program.

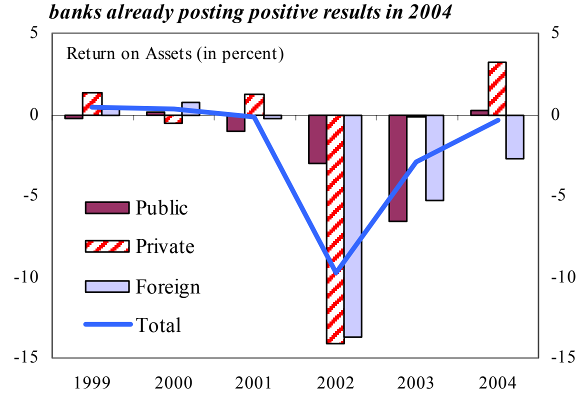
D. Money and Banking Developments

11. **Monetary policy is moving toward a tightening phase**. Toward the end of 2004, monetary growth accelerated as a result of large unsterilized interventions in the foreign exchange market. Since January 2005, however, there have been efforts towards a tightening of policy. This year, the central bank has increased its policy interest rates on three occasions by a total of 125 bps, bringing the repo rate to 3.75 percent. In addition, the BCRA has increased steadily the interest rates it pays on short-term Lebacs, albeit from very low levels. Renewed foreign exchange interventions in April and May, however, have led to an increase in base money by 9 percent in April year-on-year. During the first four months of 2005, there were also significant purchases of dollars by Banco Nacion on behalf of the government. As a result of this intervention, the *peso* has continued trading against the dollar in a narrow range of Arg$2.9–3.0 per U.S. dollar. In addition, to contain speculative inflows, the Central Bank extended the existing capital control on inward investment from 180 to 365 days.

Central Bank intervention in the foreign exchange market is rising again



Banking sector profitability is recovering with domestic banks already posting positive results in 2004



12. **The profitability of the banking system has improved** (Text Figure). Bank losses fell to Arg$0.5 billion in 2004 (from Arg$5.4 billion in 2003) as private sector credit grew briskly

(albeit from a low base) and interest rates remained low. Private sector deposits have grown, though at a slower pace than government deposits held at the public banks.

E. Sovereign Debt Restructuring

13. **Argentina's global debt exchange offer was launched in January 2005** (Box 4). The offer sought to exchange US$82 billion of eligible claims for three types of bonds (par, quasi-par and discount) and a detachable GDP-linked warrant.[1] The decline in emerging market spreads in the last part of 2004 increased the valuation of the offer to 32 *cents* per US$ of principal claims, implying a NPV haircut of around 75 percent of total claims, including past due interest. The authorities indicated that this would be a final offer and, on February 9, Congress passed legislation prohibiting the executive branch from reopening the current debt offer or reaching private settlements with nonparticipating creditors. The exchange offer period closed on February 25, and, the authorities announced a 76 percent participation level. On this basis, approximately US$20 billion in principal in default remains outstanding, in addition to an estimated US$6–7 billion in interest arrears as of May 2005. The settlement of the debt exchange, which was delayed because of attempts by some nonparticipating creditors to attach the tendered bonds through court action, is now moving ahead.[2]

F. Progress in Structural Reforms

14. **There has been little progress on structural reforms committed to under the SBA supported program** (Box 5). In the area of fiscal structural reforms, a fiscal responsibility law was approved in August 2004,[3] and some progress has been made in tax administration reforms. In the banking area, compensation payments are being gradually effected, and the due diligence and strategic review of Banco Provincia has been completed. In the area of utilities, a regulatory framework draft law submitted to congress has important shortcomings,[4] the wholesale gas and electricity prices have only been partially adjusted, and there continue to be difficulties in reaching long-term agreements with concessionaires, particularly in the electricity, gas, and water sectors.[5] Finally, an arbitration tribunal

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[1] The offer excluded past-due interest accrued after the date of the default; staff estimates that inclusion of this would increase total claims to US$106-107 billion as of end-2004.

[2] See Chapter IV in the selected issues paper for a fuller account of the debt exchange.

[3] Staff believe that the law itself has several weaknesses. See Section VI, A, below, and Chapter II in the selected issues paper.

[4] The World Bank and other interested parties have commented on the draft law and find that it would not be consistent with high private sector participation in these sectors. See Chapter III in the selected issues paper.

[5] Only 14 contracts of 63 have been renegotiated. Moreover, the systemically important contracts of energy, telecommunications and water companies are still pending a solution. See Chapter III in the selected issues paper.

constituted under the rules of the International Center for the Settlement of Investment Disputes (ICSID) awarded damages in mid-May amounting to US$133 million, plus interest, in favor of a shareholder in an Argentine privatized gas transportation company. The Tribunal found that through the *pesoization* and freeze on gas tariffs, Argentina had violated the protections accorded to the investor under the U.S./Argentina bilateral investment treaty.[6]

Box 4. The Argentine Debt Exchange

After three years in default, the authorities launched their global debt exchange offer on January 14, 2005 with roadshows in the United States, Europe, and Japan. The offer proposed the exchange of US$82 billion of eligible claims (excluding past due interest accrued after end-2001) in 152 different securities for three new types of bonds (par, quasi-par, and discount instruments), each security with a detachable GDP-linked warrant. At the time of exchange, the offer was valued at 32 *cents* per US$ of principal claims, implying an NPV reduction (including past due interest) of around 75 percent (using a discount rate of 10 percent). Prior to the exchange's conclusion, congress passed a law prohibiting the executive branch from reopening the debt offer or from reaching private settlements with nonparticipating creditors.

The exchange closed on February 25 with a participation rate of 76.15 percent. The authorities announced that US$24 billion were tendered within Argentina and US$38 billion from abroad. Despite this participation rate, residual principal in default of US$20 billion and estimated past due interest of US$6–7 billion as of May 2005 –believed to be held mostly by nonresidents–remain unresolved.

The debt restructuring improves Argentina's debt structure, and provides considerable debt relief. As a result of the exchange, the authorities announced that the stock of federal government debt declined from 148 percent of GDP in December 2002 to 72 percent in April 2005, although this figure does not take account of the debt in default which amounts to around 15 percent of GDP (including past due interest). Furthermore, the cash flow of the new bonds is greatly back loaded, thus, improving the debt service profile. The exchange leaves 37 percent of the federal government debt stock (excluding unrestructured debt in default) denominated in pesos, a sizable increase from just 3 percent before the restructuring.

Settlement of the exchange, originally to begin on April 1, was delayed because some nonparticipating creditors sought to attach the bonds that were tendered in the exchange. Although the court upheld Argentina's arguments that the tendered bonds were still the property of the bondholders and lifted the attachment orders, the judge stayed his decision, leaving these bonds frozen pending determination of the plaintiff's appeal. The Court of Appeals ruled in favor of Argentina on May 13, and settlement is now moving ahead.

[6] There are, additionally, around 30 pending cases brought against Argentina by foreign investors, mainly in the utilities sector, under the arbitration rules of ICSID.

Box 5. Structural Policy Implementation Under the Fund-Supported Programs

In the area of structural policies, there has been little progress in implementing the reform agenda envisaged under the stand-by arrangement.

- **Fiscal structural reforms.** Some progress was made in modernizing tax administration, but the government was unable to gather consensus to reform the intergovernmental revenue sharing system, and fiscal responsibility legislation was passed that contained several weaknesses. Two tax amnesties were approved despite explicit program commitments to the contrary and the export tax on oil products increased. While the government did allow for partial cross-crediting of the financial transactions tax against the income tax, this practice has significant administrative costs and was therefore less desirable than a straight reduction.
- **Banking reforms.** Compensation to banks for losses from asymmetric *pesoization* and the indexation of balance sheets proved to be contentious.[1] Despite last October's Supreme Court decision in favor of the constitutionality of the *pesoization*, the situation regarding bank losses from court injunctions (*amparos)* is still unclear. After many delays, the strategic review and due diligence of one public bank has been completed, but there has been no progress in respect of the largest public bank.
- **Utility sector reform.** The program aimed to put in place a sound regulatory framework and complete the renegotiation of long-term contracts with concessionaires by end-2004. Instead, a public services law was submitted to Congress in August 2004 that contains important shortcomings, and there have been no agreements so far on long-term contracts with some of the largest utility companies. The government continues to be reluctant to countenance tariff increases for consumers.
- **Debt restructuring**: Negotiations with private creditors were not constructive for the most part, and the authorities did not take precautions, such as the steps laid out in the March 2004 Letter of Intent to avoid a piecemeal approach (i.e., by setting an appropriate minimum participation threshold).[2] Recent legislation prohibiting the reopening of the exchange by the executive branch could hinder the resolution of the remaining arrears with private creditors.

[1] Some banks dispute the authorities' assessment of compensation for asymmetric *pesoization* and the methodology to calculate the compensation for asymmetric indexation.

[2] The authorities met with domestic and foreign creditor groups in March–April 2004, but these meetings were of procedural nature and not followed up by substantive negotiations.

IV. Macroeconomic Outlook and Risks

15. **While staff broadly agreed with the authorities' macroeconomic outlook for 2005, the central bank's inflation target range appears unlikely to be achieved on the basis of current policies**.

- **Growth is expected to decelerate to 6–7 percent in 2005 as capacity constraints are reached**. There is, however, some upward potential to this forecast,

Main Macroeconomic Aggregates (2003-07)

	2003	2004	2005	2006	2007
Real growth (percent)	8.8	9.0	6.2	3.8	3.6
Inflation (eop, percent)	3.7	6.1	10.0	8.0	7.0
Current account (percent of GDP)	10.2	5.8	1.0	-0.2	-0.6
Gross international reserves (US$ bn)	14.1	19.6	20.7	22.1	20.3
Terms of trade (percent change)	8.9	-0.6	-6.8	-3.0	-3.1

given the high carryover from 2004. The authorities noted that consumption was still strong, export volumes were rising, and that recent investments in machinery and equipment would increase potential output. The authorities believe that recent higher export volumes reflect the government's policy to maintain a competitive exchange rate.

- **The authorities have a more sanguine view on inflation than staff as they expect to meet the central bank's target range of 5–8 percent under current policies.** Staff were of the view that meeting the target would require an immediate tightening of macroeconomic policies, in the absence of which, inflation would likely reach double digits during 2005.[7]

- **It was agreed also that the external position would remain strong and further accumulation of international reserves may be possible in 2005**. A further increase was, however, not assured as the current account surplus was expected to gradually decline as a result of higher imports and interest payments. Scheduled IFI amortization payments were also substantial during the remainder of the year.

16. **The main risk to the near-term outlook is that inflation is not contained.** As described in greater detail in Section V below, the authorities will need to take macroeconomic policy measures to ensure that price rises are curbed during the second half of 2005. In a number of sectors, particularly in energy and manufacturing, capacity constraints are becoming more evident. In this situation, failure to have in place appropriate macroeconomic policies risk giving rise to a wage-price spiral that could weaken Argentina's competitiveness and undermine prospects for a smooth deceleration from the high growth rates of the recent past.

17. **On the medium-term outlook, with an appropriate policy framework, growth could potentially average 3 percent, with inflation gradually declining, and the real exchange rate appreciating** (Table 12).[8] While the authorities and staff broadly agreed on a set of medium-term projections, there were clear differences on the underlying policy requirements and risks involved in the scenario. Staff emphasized that achieving the baseline growth forecast would require a sizable contribution from private investment, including from foreign sources, and that this was unlikely to materialize under current policies. In the staff's view, the main risks for the medium-term outlook (which are described more fully in Section VI below) are: (i) macroeconomic stability could be undermined by lack of progress in institutional structural reforms, especially in the area of intergovernmental relations;

[7] The May-2005 market consensus forecast for end-year inflation was 10 percent.

[8] The projected long-term potential growth rate is consistent with net capital accumulation of 3–3½ percent, labor input growth of about 1 percent, and total factor productivity growth of 1-1½ percent per year. Potential growth estimates are, however, subject to a significant degree of uncertainty due to the high volatility of Argentina's past economic performance. For a further discussion see Chapter I of the selected issues paper.

(ii) competitiveness could be weakened without productivity-enhancing structural reforms, necessary tax policy changes, and a strengthening of the financial system; (iii) investor confidence could be undermined by concerns over the business environment, legal uncertainty, and state intervention; and (iv) capacity constraints could develop in certain sectors, particularly in the energy sector if there is insufficient private sector investment in gas and electricity distribution and generation.

18. **Staff contended that without adequate policies to guard against these risks, growth could decline over the next few years to return to the low levels associated with Argentina's past history**. The authorities stated, in response, that they were well aware of the need to build policy credibility to support a conducive investment climate. They claimed, however, that investment continued to be buoyant, demonstrating that the current policy framework provided substantial profit opportunities for new investors. The authorities dismissed concerns over potential energy shortages, though they agreed substantial new investment would be needed in the coming years.

V. Macroeconomic Policy Issues

A. Fiscal Policy

19. **The authorities' 2005 target for the consolidated public sector primary surplus, if realized, would represent a significant loosening of the fiscal stance** (Box 6). Staff noted that the 2005 consolidated primary surplus target of 3.8 percent of GDP was well below the 2004 outcome, and that in the absence of a significant overperformance—similar to that in 2004—the budget would have a procyclical impact, add to inflationary concerns, and create a financing gap that could make it difficult for the government to meet its post-restructuring debt service obligations. The authorities were reluctant to commit to any specific primary surplus beyond the budget target, but said that some overperformance may be possible given the buoyancy of tax revenues in the first part of the year. They did not foresee that expenditures—either current or capital—could be reduced from projected levels, but did assure staff that no new spending initiatives would be taken ahead of the congressional elections in late-October.

Authorities' Financing Projections for 2005 1/

	US$ mn	%GDP
Financing needs	**14,621**	**8.5**
Interest	3,255	1.9
Amortization	9,644	5.6
Of which: IMF	3,646	2.1
Other financing needs	1,722	1.0
Financing sources	**3,018**	**1.8**
IDB	148	0.1
Central bank advances	411	0.2
Domestic debt placement	365	0.2
Other public sector sources	2,093	1.2
Use of deposits	1,007	0.6
Primary surplus	**4,855**	**2.8**
Financing gap	**6,748**	**3.9**

1/ Projections refer to the National Treasury.

20. **The authorities anticipate a substantial budgetary financing gap in the remainder of 2005**. They estimate that before market borrowing (and without Fund disbursements) the financing gap would be very large—about US$6.7 billion (3.9 percent of GDP). In their debt sustainability analysis (see below), they indicate that the 2005 gap would be reduced to US$4.4 billion (2½ percent of

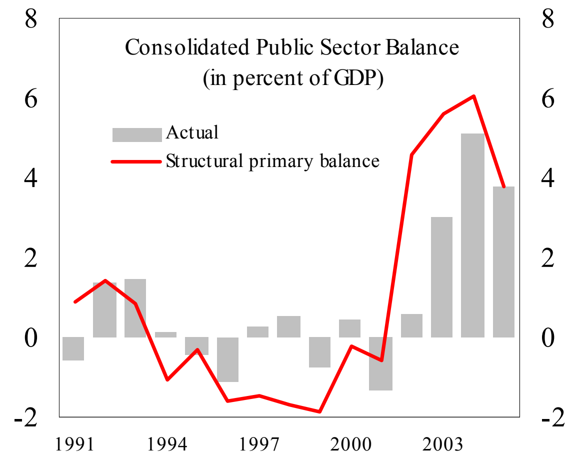
Box 6. An Assessment of the Stance of Fiscal Policy

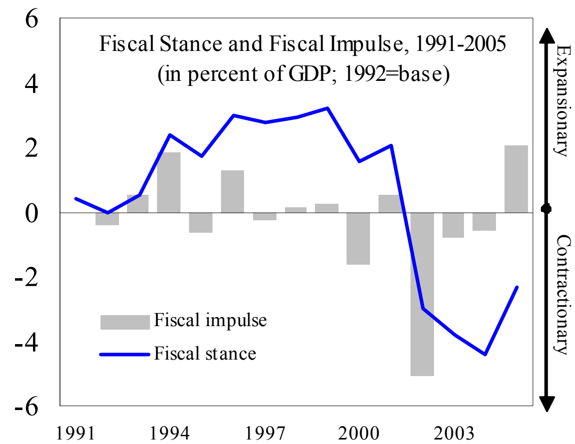
The consolidated public sector accounts improved significantly during 2002–04. The primary balance went from a *deficit* of 1.3 percent of GDP in 2001 to a *surplus* of 5.1 percent of GDP in 2004.

The structural (cyclically-adjusted) primary balance shows a similar pattern. While the structural balance should proxy the discretionary policy effort, a closer inspection suggests that the adjustment was helped considerably by a surge in tax buoyancy—a feature of many post-crisis episodes—and the introduction of highly distortionary taxes.

Since the crisis, the fiscal policy stance has been consistently contractionary, first because of a sharp contraction in primary spending (in 2002) and then because of a rapid recovery in revenues (in 2003–04).

The authorities' fiscal targets for 2005, however, imply a significant relaxation of the fiscal stance (Box Figures and Table). A cyclically neutral fiscal policy would have required a broadly unchanged primary balance in 2005. If the authorities' targets were realized, the cyclically-adjusted fiscal relaxation would be around 2 percent of GDP.





The analysis is somewhat sensitive to the potential output estimates. If, for example, potential output growth in 2005 is 2 percentage points above current estimates, the expansionary fiscal impulse would be 1.6 percent of GDP (rather than 2.1 percent) and the cyclically adjusted primary balance would be 4.3 percent of GDP (rather than 3.8 percent).

Consolidated public sector balances, 1991-2005 (in percent of GDP) 1/

	Avrg. 1991-99	2000	2001	2002	2003	2004	2005
Primary Balance	**0.1**	**0.4**	**-1.3**	**0.6**	**3.0**	**5.1**	**3.8**
Revenues	23.3	24.6	23.7	22.9	25.9	28.9	28.6
Primary spending	23.2	24.2	25.0	22.3	22.8	23.8	24.9
Cyclically Adjusted Primary Balance	**-0.5**	**-0.2**	**-0.6**	**4.6**	**5.6**	**6.0**	**3.8**
Structural revenues	22.6	24.0	24.4	26.9	28.5	29.8	28.6
Structural primary spending	23.2	24.2	25.0	22.3	22.8	23.8	24.9
Fiscal impulse 2/	**0.3**	**-1.6**	**0.5**	**-5.1**	**-0.8**	**-0.6**	**2.1**
Revenue impulse	-0.5	-0.3	1.0	0.7	-2.9	-3.0	0.2
Primary spending impulse	0.9	-1.4	-0.4	-5.8	2.2	2.4	1.8
Memorandum item:							
Output gap (in percent)	2.8	2.7	-3.1	-14.9	-9.1	-3.1	0.0

1/ Based on authorities' projections for 2005.

2/ Change in the fiscal stance, defined as the difference betweeen the actual primary and the primary balance calculated under the 1992 tax and expenditure ratios.

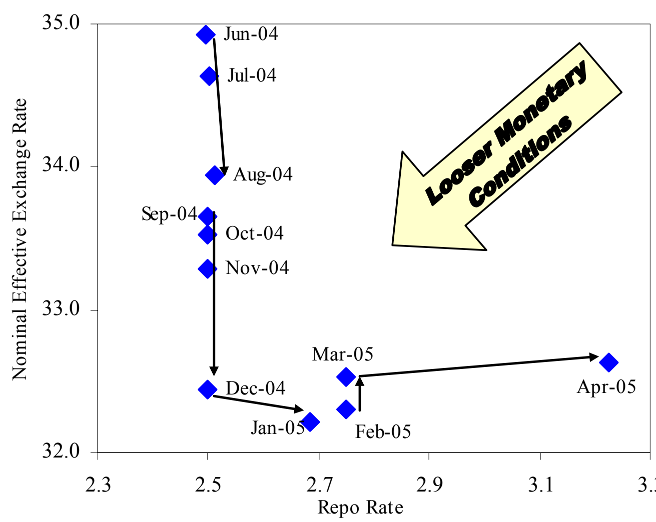
GDP) if Fund repurchases were offset by Fund disbursements from June 2005 through the end of the year.[9] Staff projections for 2005 indicate that a consolidated primary surplus of at least 4½ percent of GDP would be needed to ensure that the government's market borrowing requirement would be at a feasible level (see Section VI below). Staff proposed expenditure savings be considered as a means of achieving a higher than targeted primary surplus. The mission suggested, as examples, that a reduction in government subsidies (which have increased in recent years to 0.7 percent of GDP) and a prioritization of capital spending (which is projected to increase by 53 percent year-on-year in 2005) could help secure significant savings without having a negative social impact. Both of these options, however, were thought not to be feasible by the authorities.

B. Monetary Policy

21. **The authorities view the recent increases in inflation as mainly the result of transitory and seasonal factors, and changes in relative prices**. They, thus, believe that it would be a mistake to over-react in terms of policy tightening. They believed that interest rates had already been increased sufficiently and that inflation expectations had stabilized. In addition, they noted that recent voluntary short-term agreements with key producers of foodstuffs would ensure that future price increases in these areas would be moderate.

22. **In the staff's view, the balance of inflation risks has clearly moved to the upside**. While recognizing the difficulty of identifying the source of rising price pressures, the recent inflation appears to be a product of more permanent factors related to rising demand in the context of higher capacity utilization and monetary and fiscal stimulus. Staff emphasized that administrative controls and moral suasion would have a dampening effect on growth and would not curb underlying inflationary pressures over the longer term; indeed, they would harbor the risk of a subsequent burst of price increases.

Despite recent increases in interest rates, monetary conditions remain accommodative



[9] Under current practice, the BCRA onlends Fund financing to the federal government in domestic currency with the same maturity profile. Staff pointed out that this is not common practice among Fund members with floating exchange rates and that Fund purchases and repurchases were not generally relevant to the government financing framework (See paragraph 42 below).

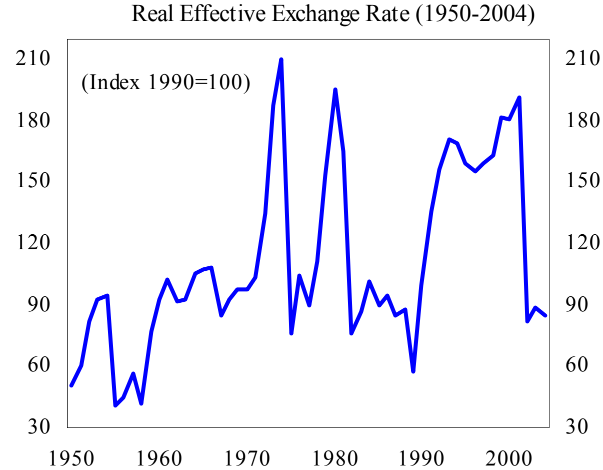
23. **Staff noted that monetary conditions were still very accommodative and that further policy tightening would be appropriate** (Text Figure). Staff noted that key policy rates have lagged increases in inflation expectations and are still heavily negative in real terms. Staff recommended that the trajectory of base money be brought down quickly to the lower band of the central bank's target range, noting this task had been made more difficult by the increased foreign exchange intervention that occurred during April–May 2005. An additional reason for caution was the sharp rise that had occurred in the money multiplier as banks had increased their lending.

24. **Staff cautioned that insufficient clarity as to the objectives of monetary policy could damage the credibility of the central bank**. In particular, the recent purchases of foreign exchange appeared driven by the objective of avoiding an appreciation of the nominal exchange rate, thereby placing at risk the achievement of the bank's inflation target. Staff underscored that the central bank should remain focused on its objective of price stability and that a move toward an inflation targeting framework (as envisaged under the SBA-supported program) would help establish this role. In response, the authorities indicated that they were reviewing whether an inflation targeting framework was appropriate for Argentina from an institutional viewpoint. They stressed that, in any case, inflation control would be the prime objective of the central bank whether or not formal inflation targeting was adopted. On the issue of foreign exchange intervention, the authorities indicated that they did not have an implicit exchange rate or reserve accumulation target in mind. They intend, however, to take the opportunity of building reserves whenever foreign exchange inflows were seasonally strong.

C. Exchange Rate Policy

25. **The authorities viewed the maintenance of a competitive exchange rate as one of the central components of their economic development strategy**. They agreed with staff that the real exchange rate would likely appreciate over time as the economic recovery deepened and relative price changes took place in the economy. The degree of undervaluation relative to the long-run equilibrium level was difficult to gauge with any specificity, given the country's history of large real effective exchange rate fluctuations (Text Figure and Box 3). However, the authorities noted that, while the post-crisis appreciation of the peso had been more muted than in other crisis countries, it needed to be borne in mind that the other countries had not experienced such a long period of a fixed exchange rate as Argentina had under the convertibility regime.

Real Effective Exchange Rate (1950-2004)



26. **Staff emphasized the need for greater nominal exchange rate flexibility**. Staff noted that, while there was a need for the central bank to continue to augment reserves, intervention should be carried out in a manner that did not effectively peg the exchange rate. Staff noted that while Argentina had, *de jure*, a floating exchange rate regime, the exchange rate had, in fact, been confined within a very narrow range, and could be classified under an empirical rule as a currency peg. Staff stressed that continuing with such a policy risked that real appreciation pressures would materialize in the form of domestic price inflation. It was noted that external competitiveness would ultimately depend on structural reforms to improve productivity and efficiency in the economy.

27. **There is an exchange restriction subject to Fund approval under Article VIII of the Fund's Articles arising from a freeze on programmed bank deposits (the *corralón*)**. As of end-February, 2005, about Arg$1.3 billion remained subject to the restriction. The freeze on deposits is scheduled to expire by end-September 2005 and staff recommends that temporary approval of the restriction be extended until that date.

VI. Structural Reforms for Sustaining Growth

28. **The policy discussions focused on what were the key structural changes necessary to maintain competitiveness and ensure continued robust growth**. The authorities considered that much had already been done to provide a firm foundation for future growth, and noted particularly the renewed vitality of the small- and medium-sized enterprise sector. Staff, however, pointed to key areas of continued vulnerability that, if not addressed, would become obstacles to growth in the coming period. These include: (i) the institutional structure for intergovernmental relations; (ii) the continued presence of highly distortionary taxes; (iii) the lack of capital in the banking system; (iv) the weak investment environment highlighted by the continuing disputes with the regulated public service companies; (v) the need for very large investments in the energy sector in the near future; and (vi) the large outstanding arrears to private sector creditors.

A. Fiscal Structural Reforms[10]

Intergovernmental reforms

29. **The volatility of fiscal policy appears to be an important factor in explaining Argentina's growth history**.[11] The inability of Argentina's institutions to enforce fiscal discipline was clearly evident in the genesis of the 2001–02 financial crisis. In the post-crisis period, fiscal discipline has been restored, but this has been in a situation where financing has been constrained both for the federal and provincial governments. The staff noted that a core element of staff and Executive Board advice over the past two or three years has been to

[10] See also Chapter II in the selected issues paper.

[11] See Chapter I in the selected issues paper.

implement institutional changes that would entrench fiscal discipline in a more normal situation where financing was more freely available. In the staff's view, the recent strong fiscal performance has obscured the long-standing problems of the fiscal federal regime and that institutional changes in the areas of the Fiscal Responsibility Law and the Law on Revenue Sharing are key conditions for lasting growth in Argentina.

30. **The authorities were more confident than staff that the recently adopted Fiscal Responsibility Law (FRL) would entrench fiscal discipline**. They indicated that the law had been already ratified by 17 of the 24 provinces, representing about 77 percent of total provincial spending, and that the Federal Council for Fiscal Responsibility was just beginning its work.[12] In combination with bilateral agreements between the federal government and the indebted provinces, the FRL would give assurances of prudent provincial fiscal behavior by limiting the growth in current spending and debt accumulation, and by improving transparency. Staff reiterated the concerns expressed at the time of the law's approval, including that the legislation fails to provide hard constraints on subnational spending and borrowing;[13] does not specify the circumstances under which the federal government may provide financing to the provinces; does not contain a mechanism to ensure subnational budgets are consistent with aggregate fiscal objectives; and continues to allow provinces to pledge their coparticipation receipts for future debt service. Staff stated that a comprehensive reform of the FRL was needed, but in the short term, as an interim measure the charter for the Federal Council should be widened to give the institution a stronger mandate to coordinate macro-fiscal policy, authorize intergovernmental financing operations, and provide recommendations for remedial actions when provinces violate spending, deficit, or debt limits specified in the FRL. The authorities, however, believed it was premature to amend the law or the council's charter. They indicated only that consideration could be given to whether the council could monitor more widely the overall financial situation of provinces and better harmonize the fiscal policies of the federal and provincial governments.

31. **Staff argued that strengthening the revenue sharing regime was a critical reform measure that would support the recommended changes to the FRL**. Staff suggested that the government simplify the current intergovernmental transfer system, increase its transparency, reduce the reliance on discretionary transfers, and increase the weight of objective criteria in determining the interprovincial distribution of transfers. To improve incentives for fiscal probity and revenue collection at the provincial level, staff argued that there should be greater devolution of revenue-raising responsibilities to the provinces and

[12] The Federal Council for Fiscal Responsibility, composed of the ministers of economy of the participating provinces, monitors compliance with the law, including through the application of sanctions. See also Chapter II of the selected issues paper.

[13] The deficit and spending growth limits in the FRL exclude IFI–financed expenditures and virtually all capital spending while the debt limits are expressed on debt service over a single year. Penalties for noncompliance with the law are only vaguely defined, and the federal government has considerable discretion to waive the limits established in the FRL.

that there should be an effort to reduce the procyclicality of federal government transfers. The mission acknowledged that such a reform would ultimately result in changes in the distribution of resources between the federal and provincial levels of government, as well as among provinces (benefiting, in particular, some of the more populated provinces) and that, therefore, it would be necessary to phase in the reform in a gradual manner. The authorities, however, argued that the reforms advocated by staff were not politically feasible even with gradual phasing. In the view of the authorities, the experience of 2004[14] had shown that achieving political consensus in this area was extremely difficult; in their view, the situation at that time had been exacerbated by the conditionality that had been included in the Fund-supported program. The authorities were, thus, extremely skeptical that advances could be made in this area, and certainly not in the short term.

Tax policy reforms

32. **The tax system still contains important distortions, introduced in the wake of the financial crisis, that constrain growth prospects**. The export and financial transaction taxes, which inhibit financial intermediation and the prospects for export-led growth, comprise about 18 percent of federally collected revenues, and directly support the federal budget as they are not shared with the provinces. Staff recommended that these taxes should be phased out in a revenue-neutral way. Doing so would deepen domestic capital markets—providing financing for productive investment—and increase the competitiveness of Argentina's key exports. The authorities agreed with the need to phase out some of these taxes—especially the financial transactions tax—but argued that substituting these taxes would be politically difficult. The staff made a number of specific recommendations to improve the tax structure,[15] but the authorities felt that none of these recommendations could be implemented, at least during the current year. They also pointed out that new taxes would need to be shared with provinces and would therefore weaken the federal budget. In this context, staff suggested that consideration be given to the possibility of reducing discretionary federal transfers so as to protect the federal budget.

Financial Transaction Taxes in Latin America

	Statutory Rate (In Percent)	Base	Complementary Regulations
Argentina	0.6	Debits and credits	17 percent of the tax paid is creditable against the income tax.
Brazil	0.38	Debits	Maximum one check endorsement.
Bolivia	0.3	Debits and credits	
Colombia	0.4	Debits	
Dominican Republic	0.15	Debits	
Paraguay	0.15	Transfers from the banking system	Transfers abroad taxed at 0.20 percent. Transfers made by check are not taxed.
Peru	0.08	Debits and credits	Obligation of using bank accounts for transactions above US$1,900 and tax deductions.
Venezuela	1.0	Debits	Second and subsequent endorsement are taxed.

Source: IMF Country Report 04/226, based on "The Rates and Revenues of Bank Transactions Taxes" by Baca-Campodonico, de Mello, and Kirilenko.

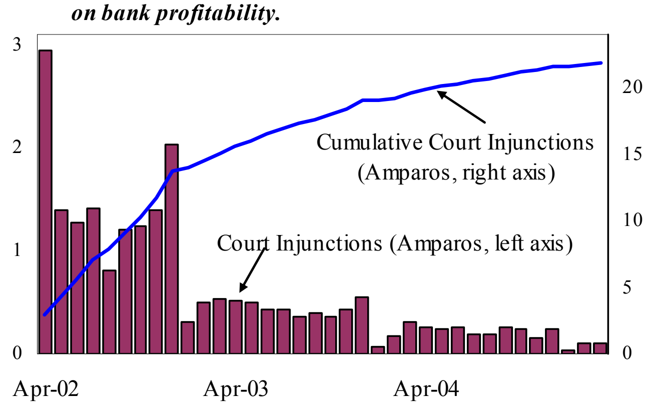
[14] In 2004, the authorities attempted a reform of the coparticipation regime. However, the proposal aimed to increase centralization and strengthen federal government influence and failed to garner provincial support.

[15] A FAD technical assistance mission in 2003 recommended among other options to eliminate unwarranted income and VAT exemptions and cross-crediting, align excises to their regional level, include excises in the VAT base, and strengthen the collection of social security and real estate taxes.

B. The Banking Sector

33. **There was agreement that Argentina needs to strengthen its banking sector and deepen financial intermediation to sustain growth in the medium term**. However, the banking system continues to be affected by the consequences of various policy actions undertaken during the financial crisis (Box 7). In particular: the government has not yet completed the compensation to the banks for asymmetric *pesoization* and indexation of bank assets and liabilities; many banks still need to deal with significant losses arising from court injunctions (*amparos)* despite decisions from the Supreme Court that confirm the legality of the *pesoization* of deposits; the share of the banking system in the hands of the state has increased sharply; the share of public securities in banks' portfolios has risen substantially; banks' exposure to interest rate risk has increased; and banks are severely undercapitalized even though they meet current regulatory standards that extend temporary forbearance.

Losses from Amparos have been a significant drag on bank profitability.



34. **Staff stressed the continued vulnerability of the banking system, despite its recent return to profitability.** In the staff's view, the policy priorities going forward would be to (i) complete the compensation payments; (ii) steadily remove the regulatory forbearance; (iii) increase bank capitalization; and (iv) clarify the legal status of *amparos.*

(i) Staff noted that compensation for asymmetric *pesoization* and indexation of banks' balance sheets was expected to have been completed by end-June 2004. The authorities acknowledged there had been delays, but stated that the bulk of compensation for asymmetric *pesoization* would be fully completed in June, 2005.[16] They also claimed that compensation for asymmetric indexation was no longer an issue as banks had not put forward any final claims. Staff noted that several banks continue to dispute the methodology adopted by the government to calculate the compensation.

(ii) The authorities reiterated their intention to adhere to the current schedule for phasing out regulatory forbearance, and agreed with staff that they should be ready to take prompt corrective actions to ensure banks meet prudential standards.

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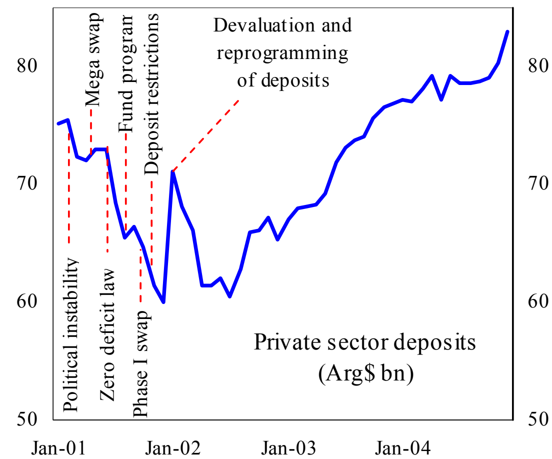
[16] Under the latest information available to staff, the authorities have completed payments for asymmetric *pesoization* of Arg$16 billion out of Arg$18 billion for the losses due to asymmetric *pesoization*, but the BCRA is still discussing the compensation for the losses arising from the *pesoization* of assets relative to other liabilities governed by foreign law (estimated at Arg$10 billion).

Box 7. The Effect of the Financial Crisis on the Banking System 1/

The recent financial crisis hit Argentina's banking system hard. During the 1990s, the banking system underwent significant transformation, that included a strengthening of the regulatory framework, increased bank liquidity and capitalization, and greater foreign participation. Nevertheless, the events of 2001–02 crippled the banking system due to a sharp drain on deposits, a significant increase in credit risk following the devaluation, and the default on public sector liabilities (which made up 50 percent of bank assets).



The impact of the crisis was exacerbated by a series of judicial and policy actions both before and after the crisis, that imposed sizeable losses on the banking system:

- In mid-2001, the government undertook a "mega swap" of government liabilities held by domestic financial institutions for new instruments with longer maturity that increased the maturity mismatch on bank balance sheets.
- In December 2001, the government announced a series of restrictions on withdrawals from the banks (the *corralito*) and introduced a debt moratorium.
- In January 2002, the convertibility regime was finally abandoned and the resulting spike in the exchange rate led to a sharp increase in nonperforming loans.
- In February 2002, the maturity of time deposits was extended (the *corralón*) and bank balance sheets were *pesoized* at asymmetric rates (Arg$1 per US$ for assets and Arg$1.4 for liabilities).
- In May 2002, assets and liabilities were indexed differentially (assets were indexed to inflation and a wage index while liabilities were linked to inflation).
- Since the *pesoization* in February 2002, depositors have resorted to courts requesting compensation for losses incurred by the *pesoization* at an exchange rate below market rates. Court injunctions have been granted by the judiciary, generating net losses to the banks estimated at Arg$ 8.8 billion.

In response to the crisis, the authorities granted regulatory forbearance as part of their strategy to promote a gradual recovery of the banking sector. A valuation mechanism for government bonds and loans was established, which allows for a gradual convergence to market value. Banks were also allowed to temporarily decrease their capital charge on interest rate risk, a measure that is scheduled to be phased out by end-2006. Finally, losses incurred due to court injunctions (*amparos*) could be booked as assets to be amortized over a period of 60 months.

Looking ahead, a full recovery of the banking system will depend to a significant extent on the resolution of the various policy-induced losses. Continued improvements in the macroeconomic environment and the gradual phasing out of regulatory forbearance are also key for re-establishing a sound banking sector.

1/ For a more detailed account see also Chapter VI of the selected issues paper.

(iii) The authorities indicated that they were also weighing the possibility of providing some marginal incentives for early recapitalization, but did not have a specific proposal at this time.[17]

(iv) Finally, the authorities acknowledged the importance of providing greater clarity on the legal status of *amparo* claims, but insisted that this was an issue for the judiciary and not the executive.

35. **Staff regretted the delays in the long-overdue strategic review of the public banks, and emphasized that this was only the initial step in the reform process**. The review for Banco Provincia has been completed and the government has recently contracted consultants to undertake the review of Banco Nación.[18] Staff noted that once the review of Banco Nación was concluded, the authorities should quickly establish a medium-term action plan to improve the operational performance of the two banks and define their future role within the overall banking system.

C. The Business Climate and Public Services

36. **Staff contended that the lack of progress in reaching agreement with the utility company concessionaires had wide implications, not only for the provision of public services, but also for the business climate** (Box 8). In particular, staff pointed to the adverse consequences of the government's recent decision to impose solutions on the companies both in the regulated sector and through exerting moral suasion on investment schemes for electricity generation. The decisions of certain companies to leave Argentina and the threat of others to withdraw would have a powerful impact on other potential investors.[19] Staff argued that, while much time had been lost, the priority should now be to re-establish a credible time-bound program for the renegotiation of long-term contracts with concessionaires that would include a clear path for tariff adjustments. Although tariff increases were not the only issue separating the government and the companies, this was a critical element, especially in the gas and electricity sectors where many systemically important concessions remained undecided and where infrastructure bottlenecks affecting growth were most likely to occur.

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[17] Such incentives could include allowing banks that bring in capital faster than required under current regulations to begin paying dividends and to qualify for early repayment of central bank liquidity assistance at favorable rates.

[18] The assessment of Banco Provincia identified several areas to be strengthened to improve the overall performance of the bank: better risk assessment and monitoring systems; more efficient loan collection mechanisms; and improvements in governance and management practices. A dedicated task force has been created within the bank to take these reforms forward.

[19] See Chapter III in the selected issues paper for further detail.

Box 8. The Status of Public Services Reforms

Private sector participation in the provision of public services requires a stable regulatory environment and price mechanisms that allow firms to earn an appropriate return on capital. To this end, the government committed under the Fund supported program to reach long-term concession agreements—including tariff adjustments—with 63 regulated utility companies by end-2004, and put in place a new regulatory framework.

Renegotiation of concessions

Progress towards the renegotiation of the key utility concessions has been scant. Of the total of 63 concessions, agreements were only reached with four electricity companies, four highway concessions, four port concessions, and two freight railways operators.[2] Most of these agreements still require congressional approval and do not involve, by and large, tariff increases for household consumers.[3] Thirteen road-related contracts were rescinded, and the government reauctioned the concessions. In addition, the government took control of the postal services concession and has announced that the company will not be reprivatized.

Little progress has been made in renegotiating remaining contracts, including for systemically important gas, electricity, water and telecommunications companies, which account for about 85 percent of total public service revenues. Moreover, the government launched public hearings for the energy companies that had not reached agreements with the authorities. During the hearings, the companies rejected the government's unilateral offer as insufficient.

Regulatory framework

The government's draft proposal for a new regulatory framework for public services has important shortcomings—an assessment shared by the World Bank and other observers. Among its main shortcomings, the law: (i) fails to establish a regular and predictable process for updating tariffs to reflect changing economic conditions; (ii) provides excessive scope for the Government and consumer groups to request tariff reductions on grounds of efficiency gains; (iii) denies concessionaires the right to apply for international arbitration; and (iv) prevents the disconnection of service to nonpaying customers. Discussion of this law in Congress has been delayed and is unlikely to take place in the near term.

Implications

Lack of progress in utility reforms has wide implications, as it contributes to a weakened investment climate, infrastructure bottlenecks, and contingent fiscal liabilities. In response to last winter's energy shortages, the authorities lifted the price freeze in some *non-regulated* sectors (including for the gas used by industry and electricity generators), but the price increases were not passed on to consumers, so that the government had to subsidize the price difference. Utility companies have now filed some 30 cases against the government in the World Bank Arbitration Tribunal (ICSID) that represent a potentially large contingent liability. The lack of progress in the renegotiation of contracts has contributed to the announced decision of several foreign investors to withdraw from Argentina's public service concessions.[4]

1/ See also Chapter III of the selected issues paper.
2/ Interim agreements were reached with the water company and two fixed-line telephone companies, but these expired in December 2004 and negotiations for the new long-term contracts are ongoing.
3/ In the case of the electricity companies, the agreement would result in a 15–31 percent adjustment in tariffs for industrial users, with additional tariff increases to be negotiated during 2005. Toll hikes would range between 14–18 percent, while the port and railroad concessions include no tariff adjustments.
4/ More recently, investors such as Suez/Aguas de Barcelona in the water provision sector and EDF in electricity distribution and transport have announced their departures, and other companies in the energy sector, such as National Grid, PSEG and CMS have sold their stakes to domestic investors.

37. **A new effort to reach collaborative agreements would be facilitated by the establishment of a sound and balanced regulatory regime**. Staff pointed out that the draft public services law currently in Congress was not supportable and would need to be modified to provide adequate incentives for continued private sector participation in the regulated sectors. Staff emphasized that the amendments should strike an adequate balance between consumer protection and the need of the concessionaires for economic viability and contractual certainty. In particular, staff urged the authorities to take into consideration the recommendations made on the draft law by the World Bank staff. Only with an appropriate regulatory framework, and certainty as to financial incentives over the medium term, would adequate investment be made in these sectors. The staff also encouraged the authorities to implement a transparent and well-targeted social tariff scheme.

38. **There are a significant number of claims relating to the utility sector that are pending in the international arbitration tribunals**. The authorities questioned the validity of these claims and argued that there had been no discriminatory treatment of international investors in the implementation of the emergency law. Staff suggested that the best way to reduce the risks from any adverse decision would be to reach early agreements with the concessionaires which could result in the voluntary withdrawal of claims by the companies. However, the authorities emphasized that the companies would have to withdraw their legal claims against the government before signing new contracts. They also suggested that any negative decision in the international tribunals would, in any case, have to be reviewed by the Argentine courts in order to be enforced in Argentina, and at that stage it could be challenged by consumer associations, thereby potentially blocking the enforcement of the international tribunal decision.

D. Social and Infrastructure Policy

39. **The basic social priorities of the government are to improve the situation of the poor by expanding employment opportunities, raising minimum wages, maintaining a safety net, and ensuring access to education and social services.** Since the beginning of 2003, about 3.5 million Argentines have moved out of poverty and almost 4 million have moved out of extreme poverty (Box 2). Unemployment has fallen with job creation in both formal and informal markets. Under the main social safety net program, the Heads of Household Program, the number of beneficiaries has declined to 1.5 million in February 2005 from 2.1 million at the end of 2002. The staff suggested that the improved trends provide an opportunity to reexamine the government's social programs. The authorities agreed and indicated that in the medium term they would like to replace the emergency social program with a training program and a more narrowly defined and well-targeted unemployment subsidy plan. Moreover, they felt that Argentina would need to strengthen its unemployment insurance system to further improve the safety net for transitional unemployment. On education, they believed that there was a need to increase spending and had announced a goal of 6 percent of GDP in education expenditures by 2015 (from about 4 percent in 2004).

40. **There was consensus on the need to prioritize government capital expenditure to allow for higher and more efficient spending on infrastructure**. The authorities pointed out that Argentina has significant medium term infrastructure investment needs and that, as a first step, they had increased investment spending in the 2005 budget by 1.3 percent of GDP. Staff agreed that while some increase in infrastructure spending may be appropriate, it would be important, given the size of infrastructure needs, to mobilize and provide incentives for private sector investment in infrastructure, so as not to crowd out government spending in other areas.

VII. Medium-Term Outlook and Debt Sustainability

41. **The authorities' debt sustainability analysis (Scenario A) shows a relatively fast decline in the debt-to-GDP ratio over the next decade**. The principal assumptions made by the authorities (detailed in Annex I) are that all defaulted debt is restructured during 2005 on the same terms as the recent debt exchange; growth averages 3 percent over the medium term; the real exchange rate gradually appreciates; borrowing costs on new debt are 9 percent in dollar terms; exposure to IFIs remains constant through 2014 and declines slowly thereafter; central bank advances to the government are not used to finance debt service; the federal primary surplus is maintained at 3 percent of GDP in the near term; and, provincial governments generate sufficient primary surpluses to cover their own debt service. Under

Argentina: Summary of DSA scenarios

	Scenario A			Scenario B			Scenario C			Scenario D		
	Authorities scenario Average			Staff assessment of authorities scenario Average			Staff scenario with reforms Average			Staff scenario with reforms 1/ Average		
	2005-08	2009-15	2016-30	2005-08	2009-15	2016-30	2005-08	2009-15	2016-30	2005-08	2009-15	2016-30
Consolidated primary surplus (percent of GDP)	3.7	3.3	2.3	3.7	3.3	2.3	4.4	3.5	2.8	4.4	3.5	2.8
Debt-to-GDP (percent of GDP)	71	54	37	73	68	72	70	52	31	70	50	27
Real GDP growth (percent)	4.2	3.0	3.0	3.5	2.0	2.0	4.2	3.0	3.0	4.2	3.0	3.0
IMF rollover assumption (percent)	86	97	80	0	0	0	0	0	0	…	…	…
Interest rate on new dollar market borrowing (percent)	9.0	9.0	9.0	10.0	10.0	10.0	9.0	9.0	9.0	9.0	9.0	9.0
Required private debt rollover rate (percent)	68	87	160	135	165	231	109	93	85	34	70	49
Possible private debt rollover rate (percent) 2/	…	…	…	50	75	90	56	93	100	60	98	100
Financing capacity (- surplus) (percent of GDP) 3/	…	…	…	2.1	1.6	4.5	1.3	0.0	0.0	-0.6	-0.6	-0.4

1/ Assumes that all Fund repurchases are made by the BCRA out of reserves.
2/ This represents staff estimate of possible private debt rollover.
3/ The financing capacity in each scenario is the difference between financing needs and identified resources, which include staff's estimate of possible market access.

these assumptions, the debt-to-GDP ratio declines from 79 percent in 2005 to 50 percent by 2014 and to 40 percent by 2020.[20] The authorities also assume market access which would allow a near 70 percent rollover of private sector debt in the period 2005–08, rising to higher levels thereafter under the assumption that it becomes possible to tap international markets.

[20] Given the back-loaded nature of obligations on restructured debt, the NPV of the debt stock in 2005 is about 19 percentage points less than the face value at a 10 percent discount rate.

42. **The scenario presented by the authorities is based on several key unrealistic assumptions**. Staff would argue that, *based on current policies*, it would be more realistic to assume the following:

- In the absence of a well articulated structural policy framework supportive of higher investment and productivity, average medium-term growth is likely to be closer to 2 percent than the 3 percent assumed by the authorities;

- The debt sustainability analysis should not assume access to Fund financial support. The authorities' assumption of constant exposure to the Fund for an extended period is neither realistic nor necessary. Fund purchases should not be relied upon as a source of budgetary financing even though this has long been the practice in Argentina.

- Under current policies, inflation and borrowing costs, at least in the near term, are likely to be at higher levels than assumed by the authorities.

Under these alternative assumptions, as shown in Scenario B, the debt ratio follows an unsustainable path, remaining around 70 percent of GDP over the medium term, and the implied rollover rate for private sector borrowing rises to unsustainable levels. Compared with the staff estimate of possible market access, this scenario gives rise to significant financing gaps both in the near and medium term.

43. **The staff's debt sustainability analysis (Scenario C) is based on a reform scenario which underpins higher growth, lower inflation, and lower borrowing costs than in Scenario B.** In this projection, staff assumes an increased fiscal effort with consolidated primary surpluses reaching 4.5 percent of GDP over the next few years and declining gradually thereafter. Staff argued that such surpluses were both feasible and appropriate given the level of Argentina's indebtedness. The staff scenario indicates sustainability over the medium term, with a similar downward trajectory of the overall debt-to-GDP ratio as in Scenario A, though at a slightly faster pace. In the near-term, however, there are large gross debt obligations that average about 8 percent of GDP during 2005–08, including substantial debt service to the Fund averaging almost 2 percent of GDP per year. Under this scenario, *and in the absence of direct recourse to central bank reserves*, a rollover rate of private sector debt of more than 100 percent is required during 2005–08. This level of required market access is higher than the possible access estimated by staff, thereby giving rise to financing gaps during 2005–08 even though adequate market access is projected over the medium term. While it is possible that the required level of market access may be achievable over the next few years, the likelihood is that borrowing costs may be higher than assumed and that this would cause a significant increase in the exposure of domestic financial institutions to the public sector.

44. **Staff suggested that, following the practice in many other countries, Fund repurchases could be made by the central bank from international reserves, rather than financed by the federal budget.** Since the currency board regime, the central bank has

onlent Fund resources to the federal government to help finance its budget deficit. The central bank's claim on government matches exactly the terms of its obligations to the Fund. To allow international reserves to be used directly to finance Fund repurchases, however, changes in the central bank's charter may be necessary.

45. **Financing payments to the Fund directly from the central bank's international reserves would significantly lower the required market issuances and allow a more rapid reduction in the debt ratio.** As shown in the staff Scenario D, the medium-term debt path is sustainable—the debt-to-GDP ratio would fall to 40 percent by 2016—and, in the near term, the required private sector rollover rate (34 percent) should be easily achievable. Under these conditions, there are financing surpluses in each period, indicating that Argentina's capacity to pay is higher than the projected debt obligations provided the assumed fiscal effort and market access are achieved. The extent of the excess capacity is about ½ percent of GDP per year over the projection period.

46. **To change Argentina's current practice in regard to Fund purchases and repurchases, a decision would need to be taken at the highest political level**. According to central bank officials, this would necessitate an amendment of the central bank's charter which would require congressional approval. Such an amendment, while easing the financing constraints in the near term, would need to be done in a manner that would not weaken the central bank's balance sheet or income position, and maintain its independence from government.

47. **The results of the staff's debt sustainability analysis are generally robust, but are sensitive to growth assumptions.** As demonstrated earlier in Scenario B, the average growth rate over the medium term has a significant impact on debt sustainability. A reduction in the average growth rate would leave the debt ratio at vulnerable levels for a longer period. In the staff scenarios (C and D) a 1 percentage point reduction in growth, would imply four additional years for the debt-to-GDP ratio to decline below 50 percent. The projection of the real exchange rate could also be critical. In the staff scenarios, the assumption is made that the current rate is close to its long-term equilibrium and there will be a gradual appreciation over the coming period. Such projections are, of course, very difficult to make. If it is the case that the rate is currently undervalued, then additional appreciation will help the debt dynamics going forward. For example, if the real exchange rate were to be 10 percent more appreciated than under the baseline scenario, then the debt stock would decrease by 8 percentage points of GDP. Changes to the level of borrowing costs and repayment terms would affect the staff conclusions only if there are extreme changes. Sensitivity tests for these and other variables are included in Annex I.

VIII. Normalization of Debt Service Arrears

48. **In discussing the debt exchange, staff stressed the potential adverse impact on debt sustainability that would result from continued arrears to private creditors.** In regard to the debt exchange itself, staff regretted that the authorities' approach was not consistent with the commitments included in the Letter of Intent of March 2004 which would

have allowed Argentina to comply with the Fund's lending into arrears policy. A full description of the debt exchange process is contained in Chapter IV of the selected issues papers. In respect of the remaining debt in default, staff noted that litigation risks and associated costs could disrupt Argentina's future market access. The authorities indicated that they were considering various modalities to normalize the situation with private creditors that had not participated in the debt exchange but, at present, were not prepared to elaborate, stating that their main focus was on settlement of the debt exchange and the issuance of new securities to participating creditors. Staff noted that the IMFC communiqué had called upon Argentina to formulate a forward-looking strategy to resolve the remaining arrears outstanding to private creditors consistent with the IMF's lending into arrears policy. Staff also noted that the debt exchange law passed by congress limited the power of the executive to effect judicial or nonjudicial settlements with nonparticipating creditors or to re-open the debt exchange. Given this situation, an amendment or repeal of the law would appear necessary for the authorities to effectively address the issue of the arrears to nonparticipating creditors. In response, the authorities stated that it was their intention to formulate a forward-looking strategy in due course, but it would be premature to make any announcement on this issue at this stage, and that it was not clear whether changes to the legal framework would be necessary.

49. **The authorities and staff agreed that it would be important for Argentina to proceed to negotiations with the Paris Club.** The authorities indicated that the terms of restructuring for official bilateral debt in the debt sustainability analysis were an example and should not prejudice the future negotiations with the Paris Club.

50. **The staff urged the authorities to remain current with all multilaterals, including the European Investment Bank** (EIB). In regard to the EIB, in a July 2004 informal meeting, staff informed Executive Directors that Argentina had accumulated arrears with the EIB which therefore caused the nonobservance of a continuous performance criterion on the nonaccumulation of arrears to bilateral and multilateral creditors. On August 30, 2004, at an informal country matters session, staff updated Executive Directors on this issue, indicating that the arrears gave rise to noncomplying purchases under the January 2003 SBA and the September 2003 SBA. On January 24, 2005, at an informal country matters session, staff informed Executive Directors that Argentina had cleared all arrears on principal and past due interest with the EIB in December 2004, but that penalty interest on the cleared arrears still remained a subject of ongoing discussions between the Argentine authorities and the EIB. Given this situation the staff recommended that the Board return to the issue following the outcome of the discussions between the authorities and the EIB. The topic of EIB arrears was raised by Executive Directors at a Board meeting to consider the extension of repurchase expectations on May 18, 2005. They inquired whether a request for a waiver for the noncomplying purchases would be brought to the Board's agenda in the near future. Staff indicated that a paper on this issue would be issued to the Board ahead of the Article IV consultation with Argentina.

IX. Staff Appraisal

51. **Argentina is emerging from an extraordinarily difficult period in its history, and has achieved a significant measure of political, social, and financial stability**. Since 1998, the country has experienced a major recession, the largest financial crisis in its history, and a period of severe social problems reflecting historically high levels of poverty and unemployment. Since 2003, however, confidence has begun to return, helped by a successful political transition and responsible macroeconomic policies. After two years of remarkable growth, which continues into 2005, real wages are recovering, output is close to its pre-1998 peak, investment and exports are reaching record levels, financial markets are relatively stable, and unemployment and poverty indicators are gradually improving. The Article IV consultation discussions have provided a valuable opportunity to discuss the policy framework that would entrench these achievements and ensure long-term growth, thereby allowing a further improvement in social and poverty indicators.

52. **Thus, while much has been accomplished, many challenges lie ahead if the current recovery is to be converted into long-lasting and equitable growth**. The experience of Argentina over the long term is that high growth periods have been interspersed with drastic crises—often associated with fiscal volatility—that have reduced average per capita growth to a very low level. The current growth momentum and accompanying political stability provide the opportunity for the government to undertake policies that will help prevent a repetition of Argentina's historical experience. For the recovery to be sustained, the authorities need to take action on a number of fronts: to continue with responsible macroeconomic policies, mindful particularly of debt dynamics and the adverse impact of inflation; to undertake structural reforms that will boost factor productivity and potential output; to strengthen financial intermediation, guard against capital flight, and normalize relations with creditors; to create a conducive investment climate for both domestic and foreign investors; and to ensure that the fruits of growth are equitably shared and that the still vulnerable sections of the community are adequately protected.

53. **Prudent macroeconomic policies during 2003–04 provided the anchor for the recovery of confidence and credibility**. Of critical importance was a steadfast implementation of fiscal policy, which produced record levels of primary surplus in the Argentinean context. With a strong improvement in tax collections and primary surpluses at both the federal and provincial levels, the authorities demonstrated the potential for Argentina to move away from its high level of national indebtedness. At the same time, monetary policy took advantage of a resurging demand for pesos, rebuilding international reserves and keeping interest rates low, thereby helping the recovery of the banking system. The achievement of two years of low inflation in the 4–6 percent range was key to restoring investor and consumer confidence.

54. **In 2005, however, as the output gap continues to close, the macroeconomic policy stance has weakened, and this has been reflected in an acceleration of inflation**. The increase in consumer prices and price expectations in the first part of 2005 should not be regarded as purely transitory, but rather as a signal of the need for tightening of both fiscal

and monetary policies. The authorities' efforts to apply moral suasion and administrative measures to stabilize prices are likely to have, at best, a short-term temporary impact, and will have other undesirable consequences, in particular, on investment. In the absence of a change to current macroeconomic policies, inflation could reach double digit levels this year, necessitating harsher measures later to prevent a wage-price escalation.

55. **In the fiscal area, the 2005 primary surplus target of 3.8 percent of GDP is well below the outcome for 2004**. Thus, the budget will have a procyclical impact unless there is a significant overperformance. The consolidated primary surplus target for 2005 represents a sizeable injection of fiscal stimulus at a time when the output gap is closing and inflationary pressures are mounting. Based on the strong outturn for the first quarter of 2005, the authorities have indicated that there is some potential for fiscal overperformance this year, and staff would urge that specific measures be put in place to ensure that the primary surplus-to-GDP ratio is raised significantly closer to the level achieved in 2004, and at least 4.5 percent of GDP, so as to minimize any procyclical impact. This will likely require some prioritization of capital spending and a review of the poorly targeted and rapidly rising current subsidies. Further fiscal consolidation compared with the budget is also called for to help facilitate—in a noninflationary and nondebt creating manner—the closing of a projected budgetary financing gap in the second half of 2005.

56. **Additional tightening of monetary policy is likely to also be needed in the short term**. The authorities have made welcome efforts during this year to gradually withdraw monetary stimulus and signal a tightening of monetary policy. However, nominal interest rates have risen more slowly than inflation expectations and real rates remain in negative territory. Given the stronger-than-expected recovery of the money multiplier, the central bank should take measures to ensure that the path of base money is quickly adjusted to the lower end of the authorities' target range. This will likely require a moderation of the authorities' intervention in the foreign exchange market and possibly a further rise in interest rates.

57. **To enhance the credibility of central bank policies to tackle inflation, the objectives of monetary policy need to be clarified**. For most of 2004, the central bank was able to successfully pursue twin objectives of low inflation and exchange rate stability while keeping interest rates low. In *de facto* terms, the nominal exchange rate has been restricted to within a very narrow range for some time. Recently, monetary policy appears increasingly driven by the need to prevent a nominal appreciation of the peso. Such a policy will not in the staff's view achieve the authorities' stated goal of a maintaining a competitive currency. Rather, it will lead to pressures for real appreciation being realized through higher inflation. It is recommended that the authorities clarify publicly that the prime objective of monetary policy is the maintenance of price stability and that the central bank has the necessary operational autonomy to effectively combat inflation.

58. **A shift in this direction will require the authorities to accept a greater degree of nominal exchange rate flexibility**. The balance of payments has remained strong and the government may still be able to build international reserves further during the remainder of

the year. However, intervention should not be carried out with an objective of maintaining a particular nominal exchange rate; rather intervention should be transparent and carefully coordinated so as to not undermine the targeted base monetary program or compromise the government's commitment to achieving its inflation targets.

59. **In the area of structural policies, there has been little progress in implementing the reform agenda envisaged under the stand-by arrangement**. The critical reforms remain the reduction of distortions in tax policy, measures to strengthen the institutional framework of intergovernmental fiscal relations, policies to strengthen the capital base of the banking system, and a strategy that will ensure adequate investment and incentives for participation by the private sector in the provision of public services. Although, for some structural reforms, it may be difficult to obtain political consensus in an election year and, for others, phased implementation may be needed, the staff would urge the authorities to utilize the current favorable situation as a platform to announce a coherent action plan to address these issues, including upfront actions to provide credibility going forward.

60. **Structural fiscal reforms are crucial to sustain over the medium term the strong budgetary performance of the past two years, and enhance prospects for growth**. For most of Argentina's recent history, the weakness of its fiscal institutions has been a key cause of economic volatility. It is imperative, therefore, that a stronger institutional fiscal framework be built as quickly as possible. This would cover three broad areas. *First*, the approved Fiscal Responsibility Law needs to be strengthened in a comprehensive manner, *inter alia*, to place more binding constraints on provincial spending and borrowing, to limit the circumstances under which the federal government may provide financing to the provinces, and to provide a mechanism to better harmonize the fiscal policies of the provinces and the federal government. *Second*, the regime for intragovernmental revenue sharing needs to be overhauled to reduce the level of vertical imbalance, lessen the vulnerability of subnational finances to cyclical movements, and promote horizontal equity among the provinces. *Third*, the distortionary taxes on exports and financial transactions need to be phased out, and substitute revenue measures introduced, in order to promote greater intermediation and export-led growth. These reforms are politically very complex, but will pay clear dividends over the medium term. They are also a necessary complement to redirecting public spending to improve infrastructure support within the framework of assuring debt sustainability.

61. **While the banking system has returned to overall profitability, the sector still remains vulnerable and undercapitalized**. The authorities are to be commended for maintaining their supervisory and regulatory framework under very difficult circumstances. However, several issues have still to be resolved to allow the banking system to play its role in promoting growth. In particular, pending compensation for policy–induced losses should be quickly completed, and all efforts should be made to obtain a further judicial clarification on the issue of *amparo*-induced losses. The authorities should strictly adhere to the announced phase-in schedule of prudential regulations on the valuation of government bonds and on limits on bank exposure to the public sector. The accompanying need to augment capital will not only be met through the inflow of future profits but will also need an

injection of new capital. A strengthening of incentives for early recapitalization may be helpful, though ultimately decisions to recapitalize will depend on the prevailing business environment and the overall economic prospects. Through this process, the central bank should continue to ensure prudential standards are applied strictly.

62. **The public banks have emerged from the crisis playing a much larger role and the government should urgently articulate a strategy for their future operations**. On the basis of the completed review of Banco Provincia and the planned review of Banco Nación, the authorities should be prepared to clarify the strategic role of these public banks going forward.

63. **The situation in the regulated utilities sector is not sustainable and failure to resolve outstanding issues will have damaging consequences for macroeconomic stability and future growth**. Despite commitments under the Stand-By Arrangement to complete renegotiations with concessionaires during 2004, little progress has been achieved. While the issue of tariffs does not affect all of the utility companies, the authorities' reluctance to raise tariffs for end-consumers or to agree on long-term phased increases in prices has been at the heart of the differences with the owners of many energy-related concessions. The authorities' insistence on retaining the complex procedures of the Emergency Law, and the recent attempts to unilaterally impose new contracts, have been strongly opposed by the companies, some of whom have withdrawn or are threatening withdrawal from the country. This issue has thus become an important litmus test of the overall investment climate. Staff believes that the authorities should proceed along twin tracks of continuing to try to reach collaborative long-term agreements with the utility concessionaires, while also putting in place an updated regulatory framework. Such a framework should provide regulatory certainty and find an appropriate balance between protection of consumers and provision of necessary investment incentives.

64. **The recent debt exchange marked an important step, but addressing remaining arrears is essential for Argentina to fully emerge from the financial crisis**. Staff regrets that the authorities' approach to the debt exchange was not consistent with the commitments made in the letter of intent of March 2004. Once the exchange has been formally completed, it will be important for Argentina to formulate a forward-looking strategy to resolve the remaining arrears outstanding to private creditors consistent with the Fund's Lending into Arrears policy, and to normalize relations with bilateral official creditors through a Paris Club agreement. The authorities' presentation of their debt sustainability analysis shows the debt-to-GDP ratio falling to relatively comfortable levels by 2015. The staff believes the medium-term macroeconomic framework underlying the authorities' analysis is feasible, though not on the basis of current policies. The attainment of an average real growth of 3 percent per year can be achieved only with proactive structural policies to encourage investment, both domestic and foreign. The staff's clear view is that the authorities' assumption of full and partial rollovers of obligations to the Fund for the next 15–20 years is unacceptable: it is not only inconsistent with the revolving nature of Fund resources, but also unnecessary. A more realistic assumption, in line with the balance of payments outlook, would be an exit from the use of Fund resources at a much earlier stage. Finally, the

authorities' debt sustainability analysis contains large financing gaps, particularly through 2012, that would need to be financed through market borrowing.

65. **The staff's analysis of medium-term debt sustainability is based on a proactive reform scenario and higher fiscal effort.** Under these assumptions, which involve a level of consolidated primary surplus of at least 4½ percent of GDP in the next few years, the debt-to-GDP ratio could be brought down to sustainable levels over the next decade. In the near term, the authorities will need to deal with significant levels of debt service, including repurchases to the Fund. Consideration should be given to financing payments to the Fund directly from international reserves in a manner that does not weaken the financial position of the central bank. Under these conditions, and provided the assumed fiscal effort and market access were achieved, there would be financing surpluses, indicating that Argentina's capacity to pay is higher than the projected debt obligations. Staff acknowledges that the use of reserves would require a decision at the highest political level, and would need to be made without impairing the autonomy of the central bank.

66. **On the exchange restriction subject to Fund approval under Article VIII**, given the timeframe for its removal, staff recommends the Executive Board approve the exchange restriction arising from a freeze on reprogrammed deposits (the *corralón*) until September 30, 2005 (a proposed decision is contained in Section X).

67. **Finally, Argentina's sharp recovery from the crisis signals its potential to rebuild sustainable medium-term growth and entrench growing prosperity**. The staff is convinced that, with a strong policy framework, Argentina will be able to attract the necessary domestic and foreign resources that will be needed to make this a reality.

68. **The next Article IV consultation will take place in accordance with the July 15, 2002 decision on consultation cycles.**

Table 1. Argentina: Selected Economic and Financial Indicators, 2001–2007

				Est.	Proj.		
	2001	2002	2003	2004	2005	2006	2007
(Annual percentage changes; unless otherwise indicated)							
National income and prices							
GDP at constant prices	-4.4	-10.9	8.8	9.0	6.2	3.8	3.6
Domestic demand (contribution to growth)	-6.5	-16.9	10.4	11.0	6.5	4.5	3.5
Net exports (contribution to growth)	2.1	6.0	-1.5	-2.0	-0.3	-0.7	0.1
Per capita GDP (U.S. dollars, thousands)	7.4	2.8	3.4	4.1	4.6	4.9	5.3
Consumer prices (average)	-1.1	25.9	13.4	4.4	9.0	8.4	7.5
Consumer prices (end-of-period)	-1.5	41.0	3.7	6.1	10.0	8.0	7.0
Social indicators 1/							
Population (millions)	36.3	36.6	37.0	37.4	37.8	38.2	38.6
Population below poverty line (in percent)	35.4	53.0	47.8	44.3	…	…	…
Population below extreme poverty line (in percent)	12.2	24.8	20.5	17.0	…	…	…
Unemployment rate	18.3	20.8	14.5	12.1	…	…	…
External sector							
Trade balance (U.S. dollars, billions)	6.2	16.7	15.7	12.1	9.7	7.0	6.3
Exports, f.o.b. (U.S. dollars, billions)	26.5	25.7	29.6	34.5	37.0	38.2	39.6
of which: net exports of hydrocarbons	3.9	4.1	4.5	4.1	…	…	…
Imports, c.i.f. (U.S. dollars, billions)	20.3	9.0	13.8	22.3	27.3	31.2	33.3
Export growth (in U.S. dollar terms)	0.8	-3.4	15.3	16.5	7.3	3.5	3.6
Import growth (in U.S. dollar terms)	-19.6	-55.8	53.9	61.3	22.3	14.3	6.8
Export volume	4.3	0.7	5.0	6.6	10.7	5.8	5.8
Import volume	-17.4	-54.1	53.2	47.0	17.4	13.3	5.8
Terms of trade (deterioration -)	-0.6	-1.8	8.9	-0.6	-6.8	-3.0	-3.1
Money and credit							
Net domestic assets of the financial system	14.9	57.3	46.2	-5.3	-3.2	4.9	4.9
Credit to the private sector	-20.2	-12.8	-15.5	15.4	18.0	16.3	13.1
Augmented base money 2/	-3.0	152.9	26.3	12.7	2.2	5.5	6.3
Augmented broad money 2/	-16.5	24.7	15.8	12.7	11.1	11.2	10.3
Interest rate (30-day deposit rate, in percent)	15.7	39.1	3.9	2.9	...	...	...
(In percent of GDP)							
Consolidated public sector							
Primary balance	-1.3	0.6	3.0	5.1	4.5	4.5	4.5
of which : Federal government	0.2	0.9	2.3	3.9	3.7	3.7	3.7
Overall balance	-5.9	-1.8	1.1	3.7	2.0	2.1	2.0
Revenues	23.7	23.0	25.9	28.9	28.6	28.4	28.2
Expenditures 3/	29.6	24.8	24.8	25.1	26.6	26.3	26.2
Total debt (U.S. dollars billions, year-end)	167.0	152.6	184.8	201.4	...	...	...
Total debt (year-end)	62.2	164.2	144.5	133.9			...
Savings-investment balance							
Gross domestic investment	14.2	12.0	15.1	19.1	19.9	21.5	21.3
of which : Public sector	1.5	0.9	1.5	2.5	3.3	3.4	3.3
Gross national savings	12.7	20.4	20.9	21.1	20.8	21.3	20.7
of which : Public sector	-4.5	-0.9	3.1	6.2	5.4	5.7	5.5
Current account balance	-1.4	8.5	5.8	2.0	1.0	-0.2	-0.6
(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)	525.3	498.2	493.4	428.9	...	...	...
Gross international reserves (U.S. dollars, billions) /4	14.9	10.5	14.1	19.6	20.7	22.1	20.3
In months of imports of goods and services	6.5	9.5	9.1	8.5	7.1	6.4	6.1
Nominal GDP (in billions of Arg $)	268.7	312.6	375.9	447.3	507.4	567.8	623.7

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

1/ Poverty data for 2004 Q1.
2/ Includes quasi-monies in circulation.
3/ Excludes interest due on nonperforming debt.
4/ Assumes no disbursements from the Fund in 2005 and 2006

Table 2. Argentina: External Financing Requirements and Sources, 2001-05
(in billions of U.S. dollars)

	2001	2002	2003	2004	2005
Gross financing requirements	41.5	23.4	23.8	20.4	13.5
Current account deficit 1/	3.9	-8.6	-7.4	-3.0	-1.7
Capital outflows	37.6	32.0	31.2	23.4	15.1
Public sector amortization	17.9	7.8	19.4	18.1	8.2
IMF	1.2	0.7	5.7	5.5	3.7
Multilateral loans	0.9	2.6	5.3	1.3	1.4
Official bilateral creditors	0.4	0.3	0.7	1.1	0.9
Bonds and notes 1/	7.2	3.1	6.5	9.3	2.1
Other	8.3	1.1	1.3	0.9	0.1
Private sector amortization, MLT	3.7	3.3	3.8	3.8	4.0
Other private sector flows, net (+outflows) 2/	16.0	20.8	8.0	1.5	3.0
Available financing	41.5	23.4	23.8	20.4	13.4
Capital inflows	29.5	6.4	13.1	10.5	8.7
Foreign direct investment	2.0	2.8	1.1	3.9	3.2
Disbursements to public sector	25.2	0.8	10.2	4.6	1.4
IMF	10.6	0.0	5.6	3.5	0.0
World Bank and IDB	1.8	0.8	4.6	1.1	1.4
Other	12.9	0.0	0.0	0.0	0.0
Private sector borrowing	2.2	2.8	1.8	2.0	4.0
Exceptional financing, arrears	0.0	12.5	14.4	15.3	5.8
Public sector arrears accumulation	0.0	8.2	11.3	15.0	4.8
Private sector arrears accumulation	0.0	4.3	3.0	0.2	1.0
Gross reserves accumulation (- increase)	12.0	4.4	-3.6	-5.4	-1.1
Rescheduling official bilateral	0.0	0.0	0.0	0.0	0.0
Residual financing gap	0.0	0.0	0.0	0.0	0.0

Sources: BCRA; and Fund staff estimates.

1/ Based on 76 percent participation in January 2005 debt offer.
2/ Includes errors and omissions.

Table 3. Argentina: Summary Balance of Payments, 2001-2007

				Est.	Projections		
	2001	2002	2003	2004	2005	2006	2007
	(In billions of U.S. dollars)						
Current account 1/	**-3.9**	**8.6**	**7.4**	**3.0**	**1.7**	**-0.4**	**-1.1**
Trade balance	6.2	16.7	15.7	12.1	9.7	7.0	6.3
Exports f.o.b.	26.5	25.7	29.6	34.5	37.0	38.2	39.6
Imports c.i.f.	-20.3	-9.0	-13.8	-22.3	-27.3	-31.2	-33.3
Services and transfers	-10.1	-8.1	-8.4	-9.1	-8.0	-7.4	-7.4
Of which: net interest payments 1/	-7.5	-7.7	-7.3	-6.8	-5.4	-4.1	-3.9
Capital and Financial Account	**-17.5**	**-24.8**	**-18.0**	**-10.9**	**-2.8**	**-0.9**	**-0.1**
Net public sector capital 1/	-2.0	-5.8	-9.1	-11.5	-3.0	-2.0	-2.2
Direct investment	2.0	2.8	1.1	3.9	3.2	3.6	3.9
Other net private sector capital 2/	-17.5	-21.8	-10.0	-3.3	-2.9	-2.6	-1.7
Overall balance	**-21.4**	**-16.2**	**-10.6**	**-7.8**	**-1.1**	**-1.3**	**-1.2**
Financing	**21.4**	**16.2**	**10.6**	**7.8**	**1.1**	**1.3**	**1.2**
Net international reserves (increase -) 3/	21.4	3.7	-3.7	-7.5	-4.8	-3.0	-2.6
Change in gross reserves	12.0	4.4	-3.6	-5.4	-1.1	-1.4	1.8
Change in reserve liabilities (IMF)	-9.4	0.7	0.1	2.0	3.7	1.6	4.4
Purchases	10.6	0.0	5.6	3.5	0.0	0.0	0.0
Repurchases	1.2	0.7	5.7	5.5	3.7	1.6	4.4
Exceptional financing 4/	0.0	12.5	14.4	15.3	5.8	4.3	3.8
	(In percent of GDP, unless otherwise specified)						
Current account	**-1.4**	**8.5**	**5.8**	**2.0**	**1.0**	**-0.2**	**-0.6**
Trade account	2.3	16.4	12.4	8.0	5.6	3.8	3.1
Exports, f.o.b.	9.9	25.3	23.2	22.7	21.5	20.4	19.7
Of which: oil products (net)	1.8	4.6	4.1	2.9	2.7	2.6	2.5
Imports c.i.f.	-7.6	-8.9	-10.9	-14.7	-15.9	-16.7	-16.6
Capital and Financial Account	**-6.5**	**-24.5**	**-14.1**	**-7.2**	**-1.6**	**-0.5**	**-0.1**
Net public sector capital	-0.8	-5.7	-7.2	-7.6	-1.8	-1.0	-1.1
Direct investment	0.7	2.7	0.9	2.6	1.9	1.9	1.9
Other net private sector capital 2/	-6.5	-21.5	-7.8	-1.8	-1.5	-1.2	-0.8
Memorandum items:							
Current account excluding interest payments on nonperforming debt,(in percent of GDP)	-1.4	13.2	9.8	5.6	2.3	1.0	0.5
Exports volumes, percent change	4.3	0.7	5.0	6.6	10.7	5.8	5.8
Imports volumes, percent change	-17.4	-54.1	53.2	47.0	17.4	13.3	5.8
Gross international reserves (in billions of US$)	14.9	10.5	14.1	19.6	20.7	22.1	20.3
(in months of imports of goods and services)	6.5	9.5	9.1	8.4	7.4	7.0	6.1
Net international reserves (in billions of US$) 3/	0.9	-3.9	-1.4	5.6	10.4	13.5	16.1
(in months of imports of goods and services)	0.4	-3.5	-0.9	2.4	3.8	4.3	4.8

Sources: Ministry of Economy and Fund staff estimates.

1/ Based on 76 percent participation rate in debt exchange. Participation by non-residents estimated at 68 percent.

2/ Includes errors and omissions.

3/ Excludes liabilities to non-residents. Fund repurchases are on an obligations basis but include repurchase expectations made Feb-Apr 2005. Projected SDR figures are converted to US dollars using WEO forecast.

4/ Includes public sector arrears to official creditors and private creditors that did not participate in debt exchange, and arrears of the corporate sector.

Table 4 . Argentina: Net Debt Service to the IFIs, 2001-2006
(in millions of US dollars)

	2001	2002	2003	2004	2005	2006
IMF 1/						
A. Debt service	1,603	1,346	6,441	6,071	4,183	2,028
Principal	1,187	746	5,796	5,515	3,674	1,647
Interest	416	600	646	556	509	381
B. Disbursements	10,563	0	5,626	3,466	0	0
C. Net debt service (A-B)	-8,960	1,346	815	2,605	4,183	2,028
D. Fund credit outstanding	13,976	14,339	15,523	14,091	10,126	8,481
WB						
A. Debt service	1,388	1,096	3,350	1,064	1,219	1,389
Principal	676	1,353	2,968	832	929	1,056
Interest	713	517	382	232	290	333
Arrears clearance	0	-774	774	0	0	0
B. Disbursements	1,329	424	1,965	770	533	1,056
C. Net debt service (A-B)	60	672	1,385	293	686	333
D. WB credit outstanding	9,439	8,511	7,508	7,447	7,050	7,050
IDB						
A. Debt service	728	1,345	2,884	911	952	1,573
Principal	258	1,596	1,591	482	512	1,174
Interest	470	466	575	428	440	399
Arrears clearance	0	-717	717	0	0	0
B. Disbursements	1,470	407	2,640	332	148	1,174
C. Net debt service (A-B)	-742	938	244	579	804	399
D. IDB credit outstanding	8,175	7,950	7,982	7,831	7,467	7,467

Source: IMF, World Bank and IDB staff.
1/ Assumes payments on an obligation basis and US$/SDR rate in line with WEO projections.

Table 5. Argentina: Projected Payments to the IMF 1/
(in millions of SDRs)

	Principal		Interest Charges		Net Payments		Credit Outstanding	
	Obligation	Expectation 1/	Obligation	Expectation 2/	Obligation	Expectation	Obligation	Expectation
2005								
January	96	0	0	0	96	96	8,977	8,977
February	96	96	91	0	186	282	8,882	8,786
March	337	96	0	0	337	432	8,545	8,354
April	160	93	0	0	160	253	8,386	8,101
May	96	0	86	0	181	181	8,290	8,006
June	315	0	0	0	315	315	7,975	7,690
July	96	0	0	0	96	96	7,879	7,595
August	96	0	82	0	178	178	7,783	7,499
September	337	0	0	0	337	337	7,447	7,162
October	96	0	0	0	96	96	7,351	7,067
November	96	0	75	0	171	171	7,256	6,971
December	315	0	0	0	315	315	6,940	6,656
Total for 2005	**2,133**	**285**	**334**	**0**	**2,467**	**2,751**	**6,940**	**6,656**
2006								
January	96	0	0	0	96	96	6,845	6,560
February	0	0	68	0	68	68	6,845	6,560
March	21	0	0	0	21	21	6,823	6,539
April	0	0	0	0	0	0	6,823	6,539
May	96	28	62	0	158	186	6,728	6,415
June	124	548	0	0	124	672	6,604	5,743
July	93	217	0	0	93	310	6,511	5,433
August	0	28	61	-3	61	86	6,511	5,405
September	152	548	0	0	152	700	6,358	4,705
October	187	217	0	0	187	404	6,171	4,301
November	28	28	58	-7	87	108	6,143	4,244
December	285	548	0	0	285	833	5,858	3,411
Total for 2006	**1,082**	**2,162**	**250**	**-10**	**1,333**	**3,485**	**5,858**	**3,411**

Sources: IMF staff.

1/ Assumes no Fund disbursements. Repurchase expectations from May 2005 to April 2006 are extended to an obligation basis.
Repurchase expectations are assumed from May 2006 on.

2/ Interest savings if payments made on an expectation basis.

Table 6. Argentina: Consolidated Public Sector Operations, 2001-2007 1/

				2004		2005		2006		2007	
	2001	2002	2003	Original Prog.	Est.	Auth. Proj.	Staff Proj.	Auth. Proj.	Staff Proj.	Auth. Proj.	Staff Proj.
(in billions of pesos)											
Revenues	**63.6**	**71.8**	**97.2**	**105.4**	**129.1**	**145.2**	**145.0**	**161.3**	**161.5**	**176.0**	**176.0**
Tax revenues	47.2	52.4	75.1	81.7	101.6	115.1	114.4	127.7	126.5	139.2	137.4
Social security contributions	9.6	9.7	11.7	13.0	14.6	17.3	17.2	19.3	20.2	21.2	22.6
Other revenues	6.8	9.7	10.5	10.7	12.9	12.8	13.3	14.2	14.7	15.5	16.0
Primary expenditures	**67.2**	**69.9**	**85.8**	**92.8**	**106.3**	**126.1**	**122.4**	**139.9**	**136.1**	**152.5**	**148.0**
Wages	26.4	26.1	29.5	32.2	34.4	39.4	39.4	44.1	44.1	48.4	48.4
Goods and services	6.3	6.3	8.6	8.7	10.7	12.2	11.7	13.2	12.6	14.2	13.6
Transfers to the private sector	25.7	28.6	34.6	35.7	40.3	44.3	44.2	48.8	48.8	53.1	53.1
of which: federal pensions	16.6	16.5	19.5	20.6	22.9	24.7	24.5	27.6	27.4	30.3	30.1
Capital spending	3.9	2.9	7.5	7.9	11.1	19.3	17.0	21.4	19.2	23.2	20.5
Other	4.9	6.0	5.7	8.3	9.9	11.0	10.1	12.3	11.3	13.5	12.4
Primary balance	**-3.6**	**1.8**	**11.4**	**12.5**	**22.8**	**19.1**	**22.6**	**21.4**	**25.4**	**23.5**	**28.0**
Interest cash	12.4	7.5	7.3	8.8	6.2	12.7	12.7	11.0	13.5	11.7	15.5
Overall balance	**-16.0**	**-5.7**	**4.1**	**3.7**	**16.7**	**6.4**	**9.9**	**10.4**	**11.9**	**11.8**	**12.5**
Arrears and interest capitalization 2/	1.8	48.5	21.2	21.2	30.3	...	5.0	...	4.6	...	4.2
Below-the-line spending 3/	1.6	48.7	4.5	4.5	6.1	...	1.8	...	1.6	...	0.0
Augmented overall balance 4/	**-19.3**	**-102.8**	**-21.5**	**-22.0**	**-19.7**	**...**	**3.1**	**...**	**5.8**	**...**	**8.3**
(in percent of GDP)											
Revenues	**23.7**	**23.0**	**25.9**	**25.3**	**28.9**	**28.6**	**28.6**	**28.4**	**28.4**	**28.2**	**28.2**
Tax revenues	17.6	16.8	20.0	19.6	22.7	22.7	22.6	22.5	22.3	22.3	22.0
Social security contributions	3.6	3.1	3.1	3.1	3.3	3.4	3.4	3.4	3.6	3.4	3.6
Other revenues	2.5	3.1	2.8	2.6	2.9	2.5	2.6	2.5	2.6	2.5	2.6
Primary expenditures	**25.0**	**22.4**	**22.8**	**22.3**	**23.8**	**24.9**	**24.1**	**24.6**	**24.0**	**24.4**	**23.7**
Wages	9.8	8.4	7.8	7.7	7.7	7.8	7.8	7.8	7.8	7.8	7.8
Goods and services	2.3	2.0	2.3	2.1	2.4	2.4	2.3	2.3	2.2	2.3	2.2
Transfers to the private sector	9.6	9.1	9.2	8.6	9.0	8.7	8.7	8.6	8.6	8.5	8.5
of which: federal pensions	6.2	5.3	5.2	4.9	5.1	4.9	4.8	4.9	4.8	4.9	4.8
Capital spending	1.5	0.9	2.0	1.9	2.5	3.8	3.3	3.8	3.4	3.7	3.3
Other	1.8	1.9	1.5	2.0	2.2	2.2	2.0	2.2	2.0	2.2	2.0
Primary balance	**-1.3**	**0.6**	**3.0**	**3.0**	**5.1**	**3.8**	**4.5**	**3.8**	**4.5**	**3.8**	**4.5**
Interest cash	4.6	2.4	1.9	2.1	1.4	2.5	2.5	1.9	2.4	1.9	2.5
Overall balance	**-5.9**	**-1.8**	**1.1**	**0.9**	**3.7**	**1.3**	**2.0**	**1.8**	**2.1**	**1.9**	**2.0**
Arrears and interest capitalization 2/	0.7	15.5	5.6	5.1	6.8	...	1.0	...	0.8	...	0.7
Below-the-line spending 3/	0.6	15.6	1.2	1.1	1.4	...	0.4	...	0.3	...	0.0
Augmented overall balance 4/	**-7.2**	**-32.9**	**-5.7**	**-5.3**	**-4.4**	**...**	**0.6**	**...**	**1.0**	**...**	**1.3**
Memorandum item											
Nominal GDP (Arg$ bn)	268.7	312.6	375.9	416.9	447.3	507.4	507.4	567.8	567.8	623.7	623.7

Source: 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/ Includes the settlement of obligations in bonds, often as a result of judicial rulings, and compensation to banks for asymmetric pesoization and asymmetric indexation of balance sheets.
4/ Data for interest capitalization, arrears, debt recognition and bank compensation are estimates.

Table 7. Argentina: Federal Government Operations, 2001-2007 1/

	2001	2002	2003	2004 Original Prog.	2004 Actual	2005 Auth Proj.	2005 Staff Proj.	2006 Auth Proj.	2006 Staff Proj.	2007 Auth Proj.	2007 Staff Proj.
(in billions of pesos)											
Revenues	**50.6**	**56.8**	**77.2**	**84.8**	**104.9**	**118.4**	**117.8**	**131.3**	**131.0**	**143.0**	**142.5**
Tax revenues	37.4	41.8	60.7	66.4	83.6	95.1	94.0	105.4	103.6	114.7	112.3
Social security contributions	9.6	9.7	11.7	13.0	14.6	17.3	17.2	19.3	20.2	21.2	22.6
Non-tax revenues	3.6	5.3	4.7	5.4	6.7	6.0	6.5	6.6	7.1	7.1	7.7
Primary expenditures	**50.0**	**53.8**	**68.5**	**74.7**	**87.6**	**103.1**	**99.0**	**114.1**	**110.0**	**124.1**	**119.5**
Primary expenditures (excl. provinces)	33.1	36.3	45.8	50.0	54.4	63.2	61.4	71.0	67.8	76.8	73.2
Wages	7.7	8.0	10.3	11.1	11.4	12.6	12.7	14.2	14.2	15.5	15.6
Goods and services	2.2	2.5	3.2	3.4	3.9	5.3	4.8	5.8	5.2	6.2	5.6
Pensions	16.6	16.5	19.5	20.6	22.9	24.7	24.5	27.6	27.4	30.3	30.1
Transfers to private sector	5.8	8.7	11.1	11.0	12.4	14.1	14.2	15.3	15.4	16.4	16.6
Capital	0.6	0.5	1.1	2.6	3.2	5.1	4.8	6.7	5.1	6.7	4.9
Other	0.1	0.1	0.5	1.3	0.7	1.3	0.4	1.5	0.4	1.6	0.4
Transfers to provinces	17.0	17.5	22.7	24.7	33.2	39.9	37.6	43.1	42.2	47.3	46.3
Automatic	11.6	11.6	17.2	...	25.3	29.4	27.9	31.4	34.6	34.4	39.1
Discretionary	5.4	5.9	5.4	...	7.8	10.5	9.7	11.8	7.6	12.9	7.2
Primary cash balance	**0.6**	**3.0**	**8.7**	**10.1**	**17.3**	**15.4**	**18.8**	**17.2**	**21.0**	**18.9**	**23.1**
Interest cash	10.2	6.8	6.9	6.9	5.7	12.3	12.3	11.7	13.0	13.3	14.3
Overall cash balance	**-9.6**	**-3.8**	**1.8**	**3.2**	**11.6**	**3.1**	**6.5**	**5.5**	**8.0**	**5.6**	**8.8**
Interest capitalization	0.4	32.6	8.8	10.3	18.8	...	4.1	...	3.8	...	3.5
Accumulation of arrears 2/	1.4	16.0	12.0	10.2	11.0	...	0.0	...	0.0	...	0.0
Below-the-line spending 3/	1.6	0.5	2.8	2.9	2.9	...	1.8	...	1.6	...	0.0
Augmented overall balance 4/	**-13.0**	**-101.1**	**-23.5**	**-20.2**	**-22.7**	**...**	**0.5**	**...**	**2.7**	**...**	**5.3**
(in percent of GDP)											
Revenues	**18.8**	**18.2**	**20.5**	**20.3**	**23.5**	**23.3**	**23.2**	**23.1**	**23.1**	**22.9**	**22.9**
Tax revenues	13.9	13.4	16.2	15.9	18.7	18.8	18.5	18.6	18.3	18.4	18.0
Social security contributions	3.6	3.1	3.1	3.1	3.3	3.4	3.4	3.4	3.6	3.4	3.6
Non-tax revenues	1.3	1.7	1.3	1.3	1.5	1.2	1.3	1.2	1.3	1.1	1.2
Primary expenditures	**18.6**	**17.2**	**18.2**	**17.9**	**19.6**	**20.3**	**19.5**	**20.1**	**19.4**	**19.9**	**19.2**
Primary expenditures (excl. provinces)	12.3	11.6	12.2	12.0	12.2	12.5	12.1	12.5	11.9	12.3	11.7
Wages	2.9	2.6	2.7	2.7	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Goods and services	0.8	0.8	0.9	0.8	0.9	1.0	0.9	1.0	0.9	1.0	0.9
Pensions	6.2	5.3	5.2	4.9	5.1	4.9	4.8	4.9	4.8	4.9	4.8
Private sector transfers	2.2	2.8	3.0	2.6	2.8	2.8	2.8	2.7	2.7	2.6	2.7
Capital	0.2	0.1	0.3	0.6	0.7	1.0	0.9	1.2	0.9	1.1	0.8
Other	0.0	0.0	0.1	0.3	0.2	0.3	0.1	0.3	0.1	0.3	0.1
Transfers to provinces	6.3	5.6	6.0	5.9	7.4	7.9	7.4	7.6	7.4	7.6	7.4
Automatic	4.3	3.7	4.6	0.0	5.7	5.8	5.5	5.5	6.1	5.5	6.3
Discretionary	2.0	1.9	1.4	0.0	1.8	2.1	1.9	2.1	1.3	2.1	1.2
Primary cash balance	**0.2**	**0.9**	**2.3**	**2.4**	**3.9**	**3.0**	**3.7**	**3.0**	**3.7**	**3.0**	**3.7**
Interest cash	3.8	2.2	1.8	1.6	1.3	2.4	2.4	2.1	2.3	2.1	2.3
Overall cash balance	**-3.6**	**-1.2**	**0.5**	**0.8**	**2.6**	**0.6**	**1.3**	**1.0**	**1.4**	**0.9**	**1.4**
Interest capitalization	0.1	10.4	2.3	2.5	4.2	...	0.8	...	0.7	...	0.6
Accumulation of arrears 2/	0.5	5.1	3.2	2.5	2.5	...	0.0	...	0.0	...	0.0
Below-the-line spending 3/	0.6	15.6	1.2	0.7	1.0	...	0.4	...	0.3	...	0.0
Augmented overall balance 4/	**-4.8**	**-32.4**	**-6.3**	**-4.8**	**-5.1**	**...**	**0.1**	**...**	**0.5**	**...**	**0.8**
Memorandum Item											
Nominal GDP (in Arg$ billion)	268.7	312.6	375.9	416.9	447.3	507.4	507.4	567.8	567.8	623.7	623.7

Source: 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, and compensation to banks for asymmetric pesoization and asymmetric indexation of balance sheets.
4/ Data for interest capitalization, arrears, debt recognition and bank compensation are estimates.

Table 8. Argentina: Provincial Government Operations, 2001-2007

				2004		2005		2006		2007	
	2001	2002	2003	Orig. Prog.	Est.	Auth. Proj.	Staff Proj.	Auth. Proj.	Staff Proj.	Auth. Proj.	Staff Proj.
				(in billions of pesos)							
Revenue	**29.9**	**32.5**	**42.7**	**45.3**	**57.4**	**66.7**	**64.8**	**73.1**	**72.7**	**80.2**	**79.7**
Tax	9.8	10.6	14.3	15.3	18.0	20.0	20.5	22.4	22.9	24.6	25.1
Non tax	3.2	4.4	5.7	5.2	6.2	6.8	6.7	7.6	7.6	8.4	8.3
Transfers from federal government	17.0	17.5	22.7	24.7	33.2	39.9	37.6	43.1	42.2	47.3	46.3
Primary spending 1/	**34.1**	**32.6**	**39.3**	**42.8**	**51.3**	**63.0**	**61.0**	**68.9**	**68.3**	**75.6**	**74.8**
Wages	18.8	18.1	19.1	21.1	23.0	26.7	26.7	29.9	29.9	32.9	32.9
Goods and services	4.1	3.8	5.3	5.3	6.7	6.9	6.9	7.4	7.4	8.0	8.0
Private sector transfers	3.2	3.3	4.0	4.1	5.0	5.5	5.5	5.9	5.9	6.4	6.4
Public sector transfers 2/	4.8	4.9	6.4	6.9	8.6	9.7	9.7	10.9	10.9	11.9	12.0
Capital	3.3	2.4	4.4	5.3	7.9	14.2	12.2	14.8	14.1	16.5	15.6
Primary balance 1/	**-4.2**	**-0.2**	**3.4**	**2.5**	**6.1**	**3.7**	**3.8**	**4.2**	**4.4**	**4.6**	**4.9**
Net arrears reduction (-, accumulation)	...	1.0	0.7	0.2	0.6	0.6	0.6	0.0	0.0	0.0	0.0
Primary balance (cash basis)	-4.2	-1.1	2.7	2.2	5.5	3.1	3.2	4.2	4.4	4.6	4.9
Interest (cash basis)	2.4	1.5	1.7	2.1	1.8	2.1	2.2	2.0	2.0	2.3	2.3
Overall cash balance	**-6.6**	**-2.6**	**1.0**	**0.2**	**3.8**	**1.0**	**1.1**	**2.2**	**2.4**	**2.3**	**2.6**
Debt recognition expenditures 3/	...	...	0.0	1.6	1.6	...	...	...	...	...	...
Interest capitalization 4/	...	8.3	0.8	2.4	1.3	...	2.3	...	1.8	...	0.2
Interest arrears	0.0	0.8	1.1	0.7	1.0	...	0.9	...	0.8	...	0.7
Augmented balance	**-6.6**	**-11.8**	**-0.9**	**-4.5**	**-0.1**	**...**	**-2.1**	**...**	**-0.3**	**...**	**1.7**
				(in percent of GDP)							
Revenue	**11.1**	**10.4**	**11.4**	**10.9**	**12.8**	**13.1**	**12.8**	**12.9**	**12.8**	**12.9**	**12.8**
Tax	3.6	3.4	3.8	3.7	4.0	3.9	4.0	3.9	4.0	3.9	4.0
Non tax	1.2	1.4	1.5	1.3	1.4	1.3	1.3	1.3	1.3	1.3	1.3
Transfers from federal government	6.3	5.6	6.0	5.9	7.4	7.9	7.4	7.6	7.4	7.6	7.4
Primary spending 1/	**12.7**	**10.4**	**10.5**	**10.3**	**11.5**	**12.4**	**12.0**	**12.1**	**12.0**	**12.1**	**12.0**
Wages	7.0	5.8	5.1	5.1	5.1	5.3	5.3	5.3	5.3	5.3	5.3
Goods and services	1.5	1.2	1.4	1.3	1.5	1.4	1.4	1.3	1.3	1.3	1.3
Private sector transfers	1.2	1.1	1.1	1.0	1.1	1.1	1.1	1.0	1.0	1.0	1.0
Public sector transfers 2/	1.8	1.6	1.7	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Capital	1.2	0.8	1.2	1.3	1.8	2.8	2.4	2.6	2.5	2.6	2.5
Primary balance 1/	**-1.6**	**-0.1**	**0.9**	**0.6**	**1.4**	**0.7**	**0.8**	**0.7**	**0.8**	**0.7**	**0.8**
Net arrears reduction (-, accumulation)	...	0.3	0.2	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Primary balance (cash basis)	-1.6	-0.4	0.7	0.5	1.2	0.6	0.6	0.7	0.8	0.7	0.8
Interest (cash basis)	0.9	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Overall cash balance	**-2.5**	**-0.8**	**0.26**	**0.0**	**0.8**	**0.2**	**0.2**	**0.4**	**0.4**	**0.4**	**0.4**
Debt recognition expenditures 3/	...	...	0.0	0.4	0.4	...	...	...	...	...	...
Interest capitalization 4/	...	2.7	0.2	0.6	0.3	...	0.5	...	0.3	...	0.0
Interest arrears	0.0	0.3	0.3	0.2	0.2	...	0.2	...	0.1	...	0.1
Augmented balance	**-2.5**	**-3.8**	**-0.2**	**-1.1**	**0.0**	**...**	**-0.4**	**...**	**0.0**	**...**	**0.3**
Memorandum item:											
Provincial financing (net)	2.6	0.7	-0.44	0.0	-1.3	-0.2	-0.2	-0.4	-0.4	-0.4	-0.4
Amortization	-0.8	-0.6	-2.0	-0.6	-0.8	-1.0	-1.0	-1.0	-1.0	-1.4	-1.4
Gross financing	3.4	1.3	1.5	0.6	-0.5	0.9	0.8	0.6	0.5	1.0	1.0
Nominal GDP (Arg$ billion)	268.7	312.6	375.9	416.9	447.3	507.4	507.4	567.8	567.8	623.7	623.7

Sources: Ministry of Economy; and Fund staff estimates.
1/ Expenditure measured on a commitment basis.
2/ Include transfers to municipalities for coparticipation and transfers to provincial pension systems.
3/ Reflects the settlement of obligations in bonds, often resulting from judicial rulings.
4/ Staff estimates.

Table 9. Argentina: Consolidated Public Debt: 2001-04
(In US$ billions, except where noted; end period)

	2001	2002	2003	Est. 2004
Total debt (I+II)	**167.0**	**152.6**	**184.8**	**201.4**
In percent of GDP	*62.2*	*164.2*	*144.5*	*133.9*
I. Federal government	**143.7**	**137.0**	**177.8**	**193.9**
A. Official debt	36.1	35.7	37.5	36.0
1. Multilaterals	31.6	30.8	31.0	29.4
IMF	14.0	14.3	15.5	14.1
World Bank	9.4	8.5	7.5	7.4
IADB	8.2	8.0	8.0	7.8
2. Bilateral	4.5	4.9	6.5	6.6
B. Private creditors	42.3	98.4	134.2	149.6
1. Performing debt	42.3	37.0	39.0	43.1
a. Banks (Bodens), compensation for:	0.0	8.9	8.3	8.6
Asymmetric pesoization	0.0	6.5	5.9	6.2
Cobertura bonds - asymmetric indexation	0.0	2.4	2.4	2.4
b. Depositors (Bodens)	0.0	5.3	6.1	7.5
Exchange of deposits for bonds	0.0	...	6.1	6.2
Compensation associated with deposit liberalization	0.0	...	0.0	1.3
c. Civil servants (compensation for 2001 wage cut)	0.0	0.0	0.9	0.8
d. Phase 1 debt 1/	42.3	22.8	23.8	26.3
2. Nonperforming (Phase 2) debt 2/	...	61.4	95.2	106.5
C. BCRA (Quasi-monies bonds)	0.0	0.0	2.4	2.6
D. Other	65.4	2.9	3.7	5.6
Treasury bills, bonds and other short-term instruments	61.8	0.0	0.0	0.0
Central bank short-term financing	0.0	1.1	2.5	4.5
Banks and other	3.6	1.8	1.1	1.2
II. Provincial governments (net of intergovernmental debt)	**23.3**	**15.6**	**7.0**	**7.5**
Memorandum items:				
Nonperforming debt 3/	...	92.4	106.3	118.0
Performing debt	167.0	60.2	78.5	83.4
Multilaterals 4/	31.6	14.3	31.0	29.4
Private creditors, BCRA, and other	135.4	38.1	43.9	50.2
of which: Bodens	0.0	14.2	17.6	19.4

Sources: Argentine authorities; and staff projections.

1/ Includes provincial debt assumed by the federal government.
2/ Includes the effect of converting pesified phase 2 bonds to their original dollar values. Excludes interest on past due principal and interest on past due interest.
3/ Includes the sum of non-performing Phase 2 debt, bilateral, bank and other debt, and assumes half of provincial debt is non-performing.
4/ Reflects arrears to multilateral development banks at end 2002.

Table 10. Argentina: Summary Operations of the Financial System, 2001-2007

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

					Projections		
	2001	2002	2003	2004	2005	2006	2007
I. Central Bank							
Net international reserves 2/	-7.1	-20.7	-11.9	4.3	21.0	29.7	37.2
(In billions of US dollars)	-7.1	-6.2	-4.1	1.4	7.2	10.2	12.7
Gross international reserves (US$ billions	14.9	10.5	14.1	19.6	20.7	22.1	20.4
Net domestic assets	19.0	49.9	58.3	48.2	32.6	27.0	23.1
Credit to the public sector (net)	15.7	54.1	61.2	64.4	52.6	48.1	42.8
Credit to the financial sector (net)	5.0	23.4	17.8	21.5	15.3	12.5	10.3
Central bank bonds (*Lebacs*)	...	-3.2	-9.6	-21.8	-19.8	-18.2	-14.6
Official capital and other items (net)	-1.7	-24.5	-11.1	-15.8	-15.4	-15.4	-15.4
Monetary base	11.9	29.2	46.4	52.5	53.6	56.7	60.3
Currency issued	11.0	18.8	30.3	37.6	40.0	42.0	44.5
Bank deposits at the central bank	0.9	10.3	16.1	14.9	13.7	14.7	15.8
II. Banks and Non-Bank Financial Institutions							
Net foreign assets	-6.0	-27.0	-15.5	-11.3	-11.0	-11.0	-9.9
Net domestic assets	66.0	92.4	92.3	94.3	104.6	117.2	128.3
Credit to the public sector (net)	24.1	83.6	77.2	69.8	65.2	64.5	63.8
Credit to the private sector	54.2	47.2	39.9	46.1	54.4	63.2	71.5
Claims on the central bank (net)	4.6	-13.9	-3.6	-1.2	4.5	8.3	11.6
Capital and reserves	-15.8	-25.0	-21.0	-21.6	-23.5	-26.4	-28.4
Other	-1.1	0.5	-0.2	1.2	4.1	7.7	9.8
Private sector deposits	60.0	65.4	76.8	83.0	93.6	106.2	118.5
Local currency	15.9	63.2	71.7	75.6	85.4	97.4	109.1
Foreign currency	44.1	2.2	5.2	7.4	8.2	8.8	9.4
III. Consolidated Financial System							
Net foreign assets	-13.1	-47.8	-27.4	-7.0	9.9	18.7	27.3
Net domestic assets	82.1	129.6	130.9	123.9	119.9	125.8	131.9
Credit to the public sector (net)	39.8	137.7	138.3	134.2	117.8	112.6	106.7
Credit to the private sector	54.2	47.2	39.9	46.1	54.4	63.2	71.5
Net capital, reserves, and other assets	-11.8	-55.4	-47.4	-56.4	-52.3	-50.1	-46.3
Liabilities to the private sector (broad money	69.0	81.8	103.5	116.9	129.8	144.4	159.2
Currency in circulation	9.1	16.4	26.6	33.9	36.2	38.2	40.8
Local currency deposits	15.9	63.2	71.7	75.6	85.4	97.4	109.1
Foreign currency deposits	44.1	2.2	5.2	7.4	8.2	8.8	9.4
Memorandum items:							
Augmented base money 3/	14.6	37.0	46.7	52.6	53.7	56.7	60.3
Augmented M1 4/	20.8	35.7	42.0	52.2	57.0	61.8	67.2
Augmented M3 5/	71.8	89.6	103.8	117.0	129.9	144.4	159.2
(Annual percent change)							
Augmented base money	-3.0	152.9	26.3	12.7	2.2	5.5	6.3
Augmented M1	10.8	71.9	17.6	24.2	9.3	8.4	8.7
Augmented M3	-16.8	24.9	15.8	12.7	11.1	11.2	10.3
Credit to the private sector	-20.2	-12.8	-15.5	15.4	18.0	16.3	13.1

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

1/ Foreign currency items in projections are valued at the an exchange rate of Arg$2.96 per U.S. dollar, and US$1.5 per SDR.
2/ Net international reserves at end-2005 assume external financing gaps are closed with exceptional external financing (see Table 3).
3/ Monetary base plus quasi-monies in circulation.
4/ Currency in circulation plus demand deposits plus quasi-monies in circulation.
5/ M1 as defined in footnote 3, plus time and savings deposits.

Table 11. Argentina: Selected Vulnerability Indicators

	2001	2002	2003	2004 1/	2005 1/	Latest Observation
Key economic and market indicators						
Real GDP growth (in percent)	-4.4	-10.9	8.8	9.0	6.2	Proj
CPI inflation (period average, in percent)	-1.1	25.9	13.4	4.4	9.0	Proj
Short-term (ST) interest rate (in percent)	...	22.2	3.7	3.0	3.7	May-05
EMBI secondary market spread (bps, end of period)	4,372	6,391	5,632	4,703	6,060	May-05
Exchange rate NC/US$ (end of period)	1.00	3.36	2.94	2.97	2.90	May-05
External sector						
Exchange rate regime	Currency board	floating	floating	floating	floating	
Current account balance (percent of GDP)	-1.4	9.0	6.1	2.1	1.0	Proj
Net FDI inflows (percent of GDP)	0.7	1.7	0.2	2.1	1.9	Proj
Exports (percentage change of US$ value, GNFS)	0.8	-3.1	15.3	16.5	7.3	Proj
Real effective exchange rate (1993 = 100)	111.8	49.5	55.9	56.7	...	Dec-04
Gross international reserves (GIR) in US$ billion	14.9	10.5	14.1	19.6	20.7	Proj
GIR in percent of ST debt at remaining maturity (RM)	59.4	79.0	64.2	79.8	89.9	Proj
GIR in percent of ST debt at RM and banks' FX deposits.	21.5	75.3	59.5	72.5	80.4	Proj
Net international reserves (NIR) in US$ billion	0.9	-3.9	-1.4	5.6	10.4	Proj
Total gross external debt (ED) in percent of GDP	52.1	133.7	115.4	170.5	...	Dec-04
o/w ST external debt (original maturity, in percent of total ED)	12.0	8.7	9.2	7.0	...	Dec-04
ED of domestic private sector (in percent of total ED)	25.2	23.4	21.3	34.6	...	Dec-04
ED to foreign official sector (in percent of total ED)	20.5	28.7	27.8	22.4	...	Dec-04
Total gross external debt in percent of exports of GNFS	451.5	472.0	437.9	433.5	...	Dec-04
Gross external financing requirement (in US$ billion) 2/	28.9	23.4	23.8	20.4	13.5	Proj
Public sector (PS) 3/						
Overall balance (percent of GDP)	-5.9	-1.8	1.1	3.7	1.4	Proj
Primary balance (percent of GDP)	-1.3	0.6	3.0	5.1	3.8	Proj
Debt-stabilizing primary balance (percent of GDP) 4/	2.5	5.0	9.5	1.5	-4.3	Proj
Gross PS financing requirement (in percent of GDP) 5/	...	...	...	3.3	4.7	Proj
Public sector gross debt (PSGD, in percent of GDP)	62.2	164.2	144.5	133.9	..	2004 (est.)
o/w Exposed to external rollover risk (in percent of total PSGD) 6	30.7	34.8	36.3	35.4	..	Dec-04
Exposed to exchange rate risk (in percent of total PSGD) 7/	...	71.1	69.1	66.8	..	Dec-04
Domestic debt exposed to interest rate risk (in percent of total l	...	31.2	22.3	22.8	..	Dec-04
Financial sector (FS) 9/						
Capital adequacy ratio (in percent)	13.3	13.9	11.7	10.7	...	Dec-04
NPLs in percent of total loans	19.1	38.6	31.1	18.8	...	Dec-04
Provisions in percent of NPLs	67.5	76.0	82.2	100.5	...	Dec-04
Return on average assets (in percent)	0.0	-8.9	-2.6	-0.3	...	Dec-04
Return on equity (in percent)	-1.5	-73.3	-24.7	-2.5	...	Dec-04
FX deposits held by residents (in percent of total deposits)	71.5	4.2	6.7	10.7	...	Dec-04
FX loans to residents (in percent of total loans)	80.0	7.2	7.1	14.1	...	Dec-04
Net open forex position (in percent of capital) 10/	76.1	35.8	53.5	36.3	...	Dec-04
Government debt held by FS (percent of total FS assets)	22.9	49.5	46.1	42.0	...	Dec-04
Credit to private sector (percent change)	-17.6	-14.4	-15.6	23.1	...	Dec-04
Memorandum item:						
Nominal GDP in billions of U.S. dollars	268.7	101.5	127.3	151.9	...	...

1/ Staff estimates, projections, or latest available observations as indicated in the last column.
2/ Current account deficit plus amortization of external debt.
3/ Public sector covers federal and provincial government based on the authorities' projections.
4/ Based on averages for the last five years for the relevant variables (i.e., growth, interest rates). The figure for 2005 stabilizes the debt ratio at the post-restructuring level (90 percent).
5/ Overall balance plus debt amortization. Assumes full participation in the debt exchange.
6/ External ST debt and maturing medium- and long-term debt, excluding external debt to official creditors.
7/ Debt in foreign currency or linked to the exchange rate, domestic and external, excluding external debt on concessional terms.
8/ Domestic ST debt and maturing medium- and long-term debt at variable interest rates, including inflation-indexed debt.
9/ Financial sector includes banks and financial intermediaries.
10/ Sum of on- and off-balance sheet exposure.

Table 12. Argentina: Medium-Term Macroeconomic Framework, 2001-2010

				Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Real GDP and aggregate demand (percent change)										
Real GDP (1993 Arg$)	-4.4	-10.9	8.8	9.0	6.2	3.8	3.6	3.4	3.2	3.0
Real domestic demand (1993 Arg$)	-6.4	-17.1	11.2	11.7	6.7	4.6	3.5	3.6	3.4	3.1
Consumption	-4.4	-13.4	7.5	7.6	5.1	3.1	3.1	3.0	2.9	2.8
Investment	-15.7	-36.4	38.2	34.5	14.0	10.9	5.2	5.7	5.2	4.1
Exports (1993 Arg$)	2.7	3.1	6.0	8.2	10.7	5.8	5.8	4.2	4.0	4.2
Imports (1993 Arg$)	-13.9	-50.1	37.6	39.8	17.4	13.3	5.8	5.6	5.6	4.9
Shares of GDP (percent)										
Consumption	84.5	73.1	74.1	73.7	75.9	76.1	77.0	77.4	76.9	77.2
Investment	14.2	12.0	15.1	19.1	19.0	20.7	20.4	20.4	21.2	21.1
Net exports	1.3	14.9	10.8	7.2	5.1	3.2	2.6	2.2	1.9	1.7
Contribution to growth (percent)										
Real domestic demand	-6.5	-16.9	10.4	11.0	6.5	4.5	3.5	3.5	3.3	3.0
Consumption	-3.7	-11.1	6.1	6.1	4.0	2.4	2.4	2.3	2.2	2.1
Investment	-2.8	-5.8	4.3	4.9	2.5	2.1	1.1	1.2	1.1	0.9
Net exports	2.1	6.0	-1.5	-2.0	-0.3	-0.7	0.1	-0.1	-0.1	0.0
Savings-investment balance (percent of GDP) 1/										
Gross domestic investment	14.2	12.0	15.1	19.1	19.9	21.5	21.3	21.2	22.0	21.9
of which : Public sector	1.5	0.9	1.5	2.5	3.3	3.4	3.3	3.6	3.5	3.7
Gross national savings	12.7	20.4	20.9	21.1	20.8	21.3	20.7	20.6	21.1	21.0
of which : Public sector	-4.5	-0.9	3.1	6.2	5.4	5.7	5.5	5.3	4.9	5.0
Current account balance	-1.4	8.5	5.8	2.0	1.0	-0.2	-0.6	-0.6	-0.9	-0.9
Consumer prices and exchange rates										
CPI inflation (average)	-1.1	25.9	13.4	4.4	9.0	8.4	7.5	6.5	6.0	6.0
CPI inflation (end-of-period)	-1.5	41.0	3.7	6.1	10.0	8.0	7.0	6.0	6.0	6.0
Real effective exchange rate (average, 2001=100)	100.0	42.5	46.3	44.4	44.8	46.2	47.9	49.6	51.1	52.2
Percent change	*5.9*	*-57.5*	*8.9*	*-4.0*	*0.9*	*3.0*	*3.8*	*3.5*	*3.2*	*2.0*
Memorandum items										
Nominal GDP (Arg$ billion)	269	313	376	447	507	568	624	684	747	814
GDP deflator (percent change)	-1.1	30.6	10.5	9.2	6.8	7.8	6.0	6.0	5.8	5.8
U.S. CPI inflation (average)	2.8	1.6	2.3	2.7	2.7	2.4	2.5	2.5	2.5	2.5
Growth accounting (percent) 2/										
Total factor productivity	...	...	...	...	3.5	1.3	1.3	1.0	0.7	0.5
Labor supply	...	...	...	...	2.5	1.5	1.0	1.0	1.0	1.0
Capital accumulation 3/					2.8	3.6	3.7	3.9	4.1	4.1
Capital -to-GDP ratio 3/	1.57	1.72	1.59	1.50	1.45	1.45	1.45	1.46	1.47	1.49

Sources: Ministry of Economy; BCRA: and IMF staff projections.

1/ Cash basis. Public sector's savings and investment for 2005 and beyond are based on authorities' budget.
2/ Using a labor share of 0.52.
3/ Productive capital stock (machinery and equipment, and non-residential dwellings). Source: INDEC.

DEBT SUSTAINABILITY ANALYSIS (DSA)

A. Authorities' Scenario (Scenario A)

1. **During the Article IV consultation, staff had an intensive discussion with the authorities on debt sustainability**. The authorities presented staff with a scenario that was based on the following assumptions:

- **Macroeconomic framework**: (i) Real growth declines from above 6 percent in 2005 to 3 percent in the medium term; (ii) average inflation falls from 7¾ percent in the near term to 3 percent in the medium term; (iii) the real peso-dollar exchange rate gradually appreciates over time but remains more than 40 percent below its 2001 level; and (iv) interest rates on new dollar borrowing remain constant at 9 percent.

Text Table: Key Macroeconomic and Interest Rate Assumptions

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average 2005-08	Average 2009-15	Average 2016-30
Growth and inflation														
Real GDP growth (percent)	6.2	3.8	3.6	3.4	3.2	3.0	3.0	3.0	3.0	3.0	3.0	4.2	3.0	3.0
Nominal GDP (Arg$ bn)	507	568	624	684	747	814	885	958	1,030	1,098	1,163	596	957	2,013
Average CPI inflation (percent)	7.7	7.7	7.2	6.8	6.4	6.1	5.8	5.2	4.4	3.5	3.5	7.4	5.0	3.5
Exchange rates														
Real peso-U.S. dollar exchange rate (2001=100)	49.6	51.3	52.9	54.5	55.8	56.5	57.0	57.1	57.1	57.1	57.1	52.1	56.8	57.1
Interest rates														
Nominal rate on new dollar borrowing	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0

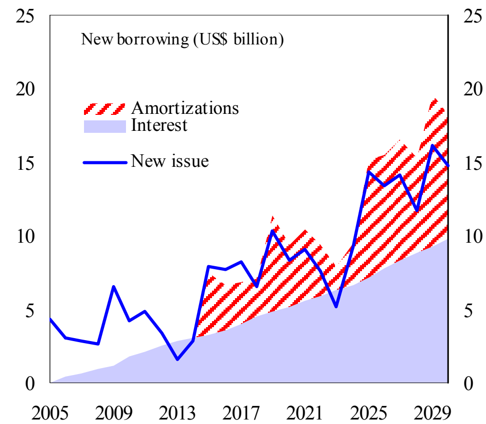
- **Coverage:** Only the federal government is covered. While not explicit in the authorities' model, it is assumed that the provincial governments make net transfers to the federal government ("recoveries") on account on debt service payments made on behalf of the provincial governments.

- **Official debt:** The international financial institutions (IFIs), including the Fund, maintain their exposure at current levels until 2014.[1] After 2014, 80 percent of principal obligations to the Fund are rolled over through 2030, when credit Fund exposure remains at US$8 billion. The exposure of other multilateral creditors also declines gradually as 80 percent of principal amortizations are rolled over starting from 2015. With regard to bilateral debt, the authorities' model assumes forgiveness of interest arrears and a stock rescheduling of the principal claims, involving a ten-year principal grace period starting from mid-2005 and ten-year repayment period. The interest rate on rescheduled claims is *Libor* plus 250 basis points, with interest capitalized during the first two years.[2]

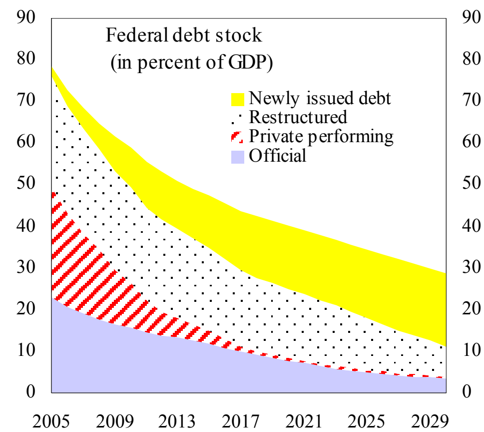
[1] The authorities assume stand-by arrangements from 2005 until 2011 and extended arrangements afterwards.

[2] The authorities indicated that this working assumption should not be construed as their negotiating position toward Paris Club creditors.

- **Fiscal effort:** The federal primary surplus that is available for debt service (appropriable primary surplus) is 2¾ percent in the near term and 2 percent in the long term. The primary surplus under the program definition is higher by the fiscal savings accumulated by the social security and other fiscal entities.



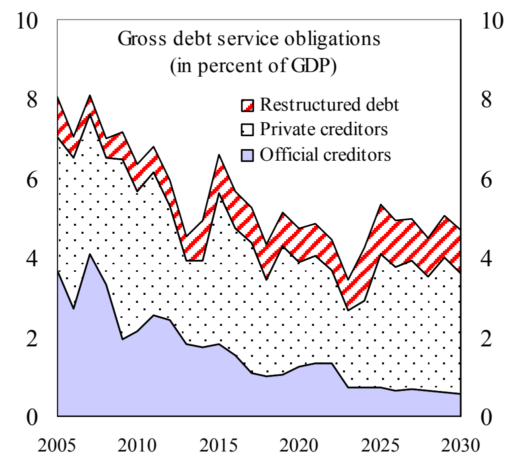
- **Financing sources:** In 2005, the scenario includes a drawdown of accumulated government deposits of US$1 billion. Any residual financing need is financed through the issuance of a generic ten-year U.S. dollar denominated bullet bond paying the market interest rate, assumed at 9 percent.



- **Restructured debt:** Debt service obligations on the restructured debt assume full creditor participation from 2005.

2. **The main implications of the authorities' scenario are as follows** (Annex Table 1):

- **While starting from high levels, the federal debt stock would decline rapidly.** The debt-to-GDP ratio would fall from 79 percent of GDP at end-2005 to 60 percent by 2010 and 30 percent by 2030, when the newly issued debt represents ⅔ of outstanding debt.



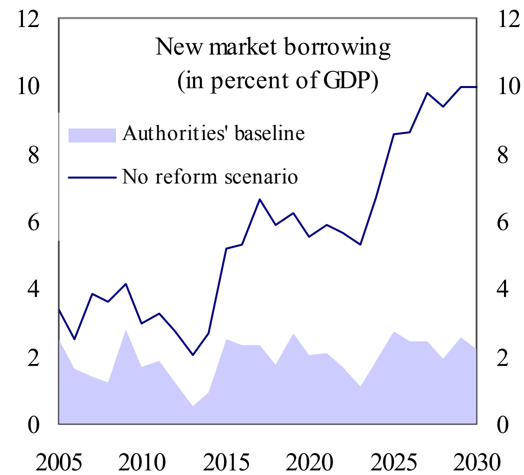
- **Argentina would face important gross debt service obligations in the near term.** Despite the low payments on the restructured debt, debt service obligations remain around 8 percent of GDP from 2005–08, with the bulk of payments due to official creditors and post-crisis performing debt. When debt service obligations on the restructured debt pick up toward the end of the projection period, as coupon rates rise and amortizations begin, overall debt service obligations would average about 5 percent of GDP.

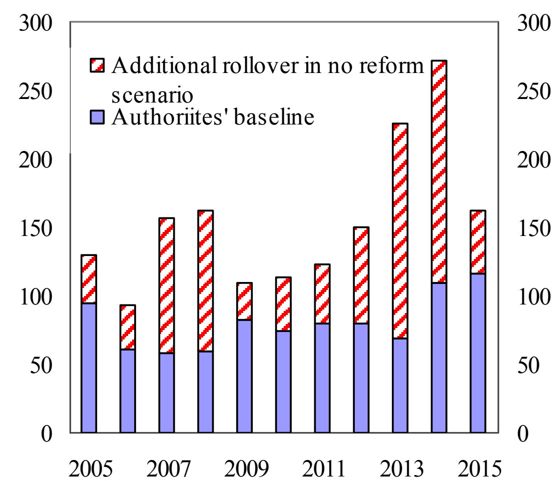
- **Accordingly, Argentina would need to place significant amounts of debt on the private capital markets.** After the assumed full rollover of principal repayments to

IFIs, new market borrowing would average 1¾ percent of GDP from 2005–2008 (or US$3.2 billion).

B. Staff Assessment of Authorities' Scenario (Scenario B)

3. **The staff argued that the authorities' scenario was based on several unrealistic assumptions.** An alternative scenario based on current policies was therefore developed, in which the absence of a structural reform policy framework results in a weaker macroeconomic outlook. Under this scenario, sluggish productivity growth reduces growth prospects closer to 2 percent over the medium term and fails to lift the real exchange rate above current levels. In addition, the authorities' fiscal scenario is retained, while inflation averages 10 percent in the medium term. These adverse developments justify a higher interest rate on new market borrowing (by 100 basis points). Finally, the unrealistic assumption of full rollover of Fund resources was dropped and no Fund disbursements were assumed in this scenario.





4. **The results of such a no-reform scenario show a significantly higher debt-to-GDP ratio and a substantial need to borrow in the private market** (Annex Table 2). The debt ratio would not converge onto a clear downward path and debt placements would be almost 3½ percent of GDP in 2005 and remain on average at around this level until 2010.

5. **It is unlikely that private sources could be mobilized to meet these borrowing needs.** Rollover rates on privately held debt would need to be as high as 129 percent in 2005 and average 150 percent in 2006–15.

C. Staff Scenario with Reforms (Scenario C)

6. **The staff developed its own scenario based on the assumption of proactive reforms, which would underpin higher growth, lower inflation and lower borrowing costs than in scenario B.** The main assumptions in this scenario are as follows:

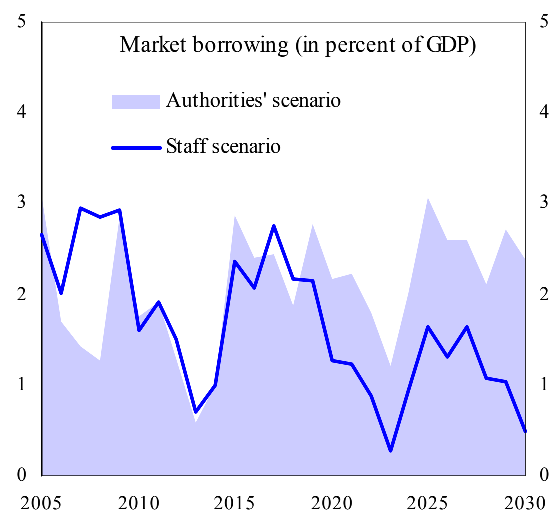
- **Official debt:** No further Fund disbursements under the current or future arrangements are assumed, implying that Fund exposure would be reduced to zero by

2009. A flow rescheduling of bilateral claims under classic terms is assumed to take place at end-2005.

- **Fiscal effort:** Active policies are assumed whereby the financial transaction and export taxes are gradually phased out starting in 2006 and compensatory measures are adopted to offset revenue losses. This active tax reform scenario, combined with prudent expenditure policies, results in a primary surplus that averages at least 4½ percent of GDP from 2005–07, 3½ percent from 2008–15 and stabilizes at 2¾ percent in outer years. Provincial governments are assumed to generate primary surpluses that are sufficient to cover provincial debt service obligations on the debt restructured in 2002, debt issued to withdraw quasi-monies, and non-intergovernmental debt.

7. **The results of the staff scenario indicate that the debt burden converges gradually towards sustainable levels but market financing needs would still remain high** (Annex Table 3):

- **Debt-to-GDP ratio:** The debt-to-GDP ratio would decline at a faster pace than under the authorities' scenario, owing to the higher fiscal effort, although the need to replace official sources with more costly private sources would partially dampen the debt-reducing effect of higher surpluses. The debt ratio would fall to 60 percent in 2009, one year earlier than in the authorities' scenario, and would be 11 percentage points lower at the end of the projection period.



- **Reliance on private capital markets:** Despite the higher fiscal effort, the market financing requirements would be even higher by almost 1 percent of GDP from 2005–08 under the staff scenario than in the authorities' scenario (A), with *additional* market borrowing averaging almost US$2 billion. The rollover rate would remain in the near term at an average of 109 percent from 2005–08, compared to 68 percent under the authorities' scenario.

D. Staff Scenario with Use of Central Bank Credit (Scenario D)

8. **The staff scenario was modified to allow for the use of central bank credit to meet net amortizations to the Fund.** It was assumed that the current limits on central bank

lending to the government are relaxed to allow for payments to the Fund from international reserves.[3]

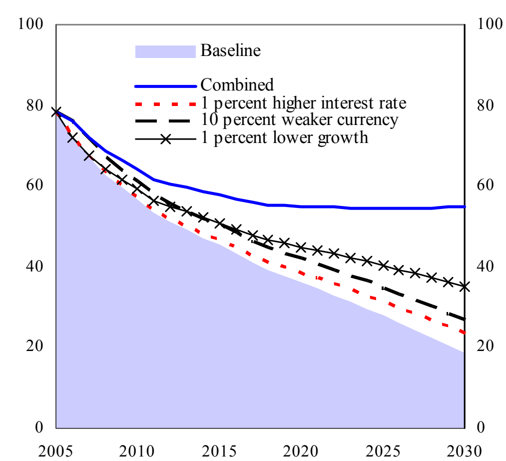
9. **The reduction in the required market borrowing would be substantial and therefore reduce rollover risk significantly** (Annex Table 4). Under this scenario, market borrowing would be about ¾ percent of GDP or 1¾ percentage points of GDP lower than in the staff's baseline scenario (C), reducing the required rollover rates to an average of only 34 percent in the near term.

E. Sensitivity

10. **The debt dynamics of the staff's scenario (C) are highly sensitive to the underlying macroeconomic assumptions**.

- In the near term, short-lived but large shocks to output growth or the exchange rate, or fiscal policy slippages, have the potential to generate significant increases in the debt-to-GDP ratio (Annex Table 5). The average long maturity of the debt structure should provide cushion against real interest rate shocks.

- In the long term, maintaining growth is key to debt sustainability both directly and indirectly (by reducing the risk of exchange rate and interest rate shocks). Compared to the baseline scenario, (i) a permanent increase in interest rates by one percentage point would increase the 2030 debt ratio by 5 percentage points; (ii) a permanent 1 percentage point reduction in the growth rate from 2006 would increase the 2030 debt ratio by 17 percentage points; and (iii) a 10 percentage point more depreciated level for the real exchange rate from 2006 would raise the 2030 debt ratio by 8 percentage points. If combined, the above mentioned shocks would lead to unsustainable debt dynamics, with the debt ratio falling only very gradually until 2015 and remaining at high levels afterwards. Conversely, a higher than projected real appreciation would reinforce the downward trend in the debt-to-GDP ratio, with a 10 percent more appreciated exchange rate reducing the debt ratio by 8 percentage points by 2030.



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[3] The illustrative assumption made by staff in the quantitative projections is that the BCRA will receive long-term bonds (with a five-year grace period on principal and a 15-year amortization period), which carry a market interest rate.

- A one-time increase in the debt stock of 10 percent of GDP, for example from liabilities in the banking and utility sectors, would not generate explosive dynamics. However, it would significantly delay the transition towards sustainable levels of indebtedness.

11. **The debt dynamics in the near term are robust to alternative assumptions on the terms of the new market borrowing**, with alternative assumptions affecting mostly the outer years of the projection period (2016–30). An assumption of gradually declining spreads[4] would only reduce the debt-to-GDP ratio by 1½ percentage points by 2030 compared to the staff scenario C. The use of bonds with a shorter grace period (five years) but a longer amortization period (15 years) for new borrowing would raise average amortizations by 0.1 percent of GDP in 2009–2015 yet reduce them by ⅓ percent of GDP in the outer years of the projection period, without affecting the debt stock.

Effect of alternative bond and interest rate assumptions
(in percent of GDP)

	Average		
	2005-08	2009-15	2016-30
Declining interest rates			
Interest	0.0	0.0	-0.3
Amortization	0.0	0.0	0.0
New borrowing	0.0	0.0	-0.3
Debt stock	0.0	-0.1	-1.5
5-y grace, 15-y amortization			
Interest	0.0	0.0	0.0
Amortization	0.0	0.1	-0.3
New borrowing	0.0	0.1	-0.3
Debt stock	0.0	0.0	0.0
Combined change			
Interest	0.0	0.0	-0.2
Amortization	0.0	0.2	-0.3
New borrowing	0.0	0.1	-0.5
Debt stock	0.0	-0.1	-1.4

12. **The burden of the debt service is somewhat less in net-present-value terms than that suggested by the headline ratios of the DSA scenarios.** Long maturities and below-market interest rates on a large part of the debt imply that the average carrying cost (on a cash basis) rises gradually from rather low levels. As a result, for discount rates between 8 and 12 percent, the net present value of the outstanding debt service obligations at end-2005 is lower than the face value of debt by between 8 to 23 percentage points of GDP. The largest relief is afforded by the restructured debt, although the existing performing debt and the debt to official creditors also contribute to alleviating the debt service burden in net present value terms.

Debt Stock at End-2005 (in percent of GDP)

	Discount rate (in percent)				
	8	9	10	11	12
NPV	70	65	61	58	55

[4] This exercise assumes spreads over US government bonds that decline from 490 basis points in 2005 to 400 in 2015 and 150 points by the end of the projection period (corresponding to interest rates of 8.4 percent and 6.4 percent, respectively).

Table 1: Argentina: Federal Government Financing Projections

A: Authorities' scenario (in percent of GDP unless otherwise noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average 2005-08	Average 2009-15	Average 2016-30
Uses of funds	**8.1**	**7.0**	**8.0**	**7.0**	**7.1**	**6.3**	**6.7**	**5.9**	**4.5**	**4.9**	**6.2**	**7.5**	**5.9**	**4.6**
A. Total cash interest payments	2.4	2.1	2.1	2.2	2.4	2.5	2.4	2.4	2.4	2.8	2.7	2.2	2.5	2.4
Official	0.7	0.7	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.6	0.6	0.7	0.7	0.3
o/w IMF	0.3	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.1
Private	1.7	1.4	1.4	1.4	1.6	1.7	1.7	1.8	1.8	2.1	2.1	1.5	1.8	2.0
o/w Performing debt 1/	0.7	0.9	0.9	1.0	0.9	1.0	1.1	1.1	1.1	1.1	1.1	0.9	1.1	1.4
Restructured bonds 2/	1.0	0.5	0.5	0.5	0.7	0.7	0.7	0.6	0.6	1.0	1.0	0.6	0.8	0.7
B. Amortizations	5.6	4.8	5.8	4.6	4.6	3.7	4.2	3.3	1.9	2.0	3.4	5.2	3.3	2.1
Official	3.0	2.1	3.4	2.6	1.2	1.4	1.8	1.8	1.2	1.1	1.2	2.8	1.4	0.6
o/w IMF	2.1	0.9	2.2	1.7	0.6	0.9	1.4	1.3	0.7	0.7	0.8	1.7	0.9	0.2
Private	2.6	2.7	2.4	2.1	3.4	2.3	2.3	1.6	0.8	0.9	2.1	2.4	1.9	1.5
o/w Performing debt 1/	2.6	2.7	2.4	2.1	3.4	2.3	2.3	1.6	0.8	0.9	2.1	2.4	1.9	1.2
Restructured bonds 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
C. GDP-linked warrant (expected payment) 3/	...	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Sources of funds	**8.1**	**7.0**	**8.0**	**7.0**	**7.1**	**6.3**	**6.7**	**5.9**	**4.5**	**4.9**	**6.2**	**7.5**	**5.9**	**4.6**
D. Recoveries 4/	1.1	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.4	0.5	0.5	0.6	0.5	0.1
E. Use of central bank credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
F. New borrowing	4.3	3.7	4.8	3.8	4.0	3.1	3.7	3.0	1.7	2.1	3.5	4.1	3.0	2.6
Official	1.8	2.1	3.4	2.6	1.2	1.4	1.8	1.8	1.2	1.1	1.0	2.5	1.3	0.4
o/w IMF	0.9	0.9	2.2	1.7	0.6	0.9	1.4	1.3	0.7	0.7	0.7	1.4	0.9	0.2
Private	2.5	1.7	1.4	1.2	2.8	1.7	1.9	1.2	0.5	0.9	2.5	1.7	1.7	2.2
G. *Appropriable surplus (authorities' definition)*	2.8	2.8	2.8	2.7	2.7	2.7	2.6	2.5	2.4	2.3	2.2	2.7	2.5	2.0
Primary surplus (program definition)	3.0	3.0	3.0	2.9	2.9	2.9	2.8	2.7	2.6	2.5	2.4	2.9	2.7	2.2
Federal debt stock	**79**	**73**	**69**	**65**	**62**	**59**	**55**	**53**	**51**	**49**	**47**	**71**	**54**	**37**
In U$ dollars (bn)	*134*	*136*	*138*	*141*	*143*	*146*	*145*	*146*	*148*	*149*	*150*	*137*	*147*	*172*
o/w Restructured Debt 2/	27	26	25	24	24	23	22	22	22	21	20	26	22	14
Newly issued debt	2	4	5	6	8	10	11	12	12	12	13	4	11	16
Memorandum items														
Outstanding Fund credit (US$ billion)	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.7	11.2	11.7	11.6	9.7
Consolidated primary surplus (program definition)	3.8	3.8	3.8	3.6	3.6	3.6	3.5	3.2	3.1	3.1	3.0	3.7	3.3	2.3
Implied rollover rate (in percent of debt falling due)														
IMF	43	100	100	100	100	100	100	100	100	100	80	86	97	80
Worldbank/IDB	100	100	100	100	100	100	100	100	100	100	80	100	97	80
Private sector debt	95	61	58	59	82	74	80	79	69	110	116	68	87	160
Real GDP growth (percent)	6.2	3.8	3.6	3.4	3.2	3.0	3.0	3.0	3.0	3.0	3.0	4.2	3.0	3.0
Real peso-U.S. dollar exchange rate (2001=100)	49.6	51.3	52.9	54.5	55.8	56.5	57.0	57.1	57.1	57.1	57.1	52.1	56.8	57.1
Average inflation rate (percent)	7.7	7.7	7.2	6.8	6.4	6.1	5.8	5.2	4.4	3.5	3.5	7.4	5.0	3.5
Effective interest rate (in percent) 5/	2.2	2.9	3.2	3.5	4.0	4.4	4.5	4.8	4.9	5.7	5.8	2.9	4.9	6.7
Interest rate on new dollar borrowing (percent)	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Capitalized interest	3.2	2.7	2.4	2.2	1.8	1.6	1.4	1.1	1.0	0.5	0.5	2.6	1.1	0.3
Inflation adjustment	2.3	2.1	1.8	1.6	1.4	1.2	1.1	0.8	0.7	0.5	0.5	2.0	0.9	0.3
Coupon (mainly on restructured debt)	0.8	0.7	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.0	0.0	0.6	0.2	0.0

Source: Ministry of Economy and Fund staff estimates

1/ Includes quasi-money bonds; debt to commercial banks and other commercial creditors; and new market borrowing.
2/ Interest payment in 2005 includes interests accrued in 2004. Assumes full creditor participation in the debt exchange.
3/ Expected payment computed as average payment in 2,500 random draws.
4/ These are non-borrowed resources of the federal government available for debt service. In 2005, it includes drawdown of deposits accumulated in 2004 (US$1 billion).
5/ Defined as average cash debt carrying cost.

Table 2: Argentina: Federal Government Financing Projections

B: No reform scenario (in percent of GDP unless otherwise noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average 2005-08	Average 2009-15	Average 2016-30
Uses of funds	**8.1**	**7.0**	**8.4**	**7.7**	**7.9**	**6.7**	**6.8**	**6.1**	**5.3**	**5.9**	**8.2**	**7.8**	**6.7**	**9.6**
A. Total cash interest payments	2.4	2.1	2.3	2.6	3.1	3.4	3.5	3.6	3.7	4.3	4.3	2.3	3.7	5.6
Official	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.6	0.6	0.3
o/w IMF	0.3	0.2	0.2	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Private	1.7	1.5	1.7	2.0	2.5	2.8	2.9	3.0	3.2	3.7	3.8	1.7	3.1	5.3
o/w Performing debt 1/	0.7	1.0	1.2	1.5	1.7	2.0	2.1	2.3	2.4	2.5	2.6	1.1	2.2	4.4
Restructured bonds 2/	1.0	0.5	0.5	0.5	0.8	0.8	0.8	0.8	0.8	1.2	1.2	0.6	0.9	0.9
B. Amortizations	5.6	4.7	6.0	5.0	4.6	3.2	3.2	2.3	1.4	1.5	3.7	5.3	2.9	3.9
Official	3.0	2.0	3.5	2.8	0.8	0.6	0.5	0.5	0.5	0.5	0.5	2.8	0.6	0.5
o/w IMF	2.1	0.9	2.2	1.8	0.2	0.0	0.0	0.0	0.0	0.0	0.0	1.8	0.0	0.0
Private	2.6	2.7	2.5	2.2	3.8	2.6	2.7	1.8	0.9	1.0	3.2	2.5	2.3	3.4
o/w Performing debt 1/	2.6	2.7	2.5	2.2	3.8	2.6	2.7	1.8	0.9	1.0	3.2	2.5	2.3	3.0
Restructured bonds 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.4
C. GDP-linked warrant (expected payment) 3/	...	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.1
Sources of funds	**8.1**	**7.0**	**8.4**	**7.7**	**7.9**	**6.7**	**6.8**	**6.1**	**5.3**	**5.9**	**8.2**	**7.8**	**6.7**	**9.7**
D. Recoveries 4/	1.1	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.3	0.4	0.4	0.6	0.4	0.1
E. Use of central bank credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
F. New borrowing	4.2	3.7	5.1	4.6	4.7	3.5	3.8	3.2	2.6	3.2	5.6	4.4	3.8	7.6
Official	0.8	1.2	1.3	0.9	0.6	0.6	0.5	0.5	0.5	0.5	0.4	1.1	0.5	0.3
o/w IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private	3.4	2.5	3.8	3.6	4.1	2.9	3.3	2.7	2.0	2.7	5.2	3.4	3.3	7.3
G. *Appropriable surplus (authorities' definition)*	2.8	2.8	2.8	2.7	2.7	2.7	2.6	2.5	2.4	2.3	2.2	2.7	2.5	2.0
Primary surplus (program definition)	3.0	3.0	3.0	2.9	2.9	2.9	2.8	2.7	2.6	2.5	2.4	2.9	2.7	2.2
Federal debt stock	**79**	**72**	**71**	**70**	**70**	**70**	**68**	**67**	**66**	**66**	**65**	**73**	**68**	**72**
In U$ dollars (bn)	*134*	*138*	*139*	*141*	*144*	*147*	*149*	*153*	*157*	*162*	*168*	*138*	*154*	*259*
o/w Restructured Debt 2/	27	26	26	26	26	26	26	26	25	25	24	26	26	18
Newly issued debt	3	6	9	13	17	19	22	23	25	26	28	8	23	48
Memorandum items														
Outstanding Fund credit (US$ billion)	10.1	8.5	4.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.8	0.0	0.0
Consolidated primary surplus (program definition)	3.8	3.8	3.8	3.6	3.6	3.6	3.5	3.2	3.1	3.1	3.0	3.7	3.3	2.3
Implied rollover rate (in percent of debt falling due)														
IMF	0	0	0	0	0	...	...	...	...	...	...	0.0	...	...
Worldbank/IDB	100	100	100	100	100	100	100	100	100	100	80	100	97	80
Private sector debt	129	93	157	162	109	113	123	150	226	271	162	135	165	231
Real GDP growth (percent)	6.2	2.8	2.6	2.4	2.2	2.0	2.0	2.0	2.0	2.0	2.0	3.5	2.0	2.0
Real peso-U.S. dollar exchange rate (2001=100)	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6	49.6
Average inflation rate (percent)	7.7	8.5	9.5	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	8.9	10.0	10.0
Effective interest rate (in percent) 5/	2.2	3.0	3.4	4.0	4.8	5.3	5.6	6.0	6.2	7.2	7.4	3.1	6.1	8.8
Interest rate on new dollar borrowing (percent)	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Capitalized interest	3.2	3.0	3.0	3.0	2.7	2.5	2.3	2.1	2.0	1.6	1.5	3.0	2.1	1.0
Inflation adjustment	2.3	2.3	2.4	2.4	2.3	2.1	2.0	1.7	1.6	1.6	1.5	2.4	1.8	1.0
Coupon (mainly on restructured debt)	0.8	0.7	0.6	0.6	0.4	0.4	0.3	0.3	0.3	0.0	0.0	0.7	0.3	0.0
Possible market access 6/	1.2	1.3	1.3	1.2	2.3	1.7	1.9	1.4	0.7	0.8	2.9	1.2	1.7	2.7
In percent of private debt falling due	45	48	51	55	60	65	70	75	80	85	90	50	75	90

Source: Ministry of Economy and Fund staff estimates

1/ Includes quasi-money bonds; debt to commercial banks and other commercial creditors; and new market borrowing.
2/ Interest payment in 2005 includes interests accrued in 2004. Assumes full creditor participation in the debt exchange.
3/ Expected payment computed as average payment in 2,500 random draws.
4/ These are non-borrowed resources of the federal government available for debt service. In 2005, it includes drawdown of deposits accumulated in 2004 (US$1 billion).
5/ Defined as average cash debt carrying cost.
6/ This represents the staff estimate of possible private debt rollover.

Table 3: Argentina: Federal Government Financing Projections

C: Staff scenario (in percent of GDP unless otherwise noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average 2005-08	Average 2009-15	Average 2016-30
Uses of funds	**8.1**	**7.2**	**8.2**	**7.3**	**7.0**	**5.7**	**5.6**	**4.8**	**4.0**	**4.4**	**5.7**	**7.7**	**5.3**	**4.2**
A. Total cash interest payments	2.4	2.3	2.3	2.3	2.5	2.5	2.5	2.5	2.5	2.8	2.7	2.3	2.6	2.0
Official	0.7	0.9	0.8	0.7	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.8	0.5	0.2
o/w IMF	0.3	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Private	1.7	1.4	1.5	1.6	1.9	2.0	2.0	2.0	2.0	2.4	2.4	1.6	2.1	1.8
o/w Performing debt 1/	0.7	0.9	1.0	1.1	1.2	1.3	1.3	1.4	1.4	1.4	1.4	0.9	1.4	1.2
Restructured bonds 2/	1.0	0.5	0.5	0.5	0.7	0.7	0.7	0.6	0.6	1.0	1.0	0.6	0.8	0.7
B. Amortizations	5.6	4.8	5.8	4.9	4.4	3.0	3.0	2.2	1.4	1.5	2.8	5.3	2.6	2.0
Official	3.0	2.1	3.4	2.8	1.0	0.7	0.7	0.6	0.6	0.6	0.6	2.8	0.7	0.3
o/w IMF	2.1	0.9	2.2	1.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	1.7	0.0	0.0
Private	2.6	2.7	2.4	2.1	3.4	2.3	2.3	1.6	0.8	0.9	2.2	2.4	1.9	1.7
o/w Performing debt 1/	2.6	2.7	2.4	2.1	3.4	2.3	2.3	1.6	0.8	0.9	2.2	2.4	1.9	1.4
Restructured bonds 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
C. GDP-linked warrant (expected payment) 3/	...	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Sources of funds	**8.1**	**7.2**	**8.2**	**7.3**	**7.0**	**5.7**	**5.6**	**4.8**	**4.0**	**4.4**	**5.7**	**7.7**	**5.3**	**4.2**
D. Recoveries 4/	1.1	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.4	0.5	0.5	0.6	0.5	0.1
E. Use of central bank credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
F. New borrowing	3.5	3.2	4.2	3.7	3.5	2.1	2.4	1.9	1.1	1.4	2.7	3.6	2.2	1.6
Official	0.8	1.2	1.2	0.9	0.5	0.5	0.4	0.4	0.4	0.4	0.3	1.0	0.4	0.2
o/w IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private	2.7	2.0	3.0	2.8	2.9	1.6	1.9	1.5	0.7	1.0	2.4	2.6	1.7	1.4
G. *Appropriable surplus (authorities' definition)*	3.5	3.5	3.5	3.1	3.1	3.1	2.8	2.5	2.5	2.5	2.5	3.4	2.7	2.5
Primary surplus (program definition)	3.7	3.7	3.7	3.3	3.3	3.3	3.0	2.7	2.7	2.7	2.7	3.6	2.9	2.7
Federal debt stock	**78**	**72**	**67**	**63**	**60**	**57**	**53**	**51**	**49**	**47**	**45**	**70**	**52**	**31**
In U$ dollars (bn)	*134*	*135*	*135*	*137*	*139*	*141*	*139*	*141*	*142*	*143*	*144*	*135*	*141*	*142*
o/w Restructured Debt 2/	27	26	25	24	24	23	22	22	22	21	20	26	22	14
Newly issued debt	3	4	7	9	12	13	14	15	15	15	15	6	14	13
Memorandum items														
Outstanding Fund credit (US$ billion)	10.1	8.5	4.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.8	0.0	0.0
Consolidated primary surplus (program definition)	4.5	4.5	4.5	4.0	4.0	4.0	3.7	3.2	3.2	3.3	3.3	4.4	3.5	2.8
Implied rollover rate (in percent of debt falling due)														
IMF	0	0	0	0	0	...	...	...	...	...	...	0.0	...	...
Worldbank/IDB	100	100	100	100	100	100	100	100	100	100	80	100	97	80
Private sector debt	101	74	125	137	86	70	82	97	91	118	106	109	93	85
Real GDP growth (percent)	6.2	3.8	3.6	3.4	3.2	3.0	3.0	3.0	3.0	3.0	3.0	4.2	3.0	3.0
Real peso-U.S. dollar exchange rate (2001=100)	49.6	51.3	52.9	54.5	55.8	56.5	57.0	57.1	57.1	57.1	57.1	52.1	56.8	57.1
Average inflation rate (percent)	7.7	7.7	7.2	6.8	6.4	6.1	5.8	5.2	4.4	3.5	3.5	7.4	5.0	3.5
Effective interest rate 5/	2.2	3.3	3.5	3.7	4.3	4.6	4.8	5.0	5.2	6.1	6.2	3.2	5.2	6.6
Interest rate on new dollar borrowing (percent)	9	9	9	9	9	9	9	9	9	9	9	9.0	9.0	9.0
Capitalized interest	3.2	2.7	2.4	2.2	1.8	1.6	1.4	1.1	1.0	0.5	0.5	2.6	1.1	0.3
Inflation adjustment	2.3	2.1	1.8	1.6	1.4	1.2	1.1	0.8	0.7	0.5	0.5	2.0	0.9	0.3
Coupon (mainly on restructured debt)	0.8	0.7	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.0	0.0	0.6	0.2	0.0
Possible market access 6/	1.2	1.4	1.4	1.4	2.6	1.9	2.1	1.6	0.8	0.9	2.2	1.4	1.7	1.4
In percent of private debt falling due	45	52	59	68	76	84	92	100	100	100	100	56	93	100

Source: Ministry of Economy and Fund staff estimates

1/ Includes quasi-money bonds; debt to commercial banks and other commercial creditors; and new market borrowing.
2/ Interest payment in 2005 includes interests accrued in 2004. Assumes full creditor participation in the debt exchange.
3/ Expected payment computed as average payment in 2,500 random draws.
4/ These are non-borrowed resources of the federal government available for debt service. In 2005, it includes drawdown of deposits accumulated in 2004 (US$1 billion).
5/ Defined as average cash debt carrying cost.
6/ This represents the staff estimate of possible private debt rollover.

Table 4: Argentina: Federal Government Financing Projections

D: Staff scenario with use of central bank credit (in percent of GDP unless otherwise noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Average 2005-08	Average 2009-15	Average 2016-30
Uses of funds	**8.1**	**7.1**	**8.1**	**7.1**	**6.7**	**5.4**	**5.4**	**4.7**	**3.9**	**4.3**	**4.5**	**7.6**	**5.0**	**3.4**
A. Total cash interest payments	2.5	2.2	2.2	2.1	2.1	2.2	2.1	2.1	2.1	2.4	2.4	2.2	2.2	1.6
Official	0.7	0.9	0.8	0.7	0.6	0.5	0.5	0.5	0.4	0.4	0.4	0.8	0.5	0.2
o/w IMF	0.3	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2	0.0	0.0
Private	1.8	1.3	1.4	1.4	1.6	1.6	1.6	1.6	1.6	2.0	2.0	1.5	1.7	1.4
o/w Performing debt 1/	0.8	0.8	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0	1.0	0.9	1.0	0.7
Restructured bonds 2/	1.0	0.5	0.5	0.5	0.7	0.7	0.7	0.6	0.6	1.0	1.0	0.6	0.8	0.7
B. Amortizations	5.6	4.8	5.8	4.9	4.4	3.1	3.1	2.4	1.7	1.8	2.0	5.3	2.6	1.7
Official	3.0	2.1	3.4	2.8	1.0	0.7	0.7	0.6	0.6	0.6	0.6	2.8	0.7	0.3
o/w IMF	2.1	0.9	2.2	1.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	1.7	0.0	0.0
Private	2.6	2.7	2.4	2.1	3.4	2.4	2.5	1.8	1.1	1.2	1.4	2.4	2.0	1.3
o/w Performing debt 1/	2.6	2.7	2.4	2.1	3.4	2.4	2.5	1.8	1.1	1.2	1.4	2.4	2.0	1.1
Restructured bonds 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.3
C. GDP-linked warrant (expected payment) 3/	...	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Sources of funds	**8.1**	**7.1**	**8.1**	**7.1**	**6.7**	**5.4**	**5.4**	**4.7**	**3.9**	**4.3**	**4.5**	**7.6**	**5.0**	**3.5**
D. Recoveries 4/	1.1	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.4	0.5	0.5	0.6	0.5	0.1
E. Use of central bank credit	2.1	0.9	2.2	1.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	1.7	0.0	0.0
F. New borrowing	1.4	2.2	2.0	1.8	2.9	1.8	2.1	1.8	1.1	1.3	1.5	1.9	1.8	0.9
Official	0.8	1.2	1.2	0.9	0.5	0.5	0.4	0.4	0.4	0.4	0.3	1.0	0.4	0.2
o/w IMF	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Private	0.6	1.0	0.7	1.0	2.4	1.3	1.7	1.4	0.6	0.9	1.1	0.8	1.4	0.7
G. *Appropriable surplus (authorities' definition)*	3.5	3.5	3.5	3.1	3.1	3.1	2.8	2.5	2.5	2.5	2.5	3.4	2.7	2.5
Primary surplus (program definition)	3.7	3.7	3.7	3.3	3.3	3.3	3.0	2.7	2.7	2.7	2.7	3.6	2.9	2.7
Federal debt stock	**78**	**72**	**67**	**63**	**59**	**56**	**52**	**50**	**47**	**45**	**43**	**70**	**50**	**27**
In U$ dollars (bn)	*134*	*134*	*135*	*136*	*138*	*138*	*136*	*136*	*137*	*136*	*136*	*135*	*137*	*120*
o/w Restructured Debt 2/	27	26	25	24	24	23	22	22	22	21	20	26	22	14
Newly issued debt	1	2	2	3	5	6	8	9	9	9	10	2	8	8
Memorandum items														
Outstanding Fund credit (US$ billion)	10.1	8.5	4.1	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	5.8	0.0	0.0
Consolidated primary surplus (program definition)	4.5	4.5	4.5	4.0	4.0	4.0	3.7	3.2	3.2	3.3	3.3	4.4	3.5	2.8
Implied rollover rate (in percent of debt falling due)														
IMF	0	0	0	0	0	...	...	...	...	...	...	0.0	...	...
Worldbank/IDB	100	100	100	100	100	100	100	100	100	100	80	100	97	80
Private sector debt	22	39	30	47	70	56	68	76	58	79	82	34	70	49
Real GDP growth (percent)	6.2	3.8	3.6	3.4	3.2	3.0	3.0	3.0	3.0	3.0	3.0	4.2	3.0	3.0
Real peso-U.S. dollar exchange rate (2001=100)	49.6	51.3	52.9	54.5	55.8	56.5	57.0	57.1	57.1	57.1	57.1	52.1	56.8	57.1
Average inflation rate (percent)	7.7	7.7	7.2	6.8	6.4	6.1	5.8	5.2	4.4	3.5	3.5	7.4	5.0	3.5
Effective interest rate (in percent) 5/	2.3	3.2	3.4	3.4	3.7	4.0	4.1	4.3	4.5	5.4	5.6	3.1	4.5	6.0
Interest rate on new dollar borrowing (percent)	9	9	9	9	9	9	9	9	9	9	9	9.0	9.0	9.0
Capitalized interest	3.2	2.7	2.4	2.2	1.8	1.6	1.4	1.1	1.0	0.5	0.5	2.6	1.1	0.3
Inflation adjustment	2.3	2.1	1.8	1.6	1.4	1.2	1.1	0.8	0.7	0.5	0.5	2.0	0.9	0.3
Coupon (mainly on restructured debt)	0.8	0.7	0.6	0.5	0.4	0.3	0.3	0.3	0.3	0.0	0.0	0.6	0.2	0.0
Possible market access 6/	1.2	1.5	1.5	1.6	3.0	2.4	2.5	1.8	1.1	1.2	1.4	1.4	1.9	1.1
In percent of private debt falling due	45	55	65	76	88	100	100	100	100	100	100	60	98	100

Source: Ministry of Economy and Fund staff estimates

1/ Includes quasi-money bonds; debt to commercial banks and other commercial creditors; and new market borrowing.
2/ Interest payment in 2005 includes interests accrued in 2004. Assumes full creditor participation in the debt exchange.
3/ Expected payment computed as average payment in 2,500 random draws.
4/ These are non-borrowed resources of the federal government available for debt service. In 2005, it includes drawdown of deposits accumulated in 2004 (US$1 billion).
5/ Defined as average cash debt carrying cost.
6/ This represents the staff estimate of possible private debt rollover.

Table 5. Argentina. Federal Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual							Projections					
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010
								I. Baseline Projections					
Federal debt 1/	**51.1**	**53.8**	**147.7**	**139.8**	**129.4**			**78.2**	**71.8**	**67.0**	**62.9**	**59.7**	**56.9**
of which : foreign currency denominated	48.8	52.0	112.0	106.2	106.0			45.6	42.0	39.0	36.5	36.0	34.7
Change in debt	3.6	2.7	94.0	-7.9	-10.4			-51.2	-6.4	-4.8	-4.2	-3.2	-2.8
Identified debt-creating flows	3.0	7.4	162.1	-31.9	-20.1			-14.1	-6.0	-4.6	-4.0	-3.5	-3.0
Primary balance (- surplus)	-1.0	-0.2	-0.9	-2.3	-3.9			-3.7	-3.7	-3.7	-3.3	-3.3	-3.3
Automatic debt dynamics 2/	3.3	6.9	137.2	-32.8	-18.2			-13.5	-5.2	-3.4	-3.0	-2.1	-1.4
Contribution from interest rate/growth differential 3/	3.3	6.9	5.1	-20.8	-19.5			-13.2	-6.0	-4.1	-3.6	-2.8	-2.4
Of which contribution from real interest rate	2.9	4.5	0.0	-9.9	-8.9			-6.1	-3.4	-1.8	-1.5	-1.0	-0.7
Of which contribution from real GDP growth	0.4	2.4	5.0	-10.9	-10.6			-7.1	-2.7	-2.4	-2.1	-1.8	-1.6
Contribution from exchange rate depreciation 4/	0.0	0.0	132.1	-12.0	1.2			-0.4	0.9	0.7	0.6	0.7	1.0
Other identified debt-creating flows	0.7	0.7	25.9	3.2	2.0			3.2	2.9	2.5	2.3	1.9	1.7
Privatization receipts (negative)	0.1	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.6	0.6	0.1	0.5	0.3			0.0	0.0	0.0	0.0	0.0	0.0
GDP-linked warrant	...	...	...	...	...			0.0	0.1	0.1	0.1	0.1	0.1
Interest capitalization	0.0	0.0	1.0	1.1	0.1			0.8	0.7	0.6	0.5	0.4	0.3
Inflation adjustment	0.0	0.1	9.4	1.2	1.1			2.3	2.1	1.8	1.6	1.4	1.2
Other (Bodens issued including for bank recapitalization)	0.0	0.0	15.4	0.5	0.4			0.0	0.0	0.0	0.0	0.0	0.0
Residual /5	0.6	-4.7	-68.1	24.0	9.7			-37.1	-0.4	-0.2	-0.2	0.3	0.2
Consolidated debt-to-revenue ratio 1/	261.6	285.3	812.9	681.3	550.2			337.0	311.4	293.3	279.4	269.2	257.5
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation						
Real GDP growth (in percent)	-0.8	-4.4	-10.9	8.8	9.0	1.3	6.8	6.2	3.8	3.6	3.4	3.2	3.0
Average nominal interest rate on public debt (in percent) 6/	7.2	7.3	27.3	3.3	2.2	7.5	7.2	2.1	3.3	3.5	3.7	4.3	4.6
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	6.1	8.4	-3.2	-7.2	-6.7	2.6	6.1	-5.0	-4.5	-2.5	-2.3	-1.5	-1.2
Inflation rate (GDP deflator, in percent)	1.0	-1.1	30.6	10.5	8.9	4.9	10.0	7.1	7.8	6.0	6.0	5.8	5.8
Primary balance (- surplus)	-1.0	-0.2	-0.9	-2.3	-3.9	-1.0	1.3	-3.7	-3.7	-3.7	-3.3	-3.3	-3.3
								II. Stress Tests for Public Debt Ratio					
Alternative Scenarios													
1. Key variables are at their historical averages in 2006-10 7/								78.2	81.4	84.3	87.0	90.2	93.6
2. Real interest rate is at historical average plus two standard deviations in 2006 and 2007								78.2	85.4	93.4	88.0	83.8	80.3
3. Real GDP growth is at historical average minus two standard deviations in 2006 and 2007								78.2	88.5	105.4	107.0	109.7	113.1
4. Primary balance is at historical average minus two standard deviations in 2006 and 2007								78.2	77.0	77.1	72.3	68.7	65.5
5. Combination of 2-4 using one standard deviation shocks								78.2	93.1	110.1	103.8	99.2	95.4
6. One time 30 percent real depreciation in 2006 8/								78.2	96.4	90.3	85.0	80.9	77.5
7. 10 percent of GDP increase in other debt-creating flows in 2006								78.2	81.7	76.3	71.6	67.9	64.8

1/ Federal government debt (excludes public deposits). Based on staff scenario C.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the numerator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Includes recoveries and non-appropriable surpluses. In 2002, it reflects the pesification of Phase 1 debt; in 2005, the restructuring of Phase 2 debt.
6/ Derived as nominal interest expenditure divided by previous period debt stock. Historical values include interest capitalization and inflation adjustment).
7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
8/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 6. Argentina: External Debt Sustainability Framework, 2000-2010 1/
(In percent of GDP, unless otherwise indicated)

	Actual							Projections					
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010
								I. Baseline Projections					
External debt	51.6	61.8	154.6	129.6	116.7			**65.3**	**58.6**	**52.2**	**46.7**	**42.8**	**39.2**
Change in external debt	0.3	10.3	92.8	-25.0	-12.9			-51.4	-6.7	-6.4	-5.5	-3.9	-3.6
Identified external debt-creating flows (4+8+9)	1.3	3.6	91.5	-38.3	-25.3			-11.1	-5.5	-4.8	-4.4	-3.9	-3.7
Current account deficit, excluding interest payments	-1.2	-3.1	-15.0	-9.6	-4.6			-5.9	-4.4	-3.7	-3.2	-2.5	-2.3
Deficit in balance of goods and services	0.7	-1.3	-15.3	-11.7	-7.4			-5.2	-2.8	-2.2	-2.0	-2.0	-2.1
Exports	11.0	11.5	28.3	26.3	25.8			24.6	22.9	22.0	21.6	21.5	21.6
Imports	11.6	10.3	13.0	14.6	18.4			19.5	20.1	19.8	19.6	19.5	19.5
Net non-debt creating capital inflows (negative)	-1.8	-0.8	-2.0	-1.1	-2.2			-2.0	-2.1	-2.0	-2.2	-2.2	-2.1
Automatic debt dynamics 2/	4.2	7.5	108.4	-27.6	-18.4			-3.3	1.0	1.0	0.9	0.7	0.8
Contribution from nominal interest rate	4.3	4.5	6.5	3.8	2.6			3.2	3.2	2.9	2.6	2.1	2.0
Contribution from real GDP growth	0.4	2.4	17.8	-10.9	-9.8			-6.4	-2.3	-2.0	-1.6	-1.4	-1.2
Contribution from price and exchange rate changes 3/	-0.5	0.6	84.1	-20.5	-11.3			...	...	...	...	...	...
Residual, incl. change in gross foreign assets (2-3) 4/	-1.0	6.7	1.3	13.3	12.3			-40.3	-1.2	-1.7	-1.0	0.0	0.1
External debt-to-exports ratio (in percent)	470.6	536.4	546.5	492.4	452.5			264.9	256.3	236.8	216.1	199.3	181.6
Gross external financing need (in billions of US dollars) 5/	49.0	48.1	26.4	29.3	32.4			17.9	19.2	24.2	23.7	21.2	21.9
in percent of GDP	17.2	17.9	26.1	23.1	21.3			10.5	10.2	11.9	10.9	9.1	8.9
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation						
Real GDP growth (in percent)	-0.8	-4.4	-10.9	8.8	9.0	1.3	6.8	6.2	3.8	3.6	3.4	3.2	3.0
GDP deflator in US dollars (change in percent)	1.0	-1.1	-57.6	15.3	9.5	-3.4	19.9	6.1	5.6	4.1	4.3	3.8	2.9
Nominal external interest rate (in percent)	8.5	8.2	4.0	3.1	2.4	6.5	2.4	3.1	5.4	5.4	5.3	4.9	4.9
Growth of exports (US dollar terms, in percent)	11.5	-0.5	-7.3	16.7	16.9	7.9	12.2	7.7	1.7	3.9	5.8	6.3	6.5
Growth of imports (US dollar terms, in percent)	0.5	-16.6	-52.1	41.1	50.4	4.7	30.0	19.1	13.0	6.5	6.5	6.5	6.0
Current account balance, excluding interest payments	1.2	3.1	15.0	9.6	4.6	3.1	5.3	5.9	4.4	3.7	3.2	2.5	2.3
Net non-debt creating capital inflows	1.8	0.8	2.0	1.1	2.2	1.8	1.1	2.0	2.1	2.0	2.2	2.2	2.1
								II. Stress Tests for External Debt Ratio					
Alternative assumptions													
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**65.3**	**62.1**	**59.0**	**53.4**	**49.3**	**45.6**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**65.3**	**70.1**	**75.2**	**68.8**	**64.2**	**60.0**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**65.3**	**112.4**	**192.2**	**180.9**	**173.2**	**166.1**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**65.3**	**70.5**	**75.0**	**69.0**	**64.6**	**60.8**
B5. Combination of B1-B4 using one standard deviation shocks								**65.3**	**100.5**	**149.9**	**136.9**	**127.4**	**118.9**
B6. One time 30 percent nominal depreciation in 2005								**65.3**	**83.7**	**76.1**	**69.7**	**65.1**	**60.9**

1/ Based on 100 percent participation in the debt exchange and assumptions in Scenario C.
2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
3/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
4/ For projection, line includes the impact of price and exchange rate changes.
5/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

FUND RELATIONS
(As of April 30, 2005)

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	10,218.00	482.64
Reserve position in Fund	0.18	0.01

III. SDR Department:

	In Millions of SDRs	Percent of Allocation
Net cumulative allocation	318.37	100.00
Holdings	1,632.45	512.76

IV. Outstanding Purchases and Loans:

	In Millions of SDRs	In Percent of Quota
Extended Fund arrangements	106.74	5.04
Stand-By Arrangements	7,994.33	377.61

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	4,171.00
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				
	2005	2006	2007	2008	2009
Principal	2,410.79	2,997.04	2,400.61	292.63	
Charges/interest	241.50	188.58	70.01	5.52	0.02
Total	2,652.30	3,185.62	2,470.62	298.15	0.02

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 conducted in December 2003. The priority recommendations of this assessment were: (i) the publication of audited annual financial statements prepared on the basis of International Financial Reporting Standards (IFRS); and (ii) a strengthening of existing control procedures to ensure that all monetary data reported to the Fund under the program reflect the definitions contained in the TMU. While the latter recommendation has been implemented, the publication of the IFRS-based financial statements will not take place until local accounting standards have been harmonized with IFRS.

C. 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.

Argentina accepted the obligations of Article VIII, Section 2(a), 3 and 4 in 1968. The Executive Board temporarily approved, until this Article IV consultation, an exchange restriction arising from the freezing of deposits pursuant to the corralón. Staff recommends continued approval of this exchange restriction until September 30, 2005. Staff is not aware of any other exchange restrictions.

IX. **Last Article IV consultation**: The 2002 Article IV consultation was concluded by the Executive Board on January 8, 2003 (IMF Country Report 03/226).

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

XI. Technical Assistance, 2002–04

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
MFD	Banking Strategy	February 2004
FAD	Public Expenditure Management	June 2004

XII. Resident Representative: Mr. John Dodsworth has been the senior resident representative in Buenos Aires since July 2003. Mr. Ernesto Ramirez Rigo has been the resident representative since August 2004.

RELATIONS WITH THE WORLD BANK GROUP[1]

1. The total current Bank portfolio in Argentina is composed of 33 loans totaling US$5.4 billion in commitments. Twenty-eight loans correspond to investment projects—or some 64 percent of total lending in dollar terms—amounting to US$3.4 billion in commitments, of which US$0.9 billion remain undisbursed. The remaining five are adjustment operations totaling US$1.95 billion in commitments, of which US$876 million remain undisbursed. The Bank's exposure to Argentina as of April 30, 2005 stands at US$7.2 billion.

2. The last Country Assistance Strategy (CAS) Report was discussed at the Board on April 15, 2004. The CAS, which covers the period April 2004 to December 2005, provides US$2 billion in support of country efforts to achieve sustained economic growth with equity, social inclusion, and improved governance, and includes financing from IBRD and IFC.

3. The Bank has moved forward with an active investment program to aid in the consolidation of the strong recovery underway in Argentina. About 77 percent of these projects in CY 2004–05 have been in support of infrastructure and social investments. In December and June of 2004 respectively, the Bank's Board approved a National Highway Asset Management Project for US$200 million and a US$200 million loan for infrastructure development in Buenos Aires Province, the country's largest and most economically important area. Disbursements in 2004 amounted to US$770 million, including US$620 in investment operations; US$150 million was disbursed in adjustment lending. In April 2005, the Bank's Board approved US$130 million for flood protection works in the city of Buenos Aires.

4. The Bank and the Government have made considerable strides in their joint effort to improve performance of the Bank's investment portfolio, with problem projects cut by more than half since the crisis in 2002–03. Today, some 25 percent of Bank investment projects are rated as unsatisfactory for implementation progress, compared with 48 percent in 2004.

5. A new Country Assistance Strategy is expected to be presented to the Board in December 2005.

[1] Prepared by the staff of the World Bank on May 4, 2005

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 May 4, 2005)			
Fully disbursed loans	14,673.7	14,673.7	0.0
Loans in process of disbursement	5,362.3	3,553.7	1,808.6
A. Investment operations			
Agriculture and rural development	240.5	149.3	91.2
Power	30.0	3.9	26.1
Municipal/provincial development	430.9	419.0	11.9
Water sector	30.0	11.7	18.3
Social sector	1,036.0	849.9	186.1
Finance, infrastructure, and natural resources	1,592.0	1015.7	576.3
Public administration	49.8	27.3	22.5
B. Adjustment operations	1,953. 0	1,077.0	876.0
Total loans	20,036.0	18,227.4	1,808.6

II. IFC Operations (as of April 30, 2005)

	Loans	Equity	Quasi	Participation
Committed	387.1	133.5	134.9	387.7
Outstanding	291.3	33.5	134.9	357.7

III. IBRD Loan Transactions (Calendar Year)

	2000	2001	2002	2003	2004	2005(*)
Disbursements	1018.8	1328.8	424.5	1962.9	770.5	88.2
Repayments	538.1	675.5	1352.8	2968.1	831.5	298.4
Net Disbursements	480.7	653.3	-928.3	-1005.2	-61.0	-210.2

(*) As of April 30, 2005

RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[1]

Country strategy and lending program

1. In November 2004, the Bank approved a new Country Strategy for Argentina for the period 2004–08. The strategy general objective is to support the Government's initiatives for promoting a more equitable and sustainable growth. To that end, the strategy focuses on three areas: (i) institutional strengthening for better governance and fiscal sustainability; (ii) improving the climate for investment and productivity growth, to enhance the country's competitiveness; and (iii) promotion of sustainable and inclusive social development. Preparation of the strategy drew from the results of a series of internal workshops, sector specific studies and self-assessment, and a consultation workshop with the government, private sector and civil society in February 2004.

2. The Country Strategy sets forth a target lending scenario of US$5.0 billion for the period 2004–08, that involves a higher concentration of new lending in investment loans to better reflect the transition of the country towards policies and programs with medium and long term objectives. The proposed target scenario entails neutral loan flows between the country and the Bank over the period of the Strategy, provided that efforts to improve project execution are strengthened and sustained in the years ahead.

3. Achieving this target scenario would demand a deepening of the reform program and definition of sector strategies; a significant improvement in the implementation of projects in execution and based on these elements, development of a lending pipeline with well defined development objectives. In 2004, the Bank approved four operations for a total amount of US$527,6 million. For the next 12 months, the lending program with the public sector totals US$1.9 billion, with nine investment operations accounting for 84 percent of this amount.

Portfolio

4. As of April 30, 2005, the Bank portfolio in Argentina consists of 43 projects totaling US$5.5 billion of which US$2.6 billion remain undisbursed. By area of activity outlined in the Country Strategy, 59 percent of approved balances are directed to poverty reduction and social inclusion, 26 percent to productivity and competitiveness, and 15 percent to improve governance and fiscal sustainability.

5. In response to the crisis, 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 priorities as well as to improve portfolio performance; and early in 2003 the

[1] Prepared by IDB staff, May 2005.

second tranche of two sector loans were reformulated. Actions plans set to improve project performance allowed the Bank and the authorities to closely follow progress and to introduce corrective measures as needed to stay on track. As a result of these initiatives, the percentage of undisbursed balances related to projects with unsatisfactory performance has dropped from 49.0 percent in December 2003, to 0.2 percent by April 2005.

6. IDB disbursements for 2004 totaled US$341.0 million. As the country moves away from crisis management to a medium-term development agenda, disbursements from the investment loan portfolio are expected to surpass their late-1990s levels of around US$500 million per year, based on a framework of fiscal sustainability and increasing Government capacity to execute investment programs.

INTERNATIONAL MONETARY FUND

ARGENTINA

Staff Report for the 2005 Article IV Consultation

Supplementary Information

Prepared by Staff Representative for the 2005 Consultation with Argentina
(in consultation with other Departments)

Approved by John Dodsworth and G. Russell Kincaid

June 17, 2005

1. The following information on recent developments and policy implementation has become available since the circulation of the staff paper on the Article IV consultation on May 31, 2005. The thrust of the staff appraisal remains unchanged.

I. Recent Developments and Indicators

2. **Recent data show continued economic growth and favorable financial conditions, but with inflationary pressures emerging.**

- **Economic activity rose in the first quarter of 2005, somewhat more slowly than expected**. Real GDP increased only 0.5 percent from the previous quarter on a seasonally adjusted basis, but was still up 8 percent year-on-year. The outcome remains consistent with staff's projection of 6–7 percent growth for real GDP in 2005.

- **Consumer prices increased by 0.6 percent in May, raising inflation in the first five months of the year to 5.2 percent.**

- **Gross international reserves rose to US$22.4 billion, well surpassing the end-year forecast of US$20.7 billion in the staff report.** The central bank president stated that gross international reserves could rise to US$24 billion by end-2005.

- **The settlement of the debt exchange was concluded on June 10 and Standard & Poor's assigned a B- rating to the new bonds.** As a result, the country risk premium declined and the new bonds currently trade at a spread of 500–600bps over U.S.-Treasuries.

II. Policy Implementation

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

- **Central bank intervention in the foreign exchange market remained heavy**. Purchases in the first two weeks of June amounted to over US$ 0.6 billion, bringing total intervention to over US$2.1 billion since end-April. Interest rates on central bank Lebacs have increased slightly since mid-May and base money remains close to the upper bound of the authorities' monetary program.

- **Fiscal performance at the federal government level remained strong through May.** In the first five months of the year, the federal cash primary surplus reached Arg$9.8 billion (1.9 percent of annual GDP), exceeding the authorities' projections by about 0.7 percent of annual GDP. This overperformance was due to both higher-than-projected revenue and somewhat lower-than-projected expenditure. In the first quarter, the consolidated primary surplus reached Arg$6.3 billion (1.2 percent of GDP). The provinces performed strongly, contributing 0.4 percent of GDP to the surplus.

- **The government announced a 16 percent increase in the minimum pension.** Despite assurances during the consultation that no additional spending initiatives would be taken, the minimum pension was raised by Arg$48 to Arg$350 per month, effective June 1. The authorities estimate an annual cost of the measure of 0.3 percent of GDP.

- **The minimum wage was increased from Arg$450 to Arg$630 per month.** The increase, to be phased in through July, mainly regularized previously decreed non-remunerative bonuses that are now incorporated in the basic minimum salary. It will benefit an estimated 900,000 workers in the private sector and 130,000 in the public sector. Preliminary estimates indicate that the net impact of this measure on the federal budget is almost neutral, but there will be some additional burden for provincial governments.

- **Congress approved a tax administration law** which increases the powers of the tax administration to conduct inspections and seize goods, allows the issuance of communications to taxpayers in electronic form, and raises penalties for tax irregularities. This law is one of several components of the second anti-evasion package, the submission of which was a structural benchmark for end-March 2004 under the current stand-by arrangement.

- **The government introduced a 30 percent non-remunerated reserve requirement on capital inflows.** The measure, intended to prevent an appreciation of the exchange rate, is primarily aimed at reducing foreign purchases of government paper and equities in the secondary market. Current account transactions, foreign direct investments, and primary issuances of bonds and shares are excluded. This new control follows an extension of the minimum stay of capital inflows from 180 to 365 days in late May. Stock market representatives have argued that the measures will segment the financial market and be detrimental to the deepening of domestic financial instruments. Staff is doubtful whether the new measures will effectively achieve their intended objective and concerned that the controls may raise the cost of government financing.

- **Staff has learned that an earlier central bank regulation has effectively weakened the targeted reduction in bank exposure to the public sector this year.** While banks were expected to meet a 40 percent limit by end-2005, the regulation excludes from this limit government securities maturing up to six months ahead.

- **New public services contracts were agreed with 5 privatized companies (mainly in electricity transmission), raising the total number of renegotiated agreements to 19** (Table 1). Congress has so far approved 8 of these agreements, although their implementation by the executive is still pending. The new agreements do not fundamentally change the staff's assessment on progress in this area, since they cover companies with a relatively low volume of sales and the contracts do not establish a path for tariff adjustments beyond 2005.

Table 1: Argentina: Progress in renegotiation of public services contracts

	Numbers of Contracts	Concessions Canceled	Letter of intention signed	Congressional Approval	Ongoing Negotiations	Tariffs Adjusted/ Revenues Enhanced 1/	Approximate Share in Total Sales
Regulated Concessions	**63**	**14**	**19**	**8**			13.5
Energy	**22**	**...**	**7**	**1**			
Electricity (transport and Distribution) 2/	11		7	1	yes	15 percent	7.0
Gas (transport and Distribution)	11				yes		
Water 2/	**1**	**...**	**...**	**...**	yes		
Telecommunications 2/	**2**	**...**	**...**	**...**	yes		
Transport	**37**	**13**	**12**	**7**			
Urban Access roads 3/	4		4	3	yes	14-18 percent	4.0
Ports 3/	4		4	4			0.8
Fright railways	5		3		yes		1.5
Airports	1						
Inter - Urban roads	15	12	1	...	yes		0.2
River toll	1				yes		
Passenger railways	6	1			yes		
Bus Terminal	1				yes		
Postal services	**1**	**1**	**...**	**...**			

1/ The agreements include an average 15 percent price adjustment (in electricity tariff increases exclude households)
2/ The 2004 interim contracts ended in December 2004 and are now under new negotiations.
3/ Public hearings took place for ports, urban access roads, and electricity companies between January and May 2005.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with Argentina

On June 20, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Argentina.[1]

Background

Argentina's economy has rebounded strongly from the financial crisis in late 2001. Reflecting buoyant domestic demand, real GDP grew close to 9 percent in both 2003 and 2004 bringing real output level back to the peak level achieved prior to the crisis. From early 2003, confidence rose steadily, and both private consumption and investment rebounded. Export receipts have increased—initially reflecting higher commodity prices—and imports remain below pre-crisis levels. International reserves have recovered, and bank deposit and external payments restrictions have been progressively dismantled.

The robust resurgence in money demand was a key aspect of the recovery. Inflation—after spiking in 2002—remained moderate (reaching only 3¾ percent in 2003 and 6 percent in 2004) despite the almost 300 percent depreciation of the currency. Given the softness of labor markets and a freeze on public service prices, real wages recovered only slowly and the real exchange rate remains somewhat depreciated.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members. A staff team collects economic and financial information, and discusses with officials the country's economic developments and policies. The staff then prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Fiscal performance was strong in 2003 and 2004, mainly as a result of improvements in tax administration and robust economic activity. The consolidated primary surplus reached 3.0 percent and 5.1 percent of GDP in 2003 and 2004, respectively, as total revenues rose from 23 percent of GDP in 2002 to 29 percent of GDP in 2004. The strengthening of tax administration and strong VAT and income tax collection were important factors behind the fiscal performance, but distortive taxes (export and financial transactions taxes) also account for close to 20 percent of total revenues. Social and capital spending accelerated towards the end of 2004, resulting in end-year expenditures exceeding original budget targets by considerable margins.

Social indicators began to improve from end-2002 at a steady, but gradual pace. The headline unemployment rate fell to about 13 percent in March 2005 from 17.8 percent in December 2002, although an additional 4.1 percent of the labor force is employed under emergency social assistance programs. The share of the population living in extreme poverty fell to 17 percent in June 2004 (from 24.8 percent two years earlier) and the share of the population below the poverty line declined from a peak of 58 percent to 44 percent in June 2004.

During the first part of 2005, economic conditions have remained generally favorable. Growth has continued in the first quarter (at 8 percent year-on-year) and consumer and business confidence indicators remain at high levels. Inflation, however, has accelerated amid rising demand, increased capacity constraints, growing wage pressures and monetary accommodation; consumer prices rose by 5.2 percent during the first five months of 2005, bringing the 12-month inflation rate to 8.6 percent. A strong trade balance and a significant reduction in private capital outflows have facilitated a sharp rise in international reserves to over US$22 billion.

The approved budget for 2005 aims for a consolidated primary surplus of 3.8 percent of GDP on a cash basis. During the first five months of 2005, the federal government achieved a primary surplus of 1.9 percent of annual GDP.

Monetary policy has moved toward a tightening phase. Since January 2005, the central bank increased its policy interest rates on three occasions by a total of 125 basis points, bringing the repo rate to 3.75 percent, and has increased steadily the interest rates it pays on short-term Lebacs. However, renewed foreign exchange interventions since April have contributed to an acceleration in base money.

Argentina’s global debt exchange offer was launched in January 2005 and closed on February 25 with a 76 percent participation level. As a result of the debt restructuring, Argentina’s debt burden has declined to 72 percent of GDP (from 147 percent of GDP in 2002) and the debt service profile has improved considerably. Nonetheless, approximately US$20 billion in principal in default remains outstanding. The settlement of the debt exchange was completed on June 2 due to a delay resulting from legal action by some nonparticipating creditors to attach the tendered bonds.

Executive Board Assessment

Executive Directors noted that Argentina is emerging from a difficult period in its history, and has made a strong recovery from the 2001 financial crisis. Directors recognized, however, that, while much has been accomplished, many challenges lie ahead. They noted that the current growth momentum and accompanying political stability provide a critical window of opportunity for the government to leave the crisis behind and undertake the policies—committed to in 2003 under the current stand-by arrangement—that would ensure long-lasting and equitable growth.

Directors emphasized that, for the recovery to be sustained, the authorities need to take action on a number of fronts: to continue with responsible macroeconomic policies, guarding particularly against inflation; to undertake structural reforms that will boost factor productivity and raise potential growth above its historic rate; to strengthen the financial system and revive intermediation; to normalize relations with creditors; and to ensure that the fruits of growth are equitably shared and that the still vulnerable sections of the community are adequately protected.

Directors noted that prudent macroeconomic policies in 2003–04 have provided an anchor for the recovery of confidence. They commended the authorities for their steadfast implementation of fiscal policy, which produced record levels of primary surplus and demonstrated the potential for Argentina to move away from its high level of national indebtedness. Directors congratulated the authorities on achieving two years of low inflation, which was key to the recovery process. Monetary policy has taken advantage of resurging demand for pesos to rebuild international reserves while keeping both interest rates and inflation low.

Directors noted, however, that the macroeconomic policy stance could weaken in 2005 relative to 2004, at a time when the output gap is closing and inflationary pressures are mounting. They urged the authorities to tighten both fiscal and monetary policies to contain inflation. They also cautioned that the authorities' efforts to apply moral suasion and administrative measures to stabilize prices are unlikely to be effective and could have adverse consequences on the investment climate.

Directors noted that the primary surplus target of 3.8 percent of GDP in the 2005 budget represents a sizeable injection of fiscal stimulus, but welcomed indications that the target might be exceeded again this year. They urged the authorities to put in place measures to ensure the achievement of a higher primary surplus, preferably closer to the level achieved in 2004, particularly in the event that revenues are higher than expected. While recognizing that the government has over-performed its primary fiscal surplus target during the first five months of 2005, Directors noted that further fiscal consolidation is needed to avoid a budgetary financing gap from arising in the second half of 2005, and emphasized the need to maintain tight expenditure for the rest of the year.

Directors welcomed the authorities' recent efforts to raise interest rates, but believed that additional tightening would be desirable. They recommended that base money be brought to the lower end of the authorities' target range, which could require reduced foreign exchange intervention and a further rise in interest rates. A number of Directors also cautioned against the inflationary risks of using monetary policy to pursue exchange rate stability, and recommended that the authorities clarify their commitment to price stability as the prime objective of monetary policy, while a few Directors stressed that the central bank needs to have the necessary operational autonomy to effectively combat inflation. In this context, most Directors called for a greater degree of nominal exchange rate flexibility, while noting that the government's foreign exchange market intervention policy should be transparent, and stressing that competitiveness is best achieved through structural reforms and prudent macroeconomic policies. A few Directors also cautioned against the use of capital controls as a means to resist upward pressures on the exchange rate.

Directors called for the steadfast implementation of key structural reforms committed to by the government under the Fund-supported program. They urged the authorities to take advantage of the current favorable situation to implement structural measures that had been committed to under the current stand-by arrangement. A few Directors also noted the importance of strong ownership and careful sequencing of such reforms.

Directors noted, in particular, that structural fiscal reforms are crucial to sustain strong budgetary performance and enhance growth prospects over the medium term.
They commended the authorities for the progress in restoring fiscal prudence and restraining overspending by the provinces. Nevertheless, most Directors underscored the importance of strengthening the institutional fiscal framework, including the Fiscal Responsibility Law, while acknowledging the political constraints facing the authorities. A few Directors also called for the establishment of clear rules to reinforce the role of the Federal Council for Fiscal Responsibility. They called for more binding constraints on provincial spending and borrowing, less discretion of federal financing to provinces, better coordination of fiscal policies across levels of government, increased budgetary transparency and consistent accounting standards at the provincial level, and more equitable and stable intra-governmental revenue sharing. In that context, a few Directors highlighted the constitutional difficulties faced by the authorities in advancing the recommended structural and fiscal reforms. Directors called for a phasing-out of distortionary taxes on exports and financial transactions, and a few emphasized that this measure should be revenue neutral and that it should not increase the share of revenues to the provinces at the expense of those of the central government.

Directors welcomed the progress in implementing the banking sector recovery strategy developed in 2003. They commended the authorities for maintaining the supervisory and regulatory framework under very difficult circumstances, while noting that considerable temporary regulatory forbearance has been extended. Directors emphasized, however, that the banking system remains vulnerable and undercapitalized relative to international standards, and that several issues remain pending, in particular with regard to the compensation for policy-induced losses and the judicial clarification of losses from *amparos*. Directors stressed the need to ensure that prudential standards are applied strictly, including the announced regulatory phase-in of market valuation of government bonds and limits to bank exposure to the public sector. At the same time, Directors recommended that incentives for early recapitalization of banks be strengthened. They also noted the expanding role of public banks and urged the authorities to articulate a strategy which would clarify the role of the public sector in the banking system going forward.

Directors observed that the situation in the regulated utilities sector is not sustainable, and that failure to resolve outstanding issues would have damaging consequences for macroeconomic stability, the investment climate, and future growth. Directors urged the authorities to quickly reach collaborative long-term agreements with the utility concessionaires that would ensure an appropriate economic return and adequate future investment in the sectors, as committed to in the current Fund-supported program. Directors also stressed the importance of putting in place, at an early date, an updated regulatory framework that would provide regulatory certainty and find an appropriate balance between protection of consumers and provision of necessary investment incentives.

Directors viewed the recently completed debt exchange as an important step toward normalization of relations with creditors. They stressed that for Argentina to emerge fully from the financial crisis and regain access to capital markets, the authorities need to develop a forward-looking strategy to resolve remaining arrears outstanding to private creditors consistent with the Fund's Lending into Arrears policy. Directors also noted the need to normalize relations with bilateral official creditors through a Paris Club agreement, and to maintain regularized relations with the European Investment Bank.

Directors emphasized that debt sustainability for Argentina will require a steadfast implementation of fiscal and structural policies. They noted that only under a proactive reform scenario, including a high and sustained fiscal effort, would the debt-to-GDP ratio return to more comfortable levels over the medium term and allow an early exit from the use of Fund resources.

Most Directors considered appropriate that the authorities should have the flexibility to draw on their international reserves to finance the significant levels of debt service, including repurchases to the Fund, that fall due in the near term, while some Directors raised questions regarding the use of international reserves for this purpose. They noted that it would be important for the use of reserves to be made in a manner that does not impair the financial soundness or autonomy of the central bank.

The Executive Board also discussed the issue of arrears to the European Investment Bank (EIB) which arose in 2003 and caused nonobservance of continuous performance criteria under the standby arrangements of January 2003 and September 2003. The misreporting of these arrears gave rise to five noncomplying purchases, and breaches of obligation under Article VIII, Section 5 of the Fund's Articles of Agreement. On December 10, 2004 Argentina cleared these arrears to the EIB. On the basis of this corrective measure, the Executive Board granted waivers of the nonobservances of the performance criteria underlying the misreporting and agreed that no further remedial action was warranted with respect to the breaches of Article VIII, Section 5.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following polic discussions in the Executive Board at the decision of the Board.

Table 1. Argentina: Selected Economic and Financial Indicators, 2000–2004

	2000	2001	2002	2003	Est. 2004
(Annual percentage changes; unless otherwise indicated)					
National income and prices					
GDP at constant prices	-0.8	-4.4	-10.9	8.8	9.0
Domestic demand (contribution to growth)	-1.1	-6.5	-16.9	10.4	11.0
Net exports (contribution to growth)	0.3	2.1	6.0	-1.5	-2.0
Per capita GDP (U.S. dollars, thousands)	7.9	7.4	2.8	3.4	4.1
Consumer prices (average)	-0.9	-1.1	25.9	13.4	4.4
Consumer prices (end-of-period)	-0.7	-1.5	41.0	3.7	6.1
Social indicators 1/					
Population (millions)	35.9	36.3	36.6	37.0	37.4
Population below poverty line (in percent)	29.7	35.4	53.0	47.8	44.3
Population below extreme poverty line (in percent)	7.5	12.2	24.8	20.5	17.0
Unemployment rate	14.7	18.3	20.8	14.5	12.1
External sector					
Trade balance (U.S. dollars, billions)	1.1	6.2	16.7	15.7	12.1
Exports, f.o.b. (U.S. dollars, billions)	26.3	26.5	25.7	29.6	34.5
of which: net exports of hydrocarbons	3.9	3.9	4.1	4.5	4.1
Imports, c.i.f. (U.S. dollars, billions)	25.3	20.3	9.0	13.8	22.3
Export growth (in U.S. dollar terms)	13.0	0.8	-3.4	15.3	16.5
Import growth (in U.S. dollar terms)	-0.9	-19.6	-55.8	53.9	61.3
Export volume	2.7	4.3	0.7	5.0	6.6
Import volume	-0.9	-17.4	-54.1	53.2	47.0
Terms of trade (deterioration -)	9.6	-0.6	-1.8	8.9	-0.6
Money and credit					
Net domestic assets of the financial system	-0.9	14.9	57.3	46.2	-5.3
Credit to the private sector	-3.8	-20.2	-12.8	-15.5	15.4
Augmented base money 2/	-8.8	-3.0	152.9	26.3	12.7
Augmented broad money 2/	3.2	-16.5	24.7	15.8	12.7
Interest rate (30-day deposit rate, in percent)	11.3	15.7	39.1	3.9	2.9
(In percent of GDP)					
Consolidated public sector					
Primary balance	0.4	-1.3	0.6	3.0	5.1
of which: Federal government	1.0	0.2	0.9	2.3	3.9
Overall balance	-3.6	-5.9	-1.8	1.1	3.7
Revenues	24.6	23.7	23.0	25.9	28.9
Expenditures 3/	28.2	29.6	24.8	24.8	25.1
Total debt (U.S. dollars billions, year-end)	145.1	167.0	152.6	184.8	201.4
Total debt (year-end)	51.1	62.2	164.2	144.5	133.9
Savings-investment balance					
Gross domestic investment	16.2	14.2	12.0	15.1	19.1
of which: Public sector	1.5	1.5	0.9	1.5	2.5
Gross national savings	13.0	12.7	20.4	20.9	21.1
of which: Public sector	-2.1	-4.5	-0.9	3.1	6.2
Current account balance	-3.2	-1.4	8.5	5.8	2.0
(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)	183.2	525.3	498.2	493.4	428.9
Gross international reserves (U.S. dollars, billions) /4	26.9	14.9	10.5	14.1	19.6
In months of imports of goods and services	9.8	6.5	9.5	9.1	8.5
Nominal GDP (in billions of Arg $)	284.2	268.7	312.6	375.9	447.3

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

1/ Poverty data for 2004 Q1.
2/ Includes quasi-monies in circulation.
3/ Excludes interest due on nonperforming debt.
4/ Assumes no disbursements from the Fund in 2005 and 2006

Statement by Hector Torres, Executive Director for Argentina
June 20, 2005

1. My authorities are grateful to the staff and management for the comprehensive and detailed discussions on the recent developments and outlook for the Argentine economy. They expect that this Art. IV Consultation will help to find a common ground on which constructive negotiations on a new Stand-By Arrangement could be soon started.

2. Before addressing some specific points of the staff report, it is worthwhile to consider where the Argentine economy stands today vis-à-vis the peak of the crisis in April 2002. In the first place, during these three years real GDP grew by 28 percent with industrial production increasing 50 percent, which points to the re-industrialization process Argentina is undergoing. All demand components have contributed to this exceptional performance. The revamping of consumption played an important role in the wake of a strong recuperation of employment and a gradual increase in real wages. Today, GDP stands at a level similar to the record reached in the second semester of 1998.

3. Another key variable has been investment, which, at 21 percent of GDP in current prices, has reached a historical record in the fourth quarter of 2004. In the external front, exports are also at a historical record growing at 20 percent annual rate while industrial goods exports are showing an annual growth rate of 43 percent. The whole process of strengthened economic activity has taken place while the fiscal front was subjected to a sharp and unprecedented adjustment with a consolidated primary surplus reaching over 5 percent of GDP in 2004. Inflation, in turn, has been subdue and, even after the recent spur, it is still within the band projected for this year. The exchange rate is at a competitive level and the business and banking community has welcomed the government policy of avoiding sharp nominal movements. Finally, and as a result of all these policies, 2.5 million new jobs have been created during this period, more than 80 percent of which were created by the private sector, in particular by small- and medium-size enterprises. This has led, in turn, to a substantial reduction in poverty, which is nonetheless hovering the 40 percent level, thus signaling the magnitude of the job that still lies ahead.

4. Having stated these facts and before addressing the policy issues, I would like to raise some specific points on the report. The staff report alludes several times to the need to transform the recovery into sustainable growth and poverty reduction in the medium-term. Whereas we fully agree with these goals, it is important to highlight that the aforementioned "recovery", that took place in a context of lack of external financing, substantial net repayments to the IFIs and a significant build up in international reserves, has already proven to be more than just a "recovery". Indeed, from the "Indian summer" of the second half of 2002 until today, skeptical pundits have abounded and a few have even dared to call it "a dead-cat jump". However, facts indicate that within twelve consecutive quarters of record fiscal performance,

both at the central government and provincial government level, Argentina has featured exceptional growth rates and has reached already the peak level of real growth observed during the 90's, at a time, it is only fair to remember, when the economy was artificially sustained by external flows. In short, the dead-cat has jumped at his highest level ever and remains comfortably there and we do not believe this is a miracle or just the result of the influence of external positive factors. It is possibly the best indicator that the government has been doing things well despite the staff's lack of understanding for the government's policy actions and difficulties in fully accomplishing some of the structural reforms envisaged in the latest arrangement with the Fund.

5. In this regard, it is important to recall that the starting date of the recovery in confidence and growth was mid-2002 and not early 2003, as mentioned in paragraph 3 of the report. Thus we are finishing the third year of continued expansion. In addition, paragraph 4 makes a fair description of the diverse factors that supported such an expansion including political stability and sound macroeconomic policies. It also adds the favorable external environment as reflected by the improvement in the terms of trade and the robust economic activity in Brazil, one of Argentina's main trading partner. Regarding the improvement in the terms of trade, this has been the case only during 2003, since during 2004 this impact has been slightly negative rather than positive and the projected impact for the current year is substantially negative. As to the impact of Brazil's growth, the facts are that only during 2004 growth has picked up in Brazil while Argentina has been growing, as we have said, since mid-2002. Moreover, Argentina is holding a significant trade deficit with Brazil which in terms of macroeconomic consequences means that Argentina's high growth is contributing to that of Brazil.

6. In the same vein, I would like to take issue with the assertion contained in the heading of paragraph 6. It is there stated that the "recovery" has also been helped by "net financial support from the international community". This is a seriously misleading assertion. Of course, while Argentina remained in default private creditors were forced by the circumstances to provide net financial support to Argentina and the same could be said as regards bilateral creditors. However, multilateral creditors have quite a different story to tell. As stated above, the sustained expansion of economic activity in Argentina took place while substantial net repayments to the IFIs was being done. These net repayments started from the beginning of the crisis and not just after the "failure to complete the third review of the three-year Stand-By Arrangement" in mid-2004 as stated by the staff in the same paragraph. Incidentally, it was not a "failure" but a decision of the Argentine government, in consultation with management and staff, to postpone that review for the reasons by all known. Thus, if we are going to measure the effort that Argentina has made to honor the "de facto" privileged creditor status of the IFIs after its most serious crisis in contemporary history, the meaningful figures should not be the ones reported in paragraph 6 but the following: from the beginning of the crisis in January 2002 up to date, Argentina has made net principal payments to the Fund of SDR 3 billion (about US$ 4.4 billion) and paid charges of SDR 1.4 billion (about US$ 2.1 billion), adding to total net

payments to the Fund of SDR 4.4 billion (around US$ 6.5 billion). For the same period, net debt payments to all the IFIs amounted to more than US$ 12 billion.

7. Paragraph 7 on political developments rightly links the high popularity ratings of President Kirchner with his willingness to take a tough line vis-à-vis multilateral institutions and the utility concessions. It is not right, however, when in the paragraph the same association is made with the attitude towards foreign investors and the debt exchange. Regarding foreign investors, President Kirchner and Minister Lavagna has repeatedly stated their desire to create a favorable climate for investment in general and for foreign investment in particular, a desire that has been followed by concrete commitments on the part of several foreign companies. In the second place, we do not believe to have taken a "tough line" with respect to the debt restructuring process but rather a "realistic and focused" approach since this was the only way to complete such a difficult task. Beyond this, it should be recalled that the restructuring was not aimed only at foreign creditors since a substantial part of that debt was held by Argentine nationals themselves, much of it through private pension funds.

8. As to the popularity gained with the treatment to privatized utilities, the staff report fails to draw the proper conclusions by leaving the impression that this is the way the Argentine government will deal with foreign capital in general. The approach towards privatized utilities should not be construed as animosity towards foreign capital. It is, rather, a reaction against the perceived bias framework that these companies, in connivance with the government of the 90s, applied to the Argentine people. A more balanced view than the one presented by the staff regarding the renegotiation of contracts with privatized companies should also mention utility companies' underperformance in terms of investment, their over-indebtedness (related to generous dividend policies), as well as inherited unsound regulations, which among other contentious elements established US dollar-denominated utility rates, indexed to the U.S. inflation, an unwarranted benefit which companies seek to preserve even after a currency devaluation of more than 50 percent. The staff report also expresses the concern that some of these companies are leaving the country, as if they were the innocent victims of an unruly government, with the logical consequences of affecting the investment climate and growth prospects. This is a distorted picture of what is going on. Moreover, the more significant fact is not that a few companies have decided to abandon the country but that so many of them, despite all the difficulties, have decided to stay. In fact, many of the companies that left the country, did so as part of a regional strategy. As to the rest of paragraph 7, starting with the second sentence, it could be disposed of and no relevant information would be lost. As it stands, it fails to give an accurate account of the complexity of the present-day political developments in Argentina and it risks creating confusion if it remains in the paper. Also, considering the ambiguity of the first sentence, the whole of paragraph 7 could be eliminated from the paper.

9. Moving now to the discussion of recent macroeconomic developments, the staff report raises three issues, the need to increase the primary surplus above the level projected in the budget for the current year, the need to contain inflationary pressures

and the need to support a continued high volume growth of exports to sustain growth. Whereas these are sensible points raised by the staff my authorities have reservations with some of the rationale presented in the report to support them.

10. On the level of the primary surplus, the staff argues for a considerable higher level than that proposed by the authorities not only for this year but also for the long-term. In the short-run, the staff's position is supported by the need to avoid the procyclical impact of a looser fiscal stance vis-à-vis the one prevalent in 2004, and, in the long-run, so as to allow for a softening of the financing needs in a context where Fund financing is non-existent. Regarding the current year, is worth noting that notwithstanding the budgeted primary surplus level and the fact that this is an electoral year, the primary surplus obtained so far remains comparable to the one observed during the exceptional overperformance of 2004 which, as Argentina's economy moves into more moderate rates of growth, should not be used as a yardstick to measure this year's fiscal performance. During the first five months of the year the primary surplus reached already 60 percent of the budgeted amount for the year as a whole. Thus, for all practical purposes the staff's warning as to the risks entailed by the budgeted fiscal stance has been so far fully avoided. If the staff wishes to make a meaningful comparison between the fiscal policy stance between 2004 and 2005, the actual fiscal performance of 2004 should have been compared with the one that is taking place so far, and not with that that is being budgeted.

11. Regarding the long-term consequences of a primary surplus lower than the one suggested by the staff, we will comment further below when analyzing the DSA exercise. We will only note here the apparent inconsistency of staff's advice that at the same time that calls for a permanently high primary surplus, demands the elimination of the so-called distortive taxes (that provide for some 4 percent of GDP in fiscal revenue) and the approval of a new revenue sharing law that would, as we will explain further on, necessarily reduce the central government's stake in the overall fiscal revenue. It should also be noted that the Argentine tax rates are in general already at a relatively high level and that the notable improvements in fiscal administration will sooner or later find their natural limits. On the spending side, the staff suggest "a prioritization of capital spending" as a way to secure significant savings. It is indeed surprising that after the heightened conscience on the importance of infrastructure investment to consolidate growth, as exemplified by the many pilot projects on the preferential treatment that should be given to this type of expenditure, yet the staff did not hesitate to recommend in paragraph 20 of the report the same old policy advice that has led many emerging countries to the deplorable state in their countries' infrastructure with serious negative consequences for growth. As an example, for the vast majority of agricultural firms, the efficiency loses due to poor infrastructure are higher than the impact of the export tax. On the whole, and in order to keep perspective we would like to point out that the overall public balance has been in permanent surplus since 2003, reaching 3.7 percent of GDP in 2004 and projected to be (under the authorities scenarios) 1.3%, 1.8% and 1.9% in 2005, 2006 and 2007 respectively.

12. On the need to contain inflationary pressures, my authorities are fully committed to that goal and have taken the necessary fiscal and monetary measures conducive to that end. As repeatedly mentioned to the IMF mission, further tightening policies will be taken if needed to keep inflation in line with the target. Thus, acknowledging the presence of pressures on the general price level and not just transitory seasonal factors and changes in relative prices. My authorities are surprised that paragraph 21 gives a different impression on both accounts. On the fiscal front, we have already mentioned the exceptionally large primary surplus. On the monetary front, the Central Bank authorities have undertaken a forceful sterilization of the monetary consequences stemming from their policy to replenish Central Bank's reserves. Sterilized interventions in the context of temporarily heightened inflation expectations have pushed up the interest rates of the 90-day bills issued by the Central Bank which have raised from 3.5 early this year to 6.2 in the latest public offering. Thus, the argument in the staff report that the acquisitions by the Central Bank of US dollars at the local foreign exchange market run the risk of excessively increasing money supply should be countered by the impact of the sterilization policy that is taking place. In addition to its sterilization policy, the Central Bank has increased its benchmark rate for short-term loans to the banks several times so far. Another important instrument to contract money supply has been the program offering incentives to banks to make anticipated cancellations of the rediscounts that were granted at the height of the crisis, which are carrying relatively high interest rates.

13. The increase in money demand derived from the larger than expected growth of economic activity should also be factored in at the moment of assessing the risk of persistent monetary pressures. In this regard, the rise in the money multiplier is a welcome development to the extent that it comes associated with a revitalization of bank credit, a necessary condition to support investment and economic activity in general, particularly for the very large number of small and medium sized companies working in Argentina, particularly when the ratio of credit to GDP has fallen sharply after the crisis and is now only at 9 percent, compared to 23 percent during the late 1990s. Finally, regarding the dampening effect on growth of administrative controls and moral suasion alluded by the staff as an inappropriate means of containing inflationary pressures, is worth explaining that these encompass only a limited subset of goods pertaining to low-income consumption baskets for each category while the majority of goods remain fully free.

14. Regarding the need to support a high volume of exports to sustain growth, it is a welcome development that export volumes in general and manufactured goods in particular are growing steadily, thus the government strategy of maintaining a competitive foreign exchange rate appears to be working. It is a well known fact that adjustments of exchange rates and the changes in relative prices entailed take time to produce the transformation of the productive structure necessary to generate more exports. In addition, the staff report asserts that export taxes are damaging the export performance without providing any supporting evidence. Export taxes not only contain the increase in prices of basic consumer products but they also provide the

revenue to finance the social programs that were and still are much necessary to address the social consequences of the crisis.

15. My authorities agree with the staff that the key variable to ensure a continued strength of exports over the medium-term is through the increase in productivity and in the efficiency of the economy. Thus, they are fully committed to create a favorable investment climate through market confidence in their sound macroeconomic and structural policies. The latter notwithstanding, my authorities are of the view that an appreciated currency, as experience during the 90s, will eventually become an insurmountable hindrance towards sustainable growth, hence they are bent to avoid this to happen again. Argentina has paid a high cost in the recent past in terms of employment and growth for neglecting the importance of the appropriate value of its currency. In any event, the present nominal value of the currency, which has found a widespread acceptance, particularly among the banking and businesses communities, represents a real appreciation rate for the peso of 16 percent vis a vis the US dollar, since early 2003. Incidentally, Box 2 suggests that the increase in the unemployment rate in Argentina was related to the higher labor market participation rate of women. This explanation hides more than it reveals the real factors at work. The unemployment in the 90s was generated in fact by the economic model in place, fully in line with the Washington Consensus. If more women wanted to work was out of the sheer need to support their unemployed husbands. This increase in female labor market participation can never be identified as a major explanation for an increase of 12 percentage points in the unemployment rate, as the one experienced between 1992 and 2001.

16. On the structural front three issues are highlighted in the staff report: the intergovernmental fiscal relations, the soundness of the banking system, and the renegotiation of contracts with privatized utilities. Regarding intergovernmental fiscal relations the staff makes the point that whereas the post-crisis fiscal stance was disciplined, this has only occurred in a context of a lack of available financing. Thus, were the financing constraints to disappear, fiscal discipline would no longer be assured unless institutional changes were introduced. We find this to be an unfair remark. Firstly because it gives no credit to the authorities' efforts to discipline provincial financial administration; efforts that have, as the staff should have said it, resulted in substantial provincial savings for the first time in decades. Secondly and beyond the authorities' willingness to administrate fiscal resources with austerity, we feel that the staff makes no justice to the recently approved Fiscal Responsibility Law. This law may not be as un-realistically strict as wished by staff but it contains key improvements in relation with the past when no specific rules existed, except for the temporary arrangements of the post-crisis years through the orderly financing programs. More importantly, both the federal and the provincial level of government have a clear track record in slashing down the presently high levels of indebtedness and to avoid market financing of the budget..

17. The federal organization of government in Argentina makes it very difficult to introduce policies that may be perceived as infringing on the provinces'

independence. The present FRL establishes clear limits to current spending and debt accumulation while increasing transparency. It is the best agreement under the present circumstances; it has already been ratified by 18 of the 24 provinces, representing more than 80 percent of total provincial spending and there is no political nor constitutional space left to attempt a comprehensive reform as requested by the staff. In the same vein, the staff's suggested reforms of the current intergovernmental tax revenue sharing system do not have much of a chance of been agreed upon shortly, as proved by the failure of the government attempts to reform the coparticipation law during 2004 as well as in many other occasions. Moreover, the streamlining of the current revenue sharing system, despite its positive aspects, would have in the short run some serious shortcomings. In the current circumstances, a new coparticipation law can only be the result of a revenue loss by the Central Government. This, of course, is totally at odds with the need for the central government to sustain a high fiscal primary surplus in the coming years.

18. Another important area of structural policy raised by the paper is the soundness of the banking system including with regard to the strengthening of its capital base and the strategic role of the public banks which obtained after the crisis a larger participation, in relation to the pre-crisis period. This has been the result of the decisions of individual banks' customers that naturally found, at a time of crisis, that public banks offered a safer place to keep their savings. It has nothing to do with administrative decisions of the public sector to take over private banks. In this regard, it is important to clarify the statement in paragraph 33: "the share of the banking system in the hands of the state has increased sharply". In fact, since 2002 public banks have only increased their share in total deposits marginally, mainly explained by a strong increase in public deposits. Moreover, since December 2003 to March 2005, the share of public banks in total deposits decreased from 47 percent to 46 percent, while deposits of the public sector in these banks increased by 11 percentage points. As to the strategic role for public banks my authorities believe that the financial system should operate in the service of sustainable, stable and equitable economic development. In this vein, we believe that public banks have an important role to play in particular to reach areas of the country and segments of the population and of the business community that private banks are not naturally inclined to reach. My authorities are committed to fulfill these tasks in a manner that does not resign efficiency nor profitability for the public banks while keeping a close regulatory oversight. The strategic review for Banco Provincia, already completed, and for the Banco Nación soon to be initiated, will provide important suggestions as to the best ways to increase productivity and efficiency of those banks. It is worth noting that the review for Banco Provincia has shown a picture much more encouraging than the one many skeptical pundits were expecting. The Banco Provincia is already implementing a medium-term action plan to further improve its operational performance.

19. Paragraph 33 also states that "the share of public securities in bank's portfolios has risen substantially". It is important to indicate that even considering BCRA bills, the share of public securities in bank's portfolios was slightly reduced from 50 percent by the end of 2003 to 47 percent in April, 2005. However, BCRA bills are not counted

as part of the regulatory government bonds limit of 40 percent of assets. Considering this last definition, government bonds in banks' portfolios represent on average 38 percent of assets, while their share has been reduced since the beginning of the year. My authorities are not retracting from any of the regulatory norms in place which allow for a temporary forbearance until international standards are fully applied.

20. Regarding the strengthening of the capital base of the banking system, the gradual strategy of the authorities continues to be implemented successfully. The system has not only reduced its losses during 2004, as mentioned in paragraph 12 of the report, but it has also obtained operational profits during the first quarter of 2005 in the wake of a continued increase in total deposits and of the rapid growth of private sector credit that is taking place. Profits is the key variable that will allow for a progressive strengthening of the capital base of the system both directly through their capitalization and indirectly through the incentives they create for a voluntary recapitalization, which will certainly be reinforced by the overall positive economic environment present in the country. In any event, important progress in the balance-sheet of banks has already occurred through the reduction of external debt in many banks including through debt capitalization. The early repayment of rediscounts has also contributed to strengthening the banks' capital base. In addition, fresh capitalization has also taken place in the recent months. Looking forward, all banks have completed their business plans for the current and coming years which incorporate an important improvement of their capital bases.

21. Moreover, the staff highlights the need to complete the compensation for asymmetric pesoization and indexation of bank assets and liabilities. However, in my authorities view this has already been largely done. What is still pending is due to differences of opinion between the BCRA and the banks on the legality of a small proportion of the claims (around 10 percent of total claims). On the issue of court injunctions "amparos", also raised by the staff, the position of the authorities has been quite clear all along. It was stated from the beginning that this was a problem that falls under the competence of the judges and that the government was not going to compensate banks for this motive. Some favorable decisions from the Supreme Court upholding the "pesoisation" has contributed to a dramatic halt of further judicial claims sharply reducing the amount of "amparos". In the meantime, banks have been allowed to amortize the losses generated by "amparos" during a five year period.

22. Finally, on the structural front there is the issue of the renegotiation of contracts with privatized utilities. In this regard, I would like to state in the first place that it is important not to downplay the progress that has been reached in several important areas such as ports and highway concessions, freight railways' operators and electricity companies. In addition, only a few conflicting cases seem to gain press coverage and the analysis presented is in general simplistically reduced to the question of tariffs, as it transpires for example from the staff report. As a matter of fact, the most serious underlying issue is the balance sheet positions of the companies burdened by very high indebtedness in hard currency that needs to be restructured. The government is making utmost efforts to facilitate those restructurings. The

question of investment commitments looking forward is also a critical aspect that is not duly considered when addressing the issue of the privatized utilities. In any event, the government is committed and is already implementing a progressive adjustment of tariffs that are progressively starting to impact family units. All these developments aim at ensuring a profitable business environment for companies while addressing the needs of the more vulnerable social groups.

23. As to Argentina's response to the recent decision against Argentina by the International Center for Settlement of Investment Disputes (ICSID) in favor of a company owning a minority stake in one of the two gas transportation companies, which is seeking compensation for the losses originated in the pesoification and freezing of utility rates since 2002, I am not aware as of yet of any formal reaction from the Argentine authorities. I can tell, however, that my authorities have questioned all along the legitimacy of those claims since the essential aspect of the international investment protection agreements signed by Argentina is to guarantee foreign investors that they will not be subjected to any discriminatory treatment and such a situation has not taken place. As to the argument that the devaluation of the currency, the pesoization and the freezing of tariffs could be assimilated to an indirect expropriation, my authorities consider that this is tantamount to say that the economic policy of a sovereign could be made subject to judicial judgment, which is obviously inappropriate. Moreover, it is noteworthy that the mentioned decision recognized that no expropriation has occurred as a result of the pesoization and tariff freeze; as such the finding in favor of the claimant appears inconsistent. It is revealing in this respect that the company holding the majority stake in the gas transportation company involved in this dispute has withdrawn its claims with the ICSID and there were recent public announcements, both from the company and the authorities, indicating that an agreement is soon to be reached.

24. On the Argentine debt restructuring, the staff presents a biased description of the characteristics and consequences of the restructuring, regardless of the time and efforts that my authorities devoted to describe the process to the staff. For example, the staff conclude in Box 5 and paragraph 48 that Argentina has not complied with the lending into arrears policy (LIA). This comes as a surprise because it is not the result of a substantiated analysis, that should be based not only on the nature of the Argentine debt restructuring but also on the LIA policy itself. Moreover, the staff's assertion is not only unsupported, but it brings a subject that does not pertain to this Art. IV discussion but rather to a specific analysis that should be, in due time, considered by the Board.

25. Having said this I will, nevertheless, take issue with the aforementioned unsupported assertion made by the staff. The main purpose of the LIA policy, that is to normalize relations with creditors, has been advanced as recently ratified by the rating agencies. In this respect, Argentina has fully complied with the LOI dated March 10, 2004, as it had indeed "endeavour[ed] to avoid a piecemeal approach to the debt restructuring". This was the overarching objective to which the Argentinean authorities were committed and it was, indeed, achieved with great success. At the time we were

negotiating the LOI some were arguing that the only way in which a piecemeal approach could be avoided was by establishing a minimum participation threshold (a 75 percent of adherence to the offer was broadly regarded as appropriate). Argentina did not believe that it was necessary to set such a nominal minimum participation threshold but nevertheless committed to "endeavour" to avoid a piecemeal approach and agreed –in order to discharge that commitment— to "finaliz[e] with the assistance of the banks an appropriate minimum participation threshold necessary for a broadly supported restructuring". In sum, finalizing an appropriate minimum participation threshold was subsidiary to the overarching objective of achieving a broadly supported restructuring. Argentina, after considering the matter with the banks decided that, given the complexity of the process, it was not convenient to include in the prospectus a nominal minimum participation threshold as by establishing a minimum participation threshold the ultimate objective could be hindered. This eventually proved to be the right approach since the debt offer was accepted by a vast majority of creditors; a number of creditors that, it is fair to say, goes beyond the minimum participation threshold that was considered appropriate at the time in which the LOI was negotiated. "

26. In Box 5 it is stated that "negotiations with private creditors were not constructive for the most part". This is viewed by my authorities as an unfair statement to the extent that the Argentine authorities traveled the world over to meet all types of creditors explaining to them the real limitations Argentina faces, including the fact that it did not have net financing from the IFIs, and listening to their desires and concerns. In fact, the final exchange offer, in terms of the characteristics of the new debt instruments, was shaped by the several suggestions gathered in those meetings (i.e. the incorporation of GDP-linked bonds, the Most Favored Lender Clause, and the Law 26.017, precluding the executive branch to re-opening the debt exchange offer). As to the fact that there were no formal "negotiations" around a table with all creditors, I have to recall that this is exactly what has occurred in all the previous debt restructurings where the majority of the debt was in the hand of a multiplicity of bond holders[1]. It is worth noting that the LIA policy does not demand negotiations with creditors in all cases.

27. From the authorities and the Staff's DSA analyses it is quite clear that even with the substantial hair cut obtained, the fiscal effort required over the medium-term will be totally unprecedented for the Argentina economy. Of course, as we will see below, the staff finally manages to make its point, but in our view at a serious cost to its credibility. It is indeed a challenge for the authorities and for the whole of the Argentine people to be able to meet the commitments created by the exchange offer and those associated with the consequences of the crisis, i.e. to compensate losses to the banking system and address the manifold social needs. The Argentine exchange offer embeds the maximum effort the Argentine economy was able to make without jeopardizing growth prospects. Going beyond that would have represented indeed a

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[1] "The Successful End of the Argentine Debt Restructuring Saga", March 2, 2005 by Nouriel Roubini.

bad faith negotiation to the extent that most likely it would lead to another default in the future.

28. Regarding the treatment of the holdout creditors, is important to reaffirm that this was the result of a free choice by those creditors perhaps ill-advised by the ones that were supposed to defend their interests. The government of Argentina went to extremes to make clear that the exchange offer was the only one that was going to be put forward and that not sweeteners to the offer should be expected. In the end, a minority of creditors, opted for rejecting the offer. The Argentine authorities have made clear that they acknowledge the existence of such a contingent liability and have indicated their intention to formulate in due time a forward looking strategy to address, within the legal framework and in consistency with the prospectus for the exchange offer, any remaining arrears with private creditors.

29. In discussing the Argentine debt sustainability analysis, the staff characterize as unrealistic the authorities scenario, called scenario A. It is somewhat startling that under the assumption that current policies are maintained, policies that as we have seen have yielded exceptional results, the staff considers that growth will decline to 2 percent a year whereas inflation and borrowing costs would increase. The staff do not attempt to explain the authorities underlying assumptions of the DSA (scenario A), which are consistent with the actual developments of the Argentine economy and the objectives of the Argentine government: sustainable output growth, employment creation and poverty reduction. In my authorities' view, the main variable to achieve those objectives is a strong macroeconomic framework. Only in this context structural reforms could be effective, since the main factor behind the sluggish GDP growth rates and its large volatility, particularly during the last three decades, has been the absence of a consistent macro framework and not the lack of structural reforms. In this respect, it is fair to recall that during the 1990s Argentina was considered a star performer by the IMF basically because of its widespread structural reform agenda while downplaying the lack of a consistent macroeconomic framework. In the aftermath of the crisis, the authorities shifted emphasis and, as a result, now the Argentine economy shows an impressive fiscal primary surplus matched with trade and current account surpluses, a competitive exchange rate, as well as a "dedollarization" of financial assets and liabilities. All this within a flexible and stable macroeconomic framework. The IMF's emphasis on structural reforms seems to be fixed in the past by giving such a key role to structural reforms that should be sequenced only in a social and political responsible manner. In spite of all the economy's favorable developments, the authorities conservatively assume that GDP growth will converge to 3 percent, consistent with an investment to GDP ratio of 21 percent, higher than the maximum ratio achieved during the Convertibility period (20.4 percent in 1998 at current prices)[2]. Consistent with this growth rates, employment creation and poverty reduction, the authorities estimate a moderate long

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[2] Nonetheless, my authorities are bent to pursue through their policies higher investment flows, since this investment ratio is just enough to sustain 3 to 3.5 percent GDP growth.

run real exchange rate appreciation and prudent interest rates. There is a sharp difference between the economic logic implied in the staff report and the authorities analysis, as my authorities consider that the staff is drawing the simplistic assumption that just by implementing structural reforms and by achieving an unrealistic primary surplus higher growth will be accomplished.

30. Stated in paragraph 42 of the report is that "Fund purchases should not be relied upon as a source of budgetary financing". However, maintaining its stock of debt to the Fund constant cannot be construed as representing budgetary financing strictly speaking. It should be rather seen as a way to cover its overall financing gap since in that case Fund financing would not be used to support current or capital expenditures. The staff reassert its view in paragraph 44 stating that "since the currency board regime, the central bank has onlent Fund resources to the federal government to help finance its budget deficit" . This statement fails to say that this has only been the case up until 2001, or to be more precise until the demise of the currency board. Since 2002 onwards, the budget accounts began rendering an overall surplus which was used to substantially reduce the exposure of the Fund and other IFIs with Argentina.

31. The staff's logic is further undermined by the fact that by excluding Fund financing altogether, as in scenario B, the debt ratio would follow an unsustainable level. Even the rosier staff scenario C, without Fund financing and higher primary surplus plus structural reforms, would require a roll over rate of private sector debt during 2005-2008 higher than the possible market access estimated by the staff itself. It is only under scenario D that the debt profile becomes sustainable and that there would even be a financing surplus indicating a higher capacity to pay than the projected debt obligations. It seems that, at last, the staff has proven that by maintaining over the medium-term a primary surplus of 4.5 percent a year and by appropriating Central Bank reserves (equivalent to 6.9 percent of GDP between 2005 and 2008) to pay the Fund, Argentina could pay more to the private creditors. This scenario looks particularly unconvincing, specially when less than a month ago Argentina's external position was characterized as vulnerable. Indeed, Argentina's extension of repurchase expectations was based on the fact that "Argentina's balance of payments outlook remains vulnerable in particular from the following factors: the relatively low level of reserve coverage, the unclear prospects for reaccessing international capital markets, and the large debt service payments falling due over the next 12 months—including US$8.1 billion to the IFIs." All together, it appears as if the whole purpose of this preposterous exercise would have been to reach the conclusion that Argentina does not need any assistance. Likewise, it seems as if the only objective of the present and future Argentine governments should be to pay the Fund as soon as possible and to content creditors while risking growth prospects and postponing in the meantime the alleviation of the pressing social needs that besiege much of the country's population.

32. As stated, scenario D is predicated on the authorities resorting to the foreign exchange reserves of the Central Bank to finance repurchases to the institution. The staff argue that this is a common practice among the membership. This came as a surprise to my

authorities, in fact, at least within our constituency this is not common practice. It would be interesting if the staff could provide more evidence on this practice. In my authorities' view the reduction of the stock of debt with the Fund should not call into question the Central Bank's independence, nor hinder its capacity to exert an effective monetary policy and defend the national currency's value. Consequently, it is our view that repurchases to the Fund should be based on fiscal surpluses or, when reasonable interest rates make it appropriate, on market based financing. The staff becomes more specific in Annex 1 when it suggests that the government should give the Central Bank 15-year bonds, with a five-year grace period, to preserve the financial integrity of the BCRA. The fact is, however, that the foreign exchange reserves are there to support the money supply and government bonds cannot do that and therefore the value of the currency, once a transaction of this type is done, would be affected by an immediate weakening pressure that could intensify inflationary pressures.

33. Finally, my authorities are somewhat baffled by the assertion in footnote 9 that "Fund purchases and repurchases were not generally relevant to the government financing framework", if that were indeed the case it would beg the question as to why governments would want to enter into the usually difficult negotiations required to agree on a Fund program. Moreover, this assertion is contradicted by the same report in paragraph 42 when trying to justify that the debt sustainability analysis DSA should not assume access to Fund financial support since as the report affirms "Fund purchases should not be relied upon as a source of budgetary financing even though this has been the practice in Argentina". As we have already stated, my authorities are not envisaging any budgetary financing from the Fund. This has been indeed the case only during the 1990s and it is precisely the consequences of that irresponsible behavior, including on the part of the Fund, which my authorities are trying to overcome.