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ARGENTINA

ECONOMIC DEVELOPMENTS

February 2016

This document on economic developments and policies was prepared in the context of an informal Executive Board briefing on Argentina under the procedures for members with excessive delays in Article IV consultations. Under these procedures, IMF staff prepares an assessment of the member's economy and policies based on information that is publicly available and without consultation with the member. The document, which constitutes the views of IMF staff, is aimed at keeping the Board informed about developments in the country. Given the absence of a more complete set of information, and a more thorough policy dialogue with authorities, this document should not be characterized as an IMF Article IV staff report nor should it be portrayed as representing the views of the Executive Board. Similarly, the associated informal Executive Board briefing does not constitute an Article IV consultation with the member.

This document is based on the information available at the time it was completed on April 29, 2015.

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EXECUTIVE SUMMARY

The last Article IV Consultation for Argentina was concluded in July 2006. This report has been prepared under the IMF framework for addressing excessive delays in the completion of Article IV Consultations. Previous reports on Argentina were discussed informally by the Board on January 29, 2013, and March 14, 2014. During the technical mission on CPI and GDP statistics to Buenos Aires during February 23–27, there were two meetings on recent economic developments with the Central Bank of Argentina and Ministry of Economy and Public Finance, which are part of an increasing interaction with the authorities. However, the absence of a regular dialogue on economic outcomes and policies with the Argentine authorities continues to affect staff's analysis, and therefore the conclusions in this report are necessarily tentative.

Economic activity slowed sharply over the past year, as a series of external shocks exposed the inconsistencies in the domestic policy framework. Weaker external demand, lower commodity prices, and the real appreciation of the peso have weighed on exports, fueling balance of payments pressures. Further tightening of foreign exchange controls helped stabilize the level of gross international reserves but at a considerable cost to economic activity. Government spending has been boosted to support domestic demand, with the fiscal deficit financed largely by the central bank. Sterilization operations have slowed money growth but are crowding out private credit.

Growth is projected to be slightly negative in 2015, and the outlook remains vulnerable. Activity has stabilized but prospects for investment and exports remain bleak. Weak external demand, growing overvaluation of the peso, and a rising fiscal deficit could intensify pressures on international reserves, laying the foundation for a future depreciation.

Systemic domestic imbalances are likely to pose challenges. The agenda ahead will likely include the removal of foreign exchange controls and unification of foreign exchange markets, a credible fiscal adjustment (focused on reducing distortionary energy subsidies and containing current spending), and the restoration of monetary policy credibility.

Approved By
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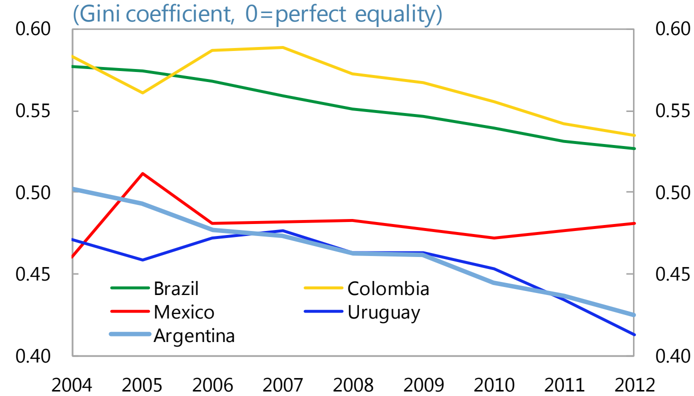
CONTEXT: IMBALANCES AND INTERVENTION

1. Argentina's impressive growth over the past decade has been accompanied by the accumulation of a number of major vulnerabilities. Rising commodity prices, strong growth in key trading partners, and expansionary domestic demand and redistributional policies have supported a rapid recovery from the 2002 crisis. GDP growth averaged 6½ percent from 2003 to 2013. Fast economic growth and a range of policy measures have facilitated a significant decline in poverty and income inequality. However, the last decade has also seen growing macroeconomic vulnerabilities.[1]

Income Inequality

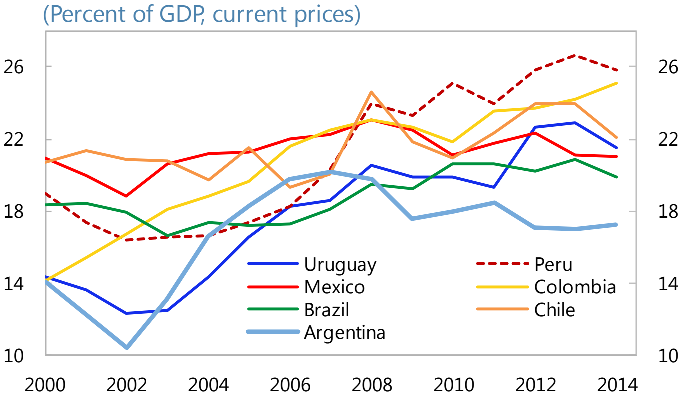
(Gini coefficient, 0=perfect equality)



Source: World Bank, Development Research Group.

Gross Fixed Capital Formation

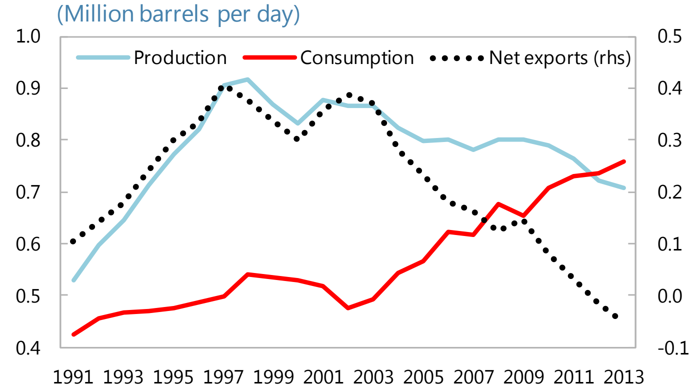
(Percent of GDP, current prices)



Sources: IMF, *World Economic Outlook;* and Fund staff calculations.

Crude Oil and Products

(Million barrels per day)



Source: U.S. Energy Information Administration.

- Argentina's economy remains heavily dependent on commodities. In 2014, agricultural products and agriculture-related manufacturing were about 60 percent of total exports. Capital goods and intermediate inputs comprise about 70 percent of total imports, making the economy highly dependent on the foreign exchange revenues generated by the commodity sector.

- Most of the output growth achieved over the past decade can be attributed to strong private consumption. However, gross fixed investment has not increased as a share of GDP since 2004 and, at 17 percent, is quite low compared to other Latin American economies.

- Government intervention in the energy sector has led to a sharp decline in investment and energy production. At

[1] In this paper, we use the official GDP and CPI indexes. While progress has been made in improving the methodology of the consumer price index and GDP statistics, remaining quality issues undermine the accuracy of the data.

the same time, the rapid expansion of subsidies boosted energy consumption, turning Argentina into a net importer of energy at a time when world oil prices were high. The reversal of the energy trade balance contributed to a weakening of the current account (from a surplus of 2 percent of GDP in 2007 to a deficit of 1 percent of GDP in 2014) while the growing subsidies undermined the fiscal position.

- The federal government's primary balance moved from a surplus of 1¼ percent of GDP in 2010 to a deficit of nearly 1 percent by 2014. Current spending rose rapidly over this period, particularly wages, pensions, and subsidies. The fiscal deficit was increasingly financed by monetary transfers from the central bank which fed inflationary pressures. The efforts to contain inflation led to a freezing of utility tariffs and agreements with retailers and producers regarding price increases for a number of products.

- The narrowing of the trade surplus and capital outflows fueled balance of payments pressures and prompted the introduction of a series of trade and foreign exchange (FX) controls since October 2011, giving rise to a growing gap between the official and parallel exchange rates.

2014: A DIFFICULT YEAR

2. Policy inconsistencies were exposed in early 2014 when mounting balance of payments pressures culminated in a sharp devaluation of the peso. To curb the rapid fall in reserves (which had reached US$27.7 billion in January 2014 down from US$30.6 billion in end-2013), the central bank devalued the currency by 23 percent in January, tightened some foreign exchange regulations, and raised policy interest rates.

3. Subsequent to the devaluation, domestic imbalances were exacerbated by a deteriorating external environment. The price of soybeans (soy products account for 30 percent of Argentina's total exports) dropped by 30 percent since early 2014, and other important export commodities, such as corn and wheat, saw significant price declines (Figure 1). At the same time, growth slowed in key trading partners, particularly in Brazil and China (in 2014, Brazilian imports from Argentina fell by 14 percent, with the automobile industry particularly affected). Also, the competiveness of exports suffered from the steady appreciation of the real exchange rate, which completely reversed the effects of the January devaluation. Over the past year, Argentina's real exchange rate appreciated by 20 percent due to the significant inflation differential with trading partners and a *de facto* crawl-like arrangement for the official exchange rate.[2]

4. At the same time, the dispute with holdout creditors continued to impede Argentina's access to international capital markets. In June 2014, the U.S. Supreme Court declined to hear Argentina's appeal, rendering final the New York court's decision that Argentina would have to pay litigant holdout creditors in full together with its next payment on restructured bonds (Box 1). The

[2] Here and in the rest of the paper, the REER is estimated using the official general salary index for the economy instead of CPI.

pari passu decision of the court and the subsequent inability to reach an agreement with the holdout creditors hindered Argentina's progress in normalizing relations with international creditors (following the government's agreements in 2013-early 2014 with the Paris Club, Repsol, and the International Centre for the Settlement of Investment Disputes).

Box 1. Status of Sovereign Debt Litigation with Holdouts

On June 18, 2014, following the U.S. Supreme Court's refusal to consider Argentina's case, the Southern District Court of New York's decision came into effect, mandating Argentina to pay the litigant holdouts in full (approximately US$1.5 billion) together with the June 30 interest payment on restructured bonds. In the ensuing days, the Argentine government refused to offer the holdouts better terms than those of the 2005 and 2010 debt exchanges, and the inability of interested parties to reach a negotiated settlement by July 30, 2014 (when the grace period for end-June interest payments expired), resulted in the non payment of any obligations on Argentina's foreign-law governed restructured bonds from that day onward. To add to the US$1.5 billion owed to the litigant holdouts in the *pari passu* case, additional holdout claims (amounting to US$6–8 billion) have been filed by the so-called "me too" investors.

As of April 2015, payments on Argentina's foreign-law restructured bonds remain blocked, while future payments on Argentina's domestic-law foreign currency denominated restructured bonds have become uncertain.

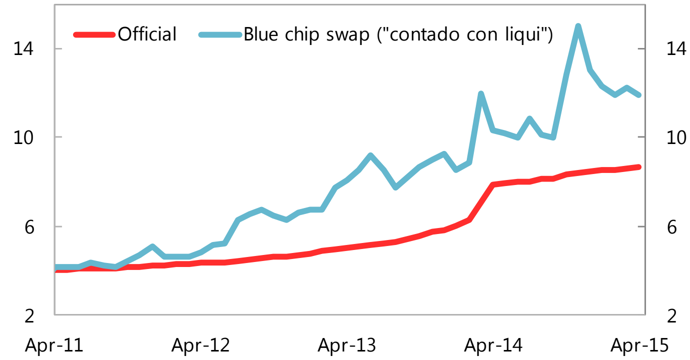
- All *foreign-law restructured bond* interest payments remain blocked pending full payment to or settlement with the litigant holdouts. The government has remained steadfast in its position not to offer the holdouts better terms than the previous debt exchanges. The High Court of Justice in London ruled that that the euro-denominated bonds were subject to English, not New York, law but, despite the London ruling, no payments have yet been made on the euro-denominated bonds.

- Future payments on *Argentine-law restructured bonds* denominated in foreign currency may be blocked by the New York court. The New York court allowed interest payments to be made on these bonds, payable in Argentina through Citibank's Argentine branch office, three times in 2014. However, on March 12, 2015, the court ruled to block Citibank's Argentine branch from processing the next set of interest payments on the bonds, due on March 31, 2015. The ruling was subsequently reversed to allow Citibank to process the March 31 and June 30, 2015 payments but it is unclear how, or whether, interest payments on the bonds will continue to be processed in the months ahead.

The government and the holdouts are both holding fast to their positions, and the risk of *acceleration* by restructured bondholders prior to the elections seems low. Holders of at least 25 percent of the outstanding amount of any bond series have the legal rights to request the trustee to accelerate the bonds, making the entire amount of outstanding principal and accrued interest on the bonds due immediately. Argentina would then have 60 days to cure the acceleration (by paying the interest due on the restructured bonds which would necessitate an agreement with the holdouts, or by garnering support of holders of at least 50 percent of the outstanding amounts of the series to reverse the acceleration). If Argentina were unable to cure the acceleration, it could force another debt restructuring, which in turn could lead to new holdouts. Market consensus is that bondholders may prefer to wait it out.

5. The combination of weak external demand, fast eroding competitiveness, and compromised access to international capital markets fueled balance of payments pressures in 2014. The widening current account deficit, lower FDI inflows (¾ percent of GDP in December 2014, one-third of their level at end-2012), and continued payments on foreign currency-denominated public debt (totaling US$ 5.5 billion in 2014) continued to put international reserves under pressure throughout 2014. In September 2014, gross reserves fell to a low of about US$27 billion, and the gap between the official exchange rate and the parallel market rate (an important indicator of confidence in the Argentine peso) rose to 90 percent.

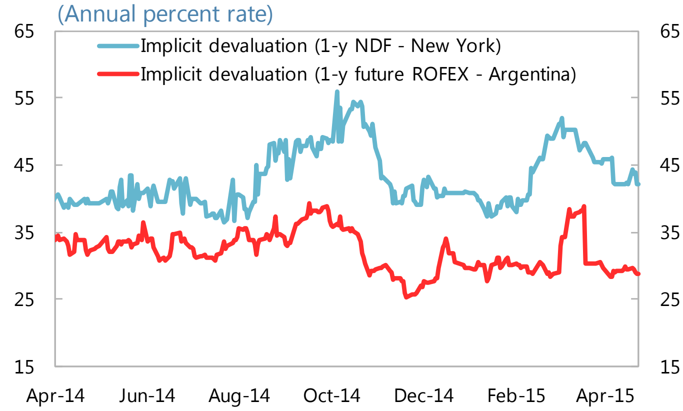
Nominal Exchange Rates
(Peso/US$)



Sources: Banco Central de la República Argentina (BCRA) and Haver Analytics.

6. A series of measures were taken in the second half of 2014 to stem the loss of international reserves and forestall the need for a more abrupt depreciation. In particular, the government negotiated and activated a renminbi swap line with the People's Bank of China, drawing a total of US$4.6 billion as of late April 2015. Other measures included an agreement with exporters of cereals and oilseeds to sell more of their inventory stocks and surrender a certain amount of dollars during the last quarter of 2014, as well as the sale of 4G telecommunications licenses at the end of 2014.[3] Thanks to these measures, gross international reserves gradually recovered in the fourth quarter of last year, ending 2014 at US$31.4 billion and remaining stable at that level until the issuance of a U.S. dollar denominated bond in late-April increased it to US$32.7 billion. Still, the stock of net reserves, estimated at US$14.9 billion as of end-February 2015, remains precariously low. Moreover, to stabilize balance of payments pressures, the authorities intensified FX controls (Box 2), including through closer monitoring of transactions in the parallel foreign exchange market by banks, stock brokers, and FX dealers. The lessening pressure is evidenced by the lowering of the gap between the official and parallel exchange rates to 40 percent by late-April 2015. Expectations of devaluation in futures markets have also moderated.

Implicit Devaluation in FX Futures Market
(Annual percent rate)



Sources: Rosario Futures Exchange (ROFEX) and Reuters.

[3] Moreover, about US$1.2 billion that was supposed to be disbursed to restructured bondholders since June 2014 remains blocked at an account in the central bank.

Box 2. Foreign Exchange Controls 1/

The following is a non exhaustive summary of certain foreign exchange measures, based on publicly available information, that staff understands are currently in place. Some of these controls are not explicitly written in regulations, but are in place as a matter of "informal" requirements or practices of the central bank.

Imports

Since 2014, barriers to imports have been tightened and importers' access to foreign exchange restricted further. Importers are required to provide detailed business information (on owners, employees, investment plans, etc.) in order to get their imports approved. The range of transactions that require the prior consent of the central bank has been expanded in 2014—for example, access to FX to prepay for imports, excluding capital goods, was reduced from one year to 120 days. In late 2014, some sectors most affected by these measures (e.g., auto manufacturers and assemblers of electronics) were given a monthly quota of dollars to pay for their imports. In February 2015, however, the central bank completely blocked sales of FX to importers for three consecutive days. Since then, commercial banks need to provide detailed information on transactions and obtain central bank approval before issuing letters of credit to importers.

Dividend remittances

Dividend remittances by foreign-owned companies remain difficult. Since end-2011, foreign companies have reported problems repatriating dividends through the official FX market, although the only sector with formal barriers to dividend remittances is the financial sector (commercial banks distributing profits are subject to additional capital requirements). Dividend remittances fell from a quarterly average of US$1 billion in 2009–11 to only US$250 million in 2012–14, while reinvested earnings accrued by foreign companies have increased sharply.

Individuals

Individuals' access to the official FX market remains tightly controlled. The purchase of FX for saving purposes has been limited since mid-2012, pushing the demand for FX into parallel markets. The controls were partially eased in January 2014, with a new system of limited FX sales based on individual income (the access applies to workers earning above two minimum wages, currently US$505, and is up to 20 percent of the declared monthly income with a maximum limit of US$2,000 per month). Although the authorized amounts are low, they imply a monthly drain of reserves of US$500 million since October 2014. FX purchases for tourism are also subject to controls and require an authorization from the federal tax agency (with a 35 percent tax surcharge since end-2013 that also covers the use of credit and debit cards abroad). Since January 2014, web-based purchases abroad require authorization and are limited to two transactions of up to $25 per year. Purchases exceeding this limit are subject to a 50 percent tax (in addition to the 35 percent tax on credit and debit card purchases).

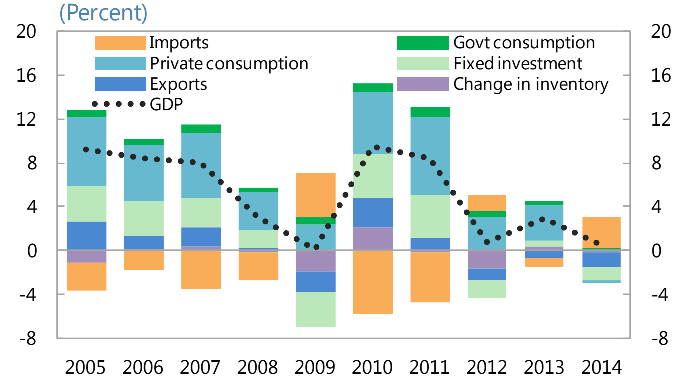
Banks

Commercial banks' net FX position is subject to a cap, which was lowered in 2014. The cap on banks' net FX position, including holdings of cash and dollar bonds, and the net FX futures position, is set at 20 percent of their capital.

1/ Staff continues to monitor developments in Argentina's exchange system. Based on available information, staff is of the view that there may be foreign exchange restrictions and multiple currency practices subject to Fund jurisdiction under Article VIII, sections 2(a) and 3. Amongst the areas that may give rise to exchange restrictions and/or multiple currency practices are (i) the broad limitations on access to the local foreign exchange market (including the central bank's preapproval requirements and ceilings) in order to make payments and transfers for current international transactions, as well as limitations on access to foreign exchange for certain invisible transactions; (ii) the deviation between the official exchange rate and parallel market rate that results in a spread of more than 2 percent between rates for current international transactions; and (iii) the imposition of a tax on certain foreign exchange transactions.

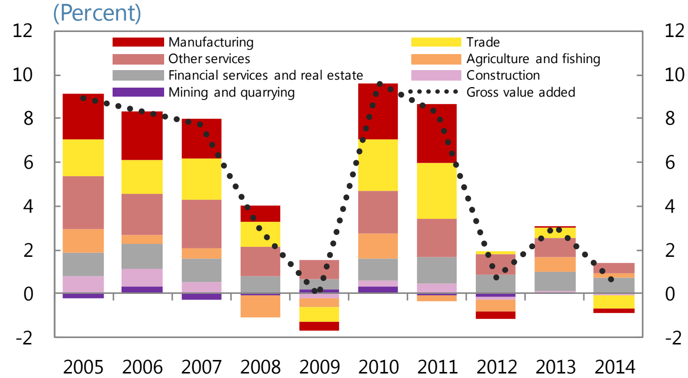
7. The same steps taken to contain Argentina's balance of payments pressures, however, contributed to the steep slowdown of GDP growth. Argentina's economy grew only ½ a percent in 2014. Domestic demand fell sharply, subtracting 1¾ percentage points from growth. Fixed capital investment fell 5½ percent on an annual basis, reflecting the terms of trade shock, lack of foreign financing, deteriorating business confidence, and more limited domestic credit. Private consumption was hurt by the sharp increase in inflation after the January devaluation (which depressed real disposable income) and balance of payments pressures (which reduced consumer confidence).[4] Positive contribution to growth came from net exports, as slower export growth was more than offset by the compression of import growth, and public consumption. On the production side, the slowdown was seen in a contraction of activity in manufacturing, with the automotive sector particularly hard hit, and construction activity falling due to the decline in infrastructure and road works (although construction activity related to the energy sector increased briskly). The main impetus for growth on the supply side came from financial intermediation and other services and, to a lesser extent, agriculture.

GDP Growth and Contributions
(Percent)



Sources: Instituto Nacional de Estadística y Censos (INDEC); Haver Analytics; and Fund staff calculations.

Sectoral Contribution to GDP Growth
(Percent)



Sources: Instituto Nacional de Estadística y Censos (INDEC); Haver Analytics; and Fund staff calculations.

8. A sharp fall in labor force participation and greater public employment cushioned the impact on the unemployment rate. Both participation and employment rates declined during 2014, before partly recovering by the end of the year, and stood about ½ a percentage point below the end-2013 levels. The unemployment rate increased by only ½ a percentage point from end-2013, to 7 percent at end-2014, with the vast majority of new jobs created by the public sector (based on staff estimates, the unemployment rate would have been ½ a percentage point higher without the spike in public sector employment).

9. Indicators suggest that the pace of contraction of economic activity bottomed out at the end of 2014, although manufacturing continues to suffer (Figure 2). Construction activity

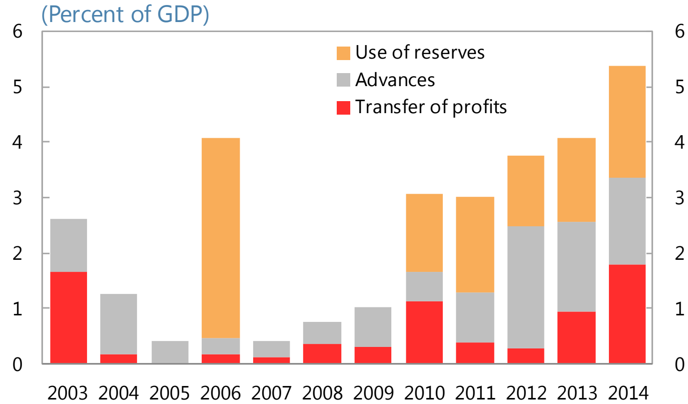
[4] Overall, with the positive contributions from net exports and public consumption broadly offsetting the drag from private consumption and investment, almost all the headline growth in 2014 came from a positive statistical discrepancy.

expanded 3.8 percent in the first two months of 2015, partly thanks to the government's subsidized home loan program (*PROCREAR*),[5] and retail sales rose 2.2 percent in the first quarter of 2015. With confidence boosted by the stabilization of balance of payments pressures and expectations of a change in policies after the end-of-year presidential elections, equity and bond markets have performed strongly.

10. The federal government's fiscal deficit deteriorated in 2014 (Figure 3). The federal government fiscal deficit increased to 2½ percent of GDP in 2014, from 1.9 percent in 2013. This was despite a significant increase in profit transfers from Argentina's central bank (BCRA) and ANSES (the social security system). Excluding these two items, the overall deficit amounted to a record-high 5.3 percent in 2014, up from 3.6 percent the prior year. Primary spending grew 40 percent, mainly reflecting growing transfers to the private sector (5½ percent of GDP), two thirds of which were for energy-related subsidies (Box 3). Real spending on wages and social security benefits also increased rapidly, due to high nominal wage and pension increases and the increase in public sector employment. The pace of primary spending has shown no signs of abating in early 2015, with year-on-year expenditure growth outpacing revenues and inflation in the first two months of the year.

11. The fiscal deficit has been mainly financed by the central bank. Without access to international capital markets, the central government has been relying mainly on the BCRA balance sheet to finance its widening deficit. Almost two-thirds of the overall fiscal deficit in 2014 was financed by loans from the BCRA.[6] The treasury was able to tap domestic financial markets, issuing US$4.7 billion in bonds in 2014, with issuances of peso bonds in March, June, and September, and issuances of U.S. dollar-linked bonds (governed by Argentine law and payable in pesos) in October and November. An additional US$1.4 billion in U.S. dollar-denominated bonds was raised in April, 2015.

Central Bank Assistance to the Treasury
(Percent of GDP)



Source: Banco Central de la República Argentina (BCRA).

[5] Launched in June 2012, *PROCREAR* credit program includes subsidized home loans with maturities of 20–30 years and interest rates of 2–14 percent. It includes loans for construction, extension, and refurbishment of houses, and for development of urban projects. The loans are assigned by lottery. The target is to provide 400,000 loans over 4 years.

[6] The BCRA provides below-the-line financing to the treasury through short-term advances, called *adelantos transitorios*, which have a legal limit mandated by the BCRA Charter, based on a formula involving the level of total federal revenues and the monetary base. The central bank also provides foreign currency loans to the Treasury (*use of reserves* in the text chart) to finance the repayment of foreign currency denominated public debt.

Box 3. Energy Subsidies in Argentina

Energy subsidies, mainly benefiting consumers of electricity and natural gas, have grown rapidly over the past decade. They accounted for 3½ percent of GDP in 2014, twice the size of federal government investment, and up from ½ percent of GDP in 2006. This increase has been a key contributor to the deterioration of Argentina's fiscal performance. Energy subsidies in Argentina were among the highest in Latin America and the Caribbean in 2011–13, only lower than those in Venezuela, Ecuador, and Bolivia (IMF WP/15/30).

Energy Subsidies and Federal Fiscal Balances

(Percent of GDP)

	2012	2013	2014	2015 1/
Energy subsidies	2.0	2.4	3.7	3.5
Primary balance	-0.2	-0.7	-0.9	-1.6
Overall balance	-2.0	-1.9	-2.5	-4.0

Sources: ASAP; Mecon; and Fund staff projections.
1/ Fund staff projections.

While energy subsidies were first introduced to cushion consumers after the sharp exchange rate devaluation of 2002, they have since become entrenched entitlements. Tariffs for electricity and natural gas were frozen in 2002, and subsequently adjusted only a few times on an *ad hoc* basis (in 2004, 2011, and 2014) but not enough to keep up with inflation or rising production costs. As a result, a widening gap developed between the international price of energy and domestic prices. As of January 2015, the average prices of natural gas and electricity in Argentina were estimated to be 28 percent and 22 percent of their respective international reference prices.

Exchange rate depreciation (in particular during 2013–14) has contributed to larger subsidies. Roughly one-quarter of natural gas consumed (including for electricity generation) is now imported, and there is a large difference between the peso price of imports and the retail prices. For instance, the import price paid by the state-owned ENARSA (*Energia Argentina Sociedad Anonima*) to Bolivia was US$10.1 per mBTU in late 2014, while the average domestic price (including that paid by industrial, commercial and residential consumers) was US$3.9 per mBTU (residential tariffs are substantially lower than this average). Residential electricity tariffs in Argentina were by far the lowest in the region, with tariffs in Uruguay, Chile, and Brazil 21 times, 11 times, and 9 times higher than Argentina, respectively.

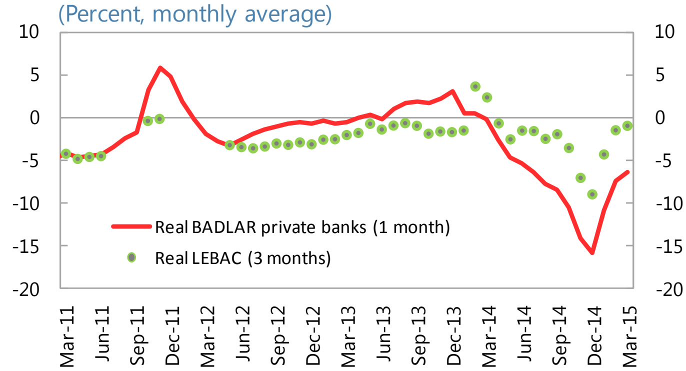
Energy subsidies in Argentina are highly regressive and impose a high economic cost. It is estimated that about 40 percent of the poorest households do not have access to the natural gas network, and must buy liquefied petroleum gas at prices that double or treble the cost of natural gas. In 2008, the government introduced the *garrafa social* (social LPG cylinder) at a lower, subsidized price, but it is not widely available. More recently, the *Hog.Ar* plan was introduced to provide direct cash transfers to low-income households that lack access to the natural gas grid, to cover part of the cost of gas cylinders. Studies estimate that, on average, the poorest 20 percent of households in low- and middle-income countries receive only 10 percent of natural gas subsidies and 9 percent of electricity subsidies. In addition to aggravating fiscal and external imbalances, subsidies have led to under-investment and energy shortages.

12. The central bank sterilized a large share of its money creating activities in 2014 (Figure 4). The monetary base grew at a monthly average (y/y) rate of 20 percent in 2014, down from the 30 percent growth seen in 2013, as the BCRA sterilized 75 percent of its financing of the government through the issuance of short-term notes (LEBACs) and repo operations with local banks. More recently though, growth of the monetary base has accelerated, averaging 28 percent (y/y) in February–March 2015, due to growing fiscal demands on the central bank and a less intense sterilization policy.

13. Rising inflation and expectations of future depreciation reduced the demand for money in 2014. In order to protect the currency after the January 2014 devaluation, the interest rate on LEBACs was almost doubled, from 16 percent at end-2013 to 29 percent in early February 2014; thereafter, the rate stabilized at 27 percent for the rest of 2014, before declining to 26 percent in early 2015. On the deposits side, rates have fallen gradually in the past year, with the BADLAR rate (on large short-term time deposits) at 21 percent in April 2015, down from 26 percent 12 months ago, and remaining negative in real terms. This has negatively affected the demand for money balances, as suggested by an increase in the velocity of money for most of 2014.

Real Interest Rates

(Percent, monthly average)



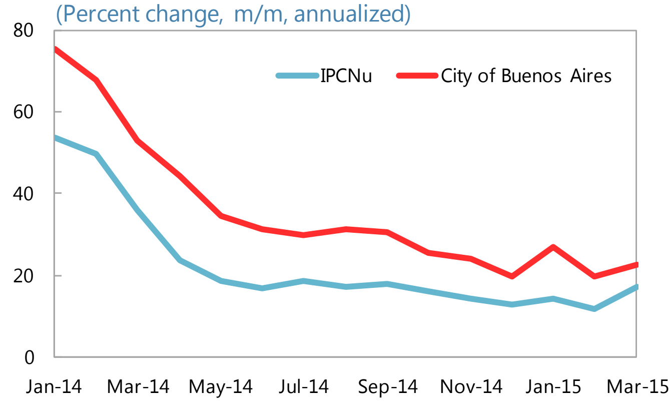
Sources: Banco Central de la República Argentina (BCRA); Instituto Nacional de Estadística y Censos (INDEC); and Fund staff calculations.

14. The expansion in domestic financing of the federal government has meant a contraction in credit to the private sector. The banking system's exposure to public sector debt, including through loans and BCRA instruments, increased significantly in 2014, from 19 percent of their total assets at end-2013 to 26 percent at end-2014 (with private banks constituting a 30 percent share of the total banking sector exposure). This has left few resources in the banking system to finance the private sector. Private credit decelerated from 31 percent (y/y) at end-2013 to 19 percent by early 2015 (a 3 percent contraction in real terms). The central bank has introduced a series of measures over the past year, including imposing a minimum interest rate on time-deposits (linked to the interest rate on 3-month LEBACs); interest-rate caps for personal loans and credit cards; and requiring banks to lend at least 5½ percent of their deposits to small companies (implicitly with subsidized interest rates). However, these have not stemmed the decline in credit. High inflation and the depreciation of the peso have driven up the profitability of Argentine banks over recent years (given their positive net FX position), but the slowing pace of loan growth and weaker economic activity pose risks to banks' profitability going forward.

15. After a burst of inflation following the devaluation in early 2014, inflation subsided but remains at among the highest levels in the world. The new official estimate of annual inflation (IPCNu) ended 2014 at 23.9 percent, falling from an annualized monthly rate of close to 40 percent in the first quarter of 2014.[7] Nominal wages rose by 33 percent in 2014 and have continued at a similar pace in early 2015. The ailing economy and the slower pace of depreciation of the exchange rate dissipated the inflationary impact of the January devaluation. The expansion of the price agreement program ("*Precios Cuidados*") has also helped moderate inflationary pressures.

Consumer Price Indices

(Percent change, m/m, annualized)



Source: Instituto Nacional de Estadística y Censos (INDEC).

2015: WEAK GROWTH, HIGH VULNERABILITIES

16. Argentina's economy is likely to continue to struggle in 2015, given the challenging external environment and persistent domestic imbalances:

- ***A contraction in output***. Support from expansionary macroeconomic policies and lower oil prices will not be sufficient to offset the impact of worsening external conditions. Exports will contract further given the slowdown in main trading partners, the terms of trade are expected to continue deteriorating, and persistent foreign exchange controls will remain a drag on activity and depress business confidence. Higher public spending will support household consumption but not enough to outweigh the contraction in investment and exports. GDP growth is projected at -0.3 percent in 2015, with risks to the downside.

- ***A growing fiscal deficit***. Lower energy prices are estimated to reduce energy subsidies by about ½ percent of GDP in 2015. However, falling export taxes (owing to a worsening terms of trade), weak import tariffs (owing to the FX controls and contraction in economic activity), and increasing spending on wages and pensions are

Federal Government Operations

(Percent of GDP)

	2011	2012	2013	2014	2015 Proj.
Revenues	24.6	26.0	27.5	29.7	29.6
Primary expenditures	24.3	26.1	28.2	30.5	31.3
Interest cash	1.5	1.9	1.2	1.6	2.4
Primary balance	0.2	-0.2	-0.7	-0.9	-1.6
Primary balance net of transfers 1/	-0.4	-1.3	-2.4	-3.6	-4.1
Overall balance	-1.3	-2.0	-1.9	-2.5	-4.0
Overall balance net of transfers 1/	-2.0	-3.1	-3.6	-5.3	-6.5
Memo: General government gross debt	35.8	37.3	40.2	48.6	48.4

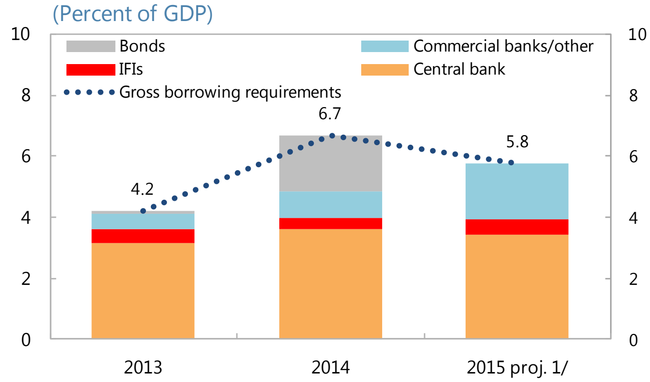
Sources: Banco Central de la República Argentina (BCRA) and Fund staff calculations.
1/ Excludes BCRA profit transfers and transfers from ANSES.

[7] Comparator indices, such as that of City of Buenos Aires, showed a higher (y/y) level of inflation by December 2014, but they have also slowed over the course of 2014 and into the first quarter of 2015.

expected to widen the federal primary deficit to 1.6 percent of GDP (4.1 percent of GDP excluding transfers from BCRA and ANSES) this year.

- ***Expanding monetary financing***. The gross government borrowing requirement is projected at 5¾ percent of GDP in 2015. Without access to international capital markets, these needs will be funded through borrowing from the BCRA (3.4 percent of GDP), IFIs (½ percent of GDP), and the issuance of bonds and other borrowing from local commercial banks (2 percent of GDP). This will further crowd out credit to the private sector.

Federal Government Borrowing Needs and Sources
(Percent of GDP)



Sources: Banco Central de la República Argentina (BCRA); and Fund staff estimates.
1/ Projected borrowing from commercial banks/other includes bond issuance.

- ***Lower inflation***. Despite the increased monetary financing, a combination of a weak economy, a gradual depreciation of the official exchange rate versus the U.S. dollar, regulated utility prices, and the extension of price-agreement programs will bring inflation to 21 percent by year-end.

- ***A continued appreciation in real effective terms***. Argentina's significant inflation differential with trading partners is expected to lead to a continued increase in the overvaluation of the peso. By year-end, the currency is projected to appreciate in real effective terms by 13 percent. While difficult to judge given the many policy distortions currently in place, staff estimates point to an overvaluation of the peso of up to 40 percent relative to the level that is consistent with medium-term fundamentals (Box 4).

- ***A contraction of the trade surplus***. Lower energy prices are expected to improve the trade balance by about 0.4 percent of GDP in 2015. However, international prices for Argentina's main exports are projected to fall further in 2015 (by 20 percent for soy and 31 percent for wheat), reducing export receipts from agriculture by almost 20 percent this year. Weak external demand (particularly from Brazil and China) and deteriorating competitiveness will also depress exports. At the same time, persistent administrative and foreign exchange controls as well as subdued domestic demand will suppress imports. On net, the trade surplus is projected to shrink by US$5 billion in 2015.

Foreign Exchange Needs
(Billions of U.S. dollars)

	2014	2015 Proj.
Current account	-5.1	-9.7
Change in gross international reserves	0.8	-10.0
Memo: GIR, end-year stock	*31.4*	*21.4*
Debt repayments	6.7	16.3
Debt service 1/	6.7	13.9
China swap		2.4

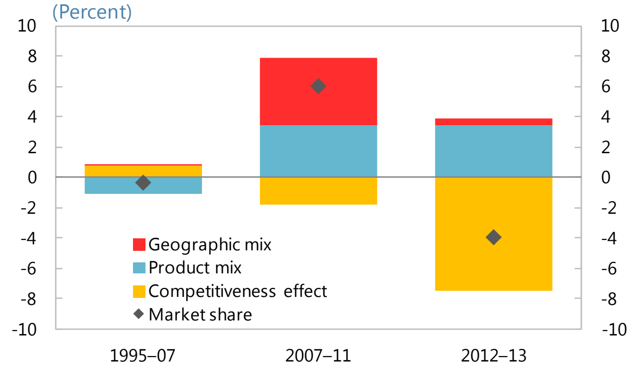
Sources: Instituto Nacional de Estadística y Censos (INDEC) and Fund staff estimates.
1/ Total FX debt service excluding BCRA, T-bills, and ANSES.

- ***Deepening pressures on the balance of payments***. Without access to external financing in 2015 and a growing current account deficit (projected to reach -1.7 percent in 2015), the imbalances in both current and capital accounts will lead to central bank sales of foreign currency. Taking into account continued access to extraordinary external financing (largely the swap line with China) as well as expected IFI inflows, gross international reserves will fall to US$21 billion by year-end (less than four months of imports).[8] A significant share of these reserves will comprise FX reserve requirements and deposits of commercial banks at the BCRA (which amounted to US$8.1 billion at end-2014).

Box 4. Competitiveness and Exchange Rate Assessment

Argentina's world market share has declined sharply since 2012 signaling a gradual erosion of export competitiveness. Using a shift-share analysis, gains or losses in export market shares can be attributed to three different factors: (i) a product mix effect (indicating how much of the gains is due to exporting a more favorable mix of products than similarly competitive exporters); (ii) a geographical mix effect (how much of the gain comes from exporting to a more dynamic group of destination countries); and (iii) a competiveness effect (the residual gain that cannot be explained by product or geographical effects). Applying this approach to Argentina's exports suggests that between 2007–11 the large improvement in export performance was driven by favorable product and geographical mix effects (reflecting the concentration of exports on products that experienced sharp price increases, like commodities, and to fast-increasing economies, like Brazil and China). However, since 2012, Argentina's export market share has fallen sharply owing to a significant deterioration in competitiveness.

Contributions to Export Market Share Growth
(Percent)



Sources: Tiffin (2013) and Fund staff calculations.

The presence of a parallel exchange rate market with a large and sustained premium is another signal that the peso is overvalued. This is particularly the case given that the emergence of a parallel market has been prompted by the introduction of foreign exchange controls (Box 2).

Quantitative estimates for REER misalignment suggest a significant overvaluation of the Argentine peso. Standard analytical methodologies to estimate exchange rate misalignment (e.g., CGER, EBA) are not easily applicable to Argentina and provide a relatively large range for the peso overvaluation, between 5 and 40 percent:

- *The EBA approach* suggests that the current account (CA) deficit is larger than its medium-term norm, with an estimated CA gap of -1.6 percent of GDP. These estimates suggest an overvaluation of the REER of about 12 percent.

- *The External Sustainability approach.* Given the uncertainty about future foreign financing and liberalization of capital account controls, selecting the appropriate level for the ratio of net foreign assets (NFA) to GDP to stabilize the current account is a challenge. Using a range of target NFA-to-GDP ratios as benchmarks, from the latest regional average for LAC countries (-12.3 percent) to the last observed value for Argentina (3.5 percent in end-2013) translates into an overvaluation range between 5 and 40 percent.

- *The long-run purchasing power parity (PPP) approach* measures REER misalignment as the proportional difference between the most recently observed value of the REER and its mean. Using the wage-based REER and taking its 20-year average as a benchmark, this approach suggests that the peso is overvalued by about 40 percent as of January 2015.

[8] The obligations to China are assumed to be repaid in full in 2016: the credit accessed in 2014 (US$2.4 billion) is assumed to be repaid by end-2015, while the new borrowing in 2015 will mature in 2016.

17. Given the range of distortions and precarious balance of payments position, the risks are evidently to the downside (Risk Assessment Matrix table). Most of the external risks are common to other emerging market economies but Argentina's domestic imbalances make the country more exposed.

- *Weaker-than-expected activity in the systemic emerging markets* would imply a greater decline of Argentina's exports, a sharper drop in its terms of trade, and lower FDI. Pressures on reserves would intensify, which may cause the authorities to strengthen FX controls, with a corresponding negative effect on activity.
- *A stronger U.S. dollar and weaker Brazilian real* would make it harder to maintain the slow pace of nominal depreciation or lead to an even greater overvaluation of the Argentine's peso. This could create pressure for another step devaluation of the peso which, in turn, would add to inflationary pressures. Unions' concern about lost purchasing power could generate social unrest.
- *A sharper-than-expected increase in the fiscal deficit* would place greater demands on central bank financing and make it more challenging to sterilize the resulting monetary expansion. This could precipitate expectations of a future depreciation of the peso, and cause a speculative attack on the currency.

18. A tentative quantified downside scenario is provided to illustrate the potential impact of some of these risks. The scenario assumes a faster increase in the fiscal deficit of about 2 percent of GDP financed by an expansion of the monetary base and a further squeeze of private credit. The pass-through to inflation would cause a stronger real appreciation and deplete international reserves. Expectations of exchange rate depreciation and rising inflation would grow, and both private consumption and investment would fall faster, eating into GDP growth.

Baseline and Illustrative Downside Scenario

(Percent change, unless otherwise indicated)

	2014	2015 proj.	
		Baseline	Downside
Real GDP	0.5	-0.3	-1.8
Private consumption	-0.5	0.4	-1.9
Investment	-5.6	-6.2	-7.6
Public consumption	2.8	4.4	4.6
Net exports, contribution to growth	1.4	0.1	0.6
Exports	-8.1	-10.0	-10.7
Imports	-12.6	-8.9	-11.8
CPI inflation	23.9	21.1	30.2
Exchange rate, AR$/US$ (average)	8.1	9.0	9.0
REER ("+" = appreciation)	-10.0	13.0	15.5
Gross reserves, US$ billion	31.4	21.4	9.0
Federal government, percent of GDP			
Primary balance	-0.9	-1.6	-3.6
Overall balance	-2.5	-4.0	-5.9
Deficit financing, AR$ billion			
External	0.0	0.0	0.0
Domestic commercial banks	12.2	98.9	198.5
Monetary base	22.6	26.3	34.2
Sterilization, percent of public sector financing	75.0	30.0	10.0
Credit to the private sector (real)	-2.1	-4.8	-9.5

Sources: Instituto Nacional de Estadística y Censos (INDEC); Banco Central de la República Argentina (BCRA); and Fund staff estimates.

Argentina: Risk Assessment Matrix 1/

Source of Risks	Relative Likelihood	Expected Impact
Protracted period of slower growth in emerging economies	**Medium**	**High** Weaker activity in emerging economies could impact Argentina primarily through trade channels, including through a negative impact on the terms of trade, as commodity prices would fall. Potential foreign direct investment to Argentina would also be adversely affected. Pressures on FX reserves would intensify.
Persistent U.S. dollar strength	**High**	**High** Strengthening of the U.S. dollar (as the U.S. economic prospects improve relative to the rest of the world) would complicate Argentina's policy of maintaining the slow pace of devaluation. Such policy would lead to larger overvaluation of the Argentine peso and further hurt Argentina's external position as the currencies of its main trading partners weaken.
Increased volatility in oil prices	**High**	**Medium** High volatility in oil prices would adversely impact investment in the energy sector and delay shale oil and gas projects. Similarly, persistently lower oil prices would discourage investment in the energy sector. Given large energy subsidies provided by the federal government to the private sector, the swings in oil prices present also an important fiscal risk.
Sharper increase in fiscal deficit	**Medium**	**High** Higher fiscal deficit financed through further money creation (such as through central bank advances and/or FX loans) would push inflation up or limit credit to private sector, if sterilized. Fiscal stimulus would be counterproductive, and demand for foreign currency would further rise, putting pressure of FX reserves, to maintain which would require additional FX restrictions. Expectations of faster depreciation against the U.S. dollar could become sell-fulfilling.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of preparation of this report. Non-mutually exclusive risks may interact and materialize jointly.

BEYOND 2015: THE CRITICAL ISSUES AHEAD[9]

19. Presidential elections will take place in October 2015. Public dialogue among the candidates shows a general acknowledgment of the need to reduce FX controls, regain access to international capital markets, rebuild investor confidence, lower inflation, and undertake a fiscal adjustment. There are, however, important differences of views on the pace, degree, and sequencing of these changes.

20. Inconsistent macroeconomic policies are at the heart of Argentina's economic challenges. Targeting a slow downward crawl of the official exchange rate versus the U.S. dollar is inconsistent with maintaining a competitive real exchange rate in the face of an expansionary fiscal policy financed by money creation. At the same time, continued intervention in the economy and FX controls are hard to reconcile with solid and sustained growth. Some form of realignment of domestic policies will likely be required.

21. A credible and sustained policy package would address two main distortions:

- ***Fiscal deficit and monetization***. The areas where fiscal pressures intensified the most in recent years are in private sector transfers and pensions, which together increased over 6 percent of GDP in 2007–14. This has created growing fiscal imbalances which have been met largely through money creation.

- ***Pervasive foreign exchange controls*** (*cepo cambiario*) which have distorted relative prices, damaged Argentina's competitiveness and potential growth, and led to the emergence of a parallel exchange market. The dual FX market distorts investment and consumption decisions, creates incentives for under-invoicing exports and over-invoicing imports, and discourages FDI.

22. These distortions are interconnected and self-reinforcing. A key lesson from the experience of other countries is that the removal of exchange rate controls and unification of exchange rate markets should be accompanied by a credible adjustment of the underlying imbalances and policy inconsistencies. Without this adjustment, foreign exchange market liberalization can lead to large capital outflows, exchange rate overshooting, and potentially a balance of payments crisis. Similarly, maintaining a control over domestic prices (such as energy tariffs) while removing FX controls could quickly worsen the fiscal position and create a destabilizing feedback loop to further depreciation and inflation.

[9] This section lays out staff's thinking on policy challenges that may emerge beyond 2015, which is necessarily tentative in the absence of in-depth discussions with the authorities.

A. Addressing Foreign Exchange Market Distortions

23. Any removal of foreign exchange controls and unification of exchange rate markets would likely result in a significant depreciation of the peso. This would eliminate the excess demand for foreign exchange (at the prevailing official exchange rate) and correct the existing real exchange rate misalignment. If there were confidence in the future policy framework, the depreciation could also help create incentives to re-monetize the economy. Looking at cases of exchange market unification in the 1980s and 1990s, Ghei, Kiguel, and O'Connell (1997) find that the level of the post-unification exchange rate has generally coincided with, or been close to, the parallel rate, particularly in those countries with severe rationing of foreign currency. However, there are large uncertainties, and the exchange rate could depreciate beyond the parallel rate. As of late-April 2015, FX futures suggest markets are expecting a 30–45 percent depreciation of the official rate at a one-year horizon.

24. A rise in investor confidence would help mitigate the degree of overshooting. Investor confidence could be boosted by a broad range of policy reforms that could help attract capital inflows and limit the exchange rate depreciation, enabling a faster return to reserve adequacy. While the net impact of flows on exchange rate dynamics is difficult to project, staff estimates suggest that for the more positive dynamic to take hold, a relatively large level of capital inflows would be needed. This would allow international reserves to meet the IMF's reserve adequacy metric,[10] cover payment on the liabilities to holdouts and the unpaid interest on the previously restructured debt, and offset the potential outflows once the capital controls are lifted.

B. Addressing Fiscal and Monetary Imbalances

25. The exchange rate depreciation following the removal of FX controls would likely induce a spike in inflation. Wage indexation, a lack of monetary policy credibility, and delayed fiscal adjustment could all create a larger spike in inflation and more persistence thereafter. Indeed, past experiences in Latin American countries show that the acceleration of inflation after the unification of exchange markets is typically higher in those countries that were already facing an inflation problem (de la Torre and Ize, 2014). In Argentina, the currency depreciation would also inflate the fiscal costs of subsidies in the absence of a significant decompression of energy prices.

26. International experience suggests that a successful disinflation strategy could be achieved through a two-pronged approach to remove both fiscal and monetary imbalances. Successful transitions from high (above 50 percent) to low inflation (below 10 percent) are typically built on greater fiscal discipline and a tightening of monetary conditions (Box 5). Following the initial spike in inflation from exchange rate unification, quickly bringing down the inflation rate to single digits would require anchoring inflation expectations by re-establishing monetary and fiscal policy credibility.

[10] See, "Assessing Reserve Adequacy" (http://www.imf.org/external/np/pp/eng/2011/021411b.pdf).

Box 5. International Experience on the Path from High to Low Inflation

The experience of countries having reduced inflation from a high to a low level can provide important insights to Argentina. The cross-country analysis presented in this box is based on a new monthly CPI database of 173 countries covering the period 1946–2014 (Eyraud and McCoy, 2015, forthcoming). The database allows us to identify successful transitions from high (50–75 percent) to lower inflation (below 10 percent). The methodology used to identify inflation regimes draws from the approach developed by Cagan (1956) and Fischer, Sahay, and Vegh (2002). We only consider “successful transitions” that imply the end of a high inflation regime and a decline in inflation to single digits.

Successful disinflations share certain characteristics:

- They tend to be prolonged—the median length of transitions is nearly three years. By comparison, the median high inflation episode lasts less than one year.
- They are generally heavily frontloaded—two thirds of the correction is done in the first year, the remaining disinflation happens more slowly over the following two years.
- They do not necessarily damage growth—the median real GDP accelerates through the transition period, especially in the first year, where we observe 1 percent improvement in growth, consistent with the finding that high levels of inflation are associated with poor macroeconomic performance (Fischer, Sahay, and Vegh, 2002).
- They are characterized by fiscal consolidation—significant fiscal adjustment takes place in the first year of the transition, with public debt decreasing on average by 10 percentage points of GDP (only one third of the effect being due to higher GDP growth).
- They are characterized by tighter monetary conditions—nominal interest rates increase significantly in the two years prior to the transition. Long-term yields increase first, followed by short-term rates (by of 10 and 20 percentage points, respectively). Median money growth also falls through the transition period, by about 10 percentage points (two-thirds of the episodes report slowdowns in money growth in the year before the transition period begins).

High Inflation Episodes and Transitions

High Inflation Episodes	160
Number of countries	65
Median length of episode (months)	11.5
Transitions From High To Low Inflation	75
Number of countries	62
Median length of transition (months)	34.5
Inflation rate in *t* , sample median	46.6
12 months after *t*, sample median	14.2

Sources: International Financial Statistics and Haver Analytics.

27. **Realigning inflation dynamics will require a reorientation of monetary policy**. If BCRA financing could be removed, it would quickly lower growth in the monetary base to zero and would reduce inflation. However, any removal of BCRA funding would open up a fiscal financing gap, which would need to be covered either through access to external financing or a reduction in the fiscal deficit.

28. **In the near term, finding alternative sources of deficit financing may be hampered by a lack of confidence and uncertainty over the holdouts**. One option would be to rationalize expenditure, phasing out the untargeted energy subsidies which are large (3½ percent of GDP in 2015) and highly distortionary. However, any removal of these subsidies would need to be accompanied by a well-targeted system of cash transfers to mitigate the adverse impact on the most vulnerable segments of the population, building on the existing infrastructure of conditional

cash transfers.[11] A de-indexation of wages and pensions could also be an avenue of fiscal consolidation and would help prevent a wage-price spiral.

29. International experience shows that price liberalization typically contributes to a one-off increase in prices but eventually reduces inflation, as it leads to a more efficient allocation of resources and reduces the fiscal deficit (e.g., Coorey and others, 2007). In the case of Argentina, staff estimates suggest that if energy subsidies were removed so as to equalize the domestic and international reference prices for natural gas, electricity and fuel, inflation would increase by 4½–5 percent in the short term. However, the associated reduction in the need for monetary financing of the fiscal deficit would have a broadly equivalent disinflationary impact. Over a longer horizon, the net impact would clearly be disinflationary.

Impact of Removing Energy Subsidies
(Percent)

	Cost of Energy	Inflation
Natural gas	257	1.6
Electricity	355	3.0
Fuel (public transport)	4	0.1
Total		4.6

Sources: Montamat y Asociados; Instituto de Estadística y Censos (INDEC); and Fund staff illustrative estimates.

30. There will likely be a need to reexamine Argentina's monetary policy framework to help anchor inflation more credibly. While some degree of exchange rate and price adjustment would probably be needed to correct the initial overvaluation, a currency overshooting would be chaotic, and could give way to a self-fulfilling dynamic. Cross-country experience suggests that a tightening of monetary policy could help contain the near-term exchange rate depreciation. Moreover, to achieve and maintain single-digit inflation rates, a credible institutional framework would be needed to provide a clear nominal anchor. There are various options. However, in a situation with large exchange rate misalignment and low reserves, an exchange rate anchor is likely to prove infeasible. Also, adopting an inflation-targeting regime would be challenging given doubts surrounding the credibility of the official inflation index. One possibility would be to adopt for a period of time explicit monetary quantity targets that were matched with the desired fiscal consolidation path.

C. An Illustrative Scenario

31. An up-front exchange rate unification scenario is provided to illustrate the potential impact of one possible adjustment path (this scenario is not intended to be viewed as prescriptive, given the inability of the team to discuss it with the Argentine authorities). The scenario incorporates the following:

- ***Assumptions on unification and FX controls***. The real effective exchange rate depreciates by about 20 percent during 2016, reaching its equilibrium level by the end of the year. In nominal

[11] To enhance the credibility of the reform and to avoid the recurrence of subsidies in the event of an increase in international energy prices, a durable subsidy reform strategy could usefully de-politicize the mechanism for setting energy prices in the country by establishing an automatic pricing formula, administered by an independent body outside the government.

terms, the exchange rate immediately overshoots by 20 percent relative to the projected end-2015 parallel rate (keeping the current premium constant). After 2016, the exchange rate is assumed to depreciate in line with inflation, keeping the real effective exchange rate unchanged. FX controls on current account transactions are assumed to be lifted quickly, and the regime leads to supportive FDI inflows.

- ***Policy assumptions***. Central bank financing of the budget is assumed to be eliminated at once (around 2½ percent of GDP relative to the baseline corresponding to the April 2015 WEO), and fiscal consolidation focused on rationalizing energy subsidies (amounting to an average cut in subsidies of 1¼ percent of GDP per year over the medium term, lowering the total transfers from 5½ percent of GDP in 2015 to below 1 percent by 2020). Monetary policy reacts by raising interest rates abruptly (by about 25 percentage points).

- ***Macroeconomic outcomes***. The scenario results in a large nominal depreciation (over 60 percent by the end of 2016), leading to a spike in inflation (over 40 percent after monetary tightening), and negative real wages that compress consumption (-2¾ percent). Export growth turns positive (for the first time since 2011), but imports contract, and investment does not pick up until late-2016. Overall, real GDP contracts by 1¾ percent in 2016, but accelerates over the medium term, resulting in a cumulative medium-term GDP gain on the order of 7 percentage points relative to the baseline scenario.

- ***Impact on the banking system***. Unlike the 2002 crisis, the banking system does not have currency mismatches that would pose risks to financial stability in an adjustment scenario. However, the regulatory measures introduced in 2014 that forced commercial banks to reduce their net foreign-currency positions have narrowed the potential valuation gains that banks could generate from devaluation. The main impact on the banking system will likely come from high inflation and interest rates. The contraction in economic activity would also adversely affect the banks, but stress tests conducted in the context of the 2013 FSAP mission suggest that the banks would generally be resilient to a major shock to GDP growth.

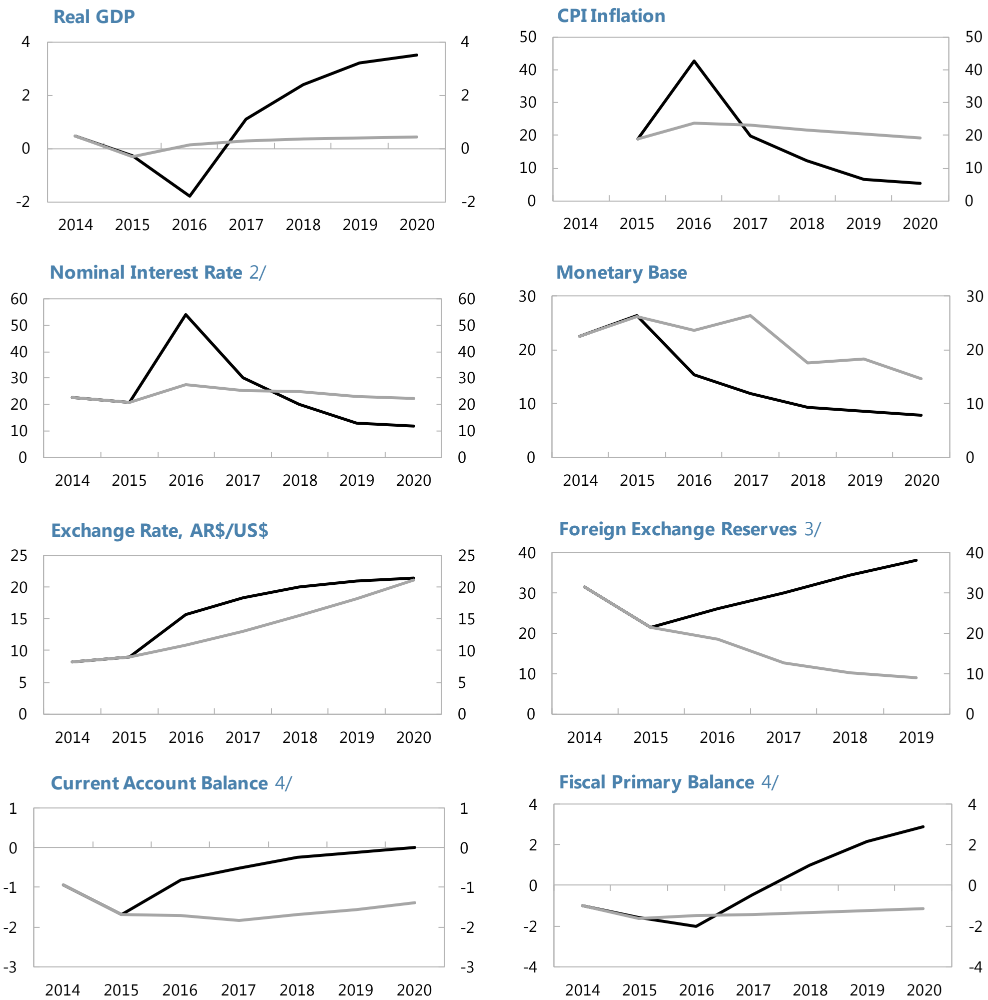
32. While it would be difficult to liberalize the various distortions without inducing a near-term recession, the scenario is very assumption-dependent, and more favorable outcomes may be feasible:

- ***Impact on consumption (wealth effect)***. The impact of the peso devaluation on private consumption is assumed to be negative (in line with past empirical relationship). However, some estimates point to the existence of an important stock of FX assets held by households (outside the Argentine financial system), which would appreciate sharply in the event of exchange rate unification. The positive wealth effect from this could potentially cushion the decline in consumption, and the expected downturn in 2016 could be milder.

- ***Capital inflows***. Foreign capital—both portfolio and FDI—could return faster than expected with greater confidence in the policy strategy. This would allow for a faster build-up of FX reserves and perhaps facilitate a faster nominal appreciation and less painful deflation.

Illustrative Medium-Term Scenarios

(Percent change unless otherwise indicated; grey=baseline 1/, black=adjustment)



Source: Fund staff estimates.
1/ The baseline corresponds to the April 2015 WEO.
2/ Percent.
3/ Billions of U.S. dollars.
4/ Percent of GDP.

D. Alternative Paths

33. The rapid removal of the FX controls described in the scenario above would likely present major risks. The spike in inflation and reduction of energy subsidies would make the devaluation of the peso an extremely unpopular measure. The recessionary impact of the measures described above could hit the most vulnerable segments of the population especially hard. The emergence of social discontent could in turn erode the political capital needed to implement some of the measures described (for example, the fiscal consolidation), effectively compromising the credibility of the overall reform agenda. Fears of the political repercussions could deter the new government from managing a process of change.

34. A gradual liberalization of FX controls could reduce the risk of an immediate large overshooting, but such a sequencing of reforms would also have risks. Removing controls on current account transactions while maintaining controls on capital and financial accounts transactions might help smooth out the adjustment process. However, sequencing and administering a gradual path of reform (on fiscal policy, utility pricing, and changing the monetary framework) would be complex, particularly given uncertainties surrounding the potential impact of various measures, and political support for a gradual liberalization may run out of steam. The feasibility of a more gradual liberalization would depend on the soundness of the financial system, the quality of institutions, and the ability to politically manage a protracted period of reform.[12]

CONCLUDING REMARKS

35. Distortions and macroeconomic imbalances threaten the sustainable growth and financial stability of Argentina's economy. Foreign exchange controls have distorted relative prices, generated a parallel foreign exchange market, and eroded competitiveness. The growing fiscal deficit has increasingly been financed by the central bank, feeding inflationary pressures. Utility tariffs have been frozen, hurting the energy sector, and driving a wedge between retail prices and cost recovery. At the same time, price agreements have temporarily suppressed inflation. Balance of payments risks have intensified, and growth has slowed sharply.

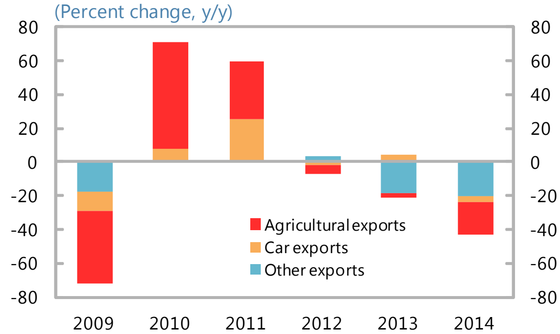
36. Dismantling these distortions will be hard to avoid but will also present critical challenges. Unifying the exchange rate and reducing foreign exchange controls would likely be inflationary, calling for a strategy to anchor inflation expectations. Eliminating fiscal dominance, tightening fiscal policy, and re-establishing central bank credibility will likely be painful. A gradual approach may reduce some of these risks but create new uncertainties, including on whether political support for a prolonged reform program could be maintained.

[12] Experiences with gradual unification suggest this could be a long process. For example, in Turkey during the 1980s, it took nearly a decade to reach full unification.

Figure 1. Argentina: The External Position Weakened in 2014

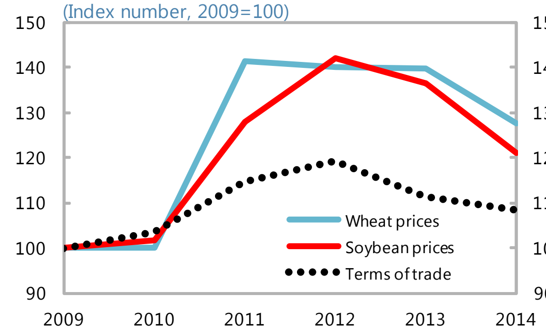
Exports saw a broad-based decline in 2014...

Exports of Goods
(Percent change, y/y)



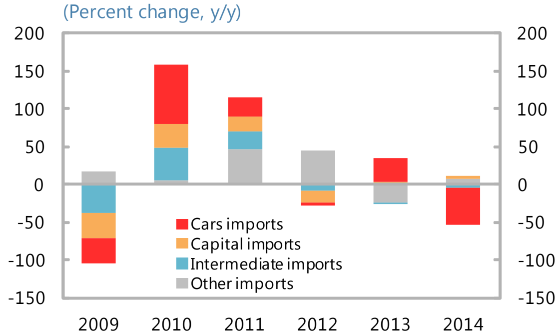
...with the price of key export commodities falling.

Commodity Prices and Terms of Trade
(Index number, 2009=100)



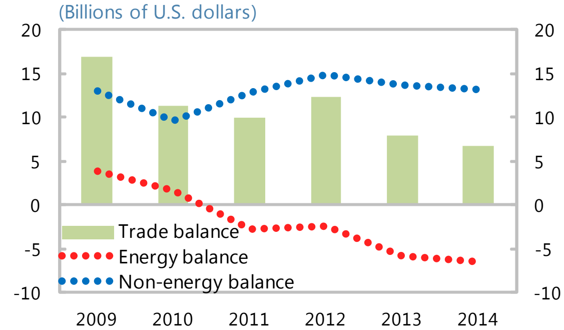
Imports also declined, owing to tight restrictions (which particularly affected car imports) and slower activity.

Imports of Goods
(Percent change, y/y)



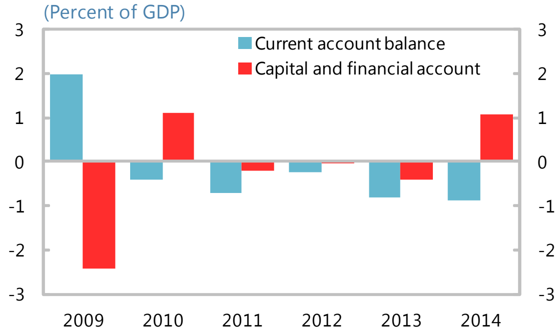
The non-energy trade surplus fell in 2014, while the energy deficit continued to widen.

Trade Balance and Energy Trade Balance
(Billions of U.S. dollars)



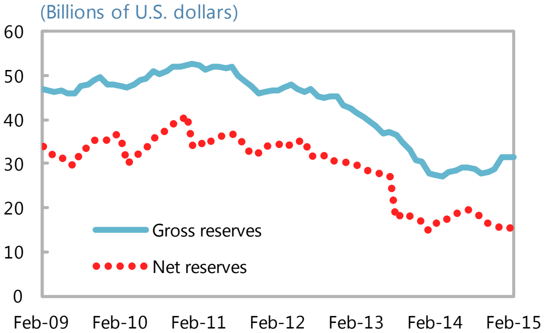
As a result, the current account deficit increased...

Current Account
(Percent of GDP)



...but gross international reserves stabilized by end-2014, owing to stricter FX controls and extraordinary financing.

International reserves
(Billions of U.S. dollars)



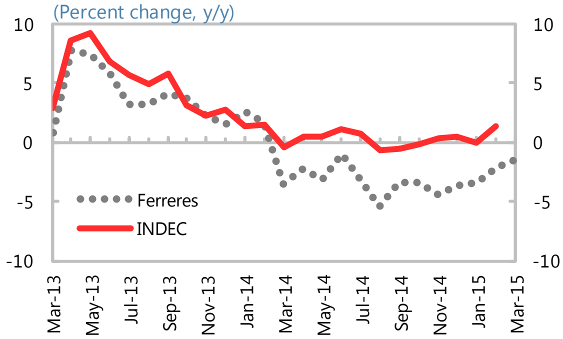
Sources: Instituto Nacional de Estadística y Censos (INDEC); Banco Central de la República Argentina (BCRA); and Fund staff calculations.

Figure 2. Argentina: After a Sharp Slowdown in 2014, Economic Activity Stabilized Recently

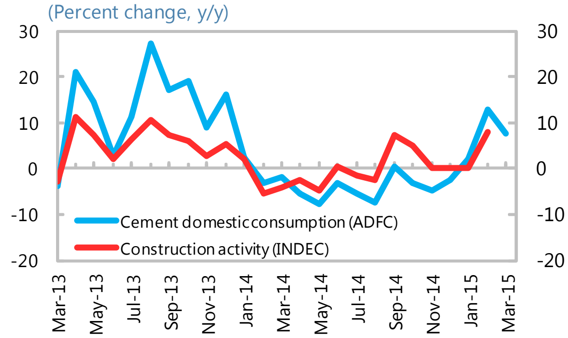
High frequency indicators have stabalized recently, suggesting the fall in activity bottomed out at end-2014.

Construction activity recovered somewhat after mid-2014 and has continued to pick up...

Indicators of Economic Activity
(Percent change, y/y)



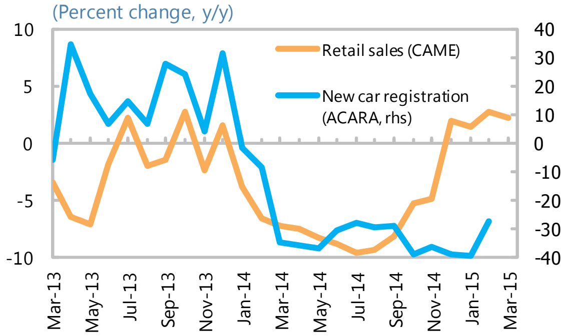
Indicators of Construction Activity
(Percent change, y/y)



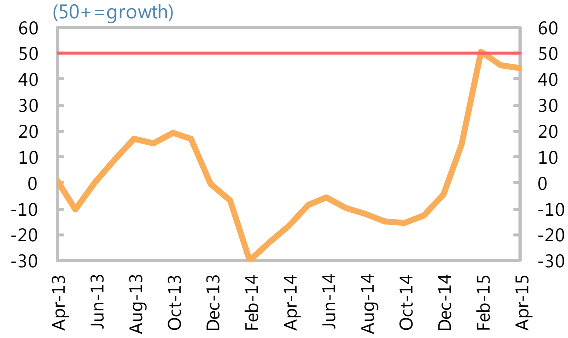
...and retail sales, down for most of 2014, have also turned the corner, although car sales remain slumped...

...with consumer confidence improving until most recently.

Indicators of Consumption
(Percent change, y/y)



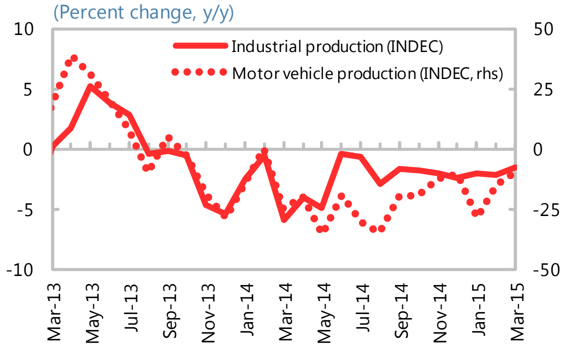
National Consumer Confidence Index (UTDT)
(50+=growth)



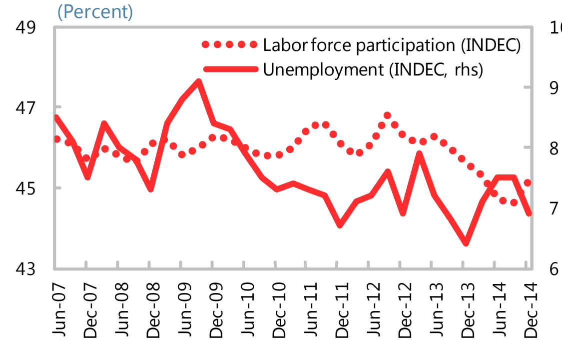
But manufacturing has declined for 20 consecutive months, driven by a sharp decline in auto production...

...and the unemployment rate ended 2014 marginally above its 2013 level, contained by higher public sector employment.

Indicators of Industrial Production
(Percent change, y/y)



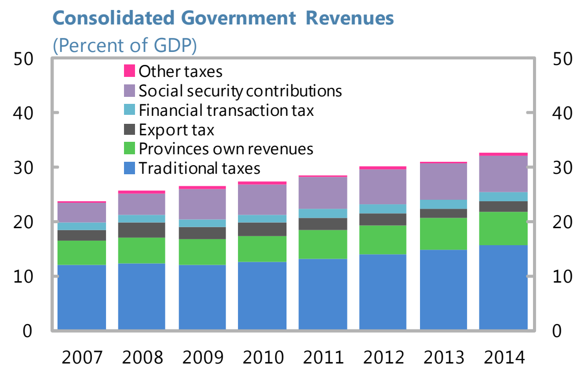
Unemployment and Labor Force Participation
(Percent)



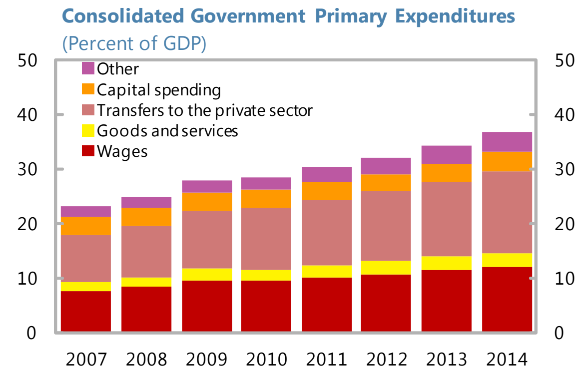
Sources: Instituto Nacional de Estadística y Censos (INDEC); Asociación de Fabricantes de Cemento (ADFC); Ministerio de Economía y Finanzas Públicas; Ministerio de Argricultura; Universidad Torcuato Di Tella (UTDT); provincial statistical offices; Fundación de Investigaciones Económicas Latinoamericanas (FIEL); Confederación Argentina de la Mediana Empresa (CAME); Orlando J. Ferreres & Asociados; and Fund staff calculations.

Figure 3. Argentina: The Federal Fiscal Position Continued to Deteriorate in 2014

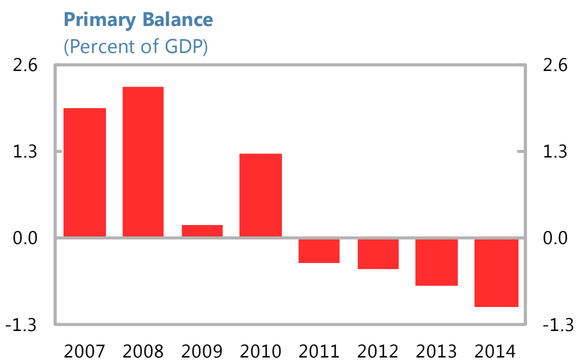
Although revenues continued to increase in 2014...



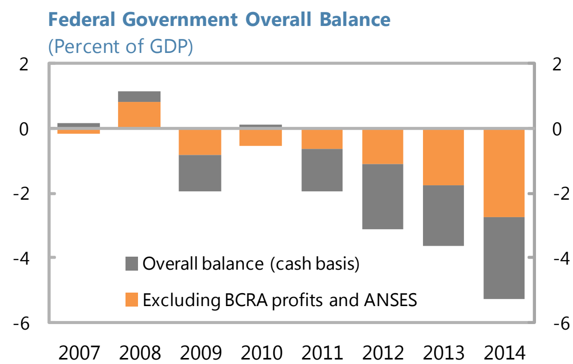
...the increase in primary spending was larger, driven by transfers to the private sector (mainly energy subsidies).



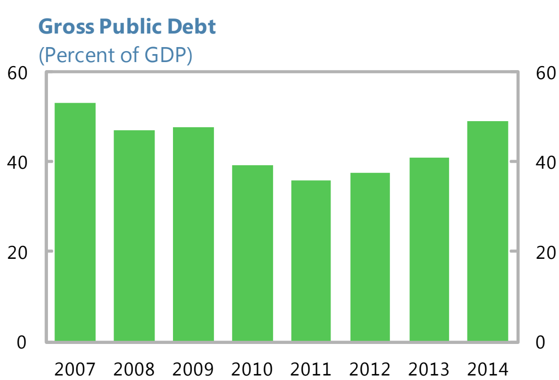
As a result, the primary balance weakened...



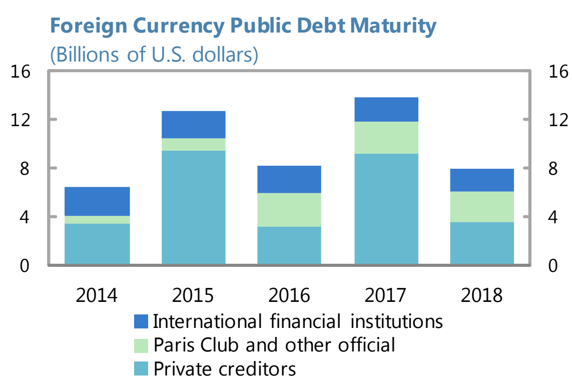
...along with the overall balance.



The debt-to-GDP ratio increased, albeit from low levels, partly due to agreements with various creditors.



Looking ahead, a large chunk of foreign currency debt will mature in 2015.

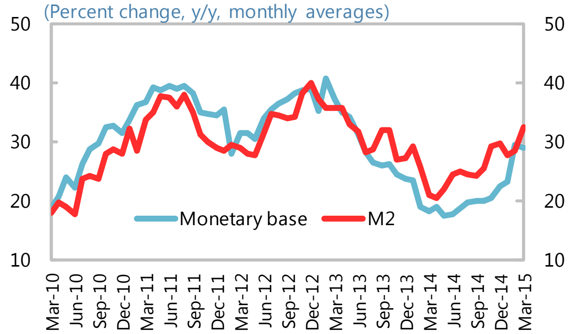


Sources: Instituto Nacional de Estadística y Censos (INDEC); Banco Central de la República Argentina (BCRA); Ministerio de Economía y Finanzas Públicas; IMF, *World Economic Outlook*; Treasury of Argentina; FGS; and Fund staff calculations.

Figure 4. Argentina: Monetary Financing of the Federal Budget Continued

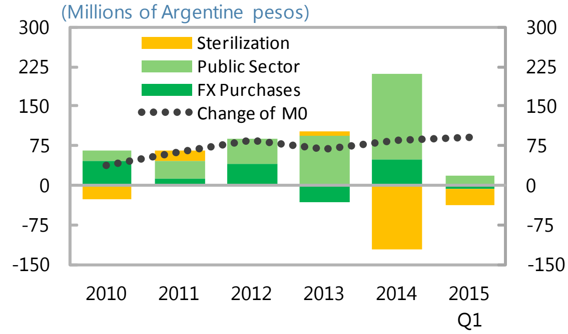
Despite increasing monetary financing of the deficit, money growth slowed in 2014, before picking up in recent months…

Monetary Aggregates
(Percent change, y/y, monthly averages)



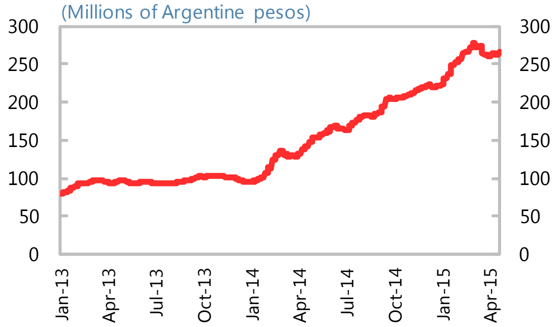
…as the aggressive sterilization policy of 2014 has subsided…

Changes in Base Money
(Millions of Argentine pesos)



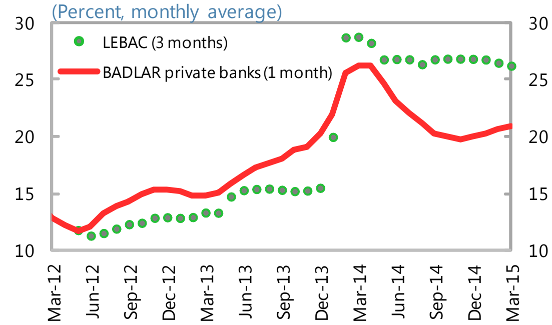
…still, leaving a legacy of a large stock of central bank notes.

BCRA Notes
(Millions of Argentine pesos)



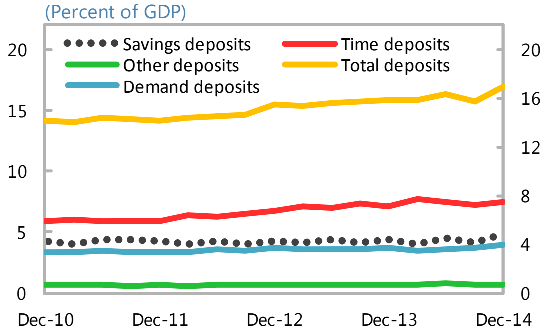
Interest rates on these notes were raised sharply in early 2014, while deposit rates have fallen in the past year.

Interest Rates
(Percent, monthly average)



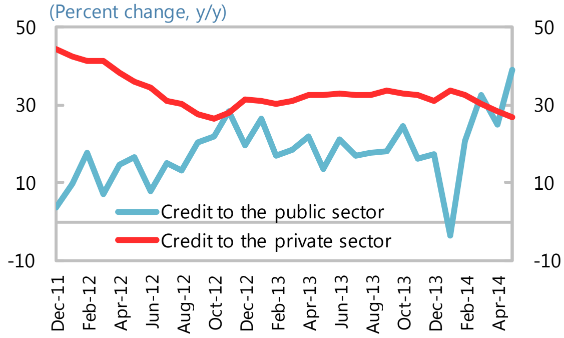
Deposits at banks have remained relatively stable…

Private Sector Bank Deposits
(Percent of GDP)



…but credit to the private sector has slowed, crowded out by banks' credit to the public sector.

Bank Credit
(Percent change, y/y)



Sources: Banco Central de la República Argentina (BCRA) and Fund staff calculations.

Table 1. Argentina: Selected Economic and Financial Indicators, 2009–15

Population (2013): 41.5 million
Quota (current; millions SDR / % total): 2,117 / 0.89
Main products and exports: soybeans, automobiles, com

Per capita GDP (2014): US$12,873
Gini coefficient (2011): 0.45

	Average 2009–11	2012	2013	2014	Proj. 2015
	(Annual percentage changes unless otherwise indicated)				
National income, prices, and labor markets 1/					
GDP at constant prices	6.0	0.8	2.9	0.5	-0.3
Domestic demand	7.6	0.5	4.2	-0.8	-0.4
Nominal GDP (Arg$bns)	1,844.8	2,765.6	3,406.3	4,388.8	5,156.8
Nominal GDP (US$bns)	465.7	607.6	622.1	540.2	575.7
CPI inflation (period average)	8.8	10.0	10.6	...	18.8
CPI inflation (end of period)	...	...	...	23.9	21.1
Unemployment rate (percent)	7.9	7.2	7.1	7.3	7.0
	(Percent of GDP unless otherwise indicated)				
External sector					
Exports f.o.b. (goods, US$bns)	69.3	80.2	81.7	71.9	56.1
Imports f.o.b. (goods, US$bns)	-54.1	-65.1	-70.5	-62.5	-51.7
Terms of trade (percentage change)	5.0	3.9	-6.6	-2.6	-5.5
Total external debt	32.8	27.1	27.7	28.5	28.5
Savings-Investment balance					
Gross domestic investment	18.0	17.1	17.0	17.2	16.4
of which: Public sector	3.4	3.0	3.4	3.6	3.5
Gross national savings	18.3	16.9	16.2	16.3	14.7
of which: Public sector	2.1	0.6	1.3	0.8	-0.6
Current account balance	0.3	-0.2	-0.8	-0.9	-1.7
Public sector					
Primary balance	0.4	-0.5	-0.7	-1.0	-1.6
of which: Federal government	0.7	-0.2	-0.7	-0.9	-1.6
Overall balance	-1.2	-2.4	-2.0	-2.7	-4.0
Revenues	29.1	31.5	33.4	35.6	35.6
Primary expenditure	28.7	32.0	34.1	36.7	37.3
Total public debt	40.8	37.3	40.2	48.6	48.4
Money and credit					
Monetary base (percent change)	27.3	37.9	22.7	22.6	26.3
M2 (percent change)	27.1	40.1	25.6	29.3	26.3
Credit to the private sector (percent change)	...		31.2	21.3	15.3
Short-term deposit rate (BADLAR, average)	12.0	13.8	17.0	22.6	20.6
Memorandum items					
Gross international reserves (US$bns)	48.8	43.3	30.6	31.4	21.4
Exchange rate (average, Arg$/US$)	3.9	4.6	5.5	8.1	...
Exchange rate (end of period, Arg$/US$)	4.0	4.9	6.3	8.6	...
REER (2005=100, wage index, average)	145.6	191.2	198.2	178.4	...

Sources: Ministerio de Economía y Finanzas Públicas; Banco Central de la República Argentina (BCRA); and Fund staff calculations.

Table 2. Argentina: Summary Balance of Payments, 2007–15

	Average 2007–09	2010	2011	2012	2013	2014	Proj. 2015
	(Billions of U.S. dollars)						
Current account	**6.6**	**-1.9**	**-4.0**	**-1.5**	**-5.0**	**-5.1**	**-9.7**
Trade balance	15.8	14.0	12.9	15.2	11.1	9.5	4.4
Exports f.o.b.	60.6	68.2	84.1	80.2	81.7	71.9	56.1
Primary products	12.6	15.1	20.2	19.2	18.7	15.1	...
Manufactures of agricultural origin	21.4	22.7	28.2	27.7	29.0	28.0	...
Manufactures of industrial origin	19.4	23.8	29.0	27.6	28.5	24.3	...
Energy	7.1	6.5	6.6	6.9	5.6	4.5	...
Imports f.o.b.	-44.8	-54.2	-71.1	-65.1	-70.5	-62.5	-51.7
Capital goods	-18.1	-22.0	-27.6	-25.1	-26.9	-24.0	...
Intermediate goods	-15.1	-16.9	-20.9	-19.1	-18.7	-17.9	...
Consumer goods	-8.5	-11.0	-13.6	-11.9	-14.1	-10.1	...
Fuels and lubricants	-3.1	-4.3	-9.0	-8.9	-10.9	-10.4	...
Services, income and transfers	-9.2	-15.9	-16.9	-16.6	-16.1	-14.6	-14.1
Services balance	-1.0	-1.2	-2.2	-3.1	-3.9	-3.1	-3.4
Earnings and dividends, net	-6.0	-10.7	-10.7	-9.2	-7.6	-8.2	-8.1
Interests, net	-2.3	-3.5	-3.3	-3.8	-3.7	-3.2	-2.0
Other flows and transfers	0.1	-0.5	-0.6	-0.5	-0.9	-0.2	-0.6
Capital and financial account	**-4.6**	**5.0**	**-1.3**	**-0.3**	**-2.7**	**6.7**	**-1.8**
Capital account	0.1	0.1	0.1	0.0	0.0	0.1	0.0
Portfolio investment, net	-2.3	11.1	-4.3	-3.2	0.1	5.1	2.5
of which: public sector	-1.5	10.9	-3.8	-3.3	-0.8	5.6	-3.8
Foreign direct investment, net	5.5	10.4	9.4	14.3	10.2	4.5	5.4
Other investment, net	-8.0	-16.6	-6.4	-11.4	-13.0	-2.9	-9.9
Errors and omissions	**0.3**	**-1.7**	**-2.8**	**-3.2**	**-5.6**	**-0.5**	**0.0**
Overall balance	**2.3**	**1.4**	**-8.0**	**-5.0**	**-13.3**	**1.2**	**-11.6**
Financing	**-2.3**	**-1.4**	**8.0**	**5.0**	**13.3**	**-1.2**	**11.6**
Change in gross reserves (increase -)	-5.3	-4.2	5.8	3.1	12.7	-0.8	10.0
Valuation changes and arrears	3.1	2.8	2.2	1.9	0.6	-0.4	1.6
	(Percent of GDP unless otherwise indicated)						
Current account	**1.8**	**-0.4**	**-0.7**	**-0.2**	**-0.8**	**-0.9**	**-1.7**
Trade balance	4.3	3.0	2.3	2.5	1.8	1.8	0.8
Exports, f.o.b.	16.4	14.8	15.0	13.2	13.1	13.3	9.7
Imports f.o.b.	-12.1	-11.7	-12.7	-10.7	-11.3	-11.6	-9.0
Capital and financial account	**-1.1**	**1.1**	**-0.2**	**-0.1**	**-0.4**	**1.2**	**-0.3**
Portfolio investment, net	-0.5	2.4	-0.8	-0.5	0.0	0.9	0.4
Foreign direct investment, net	1.5	2.2	1.7	2.3	1.6	0.8	0.9
Other investment, net	-2.1	-3.6	-1.1	-1.9	-2.1	-0.5	-1.7
Memorandum items:							
Non-interest current account balance (US$bns)	8.9	1.7	-0.7	2.3	-1.3	-1.9	-7.7
Non-interest current account balance (% of GDP)	2.4	0.4	-0.1	0.4	-0.2	-0.4	-1.3
Exports volumes (percent change)	-1.9	14.0	3.4	-6.6	3.5	-10.0	-8.9
Imports volumes (percent change)	4.2	40.3	22.1	-6.9	2.6	-11.5	-8.8
Terms of Trade (Index, 2000 = 100)	116.5	125.8	139.3	144.7	135.1	131.6	124.3
REER (2005=100, private CPI)	123.7	144.0	160.8	191.2	198.2	178.4	...
Gross international reserves (US$bns)	46.8	52.2	46.4	43.3	30.6	31.4	21.4
(in months of imports of goods and services)	10.1	9.1	6.3	6.2	4.1	4.8	3.8

Sources: Instituto Nacional de Estadística y Censos (INDEC) and Fund staff calculations.

Table 3. Argentina: Consolidated Public Sector Operations, 2007–15

	Average 2007–09	2010	2011	2012	2013	2014	Proj. 2015
	(Billions of Argentine pesos)						
Revenues	**331.6**	**535.8**	**687.8**	**870.9**	**1,138.3**	**1,564.5**	**1,837.4**
Tax revenues	247.0	375.8	489.6	618.3	799.4	1,074.4	1,256.0
Social security contributions	55.8	101.0	133.7	174.4	229.9	300.9	355.9
Other revenues	28.8	59.1	64.6	78.2	109.0	189.1	225.6
Primary Expenditures	**314.3**	**512.9**	**696.5**	**883.8**	**1,162.7**	**1,609.2**	**1,920.9**
Wages	104.0	167.5	227.5	293.7	382.5	517.6	627.4
Goods and services	24.4	40.0	53.1	63.7	85.5	115.5	136.6
Transfers to the private sector	121.0	202.9	277.2	356.1	466.3	659.5	811.7
Of which: federal pensions	66.1	107.1	147.1	204.6	272.1	363.4	464.9
Capital spending	40.2	60.4	77.3	83.5	114.7	156.0	181.3
Other	24.7	42.0	61.3	86.8	113.8	160.5	163.9
Primary balance	**17.3**	**22.9**	**-8.7**	**-12.9**	**-24.5**	**-44.8**	**-83.5**
Interest cash	20.1	22.8	36.4	52.3	43.6	73.9	125.0
Overall balance (cash)	**-2.8**	**0.1**	**-45.1**	**-65.2**	**-68.0**	**-118.7**	**-208.5**
	(Percent of GDP)						
Revenues	**26.6**	**29.6**	**29.8**	**31.5**	**33.4**	**35.6**	**35.6**
Tax revenues	19.9	20.8	21.2	22.4	23.5	24.5	24.4
Social security contributions	4.4	5.6	5.8	6.3	6.7	6.9	6.9
Other revenues	2.3	3.3	2.8	2.8	3.2	4.3	4.4
Primary expenditures	**25.1**	**28.3**	**30.1**	**32.0**	**34.1**	**36.7**	**37.3**
Wages	8.3	9.3	9.8	10.6	11.2	11.8	12.2
Goods and services	1.9	2.2	2.3	2.3	2.5	2.6	2.6
Transfers to the private sector	9.6	11.2	12.0	12.9	13.7	15.0	15.7
Of which: federal pensions	5.3	5.9	6.4	7.4	8.0	8.3	9.0
Capital spending	3.2	3.3	3.3	3.0	3.4	3.6	3.5
Other	2.0	2.3	2.7	3.1	3.3	3.7	3.2
Primary balance	**1.5**	**1.3**	**-0.4**	**-0.5**	**-0.7**	**-1.0**	**-1.6**
Interest cash	1.6	1.3	1.6	1.9	1.3	1.7	2.4
Overall balance (cash)	**-0.1**	**0.0**	**-1.9**	**-2.4**	**-2.0**	**-2.7**	**-4.0**

Sources: Ministerio de Economía y Finanzas Públicas and Fund staff calculations.

Table 4. Argentina: Federal Government Operations, 2007–15

	Average 2007–09	2010	2011	2012	2013	2014	Proj. 2015
	(Billions of Argentine pesos)						
Revenues	**273.6**	**450.4**	**567.6**	**717.9**	**936.7**	**1,301.1**	**1,528.5**
Tax revenues	202.8	307.1	396.8	329.6	404.5	563.4	654.0
Social security contributions	55.8	101.0	133.7	174.4	229.9	300.9	355.9
Nontax revenues	15.1	42.4	37.2	214.0	302.4	436.8	518.6
Primary Expenditures	**254.2**	**426.2**	**562.7**	**723.0**	**959.2**	**1,340.1**	**1,613.5**
Federal expenditures	169.6	291.9	394.9	516.8	689.3	969.6	1,179.9
Wages	31.6	57.8	74.3	96.0	122.6	171.9	205.9
Goods and services	10.1	17.8	24.0	29.3	41.0	58.5	69.6
Pensions	66.1	107.1	147.1	204.6	272.1	363.4	464.9
Transfers to private sector	42.0	75.9	103.6	119.5	154.1	245.2	287.0
Capital	16.4	24.6	30.5	37.2	54.3	79.3	91.2
Other	3.4	8.7	15.5	30.3	45.3	51.3	61.4
Transfers to provinces	84.6	134.3	167.8	205.1	269.9	370.1	433.6
Automatic	61.0	100.8	123.2	156.7	204.1	280.2	328.5
Discretionary	23.6	33.5	44.5	48.4	65.7	89.9	105.1
Primary balance	**19.4**	**24.3**	**4.9**	**-4.0**	**-22.5**	**-38.6**	**-84.9**
Interest cash	19.6	22.0	35.6	51.2	42.0	71.2	122.0
Overall balance (cash)	**-0.2**	**2.2**	**-30.7**	**-55.2**	**-64.5**	**-109.7**	**-206.9**
	(Percent of GDP)						
Revenues	**21.9**	**24.9**	**24.6**	**26.0**	**27.5**	**29.7**	**29.6**
Tax revenues	16.3	17.0	17.2	18.0	18.3	19.2	19.1
Social security contributions	4.4	5.6	5.8	6.3	6.7	6.9	6.9
Nontax revenues	1.2	2.3	1.6	1.7	2.5	3.6	3.7
Primary expenditures	**20.3**	**23.5**	**24.3**	**26.1**	**28.2**	**30.5**	**31.3**
Primary expenditures (excluding provinces)	13.5	16.1	17.1	18.7	20.2	22.6	22.9
Wages	2.5	3.2	3.2	3.5	3.6	3.9	4.0
Goods and services	0.8	1.0	1.0	1.1	1.2	1.3	1.3
Pensions	5.3	5.9	6.4	7.4	8.0	8.3	9.0
Private sector transfers	3.3	4.2	4.5	4.3	4.5	5.6	5.6
Capital	1.3	1.4	1.3	1.3	1.6	1.8	1.8
Other	0.3	0.5	0.7	1.1	1.3	1.7	1.2
Transfers to provinces	6.8	7.4	7.3	7.4	7.9	7.9	8.4
Automatic	4.9	5.6	5.3	5.7	6.0	5.9	6.4
Discretionary	1.9	1.8	1.9	1.7	1.9	2.0	2.0
Primary balance	**1.6**	**1.3**	**0.2**	**-0.2**	**-0.7**	**-0.9**	**-1.6**
Interest cash	1.6	1.2	1.5	1.9	1.2	1.6	2.4
Overall balance (cash)	**0.0**	**0.1**	**-1.3**	**-2.0**	**-1.9**	**-2.5**	**-4.0**

Sources: Ministerio de Economía y Finanzas Públicas and Fund staff calculations.

Table 5. Argentina: Summary Operations of the Financial System, 2004–14

(Billions of Argentine pesos, end of period, unless otherwise indicated)

	Average 2004–06	Average 2007–09	2010	2011	2012	2013	2014
				Central Bank			
Net international reserves 1/	45.5	134.6	168.4	174.9	171.2	130.0	199.6
Net domestic assets	16.9	-24.3	-8.0	48.0	136.1	247.2	263.0
Credit to the public sector (net)	55.5	67.5	119.8	191.5	311.7	472.2	697.7
Credit to the financial sector (net)	13.7	2.3	1.5	2.1	3.7	4.9	4.6
Central bank securities	33.1	54.9	88.6	84.2	99.9	110.5	282.1
Official capital and other items (net)	19.3	39.1	40.7	61.4	79.4	119.4	157.1
Monetary base	62.4	110.4	160.4	222.9	307.4	377.2	462.6
Currency issued	48.4	85.7	124.5	173.1	237.0	289.2	358.8
Bank deposits at the Central Bank	14.0	24.7	35.9	49.9	70.3	88.0	103.8
				Consolidated Financial System			
Net foreign assets	38.8	136.4	168.8	171.0	174.0	126.9	193.7
Net domestic assets	106.6	110.5	200.3	304.7	459.4	673.1	836.8
Credit to the public sector (net)	113.8	95.4	147.1	205.0	311.1	460.5	785.8
Credit to the private sector	63.1	132.9	204.4	295.0	387.5	508.5	616.6
Net capital, reserves, and other assets	-70.4	-117.8	-151.2	-195.3	-239.2	-295.9	-565.6
Liabilities with the private sector	145.4	247.0	369.1	475.7	633.3	800.0	1,030.5
Currency outside banks	43.8	75.7	113.6	151.3	210.0	257.8	315.9
Local currency deposits	90.5	142.0	209.0	272.1	384.1	497.0	650.6
Foreign currency deposits	11.1	29.2	46.6	52.3	39.2	45.1	64.1
				(Percent of GDP)			
Net domestic assets	16.8	8.9	11.1	13.2	16.6	19.8	19.1
Credit to the public sector (net)	18.1	7.7	8.1	8.9	11.3	13.5	17.9
Credit to the private sector	9.4	10.7	11.3	12.8	14.0	14.9	14.1
Liabilities with the private sector	21.9	20.0	20.4	20.6	22.9	23.5	23.5
Monetary base	9.4	9.0	8.9	9.6	11.1	11.1	10.5
				(Percent change, 12-month basis)			
Credit to the private sector	27.7	22.4	36.5	44.3	31.3	31.2	21.3
Liabilities with the private sector	20.1	17.5	30.3	28.9	33.1	26.3	28.8
Memorandum items:							
Net international reserves (US$ billions)	14.9	38.9	42.3	40.8	35.1	20.6	23.3
Gross international reserves (US$ billions)	26.6	46.8	52.1	46.5	43.6	31.6	31.4
M2 (percent change) 2/	25.5	18.6	34.9	30.8	40.1	25.6	29.3
M3 (percent change) 3/	21.8	17.2	37.8	25.5	32.6	25.6	28.7
Short-term lending rate	7.2	15.4	10.6	14.1	14.1	17.1	23.1
Short-term deposit rate (BADLAR)	7.0	12.0	10.1	13.4	13.8	17.0	22.6
LEBAC interest rate			11.7	12.0	12.1	14.6	26.7

Sources: Banco Central de la República Argentina (BCRA) and Fund staff calculations.
1/ Excludes foreign currency deposits of the banking system.
2/ Currency in circulation outside banks, plus demand and savings deposits, excluding in foreign currency.
3/ M2 plus time, foreign currency and other deposits.

Table 6. Argentina: External Debt, 2004–14

	Average 2004–06	Average 2007–09	2010	2011	2012	2013	2014
			(Billions of U.S. dollars)				
Total external debt (gross; includes holdouts)	147.8	150.9	140.6	152.3	153.7	149.1	159.0
Percent of GDP	85.1	42.5	30.4	27.3	25.3	24.0	29.4
By maturity							
Long-term	75.6	73.0	75.1	77.0	78.5	77.1	87.0
Short-term (includes arrears)	72.3	77.9	65.4	75.4	75.2	72.0	72.0
Of which: Public sector	43.0	42.8	22.7	27.3	25.5	22.4	22.4
By type of creditor							
Debt to official creditors	32.7	29.0	28.4	34.0	32.1	30.6	36.4
Debt to banks	9.0	9.0	9.0	9.3	8.8	8.2	7.9
Debt to other private creditors	106.1	112.8	103.2	109.0	112.8	110.3	114.7
By type of debtor							
Official debt	97.3	94.9	80.7	84.4	83.5	81.6	89.2
Bank debt	6.0	4.9	3.1	3.9	3.1	2.7	2.6
Non-financial private sector	44.4	51.1	56.7	64.0	67.2	64.8	67.1

Sources: Instituto Nacional de Estadística y Censos (INDEC); Banco Central de la República Argentina (BCRA); and Fund staff calculations.

Table 7. Argentina: Public Debt, 2004–14

	Average 2004–06	Average 2007–09	2010	2011	2012	2013	Prel. 2014
			(Billions of U.S. dollars) 1/				
Gross federal debt (includes holdouts)	168.8	175.2	178.1	192.7	211.5	216.8	249.3
Gross federal debt performing 2/	133.7	139.9	158.0	172.7	191.4	196.7	237.8
By currency:							
In domestic currency	76.5	68.4	67.7	71.4	81.1	77.2	65.6
In foreign currency	110.6	106.7	110.4	121.3	130.5	139.6	183.7
By residency:							
Held by external residents 3/	92.8	86.8	80.7	84.4	83.5	81.6	89.2
Held by domestic residents	75.9	88.3	97.4	108.4	128.0	135.2	160.1
			(Percent of GDP)				
Gross federal debt (includes holdouts)	79.7	49.3	38.6	34.5	34.8	34.8	46.2
Gross federal debt performing 2/	...	39.4	34.2	30.9	31.5	31.6	44.0
By currency:							
In domestic currency	27.0	17.5	14.7	12.8	13.3	12.4	12.1
In foreign currency	53.1	30.0	23.9	21.7	21.5	22.4	34.0
By residency:							
Held by external residents 3/	44.2	24.5	17.5	15.1	13.7	13.1	16.5
Held by domestic residents	35.5	24.8	21.1	19.4	21.1	21.7	29.6

Sources: Ministerio de Economía y Finanzas Públicas and Fund staff calculations.
1/ Debt in Argentine pesos converted to U.S. dollar the using the end of period official exchange rate.
2/ Excludes holdouts and arrears.
3/ Includes holdout creditors.